Agenda paper 4: ‘Group’ and ‘portfolio’

This paper has been prepared for discussion purposes only.[1] [2]

Objectives of this agenda item

1. Consider whether any issues might emerge from the modification of AASB 17 permitting public sector permit entities to not sub-group portfolios of contracts.
2. In this context, the Group is asked two questions:
    - Are you planning to apply the ‘relief’ provided by the modifications – that is not sub-group portfolios into:
        - groups of contracts that are onerous versus non-onerous at initial recognition [AASB 17.Aus16.1]?
        - groups of contracts issued no more than a year apart [AASB 17.Aus22.1]?
    - Have you identified any issues in applying AASB 17 at a portfolio level that you have not been able to resolve?
3. This memo identifies a number of a cases when public sector entities applying AASB 17 at a portfolio level of aggregation will need to infer the portfolio unit of account from the language in AASB 17 referring to groups of contracts. It is not intended to be a comprehensive list of terminology matters that a public sector entity might need to consider.
4. For the purposes of this memo, it is assumed public sector entities are applying the premium allocation approach to measure liabilities for remaining coverage.

Background on level of aggregation

5. AASB 17 (unmodified) uses a ‘group of contracts’ as the main level of aggregation to which the recognition and measurement requirements are applied. Groups within a portfolio are identified at initial recognition based on whether they are onerous [AASB 17.16] and when they are issued (no more than a year apart) [].
6. Public sector entities can choose not to sub-group a portfolio [AASB 17.Aus16.1 and Aus22.1] and AASB 1.Aus14.1 notes:

    Aus14.1 For a public sector entity applying the modifications in paragraphs Aus16.1 and Aus22.1, a portfolio of insurance contracts would be the main unit of account, not groups of insurance contracts.

7. Also see Appendix 1 for a relevant extract on terminology from the Basis for Conclusions to AASB 2022-9 *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector*.

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1 The AASB does not guarantee, and accepts no legal liability whatsoever arising from or connected to, the accuracy, reliability, currency or completeness of any material contained in this paper. This paper is not a substitute for independent professional advice and users should obtain any appropriate professional advice relevant to their particular circumstances. The views in this paper do not necessarily reflect the views of the AASB, or indicate its commitment to a particular course of action.

2 This paper references AASB 17 *Insurance Contracts* and AASB 2022-9 *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector*, but is intended to apply equally in the context of the New Zealand XRB’s PBE IFRS 17 *Insurance Contacts* and XRB’s *Insurance Contracts in the Public Sector (Amendments to PBE IFRS 17)*.

Initial recognition

8. AASB 17 (unmodified) refers to initial recognition of a group of contracts [AASB 17.25] to which additional contracts are added as they are issued or acquired.

9. Public sector entities choosing not to sub-group would instead be expected to add contracts to a portfolio as they are issued or acquired. Successive contracts may accumulate in that portfolio for many years, although most insurance contract coverage periods in the public sector tend to be one year.

Onerous contract measurement

10. An entity applying the premium allocation approach can assume no contracts in a portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise [AASB 17.19], which may be the case for some public sector entities intentionally pricing at or below breakeven.

11. When the relevant facts and circumstances indicate onerous contracts, a private sector entity would need to separately recognise the onerous group of contracts and subsequently monitor each group to determine whether an onerous group becomes more or less onerous and whether initially profitable contracts have become onerous.

12. AASB 17.47, 48 and 57 address onerous contract accounting in terms of groups of contracts and there are no specific public sector modifications. However, the implication of the modifications to AASB 17 is that a public sector entity can apply AASB 17.47, 48 and 57 at the portfolio level – noting that a whole portfolio may initially be onerous or subsequently become onerous.

Loss components and loss recovery components

13. AASB 17.49 addresses cases when an entity has onerous contracts.

> 49 An entity shall establish (or increase) a loss component of the liability for remaining coverage for an onerous group depicting the losses recognised applying paragraphs 47–48. The loss component determines the amounts that are presented in profit or loss as reversals of losses on onerous groups and are consequently excluded from the determination of insurance revenue.

14. A public sector entity using a portfolio level of aggregation would determine whether it has an onerous contract loss component at the portfolio level.

15. AASB 17.66B addresses cases when an entity has reinsurance contract held 'gains' that will offset underlying onerous contract losses.

> 66B An entity shall establish (or adjust) a loss-recovery component of the asset for remaining coverage for a group of reinsurance contracts held depicting the recovery of losses recognised applying paragraphs 66(c)(i)–(ii) and 66A. The loss-recovery component determines the amounts that are presented in profit or loss as reversals of recoveries of losses from reinsurance contracts held and are consequently excluded from the allocation of premiums paid to the reinsurer (see paragraph B119F).

16. The requirement applies at a group of contracts level. A public sector entity that uses a portfolio level of aggregation would need to apply the loss-recovery component accounting at that level.

17. Some public sector entities have reinsurance held arrangements. Of those entities, many are expected to have excess of loss type reinsurance held arrangements that would only rarely give rise to loss-recovery components.

Acquisition cash flows discounting accounting policy choices

18. AASB 17.59 permits a choice of accounting treatment for insurance acquisition cash flows.

> 59 In applying the premium allocation approach, an entity:
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> (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.
>
> (b) shall measure the liability for incurred claims for the group of insurance contracts at the fulfilment cash flows relating to incurred claims, applying paragraphs 33–37 and B36–B92. However, the entity is not required to adjust future cash flows for the time value of money and the effect of financial risk if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred.

19. Both accounting policy choices are available at the group of contracts level of aggregation. However, a public sector entity that uses a portfolio level of aggregation would need to apply the choice at that portfolio level.

20. All other things being equal, it would tend to be more difficult to meet the AASB 17.59 policy choice thresholds at the portfolio level than the group of contracts level.

Transition provisions

21. On transition, AASB 17 must be applied retrospectively (as if it had always applied) unless it is impracticable to do so, in which case, a modified retrospective or fair value approach can be taken. For a private sector entity, practicability is determined for each group of contracts.

> C3 Unless it is impracticable to do so, … an entity shall apply AASB 17 retrospectively, …
>
> C4 To apply AASB 17 retrospectively, an entity shall at the transition date:
>
> (a) identify, recognise and measure each group of insurance contracts as if AASB 17 had always applied; …
>
> C5 If, and only if, it is impracticable for an entity to apply paragraph C3 for a group of insurance contracts, an entity shall apply the following approaches instead of applying paragraph C4(a):
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> (a) the modified retrospective approach in paragraphs C6–C19A, subject to paragraph C6(a); or
>
> (b) the fair value approach in paragraphs C20–C24B.

22. However, a public sector entity that uses a portfolio level of aggregation would need to determine its transition approach at that level. Whether the different level of aggregation would affect a public sector entity's approach would depend on the facts and circumstances.

23. Most public sector entities are expected to be able to apply AASB 17 on a fully retrospective basis in any case because:

- they typically have contracts with coverage periods of a year (and long coverage periods are a key driver of impracticability); and
- the public sector modifications are expected to simplify transition accounting.

Questions

Question 1 – Are you planning to apply the 'relief' provided by the modifications – that is not sub-group portfolios into:

(a) groups of contracts that are onerous versus non-onerous at initial recognition?

(b) groups of contracts issued no more than a year apart?

Question 2 – Have you identified any issues in applying AASB 17 at a portfolio level that you have not been able to resolve?

If so, what are those issues?

Appendix 1 – extracts from Basis for Conclusions to AASB 2022-9 *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector*

24. The AASB 2022-9 Basis for Conclusions refers to the terminology relating to levels of aggregation in a public sector context.

BC47 The Boards are conscious that most of the requirements in AASB 17/PBE IFRS 17 make reference to 'group(s) of contracts', 'group(s) of insurance contracts', and 'same group' because it has been drafted for private sector entities that would typically have groups of insurance contracts as their main unit of account. However, public sector entities applying the exemption from sub-grouping would read, for example, the reference in AASB 17/PBE IFRS 17.57 to: "If at any time during the coverage period, facts and circumstances indicate that a **group of insurance contracts** is onerous, …" as requiring: "If at any time during the coverage period, facts and circumstances indicate that a **portfolio of insurance contracts** is onerous, …".

BC48 The Boards also note that entities are generally expected to read the requirements of AASB 17/PBE IFRS 17 based on their own circumstances. For example, when relevant, entities are required to regard references in AASB 17/PBE IFRS 17 to 'insurance contracts' as applying to 'reinsurance contacts held' in accordance with AASB 17/PBE IFRS 17.4. Therefore, the Boards concluded that public sector entities should be capable of reading AASB 17/PBE IFRS 17, when relevant, as applying to a portfolio unit of account and decided that no public-sector specific terminology modifications are needed regarding the terms 'group(s)' and 'portfolio(s)'.