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Object: CIA submission to IASB for December 2018 meeting

The Canadian Institute of Actuaries (CIA) is the national, bilingual organization and voice of the actuarial profession in Canada. Its members are dedicated to providing actuarial services and advice of the highest quality. The Institute holds the duty of the profession to the public above the needs of the profession and its members.

This letter provides input into which of the 25 concerns and implementation challenges identified in Agenda Paper 2D of the October 2018 IASB meeting (other than #20 and #22 related to the effective date) the IASB should consider for amendment. We provide these comments respecting the criteria for evaluating possible amendments to IFRS 17 as discussed at the October 2018 IASB meeting and after reviewing the recently distributed agenda papers for the December 2018 IASB meeting.

We begin with the four issues that preliminary staff analysis indicated would meet the criteria for possible amendment:

- #1 (Scope – Loans and other forms of credit that transfer insurance risk)
  - We agree this issue **meets** the criteria for possible amendment. This issue is not on the December IASB agenda.
  - However, rather than amending the scope of IFRS 17, we suggest that the IASB consider a different amendment that will address this issue as well as another issue that was not discussed in Agenda Paper 2D for October 2018. In situations where investment contracts can add an insurance contract rider (or vice versa), the investment component would often meet the definition of “distinct” if not for paragraph B32(b) of IFRS 17, because the lapse/maturity of a base contract will cause the lapse/maturity of any riders on that contract. Examples include investment contracts with waiver of premium riders and amounts on deposit for permanent insurance contracts. Broadening the definition of “distinct” investment component will improve comparability, enhance the usefulness of information, and simplify measurement and reporting of such combination contracts.

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- #12 (Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous)
    - We agree this issue **meets** the criteria for possible amendment. This issue is not on the December IASB agenda.
    - In our view, the measurement of reinsurance contracts held should recognize the relationship to the underlying direct contract at initial recognition as well as after initial recognition. Such an amendment would improve comparability and enhance the usefulness of information.
- #15 (Presentation in the statement of financial position | Separate presentation of groups of assets and groups of liabilities)
    - We agree this issue **meets** the criteria for possible amendment. This issue is on the December IASB agenda (2A).
    - We believe strongly that this amendment should be made. Insurance contract liabilities measure future outflows minus future inflows. At any point in time (other than initial recognition—at which point there are adequate disclosures), whether the net result is positive or negative is merely a function of the timing of premium payment, which is not useful information.
    - Agenda Paper 2A for the December IASB meeting includes a staff recommendation to amend paragraph 78 of IFRS 17 to lift the level of aggregation for the separate presentation of assets and liabilities from "group" to "portfolio". Our view is that no separate presentation should be required; however, lifting the level of aggregation to portfolio will achieve the same objective with a simple change.
- #24 (Transition | Modified retrospective approach: further modifications)
    - We agree this issue **meets** the criteria for possible amendment. This issue is not on the December IASB agenda.
    - Here we note the possible further reduction to comparability if the modified retrospective approach is expanded.

We next consider the two issues that preliminary staff analysis indicated might meet the criteria for possible amendment:

- #3 (Measurement | Acquisition cash flows for renewals outside the contract boundary)
    - We think this issue **does not require** amendment. This issue is not on the December IASB agenda.
    - In our view, discussion at the February 2018 TRG meeting together with the amendment to paragraph 27 of IFRS 17 proposed in paragraph 7 of Agenda Paper 2A of the June 2018 IASB meeting adequately address this issue. It is clear that acquisition expenses can be allocated to groups not yet issued (including renewals of existing contracts), so the only remaining point of concern is <u>which</u> acquisition expenses can be so allocated, which in our view is a matter of judgment and requires no amendment to IFRS 17.

    - To avoid any misinterpretation, an editorial change or footnote could be added to the amendment proposed at the June 2018 meeting to clarify that contracts “expected to be issued” might include renewals of contracts that would be new.
- #7 (Measurement | Contractual service margin: coverage units in the general model)
    - We think this issue **meets** the criteria for possible amendment. This issue is not on the December IASB agenda.
    - In our view, this amendment should be made. Contrary to statements made by IASB staff, there are many contracts without direct participation features that provide investment-related services. Moreover, those investment-related services will contribute to the CSM, so amortizing CSM as both insurance and investment-related services are provided will improve comparability and enhance the usefulness of information.

We now consider the issues that preliminary staff analysis indicated do not meet the criteria for possible amendment:

- #2 (Level of aggregation of insurance contracts)
    - We think the prohibition to include in a group contracts that are issued more than one year apart **meets** the criteria for possible amendment. This issue is not on the December IASB agenda.
    - Pooling of risk is fundamental to the insurance business model. We disagree with staff’s statement that aggregation of contracts results in a loss of useful information; on the contrary, aggregation of contracts is necessary in order to provide useful information. Within a pool of like risks, the only useful information about profitability reflects the overall experience of the pool—it matters not <u>which</u> contracts within the pool incurred a claim and which did not. Splitting pools into groups that are not credible can lead to reported results that reflect statistical fluctuations rather than underlying profitability.
    - Staff noted that this concern has been raised mainly with reference to insurance contracts with direct participation features. We agree that it is most important for such contracts, but the concern is relevant to all types of contracts whenever an annual cohort is too small to be credible. This arises partly due to another issue that was not discussed in Agenda Paper 2D for October 2018; namely, the fact that the experience adjustment for claims in a reporting period (i.e., the portion that goes through profit/loss) excludes the change in fulfilment cash flows that is a direct consequence of that experience. For example, if nobody dies in a particular annual cohort, the additional fulfilment cash flows related to experiencing fewer deaths than expected reduces the CSM (rather than current period profit), giving the wrong message to users about the future profitability of that cohort—its CSM is not depleted because it was underpriced or because experience has been poor, but rather because past profit was overstated.

- #4 (Measurement | Use of locked-in discount rates to adjust the contractual service margin)
    - We agree this issue **does not meet** the criteria for possible amendment. This issue is on the December IASB agenda (2B).
    - During the development of IFRS 17, we agreed with the International Actuarial Association's view that the CSM should be remeasured each period using current rates. However, that approach was not adopted, and using the locked-in rates for adjustments is consistent with the approach to CSM that was adopted.
    - Note that we agree with the concern expressed that the "catch-up" to interest finance income or expense when assumptions about future experience are changed could be confusing to users.
- #5 (Measurement | Subjectivity | Discount rates and risk adjustment)
    - We agree this issue **does not meet** the criteria for possible amendment. This issue is on the December IASB agenda (2B).
    - We support the principles-based approach of IFRS 17. Subjectivity and the application of judgment are necessary given the complexity inherent in insurance contracts.
- #6 (Measurement | Risk adjustment in a group of entities)
    - We think this issue **meets** the criteria for possible amendment. This issue is on the December IASB agenda (2B).
    - We disagree strongly with the staff position that the <u>issuing</u> entity determines the compensation the entity would require for bearing non-financial risk. The measurement of insurance contract liabilities in a reporting entity's financial statements must be appropriate to the <u>reporting</u> entity, and use of the word "entity" without a qualifier means "reporting entity". For the risk adjustment for non-financial risk, the views of the issuing and reporting entities will often be aligned, especially at the time of issue. However, the risk adjustment is re-evaluated each reporting period, so the view of either entity at the time of issue quickly becomes irrelevant.
    - The staff position arises from an unfortunate interpretation of the word "charged" in paragraph B87 of IFRS 17. In this context, "charged" cannot mean the amount actually included in the price, because the amount actually included in the price does not change over time. Moreover, prices are subject to competitive considerations that may force an entity to charge less (or allow the entity to charge more) than what they require to cover the risk.
    - We therefore suggest that this issue be resolved by amending paragraph B87 of IFRS 17 to change the word "charged" to "required".

- #8 (Measurement | Contractual service margin: limited applicability of risk mitigation exception)
    - We think this issue **meets** the criteria for possible amendment. This issue is on the December IASB agenda (2C).
    - We generally agree with staff's analysis in Agenda Paper 2C, with the exception of paragraph 23. As acknowledged in footnote 4, there is potential for accounting mismatch if the OCI option is used. We therefore think the IASB should consider an amendment to generalize the elimination of accounting mismatches when derivatives are used to mitigate risk.
    - Also, if the requirement for a comparative year is retained (issue # 21), we note that paragraph C3(b) of IFRS 17 should be amended to allow the option in paragraph B115 of IFRS 17 to be applied in the comparative year.
- #9 (Measurement | Premium allocation approach: premiums received)
    - We think this issue **does not require** amendment. This issue is on the December IASB agenda (2A).
    - We would not object to such an amendment (though it should apply equally to contracts not using the premium allocation approach). However, the concerns would be largely addressed if the amendment to paragraph 78 of IFRS 17 (see #15 above) is made.
- #10 (Measurement | Business combinations: classification of contracts)
    - We think this issue **meets** the criteria for possible amendment. This issue is on the December IASB agenda (2D).
    - This amendment was suggested to address issue #11 below. Contrary to comments made by staff, we think such a change would increase comparability (between contracts written and contracts acquired), enhance the usefulness of information, and simplify measurement and reporting of acquired contracts.
- #11 (Measurement | Business combinations: contracts acquired during the settlement period)
    - We think this issue **does not require** amendment. This issue is on the December IASB agenda (2D).
    - This is the main concern with issue #10 above, and would be addressed by that suggested amendment.
- #13 (Measurement | Reinsurance contracts held: ineligibility for the variable fee approach)
    - We think this issue **does not require** amendment. This issue is not on the December IASB agenda.
    - We think this issue is adequately addressed through paragraph 66c of IFRS 17 as long as the editorial correction suggested in item S16 of the February 2018 TRG meeting is **not** made.

- #14 (Measurement | Reinsurance contracts held: expected cash flows arising from underlying insurance contracts not yet issued)
    - We think this issue **does not require** amendment. This issue is on the December IASB Agenda (2E).
    - We disagree with staff's analysis that the contract boundary includes expected cash flows arising from underlying insurance contracts not yet issued. A reasonable interpretation of paragraph 62 of IFRS 17 would confirm this.
    - Further, including such cash flows would require assumptions about the amount of future direct business that will be issued, which is highly uncertain. Yet there is no discussion in IFRS 17 or its Basis for Conclusions about how this risk would be reflected in the measurement of liabilities, which suggests that it was not intended to be included. Further evidence of the IASB's intent that future cessions not be included can be found (e.g., May 2011 IASB meeting).
    - We note that adequate resolution of this issue would require IASB staff to revise their stated position and retract some educational material that has been provided.
- #16 (Presentation in the statement of financial position | Premiums receivable)
    - We think this issue **does not require** amendment. This issue is on the December IASB agenda (2A).
    - We would not object to such an amendment. However, the concerns would be largely addressed if the amendment to paragraph 78 of IFRS 17 (see #15 above) is made.
- #17 (Presentation in the statement(s) of financial performance | OCI option for insurance finance income or expenses)
    - We agree this issue **does not meet** the criteria for possible amendment. This issue is on the December IASB agenda (2B).
    - We would object to an amendment to require (rather than permit) the use of OCI. If lack of comparability is a serious concern, eliminating the OCI option would appear to be more consistent with the underlying principles of IFRS 17 than requiring it.
- #18 (Defined terms | Insurance contract with direct participation features)
    - We think this issue **does not require** amendment. This issue is on the December IASB agenda (2C).
    - We disagree with staff's analysis suggesting that there might be constructive obligations that are not contractual obligations. In our view, paragraph 2 of IFRS 17 clearly indicates that contractual obligations include those implied by customary business practices. We also disagree with staff's analysis that insurance contracts meeting the definition of direct participation features "essentially provide asset management services", as this is inconsistent with paragraph B106 of IFRS 17, which clarifies that the underlying items need not be assets.

- In our view, IFRS 17 supports a wider definition of insurance contracts with direct participation features than staff's interpretation suggests. We therefore suggest the following editorial corrections:
  - B105 – remove "However, the link to the underlying items must be enforceable (see paragraph 2)" to avoid the implication that the contractual terms of the link to the underlying items need to be stronger than other contractual terms; and
  - B101 – remove "that are substantially investment-related service contracts", and remove "investment" before "return", to avoid the implication that the underlying items must be assets.

- #19 (Interim financial statements | Treatment of accounting estimates)
  - We think this issue **meets** the criteria for possible amendment. This issue is on the December IASB agenda (2F).
  - In our view, eliminating reporting differences caused by different reporting frequencies within the same group of entities would improve comparability and enhance the usefulness of information.
- #21 (Effective date | Comparative information)
  - We think this issue **meets** the criteria for possible amendment. This issue is not on the December IASB agenda.
  - In our view, it is unlikely that simply restating financial statements measured under IFRS 4 to IFRS 17 would provide useful information, especially when IFRS 9 is also coming into effect. Users will need information to help understand the transition from IFRS 4 to IFRS 17, but a comparative year may not be the best information for that purpose.
- #23 (Transition | Optionality)
  - We think this issue **might meet** the criteria for possible amendment. This issue is not on the December IASB agenda.
  - This amendment would improve comparability and simplify measurement and reporting at transition. However, there are mixed views about whether it would enhance or diminish the usefulness of information, and it could disrupt implementation plans already underway.
- #25 (Transition | Fair value approach: OCI on related financial assets)
  - We agree this **does not meet** the criteria for possible amendment. This issue is not on the December IASB agenda.
  - We support the flexibility in IFRS 17 to take a simple approach or a more complex approach depending on the entity's circumstances.

Thank you for taking the time to consider our submission. If you have any questions, please contact Lesley Thomson or Les Rehbeli.

Yours truly,

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John Dark
President, Canadian Institute of Actuaries

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