

AAE COMMENTS ON EFRAG'S DRAFT COMMENT LETTER ON THE IASB'S ED/2019/4 AMENDMENTS TO IFRS 17

September 2, 2019

In this process, the AAE intends to continue to contribute to EFRAG's considerations with technical insight and analyses.

IFRS 17 is a very complex standard. The Exposure Draft ED/2019/4: Amendments to IFRS 17 will further increase this complexity by adding a loss-recovery component and through additional accounting for insurance acquisition cash flows. In addition, the presentation in the statement of financial position makes the implementation more complex for undertakings which can already allocate their premiums (usually life insurers) to groups of insurance contracts, even though the amendment has been argued in terms of providing operational relief for preparers of financial statements (mainly aimed at non-life insurers).

We have focused our response on topics with actuarial content where the AAE has strong opinions. Consequently, the AAE has focused on the questions marked in bold letters below:

- 1 Scope exclusions (paragraph 10, Appendix 1).
- 2 **Expected recovery of insurance acquisition cash flows (paragraph 18, Appendix 1)**
- 3 **Contractual service margin attributable to investment-return service and investment-related service and disclosures about the profit recognition patterns (paragraphs 35 and 36, Appendix 1).**
- 4 **Reinsurance contracts held – recovery of losses on underlying insurance contracts (paragraphs 37 to 47, Appendix 1).**
- 5 Presentation in the statement of financial position (paragraph 54, Appendix 1).
- 6 Applicability of the risk mitigation option (paragraphs 64 - 65, Appendix 1).
- 7 Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs 73 to 75, Appendix 1).
- 8 Transition modifications and reliefs (paragraphs 94 to 95, Appendix 1).
- 9 Minor amendments (paragraphs 99 to 105, Appendix 1)
- 10 Terminology (paragraph 110, Appendix 1).
- 11 **Annual cohorts (paragraphs 140 to 143, Appendix 2)**
- 12 Transition: Modified retrospective approach and fair value approach (paragraph 155, Appendix 2)
- 13 **Balance sheet presentation: Non-separation of receivables and payables (paragraph 161, Appendix 2)**
- 14 **Reinsurance contracts: contract boundary (paragraphs 172 to 174, Appendix 2)**

Expected recovery of insurance acquisition cash flows

We support the IASB's and EFRAG's views that an entity allocating insurance acquisition cash flows to expected renewals of contracts would provide useful and more relevant information to users of financial statements by better reflecting the economic substance and general understanding of these transactions.

Concerns have been expressed that allocating insurance acquisition cash flows to future groups of contracts might create significant scope for judgment, both in terms of allocation to future groups and in terms of measurement, which may lead to diversity in practice. However, observations of relevant needed parameters can be expected to provide a basis for economically systematic and rational allocation. Actuaries, for instance, are experienced in preparing well-argued assumptions and judgements in areas which will be relevant to the IFRS 17 framework.

EFRAG's Question to Constituents

18 Insurance contract renewals are not a defined term which may lead to diversity in practice when allocating insurance acquisition cash flows. Do you consider that insurance contract renewals should be defined in order to achieve comparability and, if so, how would you define them?

We believe that there is no need to define insurance contract renewals and that following the definition of the contract boundaries should be sufficient guidance. Related future contract renewals may belong to different groups of insurance contracts which makes the issue complex but would not impact on the principle.

Contractual service margin attributable to investment-return service and investment-related service

We support the purpose of the IASB amendment, but consider that the proposed changes need more clarifications and amendments.

Definition of investment services

EFRAG's Question to Constituents

35 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 do not have additional relevant examples and we are concerned that these kind of contracts would be considered not to offer investment service according to B119B. We think that the definition of the investment-return service is too restricted, e.g. the generation of an investment

return is essential also to annuities which have neither direct participation features nor withdrawal rights.

The Board has concluded that an investment-return service cannot exist if the contract does not include an investment component or the policyholder does not have a right to withdraw an full amount from the entity, because, in that case, the policyholder does not have the right to benefit from investment returns. We consider that these are not sufficient conditions.

The amount of the annuity payment agreed in the contract depends on the entity's expectations and might also depend on the excess return which might be used to increase the agreed annuity payment. This has characteristics of investment return service, and our view is that benefits should not be restricted to payments only on partial withdrawal.

In some other deferred annuity contracts the surrender value, being also the investment component, might be half of the carrying value from which the annuity payment is calculated. It is not appropriate in such a case that the investment service definition would be limited to half of the carrying value. If that half is surrendered does the definition of the investment service mean that there is no more investment service after the surrender even though the rest of the carrying amount develops as before?

The condition to the right to withdraw is not clear enough, for instance in relation to unconditional or restricted rights. There might be restrictions, e.g. withdrawal not allowed in the first two years or only in cases of divorce, long-term un employment or long-term disability. For instance, in the case of the two year restriction, is the investment service only considered to be included in the contract after two years?

We propose that B119B should be amended to take into account the above notes, e.g. to remove the references to the investment components and withdrawals and to replace them more generally with the benefits that are expected to depend on

- (i) the investment activities performed under an entity's own account, or
- (ii) services specified by the contracts, e.g. in unit-linked and other savings contracts.

Costs of providing investment services and their potential double counting

We do not fully agree with amendment B65(la).

Unit-linked contracts for example specify the service given to the policyholder and this is comparable with the service which asset managers give to their clients. Asset managers account for their investment services costs within IFRS 15. The insurance company must follow these same requirements when issuing unit linked contracts accounted for within IFRS 9. However, because IFRS 15 scopes out the insurance contracts, amendment B65(la) is consistent when it is applied to unit-linked contracts accounted for under IFRS 17. This conclusion could also be reached without the amendment according to the current IFRS 17 standard.

BC65(la) could cause double counting in profit and loss if it were applied also to the investment services provided in circumstances where the covering assets are under an entity's management. The profit and loss of the investments currently includes investment management costs.

Application of B65(la) to these costs will require them to be accounted for also within profit and loss under IFRS 17.

Similar issues can occur in accounting for pension insurance contracts which are accounted for under IFRS 17 with the employer's pension benefits accounted for within IAS 19.

We propose not to add B65(la) or alternatively to restrict it so that there will not be double counting.

We have some complementary comments to EFRAG's draft letter:

General model - Contracts without investment components

Under many insurance contracts, the policyholder has a right to withdraw money (or to transfer an amount to another party). This right appears to indicate the entity is providing an investment-return service. EFRAG understands that investment-return services are most commonly found in endowment contracts and certain deferred annuity contracts.

Variable fee approach

EFRAG agrees that insurance contracts with direct participation features usually provide both insurance coverage and investment-related service. It is possible that the underlying item providing return to policyholders comes not from investment return but from another factor such as mortality or expense surplus.

Reinsurance contracts held – recovery of losses on underlying insurance contracts

We agree with the amendment on the basis that it recognises the economic reality that proportionate reinsurance commonly exists specifically to offset losses for onerous contracts and so it is appropriate that fulfilment cash flows relating to the direct and reinsurance contracts are aligned.

Annual cohorts

We agree with EFRAG that it is worth reconsidering whether the annual cohort requirement is justified in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts, and that an exception for these contracts should be made.

We think that reaching the three qualitative objectives of the IASB (to appropriately depict trends in an entity's profit over time, to recognise profits of contracts over the duration of those contracts, and to recognise losses from onerous contracts on a timely basis) can be dealt by additional disclosures in the notes rather than through an overly complex, costly, judgmental and potentially arbitrary accounting process that may not give a true and fair view of the underlying profitability of these contracts.

In some large Continental European jurisdictions (notably France, Germany, Italy), requiring annual cohorts for some mutualized contracts would not be effective if the fulfilment cash flows arising from the insurance contracts cannot be reliably allocated to each cohort using adequate metrics consistent with the economics and the characteristics of the cash flows.

Indeed, some of these contracts clearly imply that no annual cohort of policyholders has a contractual right to any subset of the underlying items and that the fair value returns from the latter are shared across generations of policyholders through management's allocation of discretionary benefits. In that context, annual cohorts create a costly and artificial allocation of future discretionary benefits between annual groups that does not reflect the contractual and economic features of contracts. This is because the initial allocation of benefits – if annual cohort was applied – would need to be reconsidered in every subsequent year in order to take into account the actual, new and subsequent allocations decided by the entity to all mutualized contracts, regardless of their underwriting year.

For the purpose of achieving comparability between preparers, it seems more reasonable that no accounting figures should be based on a method that cuts across actual management, pricing and risk-management decisions in this way. Therefore, we suggest additional disclosures in the notes for the contracts benefitting from this exception, e.g.

1. Qualitative disclosure about the portfolios of mutualized contracts, their grouping criteria and the underlying supporting items;
2. Reconciliations for the CSM from the opening to the closing balances;
3. Disclosure of profitability trends of the new business of these portfolios (past and expected recognition of future CSM);
4. Disclosure and explanation of the actuarial techniques for measuring the value of the new business and the allocation of underlying items between back-book and new business.

AAE would be glad to present a more thorough description of its view and of the underlying actuarial issues as this requires a lengthier and more detailed technical document to do so.

Resolution of this issue is an urgent matter given the complexity of implementation of annual cohorts and the time available to implement the standard.

Balance sheet presentation: Non-separation of receivables

161 Do Constituents support the presentation of separate information about premiums receivable? If so, should information about premiums receivable:

- (a) be mandatory?
- (b) be based on a predefined definition of "premium receivables" and , in this case, how should premiums receivable be defined?
- (c) be provided on the face of the balance sheet or in the notes?
- (d) be separated by insurance portfolio?

AAE does not support the separate presentation of the premium receivable, on the basis that premium receivable is not defined and is not cash flow based. Reading the balance sheet with separate presentations will also make the understanding of the balance sheet information difficult about certain portfolios or groups of insurance contracts, e.g. for non-life insurance business. It

would complicate the implementation for risk adjustment and contractual service margin presentation. The implementation would become more complex.

Reinsurance contracts: contract boundary

172 Do Constituents support the IASB's tentative decision not to amend IFRS 17 for the contract boundary of reinsurance contracts held?

No.

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.