HKICPA
POCKET SUMMARY

Implementing
HKFRS 17
Insurance Contracts

May 2018

CPA

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

CONTENTS

INTRODUCTION

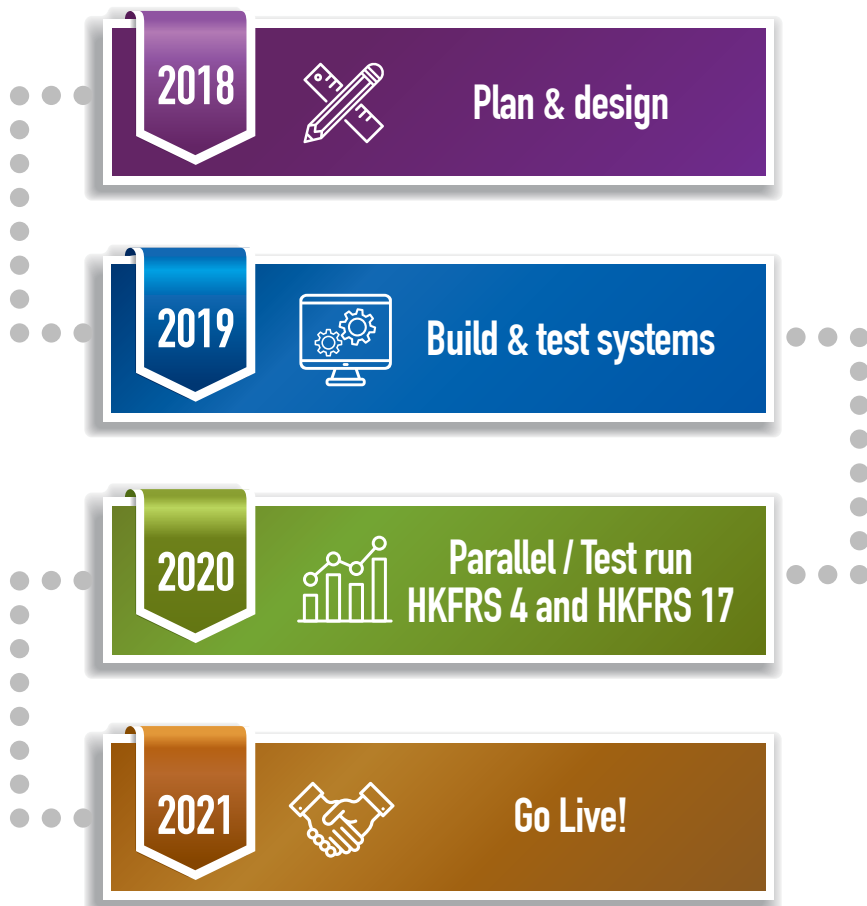This pocket summary is the first in a series of instalments.

It provides insurers with a simple framework and general references for planning the implementation of HKFRS 17 *Insurance Contracts*, and contains:

- a roadmap for implementation;
- top ten operational considerations management should discuss with the Board;
- important concepts of HKFRS 17 to bear in mind; and
- key decisions to identify information needs arising from HKFRS 17.

Readers should note that this publication is not a comprehensive summary of the standard—it does not contain all the requirements of HKFRS 17 and is not a guide on how to implement the standard. This publication may be updated in the future for new information regarding HKFRS 17 (if any).

HKICPA thanks members of its Insurance Regulatory Advisory Panel and their supporting teams, and staff of the International Accounting Standards Board for their input on this publication.

ROADMAP FOR IMPLEMENTATION

2018 — Plan & design

2019 — Build & test systems

2020 — Parallel / Test run HKFRS 4 and HKFRS 17

2021 — Go Live!

TOP TEN OPERATIONAL CONSIDERATIONS

Decisions to be agreed with
Board of Directors

IDENTIFY GAPS

Questions 1 to 3 help to identify what type of information is required to be collected and maintained by your IT systems.

1. Have you reviewed all your insurance contracts (including reinsurance arrangements) and considered key decision-making points?

2. What new presentation and disclosures are required?

3. What is the interaction with other critical projects that need to be considered? For example, HKFRS/IFRS 9 *Financial Instruments* and the new Risk Based Capital regulatory reporting being developed?

4. What changes to your IT data collection and reporting systems are required?

5. Have you engaged with your auditor as you are developing accounting policies? Are your finance and actuarial teams sufficiently educated and able to handle the workload? Do you need external consultants?

FILL IN THE GAPS

6. Have you prepared the project plan for implementation, which considers critical activities (parallel run or test run, etc), timing, resourcing, systems and budget?

7. Have you identified the appropriate: IT specifications/systems to build/acquire; human talent to hire/educate; and external consultants to assist with implementation?

8. Have you thought about when and how to communicate the financial reporting impact to your investors and stakeholders?

9. Presentation and disclosure of financial reports will change. Have you reviewed existing KPIs to consider if these need to be modified?

10. Has the impact of the standard (including project plan, budget and potential impact to investors) been communicated, and approved where necessary, by your Board of Directors and senior management?
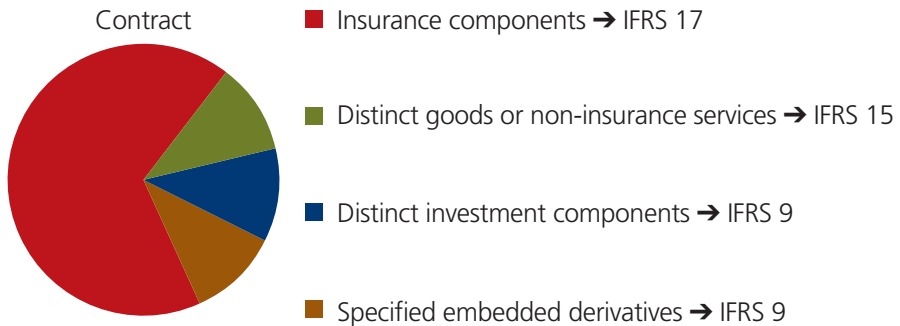
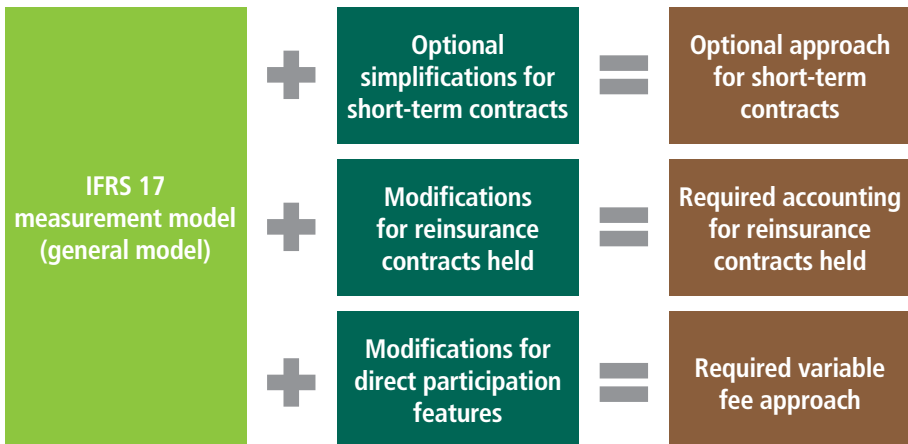# HKFRS 17 GENERAL MODEL: IMPORTANT CONCEPTS

OVERVIEW OF HKFRS/IFRS 17

Extracted from education materials published by the International Accounting Standards Board (IASB)

1. Scope of the standard - what is measured under IFRS 17?

Contract

■ Insurance components ➜ IFRS 17

■ Distinct goods or non-insurance services ➜ IFRS 15

■ Distinct investment components ➜ IFRS 9

■ Specified embedded derivatives ➜ IFRS 9

2. The measurement model

IFRS 17 measurement model (general model)	+	Optional simplifications for short-term contracts	=	Optional approach for short-term contracts
	+	Modifications for reinsurance contracts held	=	Required accounting for reinsurance contracts held
	+	Modifications for direct participation features	=	Required variable fee approach

Pocket guide to implementing
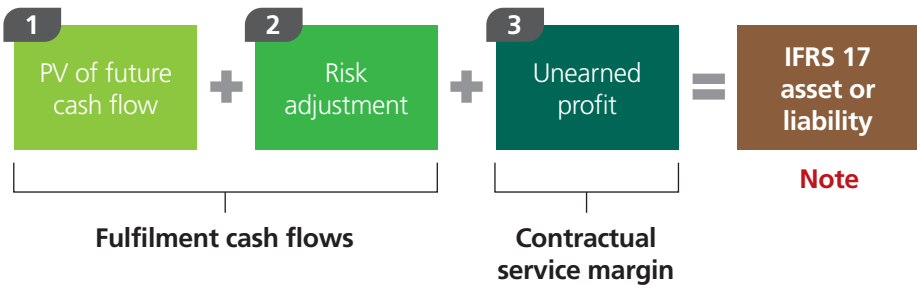HKFRS/IFRS 17
Insurance Contracts

INSURANCE CONTRACT LIABILITY

Extracted from education materials published by the IASB

2. Core requirements

All insurance contracts measured as the sum of:

- **Fulfilment cash flows (FCF)**
  1. Present value of probability-weighted expected cash flows–reflects financial risk
  2. Plus an explicit risk adjustment for non-financial risk (e.g. insurance risk)

- **Contractual service margin (CSM)**
  3. The unearned profit from the contracts

1 PV of future cash flow	**+**	**2** Risk adjustment	**+**	**3** Unearned profit	**=**	IFRS 17 asset or liability

Fulfilment cash flows   **Contractual service margin**   **Note**

Note from HKICPA:
On day one, if FCF are:
- Positive, the 'unearned profit' is of an equivalent amount (i.e. FCF + CSM = 0)

- Negative, then the 'onerous' loss amount is immediately recognised in the P&L

UNEARNED PROFIT ON DAY ONE

Extracted from education materials published by the IASB

3. Contractual Service Margin – initial recognition

The unearned profit of the group of contracts that relates to future service to be provided

The amount determined so that no gains are recognised in profit or loss on initial recognition

Example — Consider a group of contracts with PV of future cash flows of CU4,250 and risk adjustment of CU750

| If premiums CU5,500 | • Contracts profitable at inception
• CSM = CU500 [CU5,500 – CU750 – CU4,250] |

| If premiums CU3,500 | • Contracts onerous at inception
• Day-one loss CU1,500 recognised in profit or loss [CU3,500 – CU750 – CU4,250]
• No CSM |

LEVEL OF AGGREGATION (1/3)

Extracted from education materials published by the IASB

4. Why are insurance contracts grouped?

Other industries and IFRS contract accounting

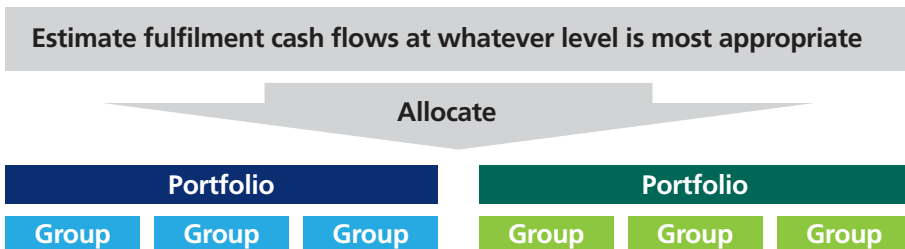Typically, recognise and measure at individual contract level

Insurance and IFRS 17 contract accounting

Aggregated risk

- Insurance activities often rely on issuing a number of similar contracts to reduce risk
- Measuring profitability on an individual contract may not reflect this
- However, if profitability is measured on a collection contracts that have been aggregated at too high a level then useful information is lost because profit and loss are treated asymmetrically in IFRS 17

5. What does grouping affect?

Fulfilment cash flows are required to be allocated to groups of insurance contracts so that the resulting fulfilment cash flows of the group comply with requirements of IFRS 17

Estimate fulfilment cash flows at whatever level is most appropriate

Allocate

Portfolio		
Group	Group	Group

Portfolio		
Group	Group	Group

LEVEL OF AGGREGATION (2/3)

Extracted from education materials published by the IASB

6. How to divide contracts into portfolios and groups

1: Identify portfolios of insurance contracts:

Portfolio 1	Portfolio 2	Portfolio 3
e.g. whole-life insurance	e.g. annuities	e.g. car insurance
✓ Similar risks ✓ Managed together	✓ Similar risks ✓ Managed together	✓ Similar risks ✓ Managed together

2: Divide a portfolio into minimum groups of:

Onerous at initial recognition, if any	Remaining contracts in the portfolio, if any	At initial recognition, no significant possibility of becoming onerous, if any

Note from HKICPA:
Do not include contracts issued more than one year apart in the same group.
If necessary, further divide groups.

LEVEL OF AGGREGATION (3/3)

Extracted from education materials published by the IASB

7. Allocation of profits for a group of contracts

- Grouping contracts means profit is not identified with each individual contract
- Coverage units provides basis for systematic allocation of unearned profit of a group to each period that represents service provided

Coverage period = 3 accounting periods		
1	2	3

CSM (unearned profit)	Earned profit (as service provided)	Earned profit (as service provided)	Earned profit (as service provided)
Balance sheet	**Profit or loss**		
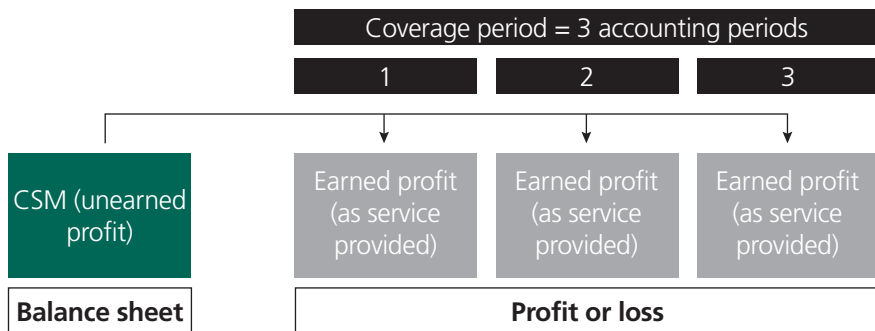
RECOGNISING PROFIT

Extracted from education materials published by the IASB

8. Unravelling the CSM

Pocket guide to implementing
HKFRS/IFRS 17
Insurance Contracts
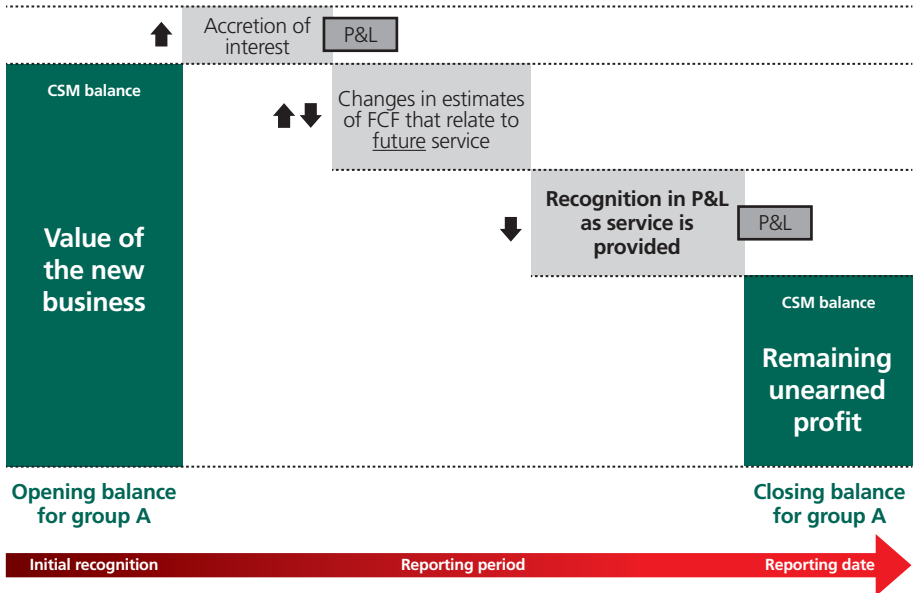
PLAN AND DESIGN:
KEY DECISION POINTS

Decisions to be agreed with
Board of Directors

The following content provides insurers with high-level general references on key questions that management should consider. It aims to help insurers identify their information needs arising from HKFRS/IFRS 17.

In the following pages:

(para) refers to the relevant HKFRS/IFRS 17 paragraphs.

CONTRACT GROUPS & COVERAGE UNITS

Insurance Contract

Non-insurance components → **Unbundle** para 11 and 12

Portfolio para 14

Contracts with similar risks & managed together are put into the same portfolio

Portfolios are divided into three groups:

Groups para 16 and 22

| Onerous Now | Maybe onerous in future | No significant possibility of becoming onerous subsequently |

Coverage units para B119

Number of coverage units are determined per group

ACCOUNTING MODEL

Insurance Contract

↓

Coverage period < 1 year, or, meets certain criteria?

YES → **Apply optional PAA model?**

para 53-54

NO → **Contracts have direct participation features?**

para B101

NO (between PAA model and Contracts have direct participation features)

Apply optional PAA model?

YES → PAA model

para 55-59

Contracts have direct participation features?

YES → Variable Fee Approach (**VFA**)

para 45

NO → **General model**

para 29

GENERAL MODEL (DAY ONE)

When do groups of contracts begin and end?

Contract boundary

para 25 and 34

Top-down or Bottom-up?

Discount rate

para 36, B80 and B81

Estimation technique?

Risk adjustment

para 37 and B91

Fulfilment cash flows (FCF)

para 32 and 33

How to allocate FCF to groups?

Allocation para 24 and 33

GENERAL MODEL (DAY ONE)

Unearned profit per group?

Contractual
Service Margin (**CSM**)

para 38,
43, 44 and
B96- B100

CSM per each
coverage unit

para 44(e)
and B119(b)

para B119
and BC279-
BC283

How to allocate coverage units per group to P&L?

Year 2020   2021   2022   ...etc

TRANSITION APPROACH BY A GROUP OF CONTRACTS

Is it practicable to apply retrospective approach?

YES

Retrospective approach

para C3 to C4

NO

para C5

Choose between:

Modified retrospective approach

Fair value approach

para C20 to C24

Is there sufficient reasonable and supportable information available to apply modified retrospective approach?

NO

YES

Modified retrospective approach

para C6 to C19

Comparatives	Current year
Opening balance: 1 Jan. 2020	Effective date: 1 Jan. 2021

Pocket guide to implementing
HKFRS/IFRS 17
Insurance Contracts

IMPLEMENTATION SUPPORT

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Subscribe to receive notifications by e-mailing **insurance@hkicpa.org.hk**

Hong Kong Insurance Implementation Support Group (HKIISG)

Find out more on the HKIISG website, and:

Submit questions | **Register as an observer** | **Follow discussion outcomes**

HKICPA is working together with the Insurance Authority and the Hong Kong Federation of Insurers

HKICPA is monitoring and sharing global developments

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