Expense

Version	Date	Comments
0.1	26 Nov 2018	Initial Version
0.2	23 Jan 2019	Revised to include: - Investment Related Expenses - Specific Expenses Applicable for Singapore - Local Regulations and IFRS 17
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This IFRS17 Working Paper aims to facilitate discussion among actuaries and other stakeholders to capture the range of opinions on the application of IFRS17 in the Singapore context and is not meant to serve as mandatory practice notes.

Any interpretation of IFRS17 set out in this Paper represents a plausible treatment given the text of IFRS17. However, it shall neither be construed as the only possible treatment nor the agreed interpretation for Singapore insurers. Users of this Working Paper shall be mindful that differences in the exact fact pattern and operating context facing each insurer may drive different interpretations. Users shall also be mindful that for the same fact pattern and operating context, there is scope for the substance of same transaction to be articulated differently depending on how the transaction is analysed. (For example, in substance, cash flows from a call option with strike price $X on an asset is equivalent to the combined cash flow from the underlying asset and a put option with strike price $X on the asset, less cash of $X.) Differences in articulation can give rise to a range of plausible treatments. An insurer remains responsible for justifying its choice of treatment after discussion with its auditor. Opinions expressed in the working papers are not representative of that of the Singapore Actuarial Society.

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1. IFRS17 Standards

The key passages in the IFRS17 standards that relate to various expense cash flows type identification and treatment are outlined below:

Paragraph 27
An entity shall recognise an asset or liability for any insurance acquisition cash flows relating to a group of issued insurance contracts that the entity pays or receives before the group is recognised, unless it chooses to recognise them as expenses or income applying paragraph 59(a). An entity shall derecognise the asset or liability resulting from such insurance acquisition cash flows when the group of insurance contracts to which the cash flows are allocated is recognised (see paragraph 38(b)).

Paragraph 38
The contractual service margin is a component of the asset or liability for the group of insurance contracts that represents the unearned profit the entity will recognise as it provides services in the future. An entity shall measure the contractual service margin on initial recognition of a group of insurance contracts at an amount that, unless paragraph 47 (on onerous contracts) applies, results in no income or expenses arising from:

> (b) the derecognition at the date of initial recognition of any asset or liability recognised for insurance acquisition cash flows applying paragraph 27; and

Paragraph 59
In applying the premium allocation approach, an entity:

> (a) may choose to recognise any insurance acquisition cash flows as expenses when it incurs those costs, provided that the coverage period of each contract in the group at initial recognition is no more than one year.

Paragraph 103
An entity shall separately disclose in the reconciliations required in paragraph 100 each of the following amounts related to insurance services, if applicable:

> (b) insurance service expenses, showing separately:
>
> > (ii) amortisation of insurance acquisition cash flows;

Appendix A
Insurance acquisition cash flows
Cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts that are directly attributable to the portfolio of insurance contracts to which the group belongs. Such cash flows include cash flows that are not directly attributable to individual contracts or groups of insurance contracts within the portfolio.

Paragraph B65
Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, including cash flows for which the entity has discretion over the amount or timing. The cash flows within the boundary include:

> (e) an allocation of insurance acquisition cash flows attributable to the portfolio to which the contract belongs.
>
> (f) claim handling costs (ie the costs the entity will incur in investigating, processing and resolving claims under existing insurance contracts, including legal and loss-adjusters' fees and internal costs of investigating claims and processing claim payments).
>
> (h) policy administration and maintenance costs, such as costs of premium billing and handling

policy changes (for example, conversions and reinstatements). Such costs also include recurring commissions that are expected to be paid to intermediaries if a particular policyholder continues to pay the premiums within the boundary of the insurance contract.

(l) an allocation of fixed and variable overheads (such as the costs of accounting, human resources, information technology and support, building depreciation, rent, and maintenance and utilities) directly attributable to fulfilling insurance contracts. Such overheads are allocated to groups of contracts using methods that are systematic and rational, and are consistently applied to all costs that have similar characteristics.

Paragraph B66

The following cash flows shall not be included when estimating the cash flows that will arise as the entity fulfils an existing insurance contract:

(d) cash flows relating to costs that cannot be directly attributed to the portfolio of insurance contracts that contain the contract, such as some product development and training costs. Such costs are recognised in profit or loss when incurred.

(e) cash flows that arise from abnormal amounts of wasted labour or other resources that are used to fulfil the contract. Such costs are recognized in profit or loss when incurred.

Paragraph B121

Paragraph 83 requires the amount of insurance revenue recognised in a period to depict the transfer of promised services at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The total consideration for a group of contracts covers the following amounts:

(b) amounts related to insurance acquisition cash flows.

Paragraph B123

Applying IFRS 15, when an entity provides services, it derecognises the performance obligation for those services and recognises revenue. Consistently, applying IFRS 17, when an entity provides services in a period, it reduces the liability for remaining coverage for the services provided and recognises insurance revenue. The reduction in the liability for remaining coverage that gives rise to insurance revenue excludes changes in the liability that do not relate to services expected to be covered by the consideration received by the entity. Those changes are:

(a) changes that do not relate to services provided in the period, for example:

(v) insurance acquisition cash flows (see paragraph B125)

Paragraph B124

Consequently, insurance revenue for the period can also be analysed as the total of the changes in the liability for remaining coverage in the period that relates to services for which the entity expects to receive consideration. Those changes are:

(a) insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period), excluding:

(iv) insurance acquisition expenses (see paragraph B125).

Paragraph B125

An entity shall determine insurance revenue related to insurance acquisition cash flows by allocating the portion of the premiums that relate to recovering those cash flows to each reporting period in a systematic way on the basis of the passage of time. An entity shall recognise the same amount as insurance service expenses.

BC180

The requirement to recognise insurance acquisition cash flows as an expense over the coverage period differs from recognising an asset or an explicit or implicit reduction in the carrying amount of the group of insurance contracts. At all times, the liability for the group is measured as the sum of the fulfilment cash flows, including any expected future insurance acquisition cash flows, and

the contractual service margin. Because the contractual service margin cannot be less than zero, the entity need not test separately whether it will recover the insurance acquisition cash flows that have occurred but have not yet been recognised as an expense. The measurement model captures any lack of recoverability automatically by remeasuring the fulfilment cash flows.

BC182
However, the Board noted that:

(a) including only insurance acquisition cash flows that are incremental at a contract level would mean that entities would recognise different contractual service margins and expenses depending on the way they structure their acquisition activities. For example, there would be different liabilities reported if the entity had an internal sales department rather than outsourcing sales to external agents. In the Board's view, differences in the structure of insurance acquisition activities would not necessarily reflect economic differences between insurance contracts issued by the entities.

(b) an entity typically prices insurance contracts to recover not only incremental costs, but also other direct costs and a proportion of indirect costs incurred in originating insurance contracts—such as costs of underwriting, medical tests and inspection, and issuing the policy. The entity measures and manages these costs for the portfolio, rather than for the individual contract. Accordingly, including insurance acquisition cash flows that are incremental at the portfolio level in the fulfilment cash flows of the insurance contracts would be consistent with identification of other cash flows that are included in the measurement of the contracts.

BC183
The Board also considered whether to restrict insurance acquisition cash flows to be included in the measurement of a group of insurance contracts to those cash flows related directly to the successful acquisition of new or renewed insurance contracts. The approach in IFRS 17 to the measurement of a group of insurance contracts is to estimate the profit expected to be generated over the duration of the group. In this context, excluding some insurance acquisition cash flows that relate to issuing a portfolio of contracts would result in an understatement of the fulfilment cash flows and an overstatement of the contractual service margins of groups in the portfolio. In addition, the Board wanted to avoid measuring liabilities and expenses at different amounts depending on how an entity structures its insurance acquisition activities, as described in paragraph BC182(a).

BC184
The Board also noted that the measurement approach in IFRS 17 automatically recognises as an immediate expense any insurance acquisition cash flows that cannot be recovered from the cash flows of the portfolio of contracts, because such cash flows reduce the contractual service margin below zero and must therefore be recognised as an expense. Hence, no amount can be recognised in the statement of financial position for insurance acquisition cash flows that are not recoverable.

Feb 18 TRG Staff Paper 4
https://www.ifrs.org/-/media/feature/meetings/2018/february/trg-for-ic/ap4-insurance-acq-cash-flows-contract-renewals.pdf

Sep 18 TRG Staff Paper 6
https://www.ifrs.org/-/media/feature/meetings/2018/september/trg-insurance/ap06-recovery-of-insurance-acquisition-cash-flows.pdf

Jan 19 IASB Meeting Staff Paper 2A
https://www.ifrs.org/-/media/feature/meetings/2019/january/iasb/ap2a-insurance-contracts.pdf

Jan 19 IASB Meeting Staff Paper 2E
https://www.ifrs.org/-/media/feature/meetings/2019/january/iasb/ap2e-insurance-contracts.pdf

2. Interpretation of Standards

Expense cash flows that relate directly to the fulfilment of the contract *(as per paragraph B65)* are within the contract boundary. These cash flows are included in the fulfilment cash flows at initial recognition *(as per paragraph 32 to 52)*. Below is a list of expense cash flows within this category from the guidance:

Type of Expenses	*IFRS 17 Guidance*
(an allocation of) Insurance acquisition costs	- Costs of selling, underwriting and starting a group of insurance contracts *(include cash flows that are not directly attributable to individual contracts or groups of insurance contracts within the portfolio)*
Claims handling costs	- Cost of investigating, processing and resolving claims *(inclusive of legal and loss-adjusters' fees and internal costs of investigating claims and processing claim payments)*
Policy administration and maintenance costs	- Costs of billing premiums - Costs of handling policy changes *(conversions, reinstatements)* - Recurring commissions expected to be paid to intermediaries
(an allocation of) Fixed and variable overheads	- Accounting - Human resource - Information technology and support - Building depreciation - Rent, maintenance, utilities

The allocation method for fixed and variable overheads should be systematic, rational, and consistently applied to all costs that have similar characteristics.

Expense cash flows that do not relate directly to the fulfilment of the contract or abnormal amount of wasted labour *(as per paragraph B66)* are outside the contract boundary. These cash flows are recognised in profit or loss when incurred. Below is a list of expense cash flows within this category from the guidance:

Type of Expenses	*IFRS 17 Guidance*
Not directly attributable costs	- **Some** product development and training costs
Wasted labour	- Abnormal amounts of wasted labour or other resources

3. Insurance Acquisition Costs

Insurance acquisition costs need to be separately identified from other expenses, unless premium allocation approach is used and the entity choose to recognise them as expenses or income (*as per paragraph 59 (a)*). Otherwise, an asset or liability is recognised based on the expected insurance acquisition costs at initial recognition and derecognised when the allocated cash flows is recognised *(as per paragraph 27)*.

These cash flows are recognized in a systematic way on the basis of the passage of time, the entity shall recognise the same amount of insurance revenue as insurance service expenses *(as per paragraph B125)*. In addition, insurance acquisition cash flows are separately disclosed in the reconciliations *(as per paragraph 103).*

While there are several additional requirements relating to insurance acquisition cash flows, the treatment is the same as other cash flows incurred in fulfilling insurance contracts. Therefore, an entity is not required to determine whether it will recover insurance acquisition cash flows at each reporting date *(as per the Sep 18 TRG staff paper 6)*. The measurement model captures any lack of recoverability automatically by remeasuring the fulfilment cash flows, with the exception of allocated insurance acquisition cash flows directly attributable to newly issued contracts for anticipated contract renewals *(as per the Jan 19 IASB Meeting staff paper 2A).*

The entity needs to assess the recoverability of the asset recognised from insurance acquisition cash flows allocated to anticipated contract renewals when the renewed contracts are recognised and recognise a loss in profit or loss for any change in carrying amounts.

4. Expense Cash Flows Process Flow

Step 1

Cash flows are within the boundary of an insurance contract that **relate directly to the fulfilment of the contract?**

No → Outside the Scope of FCF

Yes ↓

Step 2

Cash flows arising from the **costs of selling, underwriting and starting a group of insurance contracts** that are directly attributable to the portfolio of insurance contracts to which the group belongs?

No → Maintenance Costs

Yes ↓

Insurance Acquisition Costs

5. Disclosure

See below the disclosure of expenses:

	LRC		LIC	Total
	Excluding loss component	***LC***		
Beginning of Period				
Insurance Revenue	- (**Expected** Maintenance costs + Insurance acquisition costs)			
Insurance Service Expenses				
Incurred Claims & Expense			**Actual** Maintenance costs	
Reversal of Losses				
Amortization of Insurance acquisition cash flows	Insurance acquisition costs			
Cash outflows				
End of Period				

Insurance Revenue	**Expected** Maintenance costs + Insurance acquisition costs
Insurance Service Expenses	- (**Actual** Maintenance costs + Insurance acquisition costs)
Insurance Service Result	**Expected** Maintenance costs - **Actual** Maintenance costs

Insurance revenue from **Expected** Maintenance costs release applying paragraph B123 of IFRS 17 (*the total reduction in the liability for remaining coverage excluding the loss component which reflects insurance services provided in the period)* and Insurance acquisition costs applying paragraph B125 of IFRS 17.

6. Investment Related Expenses

Investment related expenses should be treated consistently with coverage units. If the investment activity is deemed as a fulfilment of services in the determination of coverage units, the associated expenses should be included in the fulfilment cash flows. Hence, variable fee contracts that incur asset management costs *(to invest on behalf of policyholders)* should be included in the fulfilment cash flows. Similarly, if there are investment return services in the determination of coverage units for general model contracts, it should also be included in fulfilment cash flows *(as per the Jan 19 IASB Meeting staff paper 2E)*.

7. Specific Expenses Applicable for Singapore

Type of Expenses	Relate directly to the fulfilment of the contract?	Costs of selling, underwriting and starting a group of insurance contracts?	Rationale
Corporate Allocation	Depends	Depends	**Conclusion:** Depends Corporate Allocation can be a mixture of various expenses. Industry participants need an understanding of the allocated cost to correctly determine treatment.
Policy Owners' Protection (PPF) Scheme	Yes	No	**Conclusion:** Maintenance Costs PPF relates directly to the fulfilment of the contract but not selling, underwriting and starting a group of insurance contracts.

8. Local Regulations vs IFRS 17

Local regulations require insurance companies to establish and maintain a separate insurance fund for each class of insurance business and put in place operational safeguards to ensure that all assets, receipts, liabilities and expenses can be properly attributable to the business to which the fund relates ("insurance fund concept"). Interpretation of this rule typically means that insurance funds will bear all expenses and charges relating to the sales, operations and management of the business/contracts written in the funds. Notwithstanding this, local regulations and companies' policies may also specify certain expenses that cannot be charged to insurance funds.

While insurance fund concept is not applicable under IFRS17, similarities can be drawn between the expense charging principles under insurance fund concept (*i.e. expenses relating to the insurance business written in the insurance funds)* and the concept of directly attributable expenses under IFRS17 *(i.e. expenses that relate directly to the fulfillment of the contract).* As such, companies' existing practice for expense charging to insurance funds can serve as a first reference point for identifying expenses as directly vs non-directly attributable expenses under IFRS17. Nevertheless, under this approach, companies would still need to give consideration to the following:

i) Are there expenses that are not charged to insurance funds, but may fulfill the definition of directly attributable expenses under IFRS17?

    One example may be the expenses that cannot be charged to insurance funds as specified by local regulators or companies' policies *(e.g. regulatory penalties, agency buy-out costs)*. Depending on the type of such expenses, companies would need to assess and decide, taking into account materiality and with appropriate justification, whether to treat such expenses as attributable or non-attributable expenses under IFRS17.

ii) Are there expenses that are charged to insurance funds, but do not fulfill the definition of directly attributable expenses under IFRS17?

    Industry participants can choose to fall back on current framework of expense charging to insurance funds to guide the considerations for directly vs. non-directly attributable expenses under IFRS17, and give further considerations to specific expense items for which treatment might differ between the two frameworks.

9. Implementation Challenges

I. **Definition**
Expense definitions require judgment and will vary across companies.

II. **Granularity**
There is currently no requirement to separately identify expenses that relate directly to acquisition activities in Singapore. Industry participants are required to distinguish insurance acquisition costs from other costs in IFRS 17.

III. **Different Basis**
The expense grouping for local regulation and IFRS 17 do not directly align. Industry participants can seek alignment between the two bases or maintain separate bases. Companies that choose to maintain one basis need to ensure that no direct conflict exists between standards.