INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

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Transmitted electronically

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

Subject: IAIS Comments on June 2019 Exposure Draft of IFRS 17 Amendments

Dear Mr. Hoogervorst:

The International Association of Insurance Supervisors (IAIS) appreciates the opportunity to comment on the International Accounting Standard Board's (IASB) Exposure Draft entitled *Amendments to IFRS 17* ("the ED").

The mission of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to global financial stability. This includes developing and assisting in the implementation of international standards. As such, the IAIS has a keen interest in the progress of the IFRS 17 standard and its successful implementation.

The IAIS supports the IASB's efforts in finalising the IFRS 17 standard. The new insurance contracts standard will promote global convergence of insurance accounting, which will improve the consistency and the comparability of financial reporting and may result in more effective market discipline and greater financial stability.

The IAIS is of the view that the IASB has followed a proper process in its consideration of amendments to IFRS 17. Detailed responses by the IAIS to the ED questions are included in the Appendix to this letter. The IAIS has chosen to limit its comments to areas of prudential concern within the limits of the ED. The IAIS does not have any fundamental objections to the proposals in the IASB's ED. The comments provided reflect IAIS views, which may have similarities with the views of other financial statement stakeholders. The IAIS also appreciates that the ED provides a number of simplifications that will ease the implementation effort associated with the international standard.

The IAIS raises some additional items in the Appendix for the IASB to consider during its deliberations. The IAIS is of the opinion that the concerns raised are not of sufficient magnitude to warrant further exposure. Beyond this, the IAIS urges the IASB to carefully consider the responses received in order to address all the important concerns raised, with the goal of finalising a quality standard as soon as practically possible.

The IAIS appreciates the opportunity provided by the IASB to comment on the proposed amendments to the IFRS 17 standard. Should you wish to further discuss our responses, please contact Jay Muska at the IAIS Secretariat (tel: +41 61 280 8953; email: jay.muska@bis.org) or Markus Grund, Chair of the IAIS Accounting and Auditing Working Group (tel: +49 228 4108 3671; email: markus.grund@bafin.de).

Yours sincerely,

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Chair, Executive Committee

Elise Liebers
Chair, Policy Development Committee

Appendix: Responses to IFRS 17 Amendments Exposure Draft

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)

<u>Exclusion of credit cards and other loan contracts that meet the definition of an insurance contract</u>
The IAIS supports the IASB's proposal to require credit card contracts that meet the definition of an insurance contract to be scoped out of IFRS 17 using the condition defined in the ED. The IAIS also does not object to the proposal to allow loan contracts that meet the definition of an insurance contract to be measured using IFRS 9 *Financial Instruments*. These amendments are expected to ease implementation of the standard without sacrificing relevant information to users of financial statements.

The IAIS also agrees that additional disclosure requirements are not necessary, given that both IFRS 17 and IFRS 9 specify sufficient disclosure requirements for such contracts.

Question 2 – Expected recovery of Insurance acquisition cash flows (paragraphs 28A-28D, 105A-105 C, B35A-B35C and BC31-BC49)

<u>Definition of insurance acquisition cash flows</u>
The IAIS does not object to the IASB's proposal to amend the definition of insurance acquisition cash flows to clarify that insurance acquisition cash flows relate to groups of insurance contracts issued or expected to be issued. The IAIS is of the opinion that the proposal would provide useful information to users of financial statements.

<u>Insurance acquisition cash flow disclosures</u>
The IAIS does not object to the IASB's proposal to require that entities disclose quantitatively, with appropriate time bands, when they expect to derecognise an asset for insurance acquisition cash flows (para 105B).

The IASB should also consider enhancing the disclosure requirements associated with acquisition cashflows in order to facilitate comparison between entities. In particular, enhanced disclosures would help users understand the financial impact of a firm's approach to capitalising acquisition costs, the consequences of changes to relevant estimates for those assets, as well as the implication of an insurance entity ceasing to write a particular major product line.

Question 3 – Contractual service margin (CSM) attributable to Investment-return service and investment-related service (paragraph 44-45, 109 and 117 (c)(v), Appendix A, paragraphs B119-B119B and BC50-BC66)

<u>Insurance contracts without direct participation features</u>
The IAIS does not object to the proposal to identify coverage units for insurance contracts without direct participation features by considering the quantity of benefits and the expected period of investment returns, if any, in addition to the insurance coverage. The IAIS is of the opinion that this simplification will also more faithfully reflect an entity's financial performance across periods.

<u>Insurance contracts with direct participation features</u>
The IAIS does not object to the clarification that an entity is required to identify coverage units for insurance contracts with direct participation features by considering the quantity of benefits and expected period of both insurance coverage and an investment related-service.

<u>Proposed disclosure requirements</u>
The IAIS does not object to the proposed quantitative disclosure requirements with respect to expected profit and loss recognition from the contractual service margin, as well as an entity's approach in determining the relative weighting provided by insurance coverage and investment return-service or investment related-service, as this will lead to improved transparency in the financial statements.

<u>Additional Comments for Consideration – Additional Guidance</u>
The IASB should consider providing additional guidance with respect to how to weigh different types of service (e.g. investment return service, insurance coverage). Given the prevalence of insurance contracts offering multiple services, it would be helpful if the IASB would clarify an approach to be followed in order to achieve the appropriate classification of an insurance contract and the associated CSM. Greater clarity would help to narrow the range of practice and increase comparability between entities.

The IASB may wish to consider setting out principles for allocation, akin to IFRS 15, which uses similar language as IFRS 17.83 *"Insurance revenue shall depict the provision of insurance contract services coverage and other services arising from the group of insurance contracts* ***at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services****"*. IFRS 15 provides detail on how to allocate *"amounts depicting the amount of consideration to which the entity expects to be entitled, in exchange for transferring the promised goods or services"* to distinct goods or services. See 'stand-alone selling price basis' in IFRS 15.73-86.

Question 4 – Reinsurance contracts held – recovery of losses on underlying insurance contracts (paragraphs 62, 66A-66B, B119C-B119F and BC67-BC90)

<u>Reducing accounting mismatch associated with reinsurance contracts held</u>
The IAIS does not object to the proposed amendment to adjust the CSM of a group of reinsurance contracts held that provide proportionate coverage and as a result recognise income when an entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts. This proposal reduces the accounting mismatch that can arise between reinsurance contracts held and the underlying insurance contracts.

Although the IAIS has no objection to the amendment in principle, it is concerned with the proportionate coverage definition and notes that the proposed approach would permit losses on underlying contracts to be offset by gains even in the event the associated reinsurance is not profitable. The IASB may wish to consider whether its proposed definition is clear, achieves its desired objectives and establishes a future proof principle to address the risk that contracts with similar cash flows may be treated differently from an accounting perspective. The IAIS is concerned that the proposed IFRS "proportionate coverage" definition may lead to changes in the design and offer of reinsurance contracts solely for accounting presentation purposes without any risk mitigation benefits.

Proportionate Coverage definition

The IASB should consider whether the current ED definition achieves the desired objective. The importance of clarifying "proportionate coverage" in the IFRS 17 ED proposal will impact most insurers given the common use of reinsurance by the industry.

Furthermore, the IAIS is of the opinion that the new definition of "proportionate" (see p. 29 of Exposure Draft from June 2019 – ED/2019/4) is different from the description in BC304 of IFRS 17, which may lead to misinterpretations and differences in recognition and measurement.

Another concern is that the new definition of the ED appears to be too narrow, given that reinsurance is a widely used and effective risk mitigation tool. The ED only considers unlimited quota share reinsurance as proportionate reinsurance. As soon as limits are introduced, the proportion of how individual claims are shared is not identical for all underlying policies. Therefore, some existing reinsurance contracts would fail as "proportionate coverage" as per the ED, even though most underlying claims in the reinsurance contract are shared proportionally on a defined percentage for each underlying policy with the reinsurer. Reinsurers provide effective risk protection, and under current market practice, retentions and limits are frequently used when entering into shared risk reinsurance arrangements.

In addition, it may be possible to structure a reinsurance contract such that, while otherwise meeting the proportionate definition, "cash flows, other than claims" (permitted under exposure draft: B119C) include variable commission arrangements (or other terms) that result in cash flows similar to those expected under non-proportionate contracts. In such circumstances, the definition should capture the economic substance of the reinsurance arrangement (i.e. effectively a non-proportionate contract).

The IASB may therefore wish to consider clarifying the definition of a "reinsurance contract held that provides proportionate coverage" to take into account other cash flows (e.g. relating to ceding commissions) to the extent that these are linked to claims when considering whether the contract provides a fixed percentage recovery.

Additional Comments for Consideration – Enhanced Disclosures

The IASB may consider enhancing the disclosures relating to losses on underlying insurance contracts. Users of financial statements should be able to identify circumstances where an immediate gain has been recognised on reinsurance to offset a loss on an underlying insurance contract.

The IAIS is of the opinion that financial statement users should be able to separately identify gains recognised due to a deterioration in the underlying contracts (i.e. para 66c (ii)) and those relating to contracts that are onerous on initial recognition (i.e. para 66ba). In the former case, reinsurers are taking losses that they were not expecting and this may affect pricing of contracts in the future. In the latter case, losses expected on underlying insurance contracts are deemed offset by proportionate reinsurance contracts but the returns to reinsurers remain in line with expectations.

Existing IFRS 17 disclosures may help to identify the adjustment made to the CSM to offset onerous underlying contracts (ED para BC74). However, these may not be sufficient to distinguish between the sources of the onerous loss. For example:

- Paragraph 100 of IFRS 17 requires an entity to disclose a loss component and this would also apply to a loss recovery component (IFRS 17: 98). However, it is not clear that this would distinguish between gains that are recognised in relation to a deterioration on underlying insurance contracts (i.e. para 66 c(ii)) or groups of contracts that are onerous on initial recognition (i.e. para 66(b)).
- Paragraph 107 requires an entity to disclose the effect on the statement of financial position for insurance contracts issued, showing their effect at initial recognition. However, this disclosure does not apply to contracts where the premium allocation approach applies.

Greater clarity would help to narrow the range of practice and increase comparability between entities.

Question 5 – Presentation in the statement of financial position (paragraphs 78-79, 99, 132 and BC91-BC100)

The IAIS does not object to the IASB simplification proposal to present separately the carrying amount of portfolios of insurance contracts rather than groups of insurance contracts that are assets and those that are liabilities.

Presenting insurance contracts at a less granular level provides practical relief to financial statement preparers without significantly diminishing the usefulness of information for the IAIS as a user of financial statements.

Question 6 – Applicability of the risk mitigation option (paragraph B116 and BC101-BC109)

The IAIS does not object to the IASB's proposal to extend the risk mitigation option to apply in circumstances when an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts. This proposal addresses an accounting mismatch that may otherwise be created from the use of financial risk mitigation.

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)

Deferral of IFRS 17 effective date and IFRS 9 temporary exemption to January 1, 2022

The IAIS supports an effective date of IFRS 17 that is as soon as practicable. The IAIS would like to see a robust international implementation of the standard and appreciates the simplifications and the extension proposed to provide insurance entities with the necessary time to properly assess the various options and assumptions needed to transition to IFRS 17, as well as additional time for testing, and quality assurance. However, the IAIS is also concerned about the workload and costs that would be borne if the standard is amended or delayed further, especially for those entities in the advanced stages of their IFRS 17 implementation.

The IAIS also supports the continued alignment of IFRS 17 and IFRS 9 temporary exemption in IFRS 4. The alignment leads to improved information and reduces the burden on transition. The IAIS would be concerned if IFRS 9 and IFRS 17 would not be implemented together for insurers.

Question 8 – Transition modifications and reliefs (paragraphs C3(b), C5A, C9A, C22A and BC119-BC146

Transition relief for business combinations
The IAIS does not object to the ED amendment to the modified retrospective approach, permitting an entity to classify liabilities acquired in a business combination as a liability for incurred claims rather than a liability for remaining coverage. The IAIS views this amendment as a practical proposal that reduces the costs associated with implementation.

Transition date relief for risk mitigation
The IAIS does not object to the proposal to designate risk mitigation relationships prospectively on or after transition date, as this would ensure consistency in the treatment of risk mitigation activities before and after the date of initial application.

Use of fair value approach
The IAIS also does not object to the proposal to permit the use of the fair value approach to a group of insurance contracts if they meet the specified criteria related to risk mitigation. The IAIS views this amendment as a practical proposal that reduces the costs associated with implementation.

Question 9 – Minor Amendments (BC147-BC163)

The IAIS supports the minor amendments proposed in BC147-BC163 as the clarifications and minor wording changes improve the quality of the standard and address minor conflicts.

Question 10- Terminology

The IAIS does not object to the proposed amendment to replace ‘coverage’ with ‘service’, as this would be consistent with the other proposed amendments in the ED. However, the IASB should consider whether there may be unintended consequences associated with the ED proposal.