



International Actuarial Association  
Association Actuarielle Internationale

December 7, 2018

International Accounting Standards Board  
Columbus Building  
7 Westferry Circus  
Canary Wharf  
London  
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UK

Dear IASB Board Members,

### **IASB Insurance Session – December 2018**

The Insurance Accounting Committee of the International Actuarial Association (IAA) met last week in Mexico City and discussed some of the Agenda Papers for the December IASB insurance session. We are writing this letter to contribute actuarial insights on some of the topics to be discussed at that session.

This letter has been prepared by the IAA's Insurance Accounting Committee. It has not been subject to the due process required for it to constitute a formal view of the IAA. Thus, these comments do not represent an official view of the IAA.

We trust that our comments will help the Board enhance the decision-usefulness of information in IFRS reports and to avoid unintended outcomes. While we support IFRS 17 overall, there are some points where significant improvements are possible to better reflect the economic aspects of the insurance products.

### **Agenda Paper 2B: Discount rates, risk adjustment and OCI option, Risk adjustment in a group of entities**

**Recommendation:** Replace in IFRS 17.B87 “charged” by “being required” to apply a consistent wording throughout, as a simple editorial change in the annual improvement process.

**Reasons:** We do not agree that the guidance regarding the perspective to be used in determining the risk adjustment for a consolidated group report should be interpreted as stated by IASB staff in the May TRG-meeting (AP 2 para. 21) and in para. 37 of IASB meeting

December 2018 AP 2B. We support the interpretation of IFRS 17 that permits the measurement of the risk adjustment for a given collection of contracts to differ across various consolidation levels based on the different risk perception of the respective reporting entities, both with respect to applied risk aversion of the reporting entity and diversification effects considered by the reporting entity. We encourage the Board not to expand the guidance to limit the risk perception to be considered to that applied at the single reporting level of the issuing legal entity.

- We understand that accounting guidance requires that each IFRS report be based on the accounting policies developed by the reporting entity, to be consistently applied to any information in the report. Subsidiaries that issue their own stand-alone reports may have reasons to develop different accounting policies for their reports.
- Insurance contract liabilities may vary on different consolidation levels for a variety of reasons, e.g. intercompany cost, past business combination effects, different reporting frequencies.

The staff's view would result in very similar contracts issued by different subsidiaries being presented at different carrying amounts in the consolidated report of the group if applying the risk aversion and individual consideration of diversification effects of the respective issuing subsidiary rather than reporting entity's risk perception.

The informational value of the risk adjustment presented in a report results from it providing a yardstick to assess the quantity of risk borne by calibrating the range of the distribution function (which is influenced by considering diversification) by a common weighting based on consistently applied risk aversion of the reporting entity. Applying inconsistent weights due to different risk aversion of different legal entities (subsidiaries) in the consolidated group would eliminate the informational value of the risk adjustment.

Further reasons:

- We have always understood that the references to "entity" in IFRS 17 refer to the reporting entity and its perspective. E.g. the references to the entity in IFRS 17.B92, BC209 (b), BC211 (a), BC213 (b) and BC215 need to apply to the reporting entity. Further, IFRS 17.B65 (f) and (g) obviously refer to the perspective of the reporting entity.
- IFRS 17.B87 last sentence: The amount charged by the issuing legal entity to the policyholder [if read as "charge to the policyholder" rather than a demanded compensation charged by the ultimate risk-bearer, the owner] is often influenced by competitive factors and may not equate to the compensation the issuing legal entity requires for uncertainty inherent in the insurance contract due to non-financial risk. The compensation the issuing legal entity requires for uncertainty in the insurance contract

due to non-financial risk is usually driven by the risk appetite of the legal entity, which is set by the board and management of the legal entity. It is possible for different legal entities within a consolidated group to have different risk appetites, depending on the group's approach to assessing risk (i.e. whether set at group or individual legal entity level) and therefore to have different values for the risk adjustment on the same type of business. Applying the risk adjustment based on amounts charged to the policyholder would not reflect the different risk averseness of different levels or reporting entities in the consolidated group and would eliminate the informational value of the risk adjustment.

- The “entity” issuing the contract is not a clear concept, considering business combinations, portfolio transfers, contract modifications, fronting (reinsurance) companies where pricing is effectively done by the parent, etc.
- In keeping with the idea that “the objective of the risk adjustment is to reflect the entity’s perception of the economic burden of its non-financial risks” [IFRS 17, BC 213(b)], the risk adjustment may differ among levels of consolidation, reports of subsidiaries vs reports for the consolidated entity. The subsidiary as reporting entity may not in fact consider the broader benefits of diversification in its perception of risk; whereas the parent company, as preparer of the consolidated report, may see that the consolidation provides the benefits of the broader diversification and accordingly it reflects this fact in its perception of the risk.

## **Agenda Paper 2C: Variable Fee Approach**

**Recommendation:** We recommend that the IASB postpone the decision on the scope of the VFA approach until it has decided what to do with issue 7 of Agenda Paper 2D October 2018 concerning investment management services for indirect participating contracts.

**Reasons:** In the IASB meeting of December 2018 AP 2C, the staff discusses whether the scope of the VFA approach is too narrow or not. The staff refer in paragraph 11 to the concern of some stakeholders about some types of insurance contracts that are economically similar to insurance contracts with direct participation features except that:

- a) the relationship between investments [underlying items] and the insurance contract arises from a constructive rather than contractual obligation; and [or]
- b) the contractual terms do not specify a clearly identified pool of underlying items.

We do not agree with the staff conclusion:

1. The question as to whether or not insurance contracts outside the scope of VFA can provide investment management services has not yet been definitively answered.
  - In issue 7 of the list in IASB meeting October 2018 AP 2D the IASB plans to consider this question. If the IASB decides to amend IFRS 17 on this topic, then it should take into account that some indirect participating contracts may contain substantive investment management services.
  - The distinction between constructive and contractual obligation is currently not relevant for the scope of the fulfilment cash flows of a contract according to IFRS 17.2, nor for expected future discretionary benefits (IFRS 17.B65). For the contracts that the staff refers to in IASB meeting December 2018 AP 2C paragraph 11, it would be worthwhile explaining why this distinction should be relevant for the method applied on the CSM.
2. Having a VFA approach and the option to revise the finance expense in the general approach causes unnecessary complexity.

The staff appears not to have analyzed in IASB meeting December 2018 AP 2C the characteristics of contracts with participating features outside the scope of VFA. In our opinion, many of those contracts are permitted to use paragraphs B72 and B132 of the standard to systematically adjust the finance expense. This already resembles one key feature of the VFA approach.

We recommend that staff makes a systematic comparison between the VFA approach and the approach used by applying paragraphs B72 and B132 on contracts where payments vary with underlying items.

If both approaches are overlapping on various points, then it is a valid question to ask whether both approaches should co-exist, or whether complexity can be reduced, and comparability and relevance increased, by having both types of contracts treated under the (unchanged) VFA approach only.

3. Consideration of the risk mitigating effect of participating features  
The current discussion does not consider that participation features are also used by insurers to mitigate insurance and financial risks to policyholders. Accordingly, the General Approach may lead to a misleading presentation of the risk mitigation, while the VFA approach better reflects the underlying economics. We can provide examples if this will help.

## **Agenda Paper 2E: Future cash flows in the measurement of reinsurance contracts held**

**Recommendation:** Change IFRS 17.62 to read

Instead of applying paragraph 25, an entity shall recognise a group of reinsurance contracts held at the initial recognition of any underlying contract. Subsequently initially recognised underlying contracts are considered in measurement of the group of reinsurance contracts:

- (a) if the reinsurance contracts held provide proportionate coverage—at the initial recognition of the underlying contract; and
- (b) in all other cases— if within the contract boundary of the reinsurance contract held, at the initial recognition of the group of reinsurance contracts held.

or retain the current wording considering following facts in applying the guidance in IFRS 17.34.

**Reasons:** Particularly for proportionate reinsurance contracts held, any value of the cession of the rights and obligations from a ceded contract arises by the existence of the ceded contract. For a hedge instrument, in contrast, there is a value regardless of the existence of any hedged item. The cedant has no substantive rights or obligations under an underlying insurance contract expected to be written in future and there is no information concerning such contracts on its financial statement. Similarly, the cedant has no substantive rights under the reinsurance contract held to receive coverage regarding that underlying insurance contract until it is written. The cedant also has no substantive obligation to pay reinsurance premiums under the reinsurance contract held for the cession of an underlying contract written in the future, since the cedant can avoid the obligation entirely by not writing such an underlying contract.

Since a cession is by definition asymmetric, the substantial rights or obligations of a proportionate reinsurance contract are not symmetric for the cedant and the reinsurer. The reinsurer has, in contrast to the cedant, a stand-ready obligation to provide coverage for future contracts since the reinsurer has no ability to avoid any coverage demanded by the cedant within the scope of the reinsurance contract.

The reasons for the above recommended change of IFRS 17.62 were provided by the IASB staff in IASB meeting May 2011 AP 3J, para. 47: The staff concluded that considering underlying contracts in the measurement of the reinsurance contract held “before the underlying

insurance contract is recognized would be misleading and is unlikely to provide any useful additional information to users of financial statements.” Consequences in an example case can be provided on demand. This 2011 decision of the IASB was not included in subsequent drafts.

We would be glad to discuss these observations with the Board at your convenience.

If you wish to discuss any of our comments please do not hesitate to contact the undersigned.

Yours sincerely,

A handwritten signature in black ink, appearing to read "William Hines".

William Hines  
Chair, IAA Insurance Accounting Committee