

Cologne, 24 September 2019

## **Comments of the DAV on the Exposure Draft Amendments to IFRS 17 of the International Accounting Standards Board**

The German Association of Actuaries (Deutsche Aktuarvereinigung e.V., DAV) appreciates the opportunity to comment on the Exposure Draft *Amendments to IFRS 17* published by the International Accounting Standards Board in June 2019, particularly on the questions for respondents set out in the Exposure Draft.

### **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?*

We agree with the proposed amendment.

*(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?*

We appreciate the change in terminology to “insurance contract services”, comprising services for insurance coverage and also investment-related services. According to our understanding, the requirement to measure those services by assessing “the quantity of benefits provided” (in the following shortened to “benefits”) according to B119 (a) should be interpreted not too narrowly as for the following reasons:

- 1) The only goal of “benefits” in this context is to serve as a kind of “reference figure” to assess services provided during the coverage period since the services itself are hard to be measured directly.
- 2) As mentioned by the TRG (e.g. refer to the summary of the meeting in May 2018):
  - a) It would not be possible to develop detailed requirements.
  - b) It involves judgement and estimates to best achieve the principle of reflecting the services provided. The main requirements for those judgements and estimates are “systematic” and “rational”.
  - c) Different interpretations of “benefits” may be suitable – even “premiums” or “numbers” may serve as reasonable proxies.

The new situation to reflect “benefits” for both kinds of service types requires even more expert judgement by preparers, with the main goal (again) to find a suitable measurement for the provision of both types of services by period. The additional challenge is to find an appropriate driver for the overall combined service provision. From our point of view, it is obvious that, therefore, different views how “benefits” could be interpreted could be appropriate to measure the delivery of both types of services.

According to our understanding, also a combined definition of “benefit” may be suitable, i.e. which comprises the “benefits” for both types of services as a single value. Nevertheless, we have heard also that some stakeholders deduce a different conclusion from the disclosure requirement of 117 (c) (v) as well as from BC62 of the Exposure Draft: They think that the IASB intends that preparers should in all cases define “benefits” separately for services for insurance coverage as well as for investment-related services and combine them afterwards by a weighting mechanism. Such an explicit weighting may be appropriate in many cases. However, we note that in certain jurisdictions (like for example Germany or Austria) for direct participation business the policyholder participates directly and in combination from both service types – from insurance coverage as well as from investment-related services. Especially in those cases, the services provided could be sensibly measured by “benefits” which already reflect the combination of both service types in a single number.

As conclusion, we suggest the following:

- 1) A clarification that “benefits” should not be interpreted too narrowly (but instead in the sense of a “reference figures which measures how services are provided in a systematic and rational way”) would help reduce uncertainty in the market.
- 2) It should be made clear in the Basis for Conclusion that “benefits” can be deducted either separately for both types of services (insurance coverage versus investment-related) or also to measure both service types in combination if sensible and appropriate for the business.

*(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?*

In consequence to our suggested changes described under (b) we propose to change the wording for 117 (c) (v) in the following way:

“to determine services for insurance coverage and investment-return service (for insurance contracts without direct participation features) or for insurance coverage and investment-related service (for insurance contracts with direct participation features) (see paragraphs B119–B119B); especially to determine the way benefits provided are defined and deducted as well as to determine the relative weighting to combine benefits provided for different service types, if applicable”.

**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?*

We agree that those liabilities should be classified as liabilities for incurred claims but observe that other liabilities are still not to be classified as liabilities for incurred claims although it would be appropriate. Therefore we suggest that a broader approach should be taken.

The proposed amendment leads to different accounting for contracts that should not be treated differently.

Consider the following contracts:

Contract 1: Acquired in a business combination in year 2020 with no remaining coverage but only a LIC left.

Contract 2: Acquired in a business combination on 1/1/2022 with no remaining coverage but only a LIC left.

Contract 3: New contract by 1/1/2021. Coverage period 1/1/2021 – 1/1/2022

Contract 4: New contract by 1/1/2021. Coverage period 1/1/2021 – 1/1/2023

Exempt from the respective coverage periods the terms of all contracts may be the same.

Contract 4 is modified on 1/1/2022. By mutual agreement the coverage period is shortened to 1/1/2021 – 1/1/2022 resulting in the modified contract 4 M applying paragraphs 72, 74, 77.

Assume the fulfillment cash flow estimated by the end of the reporting period 2021 consisting of expected claims payments only might be 2000 CU in year 2023 for all contracts. By the end of reporting period 2022 the estimation is changed to 1000 CU in year 2023 for all contracts.

C9A would apply to contract 1.

B5 and 41 et seqq. are applied to contract 2. (See TRG February 2018 AP7 S04).

41 et seqq. is applied to contract 3.

72 (a) (iii), B5, 77, 41 et seqq. are applied to contract 4 M. (See TRG April 2019 AP2 S82, TRG February 2018 AP5 (especially Example 2)).

Accounting for reporting years 2022 and 2023 would be:

Reporting year 2022

	CSM	LRC	LIC	Insurance revenue	Insurance service expenses (past service)	Insurance service expenses (current service)	Insurance service result
<i>Contract 1</i>	0	0	1000	0	1000	0	1000
<i>Contract 2</i>	500	1500	0	500	0	0	500
<i>Contract 3</i>	0	0	1000	0	1000	0	1000
<i>Contract 4 M</i>	500	1500	0	500	0	0	500

Reporting year 2023

	CSM	LRC	LIC	Insurance revenue	Insurance service expenses (past service)	Insurance service expenses (current service)	Insurance service result
<i>Contract 1</i>	0	0	0	0	0	0	0
<i>Contract 2</i>	0	0	0	1500	0	-1000	500
<i>Contract 3</i>	0	0	0	0	0	0	0
<i>Contract 4 M</i>	0	0	0	1500	0	-1000	500

It has to be noted that accounting for contract 4 M might be subject to arbitrary assumptions since the entity usually would not enter into new contracts with an existing liability for incurred claims and therefore it is purely fictional what the premium set out in paragraph 77 (a) (iii) would be. In the example the premium was assumed to be the carrying amount of the LIC resulting in a CSM of 0 at initial recognition of the modified contract.

It also has to be noted that during the coverage period of the original contract 4 there had already been accounting for insurance revenue for the service of settling all claims. The insurance revenue of contract 4 M for the periods 2022 and 2023 would therefore be double counting.

Instead of the amendment C9A paragraph 32 should be changed by introducing the concept of a liability of incurred claims at initial recognition of a contract. As a result:

- accounting would be more consistent,
- complexity and costs of implementation would be reduced,
- existing practice would not be changed,
- the danger of misleading conclusions by users of financial statements would be avoided.

### **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?*

#### **Comment on the amendment of B128**

We note that the wording of BC 161 makes it very clear that the purpose of the amendment of B 128 is to avoid adjustments of the contractual service margin from

changes in underlying items for contracts **without** direct participation features (*"Otherwise, changes in underlying items could adjust the contractual service margin of insurance contracts without direct participation features."*). However, as it is written, the new B 128 (c) is valid for any contract falling under the Standard. On the other hand, for insurance contracts with direct participation features, according to IFRS 17.45 (b) the corresponding change in the amount of the entity's share of the fair value of the underlying item adjusts the CSM and therefore has no impact on the total result of the P&L.

We have following concerns regarding this amendment:

- a) Even though this amendment shall only clarify the treatment of insurance contracts without direct participation features (according to BC 161), it influences the presentation of insurance contracts with direct participation feature in the P&L.
- b) Consider the example of an endowment policy featuring direct profit participation in both investment and risk results (the risk result also represents an underlying item). Increased death benefit payments in a given period would therefore represent a change in the fair value of underlying items. The resulting effect on the P&L would be that
  - the increased death benefit payments would be shown in insurance service expenses and reduce the insurance service result while
  - the corresponding adjustment in the contractual service margin would, according to B128 (c), represent a change arising from the effect of the time value of money and financial risk and changes therein and would hence be shown in the insurance finance result.

In essence, the effect of an event on the current period and its compensation in the CSM would be recognized in different P&L sub-categories resulting in an inappropriate presentation and in a significant loss of useful information for users of the financial statement. Therefore, this amendment contradicts one of the two underlying fundamental objectives of the new Exposure Draft.

- c) Additional doubts arise in the following case:
  - Prior to any adjustments according to IFRS 17.45 (b) and (c) we have CSM = 20 CU;
  - Death benefits incurred are 70 CU higher than expected;
  - Fulfilment cash flows for future services increase by 30 CU.

The increase in death benefits represents a change in fair value of underlying items and is as such governed by B128 (c), representing an effect of the time value of money and financial risk and changes therein.

The increase in experience and the change in FCF sum up to an effect of -100 CU, while the full CSM will be used as partial compensation (+20 CU). In this case, the sequence of adjustments determines the recognition in the P&L:

- If we first adjust the CSM for the increase in FCF for future services, the full CSM is released without any impact on the P&L and a loss of 10 CU is recognized in insurance service expenses. For the experience variance of 70 CU there is no remaining CSM, and according to 87 (c) a loss has to be

recognized in insurance service expenses. Therefore, the insurance service result is -80 CU, and no compensating insurance finance income according to B 128 (c) occurs.

- o However, if we first adjust the CSM for the experience variance (which decrease the insurance service result by 70 CU), the full **CSM release must be recognized as insurance finance income** according to B128 (c). The change in FCF for future services causes a further loss of 30 CU recognized in insurance service expenses. In this case the insurance service result is -100 CU while the compensating +20 CU are shown in insurance finance income.

This example shows that the requirement of B 128 (c) for business accounted for under the VFA may lead to different ways of P&L recognition. Therefore, we suggest harmonizing the accounting in a way to show any corresponding CSM adjustment caused by changes in the underlying item not in insurance finance result but in the insurance service result.

- d) Finally, the whole IFRS 17 standard would lead to a counterproductive peculiarity regarding the application of the OCI option (IFRS 17.89 (b)): According to B134 the P&L would contain a match with respect to the income or expenses included in profit or loss for the underlying items. In our view, such a "match" is supposed to be seen directly in the "finance" part of the P&L. However, the amendment B128 (c) would unduly influence the insurance finance income and expenses (as described above) and therefore would impede for users of financial statements to identify such a matching effect by applying B134 within the finance part of the P&L. This would make the P&L less transparent and much more incomprehensible.

Having these arguments in mind, we suggest the following:

- A) We suggest amending the current IFRS 17 standard only for the purpose describe in BC 161 of the new Exposure Draft, i.e. to avoid for insurance contracts without direct participation features that changes in underlying items could adjust the contractual service margin.
- B) This should be done without any further requirement of recognizing the impact on corresponding changes of the measurement of insurance contract in the insurance finance income and expenses.
- C) Especially for insurance contracts with direct participation features measured with the VFA, we suggest staying consistent with IFRS 17.45 and the current IFRS 17.87 (c) as well as with B 134 not to try to separate single effects causing CSM adjustments but recognize the effects of changes in the carrying amount in a consistent and harmonized way.

### ***Recognition of contracts within a group (paragraph 28 of IFRS 17, BC150)***

We support the minor amendment to paragraph 28. However, we strongly disagree with the clarification in BC150, which states that "the intention of paragraph 22 of IFRS 17 is to refer to the time at which insurance contracts are issued, rather than recognized. Therefore, the Board is not proposing to amend paragraph 22 of IFRS 17".

In our view, the objectives of the annual cohorts requirements, i.e. to appropriately depict trends in an entity's profit over time; to recognize profits of contracts over the duration of those contracts, and timely recognition of losses from onerous contracts,

are met for both concepts (i.e. issue date or recognition date). However, to build up a group of contracts and therefore track them based on the issue date would require a data base which is not available in systems so far. An implementation of the "issued" approach would require significant change to the current systems.

We had interpreted the corresponding tentative decision made by the IASB during the development of the Insurance Contracts standard differently and still strongly believe, that the requirements of the proposed standard need to be consistent between Recognition and Level of aggregation of insurance contracts.

We believe that conceptually it is more appropriate to align the date for the grouping with the recognition date than with the issue date. Grouping a contract that is not yet recognized into an established annual cohort would rather be confusing. To keep the date for the grouping consistent with the recognition date fits better to the way of how the entity manage its business.

Overall, we believe that the requirement to use the issue date for the annual cohorts requirements would require substantial additional implementation costs which outweigh significantly the additional benefits it might have.

Therefore, we propose to remove the last sentence in BC150. If a clarification were deemed necessary, in our view, using the recognition date instead of the issue date for the annual cohort would better reflect the way how the insurance companies manage their business.

### ***Comments on IFRS17.B137***

Due to the following three reasons, we recommend to remove paragraph IFRS17.B137 at least for business with direct participation features measured under the variable fee approach (VFA):

1. Contradictory to business models with annual steering (e.g. German life insurance business), as IFRS17.B137 gives rise to an economically misleading presentation of business with an underlying annual business model.
2. High risk of running into a lack of comparability between entities, especially for the CSM release is provided by IFRS 17.B137.
3. Further restrictions / disadvantages

Justification:

1. For VFA business with material options and guarantees, the interest rate dependency leads to a volatile CSM, as the entire change in the liability for remaining coverage (LRC) is adjusted against the CSM. By prohibiting a year-to-date approach, the main driver of the service recognized in the interim period – and thus also of the service recognized for the annual reporting period, determined as the sum of the services recognized for each interim period - would not be the coverage unit itself but the interest rates at each reporting date.

In addition, the derivation of the fulfillment cash flows, especially the future policyholder participation, is often based on statutory accounts with an annual steering of crediting rates and investment returns. Therefore, the figures derived at an interim reporting date are therefore often subject to rough estimation.

Determining the annual CSM release as the sum of the CSM releases derived from an isolated view on each interim period gives rise to a cumulated CSM release

that does not adequately reflect the nature of the (annual) underlying business model and relies on rough estimates rather than reliable year-end figures.

A volatile service provided in a period due to changes in interest rates, annual steering of the policyholder participation and estimation of accounting figures is not in line with the IFRS 17 principle of a stable service recognition over the lifetime of an insurance contract.

2. Although the notion of a “change in accounting estimate” is defined in IAS8.5, the notion of “treatment of accounting estimates” as referred to in IFRS17.B137 is defined neither in IFRS 17 nor in any other standard.

Our understanding of the IASBs intention of IFRS17.B137 as described in IFRS17.BC236 is to prohibit appliers of IFRS 17 from recalculating the CSM of a reporting period due to reclassifications of changes relating to future service as changes relating to current service and vice versa when applying a year-to-date approach. From our understanding, this only affects adjustments made to CSM before any CSM is recognised in profit and loss for the service provided in the period, i.e. the CSM-unlocking, but not the CSM release.

The revenue recognition itself, i.e. the CSM release, is not mentioned neither in the context of IFRS17.B137 or IFRS17.BC236 nor for the revenue recognition in IFRS15. Different adopters could apply different methodologies to determine the CSM-release at interim and annual reporting dates, giving rise to a lack of comparability and thus contradiction one of the overarching goals of IFRS17.

3. The following points should also be taken into account:
  - i. Assuming an entity reports on a quarterly basis, the annual financial statement could consist of three quarter closings based on rough estimations due to missing quarterly data and only one quarter based on a stable data base
  - ii. For entities that prepare financial statements under IFRS 17 for both their local GAAP reporting and an group reporting and for which the frequencies of the local GAAP and the group reporting differ, IFRS17.B137 will lead to significant differences in the CSM release between the two financial reports.
  - iii. Comparability of companies is not given since the amount of the CSM release depends on the number of reporting periods
  - iv. Treatment of “official” interim reporting periods will be different to voluntary periods, which will lead to different treatments in the reporting process and imply high operational burdens.