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25 September 2019

Hans Hoogervorst
Chair
International Accounting Standards Board
Columbus Building
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Dear Mr Hoogervorst

Exposure Draft 2019/4 – Amendments to IFRS 17

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ('the IASB's') exposure draft Amendments to IFRS 17 ('the exposure draft', 'the ED').

We welcome the responsiveness of the IASB in addressing with this ED the issues that have been identified since the publication of IFRS 17 through the Transition Resource Group's discussions and the IASB's outreach activities.

We are generally supportive of the proposals in the ED and have provided recommendations in a number of areas where we believe these proposals could be improved.

The approach proposed to define investment–return services in insurance contracts without direct participation features appears rule-based. We propose a principle-based approach that uses existing concepts in IFRS 17, associating the presence of the service with fulfilment cash flows that vary based on the returns of the underlying items. In other words, we believe that an insurer is required to provide investment services only with respect to non-direct participating contracts for which the cash flows vary based on the returns of the underlying items, regardless of whether the variability arises because of contractual terms or because the entity exercises discretion and regardless of whether the entity holds the underlying items. An investment-return service is also offered in insurance contracts where the policyholder does not have the ability to withdraw an amount, for example annuities where the amounts payable are revalued with reference to a discretionary return set by the insurer based on underlying items.

We believe that the scope of the proposed amendment to account for reinsurance contracts held ('recovery of losses on underlying insurance contracts') should be extended to all types of reinsurance contracts held. We acknowledge the IASB's rationale for the amendment is sound and the accounting treatment reflects the economic substance of the transactions more accurately than the existing requirements. However, we believe that the economic substance is not different if the cedant had purchased a non-proportionate reinsurance contract to mitigate the risk of insurance contracts issued being onerous at initial recognition. It is also inconsistent that non-proportionate reinsurance contracts are precluded from recognising a gain offsetting an onerous loss on underlying items at initial recognition, but not subsequently. Therefore, we believe there should be no bright line introduced on the accounting of reinsurance contracts held in terms of the initial recognition of recovery from reinsured onerous losses. In addition, we propose a solution to avoid an accounting mismatch created by recognition of insurance finance or expense in relation to that portion of reinsurance contract held that covers underlying contracts expected to be issued (for details see appendices 1 and 3 of this letter).

We also appreciate the Board's efforts to address stakeholders' concerns around the applicability of the risk mitigation option. While we do not disagree with the proposed amendment to extend the application of the

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risk mitigation option to reinsurance contracts held, we think a better solution could be achieved by extending the scope of the variable fee approach to reinsurance contracts held. This would eliminate any accounting mismatches more effectively and would result in the application of consistent principles and criteria to all insurance contracts.

We note the continuing attention of stakeholders with regard to the complexity of applying the existing requirements to contracts that present those characteristics referred to as "mutualisation". This is an item that was already discussed in the Transition Resource Group in September 2018 with an inconclusive outcome. We remain supportive of the need to have the current IFRS 17 guidance for allocating CSM to insurance revenue in a way that is materially reflective of the duration of insurance service and of the size of CSM associated with the contracts in any given portfolio and its groups of contracts. However, the guidance in IFRS 17 on the accounting for the adjustments to CSM from the changes in fulfilment cash flows arising from these contracts could be improved. In particular, IFRS 17 could be more precise on how this adjustment is done across a larger unit of accounts that may comprise several groups bound by the same "mutualisation" characteristics. We describe our approach in Appendix 2.

Appendix 1 to this letter contains our detailed responses to the questions posed in the exposure draft.

If you have any questions regarding our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884 or Francesco Nagari in Hong Kong at +852 2852 1977.

Yours sincerely

Veronica Poole
Global IFRS Leader

Deloitte.

Appendix 1

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.

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

We broadly support both of the proposed exclusions from the scope of IFRS 17. However, with respect to credit cards, given the variety of features that transfer insurance risk and the number of different types of arrangements that exist within these products, we believe that IFRS 17 should not prescribe which IFRS standard(s) is applicable to these products once they are outside the scope of IFRS 17. We provide more detailed analysis below.

Loan contracts that transfer significant insurance risk

We are supportive of these proposed amendments because, without the amendments, financial institutions issuing loan contracts that transfer significant insurance risk would have to account for those contracts applying IFRS 17 in their entirety. The majority of the assets and liabilities of those financial institutions are accounted for under IFRS 9. Introducing an irrevocable designation to scope out of IFRS 17 loan contracts that transfer significant insurance risk would enable all entities to align the accounting treatment for those contracts with the accounting treatment for the majority of their financial assets and liabilities. Financial institutions that do not have insurance contracts other than these form of loans would incur significant cost if they were required to apply the general model of IFRS 17 to such contracts. Particularly, the calculation of the risk adjustment for non-financial risk and the allocation of the CSM would result in a cost that we believe would not outweigh the benefit.

Credit card contracts that provide insurance coverage

We support the proposal in the ED that credit card contracts that provide insurance coverage would be excluded from the scope of IFRS 17 for the reasons noted in the ED. We note that credit cards provide a range of services, and while they include the provision of insurance and other obligations to provide goods or services the main service offered to customers is the offer of credit. Measuring such contracts in IFRS 17 would result in a cost that we believe would not outweigh the benefit.

The proposed scope exclusion specifically requires the credit card arrangement to be in the scope of IFRS 9 and this could read as requiring those distinct goods and services to be accounted for under IFRS 9. We do not believe that treatment was intended or is appropriate. We agree with paragraph BC14 of the ED that IFRS 9 measurement can address both credit and insurance risks. However, in certain circumstances, the insurance risk element of credit card contracts providing insurance coverage may actually be in the scope of another IFRS Standard. For example this may be the case when purchase protection arises because of law or

regulation. Further, we believe that IFRS 15 would apply to other elements such as obligations to deliver goods and non-insurance services bundled in some credit cards. Accordingly, we recommend that the amendment merely scopes out the arrangement from IFRS 17 and remains silent on which IFRS Standard applies. This would ensure that obligations bundled with the insurance component and the financial instrument component that form the credit card contract are accounted for under the most appropriate IFRS Standard.

We also note that the term 'credit card' is not defined. We believe credit cards are the most common example, rather than the only arrangement for which the scope exclusion should apply to. For example, payment cards where the customer funds the card in advance and then uses the card in the same way as a credit card can also contain insurance risk with respect to the goods and services purchased. We propose the scope refers to 'credit cards and similar payment cards' and the Basis for Conclusions explains that the scope is intended to provide relief for the insurance risk relating to the goods and services purchased under a credit relationship created by the financial institution or credit relationship created by the purchaser (in the case where the purchaser pre-funds the purchase).

Financial Guarantee Contracts held

We highlight the unintentional consequence of the proposed scope amendment to IFRS 9 bringing financial guarantees *held* into its scope. We propose to revise paragraph 2.1(e)(iii) of IFRS 9 to scope back into IFRS 9 only "insurance contracts issued that meet the definition of a financial guarantee contract".

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?

We support the proposals in the ED that entities should allocate insurance acquisition cash flows to expected renewals of contracts. This avoids a situation of a group of contracts becoming onerous only because insurance acquisition cash flows cannot be allocated to contract renewals, even though they were paid on the basis that the entity expects that some policyholders will renew their contracts. We agree with the IASB that the proposed accounting treatment would provide useful information to users of financial statements about acquisition cash flows.

We note that the impairment test for the insurance acquisition cash flows asset described in the proposed IFRS 17:B35B does not explicitly address whether it is necessary to take into account the time value of money. It refers to 'expected net cash inflow' for the related groups and for expected renewals determined in accordance with IFRS 17:32(a). We believe that more precise guidance on the effect of the time value of money in the impairment test is important. Accordingly, we would like clarification that applying the proposed IFRS 17:B35B and IFRS 17:32(a), on initial recognition of an insurance acquisition cash flows asset, future cash flows from expected renewals must be discounted using current rates at the expected future issued date. The recoverable amount would be calculated by discounting the 'expected net cash inflow' using the discount rate curve at the reporting date for the portfolio of contracts where the future groups from

renewal activity are expected to be issued from. Nevertheless, we support that there should be non-accretion of interest on the acquisition cash flows asset for the reasons stated in paragraph BC41 of the ED. Clarity of this in IFRS 17 will benefit consistent application.

Further, we note that the current words in IFRS 17:59(a) and in the proposed IFRS 17:28A allow expensing of insurance acquisition cash flows for entities applying the premium allocation approach when the groups of contracts have a coverage not exceeding one year. The insurance acquisition cash flows asset that would be recognised by the proposed IFRS 17:28B would relate to several groups of contracts not yet issued. Accordingly, we believe that it is not appropriate to allow expensing these multi-group insurance acquisition cash flows until they are allocated to a particular group of contracts. We recommend amending the text of the proposed IFRS 17:28A to say "An entity applying the premium allocation approach may recognise insurance acquisition cash flows as expenses applying paragraph 59(a) only when they are allocated to the group of insurance contracts in accordance with paragraph 28C". We recommend reflecting a similar change in IFRS 17:59(a).

Finally, we note that the term 'renewal' is not a defined term in the IFRS glossary. We expect some diversity in interpreting the term, especially between different insurance segments. We have observed that different views are held across professionals involved in the life and general insurance segments. To avoid this, we suggest that the IASB clarifies what it means by the term 'renewal'.

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 IASB proposal to address the lack of guidance on how to determine the coverage units that are related to investment services. In our view, the proposed amendments provide a principle-based approach as to how to include investment services in the CSM allocation and would provide more useful information to the users of entities that issue insurance and reinsurance contracts.

The Transition Resource Group's discussions on coverage units have revealed that several insurers struggle with the implementation of the CSM allocation requirements in IFRS 17, and the amendment would address some of the concerns raised. We understand that the IASB cannot address all issues related to coverage units that were raised by stakeholders, as many of them are very fact-pattern specific. We therefore support the IASB's approach to allow for practice to develop with regard to these other issues.

However, to promote consistent application of the proposed amendment, we recommend that the IASB defines the term 'investment-return services' using a principle-based approach. Since the publication of the ED, entities have shared with us different views as to what they regards as investment-return services. Given this, our proposal is to define the scope of such contracts using the existing principle in IFRS 17:B75. We think that investment-return services should be services that are provided for "non-direct participating contracts for which the cash flows vary based on the returns of the underlying items, regardless of whether the variability arises because of contractual terms or because the entity exercises discretion and regardless of whether the entity holds the underlying items". We believe that in order to provide such variability, an insurer must perform investment–return services.

Further, we disagree with the proposed rule introduced in IFRS 17:B119B linking the existence of investment return service to the existence of investment component or policyholder's right to withdraw an amount. The insurer's promise of benefits linked to return on underlying items means that insurer must perform investment return service in order to deliver these benefits, even in the absence of policyholder rights to withdrawal.
We are supportive of the fact that investment-related services do not have to be linked to an investment component. In our view, it is the investment activity that is relevant for determining whether investment-related services exist. In other words, the existence of an investment component is not relevant for this assessment. Even without an investment component, a contract can have cash flows that are affected by financial variables and for which an entity must deliver investment-related services to generate the return that is incorporated in the cash flows to make them vary with the underlying financial variables. In our view, the IASB's proposal of not linking investment-related services to an investment component is consistent with providing a principle-based approach.

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?

We are supportive of the IASB's proposal to reflect the benefit of coverage provided by reinsurance contracts to cedants, however, we do not think that the proposed amendment goes far enough. Our main concerns are with regard to the scope of the amendment and the subsequent measurement of reinsurance contracts held when applying the amended paragraphs.

With regard to the scope, we note that the term 'proportionate coverage' is defined in IFRS 17:B119C of the ED as "the right to recover from the issuer [of the reinsurance contract] a fixed percentage of all claims incurred on a group of underlying insurance contracts". We conclude that this excludes reinsurance contracts that provide proportionate or full coverage for:

- claims that exceed a certain amount;
- claims related to only a certain type of risk, for example a death benefit when a contract provides both death and critical illness coverages;
- claims related to some, but not all, contracts in a group of underlying insurance contracts.

It is also unclear whether the definition of 'proportionate coverage' would be met if a reinsurance contract covers a certain percentage of all claims for the underlying insurance contracts in a group and, in addition, covers 100% of claims that exceed a certain amount. We have observed that such reinsurance contracts are issued/purchased in Asia.

We also do not understand the conceptual basis for the exclusion of non-proportional reinsurance contracts held from the proposed scope of IFRS 17:66A at initial recognition, while there is no such distinction on subsequent measurement in IFRS 17:66(c) in relation to reinsured onerous losses. This approach introduces an arbitrary bright line. We believe that the existing principle in IFRS 17:66(c)(ii) should be extended to initial recognition and this approach would provide a sound basis for calculating day one gain on reinsurance contracts held when and only to the extent that they mitigate the onerous loss on a group of reinsured insurance contracts issued. In purchasing a reinsurance contract covering onerous insurance contracts issued, the cedant is able to determine whether the purchased contract mitigates the onerous losses or it only offers protection against further deterioration.

Additionally, in relation to the current IFRS 17:63 requirement for subsequent measurement of reinsurance contracts held, we would like to point out that the initial locked-in discount rate applicable to a group of reinsurance contracts held would not correspond to the time when the underlying insurance contracts are issued and reinsured. The recognition of a single insurance contract issued triggers the recognition of the reinsurance contract held and locks in the CSM discount rate. Yet, at initial recognition of the reinsurance contract held, the time value of money for contracts yet to be issued is unknown and the CSM for the stand-ready obligation associated with those future contracts is not allocated to profit or loss. This means that until the underlying contracts are issued and reinsured, the undiscounted reinsurance fulfilment cash flows from those future underlying contracts are always equal and opposite to the associated portion of the CSM. The different measurement is due only to the different measure of the time value of money in this portion of the CSM which IFRS 17 requires to be measured at a locked-in rate related to the reinsured contracts that are issued and reinsured. These issued and reinsured contracts are associated with the other portion of the overall CSM balance for which the cedant is receiving the coverage service and for which the CSM is allocated to profit or loss. Imposing a single measure of time value of money to the two portions of CSM without considering the different nature of the underlying contracts (existing vs. expected) creates an accounting mismatch and does not reflect appropriately the time value of money from the reinsurance contracts.

To address this issue, we propose requiring the CSM related to expected future issuances to be measured using yield curves of future interest rates applicable to those cash flows and discounting them at the current rate applicable at the balance sheet date. This alternative solution would mean that a portion of the CSM of the reinsurance contract held relating to underlying contracts that are still expected to be issued (future underlying insurance contracts) would be discounted using the current rate and the CSM interest accretion for that portion would also be done at the current rate. We believe that this would resolve the mismatch described above. If the entity changes its expectations regarding future fulfilment cash flows of the reinsurance contract relating to future underlying insurance contracts, this would affect future coverage and would unlock the CSM of the reinsurance contract held. The CSM unlocking adjustment at the current rate would match the adjustment to fulfilment cash flows which is also done at the current rate, resulting in nil impact on profit or loss for the portion of reinsurance contract relating to future underlying insurance contracts. The change in current discount rate affects fulfilment cash flows of reinsurance contract relating to future underlying insurance contracts and results in an insurance finance income or expense. However, the portion of CSM relating to future underlying insurance contracts is equal and opposite and, in our proposal, accretes interest at the current discount rate. This creates an equal and opposite effect on the insurance finance income or expense, resulting in a net nil effect for the portion of reinsurance contract related to fulfilment cash flows arising from future underlying insurance contracts. As underlying insurance contracts are issued, the portion of the reinsurance contract's CSM that relates to these issued contracts accretes interest and is adjusted for changes in fulfilment cash flows using a locked-in discount rate calculated applying IFRS 17:B72, based on when the first underlying insurance contract was issued. We provide an example application of this approach in Appendix 3.

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?

We support this proposed amendment mainly for the reasons stated in the Basis for Conclusions to the ED.

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?

Whilst we do not disagree with the IASB's proposal in trying to address stakeholder concerns with regard to potential accounting mismatches created by the variable fee approach (VFA), we think a better solution is possible. We believe that extending the eligibility for the VFA to reinsurance contracts held would eliminate any accounting mismatch more effectively than the proposed solution to extend the scope of the risk mitigation option to reinsurance contracts held. Extending the scope of VFA to reinsurance contracts would result in the application of consistent principles and criteria to all insurance contracts and would remove any optionality.

Proposed paragraph IFRS 17:B115 states that an entity "may choose not to recognise a change in the contractual service margin to reflect <u>some or all</u> of the changes in the effect of financial risk on the amount of the entity's share of the underlying items […] or the fulfilment cash flows" [emphasis added]. We believe that it is unclear if the quantitative threshold of 'some or all' is met if the financial risk on insurance contracts with direct participation features is *much* higher than the financial risk transferred by the reinsurance contract. This will often be the case, given that reinsurance contracts usually transfer to the reinsurer only a proportion of the risks from the underlying insurance contracts. Therefore we propose an amendment to the proposed IFRS 17:B115 to say "to the extent the entity meets the conditions in paragraph B116 *and to the extent that the change in the contractual service margin is economically offset by any reinsurance contract held for the purposes described in paragraph B116*, it may choose not to recognise ~~a~~ *such* change in the contractual service margin to reflect changes in the effect of financial risk on the amount of the entity's share of the underlying items or the fulfilment cash flows set out in paragraph B113(b)."

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?

We agree with the deferral of both IFRS 17 effective date and the delayed application of IFRS 9 for entities with significant insurance operations. We note that it will likely remain a challenging deadline for many preparers.

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?

<u>Classification of contracts acquired in their settlement period</u>

We support the proposal in the ED, however we note that this exemption is applicable only on transition and only to the extent the entity does not have reasonable and supportable information for the full retrospective approach. We are therefore concerned that insurance contracts acquired in their claims settlement phase are treated differently depending on whether they were acquired before or after transition to IFRS 17 by the acquiring entity. As these contracts would be recognised for a number of years after transition, comparability would remain a significant concern over that time.

To address this concern, we recommend that the IASB requires the presentation of the earning of the liability for remaining coverage that relates to the settlement of uncertain claims on contracts acquired in a business combination in a claim settlement phase as a gain in the insurance service expense line, and not as insurance revenue. In our view, this would still reflect the principle of measurement of such liability and related CSM over the period of discovery of the ultimate cost of claims, but it would better reflect the

economic nature of the consideration allocated to such contracts in a business combination and would improve comparability both over time and across entities.

Risk mitigation for insurance contracts with direct participation features

We are supportive of the IASB's proposals for the reasons stated in the Basis for Conclusions to the ED.

Risk mitigation for insurance contracts with direct participation features and the use of the fair value transition approach

We agree with the IASB's proposed amendment. We support it as an innovative way of resolving to a significant extent the accounting mismatch issue that otherwise would have most likely persisted for a number of years after transition. We acknowledge that in resolving the mismatch the IASB had to strike a balance between providing useful information and avoiding the use of hindsight. We think the proposal addresses both considerations. While on transition there is still some room for the use of hindsight in selecting the fair value option, this issue is limited by the fact that the entity has to apply fair value measurement to the whole group of contracts. We also note that the election to apply the risk mitigation option is irrevocable, unless the relationship no longer qualifies for the option, which in our view further limits the use of hindsight.

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?

We are supportive of most of the minor amendments proposed in the Exposure Draft. In some cases, we have proposed an alternative approach that we believe achieves what the IASB had intended, is a fair reflection of the underlying economic substance and is aligned with the principles of IFRS 17.

Excluding changes from cash flows relating to loans to policyholders from revenue

We are supportive of the amendment to IFRS 17:B123(a), however, we believe that this amendment would not be necessary if the definition of investment component focussed on the principle of the repayment in itself rather than on the direction of the initial advance and repayment. The current definition permits only one direction, being the one of the insurer receiving the advance and having the obligation to repay. We also note that the term 'cash flows from loans to policyholders' is not defined and may result in diversity in practice. Defining investment components by using a symmetrical concept of the cash flows involved (i.e. acknowledging that the investment component can be an asset or a liability) would avoid this issue and avoid the need to amend paragraph B123(a).

Excluding changes relating to the time value of money and assumptions that relate to financial risk from changes in the carrying amount of the contractual service margin

We agree with the principle in the proposed amendment to IFRS 17:B96(c) as we believe that any changes in the time value of money and in assumptions that relate to financial risk linked to repaying an investment component is a financial risk and should not be included in the CSM. However, we note a concern with the proposed paragraph's wording, and its intention to include some of the change arising from the difference in the timing of repayment of investment component in the CSM.

The proposed text of IFRS 17:B96(c) excludes differences between investment components expected to become payable and actual payments if they meet the definition of IFRS 17:B97(a). IFRS 17:B97(a) refers to

'the effect of the time value of money and changes in the time value of money and the effect of financial risk and changes in financial risk, being the effect if any on estimated future cash flows and change in a discount rate'. Since the investment components are cash flows that are certain to be repaid at one point in time, we struggle to see which risks, other than time value and financial risks, would cause a difference in the expected and actual amount of any repayment of investment components. Therefore, we propose that entities should be required to exclude from the CSM all differences between investment components expected to become payable and actual payments and reflect them in the insurance finance income or expense. To achieve this outcome, we propose to delete IFRS 17:B96(c).

Changes in the risk adjustment for non-financial risks

We are not supportive of the proposed amendments to IFRS 17:B96(d) requiring different amounts of adjustments to CSM and affecting revenue based on the entity's choice of disaggregation of amount of the risk adjustment for non-financial risk into amount relating to financial risk and amount relating to non-financial risk. Currently, the existence of a choice in IFRS 17:81 does not affect the amount of the CSM adjustment, as determined by IFRS 17:96(d) and only affects the presentation of the amounts recognised in profit or loss: either all change in risk adjustment for non-financial risk is presented in the insurance service result or it is partly presented in insurance service result and partly in insurance finance income or expenses. While we note that the entities can continue to recognise all of the change in risk adjustment for non-financial risk relating to future service in CSM, the proposed amendment would enable entities to influence the measurement of the CSM by way of an election with regard to disaggregation that relates to presentation. In our view, the presentation election should not affect measurement. Therefore, we propose to leave the existing text of IFRS 17:B96(d) and to clarify that the change in the risk adjustment relating to future service always adjusts the CSM at the current rate.

Definition of an investment component

We do not support this proposal. Various discussions at the Transition Resource Group and IASB meetings have indicated that there are many instances in which it is difficult to determine whether there is an investment component. The proposed clarification does not solve those issues. Also, the views expressed as part of the debate around the potential net settlement of investment components have introduced complexity for entities, given that the investment component can only be identified on payment, however, there would be no payment if the investment component is settled net.

We also find the proposed revised definition of an investment component based on the component being "repayable in all circumstances" (i.e., including maturity and cancellation) unclear, as we note that some amounts may only be advanced, and become repayable, part-way through a contract. Although it is certain that such amounts, once advanced, will always be repaid, they may fail the proposed definition if they are not present at the start of the contract. Instead, we propose to define investment components as cash flows that are 100% certain of repayment and for which repayment is contingent only on the passage of time. This also supports our position that any changes in the repayment of investment components represent changes in financial risk and the passage of time and we believe these changes should be excluded from the adjustments to the CSM.

Scope of investment contracts with discretionary participation features

In our view, the amendment to IFRS 17:11(b) is not needed as IFRS 17 is clear in that regard. However, if the IASB decides to proceed with the amendment, we would not object.

Recognition of contracts within a group

We are supportive of the proposed amendments to IFRS 17:28 to include in a group of insurance contracts only contracts that meet the recognition criteria in IFRS 17:25 by the end of the reporting period, as opposed to contracts that were issued by the end of the reporting period. However, we note that a similar amendment

to IFRS 17:22 previously discussed by the Board was not proposed in the Exposure Draft. IFRS 17:22 defines criteria for annual cohorts. The effect of not amending the requirements of IFRS 17:22 means that profitable contracts issued in one period with forward-starting coverages (for example, starting in a year or later) and with no payments due (and therefore not yet be recognised), would still have to be included in the measurement of the CSM of the group established in the year when they were issued. This would complicate the determination of the day one locked-in discount rate for that group for the subsequent measurement of the CSM when the entity elects the calculation of a weighted-average rate. It would also make it operationally burdensome for entities to keep such groups 'open' for when the recognition criteria for these contracts would be met. We note that such contracts are common in Eastern Europe. We propose to amend IFRS 17:22 in the same way, consistent with the amendment to IFRS 17:28.

Treatment of changes in underlying items

We are supportive of the amendment to IFRS 17:B128, as it clarifies and simplifies the treatment for changes in underlying items. However, we note that the amendment addresses underlying items that are non-financial, for example a pool of insurance contracts. Therefore, the changes in the underlying items might arise from non-financial risk, for example changes in the profitability of the underlying pool of contracts because of changes in the mortality assumptions of that pool.

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?

We do not have comments on the terminology other than those raised in our responses to the other questions in the ED.

Appendix 2 Accounting for the CSM and changes in fulfilment cash flows for contracts described in IFRS 17:B67 (so called 'mutualisation' contracts)

A material proportion of issued insurance contracts within the scope IFRS 17 have cash flows that affect or are affected by cash flows of other insurance contracts and therefore are subject to the guidance in IFRS 17:B67-B71 to account for fulfilment cash flows and CSM. As noted in IFRS 17:BC171, these contracts have been commonly referred to as having 'mutualisation' characteristics.

We have observed that the existing guidance in IFRS 17 does not result in a consistent accounting treatment when the entity adjusts the CSM for the changes in fulfilment cash flows that relate to future services. We believe the text in IFRS 17 attempts to reflect the economic substance of the profit-sharing between groups with 'mutualisation' characteristics. However, the guidance requires improvements to ensure it is consistently applied.

When a participating contract requires a policyholder to share with other policyholders the returns on the specified pool of underlying items, this has the effect of some policyholders bearing a reduction in their return because of the payments made to the other policyholders and vice versa. These adjustments will affect the CSM balance of each group of contracts. In particular, IFRS 17:B68 prescribes the accounting for each group that reflects the level of cross-subsidy between policyholders, but records the cash flows passed to policyholders of other groups in the donor group and not in the recipient group.

We believe that this guidance is not sufficiently clear on how the resulting CSM in each of these groups should be adjusted. Discussions at the Transition Resource Group highlighted the diversity in views on how the guidance applies. Specifically, the issue arises in relation to the accounting for changes in cash flows that would have made a group of contracts onerous if it did not comprise contracts with mutualisation characteristics. This scenario could be because of guarantees of minimum performance, because of proportionate sharing in the returns of the pool or because some contracts have lapsed/expired and the return expected to be accreted to them was not paid out at the time because the issuer had not declared the benefit as accreted to the individual policyholders. In this last case, the unallocated surplus is then accumulated and passed to the future policyholders as prescribed in IFRS 17:B71.

The IASB could amend IFRS 17 to clarify that the entity adjusts the CSM at a level of a single combined risk-sharing portfolio. IFRS 17 could be clear that all groups will have their CSM amounts adjusted in proportion to the changes determined at the same level of aggregation as the conditions described in IFRS 17:B67-68 would have determined to be. This would apply, for example, when a specified percentage of the returns of the pool of underlying items are allocated back to the policyholders of the groups that are included in the portfolio associated with the same underlying items. This is one of the scenario described in IFRS 17:B67 and B68 where all policyholders share in the returns pro-rata at the time of allocation.

The application of this clarification on the existing IFRS 17 guidance is illustrated in the following example.

Example - Fully mutualised portfolio, pro-rata sharing of risks, fixed % of equity holder participation

Entity A has issued contracts to 10 groups of policyholders, all forming a single portfolio, paying a premium of CU 1,000 each and each sharing equally in the returns of the insurance contracts portfolio. The portfolio of insurance contracts is a specified pool of underlying items. The returns of this pool are derived from the performance of insurance contracts (premiums, claims and other insurance contracts' cash flows). In other words the policyholders share in the insurance service result from all the contracts in the portfolio. This result is the fair value return of the underlying items. The policyholders' participation is set at 90% of the insurance result from the specified pool of underlying items (i.e. the portfolio of insurance contracts), and the share of the entity is set at 10%.

Claims of group 1 amount to CU4,000, resulting in a net loss to the entity from that group of CU3,000. Assume, for simplicity that there were no other claims. The overall profit of the portfolio, which is the underlying item, is CU6,000 = CU1,000 x 10 – CU4,000.

Because of the contractual link between contracts, Entity A is able to offset the losses on group 1 with cash flows contractually due to policyholders of groups 2 to 10.

The cash flows of donor groups 2- 10 are viewed as a tenth of combined claims plus a tenth of 90% of net portfolio result less a tenth of combined premium. However, applying this method, the same is true for group 1, giving all groups the same CSM once paragraph B112 is applied.

The fulfilment cash flows of each of the nine groups 2 – 10 would be:

(CU1,000 premium) + CU540 share of profit + CU400 foregone to compensate group 1= CU(60) gain.

The variable fee change for each of these groups would be:

CU100 (CSM at initial recognition date) – CU40 (the entity's share of the amounts that have reduced the policyholders' share of the returns on the underlying items in each of these groups following IFRS 17:B67-B68) = CU60

The fulfilment cash flows of group 1 would be:

(CU1,000 premium) + CU4,000 claim + CU540 share of profit – CU(400 x 9 compensated by other groups) = (CU1,000 premium) + CU540 share of profit + CU400 (tenth of combined claims) = CU(60) gain

The variable fee for group 1 would be:

CU100 (CSM at initial recognition date) – CU400 (the entity's share of the losses in group 1) + CU360 (the entity's share of the amounts that have increased the policyholders' payments in group 1 because that group shares the same underlying items as groups 2-10) = CU60

In tabular format:

	A	B	C = B x 9	D= A+ C
	Group 1	Each of groups 2-10	Total of groups 2-10	Total of 10 groups
	CU	CU	CU	CU
Premium	1,000	1,000	9,000	10,000
Claim	(4,000)	0	0	(4,000)
	(3,000)	1,000	9,000	6,000
90% Profit share	(540)	(540)	(4,860)	(5,400)
Subsidy	3,600	(400)	(3,600)	-
CSM	60	60	540	600

Given that policyholders of each group share 90% in the net return of the combined portfolio (i.e. the fair value return of the underlying items), we believe that each group takes its pro-rata share of combined

premium and its pro-rata share of combined claims and its pro-rata share of the 90% of the portfolio result (premiums less claims).

We believe that applying IFRS 17:B68 makes it possible to interpret 'payments arising from terms of existing contracts to policyholders of other groups […]' to include a group's share in the 100% of the losses and 100% of the premiums before attributing to the group its share of a fixed percentage (i.e. less than 100%, 90% in the illustrative example above) of the net portfolio result and that the correct application of paragraph B112 is to include in the variable fee the entity's share of the amounts that are "mutualised" across the groups of the portfolio.

Having allocated the total CSM unlocking adjustment of CU400 based on the amount determined at the portfolio level to each group (in this example, each group 10% of CU400), the entity would still need to retain the individual groups' CSM balances to determine the coverage units for each group that would allocate the CSM to insurance revenue. Groups in the "mutualised" portfolio would all be of only one category from IFRS 17:16(b) or (c). Groups will also remain in place to account for derecognition of individual contracts required under IFRS 17:76.

Appendix 3 Reinsurance CSM for underlying contracts not yet issued/reinsured

This example illustrates the approach of having a portion of reinsurance contract's CSM relating to future business having time value of money measured at current rates.

Entity Z issued insurance contracts. It holds a reinsurance contract issued by XRe, which covers 5 years of insurance contracts to be issued by Entity Z in a 50% quota share arrangement. Entity Z expects to issue 1.2m contracts: 0.2m in year 1, and 0.25m in each of years 2-5. Discount rates are expected to be 2% each year. Entity Z expects average policy premium be about CU2000, and it expects a combined claim and expense ratio of 0.75 (so 25% undiscounted profit).

Day 1								
Opening discount rates	**2%**	**2%**	**2%**	**2%**	**2%**			
Years:	**1**	**2**	**3**	**4**	**5**	**Underlying insurance contracts**	Contracts to be issued in year 1	Contracts to be issued in year 2-5
Insurance contracts	Group 1	Group 2	Group 3	Group 4	Group 5			
Exp. Premium	400	500	500	500	500	**2,400**	400	2,000
Premium discounted	*392*	*481*	*471*	*462*	*453*	***2,259***	*392*	*1,867*
Exp. Claim +RA	- 300	- 375	- 375	- 375	- 375	**- 1,800**	- 300	- 1,500
Claim discounted	- *288*	- *353*	- *346*	- *340*	- *375*	**- *1,703***	- *288*	- *1,414*
FCF discounted	104	127	125	122	78	**556**	104	452
CSM (Cr)/Dr	- 104	- 127	- 125	- 122	- 78	**- 556**	- 104	- 452
Reinsurance contract	one group with cash flows from underlying groups					**Reinsurance contract held**	portion relating to undelrying year 1 group	portion relating to undelrying year 2-5 group
Exp. Premium	- 200	- 250	- 250	- 250	- 250	**- 1,200**	- 200	- 1,000
Premium discounted	- *196*	- *240*	- *236*	- *231*	- *226*	**- *1,129***	- *196*	- *933*
Exp. recovery	150	188	188	188	188	**900**	150	750
Recovery discounted	*144*	*177*	*173*	*170*	*166*	***830***	*144*	*686*
FCF discounted	- 52	- 64	- 62	- 61	- 60	**- 299**	- 52	- 247
CSM (Cr)/Dr	52	64	62	61	60	**299**	52	247
Reinsurance contract balance						**-**		

At the end of year 1, entity Z has issued 0.2m of insurance contracts. It has revised its expectations relation to insurance contracts it expects to issue in years 2-5. Discount rates have also changed and are expected to be 3% at the end of year 1 and 4 % in years 2-5.

End of year 1 discount rates	**3%**	**4%**	**4%**	**4%**	**4%**			
End of year 1	Issued	Projected				**Underlying insurance contracts**	issued ins. contracts	future ins. contracts
Years:	**1**	**2**	**3**	**4**	**5**			
Insurance contracts	Group 1	Group 2	Group 3	Group 4	Group 5			
Premium	400	500	500	500	600	**2,500**	400	2,100
Premium discounted	*400*	*481*	*462*	*444*	*513*	***2,300***	*400*	*1,900*
Claim +RA	- 350	- 400	- 400	- 350	- 500	**- 2,000**	- 350	- 1,650
Claim discounted	- *340*	- *370*	- *356*	- *299*	- *411*	**- *1,775***	- *340*	- *1,436*
FCF discounted	60	111	107	145	102	**525**	60	465
CSM (Cr)/Dr	-	- 111	- 107	- 145	- 102	**- 465**	-	- 465
Finance expense CSM	2.08							
Fin. expense claims change in %	- 2.86							
Fin. expense accrual on claims	6.00							
Fin. expense accrual on premium	- 7.84							
P+L experience	49							
P+L CSM	- 106							
Total P+L	- 60	-	-	-	-	**- 60**	- 60	-

While only group 1 of underlying insurance contracts is issued and recognised, fulfilment cash flows and CSM of future insurance contracts are used for estimating the recognised reinsurance contract.

End of year 1	3%	4%	4%	4%	4%		Portion relating to issued ins. contracts	Portion relating to future ins. contracts
Reinsurance contract	1	2	3	4	5	**Reinsurance contract held**		
Exp. Premium	- 200	- 250	- 250	- 250	- 300	**- 1,250**	- 200	- 1,050
Premium discounted	- *200*	- *240*	- *231*	- *222*	- *256*	**- *1,150***	- *200*	- *950*
Exp. recovery	175	200	200	175	250	**1,000**	175	825
Recovery discounted	*170*	*185*	*178*	*150*	*205*	***888***	*170*	*718*
FCF discounted	- 30	- 55	- 53	- 73	- 51	**- 263**	- 30	- 232
CSM (Cr)/Dr		55	53	73	51	**232**	-	232
P+L CSM	30	-	-	-	-		30	

For the portion of reinsurance contract relating to future insurance contracts expected to be issued in years 2-5, the changes in assumptions relating to those contracts unlock the CSM and do not affect insurance service result.

Opening discount rates	2%	2%	2%	2%	2%		
	Portion relating to issued insurance contracts	**Portion relating to future insurance contracts**					
End of year 1 roll forward of opening expectation	1	2	3	4	5	Total 2-5	
Op. exp. Premium undiscounted	-200	-250	-250	-250	-250		
Op. exp. Premium discounted	-196	-240	-236	-231	-226		
% accrual (Dr P+L) op rate	4	5	5	5	5	**19**	(a)
Change in % rate (cr P+L)	-	-5	-9	-13	-17	**-44**	(b)
Op. exp. Recovery undiscounted	150	188	188	188	188		
Op. exp. Recovery discounted	144	177	173	170	166		
% accrual (Cr P+L) op rate	-3	-4	-3	-3	-3	**-14**	(c)
Change in % rate (dr P+L)	1	7	10	13	16	**46**	(d)

The table above estimates effect of discounting on insurance finance income and expense.

(a) Accrues at 2% on opening balance. E.g. –(196)*2% = 4
(b) Compares effect of rate change. E.g. –((250)/(1.04)-(250)/(1.02))=-5
(c) Accrues at 2% on opening balance. E.g. -177*2% = -4
(d) Compares effect of rate change. E.g. –(188/(1.04)-188/(1.02))=7

This is used to calculate balance sheet and profit and loss impacts, as shown on next page. The next page table shows that using current discount rate for CSM relating to future underlying contracts results in nil insurance finance income expense for that portion, does not affect insurance service result or insurance finance income or expense for current portion of reinsurance contract.

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End of year 1	**Portion relating to issued insurance contracts**	**Portion relating to future insurance contracts**			
Profit and Loss	CSM at locked rate	CSM at current rate			
	P+L Dr/(Cr)	**P+L Dr/(Cr)**			
Finance expense CSM	- 1	- 7		Cr P+L	Dr CSM
Fin. expense accrual on premium	4	19	(a)	Dr P+L	Cr premium FCF
Fin. expense prem change in %	-	- 44	(b)	Cr P+L	Dr premium FCF
Fin. expense accrual on recovery	- 3	- 14	(c)	Cr P+L	Dr Recovery FCF
Fin. expense recovery change in %	1	46	(d)	Dr P+L	Cr Recovery FCF
Total insurance finance expense	1	- 1			
P+L experience	- 24	-		Cr P+L	Dr incurred recoveries
P+L CSM	53	-		Dr P+L	Cr CSM
Total Insurance service result	29	-			
Total P+L	**30**	**- 1**			
Balance sheet					
	FCF premium	**FCF recovery**	**CSM**	**P+L**	
Future portion	Dr (Cr)	Dr (Cr)	Dr (Cr)	Dr (Cr)	
Opening	- 933	686	247		
Fin. expense accrual	- 19	14		5	
Fin. expense change in %	44	- 46		1	
CSM accrual			7	- 7	
	- 907	654	254	- 1	
Unlocking	- 43	64	- 21	-	
Closing	- 950	718	233		
Current portion					
Opening	- 196	144	52		
Fin. expense accrual	- 4	3		- 1	
Fin. expense change in %	-	1		1	
CSM accrual			1	1	
	- 200	148	53	1	
P+L experience	-	24		- 24	
Earning CSM	-	-	- 53	53	
Closing	- 200	172	-	29	
Total	**- 1,150**	**890**	**233**	**29**	

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