



September 25, 2019

Mr. Hans Hoogervorst
Chairman, The International Accounting Standards Board
Columbus Building
7 Westferry Circus, Canary Wharf
London E14 4HD, United Kingdom

Dear Mr. Hoogervorst,

On behalf of the American Academy of Actuaries¹ Financial Reporting Committee, we would like to provide the following written comments in response to the exposure draft on amendments to the International Accounting Standards Board's (IASB) International Financial Reporting Standard (IFRS) 17. We hope you will take them into consideration as the board moves to finalize its decisions on amending IFRS 17.

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 policyholder'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.

¹ The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Do you agree with the proposed amendment? Why or why not?

Response

- (a) We disagree with the proposed amendment given the rationale that the credit card companies may not assess the insurance risk associated with a specific customer. There are other products such as mobile/cell phone handset insurance where this may also be true. If an exception is to be given, it should be based on a principle from the arguments in BC 14: Where a contract contains both insurance and credit risk, if the preponderance of the risk is credit risk, the preparer could have the option of using either IFRS 9 or IFRS 17.
- (b) We see no issue with allowing the election of IFRS 17 or IFRS 9 on balance cancel products. We do not believe that this will create comparability issues. Generally, the young carry more debt than the old and for many debt cancel sales, it is often people in 20s and 30s where the level of mortality risk can make the insurance element immaterial and IFRS 9 election a rational choice for operational efficiency. We would expect that mortgage cancellation, which would be individually underwritten and apply to older individuals, would likely have the IFRS 17 option chosen.

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?

Response

No response.

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?

Response

- (a) Yes, we agree with the proposed amendment. Non-direct participation products also provide valuable investment services. Conspicuously absent is any guidance on determining relative weighting of insurance service and investment service. This will lead to comparability issues by leaving this to be a disclosure item only (question 3(c)).
- (b) Yes, we agree with the proposed amendment. It is important to recognize revenue in proportion to all services provided.
- (c) On paragraph 109, eliminating the option to describe CSM recognition qualitatively should lead to better comparability but may have an inordinate cost to calculate relative to the value of the information provided. The 117(c)(v) disclosure seems to be required in the absence of any guidance on determining relative weighting.

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?

Response

We agree with the proposed amendment as a general concept, as it is intended to allow a better accounting match in profit or loss between losses from onerous direct contracts and associated gains from reinsurance contracts. However, we do not agree with the definition of “reinsurance contract held that provides proportionate coverage,” which unnecessarily restricts the applicability of the proposed amendment.

In many cases, proportional reinsurance contracts do not provide a fixed percentage of coverage to all underlying insurance contracts in a group. Such cases include:

- A reinsurance contract reinsures some, but not all, underlying contracts in a group;
- A reinsurance contract reinsures some, but not all, risks in a group of underlying contracts;
- Multiple reinsurance contracts covering different contracts in a group of underlying contracts in different proportions; and/or
- Minimum and/or maximum limits exist on the reinsurance coverage, such as coverage that is proportional only up to a maximum limit.

We propose that the definition of “reinsurance contract held that provides proportionate coverage” in Appendix A be deleted.

We propose that paragraph B119C be deleted, as it is not necessary.

We propose that paragraph B119D be amended as follows:

“An entity shall determine the adjustment to the contractual service margin and the resulting income recognized applying paragraph 66A by multiplying:

- a) The loss recognised on the individual underlying insurance contracts within a group of contracts; and
- b) The contractually defined percentage of claims on the underlying insurance contracts the entity has a right to recover from the group of reinsurance contracts held.”

In addition to the points above, we would like to take the opportunity in this response to point out that the required approach to determining the contract boundary for reinsurance contracts held, which results in the need to recognize future insurance contracts in the reinsurance asset, significantly complicates the ability to appropriately address the accounting mismatch, as intended by this amendment. It also does not provide useful information to users, as it results in recognition of reinsurance cash flows directly related to cash flows from possible future underlying direct contracts that are not recognized.

We propose that the reinsurance cash flows associated with underlying insurance contracts not yet recognized be identified in the Standard as being outside the reinsurance contract boundary.

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?

Response

We support this proposed amendment but would have gone further and not required such a separation, as there is little to no informational value in such a split.

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?

Response

We agree with the proposed amendment, as it eliminates the accounting mismatch that results from measuring reinsurance contracts providing coverage for financial risks on underlying contracts measured under the variable fee approach. However, accounting mismatches continue to exist, due to the certain limitations placed on the application of the risk mitigation adjustment.

An accounting mismatch is created under IFRS 17 for liabilities that are hedged using non-derivative instruments. For contracts measured under the variable fee approach, changes in the value of the insurance contract liability adjust the CSM, while changes in the value of the non-derivative instruments are recorded in profit or loss or other comprehensive income.

An example of a non-derivative instrument that can be used to hedge insurance contract liability risk is a fixed maturity asset, such as a government bond or corporate bond. Fixed maturity assets seem different from derivatives in that they provide investment income. If held to maturity, changes in interest rates do not ultimately affect the income provided. However, they change in value when interest rates change, and they can be sold at a gain, much the same as derivatives. This makes them effective interest rate hedging instruments.

Another example is the use of one type of insurance contract to hedge the liability risk of another type of insurance contract. This is a type of liability portfolio diversification benefit that can be

considered a natural hedge. If one of the contracts is measured under the variable fee approach and the other is measured under the general model, an accounting mismatch is created, as the impacts of changes in financial risk adjust the CSM for one and are recognized in profit or loss for the other. This mismatch creates unnecessary profit or loss volatility.

We recommend that non-derivatives be allowed as hedging instruments under the risk mitigation approach, provided the criteria under IFRS 17 paragraph B116 are met. This change would address the mismatch and increase consistency with IFRS 9, which allows for hedging instruments beyond derivatives only.

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?

Response

We support both of these implementation date changes. The complicated nature of this standard and the level of preparation in the industry makes this a necessary change.

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?

Response

No response.

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?

Response

We agree with the proposed amendments described in paragraphs BC147-BC163, with the following exception:

Change to paragraph B107:

The purpose of the proposed amendment to change “over the duration of the group of insurance contracts.” to “over the duration of the insurance contract,” in paragraph B107(b)(ii) is unclear. Neither the revised Basis for Conclusions nor any other proposed amendment explains why this change was made. We disagree that this is a minor amendment and view this as a significant change. The proposed amendment implies that the eligibility test for measurement using the VFA approach should be performed at the contract level, which is inconsistent with approaches taken in other aspects of IFRS 17, which use groups of contracts as the unit of account. A change of this magnitude could impede implementation. In such a case, we would request a thorough explanation and justification or retraction.

Question 10—Terminology

This Exposure Draft proposes to add to Appendix A of IFRS 17 the definition ‘insurance contract services’ to be consistent with other proposed amendments in this Exposure Draft.

In the light of the proposed amendments in this Exposure Draft, the Board is considering whether to make a consequential change in terminology by amending the terms in IFRS 17 to replace ‘coverage’ with ‘service’ in the terms ‘coverage units’, ‘coverage period’ and ‘liability for remaining coverage’. If that change is made, those terms would become ‘service units’, ‘service period’ and ‘liability for remaining service’, respectively, throughout IFRS 17.

Would you find this change in terminology helpful? Why or why not?

Response

Such a change could cause more confusion at this stage of the standard than it is likely worth. Many companies have been educating internally, including technology teams and those that manage the underwriting operations of the business. As they have developed comfort with that terminology, to change it would likely confuse people, but also there may have been systems and codes that have been developed using the current terminology.

We would welcome the opportunity to speak with you in more detail and answer any questions you have regarding these comments if you wish. If you have any questions or would like to discuss further, please contact Shera Niemirowski, the Academy's risk management and financial reporting analyst at niemirowski@actuary.org.

Sincerely,

Gareth L. Kennedy, MAAA, ACAS
Chairperson, Financial Reporting Committee
American Academy of Actuaries