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25 September 2019

Dear Sir

Exposure Draft ED/2019/4 Amendments to IFRS 17

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We are supportive of the amendments proposed by the IASB as they increase the usefulness of the standard. Additionally, many of the proposed amendments reduce the cost of implementation by making the standard more practical and operational in practice.

Our responses to the questions in the ED are set out in the attached Appendix A.

We have also provided comments on topics where the IASB has not proposed amendments to IFRS 17. These are included in Appendix B.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Andrew Buchanan

Global Head of IFRS

[1] Service provision within the international BDO network of independent member firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium. Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and the member firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the member firms of the BDO network.

Appendix A

Question 1

(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?

We agree with the proposed amendment, however, we have concerns related to the scoping of the proposed amendment being too narrow. This is because it may be difficult to define what a 'credit card' is in a principled way. Using the term 'credit card' also may mean that products with similar characteristics may not be captured by the proposed amendment, such as debit cards or overdraft accounts that have very similar contractual features.

We recommend that the scope exclusion be expanded to consider other, similar products. This may be achieved by expanding the definition of products that would satisfy this scope exemption. A suggested change to paragraph 7(h) as proposed would be:

'credit card, debit card, charge cards, overdraft facilities and other similar 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 (see IFRS 9 *Financial Instruments*). In such contracts, the entity typically extends short-term credit to the customer, with the insurance component being a de minimis component of the contract's value.'

(b) *If not excluded from the scope of IFRS 17 by paragraphs 7(a)–(h), paragraph 8A proposes that an entity would choose to apply IFRS 17 or IFRS 9 to contracts that meet the definition of an insurance contract but limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract (for example, loans with death waivers). The entity would be required to make that choice for each portfolio of insurance contracts, and the choice for each portfolio would be irrevocable.*

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

We agree with the proposed amendment. The proposed amendment reduces potential operational complexity for entities who, if not for the proposed amendments, would only have contracts in the scope of IFRS 17 due to specific features in lending arrangements, despite insurance not being a substantial portion of their operations. For entities whose primarily operations relate to lending (e.g. banks), the option to account for such contracts entirely within IFRS 9 is a significant operational simplification.

Question 2

Paragraphs 28A–28D and B35A–B35C propose that an entity:

(a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to any groups that include contracts that are expected to arise from renewals of the contracts in that group;
(b) recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and
(c) assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.

Paragraphs 105A–105C propose disclosures about such assets.

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

We agree with the proposed amendment as it aligns the accounting for certain acquisitions costs paid (e.g. up-front commissions) with the underlying economics (e.g. the expected renewals of underlying insurance contracts). This provides useful information about how acquisition costs incurred by entities relate to future profits, especially in situations when significant up-front costs may be incurred, such as group insurance where substantial commissions are paid to acquire the business.

Question 3

(a) Paragraphs 44, B119–B119A and the definitions in Appendix A propose that an entity identify coverage units for insurance contracts without direct participation features considering the quantity of benefits and expected period of investment-return service, if any, in addition to insurance coverage. Paragraph B119B specifies criteria for when contracts may provide an investment-return service. Do you agree with the proposed amendment? Why or why not?
(b) Paragraphs 45, B119–B119A and the definitions in Appendix A clarify that an entity is required to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service. Do you agree with the proposed amendment? Why or why not?
(c) Paragraph 109 proposes that an entity disclose quantitative information about when the entity expects to recognise in profit or loss the contractual service margin remaining at the end of a reporting period. Paragraph 117(c)(v) proposes an entity disclose the approach used to determine the relative weighting of the benefits provided by insurance coverage and investment-return service or investment-related service.

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

We agree with the proposed amendments' attempt to align profit recognition and amortisation of the contractual service margin with the services provided. It is challenging to develop guidance that encompasses the major types of services provided by insurers in insurance contracts, such that the amortisation of the contractual service margin is aligned with the receipt of these services to customers. The proposed amendments will better align the recognition of profit with the services provided by an insurer to its customers.

Question 4

Paragraph 66A proposes that an entity adjust the contractual service margin of a group of reinsurance contracts held that provides proportionate coverage, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. The amount of the adjustment and resulting income is determined by multiplying:

(a) the loss recognised on the group of underlying insurance contracts; and

(b) the fixed percentage of claims on the group of underlying contracts the entity has a right to recover from the group of reinsurance contracts held.

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

We agree with the intention of the proposed amendment, however, we believe the proposed definition of 'reinsurance contract held that provides proportionate coverage' is too restrictive, as it is too restrictive as compared to what the basis for conclusions intends to achieve.

BC86 of the proposed amendments notes that the amendment was restricted to 'proportionate' contracts. The explanation for this restriction is given in B86(a) and (b), which demonstrates that other types of reinsurance contracts would require arbitrary assumptions to link the reinsurance recoveries to the underlying contracts. For example, in a stop loss contract where the retention is based on the cumulative losses on groups of contracts for one loss event (e.g. a hurricane), it is not possible to identify which losses in which groups of contracts cause the threshold to be breached. Therefore, it would not be possible to extend this proposed amendment to such contracts, which we agree with.

In addition to this inconsistency between the Basis for Conclusions and the proposed amendment, the proposed amendment is highly inflexible in comparison to the approach taken elsewhere in IFRS 17 (e.g. the composition of groups, the determination of the risk adjustment for non-financial risk, the allocation of coverage units, etc.).

We believe the proposed amendments are too restrictive, as there are certain types of reinsurance contracts where this link between losses in the underlying contracts and the triggering of the applicable reinsurance contract can be made on a non-arbitrary basis even when the reinsurance contracts are not purely proportionate.

Consider the following example:

- Insurer has issued five insurance contracts in one group, each with a coverage period of 12 months. The contracts are accounted for under the general measurement model.
- The premiums and expected claims for each contract are noted in the below table. All amounts are denoted in currency units ('CU').

- Each insurance contract is individually reinsured by an excess of loss reinsurance contract, which cedes CU 30 in excess of CU 20 losses on individual underlying contracts. The total cost of the reinsurance is CU 27.
- Assume the cash flows are projected as follows (ignore the effect of discounting and any acquisition costs):

Contract	Premium	Expected claims	Reinsurance recovery
1	20	18	0
2	20	12	0
3	20	11	0
4	20	21	1 *
5	20	50	30 **
Total	100	112	31

* Reinsurance recovery calculated as 1 in excess of 20 (21 loss – 20 retention)
**Reinsurance recovery calculated as 30 in excess of 20 (50 loss – 20 retention)

The underlying group is onerous because expected claims of CU 112 exceed premiums of CU 100, so a CU 12 onerous contract is recognised at the initial recognition of the group of contracts, as per paragraph 47 of IFRS 17.

Based on the proposed amendments, the reinsurance recoveries on contracts #4 and #5 could not be recognised to at least partially offset the loss arising from the group being onerous at initial recognition. This is because the excess of loss reinsurance does not 'provide an entity with the right to recover from the issuer a percentage of all claims incurred on a group…', which is part of the definition of 'reinsurance contract held that provides proportionate coverage'.

This outcome does not appear logical, because the insurer can directly link the reinsurance recovery to the underlying contracts. That is to say, there is no 'arbitrary assumption (BC86 of the exposure draft) required to determine which claims cause the contract to be onerous; it is clearly contracts #4 and #5. This appears to be consistent with the basis for conclusions to the proposed amendment, which identify this ability to link the reinsurance recovery to the losses in the underlying contracts as being a key element in requiring the effect of the reinsurance recovery to be recognised up-front to 'match' the onerous underlying contracts.

This is also consistent with the fact that in many jurisdictions prior to IFRS 17, actuaries have had to estimate the effect of reinsurance contracts (i.e. the estimated reinsurance recoveries) relating to technical reserves that are not specific to individual contracts or groups of contracts.

We suggest that the proposed amendments be modified to alter the criteria for reinsurance contracts that would be required to record an offsetting gain on onerous underlying groups of contracts. The modification should more precisely link the definition of the applicable types of reinsurance contracts to the principles discussed in BC86 of the proposed amendments. This revised definition would likely no longer utilise the term 'proportionate coverage', since as was demonstrated in the example above, more than purely proportionate reinsurance contracts should be included. The definition could be revised to state that a 'defined portion of a claim incurred on an underlying insurance contract' would be the principle determining whether a reinsurance contract should be included in the scope of paragraph 66A.

Question 5

The proposed amendment to paragraph 78 would require an entity to present separately in the statement of financial position the carrying amount of portfolios of insurance contracts issued that are assets and those that are liabilities. Applying the existing requirements, an entity would present the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities. The amendment would also apply to portfolios of reinsurance contracts held that are assets and those that are liabilities.

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

We agree with the proposed amendment. This is a very significant operational simplification since virtually all portfolios of insurance contracts will be in a net liability position. With the proposed amendment, entities will not be required to demonstrate the position of individual groups of contracts, which poses significant challenges in linking cash receipt systems to actuarial systems.

Question 6

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?

We agree with the proposed amendment.

Question 7
IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. The amendments proposed in this Exposure Draft are such that they should not unduly disrupt implementation already under way or risk undue delays in the effective date.

(a) The proposed amendment to paragraph C1 would defer the effective date of IFRS 17 by one year from annual reporting periods beginning on or after 1 January 2021 to annual reporting periods beginning on or after 1 January 2022. Do you agree with the proposed amendment? Why or why not?

(b) The proposed amendment to paragraph 20A of IFRS 4 would extend the temporary exemption from IFRS 9 by one year so that an entity applying the exemption would be required to apply IFRS 9 for annual reporting periods beginning on or after 1 January 2022.

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

We agree with the proposed amendment. While the proposed amendments improve the practicality of IFRS 17 and reduce the operational complexity, the amendments will still require time for preparers to implement, which this extension accommodates.

The amendments may partially disrupt existing implementation efforts; however, weighing the cost vs. benefit, the benefit of the amendments will still likely outweigh the costs due to disruption.

Allowing an additional year of time to implement the standard is an appropriate balance between not delaying the benefits of the new standard any further and providing sufficient time for preparers to design appropriate systems and processes.

We would also emphasise the significant information system obstacles that preparers are experiencing regarding the adoption of IFRS 17, particularly, those related to small to medium-sized entities. The largest insurers in the world have sufficient resources to allocate towards IFRS 17 and are large enough to demand the appropriate resources from service organisations (e.g. IT vendors). Small to medium-sized insurers do not have similar resources, and are therefore in a position of having to wait for availability of vendors and consultants, which further delays their implementation efforts.

As such, we believe the IASB should consider other ways in which the implementation of IFRS 17 may be eased for preparers, other than further delaying the effective date. We have noted one such option in our response to question 8 below.

Question 8

- (a) *Paragraph C9A proposes an additional modification in the modified retrospective approach. The modification would require an entity, to the extent permitted by paragraph C8, to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired. Paragraph C22A proposes that an entity applying the fair value approach could choose to classify such a liability as a liability for incurred claims. Do you agree with the proposed amendments? Why or why not? (b) The proposed amendment to paragraph C3*
- (b) *would permit an entity to apply the option in paragraph B115 prospectively from the transition date, rather than the date of initial application. The amendment proposes that to apply the option in paragraph B115 prospectively on or after the transition date, an entity would be required to designate risk mitigation relationships at or before the date it applies the option. Do you agree with the proposed amendment? Why or why not?*
- (c) *Paragraph C5A proposes that an entity that can apply IFRS 17 retrospectively to a group of insurance contracts be permitted to instead apply the fair value approach to that group if it meets specified criteria relating to risk mitigation.*

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

We agree with the proposed amendment.

In addition to the proposed amendments noted above, we suggest an additional option be considered for entities that are transitioning to IFRS 17. This option would be to not restate comparative figures and instead, record the effect of the adoption of IFRS 17 in opening equity as of the effective date. This option is similar to the optionality included in the initial application requirements for IFRS 9, IFRS 15 and IFRS 16.

We acknowledge that removing comparative information in the financial statements in which an entity adopts IFRS 17 removes potentially useful information to users; however, we believe the balance of cost reduction vs. loss of information achieved by providing this option is appropriate. We note that IFRS 15 and 16 both provided this option, and in the Basis for Conclusions to those standards, the Board noted that this option responded to feedback from constituents who noted the high costs of providing comparative information (BC279 of IFRS 16).

In light of this, the IASB proposed additional disclosures when this option is utilised (BC280 of IFRS 16), which we are also suggesting. For many entities such as airlines and retailers, the effect of adopting IFRS 16 was extremely significant, which is similar to the effect of adopting IFRS 17 for many entities. We therefore feel that similar concepts should be considered in how IFRS 17 is adopted.

The introduction of this option would have several benefits:

- It would provide additional time for entities to address the significant judgments, estimates and system issues presented by IFRS 17 without deferring the date by which entities would be providing their first annual IFRS 17 compliant financial statements;
- It would align the effect of transition to IFRS 9 and 17 to the same date of initial application. As a substantial portion of the assets and liabilities for insurance companies consist of items within the scope of IFRS 9 and 17, the converging of the timing of the effect of these standards would better explain the overall impact of transition, as opposed to having one standard restate comparative figures, but not the other; and
- Providing comparative information under the entity's IFRS 4 policies and format of presentation would provide meaningful comparison of an entity's previous accounting policies compared to the new ones. For many entities, IFRS 17 is a very substantial change in the timing and recognition of insurance contracts, as well as how insurance contracts are presented in the statements of financial position and comprehensive income.

The introduction of additional disclosure requirements when this option is used, akin to IFRS 16.C12(b), would require entities to qualitatively and quantitatively explain how balances and accounting policies were adjusted upon adoption of IFRS 17.

For example, if an entity presented numerous distinct line items in the statement of financial position under IFRS 4 (e.g. claims liabilities, deferred policy acquisition expenses, premiums receivable, etc.), this disclosure could explain the 'collapsing' of these balances into a single insurance contract liability. The disclosure would also include appropriate adjustments to the carrying amount aside from the change in presentation (e.g. effect of revision in discount rate, etc.).

We feel that this option provides many of the benefits that would be provided to preparers if IFRS 17 were delayed beyond the proposed effective date of 1 January 2022 without further delaying the effective date.

Question 9

This Exposure Draft also proposes minor amendments (see paragraphs BC147–BC163 of the Basis for Conclusions).

Do you agree with the Board's proposals for each of the minor amendments described in this Exposure Draft? Why or why not?

We agree with the proposed amendment, except for two areas.

The first relates to the proposed addition of paragraph (c) to B128:

> 'Paragraph 87 requires an entity to include in insurance finance income or expenses the effect of the time value of money and financial risk and changes therein in assumptions that relate to financial risk. For the purposes of IFRS 17:
>
> (a) …
> (b) …
> (c) changes in the measurement of a group of insurance contracts caused by changes in the fair value of underlying items (excluding additions and withdrawals) are changes arising from the effect of the time value of money and financial risk and changes therein.'

This proposed amendment would result in the fair value change of any underlying items to be presented in finance income, however, not all 'underlying items' would be financial instruments. Presenting all such changes in fair value as a component of finance income might mischaracterise the nature of the change in fair value for certain underlying items. For example, a change in an underlying item such as mortality would be better presented as insurance income, as it is not related to the investment itself. For changes that are clearly financial (e.g. a change in the fair value of a financial instrument), the proposed change is an improvement.

We suggest that the IASB consider modifying B128 to require the fair value change in underlying items to be presented as either finance income or insurance income depending on whether the underlying item relates to a financial instrument.

The second item relates to the proposed amendment to paragraph (b)(i) of B107. The proposed amendment changes the level at which the assessment of variability in the amounts in paragraphs B101(b) and B101(c) occurs. Prior to the proposed amendments, B107(b)(i) stated that this assessment occurred 'over the duration of the group of insurance contracts', but the proposed amendment modifies this to be 'over the duration of the insurance contract'. This appears to have been done to align the unit of account of this assessment with B101, which discusses' insurance contracts with direct participation features', not 'groups of insurance contracts…'

For some entities, this may be a significant change in practice, as we observe that some preparers have been interpreting B107(b)(i) as currently written to mean the assessment occurs at the group level. This may disrupt some entities' implementation efforts. We suggest that this be given consideration during the redeliberation process and that the intention of the Board be clarified in this case, since the proposed amendment has not been discussed in the Basis for Conclusions to the exposure draft.

Question 10

This Exposure Draft proposes to add to Appendix A of IFRS 17 the definition 'insurance contract services' to be consistent with other proposed amendments in this Exposure Draft.

In the light of the proposed amendments in this Exposure Draft, the Board is considering whether to make a consequential change in terminology by amending the terms in IFRS 17 to replace 'coverage' with 'service' in the terms 'coverage units', 'coverage period' and 'liability for remaining coverage'. If that change is made, those terms would become 'service units', 'service period' and 'liability for remaining service', respectively, throughout IFRS 17.

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

We agree with the proposed amendments.

Appendix B

In addition to providing our comments on the questions posed by the exposure draft, we would like to provide our views on two topics where the IASB has not proposed amendments to IFRS 17.

<u>Annual Cohorts and the Level of Aggregation required by IFRS 17</u>

We understand that the requirement in IFRS 17 to aggregate insurance contracts into groups containing annual 'bundles' of insurance contracts issued no more than one year apart was done as a practical solution that balanced many considerations.

Original proposals from the IASB considered the grouping based on a principle of 'similar risk and similar profitability', however, including the annual cohort requirement made this requirement more practical in terms of implementation and comparability between insurers. Without the annual cohort requirement, different insurers may have created groups with disparate characteristics, which would reduce comparability.

There has been significant criticism of the annual cohort requirements for numerous reasons, including the fact that it is rules-based and lacks a conceptual basis, and some entities have noted that many insurance products are not managed in annual cohorts.

Despite these criticisms, we maintain that the annual cohort requirement strikes an appropriate balance between conceptual consistency and practicality, which is fundamental in issuing useful IFRSs. If groups of contracts were expanded significantly beyond one year, then it may be possible for profits from past contracts to 'subsidise' or hide unprofitable contracts issued by an entity.

The annual cohort requirement also makes it possible for users of financial statements to analyse the results of insurance operations more discretely. For example, if an insurer issues groups of insurance contracts in one period that are onerous due to poor underwriting processes, the annual cohort requirement will demonstrate this by the contracts being onerous either at inception or subsequent to initial recognition.

For these reasons, we support the IASB's decision to not propose amendments to IFRS 17 relating to the level of aggregation that is fundamental for the remaining aspects of IFRS 17's application.

<u>Interim Financial Reporting</u>

We note the Board's reasoning for not proposing amendments to IFRS 17 relating to its interaction with IAS 34 in BC214 – BC216 of the exposure draft. BC215 acknowledges that some stakeholders have expressed concern about the application of B137 of IFRS 17 and its interaction with IAS 34. Primarily, the concern relates to whether 'year-to-date' accounting or 'date-to-date' accounting is appropriate in situations where an entity prepares IAS 34 compliant financial statements.

Given the continued lack of certainty that exists, along with the practical implications of year-to-date versus date-to-date accounting on systems and processes necessary to comply with IFRS 17, we suggest that the IASB consider whether the Basis for Conclusions may be clarified to remove any ambiguity.