



## EXPOSURE DRAFT ED/2019/4 AMENDMENTS TO IFRS 17

Issued 25 September 2019

ICAEW welcomes the opportunity to comment on the *Exposure draft ED/2019/4 Amendments to IFRS 17* published by the International Accounting Standards Board (IASB) on 26 June 2019, a copy of which is available from this [link](#).

We commend the IASB for continuing to develop IFRS 17, including the considerable outreach activities by the Board and staff. In general, we believe the proposals improve IFRS 17.

We have noted some issues (in addition to answering the specific questions in the consultation paper) that are of specific importance to the UK insurance sector that we believe should be given further consideration by the IASB, either because they would improve the quality of financial reporting or simplify the application of the standard. We have been mindful of the IASB's criteria for considering changes to IFRS 17 in highlighting these issues:

- The proposed application date;
- Accounting for annuities that have vested from with-profits contracts;
- Aspects of accounting for reinsurance held;
- Aspects of accounting on transition to IFRS 17;
- The criteria for assessing whether contracts are eligible for the variable fee approach ('VFA').

While we have not commented specifically on the level of aggregation in our response, this is a significant issue for some UK insurers but we are aware that this topic is being considered in a number of other responses to the Exposure Draft.

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1. We commend the IASB for continuing to develop IFRS 17, including the considerable outreach activities by the Board and staff. In general, we believe the proposals improve IFRS 17.
2. We have noted some issues that are of specific importance to the UK insurance sector that we believe should be given further consideration by the IASB, either because they would improve the quality of financial reporting or simplify the application of the standard. We have also been mindful of the IASB's criteria for considering changes to IFRS 17 in highlighting these issues:

## KEY ISSUES

3. **Proposed effective date.** We welcome the deferral of the effective date of IFRS 17. However, we are concerned the proposed effective date of 1 January 2022 may not allow sufficient time for a smooth and orderly transition, given the changes that are required to finalise the standard. We also note the endorsement process creates uncertainty about whether 2022 is a realistic effective date.
4. **Accounting for annuities that have vested from with-profits contracts.** This is discussed in paragraphs 9 to 15 of our response. We are concerned that, as currently drafted, the standard could be interpreted as requiring application of the variable fee approach to annuities that have vested from with-profits contracts. This would result in accounting mismatches and significant operational complexity, both on transition and for on-going reporting. It will also impair comparability with performance reporting for these annuities compared with those issued separately that are accounted for under the general model. We suggest a clarification be made to resolve this issue.
5. **Aspects of accounting for reinsurance held.** This is discussed in paragraphs 16 to 18. We believe the IASB's proposed solution relating to the recovery of losses on onerous underlying insurance contracts is unnecessarily restrictive and should be available for a wider range of reinsurance contracts. We propose an approach that upholds the principle to measure objectively the impact of the reinsurance held for individual insurance contracts within a group. Commonly, quota share, surplus, and individual excess of loss reinsurance would meet this criterion. We also believe there are scenarios where reinsurance held should be accounted for under the variable fee approach.
6. **Aspects of accounting on transition to IFRS 17.** These are addressed in a number of areas of our response. Overall, we believe that application of a retrospective approach to transition results in more relevant and reliable information and therefore the ability to apply a retrospective approach should be made easier.
7. **The criteria for assessing whether contracts are eligible for the VFA.** We note the proposed change to the wording in B107, which we believe would be a major change requiring significant additional work to implement. We have set out our concerns in our response to question 9.
8. In addition, we have included in the section below, some other areas that have not been addressed in the Exposure Draft that we consider are important in the context of the UK insurance sector. While we have not commented specifically on the level of aggregation in our response, we recognise that this is a significant issue for some UK insurers and we are aware that this topic is being considered in a number of other responses to the Exposure Draft.

## ISSUES NOT RAISED SPECIFICALLY IN OUR RESPONSES TO QUESTIONS

### Accounting for annuities that have vested from with-profits contracts under IFRS 17

9. It has been commonplace in the UK for with-profits savings contracts to contain a guaranteed annuity option ("GAO") that gives the policyholder the option to take out an annuity at a guaranteed rate, similar to the example referenced in paragraph B24 to IFRS 17. These

contracts have participating features during the savings phase but there is no participation once the annuity vests.

10. The contract boundary requirements could be interpreted to mean that such contracts have a contract boundary that includes the participating savings phase and the annuity pay-out phase.
11. As the classification of a contract as general measurement model or variable fee approach occurs at inception and is irrevocable, this could mean certain products would be classified as in the scope of the variable fee approach, even when for a significant proportion of the product life there are no underlying items and no participation. This results in a number of significant and potentially costly operational issues, as well as the potential for significant accounting mismatches and inconsistency with the accounting for other annuities. A fuller explanation of these is provided in Appendix 1. We note the link with the issue we highlight in paragraphs 34 to 39 caused by the requirement to use a 'locked-in discount rate' when adjusting items in the contractual service margin ("CSM").
12. Further analysis of the facts and circumstances of the product features and terms of the option indicate that a contract boundary may be established when the option is exercised. A cash flow occurs between components of the entity, which settles the annuity liability arising from the GAO. The terms of this transfer are based on commercial rates that would be applicable to any new customer and represent an adjustment to the cash flows of the participating contract holders as their benefits are reduced by the cost of providing the annuity.
13. We suggest this issue can be resolved by adding the following wording to the contract boundary requirements:
14. "In circumstances where the exercise of an option results in a cash flow that settles a liability between different components of the reporting entity such as policyholder and shareholder funds, this would result in a contract boundary being established (provided the criteria in para 34 and B61- B71 are met) such that the cash flows subsequent to the settlement of the option are measured as a new contract".
15. This solution does not require any change to the contract boundary criteria in paragraph 34 of IFRS 17 and would not result in increased options in applying IFRS 17. It may help to resolve the uncertainty over interpretation and clarify that the reference to inclusion of the cash flows within the contract boundary refers only to the cash flow to settle the liability created by the exercise of the option.

### **Reinsurance contracts held: eligibility for VFA**

16. We support the proposed amendments to permit the use of reinsurance contracts held as a risk mitigation technique in paragraphs B115 to B118.
17. However, this solution does not address one scenario that we believe is important. Some reinsurance contracts transfer both non-financial and financial risk on contracts with direct participation features to the reinsurer. The prohibition to apply the VFA to the reinsurance contract will give rise to accounting mismatches, which in the UK are likely to be significant in some cases. An example of this is where large-scale transfers of with-profits and unit-linked insurance contracts are effected through reinsurance contracts that can last for several years.
18. Paragraph BC213 states that the reason for excluding reinsurance issued from the VFA approach was due to these contracts not providing investment-related services. In the UK there are a number of examples where these reinsurance contracts provide investment-related services. An example of this is where the contracts are reinsured between entities with a consolidated group. The underlying contracts (which contain an investment component) are ceded by the direct insurer to the reinsurer. The reinsurer provides investment management services, the benefit of which is provided to the direct contract holders under the reinsurance contract. Given that in these cases investment-related services are being provided, the rationale for not permitting the reinsurance contract to qualify for the VFA is not valid.

## Accounting for with-profits business

19. We identified two issues related to with-profits business that have insurance contracts as underlying items. These issues create accounting mismatches and additional operational complexity.

### The CSM on insurance contracts that are underlying items

20. It is common for UK with-profits funds to issue non-participating insurance contracts (such as annuities) that are underlying items of the participating with-profits contracts in the fund. As such, the profits of the non-participating insurance contracts are part of the return credited to the with-profits contracts.
21. As a consequence of the participation by the with-profits contracts in the non-participating contracts, the CSM on the non-participating contracts will not be recognised as profit. Instead, it will be allocated to the participating contracts and to the variable fee in accordance with the sharing mechanism of the fund. Including in the CSM amounts that will ultimately be part of the benefits paid to policyholders is potentially misleading to users of the financial statements. This is because the CSM will commingle amounts that are future profits of the entity and amounts that represent benefits to policyholders.
22. Given the primary purpose of the financial statements is to communicate the financial position and performance to shareholders, in this scenario we believe the CSM should represent the amount due to the shareholder. That is, the excess over the amounts expected to be allocated to the with-profits contracts from the non-profit contracts.

### Accounting mismatches that arise where insurance contracts are underlying items

23. There is a further issue that results in accounting mismatches where insurance contracts are underlying items. Underlying items are measured at fair value (in accordance with IFRS 13) whereas non-profit insurance contract liabilities are measured at fulfilment value (in accordance with IFRS 17).
24. There could be a number of reasons why these values differ, resulting in accounting mismatches. We are concerned that this may result in significant volatility that cannot be mitigated by existing options in IFRS 17.

## UK policyholder tax

25. UK life insurance companies are subject to a corporation tax regime that incorporates charges for tax on both the shareholders' profits and, for certain categories of business, the policyholders' shares of investment returns. These charges for tax are accounted for under IAS 12. The companies make deductions from policyholder funds (in accordance with their contractual arrangements with policyholders) in respect of the tax relating to the policyholders' share of the investment returns. Under IFRS 4, a commonly-used presentation has developed that analyses the policyholder and shareholder components of this tax.
26. Under B65(b), those expected deductions from policyholder funds in relation to future investment returns reduce the expected payments to policyholders.
27. However, there is a lack of clarity as to whether the associated tax is in scope of B65, as the tax is levied on the entity with contractual agreements to recover a portion from the policyholder. Therefore, it differs from what is normally considered to be tax paid in a fiduciary capacity.
28. If the tax that relates to the policyholders' share of the expected investment returns is not included in the fulfilment cash flows, the CSM will be proportionately larger, as it will not reflect the expected cash outflows in respect of the tax on policyholders' share of investment returns. As a consequence, the profitability of the contracts will be higher than we believe should be the case, which is important not only for revenue recognition but also for onerous contract testing (fewer contracts will be onerous if the tax cash flows are excluded).

29. Furthermore, there is a potential inconsistency between the treatment of income taxes in paragraphs B65(j) and B66(f) and the exclusion in B66(g), because, in the UK context, the cash flows may change the amount that will be paid to policyholders.
30. We suggest the IASB make clarifying amendments, the detail of which we would be happy to discuss further in the context of similar concerns which we understand are being raised elsewhere in relation to other tax jurisdictions.

### Differences in reporting frequency and levels

31. Paragraph B137 of IFRS 17 requires an entity not to change the treatment of accounting estimates made in previous interim financial reports when applying IFRS 17 in subsequent periods. This introduces additional complexity and costs in two ways:
  - a. For those entities that report interim results, due to, for example, the need to reassess coverage units, risk-adjustments and groupings of insurance contracts at each half-yearly or quarterly reporting date;
  - b. For groups that prepare both consolidated and individual financial statements under IFRS because of the need to calculate and store information on CSMs that will differ between the individual and consolidated levels.
32. These matters are compounded in the year of initial application of IFRS 17 because retrospective approaches take account of interim reporting periods prior to the date of transition in calculating the CSM on transition.
33. In our view, it would be helpful if B137 were deleted so that entities estimate insurance contract-related balances and transactions using the requirements in IAS 34. If B137 is not deleted, we encourage the IASB to consider a modification not to require considering interim periods in determining the CSM on transition.

### Locked-in rates in the general measurement model (“GMM”)

34. IFRS 17 requires that adjustments to the CSM for changes in estimates of cash flows are discounted at the rate that was applied when the CSM was originally determined (the ‘locked-in rate’). By contrast, the fulfilment cash flows (‘FCFs’) and risk adjustment are measured at the prevailing current rate.
35. We expect most UK insurers will account for their assets at fair value through profit or loss under IFRS 9 and will therefore not use the OCI option available in IFRS 17. In addition, they often hold assets whose market value is sensitive to interest rates to support the liability and capital required. This will result in an accounting mismatch for entities that recognise changes in discount rates in profit or loss due to the effects on the CSM component of the liability using the locked-in rate.
36. This issue is more significant for UK insurers than in some other countries because many of the long-duration contracts issued by UK insurers will be accounted for under the GMM. The locked-in discount rate affects a much higher proportion of a much larger share of the business in the UK than in other countries.
37. We believe that using the locked-in rate misrepresents the finance expense in the period in circumstances where there is an operating assumption change. This is because it includes an element that relates to reversing amounts recognised in profit or loss in earlier periods. Therefore, the amount reported in the performance statements as a gain or a loss depends not on whether there has been an increase or decrease in the liability, but on the differential between the historic discount rate at which the CSM is measured and the current rate at which the FCFs are measured.
38. An alternative would be to remeasure the CSM using the current rate rather than at the historic locked in-rate. This would be consistent with the approach adopted for VFA business. A fundamental aspect of insurers’ business models is the relationship between assets and



liabilities. UK insurers will typically match the duration and timing of cash flows of insurance contracts and financial instruments regardless of whether the contracts are accounted for under the GMM or the VFA, so we believe a consistent approach is necessary.

39. It is also important to note that remeasuring the CSM using the current rate compared to the locked-in rate would not change the insurance result. Remeasuring the CSM would change only the timing of the emergence of the financial result over the duration of the contract.

## ANSWERS TO SPECIFIC QUESTIONS

**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?**

40. The proposal is welcome, as it avoids an unforeseen consequence of IFRS 17 changing the accounting for these contracts from commonly accepted accounting which is understood by users of the financial statements. It should be noted, however, that this requirement will lead to additional cost and effort by issuers of such contracts to demonstrate that the conditions set out in IFRS 17 are met. It may therefore be more beneficial to consider the assessment required by IFRS 17 here as a rebuttable presumption, and issuers of credit card contracts should only consider treating them as insurance contracts where explicit evidence is available that indicates that insurance risk is reflected in pricing.
41. The definition of an insurance contract in IFRS 17 is unchanged from IFRS 4. However, IFRS 4 permits the separation of some non-insurance components from the host insurance contracts and apply other IFRS standards to them. IFRS 17 does not allow this separation and it is more prescriptive in its requirements for accounting for all aspects of insurance contracts in their entirety. In addition the definition of insurance in IFRS 17 is not limited to only contractual rights and obligations which can be established from business practice but includes rights and obligations that arise from law or regulation.
42. The amendment proposes to exclude credit cards from the scope of IFRS 17. However, “credit card” is not a defined term and there may be other types of lending arrangements which could fall within the definition of insurance as a result of consumer protection legislation or other legal and regulatory requirements (e.g. protecting customers from fraud).
43. In addition, current and deposit accounts (financial liabilities of a bank) could meet the definition of an insurance contract due to such consumer protection provisions (for example if a bank commits to a reimbursement if a customer inadvertently made a payment that turns out to be fraudulent). Since the current or deposit account is a financial liability to the bank, rather than a loan (a policyholder’s obligation) or credit card, this situation does not seem to be covered in either of the proposed amendments.
44. The need for consumer protection can make the interaction of legal and regulatory requirements with financial instruments complex. This area may require further standard-setting activity, such as widening the exemption for credit cards to cover other banking products whether they are financial assets or liabilities to the bank, or similarly widening the policy option for loans to include bank accounts. In addition, educational material in this area would help ensure consistent application.

***(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?***

45. We welcome the IASB’s proposal to allow an accounting policy choice for these types of contracts, as it will allow issuers of these contracts to continue to present the accounting outcomes in a manner that is meaningful for users of financial statements.

***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?***

46. We agree with the proposed amendments on the basis that:

- It will more faithfully present the profit or loss generated from a group of insurance contracts over the initial and expected renewal periods and therefore more closely represent the business model and customer retention assumptions used to determine the premiums charged over those periods and the basis on which such costs are expected to be recovered.
- These amendments are consistent with the treatment of contract costs under IFRS 15 Revenue from Contracts with Customers and acquired customer-related intangible assets under IAS 38 Intangible Assets which represent the capitalisation of costs incurred in respect of starting contracts with customers

***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?***



47. We agree with the proposed amendment as it reflects our view that many insurance contracts have significant elements of both insurance coverage and investment return services. Accordingly, the CSM at inception reflects the revenue expected from these services and should be recognised as the services are provided.
48. However, we have some reservations about the approach. The insurance services and investment return services may be highly inter-related and thus determining the quantity of service provided for these services separately (as seems to be required by the interaction of B119 and B119A) will be subjective and complex.
49. We believe that in some circumstances, policyholders may benefit from investment services when there is no right of the policyholder to withdraw amounts from the insurer. A consequence of this is that contracts that are economically similar, but that do not have a withdrawal option, will have different revenue recognition and different measurement of the future cash flows. Therefore, we propose that B119B(a) is removed from the definition of an investment return service.
50. We note that as a consequence of the proposed change to paragraph 44, the IASB has clarified BC63 that investment management expenses should be included in the cash flows of the liability. For some preparers, this represents a significant operational change because different proportions of the investment management expenses will be included in the cash flows at different stages in the contract depending on whether an investment return service is being provided.
51. We have reservations about the definition of investment components and whether they reflect the IASB's intention. We have commented on this further in our response to Question 9.

***(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?***

52. We agree with the proposed amendment. Investment-related services may represent a significant proportion of the total service in an insurance contract so including investment-related services better reflects the provision of service in the recognition of revenue.

***(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?***

53. We agree with the proposed disclosure requirements.
54. As there is a wide range of contracts issued by insurers within the scope of IFRS 17, we believe that it would be inappropriate to restrict the approaches that entities can take to weighting the coverage units between different services and this disclosure.

***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?***

55. We welcome the IASB's proposal to recognise income on reinsurance contracts held when a loss on initial recognition of an onerous group of underlying insurance contracts is recognised, or on addition of onerous contracts to that group.

56. We agree with the underlying principle and support the objective for reducing accounting mismatches at the inception of onerous groups of insurance contracts. However, in our view the proposed definition of a 'reinsurance contract held that provides proportionate coverage' is too restrictive to enable a meaningful practical benefit from the proposed amendment. The method for calculating the adjustment to the reinsurance CSM (and related income) should be revised to avoid an unintended outcome whereby an entity would be required to defer losses that are not recoverable under the reinsurance contract. The arguments supporting our views and our alternative proposal are outlined below. An illustrative example is provided in Appendix 2.

a) Definition of a reinsurance contract held that provides proportionate coverage

57. We note that the proposed definition of a reinsurance contract held that provides proportionate coverage is too restrictive to enable a meaningful practical benefit from the proposed amendment.

58. The proposed definition does not reflect the risk transfer practices and terms and conditions of reinsurance contracts. A recovery of a fixed percentage of all claims in a group precludes surplus lines, the existence of treaty limits or per event limits, accumulation clauses or foreign currency translation clauses (to name just a few). The latter are common features of most open market proportional reinsurance contracts, particularly in non-life reinsurance. The use of unlimited, single currency reinsurance that easily fits the definition is more prevalent in intra-group reinsurance contracts.

59. As a result, from the reinsurance agreements currently used in practice, only a very limited number will meet the proposed definition.

60. In addition, under the proposed amendments to paragraph 62, an entity will recognise proportional reinsurance contracts that do not meet the proposed definition of 'proportionate coverage' from the beginning of their coverage period, no matter that at that point, no underlying contract may have been recognised. The latter would be inconsistent with the logic outlined in the Basis of Conclusions paragraph BC305.

61. A further consequence of the definition proposed is that insurers will be required to analyse their underlying unit of account for onerous contracts in order to match the reinsurance contracts held.

b) Method of calculating the amount of the reinsurance CSM adjustment

62. We have observed that the method of calculating the amount of the reinsurance CSM adjustment and the resulting income as proposed in paragraph B119D may have unintended consequences.
63. Appendix 2 provides an illustration of how the proposed method would result in deferral of the recognition of losses on underlying onerous contracts that are not recoverable under the terms of the reinsurance contract. The latter may occur when the reasonable practical assumption made in BC79 does not hold true. For example, this may occur when expenses, not recoverable from the reinsurer, contribute to the loss of the underlying onerous contract.
64. We note that the circumstances shown in the Appendix 2 illustration are not uncommon in practice. Contracts are usually identified as onerous at inception, mostly because an entity has made a conscious commercial decision to charge a premium that is at a discount from the price it would otherwise charge under its underwriting and pricing policy.

c) Alternative proposal for limited amendments

65. In line with the above considerations, we are of the view that the principle underlying the proposed amendment to paragraphs 62, 66A–66B, B119C–B119F and BC67–BC90 will be better achieved by the following:
  - i. Remove the definition of a ‘reinsurance contract held that provides proportionate coverage’ and replace with a definition of a ‘reinsurance contract held that provides proportional coverage’. This would be defined as:

‘A reinsurance contract held that provides an entity with the right to recover from the reinsurer amounts that are specified as a proportion of amounts payable on the insurance contracts and imposes an obligation on the entity to pay reinsurance premiums that are specified by way of a proportion of the premium on the underlying groups of contracts, or as the sum at risk on the group of contracts multiplied by a factor’. The entity and the reinsurer share similar proportions of the premiums charged and the claims incurred by the entity plus associated expenses.
  - ii. Replace the use of ‘proportionate reinsurance’ by ‘proportional reinsurance’ throughout the Standard.
  - iii. Remove the phrase ‘that provides proportionate coverage’ from the proposed wording of paragraph 66A, and replace with ‘that provides proportional coverage’.
  - iv. Amend paragraph B119C to read:

“Paragraph 66A applies to reinsurance contracts that provide proportional coverage. Common forms of reinsurance that would usually meet the definition of ‘a reinsurance contract held that provides proportional coverage’ include quota share and surplus lines. For reinsurance contracts held which provide proportional coverage, the impact of the reinsurance on each individual underlying ceded group of contracts can be reliably determined in a systematic and rational manner.”
  - v. Amend what is now paragraph B119D to read:

“An entity shall determine the adjustment to the contractual service margin and the resulting income recognised applying paragraph 66A as equal to the net fulfilment cash flows of the group of reinsurance contracts that match the recognised loss on onerous groups of underlying insurance contracts at inception, or on addition of onerous contracts to the groups.
  - vi. Amend the wording of paragraph C15A to align it with the proposal under item v. above.

66. In our view, this proposal is consistent with the principles of IFRS 17, the subsequent measurement approach specified in paragraph 66 (c) (ii) and the logic reflected in BC300 and BC315, namely that:

- the cash flow used to measure the reinsurance contracts held would reflect the extent to which those cash flows depend on the cash flows of the contracts they cover, and to the extent that the fulfilment cash flows of the group of underlying contracts recognised in profit or loss, are matched with fulfilment cash flows on the group of reinsurance contract held, there is no net effect on profit or loss.

67. In addition, the above proposal is not likely to cause undue disruption in the entities' implementation effort or result in a loss of useful information. Entities would continue using already existing capabilities for cash flow projection for reinsurance contracts held. They will also apply terminology, which is well embedded and commonly understood in current reinsurance market practices.

**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?***

68. We welcome the proposed amendment of presenting the net carrying amounts of insurance contracts issued and reinsurance contracts held at a higher level of aggregation (i.e. portfolio rather than group level). This is a presentation and disclosure relief that will help reduce implementation and operational costs in relation to systems integration and upgrades that would otherwise be required in order to identify and allocate cash flow (payment) data on a timely basis at a more granular level.

**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?***

69. We welcome the extension of the risk mitigation option to circumstances where reinsurance is held to mitigate financial risk as this will help to reduce accounting mismatches. However, we believe that without a further extension to other invested assets used in risk mitigation strategies, accounting mismatches will remain.

70. There are many ways in which derivatives (put and call options, futures, forward contracts and various types of swap contracts) are routinely used to modify an investment position or to implement a market strategy. Derivative strategies as adopted by insurance entities are generally defensive, providing protection against an adverse event or removing uncertainty. For a defensive strategy, it would be counterintuitive to consider the derivative instrument without

reference to the associated liability and asset. For example, an interest rate swap is a derivative that can be used to alter the cash flow of a particular asset (fixed income asset), such that the net cash flow as received by an insurance entity may be converted from variable to fixed, or vice versa. In such instances, it is necessary to consider the derivative instrument and other invested assets together because the derivative works in partnership with fixed interest assets to provide the requisite cash flow and therefore the hedge protection against the associated liability. Further examples would include a duration hedging strategy or a portfolio level hedging strategy, as with such defensive strategies, the derivative is selected such that it acts to complement the liabilities and assets held. Hence, in such instances, they should be considered in combination.

71. Therefore, we recommend extending the risk mitigation option to include all financial instruments, rather than derivatives only, as long as they meet the criteria in B115 to B118.

**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?**

72. We welcome the deferral of the effective date of IFRS 17. However, we are concerned the proposed effective date of 1 January 2022 may not allow sufficient time for a smooth and orderly transition, given the changes that are required to finalise the standard. We also note the endorsement process creates uncertainty about whether 2022 is a realistic effective date.
73. We do not believe that transitional relief for comparatives would provide a solution sufficient to alleviate concerns.

**(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?**

74. We welcome the decision to extend the temporary exemption to applying IFRS 9 because it will align the implementation dates for both standards. It would also avoid accounting mismatches arising from inconsistent implementation of the two standards and the significant cost and effort of having to deal with two sets of major accounting changes. We recognise there is pressure for implementation of IFRS 9 but consider it essential that insurers have the ability to adopt both standards at the same time without compromising the preparation period for the insurance contracts standard. Given the fact that UK insurers make little use of amortised cost, with the majority of assets at FVTPL, we do not believe this results in the loss of much useful information in practice.

**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?***

75. We agree with the proposed amendment to require an entity on transition to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired. The amendment will address concerns raised by stakeholders and will provide a practical relief on transition.

***(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?***

76. We welcome the extension of the risk mitigation option such that it can now apply prospectively from the date of transition rather from the date of initial application. However, where a company has historically hedged financial risk in respect of business accounted for under the variable fee approach, past movements in the fair value of hedging instruments (prior to the date of transition) will have been recognised in income and equity under IFRS 9 whereas movements in the value of hedged items over that period will have been recognised in the CSM. As hedging is fundamental to how insurers manage and mitigate financial risk, this will result in a significant misstatement in shareholder equity at the date of transition and in profit emergence in future years.

***(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?***

77. The proposal to offer a fair value transition option as an alternative to retrospective application of the hedge adjustment does not resolve the issue described above. The fair value approach is a different measurement basis to either the fully retrospective or the modified retrospective approach and, as such, it is to be expected that in many circumstances it will result in a different CSM at transition. For example:

- In an environment of decreasing interest rates where the predominant risk that is hedged is interest rate risk, the CSM at transition is likely to be higher on a fair value basis than on a retrospective basis.
- In an environment of equity growth where the predominant risk that is hedged is equity risk, the CSM at transition is likely to be lower on a fair value basis than on a retrospective basis.



78. This would lead to lack of comparability between portfolios that are or are not hedged, between portfolios subject to different types of risk, between business written before and after the transition date and, consequently, between entities. A solution is required that works in these circumstances to improve consistency.
79. Retrospective application of the risk mitigation option for periods prior to the date of transition would result in a more appropriate accounting outcome reflecting the actual economic performance of historic hedging relationships. We acknowledge the IASB's concerns regarding whether such retrospective application could be achieved without the use of hindsight. However, we believe that such concerns can be addressed by restricting the risk mitigation option to circumstances where the company can demonstrate, using reasonable and supportable information, that a documented and internally approved hedging strategy was in place.

**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?***

80. We note the change of wording in B107, relating to the eligibility for the VFA. B107 b (ii) has been changed to "over the duration of the insurance contract", whereas previously it was "over the duration of the group of insurance contracts". Currently, many preparers are performing the VFA test at the level of the group based on paragraph 24 which states that recognition and measurement should be performed at the level of the group. This is consistent with the requirement to allocate the fulfilment cash flows at the level of the group (not contract). This is also consistent with paper 2C from the November 2016 IASB Board meeting that confirmed that "the scope of the variable fee approach and in particular the assessment of expected cash flows is assessed on the basis of the cash flows of the group". There is no explanation in the basis for conclusions or the other documents released explaining why this change has been made. We suggest the board confirms that this should refer to "contracts" rather than contract and that the VFA test should be performed at the level of the group as per paragraph 24. If this is not the intention, we believe this is a major change, which could seriously disrupt the implementation of preparers, lead to significant additional costs and may jeopardise the ability to implement by 2022. Such a fundamental change would not appear to be in line with the principles the board set when producing the limited review of the standard which has led to the exposure draft.
81. BC156 – Whilst the expansion in terminology is consistent with the wording in the basis of conclusions, it is unclear that the approach discussed by the TRG delivers the comparability in the income statement that the IASB were envisaging when constructing the approach. For example, an insurance contract which provides two different insurance coverages can often be interpreted as an investment component. This means that in some circumstances, contracts with identical cash flows and guarantees can be reported differently because of differences in the past. It is also the case that separating these components and selling them separately would lead to different income statement presentation and, due to the proposals of this ED, potentially different CSM measurement. The consequence is that there is often reduced comparability between insurance entities and limited comparability with banks. We note that some insurers had different interpretations of the requirements prior to the discussion at the TRG and the clarification adds significant complexity to implementation plans for these companies. We would therefore welcome the IASB reconsidering the definition of investment components by limiting its extent to contracts where there is an explicit savings objective and savings characteristics in the contract.
82. There has been a change in the exposure draft to paragraph 11(b) as follows: Paragraph 11(b) separate from a host insurance contract an investment component if, and only if, that

investment component is distinct (see paragraphs B31–B32). The entity shall apply IFRS 9 to account for the separated investment component unless it is an investment contract with discretionary participation features (see paragraph 3(c)). There is a danger that this could be interpreted that a distinct investment component without discretionary participation features cannot be separated from an investment contract with discretionary participation features. It would be helpful if the basis for conclusions could be amended to confirm that where an investment contract with discretionary participation features contains a distinct investment component without discretionary participation features then this should still be separated from the host contract and valued under IFRS 9.

83. Amendments to other IFRS Standards - IFRS 9 paragraph 2.1(e) (iii). We understand that the intention of the revision to this paragraph is to ensure that entities have a choice of applying IFRS 9 or IFRS 17 to financial guarantees they have issued. However, as currently drafted, the paragraph would appear to require that financial guarantee contracts held must be accounted for in accordance with IFRS 9, when such contracts are actually outside the scope of both IFRS 9 and IFRS 17, since 2.1(e)(iii) states that IFRS 9 applies to such contracts, whether issued or held. This would be a significant change to the accounting for financial guarantees held and would be inconsistent with other accounting by holders of insurance contracts.

### **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?***

84. We would find this new terminology helpful as it aligns more closely with the concept of investment-related service and other service provided in insurance contracts and investment contracts with direct participation features.

## APPENDICES

### Appendix 1

85. On retirement, the policyholder has the option to acquire an annuity from any provider but will have a financial incentive to stay with the existing insurer if the guaranteed rate is higher than current market rates. We understand that this optionality falls within the contract boundary of the with-profits savings contract.
86. The insurer will typically effect the option by requiring the annuity company or fund in the group to issue the annuity. The annuity company or fund will charge a market price for the annuity to the with-profits fund, which means that the remaining policyholders receive lower benefits than would otherwise be the case.
87. There is a contract boundary on the vesting date arising from the re-pricing of the annuity, the cost of which is borne by the with-profits fund (and hence current and future with-profits policyholders); however, our understanding is that this re-pricing of the annuity falls within the contract boundary given the annuity option is guaranteed by the contract's issuer.
88. Given the contract's structure, we understand that there is a with-profits phase that could be accounted for under the VFA and the annuity phase that would be accounted for under the general model. In light of this, we understand the likelihood is the VFA criteria will not be met in most instances at contract inception as IFRS 17 does not permit contracts to switch between accounting models. That is, if the contract is determined to qualify for the VFA on inception (or at transition if classification is determined at that point) then it will be accounted for under the VFA until it is derecognised. The converse also applies if the contract is determined not to qualify for the VFA on inception, with the contract being accounted for under the general model until it is derecognised.
89. As a consequence, some contracts within an annuity fund may be accounted for under the VFA, even though others (for example, immediate and deferred annuities that have not vested from with-profits contracts) will be accounted for under the general model.

### Accounting implications

90. This section describes the accounting model for an annuity that has vested from a WP contract. It assumes that the contract qualifies for the VFA for the reason above. It compares it with the accounting model for an identical annuity under the general model. It is worth noting that during the annuity phase there will be no underlying items.

	General model	VFA
Accretion of interest on the CSM	Locked-in rate	Current rate
Changes in fulfilment cash flows that do not vary based on returns on underlying items	Locked-in rate (B72(c))	Current rate (B113(a))

91. Under the VFA model, changes to discount rates are effectively adjusted against the CSM. It is common for insurers to match the exposure to discount rates with appropriate assets. In this case, assets and liability values would be well matched, but there would be a further adjustment to the CSM which would affect the profit for that year. This issue is not present where the general model is applied to regular annuity contracts, so presents issues of both accounting volatility and incomparability.
92. Also, it is relatively common for material changes to be made to longevity assumptions for annuities. For example, the FT reported that UK insurers weakened longevity assumptions by c £1.5bn in 2018. The effect on CSM of discounting the changes in assumptions at historic rates and current rates would likely be highly material for a number of insurers.

### Operational implications

93. There are a number of operational implications that arise.

*Annuities would be divided into two portfolios*

94. Separate portfolios will be required for annuities under the general model and the VFA. This increases the granularity of data required, increases the number of allocations and increases the assumptions data that must be computed and held.

*Reduces the availability of the full retrospective approach on transition*

95. A CSM on transition for annuities under the VFA will be needed. A number of insurers are concerned that their systems do not contain the source of their annuity contracts (that is, they are not able to determine whether it vested from a with-profits contract), which will mean that they cannot apply the full retrospective approach to any of their annuity business (since the inception date is unknown).

96. This may be less of a concern under the modified retrospective approach, as this permits determining whether the contract qualifies for the VFA at transition if the entity is unable to make the assessment from the inception date. However, even in this scenario, applying the modified retrospective approach ("MRA") will be challenging because information about the source of the contract is not available (that is, whether it vested from a WP contract). This means that insurers and with-profits funds would need to account for the contracts using the fair value approach at transition, which is poorer quality implementation of IFRS 17 and present a number of practical difficulties in terms of determining the CSM at such date.

*On transition, some contracts may qualify for the general model and others the VFA*

97. If a modified retrospective approach is applied and the option to make the model assessment on transition is used, some contracts may meet the VFA criteria (because they have a long period until vesting) and others will not (because they will vest sooner or have already vested). This will mean that some contracts that are currently in the with-profits savings phase will be accounted for under the general model, giving rise to adjustments to the CSM and therefore profit recognition.

*For annuities that vested from WP contracts that qualify for the GMM on inception, the GMM would need to be applied to the with-profits phase*

98. A contract may be classified under the GMM on transition under the MRA because it fails the VFA criteria at the transition date. Calculating a CSM for the contract would need to apply the general model principles to the with-profits phase of the contract.

## Appendix 2

### Illustration of unintended consequences of paragraph B119D

<b>Gross contracts at inception</b>	<b>Group 1</b>	<b>Group 2</b>	<b>Group 3</b>	<b>Total</b>
premiums	1,000	1,000	1,000	3,000
claims	1,100	1,100	1,100	3,300
expenses	160	80	50	290
<b>Gross result: (loss) / profit</b>	<b>(260)</b>	<b>(180)</b>	<b>(150)</b>	<b>(590)</b>

#### Reinsurance (RI) contract

Quota share % = 40%

Ceding commission % = 7.5%

	<b>FCF related to Group 1</b>	<b>FCF related to Group 2</b>	<b>FCF related to Group 3</b>	<b>Total RI contract FCF</b>
premiums ceded net of ceding commission	370	370	370	1,110
claims recovered	440	440	440	1,320
<b>RI (net cost) / net gain</b>	<b>70</b>	<b>70</b>	<b>70</b>	<b>210</b>

#### Income allowed to be recognised under ED B119D

	104	72	60	236
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#### Potential deferral of loss not recoverable by the reinsurer

	(34)	(2)		(36)
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#### Reinsurance CSM (asset)

26

#### Loss recovery component (asset)

236

#### Reinsurance CSM without loss recovery component (net gain)(liability)

(210)

For simplicity, in the above example risk adjustment and time value of money have been ignored.