Canadian Institute of Actuaries / Institut canadien des actuaires

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Bruce Mackenzie, Chair
IFRS Interpretations Committee
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Subject: Transfer of Insurance Coverage under a Group of Annuity Contracts (IFRS 17)

The Canadian Institute of Actuaries (CIA) is thankful for the opportunity to comment on the IFRS Interpretations Committee (IFRIC) tentative decision on the transfer of insurance coverage under a group of annuity contracts (IFRS 17 insurance contracts), following their meeting held on March 15, 2022. This meeting was held to address a submission received regarding the interpretation of IFRS 17 with respect to the service provided by a life contingent annuity and the principles for recognizing that service through the release of the contractual service margin (CSM). The submission sought views on whether the two approaches presented in it were both acceptable interpretations of the principles of IFRS 17. The CIA respectfully disagrees with the tentative decision rendered by the IFRIC. This letter details the CIA's position.

Introduction

IFRS 17 paragraph B119 states "An amount of the contractual service margin for a group of insurance contracts is recognised in profit or loss in each period to reflect the ***insurance contract services*** [emphasis added] provided under the group of insurance contracts in that period."

Appendix A of the IFRS 17 Standard defines ***insurance contract services*** as "the following services that an entity provides to a **policyholder** of an **insurance contract**:

> (a) coverage for an **insured event** (insurance coverage);
> (b) for **insurance contracts without direct participation features**, the generation of an investment return for the policyholder, if applicable (investment-return service); and
> (c) for **insurance contracts with direct participation features**, the management of underlying items on behalf of the **policyholder** (investment-related service)."

The fact pattern presented in the submission of the Institute of Chartered Accountants in England and Wales (ICAEW) did not include information on whether or not investment-return services or investment-related services exist. Therefore, the IFRIC tentative decision on whether or not insurance contract services are provided in a given period focused on whether or not there is insurance coverage in the given period as the topic of investment-return services or investment-related services was out of scope.

This letter focuses on the question of the existence of insurance coverage in the fact pattern addressed in the IFRIC tentative decision, and the implication of that assessment on other potential fact patterns.

Analysis of the IFRIC interpretation on the issue
On page 7 describing Approach A (Method 1), the ICAEW submission states "Proponents of this approach believe that an annuity contract has a series of insured events, being survival to future points in time that valid claims can be made by the policyholder under the contract. A key feature of the contract is that the policyholder needs to remain alive up to each point in time in order to claim from the insurer the contractually agreed annuity payment." Put another way, the next payment that an annuitant will receive is contingent upon survival to that point.

IFRIC acknowledges that this contingent survival requirement makes the annuity contract an insurance contract, which is subject to accounting under IFRS 17. While IFRIC acknowledges that there is insurance coverage under the contract given the contingent survival, it restricts its interpretation of insurance coverage to amounts "determined based on the annuity payment the policyholder is able to validly claim ***in the current period*** [emphasis added]."

The CIA believes that IFRIC's interpretation of Approach A (Method 1) is too narrow, for the following reasons:

1. IFRS 17 Appendix A defines **insurance contract services** as "…(a) coverage for an **insured event**…," and defines an **insured event** as "an uncertain future event covered by an **insurance contract** that creates **insurance risk**." There is no dispute that an annuity contract, as defined in the fact pattern of the ICAEW submission, provides insurance coverage, but clarity is lacking over exactly when insurance coverage is provided.

   The CIA supports the view that insurance coverage is provided from initial recognition of the annuity contract for contracts that are not onerous,[1] given that recognition of the contract creates insurance risk in that all future payments are subject to uncertain future events from the moment the contract is recognized. This logic would be applicable to payout and deferred annuities.

2. The "Applying paragraph B119 of IFRS 17" subsection of the IFRIC's tentative decision states that "The definitions of the liability for incurred claims (LIC) and the liability for remaining coverage (LRC) in Appendix A to IFRS 17 describe insurance coverage as 'an

[1] For onerous contracts, initial recognition may occur prior to the start of the coverage period (per IFRS 17 paragraph 25). The CIA's view is that insurance coverage under these contracts would become effective on the date the contract would have been recognized had it not been onerous.

entity's obligation to investigate and pay valid claims for insured events.'" IFRIC's response infers that these definitions mean there can only be insurance coverage provided in an accounting period for which a claim can be made in that period.

The CIA does not agree with such an inference, as the requirement to pay a valid claim in the definitions of LIC and LRC are cited out of context in support of IFRIC's position, nor do those definitions of LIC or LRC imply there is no coverage in an accounting period where there is no possibility of a claim being paid.

3. IFRIC's response goes on to say in the same paragraph "In addition, paragraphs BC140 and BC141 of the Basis for Conclusions on IFRS 17 explain that an entity can accept insurance risk before it is obliged to perform the insurance coverage service. Therefore, in determining the quantity of the benefits of insurance coverage provided under a contract, an entity considers (a) the periods in which it has an obligation to pay a valid claim if an insured event occurs; and (b) the amount of the claim if a valid claim is made."

   Those particular Basis of Conclusions paragraphs relate to the initial recognition of an insurance contract, not to amortization of CSM subsequent to initial recognition. Although we acknowledge that an entity can accept insurance risk before insurance coverage service is provided for onerous contracts, the CIA believes that this reference to BC140 and BC141 is taken out of context. The coverage period for deferred annuities starts at the beginning of the deferral period and insurance coverage service is provided throughout the deferral period. The situation covered in paragraphs BC140 and BC141 does not apply to the issue being analyzed, as insurance risk is accepted throughout the coverage period for deferred annuities. The intent of BC140 and BC141 is to minimize administrative complexity associated with recognizing insurance contracts before contractual coverage becomes effective, not to create an inference that there can only be insurance coverage in a period in which a claim payment can be made.

   The IFRS 17 Standard does not explicitly state that the possibility of a payment in an accounting period is a prerequisite for insurance coverage in that period. We acknowledge the reasonability of such a conclusion in the context of some fact patterns, such as a life insurance contract, where the insured event is death, and the occurrence of the insured event expires the contract – clearly there is no insurance coverage if occurrence of the insured event can expire the contract without a benefit being paid. But such a conclusion does not seem like a sound interpretation of the Standard in the context of an annuity contract (or an endowment contract), where the insured event is survival, and the occurrence of the insured event does not expire the contract – i.e., coverage continues if the insured event happens, whether or not a payment is made in the period.

4. In its conclusion, IFRIC endorses approach A (Method 1), saying "the amount of the annuity payment the policyholder is able to validly claim (Method 1) meets the principle

in paragraph B119 of IFRS 17 of reflecting the insurance coverage provided in each period by:

a. assigning a quantity of the benefits only to periods for which the entity has an obligation to investigate and pay valid claims for the insured event (survival of the policyholder); and
b. aligning the quantity of the benefits provided in a period with the amount the policyholder is able to validly claim in each period."

Such an inference is based on the narrow interpretations of Appendix A and BC140/141 noted above in points 2 and 3.

Paragraph B119 simply states that "The number of coverage units in a group is the quantity of insurance contract services provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage period." To be clear, IFRS 17.B119 does not state that there can be a quantity of benefits assigned only to periods for which the entity has an obligation to investigate and pay valid claims.

The CIA is of the view that IFRIC's tentative conclusion is an overly narrow interpretation of the requirements of other parts of the Standard, taken out of context, and not an objective application of B119.

Furthermore, IFRIC's rationale for rejecting Approach B (Method 2) is founded on the same narrow interpretation that there must be a benefit potentially payable in an accounting period in order for there to be insurance coverage in that accounting period. For the same reasons noted above, the CIA does not believe that this "stand ready to pay in an accounting period" is a prerequisite for the existence of insurance coverage under the IFRS 17 Standard. As such, the CIA does not agree that the IFRIC response provides sound reasoning to invalidate Approach B (Method 2) as contrary to the Standard.

Logical inconsistencies of IFRIC's interpretation with specific examples

Regarding the application of either Approach A (Method 1) or Approach B (Method 2), the CIA believes that the fundamental issue is whether or not insurance coverage can be provided during a period in which a contractual benefit is not potentially payable. IFRIC's response suggests that it cannot be. However, this position leads to inconsistencies in its application.

Consider an endowment insurance contract that pays a benefit to the insured if, and only if, the insured survives to a point several years in the future. Application of the "stand ready to pay" doctrine in IFRIC's position would imply that there is no insurance coverage provided under this contract until the very last accounting period of the contract, should the insured survive to that point, because this is the only accounting period in which a benefit could potentially be paid under the endowment contract. The CIA is of the view that this interpretation would be contrary to the intent of B119. This type of outcome is the consequence of artificially narrowing the interpretation of the IFRS 17 Standard to suit one particular conclusion.

In the case of an endowment contract noted in the previous paragraph, the CIA believes that a sounder judgment would be a level coverage unit basis over the entire term of the contract, perhaps weighted for the probability of survival to each future period, although that latter nuance is not important for this discussion. A level coverage unit basis would recognize that there is an uncertain future event that creates insurance coverage from the moment the endowment contract is recognized, per the definitions of insurance contract services and insured events in IFRS 17 Appendix A. The potential future benefit is a good proxy for the amount of that coverage throughout the lifetime of the contract.

Similarly, an annuity contract is merely a series of endowment contracts. The next benefit payable could be a sound coverage unit basis under Approach A (preferable to the benefit payable in the current period), as it appropriately reflects that there is insurance coverage in the form of contingent survival to the next payment date, even if that next payment date is not in the current accounting period. This type of application of the next benefit payable would be well suited to certain types of deferred annuities, or to immediate annuities in which the next benefit payment does not occur until a subsequent accounting period (for example immediate annuities where the payment is made annually as opposed to quarterly).

The broader issue of serving the public interest

The CIA would like to highlight its duty to the public interest over the actuarial profession. While we fully respect the IASB's authority over the Standard, we are concerned that the narrow interpretation of the Standard in the IFRIC tentative decision would do a disservice to the public in the case of deferred annuities and other products with a similar fact pattern.

Regardless of the IASB's decision, insurance entities will be required to hold capital for insurance risk during the deferral period. The premise in the IFRIC tentative decision that there can be no insurance coverage during the deferral period (where no benefits are payable) would mean that, in many fact patterns, there would be no profit recognition until the end of the deferral period (other than some release of risk adjustment). Entities issuing deferred annuity contracts would seek additional compensation for the deferral of profit recognition in order to earn an adequate return on capital.

Therefore, potential consequences of this narrow interpretation of the IFRS 17 Standard could be increased prices charged to consumers and/or elimination of some types of contracts altogether.

We do not believe that such outcomes are in the best interest of the public, nor do we believe that it is the intent of IFRIC or the IASB to endorse an unduly narrow interpretation of the Standard to this potential end.

Conclusion

The CIA encourages the IASB to reconsider the consequences of endorsing an unnecessarily narrow interpretation of the IFRS 17 Standard. The IFRIC's tentative conclusion is not in the public interest and more importantly could lead to inconsistencies in the application of IFRS 17 as noted above: No insurance coverage over the life of an endowment insurance coverage and inconsistent reflection of insurance coverage in annuity contracts with certain fact patterns not presented in the ICAEW submission.

The CIA appreciates the opportunity to provide feedback on these issues, and we would welcome further discussion with you throughout this process.

If you have any questions, please contact Chris Fievoli, FCIA, Actuary, Communications and Public Affairs, at 613-236-8196 ext. 119 or chris.fievoli@cia-ica.ca.

Sincerely,

[Original signature on file]

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