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Date
02.09.2019

EFRAG draft comment letter on the IASB's proposed amendments to IFRS 17 (IASB's Exposure Draft ED/2019/4)

Dear Madam or Sir

On behalf of the German Insurance Association (GDV) we welcome the opportunity to provide our comments to the EFRAG's draft comment letter on the IASB's Exposure Draft "Amendments to IFRS 17", issued for public consultation on 15 July 2019.

The German insurance industry continues to be committed to support IFRS 17 *Insurance Contracts* as a necessary global financial reporting standard. Therefore, we closely follow the substantial efforts undertaken by the IASB/TRG to adequately respond to the concerns identified by insurance undertakings when implementing the challenging requirements of the new standard. And we greatly appreciate the EFRAG's high level of proactive engagement in IFRS 17-related discussions; we specifically welcomed the letter of 3rd September 2018 in which key issues of concern has been brought to the IASB-Chairman's attention. Concurrently, considering at the EU level also the endorsement context of the current discussions we like to underline the utmost importance of finalising the process of amending IFRS 17 at the IASB level in due time.

Therefore, we are fully supportive of the targeted and disciplined proceeding of the IASB when working on issues identified in October 2018 and later on in the process. We **welcome** the proposal to defer the effective date of IFRS 17 by **one-year only** and share the Board's rationale for it. The **parallel deferral of IFRS 9** for eligible insurers is a consequently right step. But we also believe that, after the public consultation phase, a further targeted and disciplined proceeding at the IASB level is essential to **avoid any additional delay** of the effective date of IFRS 17. Any further

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uncertainty in this regard would be very disruptive and costly for all ongoing implementation projects and hence should be avoided.

In general, we agree with the **targeted amendments** to IFRS 17 proposed in the IASB's ED and support their implementation in due course. However, specifically on the **reinsurance contracts accounting issue** (**Question 4**) there is still some **further fine-tuning** of the proposed amendment **necessary** to fully meet its intended objectives which we strongly support. Otherwise important forms of proportional reinsurance would not be covered by the new definition of 'proportionate reinsurance' as for example quota shares with a limit or cap and surplus contracts.

Furthermore, we believe that the remaining significant concerns with regard to **annual cohorts** requirements for VFA contracts and for in-force business at transition date, and finally the concerns related to the mandatory **restatement of comparative information at transition** to IFRS 17 could and therefore should be addressed within the timeframe given. We have the view that approaching und solving these remaining issues would be conceptually appropriate and at the same time a pragmatic measure to provide a significant timing-/ and cost-relief for all insurance undertakings challenged currently with the implementation of systems for going live with IFRS 17's requirements in due time.

Our detailed comments to the specific questions in the IASB's ED are provided in annex 1 of this letter. In annex 2 we provide our views which further limited amendments to IFRS 17 would still be helpful and feasible in the timeframe given as mentioned above. Our comments also refer to EFRAG's tentative views expressed in EFRAG's draft comment letter.

If you would like to discuss our comments further, please do not hesitate to contacts us.

Yours sincerely,

German Insurance Association (GDV)

Annex 1: GDV's comments on specific questions raised in the IASB's Exposure Draft ED/2019/4 "Amendments to IFRS 17" (June 2019)

Question 1 – Scope exclusions – credit card contracts and loan contracts that meet the definition of an insurance contract (paragraphs 7(h), 8A, Appendix D and BC9–BC30)

(a) Paragraph 7(h) proposes that an entity would be required to exclude from the scope of IFRS 17 credit card contracts that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

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

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

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

(a)

Like EFRAG we are supportive of the proposed scope exclusion.

In addition, we support the Board's decision not to make a difference depending on whether an entity is obliged (by law or regulation), or chooses, to provide insurance coverage when issuing credit card contracts (BC17).

(b)

Like EFRAG we agree with the proposed amendment.

In addition, we are also supportive of the suggested accounting policy choice to be irrevocably exercised for each portfolio of insurance contracts at the portfolio level. In particular, we agree with the IASB's rationale provided in the paragraph BC19 (b) that more useful information for users of financial statements will be provided if an entity applies the same Standard (i.e. either IFRS 17 *Insurance Contracts* or IFRS 9 *Financial Instruments*) to those contracts as it applies to other similar contracts it issues.

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?

Like EFRAG we appreciate the proposed changes.

The amendments will help to properly reflect the matter of fact that commissions are often paid by insurance undertakings in expectation that policyholders will renew their contracts in the future. And it used to be an evidenced practice that renewals take place. The proposed change will hence avoid that some insurance contracts are misleadingly presented as onerous at initial recognition, though economically there is overall no loss situation occurring for the insurer. Furthermore, the intended change will increase the conceptual consistency between IFRS 17 and IFRS 15 *Revenue from Contracts with Customers* with regard to the treatment of acquisition cash flows.

In addition, we fully support the proposal that the recoverability of an asset for insurance acquisition cash flows is assessed <u>if</u> (and only if) facts and circumstances indicate the asset may be impaired. We believe that it strikes the right balance in the principle-based standard.

We also agree with the proposed disclosures to accompany the recognition of insurance acquisition cash flows as an asset if the cash flows are paid before the group of insurance contracts to which they are allocated is recognised.

Finally, we don't see a need to define the term 'insurance contracts renewals' in the principle-based IFRS 17.

Question 3 – Contractual service margin attributable to investment-return service and investment-related service (paragraphs 44–45, 109 and 117(c)(v), Appendix A, paragraphs B119–B119B and BC50–BC66)
(a) Paragraphs 44, B119–B119A and the definitions in Appendix A propose that an entity identify coverage units for insurance contracts without direct participation features considering the quantity of benefits and expected period of investment-return service, if any, in addition to insurance coverage. Paragraph B119B specifies criteria for when contracts may provide an investment-return service. Do you agree with the proposed amendment? Why or why not?
(b) Paragraphs 45, B119–B119A and the definitions in Appendix A clarify that an entity is required to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service. Do you agree with the proposed amendment? Why or why not?
(c) Paragraph 109 proposes that an entity disclose quantitative information about when the entity expects to recognise in profit or loss the contractual service margin remaining at the end of a reporting period. Paragraph 117(c)(v) proposes an entity disclose the approach used to determine the relative weighting of the benefits provided by insurance coverage and investment-return service or investment-related service. Do you agree with the proposed disclosure requirements? Why or why not?

(a)

Like EFRAG we support the proposed amendment because it reflects the matter of fact that some of the insurance contracts in the general model also provide investment-return services in addition to the provision of the insurance coverage. The proposal would indeed allow considering this when determining coverage units for insurance contracts without direct participation features but providing an investment-return service.

(b)

Like EFRAG we support the proposed amendment because it is indeed an immanent nature of insurance contracts with direct participation features, i.e. in the scope of the variable fee approach (VFA), that investment-related services are provided. Consequently, it is essential that both insurance coverage and investment-related services are considered when the coverage units are determined for this type of contracts.

(c)

Like EFRAG we acknowledge the rationale for the proposed disclosure requirements and are not in disagreement with the proposed amendments in paragraph 117 (c) (v). However, we like to observe that the additionally suggested change in the existing IFRS 17.109 does not seem necessary to us. There might be cases in which quantitative disclosures might be too sensitive for the business of a particular entity to be disclosed. Hence, we would encourage EFRAG to support keeping IFRS 17.109 unchanged which considered as an equivalent alternative an explanation with qualitative information only.

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?

Like EFRAG we greatly appreciate the intention of the IASB to address the currently existing **mismatch in cedants' accounts** between the group of onerous underlying insurance contracts and the corresponding reinsurance contracts, with the objective to avoid the recognition of **economically not existing losses at initial recognition**, i.e. to avoid **distortions in performance reporting**. Hence, we fully agree with the objective of the ED to properly **align the initial and subsequent accounting** for reinsurance contracts held when onerous underlying contracts are covered by reinsurance contracts and see the proper fix to the standard as an indispensable step which has to be taken in due course when finalising the amendments to the standard.

To achieve this objective, the ED proposes that income/gain on proportionate reinsurance should be recognised in profit or loss to the extent that it (partially) offsets a loss on an onerous group of underlying insurance contracts. We believe that the suggested mechanics of the proposed approach are suitable to ensure that the statement of profit or loss better reflects the economic effects achieved by the reinsurance contracts held and the related risk transfer without changing the accounting for the underlying contracts by the respective primary insurer. And we are generally supportive of the intended scope of the amendment being reduced to address the proportional reinsurance arrangements only.

However, the ED surprisingly suggests providing a specific **definition of proportionate coverage** in Appendix A “reinsurance contract held that provides proportionate coverage”. And this new definition (as explained in BC80 of the ED) would be **too limiting**. Specifically, with this narrow new definition different forms of proportional reinsurance would be not eligible to the solution in paragraph 66A as in many cases, proportional reinsurance contracts cannot be aligned to a fixed percentage basis to underlying

insurance contracts. For example, proportional reinsurance contracts might set a minimum and/or maximum limit on the reinsurance cover (e.g. contracts that provide proportionate reinsurance above and below a fixed level) to pre-determine the maximum exposure for the reinsurer. The definition proposed in the ED would not capture such regularly occurring arrangements. In a very strict interpretation one would have to assume that only pure and unlimited quota share contracts would pass the definition in BC80 of the ED. They are however even in the markets with predominantly proportional reinsurance contracts not very common in practice.

As a matter of principle, we do not see a need for IFRS 17 to be amended to include a new definition of a proportionate reinsurance. The existing definition in BC304, which is a part of IFRS 17 materials, was precise enough, and it has been the robust basis for the ongoing and well-advanced implementation projects. The significant **change in definition** at this stage would be indeed **very disruptive** in this regard while not contributing positively to the intended objectives.

If a new definition of the term “reinsurance contract held that provides proportionate coverage” should be nevertheless included into the standard itself, the definition should not require that reinsurance covers all contracts in a single underlying unit of account in the same proportion. It would be more appropriate to refer to a specified, proportional share of individual underlying insurance contracts. This difference and the necessary change of the proposed definition is essential to ensure that **risk mitigation** efforts of primary insurers using reinsurance can be **properly reflected** in the cedants’ financial statements as intended by the Board. Otherwise IFRS 17 might drive the design of established products and hence influence the reinsurance business model significantly.

Furthermore, impacting the existing demand for reinsurance coverage might have also **financial stability implications** when the risk sharing would be negatively affected by the adoption of IFRS 17. At the same time, in general, regulatory regimes accept reinsurance as a fully effective risk mitigating instrument. For example, Solvency II recognises the risk mitigation effect of reinsurance arrangements whenever risk transfer can be shown. Therefore, there is an urgent need for the IASB to fine-tune the proposed amendment to achieve its objectives within financial reporting more fully and to avoid inconsistency between IFRS and Solvency II.

Finally, as mentioned above, we don’t argue for a similar treatment between proportionate and non-proportionate reinsurance contracts because non-proportionate reinsurance operates on a cumulative basis without a direct linkage to individual underlying insurance contracts. Hence, we generally agree with the IASB when focusing on the proportionate reinsurance only.

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?

Like EFRAG we appreciate and fully agree with the proposed amendment to IFRS 17 so that the **presentation of insurance contracts** assets and liabilities in the statement of financial position is **determined using portfolios of insurance contracts** rather than groups of insurance contracts. We also support the related changes to the reconciliations requirements in paragraph 99 and with regard to liquidity risk disclosures in paragraph 132 (BC93). These amendments will provide a **significant operational relief** for insurance undertakings adopting and applying IFRS 17 while not reducing the benefits for users of financial statements. Specifically, insurance contracts are managed by insurers at the portfolio level; hence the presentation at such level is also conceptually providing **more relevant information** to users.

However, and unlike EFRAG, we continue to argue that premiums receivable and claims payable should be included in the insurance contracts measurement on an accrual basis, i.e. in line with the current accounting and reserving practice. Payments and receipts are usually managed and administered in systems separate from actuarial systems which are more stable this way. Our concern is that IFRS 17 leads to significant investments in IT systems to formally comply with its requirements. Indeed, significant investments will be required in actuarial and finance systems to ensure that financial information is prepared on the theoretical cash basis.

Therefore, we would greatly appreciate further IASB consideration whether the standard could be amended to include premiums and claims on an **accrual basis** in the measurement of insurance liabilities, with separate presentation of premiums receivable and claims payable on the balance sheet. This would reduce implementation efforts and additionally increase the quality of financial information presented. Such an approach could be provided as **an alternative option** as it can be demonstrated that it provides a similar outcomes with regards to the equity and performance reporting presentation. For further details please consider our rationale provided in annex 2, paragraph c).

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?

Like EFRAG, we fully support the proposed amendment to extend the applicability of the risk mitigation option under the variable fee approach (VFA) to circumstances when entity uses **reinsurance contracts held** to mitigate financial risk arising from insurance contracts with direct participation features ('VFA contracts').

We also back the Board's rationale for the suggested amendment and agree specifically with the assessment that this amendment is conceptually consistent with the option introduced previously to address a similar concern regarding the occurrence of accounting mismatches when using **derivatives** to mitigate financial risk under the variable fee approach (BC106).

Finally, the proposed **amendment rightly removes the potential accounting disadvantage** for economic hedging arrangements that include reinsurance contracts held which would arise when the scope of risk mitigation option would remain limited to derivative instruments only.

Question 7 – Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs C1, [Draft] Amendments to IFRS 4 and BC110–BC118)

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

(a) The proposed amendment to paragraph C1 would defer the effective date of IFRS 17 by one year from annual reporting periods beginning on or after 1 January 2021 to annual reporting periods beginning on or after 1 January 2022.

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

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

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

(a)

We respectfully recommend to EFRAG to support the proposed **one-year deferral only**. From the perspective of the German insurers it would sufficiently address the **uncertainty** which indeed arose with regard to (potential changes of) the effective date of IFRS 17 in October 2018 when the IASB decided to re-evaluate all the 25 issues of concern as identified by various stakeholders. Hence, we agree with the IASB's rationale provided in BC114 of the ED. Indeed, **any additional delay** of the effective date would be **rather disruptive and costly** than helpful. Hence, it should not be subject to further Board's consideration.

Instead, we firmly encourage the IASB to continue to **proceed in a disciplined and focused way** while finalising the work on the proposed targeted amendments and addressing some of the additional main issues not addressed so far by the IASB/ED and as laid out in detail in annex 2 of this letter.

In any case, and like EFRAG, we also believe that it is of utmost importance that the IASB's work will be finalised within the expected timeframe, i.e. in the first half of 2020. And we believe that this **timeframe is feasible** and can be met by the IASB not only with regard to the suggested and key amendment to IFRS 4 *Insurance Contracts* but also with regard to the whole comprehensive package of necessary fixes to the standard IFRS 17.

We fully agree with EFRAG's underlying assessment that **timely finalisation of the work at the IASB level is indispensable** to enable a timely endorsement of final amendments at the EU level.

However, referring to this (i.e. paragraph 75 (c) in the EFRAG's draft comment letter) we would like to observe that also the usage of the **early application option** in IFRS 17 is a realisable option for European insurers only if the standard is formally endorsed in the EU in due time anyway. In this regard we like to highlight that one of the main objectives should be to ensure that specifically insurers operating globally are in a position to implement IFRS 17 at a common effective date on a global basis. Hence, we believe that EFRAG should undertake any efforts to contribute to **timely finalisation of the EU endorsement process** being achieved within the IASB's revised timeline for IFRS 17.

(b)

Like EFRAG we continue to share the view that **IFRS 17** and **IFRS 9 *Financial Instruments*** should be **adopted at the same effective date** because of the inherent interlinkage of both standards. Hence, we fully support the proposed parallel extension of the temporary exemption from IFRS 9 by one year, and in line with the revised effective date of IFRS 17.

Our remaining concern refers to the **requirement to provide fully restated** (and audited) **comparative information at transition to IFRS 17** while IFRS 9 did/does not require it. For our rationale in more detail please refer to <u>annex 2, paragraph b)</u>.

Question 8 – Transition modifications and reliefs (paragraphs C3(b), C5A, C9A, C22A and BC119–BC146)	
(a)	Paragraph C9A proposes an additional modification in the modified retrospective approach. The modification would require an entity, to the extent permitted by paragraph C8, to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired. Paragraph C22A proposes that an entity applying the fair value approach could choose to classify such a liability as a liability for incurred claims. Do you agree with the proposed amendments? Why or why not?
(b)	The proposed amendment to paragraph C3(b) would permit an entity to apply the option in paragraph B115 prospectively from the transition date, rather than the date of initial application. The amendment proposes that to apply the option in paragraph B115 prospectively on or after the transition date, an entity would be required to designate risk mitigation relationships at or before the date it applies the option. Do you agree with the proposed amendment? Why or why not?
(c)	Paragraph C5A proposes that an entity that can apply IFRS 17 retrospectively to a group of insurance contracts be permitted to instead apply the fair value approach to that group if it meets specified criteria relating to risk mitigation. Do you agree with the proposed amendment? Why or why not?

a)

Like EFRAG we are supportive of the amendments proposed in the ED for the reasons provided in the EFRAG's draft comment letter. We also agree with IASB's assessment that no additional disclosures are necessary (BC122 of the ED).

b), c)

While we generally agree with the proposed amendments and also share their respective objectives and rationale provided in the ED, we still believe that further consideration should be given to the design of the **modified retrospective approach**. The objective should be to further contribute to a proper transition to the significantly new requirements of IFRS 17 with the fair value approach being really a default one. In particular, we believe that further modifications could provide a greater level of flexibility and specifically allow reasonable approximations to be made where necessary while still ensuring and contributing to an increased level of comparability and reducing the operational efforts. In this regard, we indeed appreciate the intended efforts of the IASB to better **clarify** that the **inclu-**

sion of specified modifications in IFRS 17 does not imply that an entity cannot **make its own estimates** in applying IFRS 17 retrospectively (BC143). We think that explicitly addressing and overcoming this potential confusion with regard to the specific modifications provided in IFRS 17 in co-existence with the 'regular' rules of IAS 8 might help to avoid creating unnecessary interpretation challenges for preparers and potential tensions with auditors.

With regard to the question in paragraph 94 of the EFRAG's draft comment letter we like to express the view that we would indeed **prefer the retrospective application** of the risk mitigation option for VFA contracts being allowed instead of the two consequential amendments in b) and c). However, we have being informed by our members that the amendments as proposed in the ED are addressing the related concerns to a significant extent and hence we do support them as a second-best solution.

Finally, to ensure the cost-effectiveness of any transition approach we reiterate our recommendation to **reconsider the need for annual cohorts** being created at transition **for in-force business**, irrespective of the transition approach followed. And finally, we reinforce our firm view that **comparative information** for IFRS 17 should be provided on an **optional** basis only. For our respective rationale in more detail please consider our comments presented in annex 2, paragraph a) and paragraph b).

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?

Like EFRAG we generally agree with the IASB's objective to address cases in which the current wording of the standard does not fully achieve the Board's intended objectives. However, we believe that only absolutely necessary changes in wording of the standard should be approached at this stage of the process to avoid any disruptive impact on the ongoing and well-advanced implementation projects.

We have identified the following amendments in the ED which we prefer would not be made:

- Change suggested for paragraph B107 (b) (i)

  Based on the **explicit requirement** in IFRS 17.24 we have assumed that the eligibility test for the variable fee approach (VFA) has to be performed at the **group level** of insurance contracts. Therefore the **proposed amendment** in paragraph B107 would mean a critical change in this current working assumption of our members as the proposed switch in wording would imply that it would be read as requiring the **VFA eligibility test** to be carried out **at the individual contract level** rather than at the group level.

  In particular, we disagree with the IASB's assessment that it would be a 'minor' wording change only. We assess that the intended change would require a revised set up of systems, being disruptive at this stage of the implementation projects. The new wording would require the allocation of all cash flows to individual insurance contracts before the test can be performed. Any mutualisation effects would also need to be allocated to contract level in all scenarios to consider. Such a change would cause significant additional efforts and unnecessary incremental cost for entities. Finally, it would be inconsistent with the main principle of IFRS 17 that rightly assumes that group of contracts is the proper unit of account.

  For conceptual reasons and specifically because of the very disruptive nature of the suggested amendment we don't agree with the proposed change in wording in B107.

- <u>'Clarification' included in paragraph BC150</u>

  IFRS 17.22 determines that portfolios of insurance contracts have to be subdivided into annual cohorts. We believe that following the rationale provided in BC150 for the proposed change to paragraph 28 also paragraph 22 should be consistently amended to refer to "*contracts <u>initially recognised</u> more than one year apart*". The suggested 'clarification' in the ED that it should be the time of issuance is causing significant disruption for ongoing implementation processes.

  Should the annual cohort requirement remain in IFRS 17 as a rule to be followed for the new business (please see our recommendations in <u>annex 2, paragraph a)</u>), **paragraph 22 should then rather refer to the time of initial recognition** as it used to be the natural point of reference in financial accounting.

- <u>Change proposed for paragraph B128: treatment of changes in underlying items</u>

  We believe that the amendment proposed to IFRS 17.B128 should be further fine-tuned to avoid unintended consequences when requiring that measurement changes caused by changes in fair value of underlying items to be included solely in insurance finance income or expenses. In this regard we believe that a **more nuanced approach might be more appropriate** because it does not seem to be fully correct to assume that all underlying items are financial assets. Underlying items might indeed include a mixture of assets and other items. In such circumstances the proposed amendment might be leading to distorted presentation in the statement of profit or loss (i.e. commingling between insurance service result and finance result) when the nature of the underlying item (financial/non-financial) and/or the nature of the fair value change (e.g. mortality) are not taken into account.

We reserve the right to provide further comments to the organization, once further issues caused by wording or clarifying amendments have been identified as problematic.

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?

Unlike EFRAG we don't support terminology changes at this stage of the process. It would not be helpful but annoying for the implementation work. Hence, from our perspective the proposed change would be rather disruptive, time-consuming and costly for the advanced implementation projects. We recommend giving up this idea and respectfully ask EFRAG to reconsider its tentative view in this regard.

Annex 2: GDV remaining main concerns with IFRS 17's requirements not addressed by the IASB's Exposure Draft ED/2019/4 "Amendments to IFRS 17" (June 2019)

The IASB proposes in the ED to address many significant issues of concern which have been identified by the insurance industry or other stakeholders (e.g. TRG/Transition Resource Group, EFRAG/European Financial Reporting Advisory Group) with regard to the requirements of IFRS 17 *Insurance Contracts*. Nevertheless, there are still some additional essential topics on which further IASB's work would be helpful to further fine-tune the balance between the implementation costs and the benefits of the standard. We believe that this valuable additional work can be completed within the **timeframe given** and which we fully support. To achieve this objective a **targeted approach** is necessary. That's why we decided to focus on the **limited number of issues** which had been identified by the German insurance industry. In addition, we have developed constructive suggestions on how to approach and solve them in a pragmatic manner.

Furthermore, we are fully aware that changes/improvements to the standard at this stage of the process might be considered as somehow disruptive for the current implementation projects. However, German insurers believe that in cases in which a particular targeted relief might be provided and in which cost-benefit consideration is a positive one, it is appropriate to approach such a change to the standard instead of being forced to adopt and apply for many (decades of) years requirements/rules which are not aligned with the economics of the insurance business model and/or which require significant investments and essential ongoing implementation costs while providing effectively no significant or only a limited added value for users of financial statements. Hence, such amendments/improvements to the standard shouldn't be qualified as disruptive.

a) Annual cohorts' issue: two targeted modifications recommended

The German insurance industry continues to argue that IFRS 17.22 introduces a rule into the principle-based standard which is not compatible with the nature of the insurance business. And we continue to have the view that it would be a significant improvement to the standard if the requirement for annual cohorts would be removed.

Nevertheless, we fully acknowledge that the IASB from its perspective is facing a **trade-off between the need to allow an appropriate level of aggregation** (as rightly recognized in BC164[1]) **and** the objective to ensure

[1] In the BC164 the IASB explains its rationale as follows: "However, as an exception to the general approach in IFRS Standards, IFRS 17 does not require measurement of individual contracts. This reflects the Board's view

specifically a **timely recognition of group of onerous contracts when occurring** at initial recognition or subsequently. In this regard we have evaluated consequently in which cases the requirement for annual cohorts provides the highest distortion in implementation and ongoing application of the new standard and therefore in which cases it should be revisited.

On the bases of our analysis and our conclusions we recommend removing the rule-based requirement for annual cohorts at a minimum in the following two situations:

- Creation of annual cohorts should not be required **for in-force business at transition for all insurance contracts**, irrespective of the transition approach applied.

  It would provide a significant one-off cost relief for insurance undertakings at the most time-critical stage of the implementation process. Annual cohorts would remain in place for new business written after the transition to IFRS 17.

- No annual cohorts should be required for insurance contracts within the scope of the variable fee approach ('**VFA contracts**').

  Apportionment of the VFA contracts to annual cohorts is inconsistent with the way such business is run. In particular, returns on underlying items are shared between different generations of policyholders, i.e. also between insurance contracts written more than one year apart. And one of the main characteristics of VFA contracts is the enforceable linkage between the policyholder participation and the return on the underlying items (IFRS 17.B101). The intergenerational mutualisation of cash flows has also implications on the CSM calculation causing significant costs and efforts being required if it would have to be done on an annual cohort's basis. Furthermore, in practice profitability of insurance business will be assessed and steered anyway only at the level of mutualized portfolios and then allocated to annual cohorts so that no real loss of useful information will occur if no annual cohorts will be created in such circumstances.

  We believe that specifically **in case of VFA contracts the requirement for annual cohorts is an artificial one** where the costs for preparers clearly exceed the benefits for potential users.

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that **measuring individual contracts would not provide useful information about insurance activities**, which often rely on an entity issuing many similar contracts to reduce risk." (accentuation included only here)

Specifically, with regard to the need for **transparency about trends in profitability** we like to note that such information is **already available** when applying the existing disclosure requirements of the standard. IFRS 17 already requires entities to disclose the amount of the **CSM generated by new business** (IFRS 17.107 (d)) and to disclose **movements in the CSM balances for in-force business** (IFRS 17.101 (c)). In our view this is the key focus of users' analyses anyway. In addition, amendments proposed by the ED will strengthen the existing disclosure requirements even further via obliging entities to provide **quantitative forecasts** on when the entities expect to recognize in profit or loss the CSM remaining at the end of the period (IFRS 17.109 as proposed to be amended by the ED).

In this regard we appreciate and strongly support EFRAG's respective recommendations in paragraph 138 and paragraph 139 of the EFRAG's draft comment letter to the IASB to reconsider the scope of the rule-based requirement for annual cohorts in IFRS 17.

Nevertheless, with regard to paragraph 130 of the EFRAG's draft comment letter we like to observe however that the annual cohort requirement is from our perspective not an outcome of the IASB's **trade-off** "*between tracking of individual contracts whilst ensuring the recognition of onerous contracts even where there are contracts with similar risks but different levels of profitability.*" In our view, the IASB is indeed facing, as mentioned above, a trade-off but *between the need to allow an appropriate level of aggregation* (as highlighted in BC164) *and the objective to ensure specifically a timely recognition of losses for groups with onerous contracts when occurring at initial recognition or subsequently.* This trade-off is an outcome of the **top-down approach** the IASB decided in general to follow for the standard in line with the business model of insurers. Hence, we strongly believe that the individual contracts perspective as a starting point is neither the proper basing point from conceptual perspective nor the one established by IASB for IFRS 17 *Insurance Contracts* when evaluating the annual cohort issue.

Irrespective of this observation, we support the EFRAG's assessment expressed in paragraphs 131-137 of the draft comment letter and fully share the underlying assumption that there is generally an urgent need to reconsider the IASB's perceived conceptual rationale for the annual cohorts' requirement in IFRS 17 on a general basis and the cost-benefit balance of this **particularly burdensome requirement** on both the ongoing and one-off basis. Addressing this issue would provide a significant operational relief for insurers while effectively not significantly reduce the value of the information provided to users of financial statements as outlined above.

b) Comparatives at transition to IFRS 17: restatement should be optional

We agree with the view expressed in the EFRAG's draft comment letter with regard to the need "*to address the implementation challenges and prevent that a strict interpretation approach unduly restrict the use of retrospective and modified retrospective approach*" (paragraph 153) and generally support the related recommendations.

Furthermore, we like to highlight an additional transitional issue of concern which is **not covered by the EFRAG's draft comment letter so far**. While we fully support the IASB's proposal with regard to the one-year deferral only (Question 7), we continue to strongly believe that the **requirement to provide fully restated** (and audited) **comparative information at transition to IFRS 17** should be reconsidered.

- Firstly, it creates a conceptual misalignment between IFRS 17's and IFRS 9's requirements for the transition period in this regard.

- Secondly, it reduces the implementation period effectively by one year and hence undermines the deferral decision with regard to adoption of IFRS 9 by insurers because of the understood and accepted need to apply both standards at the same effective date.

  To achieve a meaningful performance reporting for the preceding period insurers would be effectively forced to provide restated comparatives for both insurance contracts (IFRS 17) and financial instruments (IFRS 9); and to run in parallel two systems for this purpose would be extremely costly and complex.

Finally, and not to forget that IFRS 9 comparatives are not really meaningful as they result from a mixture of old IAS 39's and new IFRS 9's rules. Hence, we respectfully disagree with the IASB's conclusions in paragraphs BC117 and BC118 of the ED.

Consequently, German insurers continue to urge the IASB to **make the presentation of comparative information under IFRS 17** in the first published financial statement **optional** the same way IFRS 9 does in this regard. Only this way a level playing field with banking industry can be ensured and the conceptual misalignment in the preceding period solved in a pragmatic manner.

We would appreciate if our position could be included in the final comment letter of EFRAG on the IASB's ED.

c) Balance sheet presentation: keep premiums receivable/claims payable

The IASB proposes in the ED to revise the level of aggregation for requirements regarding the **balance sheet presentation and the related disclosures** (Question 5). **Like EFRAG** we appreciate and **fully support these proposals** as they **address an essential concern** to a significant extent and will achieve a **substantial operational relief** for insurance undertakings when adopting and applying IFRS 17.

However, and **unlike EFRAG** (paragraph 157 of the draft comment letter), we continue to argue that IFRS 17 should be amended so that premiums receivable and claims payable are included in the insurance contracts' measurement on an accrual basis. Otherwise and irrespective of the amendment proposed in the ED fundamental change in the set-up of the current IT systems would be still necessary only because of the adoption of IFRS 17's requirements. The reason is that w**hile the existing actuarial systems are set up on an accrual basis, IFRS 17 is based on a pure cash basis**. Consequently, IFRS 17 does not require any separate presentation of premiums receivable or claims payable and all changes in expected cash flow (including forecasts with regard to policyholders' payments behavior) have to be fully reflected when measuring insurance contracts in accordance with IFRS 17. In other words, IFRS 17 requires premiums and claims to be included in the insurance contracts' measurement on a cash paid/received basis. The current practice is to recognise them on a due (accrual) basis and payments/receipts are managed and administered efficiently in systems separate from (stable) actuarial systems.

Consequently, to fully comply with IFRS 17's requirements will cause significant investments to the established and well-functioning IT systems while decreasing the value of balance sheet content. Indeed, significant investments will be required in actuarial and finance systems to ensure financial information is prepared on the theoretical expected cash flow basis. The IFRS 17's requirement to **measure insurance contracts** on a cash basis would be **even more burdensome** because of the level of the required granularity. I.e., as the standard introduces the need to subdivide portfolios of insurance contracts into **annual cohorts**, it will be necessary to allocate the cash flows from the cash collecting systems to the respective groups of insurance contracts at a level not practised or required currently. Furthermore, the expected cash flows would have to be modelled at this level of granularity within the actuarial systems, creating higher costs and efforts for undertakings because of the need to base the actuarial systems on cash basis likewise, in contradiction to the currently used due basis. It will increase for example additional challenges when dealing with experience adjustments (IFRS 17.B96a), lowering the level of stability in the actuarial systems.

We recommend further IASB consideration whether the standard could be amended to include premiums and claims on an **accrual basis** in the measurement of insurance liabilities, with separate presentation of premiums receivable and claims payable on the balance sheet. This would significantly reduce implementation efforts/costs for insurance undertakings and increase the quality of financial information presented at the same time. We recommend allowing such **an alternative approach** in addition to the cash based approach of the standard. Such an option would also reflect the genuine Board's thinking as reflected in paragraph IFRS 17.33(a) that future cash flows should be incorporated into the measurement of insurance contracts, but they should be estimated based on information available or collected without undue cost or effort. We think that the basic change from the accrual basis to cash basis is <u>not</u> leading to significant improvements in information provided to users via the financial statements which would justify the enormous IT systems' efforts necessary to comply with IFRS 17 as currently required.

Consequently, we believe that IFRS 17 could **provide at least a pragmatic relief** which would allow referring to the **accrual basis on an optional basis** because it would not cause significant differences with regard to equity and performance reporting implications in our assessment. Such an alternative would be better or even fully in line with the accrual basis of accounting as laid down in paragraph 27 of IAS 1 *Presentation of Financial Statements* and in paragraph 1.17 of the *Conceptual Framework for Financial Reporting*. Finally, we believe that the **accrual basis better reflects the main idea of IFRS 17** which is to transparently reflect all rights and obligations resulting from insurance contracts. For example linking the measurement of liabilities for remaining coverage (LRC) under the premium allocation approach (PAA) to premiums received (IFRS 17.55) rather than to premiums receivable might have a significant impact on the informative value of the presentation in the statement of financial positon when e.g. multiyear industry insurance contracts are considered.

We would appreciate if our views and our rationale could be considered in the final comment letter of EFRAG on the IASB's ED.

d) Reinsurance contracts held: contracts boundary to be re-adjusted

Like EFRAG we greatly **appreciate the objective of the IASB's amendment proposed in the ED** with regard to the issue on how to approach distortions in cedants' performance reporting and properly align the initial and subsequent accounting for **reinsurance contracts held when onerous underlying contracts are covered by reinsurance contracts on a proportional basis**. We are confident that the necessary fine-tuning of the proposed wording of the amendment can be fixed to fully achieve the intended objectives. In this regard we refer to our response to Question 4.

Nevertheless, there is also another important topic where an essential concern is remaining. After discussions at TRG level it became evident that IFRS 17 would introduce a requirement that for the **measurement of reinsurance contracts held** the estimate of future cash flows has to include also those future cash flows that relate to future insurance contracts the entity expects to issue. In BC183 some of the consequences regarding for example the interest accretion on the CSM are pointed out.

Unlike EFRAG (paragraph 166 of the EFRAG's draft comment letter) **we don't support the IASB's tentative decision not to amend IFRS 17 in this regard.** We believe that the standard should be amended to provide a pragmatic exemption from the general contract boundary principle. The aim should be to require only cash flows to be included into the measurement of reinsurance contracts held that arise from the underlying insurance contracts already recognized. It would **exclude** from the measurement of the reinsurance contracts held the **cash flows related to insurance contracts not written yet** and hence remove the additional burden to make a forecast of the future business. We don't believe that linking measurement of the reinsurance contracts held to future business while the recognized underlying insurance contracts are based on the business written yet only provides useful information to users, specifically when taking into account the discount rate differential between the unlocking of the reinsurance CSM and the update of the fulfilment cash flows from future business ceded.

Overall, we believe that there is a conceptual rationale to **re-adjust the contract boundary** in this specific case as it would be more appropriate and more understandable to **refer only to the underlying contracts already recognized** when measuring the reinsurance contracts held. In addition, the refinement would have a significant positive impact with regard to operational complexity of the standard.

We would appreciate if our position and our rationale could be considered in the final comment letter of EFRAG on the IASB's ED.

e) Interim financial statements: the concern regarding paragraph B137

Paragraph B137 of IFRS 17 is an essential and growing concern for German insurers and we respectfully suggest removing it. Should paragraph B137 stay in the standard, we recommend at least a modification to it which would require an **annual "year to date" approach** to be applied.

Our rationale is that paragraph B137 specifically defines for insurance contracts accounting that an entity shall not change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period (BC236 to IFRS 17 as issued in May 2017). It means that the **established actuarial practice** which is **based on an annual basis** (and with estimates derived from it for interim reporting at a quarterly or monthly basis where necessary) would have to be changed. Otherwise IFRS 17.B137 cannot be properly complied with. This change in actuarial systems would create an **extra implementation burden** for insurers while the added value of this exercise would not exceed the implementation efforts/costs from our perspective.

Based on this rationale we respectfully ask the IASB to remove the specific paragraph B137 from IFRS 17 to avoid a 'frozen' CSM at interim reporting level and instead to allow a reference to established practice based on the existing IAS 34 *Interim Financial Reporting*. Should B137 however stay in the standard, we **recommend at least a modification** to it which would **require an annual "year to date" approach** to be applied, irrespective of the frequency of reporting. Such an amendment would prevent the need to calculate different CSMs at different levels of group consolidation only because of the different reporting frequency.

We would appreciate if our views could be included in the final comment letter of EFRAG on the IASB's ED.