The meeting of the Transition Resource Group for IFRS 17 Insurance Contracts (TRG) on 2 May 2018

May 2018

OVERVIEW

The Transition Resource Group for IFRS 17 Insurance Contracts (**TRG**) is a public forum for stakeholders to follow discussions of questions raised on interpretation and implementation of IFRS 17, the new standard on accounting for insurance contracts which will apply from 2021. The **Members** of the TRG are representatives from the insurance industry around the world.

On 2 May the TRG considered 7 papers (numbered AP01 to AP07) drafted by the **Staff** of the International Accounting Standards Board (**IASB**). Copies of the papers and recordings of the discussions are available on the IASB's web site.[1] In this Update we note key points arising from the discussions.

The next meeting of the TRG is scheduled for 26 September 2018. (The latest submission date for questions that may be considered at that meeting is 20 July.)

Coverage Units (Paper AP05)

Members expressed concern about combining coverage units for riders with different risks without considering some weighting to put them on a consistent basis.

It was suggested that, where contracts in a group include various riders, using (for example) premiums as coverage units but weighting those premiums according to the likelihood of claim under the various riders may more closely reflect the economic reality of the services provided for the group.

Several Members commented that the standard approach to amortising the Contractual Service Margin (**CSM**) should be 'passage of time' (i.e. using policies in-force). Where this is not a good proxy for the provision of services then alternatives should be considered.

Amortising coverage units for savings contracts that are not eligible for the Variable Fee Approach (VFA)

This part of Paper AP05 generated a lively discussion.

The Staff will be recommending that the Board amends the Standard to make it clear that for contracts **subject to the VFA**, the CSM should be amortised in line with the provision of both investment and insurance services.

Members generally disagreed with the Staff's conclusion that for all contracts subject to the General Model the only coverage provided is insurance services. For many contracts that **do not qualify for the VFA,** policyholders do have the expectation that the insurer is providing some investment management services.

It was noted that under the General Model the CSM calculated at inception captures the present value of profits expected to arise from any investment component of the contracts. Where the value of that component is not immaterial it seems reasonable for the amortisation of the CSM to reflect the timing of the provision of both investment and insurance services, not just the provision of the latter.

By way of example, reference was made to a deferred annuity that provides only investment services before it converts to an annuity at retirement age. For this contract there would be no CSM release in the pre-retirement period if only insurance services are considered, although a large component of the CSM will be the present value (determined at policy issue) of the expected future investment spread.

Members noted that many US-style universal life contracts provide investment and insurance services, but are not eligible to the VFA approach. Some unit-linked contracts are also not eligible for the VFA only because the internal funds to which benefits are linked are not disclosed to policyholders.

Members proposed that the Standard should make clear that the amortisation of coverage units should reflect the services that contribute to the CSM.

Implementation challenges (Paper AP06)

Paper AP06 identifies some areas where the IFRS 17 Standard will introduce significant changes compared to existing practice.

A Member noted that a significant implementation issue not covered in the Paper is the requirement to identify underlying gross contract cashflows, which will be very difficult if not

[1] https://www.ifrs.org/groups/transition-resource-group-for-insurance-contracts/#meetings (select the 2 May meeting and click the "go" button).

Milliman does not certify the information in this update, nor does it guarantee the accuracy and completeness of such information. Use of such information is voluntary and should not be relied upon unless an independent review of its accuracy and completeness has been performed. Materials may not be reproduced without the express consent of Milliman.

impracticable for reinsurers with complex netting arrangements between counterparties.

It was proposed that a comprehensive list of implementation issues is agreed by Members and submitted for consideration at future meetings.

The granularity of information that must be presented

It was noted that, for general insurers in particular, the Standard will not change how insurance contracts are constructed and managed. However, it requires insurers to disaggregate the management information they currently use and to re-aggregate it into groups of profitable and unprofitable contracts for presentational purposes. A number of members were concerned that the scale of this exercise, and the significant additional cost, are not communicated in the Paper. They also queried what useful additional information this disaggregation and re-aggregation will provide to readers of financial statements.

A number of representatives of general insurers said that the granularity required by the Standard was the top concern, or one of the top three concerns, raised by those they represent.

Treatment of insurance contracts acquired in their settlement period

The Standard permits the Premium Allocation Approach (**PAA**) to be applied to those policies written by a general insurer that move into their settlement period, but not to those policies acquired (but not originally written) by the insurer that are in their settlement period. The rationale for this is that the acquirer is providing cover for adverse loss development.

Members noted the inconsistent treatment, and queried whether it will provide relevant information for investors.

It was also observed that general insurers that expect to apply the PAA to all contracts they issue will have to build systems to support the General Model approach if, in the future, they expect to acquire contracts during their settlement period.

Determining the risk adjustment in a group of entities (Paper AP02)

In Paper AP02 the Staff propose that the risk adjustment determined for a holding company should be the sum of the risk adjustments determined by each of its subsidiaries. That is, diversification can be allowed for, but only if the subsidiary takes it into account when determining its risk adjustment.

Although this issue is straightforward to state, it generated a long discussion.

The Standard refers to the risk adjustment as the compensation for accepting the risk required by "*the entity*". The Staff observed that only the entity issuing the contract was directly writing the risk, and so this entity's risk adjustment should be reflected in the risk adjustment of its holding company.

Some Members challenged this interpretation of the Standard, arguing that the reference to "*an entity*" relates to the one for which you are preparing IFRS 17 accounts. So when preparing accounts for a holding company you should reflect the holding company's view rather than that of the subsidiary.

Some Members observed that the group function would typically specify the allowance that subsidiaries should make for risk. In many cases the subsidiary applied its group's requirements. However, some subsidiaries can be constrained on the extent to which they can follow this instruction (for example, if the group requirement is not expressed in terms that fit with the minimum regulatory capital requirements applicable to the subsidiary), or the subsidiaries may not exactly follow the Group requirements for other reasons.

Several Members considered that preparers could make the proposed interpretation work even though it is not exactly how insurers manage their companies.

Cashflows within the contract boundary (Paper AP03)

There was a discussion about the circumstances in which the cashflows that may arise from a policyholder option (to take out additional insurance coverage or to extend coverage) would be within the contract boundary. The contract boundary includes all cashflows where there is a right to compel the payment of premiums, or where the insurer has an obligation to provide services. The requirement to provide services ends at the point when the insurer can reassess risks and set a premium that fully reflects that risk.

Paragraph 42 of Paper AP03 indicates that to exclude an option from the boundary, the insurer has also to be able to reset the premium for the underlying contract, not just be able to set the premium for the option. Members noted that repricing the base contract at the time an option was exercised would not happen in practice.

The consensus view of Members was that where premiums are set for the risks introduced by the option when it is exercised, and there are no constraints on the premium setting process for the option, there are no substantive obligations for the insurer arising from that option before it is exercised.

Milliman does not certify the information in this update, nor does it guarantee the accuracy and completeness of such information. Use of such information is voluntary and should not be relied upon unless an independent review of its accuracy and completeness has been performed. Materials may not be reproduced without the express consent of Milliman.

Copyright © 2018 Milliman, Inc.

It was agreed that a further box needs to be added to the top of the flow diagram in Appendix A to Paper AP03 that asks "*Does the option give rise to a substantive right or obligation?*" If the answer is "no" (e.g. the price of the option can be set at the time it is exercised) then the option is outside of the contract boundary.

Bundling insurance contracts (Paper AP01)

Paper AP01 considers when separate insurance contracts should be combined and treated as one (**bundled**) for the purposes of the IFRS 17 Standard.

Members commented that the considerations for determining whether separate contracts should be combined for measurement purposes were the same considerations for determining whether components of a single contract should be separated for measurement purposes. (The latter was discussed at the February 2018 meeting of the TRG.)

Members also expressed the view that no individual consideration should be given more weight than any other (e.g. time of issue, lapse of one contract leading to the lapse of another).

In particular, several Members were concerned by the weight placed in the Paper on separate policies only being eligible for bundling if they were issued at the same time or within a short period.

In some markets additional coverages (in the form of riders) can be issued at a significant discount (or for no premium) after the underlying base policy has been issued. If closeness of issue dates is necessary this would require such riders to be treated separately from the base policies, and so being recognised immediately as a loss in the P&L account. It was noted that the paragraphs on bundling in the draft of the Standard issued in 2013 included reference to policies "*being issued at the same time*". This was deleted from the published Standard. Concerns were raised by Members that the requirement was being reintroduced through this Paper.

Reinsurance contract boundary (Paper AP04)

Members agreed with the Staff's analysis for the particular example in Paper AP04. It is a narrow scope example which most said they have not seen in practice. Consensus was that both parties to the reinsurance agreement need to be able to get out of the contract at the same time for the boundary to be reached.

HOW MILLIMAN CAN HELP

Milliman has a depth of experience and expertise in IFRS 17 having closely followed its development over the past 20 years.

We are therefore well placed to offer the following services:

- Training on IFRS 17 concepts;
- IFRS 17 gap analysis through the use of our readiness assessment tool;
- Assistance with transition including impact analysis;
- Review of calculations and methodology; and,
- Implementation of an IFRS 17 systems solution through our award-winning Integrate™[2] platform which can be implemented with cashflow output from any actuarial system. For more information see: IFRS 17: The Integrate Solution.

If you have any questions or comments on this paper or any other aspect of IFRS 17, please contact any of the consultants below or your usual Milliman consultant.

CONTACTS

United Kingdom

Andrew Gilchrist
andrew.gilchrist@milliman.com

Lindsay Unwin
lindsay.unwin@milliman.com

Magnus Wilson
magnus.wilson@milliman.com

Amritpal Khangura
amritpal.khangura@milliman.com

Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in life insurance and financial services, property & casualty insurance, healthcare, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe.

Milliman maintains a strong and growing presence in Europe with 250 professional consultants serving clients from offices in Amsterdam, Brussels, Bucharest, Dublin, Dusseldorf, London, Madrid, Milan, Munich, Paris, Stockholm, Warsaw, and Zurich.

uk.milliman.com

milliman.com/ifrs

[2] INTEGRATE is a trademark of Milliman, Inc., registered in the U.K., France, and the U.S.

Milliman does not certify the information in this update, nor does it guarantee the accuracy and completeness of such information. Use of such information is voluntary and should not be relied upon unless an independent review of its accuracy and completeness has been performed. Materials may not be reproduced without the express consent of Milliman.

Copyright © 2018 Milliman, Inc.