IFRS 17 Accounting Policy Paper: Level of aggregation

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Approvers / Reviewers:	Approved by: FA Accounting Committee
Subject:	Level of aggregation

Disclaimer:

This accounting policy paper, which is the responsibility of the Facility Association's (FA) management, is prepared solely for the FA as administrator of certain insurance pools, namely the Facility Association Residual Market (FARM) and each of the Risk Sharing Pools (RSPs). It is intended solely for the use of the FA to document management's accounting policy determinations under IFRS 17 as part of management's internal financial reporting and governance processes as applicable to the FARM and each of the RSPs.

This accounting policy paper is being made available through the FA website to member insurance companies for general information purposes only and does not constitute advice from the Facility Association. Member insurance companies are responsible for their own assessment of IFRS 17 as applicable to their financial reporting. We disclaim any responsibility to any member insurance company who may rely on this document.

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Purpose

The purpose of this memo is to document Facility Association's assessment of the requirements of IFRS 17 relating to the key management judgements and interpretations with respect to the level of aggregation of insurance contracts, and identification and treatment of onerous contracts. This paper provides guidance on how Facility Association plans to fulfil the IFRS 17 requirements to insurance contracts associated with the Facility Association Residual Market ("FARM") and with each of the six Risk Sharing Pools ("RSPs").

Entities:

Facility Association (FA) administers three types of mechanisms on behalf of its membership. This paper covers only the two mechanisms in the scope of IFRS 17, namely:

- Facility Association Residual Market ("FARM")
- Risk Sharing Pools ("RSPs")*

* Outside the scope of this paper are requirements relating to the direct business issued by the individual members prior to transferring the business to the RSPs. Only business assumed via the RSPs will be addressed in this memo.

Topics Covered

The topics covered in this paper are as follows:

1. What are the insurance contracts included in the identified portfolio?
2. How are the insurance contracts aggregated into groups within the portfolio?

Dependencies and Relationships

The technical positions developed in this paper affect (i.e., have downstream dependency on) the conclusions of the following papers:

1. Scope
2. Initial recognition and contract boundary
3. Initial recognition and subsequent measurement (which includes qualification for the premium allocation approach (PAA) and onerous contract analysis)
4. Insurance acquisition cash flows
5. Risk adjustment
6. Discount rate
7. Transition
8. Modification and extinguishment of insurance contract

Executive summary

FA reached the following conclusions regarding the requirements of IFRS 17 relating to the level of aggregation for insurance contracts associated with the FARM and with each of the six RSPs:

1- What are the insurance contracts included in the identified portfolio?

   a. FARM: In each province or territory where FARM operates, there will be two portfolios:

      i. Private passenger vehicles; and
      ii. Non-private passenger vehicles

   b. RSPs: Each provincial pool is its own portfolio (with two for Alberta):

      i. Ontario Risk Sharing Pool;
      ii. Alberta Grid Pool;
      iii. Alberta Non-Grid Pool;
      iv. New Brunswick Risk Sharing Pool;
      v. Nova Scotia Risk Sharing Pool; and
      vi. Newfoundland and Labrador Risk Sharing Pool

2- How are the insurance contracts aggregated into groups within the portfolios?

   a. FARM:

      i. There will be two profitability groupings:

         1. Onerous at initial recognition; and
         2. Others

      ii. Facts and circumstances will be assessed at the group of contracts level as this is the level at which reasonable and supportable information exists.

      iii. Contracts within the same group cannot be issued more than one year apart therefore contracts within the groups within the portfolios will be further subdivided into annual cohorts based on their effective date.

   b. RSP:

      i. There will be two possible profitability groupings:

         1. Onerous at initial recognition; and
         2. Others

      ii. Based on the nature of the RSPs, it is likely that the contracts will be onerous at initial recognition.

      iii. Facts and circumstances will be assessed at the group of contracts level – being each contract for RSP - as this is the level at which reasonable and supportable information exists.

      iv. Contracts within the same group cannot be issued more than one year apart. As the RSPs function similar to a facultative-obligatory reinsurance treaty written on a losses-occurring-during basis, contracts within the groups within the portfolios will be further subdivided into annual cohorts based on their accident year.

Question 1: What are the insurance contracts included in the identified portfolios?

> ***Technical References and Guidance***
>
> **IFRS 17 Standard**
>
> 2 An entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulation, when applying IFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on the economics of the contract). Implied terms in a contract include those imposed by law or regulation. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services).
>
> 14 An entity shall identify portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together. Contracts within a product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are managed together. Contracts in different product lines (for example single premium fixed annuities compared with regular term life assurance) would not be expected to have similar risks and hence would be expected to be in different portfolios.

Technical Analysis:

Per IFRS 17.14, insurance contracts that are subject to similar risks and managed together are included within the same portfolio.

Little guidance is provided with respect to the definition of "similar risks" but in using the term "risk", IFRS 17 focuses on the similarities in exposure to insurance claim.

In addition, IFRS 17 provides no guidance on the definition of "managed together". The term is subject to management's interpretation and application.

FARM

All policies issued by the servicing carriers of the FARM on behalf of FA's members are "similar risks" as they relate to automobile insurance. The financial results of the insurance coverage provided to the policyholders through the FARM are pooled among all participating insurance companies licensed to write automobile insurance in the province based on participation ratios described in the Plan of Operation.

However, Facility Association calculates participation ratios and reports to members on two business segments:

- Private passenger vehicles; and
- Non-private passenger vehicles

These business segments are as defined by and aligned to the Plan of Operation which defines the Residual Market Risk which is different for each of these segments and drives the participation ratio and sharing. Therefore, each segment is considered to be managed separately.

In each province where FARM operates there will be two portfolios: **1. Private passenger vehicles** **2. Non-private passenger vehicles**

RSP

Reporting entity is defined in Appendix A to the Conceptual Framework as "an entity that is required, or chooses, to prepare general purpose financial statements". In this case, the reporting entity is each RSP administered by FA. Therefore, no consideration is given to aggregation or disaggregation of contracts between RSPs.

Each RSP operates in one specific jurisdiction and is governed by its own rules based on the Plan of Operation. As such, each RSP has its own risks and is managed separately.

Each provincial pool is its own portfolio (with two for Alberta): **Ontario RSP** **Alberta Grid RSP** **Alberta Non-Grid RSP** **New Brunswick RSP** **Nova Scotia RSP** **Newfoundland and Labrador RSP**

Technical position:

Mechanism	Technical Position
FARM	FARM will have two portfolios in each province in which it operates: • Private passenger vehicles • Non-private passenger vehicles
RSP	Each provincial pool is its own portfolio (with two for Alberta): • Ontario RSP • Alberta Grid Pool • Alberta Non-Grid Pool • New Brunswick RSP • Nova Scotia RSP • Newfoundland and Labrador RSP

Question 2: How are the insurance contracts aggregated into groups within the portfolios?

Technical References and Guidance

IFRS 17 Standard

16 An entity shall divide a portfolio of insurance contracts issued into a minimum of:
- (a) a group of contracts that are onerous at initial recognition, if any;
- (b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
- (c) a group of the remaining contracts in the portfolio, if any.

17 If an entity has reasonable and supportable information to conclude that a set of contracts will all be in the same group applying paragraph 16, it may measure the set of contracts to determine if the contracts are onerous (see paragraph 47) and assess the set of contracts to determine if the contracts have no significant possibility of becoming onerous subsequently (see paragraph 19). If the entity does not have reasonable and supportable information to conclude that a set of contracts will all be in the same group, it shall determine the group to which contracts belong by considering individual contracts.

18 For contracts issued to which an entity applies the premium allocation approach (see paragraphs 53–59), the entity shall assume no contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise. An entity shall assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous subsequently by assessing the likelihood of changes in applicable facts and circumstances.

19 For contracts issued to which an entity does not apply the premium allocation approach (see paragraphs 53–54), an entity shall assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous:
- (a) based on the likelihood of changes in assumptions which, if they occurred, would result in the contracts becoming onerous.
- (b) using information about estimates provided by the entity’s internal reporting. Hence, in assessing whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous:
  - i. an entity shall not disregard information provided by its internal reporting about the effect of changes in assumptions on different contracts on the possibility of their becoming onerous; but
  - ii. an entity is not required to gather additional information beyond that provided by the entity’s internal reporting about the effect of changes in assumptions on different contracts.

20 If, applying paragraphs 14–19, contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity’s practical ability to set a different price or level of benefits for policyholders with different characteristics, the entity may include those contracts in the same group. The entity shall not apply this paragraph by analogy to other items.

21 An entity is permitted to subdivide the groups described in paragraph 16. For example, an entity may choose to divide the portfolios into:
- (a) more groups that are not onerous at initial recognition—if the entity’s internal reporting provides information that distinguishes:

i. different levels of profitability; or
ii. different possibilities of contracts becoming onerous after initial recognition; and

(b) more than one group of contracts that are onerous at initial recognition—if the entity's internal reporting provides information at a more detailed level about the extent to which the contracts are onerous.

22 An entity shall not include contracts issued more than one year apart in the same group. To achieve this the entity shall, if necessary, further divide the groups described in paragraphs 16–21.

BC128 The same principle of grouping applies to insurance contracts to which the premium allocation approach applies and to reinsurance contracts held, but the wording is adapted to reflect their specific characteristics.

Technical Analysis:

As stated in the guidance above, IFRS 17 requires an entity to identify portfolios of insurance contracts and to divide each portfolio into a minimum of:

a) a group of contracts that are onerous at initial recognition;
b) a group of contracts that have no significant possibility of becoming onerous at initial recognition; or
c) a group of remaining contracts.

When a group of contracts is identified as onerous, the group of contracts is expected to be loss making. The general expectation under IFRS 17 is that losses are recognized upfront for any onerous group identified. IFRS 17 limits the offsetting of onerous contracts against profitable ones by only allowing entities to measure their contracts at an aggregated level when certain criteria are met.

As per IFRS 17.18; for contracts issued to which an entity applies the premium allocation approach, the entity shall assume that no contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise.

Finally, per IFRS 17.22, an entity shall not include contract issued more than one year apart in the same group, but the period can be shorter.

FARM

Based on the insurance member companies determination on their automobile insurance policies, it is unlikely that any contracts will meet the description of "no significant possibility of becoming onerous". As such, under IFRS 17.16, FARM insurance contracts would be grouped only in two profitability groups being:

- onerous at initial recognition; and
- others

In addition, the regulatory carve out (paragraph 20) which states that *contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics, the entity may include those contracts in the same group* does not apply to FARM as FA uses pricing tables for each provinces based on the two operational segments (PPV vs non PPV) and as such, all policies within a group are expected to have similar profitability.

Finally, as per IFRS 17.21, an entity is permitted to subdivide the groups into smaller groups and further disaggregate into groupings that are more granular. Management has considered this option (such as disaggregating by the government lines of business) but has come to the conclusion that the profitability group is the appropriate level as this is at the level at which reasonable and supportable information exists and the level at which the cost of fulfilling insurance contracts will likely occur. This is also the level at which management analyses the actual versus expected and thus, the level at which information is shared and analyzed by chief decision makers.

Only two profitability groups would exist within each FARM portfolio:
Onerous at initial recognition; and
Others
No further disaggregation deemed appropriate

As per IFRS 17.17, the analysis for the classification will be performed at the group of contracts level as this is the level at which reasonable and supportable information exists and the level at which we would expect changes in the cost of fulfilling insurance contracts to occur.

Each contract issued by the servicing carriers of the FARM on behalf of FA's members is assumed to be measured under the PAA (see Initial recognition memo) and therefore, on a quarterly basis, FA will consider the following to determine the appropriate classification of the groups of contracts:

a. the expectation of a fulfilment[1] ratio greater than 100%;
b. previous cohorts for the same group were deemed to be onerous;
c. historical losses with a fulfilment ratio over 100% in the previous year;
d. unfavorable experience trends;
e. unfavorable external or other conditions; and
f. other considerations.

As per IFRS 17.22, a*n entity shall not include contracts issued more than one year apart in the same group* and as such, for FARM, contracts within the groups within the portfolios will be further subdivided into annual cohorts based on their effective date (being the issued date as defined in the Contract Boundary policy paper).

Similar to a direct insurer, contracts get added to the FARM throughout the calendar year – based on effective date.

[1] *Fulfilment ratio is defined as: expected insurance service expenses / insurance revenue on a present value basis (e.g. present value of claims, attributable expenses and risk adjustment divided by present value of expected insurance premiums).*

As such, contracts with an effective date of January 1, 20X1 will be "issued" approx. 12 months apart from contracts with an effective date of January 1, 20X2 and therefore, will be separated into their respective cohorts.

Annual cohorts will be determined based on the effective date of the policies and will represent each calendar year.

RSP

Similar to FARM and aligned to the insurance member companies determination on automobile insurance policies, it is unlikely that any contracts will meet the description of “no significant possibility of becoming onerous”. As such, there are two possible profitability groupings being:

1. Onerous at initial recognition; and
2. Others

FA designed the risk sharing pools to promote stability in the market by making it possible for companies to accept risks for which they believe that their prices are not totally adequate. Therefore, the general expectation is that the RSPs, by their very nature, will operate on an overall basis at a financial loss (thus likely being “onerous at initial recognition”), but the two groupings will be considered.

As per IFRS 17. 24, a *group of insurance contracts shall comprise a single contract if that is the result of applying paragraphs 14–22* which is the case for RSPs. Because of the nature of the RSPs – being each pool represents a single contract – disaggregation beyond the contract limit is not permissible (the contract is the lowest unit of account) and therefore, the group will be composed of only one contract – being each respective pool.

As per paragraph 17, the analysis for the classification will therefore, be performed at the group level (which is equal to the contract level) being the level at which reasonable and supportable information exists and the level at which we would expect changes in the cost of fulfilling insurance contracts to occur.

Only two profitability groups would exist within each portfolio:
Onerous at initial recognition; and
Others

Similar to FARM, each RSP is assumed to be measured under the PAA (see Initial Recognition memo).

As per IFRS 17.22, a*n entity shall not include contracts issued more than one year apart in the same group* and as such, for RSPs, each accident year policy will remain separate from the preceding and succeeding years and will be considered the “cohort” under IFRS 17.

Annual cohorts will be determined based on the accident year and will represent each calendar year

Technical position:

Mechanism	Technical Position
FARM	Only two profitability groups would exist within each portfolio: • Onerous at initial recognition; and • Others Annual cohorts will be determined based on the effective date of the policies and will represent each calendar year.
RSP	Only two profitability groups would exist within each portfolio: • Onerous at initial recognition; and • Others Annual cohorts will be determined based on the accident year and will represent each calendar year.