

Mr Jean-Paul Gauzès
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2 September 2019

567

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Dear Mr Gauzès

Re.: EFRAG's Draft Comment Letter on the IASB's Exposure Draft 'Amendments to IFRS 17'

The IDW appreciates the opportunity to contribute to EFRAG's Draft Comment Letter (herein referred to as 'DCL') on the IASB's Exposure Draft 'Amendments to IFRS 17'.

Please find attached the current draft of our comment letter to the IASB, containing the current status of our general remarks and detailed responses to the questions raised in the Exposure Draft.

With respect to the forthcoming endorsement of IFRS 17, we would like to point out that for those insurers who are planning to apply IFRS 17 in 2022 for the first time, any further delay could result in significant additional costs with no corresponding benefit. We consider it important that all those involved in the endorsement process do what is necessary to ensure a timely endorsement for the initial application of IFRS 17 in 2022.

With regards to the questions raised by EFRAG in the DCL to constituents, we would appreciate your considering our comments as follows:

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Daniela Kelm, RA LL.M.;
Melanie Sack, WP StB

Question to Constituents, paragraph 35

Contractual service margin attributable to investment-return service and investment-related service and disclosures about the profit recognition patterns).

EFRAG has been informed of possible fact patterns of deferred annuities for which there is no investment component as defined by the ED, nor a right to withdrawal; however, the insurance entity performs asset management activities, revenues of which would not be captured in the CSM release. For example, for particular Deferred Annuities, there is an accumulation phase followed by the annuity phase. The policyholder's beneficiaries receive no return if the policyholder dies during the accumulation phase. During the annuity phase, a surviving policyholder receives a fixed annuity amount based on premiums/technical provisions. In these deferred annuities the policyholder does not have a right to withdraw during either the accumulation phase or the annuity phase. Do you have additional examples of investment activities that are not captured by the proposals in the ED?

We refer to our response to question 2 of the IASB Exposure Draft.

Question to Constituents, paragraph 45

Reinsurance contracts held – recovery of losses on underlying insurance contracts

For proportionate reinsurance contracts, please provide fact patterns that are not captured by the amendment but for which the solution proposed by the IASB would be relevant.

We refer to our response to question 3 of the IASB Exposure Draft.

Questions to Constituents, paragraph 73 - 75

Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4

Do you consider that the proposed deferral of the effective date to 1 January 2022 is sufficient or would you support an additional year (i.e. 1 January 2023)?

We refer to our response to question 7 of the IASB Exposure Draft.

Questions to Constituents, paragraph 94

Transition modifications and reliefs

Do Constituents agree with the approach suggested by EFRAG, i.e. to prefer retrospective application of paragraph B115 instead of supporting the two consequential amendments? Please explain why.

We refer to our response to question 8 of the IASB Exposure Draft.

Questions to Constituents, paragraph 110

Minor amendments

Do Constituents consider that there may be any unintended consequences arising from the proposed change in terminology? Please explain.

We refer to our response to question 9 of the IASB Exposure Draft.

Questions to Constituents, paragraph 140, (a)

Annual cohorts

For contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts:

- (a) *EFRAG is suggesting to the IASB to provide an exception to the requirement to restrict the grouping of contracts using the annual cohorts. Would Constituents agree with this proposal? Please explain why or why not.*

We refer to our comments on 'annual cohorts' within the section headed general remarks in our draft comment letter.

We also refer to the general remarks section of our draft comment letter, where we comment on additional issues not addressed in EFRAG's Draft Comment letter.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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Technical Director
Assurance Implementation

Daniel Groove
Technical Manager

Mr Hans Hoogervorst
Chairman of the
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567

Dear Mr Hoogervorst

Re.: IASB ED/2019/4 'Amendments to IFRS 17'

The IDW appreciates the opportunity to comment on the IASB's Exposure Draft 'Amendments to IFRS 17'.

General Remarks

We welcome the IASB's decision to make targeted amendments to the requirements in IFRS 17 'Insurance Contracts', which aim to ease the implementation of the Standard by reducing implementation costs and making it easier for companies to explain the results of applying IFRS 17 to investors and others. The IDW especially welcomes the IASB's decision to defer the effective date of IFRS 17 by one year to 1 January 2022. In our comment letter on EFRAG's Draft Comment Letter on the IASB's Exposure Draft 'Amendments to IFRS 17' we support a timely EU endorsement of IFRS 17 for the initial application of IFRS 17 in 2022.

In addition to our responses to the questions posed in the Exposure Draft, we have identified the following issues that we would like to address in this letter:

- The IASB rejected the suggested removal of the requirements for **annual cohorts** (paragraphs BC173 of IFRS 17 et seqq.). We agree with the IASB's aim to depict profit trends over time, recognise profits of contracts over the duration of those contracts and timely recognise losses from onerous contracts. However, the requirement of annual cohorts will be unnecessary burdensome and costly for the preparers. Therefore, we suggest the IASB re-

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consider whether the annual cohorts requirement is always justified and recommend instead the IASB consider developing a principles based approach based on paragraph BC138: Annual cohorts may not be required if the entity reasonably expects that the resulting measurement would not differ materially from the result of applying the annual cohort requirements.

- IAS 34.28 sets out a clear principle for **reporting interim financial statements** ('To achieve that objective, measurements for interim reporting purposes shall be made on a year-to-date basis.'). Historically, this principle has been interpreted in a way that – except for situations where the measurement is adjusted due to a triggering event (e.g. Goodwill-Impairment, IAS 39 Impairment) for any given quarter/half-year – there is a year-to-date view on the profit or loss. During the discussions that led to IFRIC 10, neither the IASB nor IFRIC signaled an intent to overcome the principle in IAS 34.28.

IFRS 17 expressly deviates from IAS 34.28 in paragraph B137. Although the rationale is not explained in the Basis for Conclusions, Agenda Paper 2F of the December 2018 IASB Meeting explains that applying IAS 34.28 would 'provide a significant practical burden' to some stakeholders. Based on this, the Board apparently decided to deviate from established guidance for IAS 34. However, based on discussions with preparers that write business globally, it appears that there is more than only 'a significant', but rather a substantial burden for these preparers. For the primary life insurance industry in particular, applying the Variable Fee Approach (VFA) would create massive requirements for the preparation of annual financial statements based on the sum of the interims rather than year to date figures. Consequently, in our view, the argument of practical burden appears questionable. The business model of most life insurance contracts (especially under the VFA) typically involves annual steering; most changes in assumptions are made because of annual management actions. This includes policyholder dividends, but also investments. The estimate of the policyholder participation requires a projection of the profit basis which – in Germany – is German GAAP. For this, there are usually only annual reports available to provide a solid basis for the estimates. While it is possible to approximate the outcome to report for interim periods sufficiently under IAS 34, year-to-date information provides a better depiction of mechanisms (which are annual). By adding stand-alone quarters together to achieve a result, both quarters and year-end figures will lack the degree of accuracy which can be achieved by preparing a year to date (including some true-up of the contractual service margin (CSM) release) figure.

In order to achieve a more accurate period-to-date result, there would need to be a comprehensive estimation process for interim reporting which still cannot overcome the limitations as set out above. Lastly, it seems questionable whether a review of such an interim reporting would be appropriate or if it would trigger a full financial audit of each quarter/half year estimation. This would increase the costs for preparers.

This decision has an impact on insurance contract revenue and the CSM, but not on any other balance sheet item. Consequently, it appears reasonable to compare this treatment to IFRS 15 'Revenue from Contracts with Customers'. This standard has no similar prohibition akin to paragraph B137.

In summary

- Paragraph B137 is inconsistent with IAS 34
- The practical burden exists either way.

Consequently, we recommend the deletion of paragraph B137.

- Although it is not one of the areas the Board considered, we would like to draw the Board's attention to an issue we have encountered with the accounting of certain **non-participating elements in contracts** that fall under the VFA, namely contracts which did qualify for the VFA applying the tests in paragraph B101 at inception, but which contain cash flows not covered by underlying items.

We are aware of examples which include, but may not be limited to:

- German accident insurance with premium refund
- Variable annuities with a participating accumulation phase covered by underlying items, and a non-participating annuity phase not covered by underlying items.

The issue may also arise in regard to some participating products with significant non-participating risk riders and can be described as follows:

IFRS 17.B113(b) requires the CSM to be unlocked for changes in the time value of money not arising from underlying items, while the mirroring approach in IFRS 17.B134 only applies to the underlying items. Paragraph B113(b) explains that changes in the time value of money not arising from underlying items relate to future service and adjust accordingly the CSM. The investment result from general account investments backing the non-variable future cash flows directly feeds into profit or loss in the current period while respective changes in the time value of money unlock the CSM, instead of being recognised as insurance finance income or expense. As a result, there is a greater risk that the contract might become onerous since

effects of interest rate changes adjust the CSM without an offsetting effect from investment returns from the general account assets on the CSM. As the respective investments are not underlying items, the current period investment returns do not unlock the CSM.

In our view, under the current wording of IFRS 17 it is difficult to argue that the contract should be split into two components and proceeds as if they were to exist independently of each other.

We understand the ascertainment in IFRS 17.B113(b) that 'changes in the effect of time value of money and financial risks ... relate to future service', was not intended to apply to contractual cash flows which are conceptually separate from the underlying items as in the fact pattern above. We understand the intention was to apply to minimum guarantees that are embedded in contracts with direct participating features, since these relate to future service. For those contractual cash flows not covered by underlying items, it is not readily understandable why they should relate to future services, and therefore, in our view, why the general unlocking mechanisms of the general measurement model (IFRS 17.44) should apply.

The objective, namely, to adjust the CSM for changes that relate to future service, could be achieved by amending the scope of application of IFRS 17.B113(b) through the following change in the wording:

'B113 Changes in the fulfilment cash flows that do not vary based on the returns on underlying items (paragraph B104(b)(ii)) comprise:

- a.
- b. *the change in the effect of the time value of money and financial risks not arising from the underlying items; for example, the effect of financial guarantees. ~~These relate to future service and, applying paragraph 45(c), adjust the contractual service margin~~ An entity shall apply paragraphs B96–B97, consistent with insurance contracts without direct participation features, to determine to what extent they relate to future service and, applying paragraph 45(c), adjust the contractual service margin, except to the extent that paragraph B115 applies.*

In essence, this would clarify, that paragraph B113(b) is intended to relate to guaranteed cash flows which are not covered by risk mitigation (IFRS 17.B115), as we believe is the case, but not to account for all non-participating contractual cash flows which are not covered by underlying items, which otherwise would give rise to accounting consequences which may not have been anticipated when the wording of the standard was developed.

Comments on the specific proposals

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 policy holder'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?

In our view, the concerns raised in paragraphs BC9-BC30 are relevant and we agree with the proposed amendments.

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?

The IDW supports the proposal with regards to the treatment of acquisition cost and agrees with reasoning provided in the corresponding Basis for Conclusions.

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?

We support the proposal regarding the treatment of contractual service margin attributable to investment-return service and investment-related service.

However, we question whether the application guidance in paragraph B119B for investment-return service is appropriate. According to paragraph B119B(a) an insurance contract without direct participation features may provide an investment-return service if, and, only if, an investment component exists or the policyholder has a right to withdraw an amount. In our view, there might be insurance products with no investment component as defined by the Exposure Draft, nor a right to withdrawal; however, the insurance entity performs asset management activities which would not be captured in the CSM release, e.g. the policyholder may have an asset that increases due to interest accretions, even if the asset may be contingent e.g. on survival (deferred annuities).

Regarding the amendments for insurance contracts with direct participation features, we would also like to explain our concerns regarding the definition of 'insurance contract service'. According to the definition for contracts which – at their initial assessment and after that only temporarily – had direct participating features, insurance contract services would only include 'insurance coverage' and 'investment-related services', the latter is limited to the management of underlying items. I.e. no investment management service would be assumed for the phase of the contract without participating feature for which there are no underlying items. We believe that in that phase there could well be 'investment-return services', which should also be taken into account for the CSM release, consistent with the service provided for insurance contracts without direct participating features.

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?

In our view, the concerns raised in the related Basis for Conclusions are relevant and we support the proposals of the IASB which aim to reduce the accounting mismatches for reinsurance contracts held.

However, we would like to point out that the added definition of 'reinsurance contract held that provides proportionate coverage' does not correspond with paragraphs B119C et seqq. and BC304 as it does not capture all relevant patterns of proportionate coverage as are currently described in paragraph BC304. In the ongoing conversion projects, for the purpose of recognising groups of reinsurance contracts held in accordance with paragraph 62, paragraph BC304 was used to interpret 'proportionate coverage'. Consequently, we believe that the added definition would cause a significant disruption for ongoing conversion projects. In our view, paragraph BC304 provides a sufficient and appropriate basis for describing the nature of proportionate coverage. Therefore, we believe that the added definition is not needed. If a definition is considered necessary, it should be modified in order to cover all relevant patterns of proportionate coverages. In our view, it should not depend on the form of a reinsurance contract, but on whether the reinsurer actually assumes the losses of the underlying insurance contracts and whether it can be allocated 1:1 to the onerous contracts.

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?

The IDW considers the proposed amendments an adequate compromise, as they would simplify processes for preparers and decrease the costs of implementation. However, from a conceptual point of view, we would like to point out that cash flows from insurance contracts, whether due, or not, are now aggregated in one balance sheet item for accounting purposes. In our view, such aggregation limits transparency.

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?

In our view, the proposal adequately addresses an accounting mismatch that may arise when reinsurance is held to mitigate financial risks.

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?

The IDW welcomes the IASB's decision to defer the effective date of IFRS 17 by one year to 1 January 2022.

We are aware that some stakeholders are in favour of an additional deferral of the effective date. In our view, there is no need for further deferral. On the contrary, such deferral would lead to significant unnecessary additional costs, as German insurance entities have geared their conversion projects to meet 1 January 2022 as the relevant effective date.

It is important that the Board finalise the amendments to IFRS 17 in a timely manner, because, due to the proposed effective date, the EU endorsement process will also require sufficient time.

We support the proposed amendment regarding the IFRS 9 temporary exemption, as the effective date for IFRS 9 should be aligned with the effective date for IFRS 17.

Nevertheless, to reduce initial effort for the first time application of IFRS 17, it would be very helpful if the Board were not to require the preparation of full comparative information.

Conversely, in case comparatives (2021 figures) are required, we expect that those comparatives would need to be prepared more or less completely during the year 2021, as for the first interim reporting 2022, insurance entities have to ensure consistency with year-end 2021 reporting and therefore, in addition, with all of the interim periods of the year 2021 (reconciled to year-end). This will be necessary, because in the first months of 2022 companies will – in any case – need to prepare the year-end 2021 financial statements according to existing requirements. Thus, insurance companies which are under pressure to meet the IFRS 17 implementation timeline would gain some additional time for the implementation in 2021 if the requirement to prepare comparatives were deleted.

Seite 11/13 IDW CL to Mr Hoogervorst on the IASB ED/2019/4 'Amendments to IFRS 17'

Under IFRS 9, the restatement of comparatives is possible, but not required. As a result, insurers can avoid the complexities of the IFRS 9 transition requirements. However, if IFRS 17 comparatives are required, insurers might feel pressure to restate IFRS 9 figures in the comparative period to achieve consistency with presentation of the current period and thus to provide reasonable comparatives to investors: Here, the Board needs to consider that there are various interactions between the accounting for investments and for insurance contracts. Important issues that need to be considered are the accounting options and decisions regarding the classification for both IFRS 9 and IFRS 17. Those options/decisions will be taken under consideration of the impact of the interaction on financial statements taken as a whole for 2022 and later on.

As the comparative information could contain a mixture of IAS 39 and IFRS 9 accounting the comparability of the financial statements of insurance entities will be limited. We do not expect that consistency between the approaches taken in the market will be achieved.

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?

We support the proposal with regards to transition modifications and reliefs and agree with the reasoning provided in the corresponding Basis for Conclusions.

With regards to the transition relief for business combinations before the transition date, we support the approach for practical reasons. The proposed amendments of paragraph C9A would require an entity, to the extent permitted by paragraph C8, to classify a liability for settlement of claims incurred before an insurance contract was acquired as a liability for incurred claims. In our view, such an approach would also be appropriate for the acquisition of insurance contracts after the transition date, as the nature of the liability for settlement of claims (which does not represent an insurance service) does not change as a result of the acquisition. A different view might be appropriate for portfolio transfers.

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?

According to paragraph B128(c) changes in the measurement of a group of insurance contracts caused by changes in the fair value of underlying items (excluding additions and withdrawals) are changes arising from the effect of the time value of money and financial risk and changes therein. We question whether this assertion is correct, as it implies that underlying items can only be financial instruments. Since underlying items can also relate to reinsurance or mortality for example, we do not consider the amendment appropriate. In our view, this causes inconsistency with the presentation of the changes in the fair value of underlying items themselves.

Seite 13/13 IDW CL to Mr Hoogervorst on the IASB ED/2019/4 'Amendments to IFRS 17'

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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