

91. Sitzung IFRS-FA am 19.10.2020
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IFRS Technical Committee

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Berlin, 16 September 2019

Dear Hans,

RE: IASB ED/2019/4 Amendments to IFRS 17

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB's ED/2019/4 *Amendments to IFRS 17* (herein referred to as the 'ED'). We appreciate the opportunity to comment on this ED.

After almost 20 years of development, IFRS 17 is the first true international financial reporting standard dealing with insurance contracts. In comparison to its predecessor IFRS 4, which contained only limited guidance and grandfathered most of jurisdictional practices, IFRS 17 contains a holistic and complete depiction of the subject matter. The complexity of the insurance business as such as well as the challenges arising from a drastically changed environment during the development of the standard (e.g., a low-interest environment, increasingly volatile markets, to name but two) have made it difficult to agree on a global reporting standard.

A 'gold standard' on insurance accounting will hardly ever be reached. IFRS 17 is a compromise solution, and it is inherent in every compromise that for some the perceived benefits of that solution are more difficult to explain and justify against the backstop of the current reporting environment, which may have fitted them reasonably well, than for others. IFRS 17 encompasses significant changes, and many of those changes come at significant cost. As a national standard setter, we are therefore receptive to any concerns we hear in our jurisdiction that challenge the validity of decisions made under cost benefit considerations. We commend the IASB for its willingness to reconsider the requirements in IFRS 17 where, upon developing the standard, decisions had to be made by the Board in circumstances of uncertainty (i.e., without seeing the complete picture and being able to judge the full implications of its decision).

Generally speaking, we are highly appreciative of the IASB's efforts and are very supportive of the proposed amendments, which we believe will help reduce the cost of implementation while maintaining the core benefits associated with the standard. We also concur with the IASB that no changes be proposed at this stage that would be unduly disruptive to implementation of the standard. Based upon evidence gathered for insurance entities in our jurisdiction, we believe that implementation is well underway. Any delay in finalisation would, in essence, mean additional cost for preparers, who would have to set aside additional budget and resources.

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The proposed extension of the effective date by one year is nonetheless supported, as it helps ensuring a more robust transition that is less reliant on judgment and assumptions and contributes to facilitating finalisation of the EU's endorsement process in time. That said, our community would be highly concerned if the effective date was pushed out beyond that horizon.

The one area from the main list of suggested changes where we believe further improvements are warranted relates to the proposals around reinsurance contracts, which we feel have been narrowed down to a population that does cast doubt as to why contract types of similar nature and similar effect are treated differently and are not part of the proposed solution. Please refer to our answer on question 4 in Appendix A in this regard.

Further, we believe that the wording underpinning the scope of the modified retrospective approach could be strengthened by clarifying that the prerequisite of having to demonstrate the existence of '*reasonable and supportable evidence*' is not meant to go beyond the general transition requirements laid out in IAS 8. Please refer to our answer to question 8 in Appendix A. Lastly, we provide a few suggestions regarding the proposed limited amendments where we see room for clarification and/or improvement, please confer our answer to question 9 in Appendix A.

In respect of the issues for which the IASB does not propose changes – as evidenced in the Basis for Conclusions accompanying the ED – we generally agree with the IASB's decisions and the reasoning provided. On business combinations (BC204 et seq.), interim reporting (BC214 et seq.), and comparative information to be provided on transition (BC117 et seq.), we acknowledge the reasoning of the IASB but feel that cost-benefit considerations have not been fully taken into account and therefore suggest reconsideration of these issues. Please see our detailed answers in Appendix B.

Lastly, we note stakeholders' concerns about the decision not to revisit the annual cohort requirement. We are fully aware of the fact that the IASB had originally proposed a principle-based solution to the level of aggregation (i.e., '*similar risk and similar profitability*') that was dismissed on grounds of practical unfeasibility. The current requirement of annual cohorts was developed to address that feasibility concern and was seen as a reasonable proxy that would still achieve the core objective of the IASB, namely, to depict changes in profitability of an insurer over time. Whilst we agree that the requirement will achieve the stated objective, we question whether it does it at reasonable cost in all cases. The area cited most often where this may be challenged concerns contracts that share risk, which in our jurisdictions affects predominantly participating contracts in the VFA business.

The IASB states in BC138 of the current standard that the annual cohort requirement need not be applied if the outcome of applying it would not be different to one where the contracts were pooled. This *ex post* description seems to acknowledge that cases *do* exist where the extra cost incurred in breaking down a population by cohorts would be unnecessary. However, in order to prove that this was the case, entities would first have to apply the requirement, only to subsequently establish that there was no need to do so. Hence, an *ex ante* criterion is needed to enable an *a priori* decision by the entity for which types of contracts, given their characteristics, the annual cohort requirement would be dismissible.

If, building from existing research and material, the IASB was able to find such a criterion whilst redeliberating the proposals and comments received without endangering finalisation of the standard by the previously announced due date of Q2/2020, we would certainly be appreciative of such efforts. If, on the other side, a solution cannot be found without significantly delaying finalisation of the standard, our advice would be to retain the current requirement. Please refer to our detailed answer in Appendix B in this regard.



Please find our detailed comments in the two appendices to this letter. If you would like to discuss our comments further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

**Appendix A – Answers to the questions of the ED and the related proposals****Issue (a) / Question 1—Scope exclusions—Credit card contracts and loan contracts**

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

(a) Credit card contracts

We agree with the proposed amendment.

We also agree with the IASB's assessment and conclusion that credit card contracts are 'borderline' products as regards their most appropriate accounting – depending on the primary risk inherent in the contract. For contracts which do not foresee any link between the insurance risk of a credit card customer and setting a price for the credit card contract, we agree that IFRS 9 is the more appropriate way to account for these products. Conversely, if there was recognition of the specific insurance risk of the individual customer, it does make more sense to retain them within IFRS 17.

(b) Loan contracts

We also agree with the change proposed to loan contracts.

In contrast to credit cards, where arguably credit risk often is the primary risk, the prime risk for loan contracts may be argued either way in favour of credit or insurance risk. We concur with the IASB that both types of risk are inherent in these contracts. Conceptually speaking, one could argue that it would be more beneficial to users if such contracts were all treated the same, based upon the principle that like transactions be accounted for alike. However, we understand and agree with the Board's consideration that different entities developed different accounting policies under legacy standards, such that mandating changes in that area associated with cost for little or no benefit would be difficult to defend (BC19 of the ED).

Issue (b) / Question 2—Expected recovery of insurance acquisition cash flows

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

We fully agree with the proposed amendment.

Whilst we acknowledge the conceptual and wording differences between IFRS 15 and 17 as regards anticipated prolongations of contracts, as noted in BC47 et seqq. of the ED, we believe that such differences are hard to communicate outside of the world of accounting experts: For contracts that are acquired with a view to the customer extending the contracts and the fees paid to the agent being non-refundable, it should not matter whether the underlying item to the contract was a powerline agreement, a mobile phone contract, the rent of an apartment, or a car insurance policy. Under all these scenarios, customers are usually equipped with a right to extend or cancel – either by law generally or through the contract agreed between the parties to the contract. To mandate different accounting requirements for establishing the contract boundary would make insurance accounting even harder to understand when comparing it to the reporting in other industries and under other standards. We therefore believe that the cost of changing the contract boundary in IFRS 17 would be more than exceeded by the benefits of doing so, as comparability and understandability would be enhanced and the business rationale for paying high acquisition cost be reflected in a more appropriate way.

We are aware of concerns in some jurisdictions where German insurers have subsidiaries and where the acquisition cost have never been so high that the first cohort of contracts would be



considered onerous. For these entities, the proposed amendment would mean a change in that they now would have to spread the acquisition cost over the anticipated renewal period. On the other hand, we believe that many (if not most) of those contracts would qualify for the premium allocation approach (PAA), for which there is already an explicit choice to recognise any acquisition cost when incurred to profit or loss per IFRS 17.59(a), which would achieve the same outcome as before and should, hence, mitigate these concerns.

Finally, we also agree with the requirements to test the recognised acquisition cash flows for impairment and to provide additional disclosures.

Issue (c) / Question 3— Contractual service margin attributable to investment-return service and investment-related service

Do you agree with the proposed amendments and the proposed disclosure requirements? Why or why not?

(a) and (b) Identification of coverage units

We agree with and support the proposed amendments.

For insurance contracts that also provide a service element related to investments, a release of the CSM only over the period for which the entity provides insurance coverage would not faithfully reflect the substance of the transaction, as part of the premium was surely attributable to the other service element. Such inappropriate reflection would be most significant for long-duration contracts where the insurance element was either severely front- or back-loaded, such that there would either be no revenue from the contract after or until the insurance coverage period.

Notwithstanding our agreement, we are aware of isolated concerns around the definition of investment-return services, in particular the surrender and transferability criteria (refer to BC58 et seqq. of the ED). We suggest the IASB revisit the necessity of these criteria in the definition, if the economics of the contracts otherwise are the same or very similar to contracts that meet these criteria, so that like transactions are accounted for alike.

(c) Disclosures

We agree with the proposed disclosures and believe them to be proportional.

Issue (d) / Question 4—Reinsurance contracts held—recovery of losses on underlying insurance contracts

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

Whilst we fully support the intention of the proposed amendment, we have reservations as to the population of types of reinsurance that would benefit from the changes.

Over the past twelve months, the ASCG has worked intensively with other National Standard Setters to develop a solution to the day one accounting mismatch that exists under the current standard. Economically, reinsurance contracts are a type of risk mitigation that insurers seek to enter to adjust, modify or eliminate their risk exposure from insurance policies written. Whilst the mitigating effect of reinsurance policies is fully reflected in the provisions of IFRS 17 for subsequent accounting, there is no equivalent recognition of an economic setoff on initial recognition. Rather, the insurance policies written, and the reinsurance policies acquired are viewed as separate contracts. Although we concur with the IASB's rationale that insurance and reinsurance contracts are separate contracts with separate counterparties that should be accounted for separately, we do not believe that separate accounting should go as far as to



present day one losses where, economically, they do not exist. In this regard, we fully subscribe to the IASB's intention to change IFRS 17's requirements to allow for immediate recognition of an opposite gain provided certain conditions are met.

Our reservation regarding the IASB's proposed amendments concerns the definition of '*proportionate coverage*'. The term 'proportionate' is used in the current text of IFRS 17 in BC304. The understanding of that paragraph was widely shared in the industry, not just in Germany but equally elsewhere, and had been used as a basis for implementing the requirements of IFRS 17 relating to reinsurance contracts. The definition of '*reinsurance contract held that provides proportionate coverage*' that is now added with the proposals differs significantly from that prior understanding, as it limits proportionate reinsurance to those contracts that "*recover [a] fixed [percentage of] all claims incurred in a single group of underlying insurance contracts*" (Draft Appendix A). This type of reinsurance contract is a so-called quota share reinsurance (without limit) and surely exists in our jurisdiction. However, it is by no means the only type of reinsurance that entities consider to be proportionate (e.g., quota share reinsurance with limit, surplus reinsurance, per risk excess of loss reinsurance), nor is it the most prominent type.

We believe that any decision whether or not to exclude other types of reinsurance contracts from the scope should be based on the economic substance of those contracts: If other types of contracts react in the same or in a very similar way as quota share reinsurance in that they achieve the same or very similar outcome in offsetting losses on the primary insurance policies, it would be hard to defend why the accounting should differ. The ASCG has discussed the issue in great detail in its insurance accounting working group comprising representatives from the preparer, audit, user and academic community. We specifically requested our members from the reinsurance industry to prepare a paper describing the different types of proportionate reinsurance contracts and outlining how they work. The examples developed demonstrate that the economics are indeed very similar to the results achieved under the quota share reinsurance. We therefore have reason to believe that the proposed text in the ED should be revisited and reconsidered for inclusion of other types of reinsurance where the economic outcome is the same or not dissimilar to those achieved by quota share reinsurance. We would be more than happy to share any evidence including the descriptions and examples with you.

Lastly, the IASB has tentatively decided to provide a solution only for proportionate reinsurance contracts. As laid out in BC86 et seqq. of the ED, the Board has insofar ruled out recognising offsetting gains and losses if the reinsurance contract is non-proportionate in nature. Whilst it may be harder to ascertain the exact level of offset achieved, the economic fact that an offset exists is hardly disputable. Non-proportionate business therefore contains additional measurement and documentation challenges that we acknowledge. If a solution to those challenges can be found within the re-deliberation phase, we would not be opposed to further changes.

Issue (e) / Question 5—Presentation in the statement of financial position

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

We agree with the proposal.

Even though the proposed amendments are not principles-based, we consider them constituting a reasonable compromise that strikes a better cost benefit trade-off than the current requirements. We note that, in rare cases, the proposal may lead to presentation of a group of insurance contracts as an asset. We also note concerns by some that aggregating cash flows from insurance contracts regardless of whether or not they are due, does lead to less transparent presentation. On balance, however, even those that raise the conceptual concerns mentioned above do believe that the proposal represents an acceptable solution, taking a practical perspective and considering implementation efforts, and are therefore supportive.



Issue (f) / Question 6—Applicability of the risk mitigation option

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

We agree with the proposal.

Based on our information, the proposed amendments will have little to no relevance for insurance entities in our jurisdiction. As they do not harm either, we do not object to this change if it helps elsewhere around the globe.

Issue (g) / Question 7—Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4

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

We agree with and support the proposed amendments.

When the IASB issued IFRS 17 in May 2017, it considered that an effective date of 2021 would be sufficient. However, whilst the target is the same for all preparers, the starting point is not, as IFRS 4 mainly grandfathered national practices, which for some may be closer, for others further away from IFRS 17's principles and requirements. Based upon evidence gathered for insurance entities in our jurisdiction, we are confident that implementation is well underway. Entities in our jurisdiction have undertaken huge efforts early on in order to be ready for the current effective date. That said, 2021 could have been met only with a fair amount of (reasonably well-grounded) judgment, assumptions and IT shortcuts. It should therefore not come as a surprise that the insurers in our jurisdiction are appreciative of the IASB's proposal to extend the effective date for IFRS 17 (and IFRS 9) by one year. This contributes to ensuring a more robust transition that is less reliant on judgment and assumptions. It also adds to facilitating finalisation of the EU's endorsement process in time, even though it will remain challenging also with the extra year. That said, our community would be highly concerned if the effective date was pushed out beyond that horizon.

Issue (h) / Question 8—Transition modifications and reliefs

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

(a) Further modifications under the modified retrospective approach

We generally agree with and support the proposed amendments in C9A and C22A.

Notwithstanding our agreement, we would like to bring to the IASB a concern that seems to be shared widely: the usability of the modified retrospective approach (MRA) in general. Despite the fact that the condition imposed when reverting to the MRA – having to demonstrate the existence of 'reasonable and supportable evidence' – is not new but has been used in the same way in IFRS 9, there appears to be broad uneasiness in the industry that the level of robustness required must be the same as under the Full Retrospective Approach. Some stakeholders (which includes both preparers and auditors) seem to read the text in a way that detaches it from the general transition requirements in IAS 8 in that the use of assumptions and estimates was irreconcilable with the MRA.

In our view, the Full Retrospective method constitutes the benchmark approach for transitioning to IFRS 17. Entities should as much as possible make use of available data to retrospectively apply the standard's requirements to the in-force business (i.e. treat the business as if IFRS 17 had always existed). The MRA is meant to be an alleviation to this principle in that entities need not go all the way back but could shortcut retrospective application in a defined set of circumstances – provided that the information available still meets the qualitative characteristics of being reasonable and supportable. To us, this does not mean that an entity must



demonstrate availability of all datapoints. If certain datapoints are missing but can be recreated through estimation techniques and modelling, such assumptions and estimates should qualify for use of the MRA. It would seem odd to us to impose a higher threshold to qualify for the MRA than under the full retrospective method (where the use of assumptions and estimates are perfectly ok as long as they do not come like a bolt from the blue). Moreover, if one were to disqualify the use of the MRA in these situations, entities would have to revert to the Fair Value Approach, under which many of the same techniques and estimates would have to be applied in order to arrive at a value (and in many cases, absent liquid markets, the fair value would be a level 3-type measure).

When speaking to the industry, we understand that a clarification would be helpful and sufficient in this regard. We are supportive of this proposal and therefore suggest the IASB consider adding a lead-in sentence in the main body to the transition section stating that the requirement of having to demonstrate the existence of reasonable and supportable evidence when using the MRA does not mean that estimates, assumptions and the use of judgment cannot be used – the information to be recreated must somehow be supported and be reasonable and the requirements should, hence, be read in conjunction with IAS 8.

(b) Applicability of the risk mitigation option

We agree with making the risk mitigation option available as from the transition date.

We understand from conversations with industry representatives that they would have preferred retrospective application of the risk mitigation option. We equally acknowledge the IASB's concern allowing doing so by referencing the possibility of hindsight and selective usage of the option, as laid out in BC128 of the ED. To us, these concerns are similar to IFRS 9's prohibition to apply the hedge accounting requirements retrospectively, so they do not come as a surprise. However, we believe that insurance entities bear an additional burden vis-à-vis other industries as prohibiting application of risk mitigation retrospectively is most likely to have a cross-cutting effect on establishing the CSM initially at transition. If the IASB can be convinced by an approach that effectively rules out the use of hindsight by providing robust documentation, and if a solution could be found regarding the selection issue, we would not be opposed to that solution. In the absence of such a solution, though, we support the IASB in its position on prospective application yet allowing to make use of the risk mitigation option already for the comparative period.

(c) Applicability of the fair value approach

We agree with the proposals for the same reasons outlined above in (b).

Issue (i) / Question 9—Minor amendments

Do you agree with the Board's proposals for each of the minor amendments? Why or why not?

Except for two (discussed in BC161 and 162 of the ED), we agree with the proposed minor amendments. On some of the other proposals we provide comments that we hope are helpful for your redeliberations.

BC148(a): Use of the term "issued" (IFRS 17.27) – editorial comment

BC148(a) of the ED seems superfluous as the paragraph cited therein is deleted completely (and not merely the 'or liability').

BC149: Scope / Investment contracts with DPF (IFRS 17.11(b)) – request for clarification

The change explained in BC149 of the ED aims to clarify that the separation requirement for an investment component and its accounting under IFRS 9 applies only, if the component was distinct and does not contain discretionary participation features.

We take note of voices in our jurisdiction stating that the wording could be clearer as, to them, it is not evidently clear as to whether the amended paragraph is now stating that, for investment contracts with discretionary participation features, separation of and accounting for the investment component under IFRS 9 is inappropriate and forbidden, or separation as such is not necessary in these cases. We would appreciate if the Board had a second look as to what the intended treatment for contracts with distinct participation features was and how that treatment could be articulated more clearly.

BC150: Recognition of contracts within a group (IFRS 17.28) – a potential inadvertent consequence

In BC150 of the ED, the IASB is justifying the change proposed to paragraph 28 of the standard such that inclusion of insurance contracts to a group of contracts depends solely on meeting the recognition criteria and independent of their issuance date. We agree with that statement and the clarification proposed.

However, the text then goes on to contrast the treatment in the amended paragraph 28 with paragraph 22, which is unchanged and where the IASB states that inclusion to annual cohorts nonetheless depends on when the policies are issued and not when they are recognised. We have been notified by constituents that the reading of the text so far has been that paragraphs 22 and 28 were aligned and understood in the same way: Recognition of and inclusion into (a) a group of contracts and (b) an annual cohort would depend upon meeting the recognition criteria and not upon the issuance date. The bold statement in the penultimate sentence of BC150 of the ED would deem that understanding inappropriate, thus causing disruption and system changes that were not foreseen previously. This is partly due to the fact that inclusion of contracts to cohorts when issued means that a different locked-in rate would apply.

BC156: Definition of an investment component (IFRS 17 Appendix A) – request for clarification

In BC156, the Board explains the rationale for amending the definition of an investment component in Appendix A. Specifically, the current BC contains additional characteristics that were not reflected in the definition. The IASB now proposes to clarify and amend the definition such that the investment component is *“the amount that an insurance contract requires the entity to repay to a policyholder in all circumstances, regardless of whether an insured event occurs.”*

The ASCG has been informed that reinsurance contracts are specifically negotiated such that the current definition would often give rise to investment components, which does not appear to have been the intention of the IASB. We therefore ask the IASB to reconsider the proposed wording and to clarify it accordingly.

BC157: Excluding changes relating to the time value and to financial risk from adjusting the CSM (IFRS 17.B96(c) – request for dealing with a consequential question arising from the proposal.



The IASB proposes to exclude changes in relation to the time value of money and to assumptions relating to financial risk from adjusting the carrying amount of the CSM and to amend paragraph B96(c) accordingly.

Whilst we agree with the proposed change, there is a knock-on question as to where such changes should then be presented in the statement of profit or loss (i.e. as insurance service or finance income). The amendment implies a segregation of any unexpected investment component payments into a part that is due to a change in financial variables and a part that is due to a change in non-financial variables, which we feel would increase operational complexity and is neither desirable nor warranted.

BC161: Treatment of changes in underlying items (IFRS 17.B128) – request for reconsideration

The IASB proposes amending B128 such that changes in the measurement of a group of insurance contracts caused by changes in underlying items be treated as changes arising from the effect of the time value of money and assumptions that relate to financial risk for the purposes of IFRS 17. In essence, this would mean that changes in underlying items should always be treated as finance income, regardless of whether the cause that gave rise to the change was endogenous or exogenous to the investment. We question the validity of that conclusion.

Underlying items are not necessarily financial instruments: they may relate to internal costs, to reinsurance, to mortality, etc.; hence, treating any changes in them as finance income does not appear appropriate as it would comingle different sources of income. We believe that such an outcome does not positively contribute to the understanding of an insurer's performance. We therefore ask the IASB to reconsider its decision and to require presentation of changes in underlying items in accordance with the substance that caused the change: If the change was non-financial and thus exogenous to the investment, it should be presented as insurance income (and not as finance income); conversely, if the change was financial, it should be presented as finance income.

BC162: Amendment to IFRS 3 (IFRS 17 Appendix D) – request for reconsideration

The IASB proposes a change to IFRS 3 by amending paragraph 64(N) such that entities can continue to use the exception in IFRS 3.17(b) for business combinations that occurred before the initial application of IFRS 17.

Whilst we appreciate the relief provided to legacy contracts, we are concerned about the impact on those contracts that will be acquired in future business combinations. Whilst we acknowledge that acquisition accounting per IFRS 3 'resets the clock' and requires treating all assets and liabilities assumed as if they were newly originated or incurred, respectively, we are concerned by the outcome of that conclusion – particularly concerning contracts that are acquired during the settlement period. If an insurance contract is already outside of the coverage period, with the loss event having occurred and the insurer now being in the settlement phase, it does appear counter-intuitive to us to ignore that substance upon execution of a business combination and to be required to treat that run-off contract as if it was a newly issued insurance contract. The consequence of that line of argument would be that the insurer would have to artificially assign a CSM to a contract as if there was a period of remaining coverage where, in substance, no such coverage exists anymore.

Treating liabilities for incurred claims in the books of the acquiree as liabilities for remaining coverage in the books of the acquirer does not only give rise to completely different accounting (which is a general consequence of acquisition accounting that we acknowledge); we strongly



believe that such accounting is nonsensical and does not positively contribute to the understanding of the business to an outside reader. We are not opposed to the general recognition and measurement consequences of IFRS 3; we are primarily concerned about the reclassification effect involved. We are not aware that any comparable circumstance exists elsewhere in the literature or any other industry. In this regard, we believe that an isolated, continued hard-wired exception to IFRS 3 would neither be harmful nor running the risk of undermining the general application of the business combination standard within and outside of the insurance industry (as similar cases simply do not appear to exist elsewhere).

We therefore urge the IASB to reconsider its conclusion to limit the relief provided by IFRS 3.64(N) to legacy contracts only. Please also consider our answer in Appendix B on page 13.

Question 10—Terminology

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

Changing/bringing in new terminology at this late stage might run the risk of unintended consequences, hence, we believe that it should generally and as a matter of principle be avoided (unless there was a clear flaw).

We are not opposed to the specific changes proposed and believe that they would positively contribute to a better understanding of the standard's requirements. However, we request the IASB to (a) double-check for potential unintended consequences and (b) carry the change across the entirety of materials, including education material, TRG minutes, website articles etc. in order to be consistent with the terminology used.

Appendix B – Comments on issues for which the IASB considered, and decided not to propose, amendments

Level of aggregation – Annual cohorts

The requirement of having to allocate insurance contracts to annual cohorts has been the source of long debates among and between various stakeholder groups, and this is true for our constituency as well (even though it is less vigorously put forward compared to what we hear from preparers in other jurisdictions). Preparers by and large hold the view that the requirement is rules-based, is not a fair reflection of how the business is managed and is leading to huge cost for developing and customizing software – cost that they believe does exceed the benefits and should therefore ideally be abandoned. The audit profession and the user community offer a more differentiated view. They hold that the starting point of any aggregation requirement is a single transaction that is to be accounted for. They acknowledge that the business logic of the insurance business requires consideration of the law of large numbers, with risk diversification being taken in account, which makes some sort of aggregation necessary and inevitable. However, they do not believe that abandoning the annual cohort requirement altogether was the appropriate solution to preparers' concerns, as it would effectively mean that contracts from completely different generations were pooled together in a single portfolio.

The IASB had originally proposed a principle-based solution to the level of aggregation (i.e., *'similar risk and similar profitability'*) that was dismissed on grounds of practical unfeasibility. The current requirement of annual cohorts was developed as an alternative to address that feasibility concern and was seen as a reasonable proxy that would still achieve the core objective of the IASB, namely, to depict changes in profitability of an insurer over time. Whilst we agree that the requirement will achieve the stated objective, we question whether it does that at reasonable cost in all cases. The area cited most often where this may be challenged concerns contracts that share risk, which in our jurisdictions affects predominantly (though not exclusively) participating contracts in the VFA business. The IASB states in BC138 of the current standard that the annual cohort requirement need not be applied if the outcome of applying it would not be different to one where the contracts were pooled. Nonetheless, the IASB decided against providing an exception for these types of contracts stating that *"setting the boundary for such an exception would add complexity to IFRS 17 and create the risk that the boundary would not be robust or appropriate in all circumstances."* Yet, it further acknowledged: *"Nonetheless, the Board noted that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. **Therefore it may not be necessary for an entity to restrict groups in this way to achieve the same accounting outcome in some circumstances.**"* (emphasis added).

This *ex post* description seems to acknowledge that cases *do* exist where the extra cost incurred in breaking down a population by cohorts would be unnecessary. However, in order to prove that this was the case, entities would first have to apply the requirement, only to subsequently establish that there was no need to do so. Hence, an *ex ante* criterion is needed to enable an *a priori* decision by the entity for which types of contracts, given their characteristics, the annual cohort requirement would be dismissible. In this regard, the members of the ASCG's insurance working group suggest that participating contracts that are accounted for under the VFA approach would be the most obvious candidate for exploring whether criteria can be identified that would meet the test of an *ex ante* criterion. If, building from existing research and material, the IASB was able to find such a criterion whilst redeliberating the proposals and comments received without endangering finalisation of the standard by the previously announced due date of Q2/2020, we would certainly be appreciative of such efforts. If, on the other side, a solution cannot be found without significantly delaying finalisation of the standard, our advice would be to retain the current requirement.

Business Combinations – Contracts acquired during settlement period

Building from our answer to question 9 in Appendix A, we are worried about future business combinations where the relief proposed would not apply. Our concerns are that such a treatment – contrary to the Board’s belief – would add and not avoid complexity, would not be a fair reflection of the underlying nature of the transaction, and would likely cause operational challenges.

Firstly, we do not believe that maintaining the classification of insurance contracts acquired in a business combination at the point in time the business combination takes place would confuse users. Given that this treatment has been existing practice under IFRS Standards for almost fifteen years, we are unaware of any user complaining about this treatment. On the contrary, we believe that changing this practice is likely to create confusion and complexity; hence, we disagree with the argument put forward by the IASB in BC206 et seqq. of the ED.

Secondly, we do not agree with the analogy put forward by the Board in BC206 of the ED as regards classification of financial assets (i.e. the eligibility for amortised cost classification in the books of the acquirer). We believe that classifying insurance contract liabilities as either liabilities for remaining coverage or incurred claims is not a free choice of the entity, but a matter of fact that solely depends on the nature of the underlying economics. Liabilities for remaining coverage are materially different from liabilities for incurred claims. If one wanted to draw an analogy to financial instruments, it would be about classifying purchased credit-impaired (PCI) financial assets, which retain their original classification as credit-impaired in a business combination: For both, PCI financial assets, and liabilities for incurred claims, a loss event has already occurred that gave rise to a different treatment in the books of the acquiree. That loss circumstance is not reversed through a business combination and does not make that loss instance unhappened. Also, we see a material difference between the acquisition of a portfolio of liabilities for incurred claims – for which there may well be a primary objective of discharging the liabilities in a more cost-efficient way and earning a yield on it – and the acquisition of an entire entity, where the primary view is to acquire an in-force business but having to take on the run-off business of the acquiree as well.

For liabilities for remaining coverage, the major source of uncertainty is the risk of the insured event occurring. As a result, the liability for remaining coverage is estimated in a manner that reflects the potential for various events, claimants and injuries. By contrast, for liabilities for incurred claims, the inherent uncertainty is around the ultimate costs associated with particular events, claimants and injuries. The argument used by the IASB of *“bring[ing] insurance accounting in line with the accounting for other types of contracts”* appears to say that unlike transactions are now made like for accounting purposes, which seems odd to us. We therefore uphold our reservation raised before that treating a liability for incurred claims as a liability for remaining coverage after the acquisition date would result in misleading information. As a result, there is a reasonably foreseeable probability that insurers would react to this change, should it be invoked, by introducing non-GAAP measures for capital market communication, which we believe cannot be in the interest of the Board.

Lastly, we note the concerns listed by the Board in BC205 of the ED that different accounting would apply to contracts that, economically speaking, are the same but are treated fundamentally different depending on whether or not they have been issued or acquired in a business combination. Apart from the operational complexity that is caused by this distinction, we have difficulty seeing business combination accounting trumping depicting economic substance, honestly, and see no counterargument in the paragraph that would address any of the concerns raised therein. We therefore suggest the Board revisit and either reconsider its decision or provide a specific solution similar to PCI financial assets in IFRS 3.B41.

Interim financial statements

We take note of concerns brought forward with regard to interim financial statements, including the discussion contained in BC214 et seqq. of the ED. We believe that the lead-in section in BC214 is confusing as it recalls only one of the two principles in IAS 34, namely: the principle that the frequency of reporting should not affect the measurement of an entity's annual results (IAS 34.28, second sentence). The first sentence of that paragraph states that *“an entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements”*, which, in our view, would encompass the accounting estimates cited in BC214 of the ED. By using the wording “exception” in that paragraph, several constituents have raised the question with us what the meaning of that paragraph precisely was.

As is the case for impairments of goodwill per IAS 36 and AFS securities per IAS 39 that are recognised in interim financial statements and cannot be reversed, there is an inherent conflict in IAS 34 between the two principles, which becomes evident under IFRS 17 as well. IFRIC 10 provided an “interpretation” as to how that conflict was to be resolved for IAS 36 and IAS 39 (which is: in favour of the first sentence of IAS 34.28, so entities *must* use the same accounting policies in their interim financial statements, and the existence of interim reporting *can* make a difference to the annual results), but the words in IAS 34 remained unchanged. Moreover, IFRIC 10.9 states that this reading should not be extended *“by analogy to other areas of potential conflict between IAS 34 and other standards.”* It is our understanding that the wording used in BC214 of the ED is reiterating the same logic that is contained in IFRIC 10.8.

We note concerns in our constituency and elsewhere (as listed by the Board in BC215) that this requirement could – and in many cases indeed would – mean a fundamental change from current practice. Many insurers have used year-to-date accounting in their interims (so *have* effectively reversed estimates) rather than date-to-date accounting. In fact, there seem to be differing views in our jurisdiction and across industries as to what the “correct” presentation per IAS 34 should be. The uniform feedback from the industry in our jurisdiction was that they all prefer using year-to-date accounting in their interim financial statements and would regard retention of paragraph B137 in IFRS 17 as a major disruptive element in their implementation causing unnecessary complexity and costs.

IAS 34 is a very old standard for which there has never been a post-implementation review. Given the many recognition and measurement requirements that have been introduced to IFRSs after IAS 34 was issued, it may well be that the understanding as to what interims should depict has changed meanwhile, and a consensus does no longer exist. If the IASB retains its decision of not changing (or deleting) the requirement in IFRS 17.B137, we strongly suggest that (a) the reasoning in BC214 et seqq. be clarified to address the confusion existing in the market, and (b) a PiR for IAS 34 be initiated imminently so as to be better informed what constituents' views regarding interim reporting are. The feedback obtained could then be used by the IASB to make an informed decision about the future course of interim reporting – not only for insurance entities but for all entities. And if the PiR for IAS 34 was started no later than 2020, results should be available by the time the insurance standard becomes effective.

Transition – Comparative information

A common concern that has been raised with and by us at ASAF and other occasions focuses on the requirement to present comparative information for IFRS 17 but not for IFRS 9. We continue to challenge that decision as it appears nonsensical to us to require an entity whose business model relies on an integrated asset liability management to present comparatives only for (part of) one side of the balance sheet. The data resulting from this asymmetric requirement leads to data that is neither comparable to previous nor to future periods, so there



will be two breakpoints in the time series (t_{-2} : IAS 39 + IFRS 4; t_{-1} : IAS 39 + IFRS 4 [data presented for the year]/IFRS 17 [data produced simultaneously for comparatives in t_0]; t_0 : IFRS 9 + IFRS 17). We fail to see the merit of such depictions. We do acknowledge and agree with the argument that users want to see IFRS 17 information as quickly as possible; for us, however, this does not necessarily equate to a complete set of financial statements. Rather, the most informative pieces of information can equally be presented through disclosure in the notes. This includes, for instance, the new breakdown of revenue from insurance and other business sources. As soon as subtotals are calculated that are not exclusively based on IFRS 17 but are influenced by IAS 39, the numbers appear meaningless as they do not have any anchor to the past or to the future.

We believe that the argument of bringing IFRS 17 and IFRS 9 into force at the same time for insurers has almost exclusively focused on a converged *effective* date (which has been achieved) at the price of different *transition* dates. Converging transition dates without compromising converged effective dates can only be achieved in one of two ways: either by waiving the requirement for comparative information for both IFRS 9 and 17 – which we understand would be the preparers' first choice on grounds of reducing cost required otherwise for running systems in parallel and having full-scope audits for those comparatives in place – or by introducing a requirement for comparative information for both IFRS 9 and 17. To our knowledge, the second alternative has not been discussed on the grounds that insurers should be put on equal terms with other industries for which comparative information under IFRS 9 was not required. We acknowledge that argument but see room to revisit this decision and reconsider it against the background of the discussion around deferring the effective dates for both standards. As we have already given this idea some thoughts, we stand ready to discuss the issue further with you.

Contracts in the scope of the VFA also comprising non-participating elements

Lastly, we would like to flag a matter to you that has been brought to our attention only recently through members in our insurance working group in the course of their implementation efforts. Apparently, there are contracts that fall under the VFA, but have individual cash flows for which there are no related underlying items (de facto "non-participating elements"). For such contracts, there is – at least to a certain degree – no asset-related counter-balancing effect for those CSM changes that result from the general "participating" VFA agreement. We understand that this matter is relevant in our jurisdiction.

The relevant paragraphs in this context are the provisions in B113(b) and B134. B113(b) appears to be too rules-based and to go beyond what was originally intended by the Board in setting the requirement. The rationale was that interest rate guarantees granted in connection with a discretionary participation are future-related and their effects are therefore accounted as a change to the CSM. If the liabilities are not covered by underlying items and there is a period in which no profit participation occurs, this leads to an accounting mismatch. In such a scenario, interest-related changes do not relate to the future and should therefore be recognised immediately in profit or loss or OCI, respectively – which the current wording would seem to prohibit.

We would appreciate if the Board considered this issue and amend the paragraph concerned.