January 4, 2019

International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD
UK

Dear IASB Board Members,

IASB Insurance Accounting Topics

The Insurance Accounting Committee of the International Actuarial Association (IAA) submitted a letter in December 2018 regarding insurance topics that were discussed at the December IASB insurance session. We are writing this letter to contribute actuarial insights on some of the topics identified in the October IASB meeting for consideration, but have not yet been discussed by the Board.

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.

October 2018 Agenda Paper 2D, Issue 3: Measurement – Acquisition cash flows for renewals outside the contract boundary

Recommendation: We recommend an amendment to IFRS 17 to allow allocation of insurance acquisition cash flows to include expected renewals of insurance contracts.

Reasons: As noted in the October 2018 IASB staff paper, entities often incur significant costs to sell, underwrite, and start insurance contracts (acquisition costs) and insurance contracts are

1203-99 Metcalfe
Ottawa ON K1P 6L7
Canada

Tel: +1-613-236-0886
Fax: +1-613-236-1386
www.actuaries.org

generally priced to recover these costs through premiums or other charges. Entities will usually incorporate an expectation of expected future contract renewals into this pricing analysis so that acquisition costs can typically be recovered over a period beyond the technical contract boundary, as defined by IFRS 17.

By not allowing an allocation of insurance acquisition cash flows to expected contract renewals, many insurance contracts would be presented as onerous in their first year (when acquisition costs typically exceed surplus of premiums over claims) even though the contracts are expected to be profitable over the longer term as acquisition costs are recovered from expected renewal premiums.

Allowing an allocation of directly attributable insurance acquisition cash flows to expected contract renewals would:

- More accurately reflect the economic basis on which the business is generally managed and priced,
- Provide more useful information to users of the financial statements by not identifying contracts expected to be profitable as onerous in their first year, and
- Not unduly disrupt entities' implementation processes if entities were allowed, rather than required to make an allocation of insurance acquisition cash flows to expected future renewals, and
- Not impair comparability if IFRS 17 required clear disclosure of the methodology, approach and time period over which any allocation to expected future renewals is made.

We suggest accounting guidance consistent with IFRS 15.91-92 and 103-104 for recovery of acquisition costs under IFRS 17, i.e.:

- An entity shall recognise as an asset the incremental costs of obtaining an insurance contract if the entity expects to recover those costs.
- The incremental costs of obtaining an insurance contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission). Guidance for impairment should follow IFRS 15.103-104.
- Guidance for impairment should follow IFRS 15.103-104.

1203-99 Metcalfe
Ottawa ON K1P 6L7
Canada
Tel: +1-613-236-0886
Fax: +1-613-236-1386
www.actuaries.org

October 2018 Agenda Paper 2D Issue 7: Measurement – Contractual service margin: coverage units in the general model

Recommendation: We recommend returning to a principle-based approach regarding the release of the CSM. In particular, we recommend two items in IFRS 17 be amended as follows:

> **Appendix A:** coverage period - The period during which the entity provides coverage for insured events or any other service to the policyholder. This period includes the coverage or services that relate to all premiums within the boundary of the insurance contract.
>
> I**FRS 17.B119:** … (a) identifying the coverage units in the group. The number of coverage units in a group is the quantity of coverage or other services to the policyholder provided by the contracts in the group, determined by considering for each contract the quantity of benefits from the coverage or other services provided under a contract and its expected coverage period.

Reasons: We understand that the IASB wanted to restrict the variety of practices of allocating the CSM to accounting periods, i.e. recognizing revenue in periods by considering only the defining service of insurance contracts.

The key issue for a suitable narrowing of the practices is a clear understanding of the term "service". We understand investment services as a service provided by an entity where the entity is obliged to accept a principal from the counterparty, to invest it in an economic process and to return the principal to the counterparty plus at least a contractually defined share in the proceeds from the particular economic process (the proceeds may be as well negative). IFRS 17 refers to such a service by three different words, investment services (IFRS 17.71 (c)), investment management services (IFRS 17.B21 (a)) and investment-related services (IFRS 17.B101). We understand all three words to have the same basic meaning while the latter is intended to emphasize a very broad interpretation, i.e. not being limited to investment in financial assets (see IFRS 17.B106). The presence of investment components has nothing to do with the presence of investment services – investment services can be included in contracts with and without investment components and investment components can be repaid with or without being connected with investment services. Further, the IASB clarified that the settlement of the consequences of the contractually defined insured events (even if the coverage refers in case of retroactive reinsurance referring to uncertainties resulting from the consequences of past events) is no service.

1203-99 Metcalfe
Ottawa ON K1P 6L7
Canada
Tel: +1-613-236-0886
Fax: +1-613-236-1386
www.actuaries.org

Coverage is only the defining service of an insurance contract that might not be more than just "significant". Other services might be predominant even if not substantial. Coverage is already significant if it is present only for a very limited time and very limited quantity while other services, particularly investment services, might be provided for much longer times and at much larger quantity. The development or pattern of the quantity of providing investment services might be even opposite to the development or pattern of providing coverage. IFRS 17 is not applicable only to contracts where coverage is predominant. It applies equally to contracts with even a small amount of coverage as the specific accounting consequences cannot be provided by more general standards like IFRS 9 or IFRS 15. Beyond that specific guidance, IFRS 17 treats any financial risk broadly in line with IFRS 9. We would expect that as well services are treated broadly in line with IFRS 15, as it is done in IFRS 17 except for the CSM release.

We do not agree that only insurance contracts with direct participation features include investment services. To include investment services in the broadest sense is not a defining characteristic of such contracts but it is an unavoidable consequence from the criterion in IFRS 17.B101 (a) that those contracts include substantial investment services. Logically, that does not mean that other contracts cannot include substantial investment services. Contracts where investment services are predominant may, for other reasons, not meet the criteria in IFRS 17.B101, e.g. many investment contracts with discretionary participation feature do not meet the criteria in IFRS 17.B101 but they do not provide any service other than investment services.

We understand that in some cases standard setters need to deviate from the self-constituted principles for pragmatic reasons like narrowing the variety of permitted practices. However, in the case here we note that the narrowing will cause misleading results for certain contracts of many entities that cannot be justified under the principle as outlined in IFRS 17.44 (e) and B119 first sentence. The users of the report will expect that any narrowing of permitted practices will still result in broad consistency with the referred to principles and not deviate entirely from them.

To outline the issue, consider a 10 year single premium investment contract with discretionary participation feature, e.g. a unit-linked contract where the annual charge is at the discretion of the insurer, but the annual charge has to be stipulated one year in advance. According to IFRS 17.71 (c), the insurer would release the CSM broadly in proportion to the expected funds under management in each period.

If we add to the contract a small accidental death coverage only for year 1 in the value of about 10% of the annual charge for investment services, would result that the contract is an insurance contract. Applying IFRS 17.B119 would cause that the total CSM is released in year 1 disregarding the fact that in year 1 only a very small part of total service of the contract is provided and significant uncertainty arising from the provision of services are present for 9 further years. Such products, often more sophisticated as described here, are wide-spread in some jurisdictions, e.g. Hungary, and the IFRS report of some entities is dominated by the effects from such business. Such entities would show in years with a lot of new business very high profits (after overhead) while in periods of low new business they might not be able to cover overhead. The overhead expense is needed in all years to support the nearly unchanged ongoing service provision. We believe such revenue recognition is not providing decision useful information. There are other cases where the reported profits might be severely distorted by the current approach of IFRS 17.B119.

Other common examples where IFRS 17.B119 produces counterintuitive results are:

- Traditional regular premium endowment life insurance where the increasing investment service results in a decrease of coverage (found in many jurisdictions)
- Contracts where the policyholder is entitled to continue the interest bearing deposit for a limited or even unlimited time after termination of the coverage´ (found e.g. in Germany for tax reasons)
- Contracts where the premiums are held in an interest bearing deposit for an extended time before coverage commences (e.g. some forms of deferred annuities as present in many jurisdictions)

Cases where services are provided in addition to coverage or investment services are less common and might not demand a principle-based approach.

Our proposal does not cause additional implementation issues considering that the IASB plans to change the guidance for direct participating contracts. Since IFRS 17.B119 applies to all contracts under the general model equally, the procedures to be developed for contracts with direct participation features can be used as well for other contracts under the general model.

October 2018 Agenda Paper 2D Issue 13: Reinsurance contracts held: ineligibility for the variable fee approach

Recommendation: We recommend to replace IFRS 17.B109 by

Reinsurance contracts issued and reinsurance contracts held are insurance contracts with direct participation features if and only if

1203-99 Metcalfe
Ottawa ON K1P 6L7
Canada

Tel: +1-613-236-0886
Fax: +1-613-236-1386
www.actuaries.org

(a) the reinsurance contracts meet the conditions in paragraph B101 and

(b) for reinsurance contracts issued, the pool of underlying items is the same as for at least one other insurance contract meeting the conditions in paragraph B101 issued by the entity with a counterparty that is not related to the counterparty of the reinsurance contract or

(c) for reinsurance contracts held, the pool of underlying items is the same as for the underlying insurance contracts meeting the conditions in paragraph B101 and the compensation under the reinsurance contract held also includes the related obligation of the entity to the policyholders of the underlying insurance contracts described in paragraph B104.

Reasons: We understand that the compensation paid by a reinsurer for insured events of underlying contracts of the cedant under a reinsurance contract would not be seen as underlying item in the sense of IFRS 17.B106. The provision of coverage to the counterparty is not an investment-related service in the sense of IFRS 17.B104. We recommend to clarify that by discussing the topic in the Basis for Conclusion.

Nevertheless, contracts classified as reinsurance contracts may contain features that contain investment-related services meeting the conditions in IFRS 17.B101. This is particularly true if the issuer of such reinsurance contracts also issues other insurance contracts with direct participation features to unrelated parties and shares with the cedant under the reinsurance contract and the policyholders of the direct insurance contracts the results in the same pool of underlying items, often at equal terms. It would be overly burdensome and not produce decision useful information to require the entity to account for the reinsurance contracts differently. In such cases, the VFA should apply equally to all insurance contracts sharing in the same pool of underlying items. Example of such reinsurance contracts exist under some fronting arrangements, where it is the ultimate intention of the policyholders of the underlying contracts to share in the normal pool of underlying items of the entity, a normal direct insurer, acting here formally as reinsurer to the fronting company. To differentiate such arrangement from typical connections of reinsurance contracts like common upper limits etc, which apply only to reinsurance contracts with the same or related cedants, we included the condition of unrelated counterparties.

Further, if the holder of such a reinsurance contract is sharing with the reinsurer the obligation to pay to the policyholder a share in the pool of underlying items and also shares the variable

1203-99 Metcalfe
Ottawa ON K1P 6L7
Canada

Tel: +1-613-236-0886
Fax: +1-613-236-1386
www.actuaries.org

fee the reinsurance contract held should be measured consistently with the underlying contracts, i.e. applying the VFA as well to the reinsurance contract held.

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,

William C Hines

William Hines
Chair, IAA Insurance Accounting Committee