Canadian Institute of Actuaries | Institut canadien des actuaires

September 24, 2019

Mr. Hans Hoogervorst
International Accounting Standards Board
Columbus Building,
7 Westferry Circus, Canary Wharf
London, E14 4HD
United Kingdom

Re: Comment Letter on Exposure Draft Amendments to IFRS 17

Dear Chairman Hoogervorst,

The Canadian Institute of Actuaries (CIA) welcomes the opportunity to comment on the proposed Draft Amendments to IFRS 17 on behalf of its members.

The Canadian Institute of Actuaries (CIA) is the national, bilingual organization and voice of the actuarial profession in Canada. Our 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.

The CIA appreciates the efforts of the IASB to address stakeholder concerns related to the implementation of IFRS 17, and supports many of the proposed amendments. Having said that, we think that there are a few areas that require further consideration. We would especially like to highlight our concerns on the following key topics:

IFRS 17 effective date

We agree that the effective date of IFRS 17 should be deferred.

However, if European adoption of IFRS 17 is likely to be later than January 1, 2022, we strongly urge the IASB to delay the effective date of IFRS 17 accordingly. The Canadian process for adoption of IFRS 17 does not allow for a different effective date, which would mean that Canada would be forced to adopt IFRS 17 before Europe. This would be confusing to users and contrary to the goal of a single global effective date.

Reinsurance contracts held – definition of “proportionate reinsurance”

We agree with the goal of the proposed amendment to adjust the CSM of a group of reinsurance contracts held to offset the portion of a loss on initial recognition of onerous underlying contracts that will be recovered by the reinsurance.

However, the description of “proportionate coverage” in paragraph B119C is too narrow and should be expanded to include all types of reinsurance where recoveries are certain and identifiable, and not be limited to situations where the recoveries are a fixed percentage.

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In addition, the new requirement to track loss recovery components on groups of reinsurance contracts adds significant complexity for little value.

CSM attributable to investment-return services and investment-related services

We agree with the goal of the proposed amendment to include in the definition of coverage units (i.e., for the purpose of CSM amortization) some investment services in addition to insurance services. However, when combined with the minor amendment to the definition of investment component, the draft amended Standard is more complex and confusing than needed to achieve the goal. In particular, the description of "investment-return" services in paragraph B119B is unclear, and likely to cause confusion and inconsistent application.

We encourage the IASB to simplify the proposed amendments in a way that achieves the primary goal, which we support. We would be pleased to provide further support in developing such potential simplification.

Recoverability testing of deferred acquisition costs

We agree that the recoverability of an asset set up for insurance acquisition cash flows paid before initial recognition of the group to which the cash flows are allocated should be assessed for each (future) group as required by paragraph B35B(a). However, we do not agree with the additional test of the recoverability of the portion of each group's asset that arose from the insurance acquisition cash flows in paragraph B35A. That is, we think that paragraph B35B(b) should be removed.

In addition, we have proposed some amended wording, to eliminate some confusion in the application.

Transition modification – treatment of claims in settlement acquired in transfer or business combination

We agree with the effect of this amendment. However, we support the view that an entity should have choice in the treatment of claims in settlement that are acquired in a transfer or business combination, consistent with the agreement coming out of AP01 of the September 2018 TRG meeting that insurance risk consequent to an incurred claim can be viewed as either LIC or LRC.

Risk mitigation option

We agree with the proposed amendment to extend the risk mitigation option to circumstances when an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts with direct-participation features. Furthermore, in our view, the risk mitigation option should extend to circumstances where financial risk is hedged with assets other than derivatives if those assets perform the same function as derivatives.

Finally, the risk mitigation option should be extended to remove the accounting mismatch arising from non-participating product features (e.g., riders) that are outside the underlying items.

Conclusion

We attach our detailed comments to each of the questions posed by IASB staff in its request for comments. We appreciate your consideration of our comments, and would be pleased to discuss these topics with you in more detail.

We appreciate the opportunity to respond, and trust that these comments will be of value. If you have any questions, please contact Chris Fievoli, CIA Staff Actuary, Communications and Public Affairs, at 1-613-656-1927.

Sincerely,

[original signature on file]

Marc Tardif, FCIA
CIA President

Appendix 1: Detailed Responses to Exposure Draft questions

Question 1—Scope exclusions—credit card contracts and loan contracts that meet the definition of an insurance contract (paragraphs 7(h), 8A, Appendix D and BC9–BC30)

(a) Paragraph 7(h) proposes that an entity would be required to exclude from the scope of IFRS 17 credit card contracts that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

Do you agree with the proposed amendment? Why or why not?

(b) If not excluded from the scope of IFRS 17 by paragraphs 7(a)–(h), paragraph 8A proposes that an entity would choose to apply IFRS 17 or IFRS 9 to contracts that meet the definition of an insurance contract but limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract (for example, loans with death waivers). The entity would be required to make that choice for each portfolio of insurance contracts, and the choice for each portfolio would be irrevocable.

Do you agree with the proposed amendment? Why or why not?

Response:

1(a)

We agree with the proposed amendment to exclude from the scope of IFRS 17 certain credit card contracts, as this will provide relief to entities that write contracts with only incidental insurance risk.

1(b)

We agree with the proposed amendment to allow the choice to apply IFRS 9 or IFRS 17 to contracts where the only insurance risk relates to amounts required to settle policyholder obligations created by the contract, as this will provide implementation relief for contracts that include only incidental insurance risk.

Question 2—Expected recovery of insurance acquisition cash flows (paragraphs 28A–28D, 105A–105C, B35A–B35C and BC31–BC49)

Paragraphs 28A–28D and B35A–B35C propose that an entity:

(a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to any groups that include contracts that are expected to arise from renewals of the contracts in that group;

(b) recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and

(c) assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.

Paragraphs 105A–105C propose disclosures about such assets.

Do you agree with the proposed amendments? Why or why not?

Response:

2(a)

We agree with the proposed amendment to require a portion of insurance acquisition cash flows that are directly attributable to a group to be allocated to groups outside the contract boundary that include expected renewals of the insurance contracts in that group, as this will improve the usefulness of information about the profitability of groups of newly issued contracts compared to groups of renewals of those contracts.

We suggest two refinements to the wording of the proposed amendment to clarify its intent:

- Paragraph 28A could be misinterpreted as applying in its entirety only when the premium allocation approach (PAA) is applied. We therefore suggest a revision to 28A such as:

  "*Unless an entity recognizes insurance acquisition cash flows as expenses applying paragraph 59(a), the entity shall allocate insurance acquisition cash flows to a group of insurance contracts on a systematic and rational basis applying paragraph B35A*."

- Paragraph 28C references paragraph 38(b), which is not relevant in the case of PAA. We therefore suggest adding references to paragraph 55(a)(iii) to clarify the approach under PAA.

2(b)

IFRS 17 already requires that an asset be set up for insurance acquisition cash flows paid before initial recognition of the group to which the cash flows are allocated. We agree with the proposed amendment to add the insurance acquisition cash flows noted in 2(a) (i.e., insurance acquisition cash flows that are directly attributable to a group) to that asset.

However, we note two possible areas of confusion:

- Paragraph 28A could be misinterpreted as limiting the insurance acquisition cash flows allocated to groups of insurance contracts on a systematic and rational basis to the insurance acquisition cash flows that are directly attributable to a group. This is clearly not the intent of the Standard (as confirmed by BC38) and we therefore suggest a clarification to either paragraph 28A or paragraph B35A.
- Paragraph 28B and, correspondingly, paragraphs 38(b) and 55(a)(iii), do not address the treatment of other cash flows (i.e., other than insurance acquisition cash flows), that might occur prior to initial recognition of a group of contracts; for example, premiums for non-onerous contracts received by the entity prior to their contractual due date and prior to the start of the coverage period. This omission could be misinterpreted as intentional, and we therefore suggest a clarification.

2(c)

We agree that the recoverability of an asset set up for insurance acquisition cash flows paid before initial recognition of the group to which the cash flows are allocated should be assessed for each (future) group as required by paragraph B35B(a). However, we do not agree with the additional test of the recoverability of the portion of each group's asset that arose from the insurance acquisition cash flows noted in 2(a). That is, we think that paragraph B35B(b) should be removed. To explain:

- IFRS 17 (without amendment) requires the identification of insurance acquisition cash flows that are directly attributable to a portfolio and requires that those expenses be allocated to the groups within that portfolio. Some of those groups will already be recognized (in which case the insurance acquisition cash flows are included in the measurement of the group) and some of those groups will not yet be recognized (in which case the insurance acquisition cash flows are set up as an asset (call this asset "DAC" for convenience)). There was never a prohibition against allocating some insurance acquisition cash flows to groups that had not yet been recognized (including groups outside the contract boundary that include expected renewals of contracts in existing groups); however, discussion at the February 2018 TRG meeting revealed that some believe that IFRS 17 prohibits the allocation of a portion of non-refundable commissions to future renewals. [For clarity, all agree (and BC38 confirms) that if commissions are refunded in the event the contract does not renew, IFRS 17 allows for the refundable portion of the commissions to be allocated to renewals.]
- Therefore, the amendments introduce a new category of insurance acquisition cash flows, viz., those that are directly attributable to a group, and only those expenses are included in paragraph B35A. Also, paragraph 28B(b) introduces the requirement that a separate DAC be established for each group not yet recognized to which acquisition cash flows are allocated. Note that the DAC associated with a particular group not yet recognized could include both acquisition cash flows that were allocated to it from paragraph B35A (e.g., non-refundable commissions) and acquisition cash flows that were allocated to it directly (e.g., refundable commissions).
- Paragraph 28D introduces the requirement for testing recoverability of each group's DAC, and refers to paragraph B35B for application guidance. Paragraph B35B(a) says to recognize an impairment loss if the group's DAC exceeds the expected net cash inflow for the related group. This would appear to suffice; however, paragraph B35B(b) requires an additional impairment test for the subset of the group's DAC that arose from expenses allocated to it from paragraph 35A and the subset of expected net cash inflow for the related group that arises from expected renewals of contracts related to B35A expenses. This additional impairment test would add significant complexity to implementation by adding an aspect of measurement within the group – i.e., within the unit of account of measurement. Furthermore, in our view, this additional impairment test is unnecessary, as there is no reason to differentiate between recoverability of the portion of the DAC that arose from paragraph 35A cash flows and the portion that arose from other cash flows. Paragraph 35B(b) should be removed.

Furthermore, with respect to B35C (reversal of impairment loss), it is our understanding from discussion with IASB staff that the IASB did not intend to require such reversal at the time the DAC itself is derecognized because of initial recognition of its associated group of contracts (paragraph 38(b) or 55(a)(iii)). In other words, there is no requirement to write the DAC back up immediately before it is derecognized when initial recognition of the group indicates that the DAC was less impaired than the DAC balance at the end of the prior reporting period indicated, as this would require an arbitrary attribution of revenue to sources of loss. The amendments are unclear on this point, so we suggest clarifying that the tests in paragraphs 35B and B35C need be undertaken only at the end of each reporting period.

2(d)

We agree with the disclosures proposed in paragraphs 105A–105C, as they will provide useful information to users of the financial statements.

Question 3—Contractual service margin attributable to investment-return service and investment-related service (paragraphs 44–45, 109 and 117(c)(v), Appendix A, paragraphs B119–B119B and BC50–BC66)

(a) Paragraphs 44, B119–B119A and the definitions in Appendix A propose that an entity identify coverage units for insurance contracts without direct participation features considering the quantity of benefits and expected period of investment-return service, if any, in addition to insurance coverage. Paragraph B119B specifies criteria for when contracts may provide an investment-return service.

Do you agree with the proposed amendment? Why or why not?

(b) Paragraphs 45, B119–B119A and the definitions in Appendix A clarify that an entity is required to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service.

Do you agree with the proposed amendment? Why or why not?

(c) Paragraph 109 proposes that an entity disclose quantitative information about when the entity expects to recognise in profit or loss the contractual service margin remaining at the end of a reporting period. Paragraph 117(c)(v) proposes an entity disclose the approach used to determine the relative weighting of the benefits provided by insurance coverage and investment-return service or investment-related service.

Do you agree with the proposed disclosure requirements? Why or why not?

Response:

3(a)

We agree with the goal of the proposed amendment to include in the definition of coverage units (i.e., for the purpose of CSM amortization) some investment services in addition to insurance services. However, when combined with the minor amendment to the definition of investment component, the draft amended Standard is more complex and confusing than needed to achieve the goal.

In particular, the description of "investment-return" services in paragraph B119B is unclear, and likely to cause confusion and inconsistent application. For example:

- B119B/BC60 – Paragraph BC60 indicates that identifying investment-return service should be a matter of judgment and the criteria are necessary but not determinative. However, paragraph B119B uses "if, and only if", which typically implies the criteria are determinative. We suggest that paragraph B119B should use "only if" to be more clearly consistent with the intent expressed in BC60.
- B119B(a)/BC58 – The new concept of an amount that a policyholder has a "right to withdraw" as a feature that could give rise to an investment-return service is unclear. In particular, paragraph BC58 indicates that a "right to withdraw" could exist if the policyholder has rights to transfer an amount to <u>another</u> insurance provider. However, it is not clear whether a "right to withdraw" could exist if the policyholder has rights to transfer an amount <u>within</u> the same entity to acquire another service (e.g., to purchase an annuity). It seems that the same service is provided regardless of whether the transfer is to another entity or within the same entity, yet BC58 appears to imply that only transfers to another entity qualify as "rights to withdraw".
- B119B(a) – Furthermore, it is unclear why the term "right to withdraw" was introduced at all, since it appears that any "right to withdraw" must be either an investment component or a premium refund. If not, the accounting treatment of such product features should be discussed.
- B119B(b) – In identifying investment-return service, the meaning of "positive investment return" is unclear. Without the parentheses, "positive" clearly means "greater than zero". The parenthetical comment that a positive investment return could be below zero suggests that the word "positive" means "greater than something", in this context, but what is "something"? Risk-free rates? An example of a product for which the answer to this question is critical is permanent whole life insurance contracts with fixed guaranteed cash surrender values. The cash surrender values are an investment component or right to withdraw, but they may or may not provide investment-return service depending on the meaning of the word "positive" in B119B(b). If "positive" means "greater than zero", then cash surrender values would provide investment-return services, but if "positive" means "greater than risk-free rates", then cash surrender values may or may not provide investment-return services (depending on the rate credited).
- B119B(c) – In identifying investment-return service, it is unclear what is meant by "investment activity to generate that positive investment return". In the cash surrender value example above, the entity undertakes investment activity by investing premiums received before claims are paid, but that activity would take place regardless of whether a cash surrender value is provided or not.

We are concerned, based on discussions with professional and industry peers on these points, that the confusion caused by these proposed amendments (when combined with the confusion explained in the response to Question 10) will result in significant disruption as entities struggle

to determine the related measurement and reporting implications of the proposed changes and attempt to reach consensus on interpretation and application of the requirements across a broad spectrum of insurance contracts. We therefore encourage the IASB to simplify the proposed amendments in a way that achieves the primary goal which, as indicated at the outset, we support. We would be pleased to provide further support in developing such potential simplification.

3(b)

We agree that coverage units for insurance contracts with direct participation features should consider both insurance and investment services.

We note that "investment-related services" on insurance contracts with direct participation features would meet the definition of "investment-return service" on insurance contracts without direct participation features. Therefore, the amended Standard could be simplified by using the term "investment-return service" for insurance contracts with and without direct participation features.

3(c)

We agree with the proposed disclosure requirements, as they will provide useful information about an area of judgment where different approaches could be used.

Question 4—Reinsurance contracts held—recovery of losses on underlying insurance contracts (paragraphs 62, 66A–66B, B119C–B119F and BC67–BC90)

Paragraph 66A proposes that an entity adjust the contractual service margin of a group of reinsurance contracts held that provides proportionate coverage, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. The amount of the adjustment and resulting income is determined by multiplying:

(a) the loss recognised on the group of underlying insurance contracts; and

(b) the fixed percentage of claims on the group of underlying contracts the entity has a right to recover from the group of reinsurance contracts held.

Do you agree with the proposed amendment? Why or why not?

Response:

We agree with the goal of the proposed amendment to adjust the CSM of a group of reinsurance contracts held to offset the portion of a loss on initial recognition of onerous underlying contracts that will be recovered by the reinsurance, as this will improve the usefulness of information about the profitability of the entity's insurance business. In particular, we agree with defining the eligible loss recovery as the recovered portion of the initial loss on the underlying contracts. This is a simple, practical approach that achieves the objective of improving matching and therefore the usefulness of information about the profitability of the entity's insurance business.

However, we offer the following suggestions to simplify and improve the amendment.

- First, the description of “proportionate coverage” in paragraph B119C (and Appendix A) is too narrow. In particular, the requirement for “a fixed percentage of all claims incurred on a group of underlying contracts” excludes common types of proportionate reinsurance contracts where the amount recovered is a fixed percentage above a certain dollar threshold, or fixed percentages that vary by type of coverage within a contract. However, for the purpose of this amendment, recoveries on these types of proportionate reinsurance contracts are as certain and identifiable as recoveries on reinsurance contracts described in paragraph B119C, and therefore should be eligible to provide relief.

  Our suggestion is to revise the description of proportionate coverage in paragraph B119C (and Appendix A) from “…fixed percentage of all claims incurred…” to “…known portion of each claim incurred…”, and remove the proposed footnote to BC304.

  Consequently, paragraph B119D would be modified to “An entity shall determine the adjustment to the contractual service margin and the resulting income recognised applying paragraph 66A as the portion of loss on the underlying insurance contracts that the entity has a right to recover from the group of reinsurance contracts held.”

- Second, the new requirement to track a loss-recovery component for groups of reinsurance contracts held adds significant complexity to implementation for little added value. Furthermore, it is unclear whether the loss-recovery component should be treated as (a) a separate component of CSM with its own amortization pattern (paragraph B119F), or (b) a notional portion of the total CSM, which would be amortized as services are received.

Question 5—Presentation in the statement of financial position (paragraphs 78–79, 99, 132 and BC91–BC100)

The proposed amendment to paragraph 78 would require an entity to present separately in the statement of financial position the carrying amount of portfolios of insurance contracts issued that are assets and those that are liabilities. Applying the existing requirements, an entity would present the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities. The amendment would also apply to portfolios of reinsurance contracts held that are assets and those that are liabilities.

Do you agree with the proposed amendment? Why or why not?

Response:

We agree with the proposed amendment to change the requirement for separate presentation of positive and negative insurance contract liabilities from the group level to the portfolio level, as it provides significant implementation relief with no loss of useful information.

Further, we would support eliminating the need for separate presentation entirely, as the separation does not provide useful information and could be confusing. The measurement of insurance contract liabilities includes all future inflows as well as all future outflows, and whether the total is positive or negative is a matter of the timing of inflows versus outflows rather than an indication of profitability, or whether the entity has net rights or net

obligations. For example, an insurance contract "asset" can arise merely because premiums (which would never qualify as a stand-alone asset) are due later than the coverage is provided. People sometimes conflate liabilities/assets with "onerous"/"profitable", but the concepts are not the same. Appropriate information about profitability will be in the disclosures – most importantly, the separate disclosure of CSM and the new business disclosure requirements.

Question 6—Applicability of the risk mitigation option (paragraphs B116 and BC101–BC109)

The proposed amendment to paragraph B116 would extend the risk mitigation option available when an entity uses derivatives to mitigate financial risk arising from insurance contracts with direct participation features. That option would apply in circumstances when an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts with direct participation features.

Do you agree with the proposed amendment? Why or why not?

Response:

We agree with the proposed amendment to extend the risk mitigation option to circumstances when an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts with direct participation features, as this solves the primary concern (mismatch) arising from the paragraph B109 restriction that reinsurance contracts held cannot be insurance contracts with direct participation features for the purposes of IFRS 17.

Furthermore, in our view, the risk mitigation option should extend to circumstances where financial risk is hedged with assets other than derivatives if those assets perform the same function as derivatives. For example, hedging a minimum guaranteed return can be accomplished by (a) purchasing a put option or (b) purchasing a combination of fixed income assets and derivatives that mimics the cash flows of the put option but less expensively. Since the risk mitigation option applies to (a), it should also apply to (b), provided the entity meets the requirements of paragraph B116.

Finally, the risk mitigation option should be extended to remove the accounting mismatch arising from non-participating product features (e.g., riders) that are outside the underlying items. Alternatively, paragraph B113(b) could be amended to exclude non-participating product features that are outside the underlying items.

Question 7— Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs C1, [Draft] Amendments to IFRS 4 and BC110–BC118)

IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. The amendments proposed in this Exposure Draft are such that they should not unduly disrupt implementation already under way or risk undue delays in the effective date.

(a) The proposed amendment to paragraph C1 would defer the effective date of IFRS 17 by one year from annual reporting periods beginning on or after 1 January 2021 to annual reporting periods beginning on or after 1 January 2022.

Do you agree with the proposed amendment? Why or why not?

(b) The proposed amendment to paragraph 20A of IFRS 4 would extend the temporary exemption from IFRS 9 by one year so that an entity applying the exemption would be required to apply IFRS 9 for annual reporting periods beginning on or after 1 January 2022.

Do you agree with the proposed amendment? Why or why not?

Response:

7(a)

We agree that the effective date of IFRS 17 should be deferred, because implementation on the original schedule would be impossible, especially given the requirement for comparative statements (which means the transition date is January 1, 2020) and the uncertainty in the requirements of the Standard. Even with a one-year delay, implementation will be a significant challenge, as the final Standard is not expected until mid-2020, which is only six months before the transition date. Also, vendors are still in the development stage of creating software to handle the new requirements of IFRS 17 (in particular, the CSM), and will not be able to finalize until after the Standard is final. This leaves little time for testing before the transition date.

Furthermore, if European adoption of IFRS 17 is likely to be later than January 1, 2022, we would strongly urge the IASB to delay the effective date of IFRS 17 accordingly. The Canadian process for adoption of IFRS 17 does not allow for a different effective date, which would mean that Canada would be forced to adopt IFRS 17 before Europe. This would be confusing to users and contrary to the goal of a single global effective date.

7(b)

We agree with extending the temporary exemption from IFRS 9 to the effective date of IFRS 17. In Canada, current financial reporting (IFRS 4) links the measurement of liabilities to the measurement of the supporting assets. Therefore, applying IFRS 9 before IFRS 17 would be costly, as entities would have to go through the process of classifying assets twice. Also, it would be confusing to users, as the comparative statements would be based on IFRS 4 and IFRS 9, which is different than the prior years (IFRS 4 and IAS 39) and the following years (IFRS 17 and IFRS 9).

Question 8— Transition modifications and reliefs (paragraphs C3(b), C5A, C9A, C22A and BC119–BC146)

(a) Paragraph C9A proposes an additional modification in the modified retrospective approach. The modification would require an entity, to the extent permitted by paragraph C8, to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired. Paragraph C22A proposes that an entity applying the fair value approach could choose to classify such a liability as a liability for incurred claims.

Do you agree with the proposed amendments? Why or why not?

(b) The proposed amendment to paragraph C3(b) would permit an entity to apply the option in paragraph B115 prospectively from the transition date, rather than the date of initial application. The amendment proposes that to apply the option in paragraph B115 prospectively on or after the transition date, an entity would be required to designate risk mitigation relationships at or before the date it applies the option.

Do you agree with the proposed amendment? Why or why not?

(c) Paragraph C5A proposes that an entity that can apply IFRS 17 retrospectively to a group of insurance contracts be permitted to instead apply the fair value approach to that group if it meets specified criteria relating to risk mitigation.

Do you agree with the proposed amendment? Why or why not?

Response:

8(a)

We agree with the effect of this amendment.

The underlying issue is the treatment of claims in settlement that are acquired in a transfer or business combination – in particular, the concern that such obligations, which are LIC in the entity from which the obligations were acquired, become LRC in the acquiring entity. We support the view that an entity should have choice in the treatment of claims in settlement that are acquired in a transfer or business combination, consistent with the agreement coming out of AP01 of the September 2018 TRG meeting that insurance risk consequent to an incurred claim can be viewed as either LIC or LRC.

8(b)

We agree with the proposed amendment to allow the risk mitigation option to be applied from the transition date if it can be done without hindsight, as this will improve the usefulness of the comparative statements.

8(c)

We agree with the proposed amendment to permit the application of the fair value approach even if retrospective application is not impracticable if the group meets criteria relating to the risk mitigation.

However, we believe there are other circumstances in which the fair value approach should be permitted even if retrospective application is not impracticable. In particular, the fair value approach should be permitted whenever retrospective application would take undue cost and effort. This adds an element of judgment, but without it the Standard contains, by definition, the potential to create an undue burden on implementation. It appears that the accounting interpretation of the word "impracticable" in IAS 8 has evolved to ignore the cost and effort required to do the calculations, and though this might be reasonable for retrospective application of a Standard that affects only a small part of the business, it is an unreasonable burden for insurance companies implementing IFRS 17. In our view, the extensive disclosures required for blocks using different transition approaches adequately addresses any concern that adding this element of judgment might reduce comparability.

Question 9—Minor amendments (BC147–BC163)

This Exposure Draft also proposes minor amendments (see paragraphs BC147–BC163 of the Basis for Conclusions).

Do you agree with the Board's proposals for each of the minor amendments described in this Exposure Draft? Why or why not?

Response:

Note: This section only includes comments other than those included in the responses to other questions; in particular, issues with the minor amendments related to the new term "insurance contract services" are discussed in the response to Question 10.

Minor amendments discussed in BC147–BC163:

- **22/25/28, BC150** – The amendments to clarify that grouping should be based on date of issue even if initial recognition in a later reporting period introduces a complication that was unforeseen and could significantly disrupt implementation efforts. To address this, it would be helpful to clarify that the practical expedient in paragraph 25 that allows for initial recognition to take place later than the issue date (unless the group is onerous) need not be used (i.e., initial recognition at the time of issue should be permitted).
- **48(a)/50(b)(i), BC152** – The minor amendment to paragraphs 48(a) and 50(b)(i) could cause confusion by (apparently) limiting the changes related to future service that should be taken into account when adjusting the loss component. Assuming adjustments to the loss component are intended to mirror the adjustments to the CSM, we suggest using wording consistent with paragraphs 44(c) and 45(c) – i.e., removing "arising from changes in estimates of future cash flows and the risk adjustment for non-financial risk" from paragraphs 48(a) and 59(b)(i).
- **103(c), BC153 and Appendix A, BC156 – investment components and premium refunds** – The minor amendment to the definition of investment component arose in part from the realization that there was some overlap with "premium refunds", which should also be excluded from insurance revenue and insurance service expense, though there is no specific mention of premium refunds in IFRS 17 (other than the minor amendment to paragraph 103(c) to provide relief in the disclosures under certain conditions). In our

view, the Standard should be amended to include the treatment of premium refunds (and, if necessary, rights to withdraw) explicitly.

We further note that the revised definition of investment component proposed in Appendix A is as likely, or more likely, to lead to inconsistent interpretation as is the current definition. For example, the suggestion (e.g., paragraph 10(d) of AP01 of the April 2019 TRG meeting) that an amount repayable in all circumstances can include payments of zero value in some circumstances is confusing, especially since it contradicts the view expressed in paragraph 31 of AP03 of the September 2018 TRG meeting.

Further, the non-intuitive delinking of the term "investment component" from common product features such as surrender values or contract account values and the resulting need to account for payments related to such features as premium refunds or "rights to withdraw", even though such payment amounts may be considerably affected by investment returns, also creates confusion.

The following examples illustrate situations where we believe the change in definition of investment component is problematic:

- Examples #1 and #2 in AP01 of the April 2019 TRG meeting consider cases where a single-premium life insurance policy provides a payment to the policyholder in all circumstances because, in those examples, termination of the policy by the policyholder does not have commercial substance. However, in the more typical case of an annual premium contract (assuming the same benefit structure), there are relevant circumstances where the policyholder may allow the contract to lapse (i.e., stop paying premiums), in which case no amount would be payable, suggesting that no investment component would exist, even though the benefit payments were the same as in the examples in AP01. It seems counterintuitive, and perhaps unintended, that the characterization of benefit payments as being investment component payments or insurance claim payments would differ depending on the premium payment frequency.
- Building on the example above, in the common case where an annual premium whole-life contract provides guaranteed cash surrender values prior to maturity, because the contract could in certain circumstances lapse due to non-payment of premium with no benefit payable, it is unclear whether the payment of a cash surrender value should be characterized as a premium refund or an investment component.
- As an even more counterintuitive example, in the case of a flexible-premium universal life contract where there may be significant investment returns (and significant variance in those returns) credited to the policyholder account balance, the fact that under certain circumstances the contract could lapse due to non-payment of a minimum level of premiums, with no benefit payable, might suggest there is no investment component even though intuitively such an

account value is exactly what the concept of investment component was intended to capture.

- Finally, the example discussed in AP2C of the May 2019 IASB meeting (paragraph 6) of a single premium deferred annuity continues to cause confusion. IASB staff have indicated that such contracts do not contain an investment component. However, it would seem more reasonable (and intuitive) to consider such contracts as containing an investment component in the accumulation phase (amounts are paid by the entity in all circumstances (surrender, death, annuitization)). If not, there needs to be another way to make it clear that such amounts should be excluded from insurance revenue and insurance service expense.

The examples above illustrate that with the proposed change in definition of investment component, the term seems to have no intuitive meaning. Furthermore, given the introduction of the separate new concepts (of investment-return service and of "rights to withdraw") required for purposes of identifying coverage units, and the fact that other payments to policyholders besides investment components will need to be excluded from insurance service results (premium refunds, loans, and possibly amounts withdrawn that are neither repayments of investment components nor premium refunds), the concept of an investment component seems to have little if any relevance.

- **B96(d), BC158** – The amendment to paragraph B96(d) introduces a measurement difference based on a presentation choice (whether to disaggregate the change in risk adjustment between financial and non-financial causes). However, in the past, when preparers argued that the discount rate used to unlock the CSM (B72(c)) should be the locked-in rates if the OCI option is elected but the current discount rates otherwise, the IASB rejected the suggestion on the grounds that measurement cannot depend on a presentation choice. Now that B96(d) has been changed to allow such a dependency, we would ask the IASB to reconsider the suggestion that the discount rates in B72(c) be chosen to match the impact on profit and loss.

  Also, we observe that, due to differences in wording between the amended B96(d) and paragraph 81, it may not be entirely clear that there is a single disaggregation choice that applies to both of the paragraphs. We therefore suggest the use of consistent wording and a cross-reference between the paragraphs to clarify.

- **B128(c), BC161** – It would be helpful to add a comment about what this amendment means for presentation when the underlying items include non-financial items (e.g., mortality risk). Similarly, it would be helpful to note that the policyholders' share of underlying items would – by definition – be an investment component (for insurance contracts with and without direct participation features).

Other minor amendments identified:

- **B107(b)(ii)** – Changing "group of insurance contracts" to "insurance contract" in this context could be misconstrued as a further restriction on the scope of contracts meeting the definition of insurance contracts with direct participation features. For example, in

discussion at the February 2018 TRG meeting (item S26 of AP07), paragraph B107 was used to explain that contracts need not pay the fair value of underlying each year, but rather over time. However, this is done in pools, not contract by contract.

Question 10—Terminology

This Exposure Draft proposes to add to Appendix A of IFRS 17 the definition 'insurance contract services' to be consistent with other proposed amendments in this Exposure Draft.

In the light of the proposed amendments in this Exposure Draft, the Board is considering whether to make a consequential change in terminology by amending the terms in IFRS 17 to replace 'coverage' with 'service' in the terms 'coverage units', 'coverage period' and 'liability for remaining coverage'. If that change is made, those terms would become 'service units', 'service period' and 'liability for remaining service', respectively, throughout IFRS 17.

Would you find this change in terminology helpful? Why or why not?

Response:

We agree with the goal of the proposed amendment to include in the definition of coverage units (i.e., for the purpose of CSM amortization) some investment services in addition to services related to providing insurance coverage. However, we observe that the amendments introduce new terminology that – though intended to be helpful – has made the Standard more confusing.

First, note that the main purpose of identifying investment components is to identify premiums paid to the entity that should not be included in insurance revenue (see paragraphs 85, B120) and benefits paid by the entity that should not be included in insurance service expense (paragraphs 84, 85).

In contrast, the purpose of identifying "investment-return service" is to identify those <u>services</u> that should be considered when amortizing CSM as services are provided (i.e., the services to include in coverage units "CU"). At the April 2019 TRG meeting, it appeared that the definition of investment-return service would require the existence of an investment component, but in May 2019, Staff identified a case where investment-return service exists in the absence of an investment component but where the policyholder has "a right to withdraw". The "right to withdraw" feature – like investment components and premium refunds – should also be excluded from insurance revenue and insurance service expense.

Therefore, given the terminology in the ED, there are four different types of feature/service to identify in an insurance contract (consider insurance contracts without direct participation features for simplicity):

1. Insurance coverage (coverage for insured events) and related service (e.g., paying claims) – **I**ncluded in revenue/expense; **I**ncluded in CU
2. Investment components (and rights to withdraw) that do provide investment-return service – **E**xcluded from revenue/expense; **I**ncluded in CU

3. Investment components (and premium refunds and rights to withdraw) that do not provide investment-return service – **E**xcluded from revenue/expense; **E**xcluded from CU
4. Other services (e.g., non-distinct service components) – **I**ncluded in revenue/expense; **E**xcluded from CU

The new term “insurance contract services” is defined to include services related to #1 and #2 – i.e., it identifies those services that should be considered when amortizing CSM as services are provided. However, the amended Standard uses the new term more broadly, creating confusion and in some cases, significant (likely unintended) change. In particular (in order of the Standard):

- **Paragraph 12** – The proposed amendment, when combined with paragraph 11, indicates that distinct product features that provide investment-return service would be separated from the insurance contract if an investment component, but not if a right to withdraw. Inconsistent treatment of features/services that are substantially the same would appear to be unintended.
- **Paragraph 34** – Restricting the contract boundary definition to “insurance contract services” rather than all services provided under the contract is a significant change. Insurance contracts include substantive obligations related to investment components that do not provide investment-return service (#3) and other services (#4), and cash flows associated with these obligations should be within the boundary of the contract. For example, consider an insurance contract with an investment component that does not provide investment-return service (#3) where payments under the investment component continue after the insurance coverage has expired. The proposed amendment to paragraph 34 would imply that the contract boundary ends when the insurance coverage ends and the subsequent investment component payments would be outside the contract boundary. That is a significant change that would appear to be unintended because it was never discussed.
- **Paragraph 41(a)** – As with paragraph 34, restricting insurance revenue to the reduction of the LRC because of “insurance contract services” provided in the period is an incorrect use of the term and conflicts with paragraph B120. Revenue should be the reduction in LRC because of #1 and #4 above – i.e., everything other than investment components and premium refunds/rights to withdraw. In our view, paragraph 41(a) should have been left as it was (referring to all services), with paragraph B120 clarifying that investment components (and premium refunds/rights to withdraw) are excepted.
- **Paragraphs 44(e), 45(e), 76(c), B119** – This is the correct use of “insurance contract services”.
- **Paragraphs 53(b), 55(b), 56** – This is also a correct use of “insurance contract services”, consistent with the amended definition of “coverage period”.

- **Paragraph 83** – See comments under paragraph 41(a). Revenue should not be limited to “insurance contract services”, but rather everything other than investment components and premium refunds/rights to withdraw. Again, paragraph 83 could have been left as is (all services), with paragraph B120 clarifying.
- **Paragraphs 103, 104** – Limiting these reconciliations to “insurance contract services” would again seem to be an unintended change. For example, 103(c) would be limited to investment components that provide investment-return service (#2) and ignore investment components that do not provide investment-return service (#3). Similarly, 104(a)(i) would exclude changes in estimates that adjust the CSM if those changes are related to #3 or #4.
- **Appendix A (contractual service margin)** – This is the correct use of “insurance contract services”.
- **Appendix A (coverage period)** – The amended definition works well when the term “coverage period” is used in the context of CSM amortization (e.g., paragraph 44(e)). However, the amended definition causes an (unintended) significant change to the Standard when the term is used in the other contexts (e.g., recognition, PAA approach).
- **Appendix A (LIC, LRC)** – The amendments to these definitions have excluded #3 and #4, and again, this would seem to be an unintended change. For example, the LRC should include obligations to pay investment components whether or not they provide investment-related service (#3), and other non-insurance-contract services (#4). The original definitions are somewhat unclear, but the proposed amendments are incorrect.
- **Paragraph B65** – The proposed amendment (by omission) could imply that costs the entity will incur while providing #3 and #4 would not be included in cash flows. This could be clarified by revising paragraph B65(la) to be specific to the expenses of managing assets (including any related payments to meet tax obligations incurred by, or on behalf of, policyholders) to provide investment-return/related service.

To answer Question #10 directly, we would not support changes in terminology until the use of the terms “insurance contract services” and “coverage period” are revisited throughout the Standard to avoid confusion.

Appendix 2: Comments on amendments not made (BC164-220)

Level of aggregation (BC164–BC179)

In our view, the prohibition to include in a group contracts that are issued more than one year apart should be removed.

Pooling of like risks 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 which 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. For example, if groups of life insurance contracts are established at an individual contract level, reported results would show the (useless) information that those who died have been unprofitable and those who have lived have been profitable.

The concern is relevant to all types of contracts whenever an annual cohort is too small to be credible. This arises in part due to a different issue, 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.

Our suggested solution is to delete paragraph 22 or replace it with a cohort based on pooling of like risks. This will reduce costs and administrative burden and improve the meaningfulness of information provided.

However, assuming the requirement for annual cohorts is retained, we agree with the decision not to attempt to identify contracts where an exception is warranted. It is always acceptable to apply an alternative practical approach that gives a similar result, so identifying particular exceptions could have the unintended consequence of implying that a simplified approach is not permitted in any other case.

Cash flows in the boundary of a reinsurance contract held (BC180–BC185)

As described in our past submission, we disagree with Staff's position on this matter. However, discussion at the September 2018 TRG meeting illustrated that there is little, if any, practical concern.

Subjectivity in the determination of discount rates and the risk adjustment for non-financial risk (BC186–BC188)

We support the flexibility in IFRS 17 to take a simple approach or a more complex approach depending on the entity's circumstances.

Risk adjustment for non-financial risk in a consolidated group of entities (BC189–BC192)

In our view, the measurement of insurance contract liabilities in a reporting entity's financial statements should be appropriate to the reporting entity at the time the financial statements are issued. 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 the issuing entity at the time of issue quickly becomes irrelevant.

The lack of amendment could reduce comparability by permitting different practices. However, this loss of comparability is preferred to an amendment that would require the risk adjustment to be based on the issuing entity's view at the time of issue.

Discount rate used to determine adjustments to the contractual service margin (BC193–BC199)

As noted in the response to Question 9 (paragraph B96(d)), in our view, adjustments to the CSM (B72(c)) should be determined using the discount rate that is appropriate to the statement of profit and loss to provide more meaningful information to users.

Other comprehensive income option for insurance finance income or expenses (BC200–BC202)

We note that entities within the same jurisdiction need not make the same accounting policy choice, so comparability is not guaranteed.

Business combinations (BC203–BC208)

As noted in the response to Question 8, we support the view that an entity should have choice in the treatment of claims in settlement that are acquired in a transfer or business combination, consistent with the agreement coming out of AP01 of the September 2018 TRG meeting that insurance risk consequent to an incurred claim can be viewed as either LIC or LRC.

If this suggestion is not adopted, an alternative would be to allow any deferred gain on such an acquisition to be amortized in insurance service expenses over the life of the claims to avoid the operational complexity of a CSM.

Scope of the variable fee approach (BC209–BC213)

As noted in the response to Question 9, we are concerned that the scope of the variable fee approach has been inadvertently narrowed by the proposed amendment to paragraph B107(b)(ii).

Interim financial statements (BC214–BC216)

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. However, we would not support removing paragraph B137.

Mutual entities issuing insurance contracts (BC217–BC220)

We agree with the decision to leave this to the facts and circumstances of the entity and its jurisdiction. Adding a footnote to BC265 of IFRS 17 is a positive step.