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Australian Accounting Standards Board

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25 September 2019

Mr Hans Hoogervorst
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Dear Board members,

Re: Comments on ED/2019/4: Amendments to IFRS 17 Insurance Contracts

I am writing on behalf of the Australian Accounting Standards Board (AASB) in response to ED/2019/4, the proposed changes to IFRS 17 Insurance Contracts.

Our response has been prepared by members of the AASB Transition Resource Group (AASB TRG), which was set up in November 2018 to facilitate discussion of implementation issues for Australian insurers and to inform the AASB Board so that they can determine what, if any, action is needed to address those issues. The AASB TRG has been monitoring and discussing issues raised at the IASB TRG and IASB Board discussions on IFRS 17 as well as discussing local implementation issues and submitting both outreach responses and papers to the IASB.

The AASB TRG has broad representation across the Australian insurance sector bringing together preparers across the health, life and general insurance sectors, the Actuaries Institute Taskforce (set up by the Actuaries Institute, representing the actuarial profession in Australia, specifically to discuss implementation of IFRS 17) as well as representatives of the public sector, corporate and capital regulators and the Australian Tax Office.

The AASB TRG consider that the proposals in ED/2019/4 will improve IFRS 17 without detriment to users and without impacting implementation projects underway. Importantly, many of the proposals will resolve some of the implementation difficulties in IFRS 17.

We would like to draw your attention to the following remaining areas of concern:

- The proposed change to reduce the accounting mismatch between reinsurance contracts held and recognition of underlying onerous contracts (question 4) is insufficiently wide in scope to deal with the variety of reinsurance contracts that are used in practice. Changes to the proposed wording of IFRS 17 are required to widen the scope of this change. We have set out an alternative approach which would provide a principles-based approach and apply consistency across different types of reinsurance contracts held and which does not require further arbitrary assumptions to be introduced.
- We recommend some changes to the proposed wordings regarding recognition of insurance acquisition cash flows (question 2) and recognition of contractual service margin attributable to investment-return service and investment-related service (question 3) to improve clarity for preparers and to better convey the IASB intent as we understand it.
- The treatment of acquired contracts under IFRS 17 (whether through a business combination under IFRS 3 or through an acquisition of insurance contracts) results in an overly complex accounting approach for acquired insurance contracts which, in many transactions, will not reflect the business model of the entity and will potentially confuse users. We recommend adopting a similar approach to that summarised in IFRS 3.15: "*The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies and other pertinent conditions as they exist at the acquisition date.*" This will allow recognition of the insurers business model when accounting for acquired insurance contracts and aligns more closely to the approach adopted for IFRS 9: Financial Instruments. Our comments are included in the response to question 8.
- Consistent with our previous submissions to the IASB, we remain concerned about the use of inception date discount rates in applying the general model and the resulting accounting mis-matches this produces. The more recent clarification by the IASB, that the contract boundary of reinsurance contracts held includes all future underlying contracts (i.e. including those not yet issued), will result in further accounting

mis-matches. We therefore support a change to IFRS 17 that would reduce, or eliminate, the accounting mis-match impact of using locked-in discount rates, particularly in the case of long-term reinsurance contracts held which provide reinsurance protection for shorter term underlying contracts. Our proposals are included in Appendix B.1.

- We remain concerned with the override of IAS 34 which is included in IFRS 17.B137. Whilst we understand this was included to assist some preparers it has a significant impact on other preparers, requiring dual reporting by subsidiaries within a consolidated Group which have a different reporting cadence to the Group parent. As such we consider B17.137 should be optional. Our concern and approach are included in Appendix B.2.

Our detailed responses to each of the questions raised by the IASB are included in Appendix A to this letter.

Appendix B sets out feedback from the AASB TRG on issues discussed by the IASB Board which were not addressed in ED/2019/4 where AASB TRG members have concerns with this omission which we would like the IASB to re-consider.

Appendix C sets out feedback from the AASB TRG on issues discussed by the IASB Board which were not addressed in ED/2019/4 and where AASB TRG members agree with the approach taken.

If you would like to discuss any of the contents of this letter, please contact me.

Kris Peach
Chair
Australian Accounting Standards Board

Appendix A - Responses to Questions raised in ED/2019/4

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)

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?* *(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?*

Based on feedback from the AASB TRG, we support the proposed scope exclusions. The insurance cover is essentially an adjunct to non-insurance products, with the main focus of these products being customer finance [paragraph BC16]. Keeping the insurance aspects of these contracts within the scope of IFRS 17 could create substantial costs for the effected entities for little or no benefit to users.

Expected recovery of insurance acquisition cash flows (paragraphs 28A-28D, 105A-105C, B35A-B35C and BC31-BC49)

> ***Question 2***
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> *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?*

Based on feedback from the AASB TRG, we agree with the proposed amendments as a practical and sensible approach to deal with the situations highlighted by the IASB in both their snapshot of ED/2019/4 changes (page 6) and in the Basis for Conclusions to ED/2019/4 (paragraphs BC34 to BC41). The proposed amendments will provide more useful information to users of the financial statements in the situations described where insurance acquisition costs are recovered by the entity through future expected contract renewals. Further, the change better reflects the economics of the scenario whereby the high upfront acquisition costs reflect the expectation of renewals.

Feedback from the AASB TRG has highlighted three items which we agree require further consideration by the IASB as follows:

1. Unintended consequences of paragraph B35A

Based on the Basis for Conclusions it appears the intention of the change is to require acquisition costs to be amortised over the period expected to recover the costs. The wording adopted by the IASB has potential unintended consequences for entities that underwrite new business with an expectation that there will be renewals but do not recover acquisition costs through future expected renewals from a commercial perspective (for example, many general insurance contracts).

The existence, or not, of renewals may have no bearing on the commission structure and other acquisition costs incurred (including internal cost allocations) but the wording in the proposed IFRS 17.B35A includes the very broad term “expected to arise from renewal of the insurance contracts”, which has the potential to capture a much wider scope of costs beyond those contemplated by the IASB as evidenced in the Basis for Conclusions. The Basis for Conclusions to ED/2019/4 notes at paragraph BC39 (emphasis added):

> *… The Board was persuaded that the payment of the commissions creates an asset that may **be expected to be recovered through expected renewals of contracts**. The resulting information would also be comparable to the information provided by IFRS 15 for the incremental costs of obtaining a contract.*

The term “expected to be recovered through expected renewals” is not currently used in the proposed IFRS 17 requirements but is significant to achieve the intended outcome.

Impact of issue highlighted

Feedback from preparers has indicated that the wording adopted to implement the changes intended by the IASB, if interpreted more widely than the Basis for Conclusions suggests, would significantly increase the costs and complexity of implementation projects with regard to deferral and amortisation of acquisition costs for insurance products that do not use the commission structures identified in the Basis for Conclusions.

If the proposed wording of B35A is interpreted to mean that all directly attributable insurance acquisition costs are incorporated, irrespective of whether they are recovered through future renewals, then entities would require processes to split between new and renewing contracts to facilitate deferral and amortisation over different periods of expected renewals. This could result in significant process redesign and potentially unduly disrupt implementation projects as well as fundamentally change the principle in IFRS 17 relating to acquisition cash flows which go against the IASB staff's criteria for proposed changes.

Recommended solution

We suggest changing the wording in the proposed IFRS 17.B35A as follows:

> *B35A To apply paragraph 28A, an entity allocates insurance acquisition cash flows that are directly attributable to a group of insurance contracts:*
>
> *(a) to that group; and*
>
> *(b) to groups that include insurance contracts that are expected to arise from renewal of the insurance contracts in that group and are expected to recover the insurance acquisition cash flows.*

2. Determination of asset on transition to IFRS 17

Paragraph 28B(b) proposes the recognition of an asset in respect of future groups of insurance contracts to which insurance acquisition cash flows are allocated. In order to calculate the value of this asset upon transition to IFRS 17, historical information relating to the insurance contracts will be required. Feedback from preparers notes that this information may be difficult to obtain without significant cost or effort because it relates to contracts originally issued and lapsed many years ago and includes:

- Historic insurance acquisition costs relating to contracts previously originated.
- Expected lapse and renewal profile of contracts issued many years prior to transition to IFRS 17, and their subsequent actual experience.

Impact of issue highlighted

The requirement to recognise the asset proposed in 28B(b) is expected to add significant cost and complexity to implementation of IFRS 17 given that retrospective application is likely to be impracticable for many insurers.

Recommended solution

We suggest that Appendix C be amended to include explicit allowance for the recognition of the asset proposed in paragraph 28B(b) as part of the modified retrospective and fair value transition approaches.

Explicit allowance for 28B(b) under the modified retrospective and fair value approaches will provide entities an alternative where it is impracticable to apply a full retrospective approach.

We suggest the following amendments and insertions to Appendix C:

> *C7 Paragraphs C9-C19 set out the permitted modifications to retrospective application in the following areas:*
>
> *(a) …*
>
> *(b) amounts related to the contractual service margin, ~~or~~ loss component or recognition of any asset relating to insurance acquisition cash flows paid before a group of insurance contracts is recognised for insurance contracts without direct participation features.*
>
> *(c) Amounts related to the contractual service margin, ~~or~~ loss component or recognition of any asset relating to insurance acquisition cash flows paid before a group of insurance contracts is recognised for insurance contracts with direct participation features.*
>
> *C16A To the extent permitted by paragraph C8, for contracts without direct participation features, an entity shall determine the asset recognised under 28B(b) based on an estimate of insurance acquisition cash flows arising prior to the transition date, adjusted for portions derecognised prior to the transition date on a systematic and rational basis.*
>
> *C17A To the extent permitted by paragraph C8, for contracts with direct participation features, an entity shall determine the asset recognised under 28B(b) based on an estimate of insurance acquisition cash flows arising prior to the transition date, adjusted for portions derecognised prior to the transition date on a systematic and rational basis.*

C20B To apply the fair value approach, an entity shall determine the amounts related to the recognition of any asset relating to insurance acquisition cash flows paid before a group of insurance contracts is recognised for insurance contracts at transition date as zero.

3. Clarification of the number of assets under 28B

Paragraph 28B(b) requires that *"An entity shall recognise such an asset for **each existing or future group** of insurance contracts to which insurance acquisition cash flows are allocated."* (emphasis added).

We understand that the Board's intention was for a single asset to be recognised in respect of all existing or future groups for which insurance acquisition cash flows are paid before recognition of the group. However, we are concerned that the words "*each existing or future group"* could be interpreted to require a different asset for each existing or future group. This would add significant operational complexity due to the number of assets that would require tracking, storing and regular testing for impairment.

We suggest the word "each" in paragraph 28B(b) be changed to "all" in order to clarify the Board's intention that only a single asset is required. That is, 28B(b) is modified as follows:

> *28B(b) insurance acquisition cash flows paid before the related group of insurance contract is recognised as an asset. An entity shall recognise ~~such an~~ this asset for ~~each~~ all existing or future group**s** of insurance contracts to which insurance acquisition cash flows are allocated.*

In addition, we propose the following modifications to 28C, 28D and B35Bto ensure consistency:

> *28C An entity shall derecognise ~~an~~ a portion of the asset recognised applying paragraph 28B(b)…*

and

> *28D At the end of each reporting period, an entity shall assess the recoverability of ~~an~~ the asset recognised applying paragraph 28B(b) if facts and circumstances indicate…*

and

> *B35B To apply paragraph 28D:*
>
> *(a) an entity shall recognise an impairment loss in profit or loss and reduce the carrying amount of ~~any~~ the asset for insurance acquisition cash flows recognised applying paragraph 28B(b), so that the carrying amount of ~~each~~ the asset does not exceed the expected net cash inflow for the related group, determined applying paragraph 32(a).*
>
> *(b) in addition, when an entity allocates insurance acquisition cash flows to groups of insurance contracts applying paragraph B35A(b), the entity shall recognise an impairment loss in profit or loss and reduce the carrying amount of the ~~related~~ asset~~s~~ for insurance acquisition cash flows to the extent that:*
>
> > *(i) the entity expects those insurance acquisition cash flows to exceed the net cash inflow for the expected renewals, determined applying paragraph 32(a); and*
> >
> > *(ii) the excess determined applying paragraph B35B(b)(i) has not already been recognised as an impairment loss applying paragraph B35B(a).*

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)

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?

Based on feedback from the AASB TRG, we agree with the IASB's proposals in (a) and (b) (i.e. changes to 44(e), 45(e) and B119) clarifying that the contractual service margin (CSM) should include future expected investment services (as well as future insurance services) whenever relevant (that is, whether or not the contracts have direct participation features). Feedback from preparers highlights this is particularly important when, later in their lifecycle, some 'insurance contracts' become substantively investment-only contracts and IFRS 17.B25 prohibits them from being reclassified out of IFRS 17. As the CSM will now also represent investment services, a relevant portion of the CSM will be available to be allocated to later periods in the lifecycle of such a contract – otherwise, CSM is recognised too early.

The IASB's proposals will ensure that the CSM allocated to profit or loss will reflect both insurance and investment services provided to the policyholder to enable insurers to faithfully represent the investment services they provide in the relevant periods.

Further changes to the proposals in the ED are suggested to make the requirements clearer. However, we note that this topic is not a major concern for our Australian insurance industry stakeholders

(a) Investment return services

Based on feedback from the AASB TRG, we support the assertion that there may be an investment-return service provided by the contract without an investment component being present (B119B(a)). Under many insurance contracts, the policyholder has a right to withdraw. Where the withdrawal includes investment returns accrued, then it indicates that the entity is providing an investment-return service.

The definition of an investment-return service in B119B(b) requires a **'positive investment return'** to be provided. Feedback from preparers has identified the following issues related to this requirement:

- It is not clear what a 'positive investment return' is (and B119B(b) indicates that it could even be negative).
- The inclusion of a 'positive investment return' implies the explicit addition of some amount to deposits made by the policyholder. Yet, a typical surrender value (which would often represent the value of an investment

component) for a traditional product is often calculated prospectively, being the present value of future cash flows – past investment returns are irrelevant, and future expectations for determining a present value may not immediately reflect ‘positive returns’ earned in the past. It is not clear what the inclusion is in those circumstances.

- The reference to a ‘positive investment return’ implies that if an investment component does not provide a ‘positive investment return’ then you may have an investment component that does not provide an investment-return service. As the component of a contract must provide some service (the policyholder would not enter a contract where no service was provided to it), this raises the question of what service is provided by an investment component (in a contract without discretionary participation features) if it is not an investment-return service?

We believe that simply requiring an ‘investment return’, without specifying that it be ‘positive’, would be sufficient, and consistent with other products that provide either an ‘investment-related service’ or the service provided by an investment funds management contract (i.e. providing a service to the policyholder which they are unable to provide to themselves due to amounts invested (being too small), expertise, etc.).

Also, we do not believe that it should be necessary to constrain the service provided by an investment component in this way. The aim should be that, while an investment-return service is not dependent on the presence of an investment component, an investment component should always provide either an investment-return service (for a contract without discretionary participation features), or an investment-related service (for a contract with discretionary participation features).

In addition, all insurance contracts (where premium is received in advance of the service being provided and benefits being provided) must involve investment of assets by the entity in the interim. All insurance entities are expected to perform investment activity, whether they provide an investment-return service or not. Consequently, B119B(c) is not sufficient as evidence that an investment-return service is being provided. For a ‘right to withdraw’ to provide an investment-return service the investment activity needs to be performed **for the policyholder**, in order to generate an investment return for them.

Recommended solution

Suggested rewording is as follows:

B119B Insurance contracts without direct participation features may provide an investment-return service if, and only if:

(a) an investment component exists, or
(b) the policyholder has a right to withdraw ~~an amount~~, and both

(i) the ~~entity expects the investment component or amount the policyholder has a right to~~ withdrawal ~~to~~ includes (either implicitly or explicitly) an ~~positive~~ investment return, ~~(a positive investment return could be below zero, for example, in a negative interest rate environment)~~; and

(ii) the entity ~~expects to~~ performs investment activity for the policyholder to generate that ~~positive~~ investment return.

(b) Investment-related services

Based on feedback from the AASB TRG, we agree that insurance contracts with direct participation features provide both insurance coverage and investment-related service. IFRS 17 refers to insurance contracts with direct participation features as being substantially investment-related service contracts under which an entity promises an investment return based on underlying items (B101).

We therefore support the proposal that, in addition to insurance coverage, these contracts provide investment-related services to policyholders and the coverage units to release the CSM should reflect these services.

(c) Disclosure requirements

Based on feedback from the AASB TRG, we support the proposals to require disclosure of:

- quantitative (rather than qualitative) information about when the entity expects to recognise in profit or loss the CSM remaining at the end of a reporting period [IFRS 17.109], in appropriate time bands; and
- the approach used to determine the relative weighting of the benefits provided by insurance coverage and investment-return service or investment-related service [IFRS 17.117(c)(v)].

We consider that the quantitative disclosures about the amount of CSM expected to be recognised over time are important as these disclosures enable users of financial statements to monitor the profitability pattern, allowing informed comparisons across entities. We consider that an entity needs to determine this release pattern for its own purposes (including estimation of that release pattern in the future). Therefore, preparers should be able to provide this quantitative information without undue cost or effort.

We acknowledge that there will be subjectivity in applying the proposed amendment, and determining the weighting between the insurance coverage services and either the investment-return services or the investment-related services, in order to determine the coverage units and the release pattern of the CSM. However, an entity is already required to make similar assessments and judgements for contracts which provide more than one type of insurance coverage. These disclosures will enable users to better understand the sources of profit and to make comparisons both between types of contracts and across entities and over time and, therefore, we consider that this proposal will not require the excessive use of judgement and will facilitate users' understanding of the impact of all relevant services on the amortisation of CSM.

Overall, we consider that the disclosure proposals will provide useful information to users of financial statements. The proposals will lead to the provision of relevant information about the services being provided to the policyholder. Therefore, the resulting CSM amortisation provides a faithful representation of those services being provided.

(d) Additional clarification requested in relation to Q3 impacts in ED/2019/4

We agree with and support the proposed addition of paragraph B65(la) which clarifies that costs incurred in providing investment-return or investment related services are included within the fulfilment cashflows.

However, we are concerned that it is unclear that costs associated with tax payments attributable to the policyholder that arise from investment-return or investment related services are also included in the fulfilment cash flows. These taxes also represent a cost to the insurer which are, in substance, incurred for, or on behalf of, the policyholder.

BC63 notes that, as the entity is regarded as managing assets on behalf of policyholders, asset management costs should be regarded as part of the cost of fulfilling the contracts. This equally applies to policyholder taxes arising from investment-return or investment related services which are incurred for, or on behalf of, the policyholder and therefore should be included in the fulfilment cash flows to ensure a faithful representation of the economics of the related insurance contracts.

We propose the following amendments to B65(j) and B66(f) to clarify that costs relating to taxes which are incurred for, or on behalf of, the policyholder due the provision of investment-related or investment return services are included in the fulfilment cash flows:

> *B65 (j) payments made by the insurer in a fiduciary capacity or as result of providing an investment-related or investment return service to policyholders to meet tax obligations incurred by the policyholder, or by the insurer in respect of policyholder funds, and related receipts*

> *B66(f) income tax payments and receipts the insurer does not pay or receive in a fiduciary capacity or as result of providing an investment-related or investment return service to policyholders. Such payments and receipts are recognised, measured and presented separately applying IAS 12 Income Taxes.*

Reinsurance contracts held-recovery of losses on underlying insurance contracts (paragraphs 62, 66A-66B, B119C-B119F and BC67-BC90)

> ***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 support amending IFRS 17 to allow the recognition of reinsurance recovery income when the entity recognises losses on onerous underlying contracts. We consider that this reflects the nature of a reinsurance contract as a risk mitigation tool and provides essential information for users of financial statements by fairly representing the economic substance of the reinsurance protection purchased.

However, we disagree with the scope of the proposed amendment, specifically, its limitation to “reinsurance contracts held that provide proportionate coverage” (‘proportionate reinsurance’) as defined in paragraph B119C[1]. In our view, the proposed amendment should be applied to all reinsurance contracts where there is a direct link between the expected recoveries and the claims (and therefore, onerous losses) of the underlying contracts they cover because:

1) The proposed amendment is insufficient in scope to deliver value for users of financial statements because reinsurance **transactions that provide the same economic outcomes would be accounted for differently** depending on whether:
   - the reinsurance contracts provide ‘proportionate’ or ‘non-proportionate coverage’; and
   - the underlying contracts were expected to be onerous on inception, or subsequently.

   This issue arises because the proposed definition of “proportionate coverage” in B119C **excludes a significant portion of reinsurance contracts in the market which are of the same nature and substance**.
2) The reinsurance recoveries on non-proportionate reinsurance contracts that relate to a loss recognised on underlying insurance contracts can be identified **without making arbitrary assumptions** beyond the existing assumption already set out by the IASB, i.e. that the onerous loss is caused only by claims. In section 2 below, we propose a method for allocating recoveries to the onerous underlying losses that **can be applied consistently** by all entities for all types of reinsurance contracts and **does not require subjective judgment**.

1. Inconsistent accounting treatment of reinsurance transactions with the same economic outcomes

1.1 The current scope of the proposed amendment would significantly limit the usefulness of information to users of financial statements because the limitation:

(a) Will result in **different accounting treatment of reinsurance transactions that have the same economic effect**;

(b) Will result in an **inconsistent treatment across reinsurance contracts of the same nature and substance** and where there is an equally direct link between the expected reinsurance recoveries and the losses on the underlying contracts[2];

(c) Is **inconsistent with the subsequent measurement requirement set out in IFRS 17.66(c)(ii)** which allows a gain on reinsurance held to be recognised in profit or loss where they relate to underlying

[1] “Such reinsurance contracts provide the entity with the right to recover from the issuer a fixed percentage of all claims incurred on a group of underlying insurance contracts.” [paragraph B119C]

[2] Acknowledged by the IASB in *Basis for Conclusions on ED Amendments* BC79

contracts that become onerous (or more onerous) after initial recognition because of adverse changes in estimates **regardless of the type of reinsurance contract held**; and

(d) May give rise to **inconsistent interpretations** as the proposed amendment adds a new distinction ('proportionate' vs 'non-proportionate') that may be difficult to apply.

This may result in non-GAAP measures being used by preparers to mitigate the reduced understandability brought about by the different treatment across reinsurance contracts held.

1.2 The narrow definition of "proportionate coverage" means that the proposed amendment will have limited application in practice as a significant portion of reinsurance contracts in the market will not meet the definition set out in in B119C. In summary:

(a) The proposed amendment excludes a significant body of reinsurance contracts held which are used in practice in global reinsurance such as excess of loss (XOL)[3] and surplus reinsurance contracts[4] that are widely used in the life and general insurance market globally – these include simple facultative reinsurance contracts that cover only one risk/underlying contract. For some of these reinsurance contracts, the reinsurance retention / deductible may apply to specific individual underlying claims and therefore, for each claim the insurer expects to incur there is a direct link to the reinsurance recoveries the insurer expects to receive. These contracts would not appear to meet the definition of 'proportionate' as they do not cover a fixed percentage but may vary for each claim based on the claim size;

(b) Proportional reinsurance contracts (such as simple quota shares (QS)) are often subject to specified limits - e.g. a quota share reinsurance contract that will pay the cedant recoveries of 50% of all underlying claims subject to a limit of CU1m. These reinsurance contracts do not cover a fixed percentage of **all claims**[5,6] and would therefore, appear not to meet the definition of "proportionate" in paragraph B119C, even if they cover a fixed proportion of claims at the individual contract level;

(c) Proportional reinsurance contracts which have contract terms that do not align with the underlying cohorts in a group (e.g. reinsurance contracts in force from July to June covering underlying contracts in groups comprising contracts issued between January and December) will not be in scope of the proposed amendment if those reinsurance contracts do not cover all contracts in a group, even though all claims in the group may have the right to a fixed percentage of reinsurance recoveries if the reinsurance contracts covering the group are considered collectively (e.g. a January – December annual cohort covered by 2 back to back reinsurance contracts which have July to June contract terms); and

(d) A group of underlying contracts issued may be covered by more than one reinsurance contract – e.g. a facultative excess of loss (XOL) reinsurance contract (non-proportionate) that provides coverage for claims above a deductible and up to a limit, and a quota share (QS)(proportional) that covers a fixed percentage of all claims not covered by the XOL reinsurance contract. The QS in this scenario would appear not to meet the definition of 'proportionate' in paragraph B119C as it does not cover a fixed percentage of **all claims** of the group of underlying contracts.

Whilst we understand that the example provided in pages 11-12 of the *Snapshot: Amendments to IFRS 17* is intended to be illustrative, we note that it is not reflective of the majority of reinsurance contracts in the market. The reinsurance contracts described in (a) – (d) above may be used to achieve the same economic outcomes as those that are in scope of B119C but would be accounted for differently under the IASB's proposed amendment - Appendix D – Section 1 (of this submission) sets out examples of various reinsurance transactions and structures that demonstrate this.

[3] Reinsurance contract that will pay recoveries for losses in excess of an agreed amount ('deductible') and generally, up to a specified limit. An XOL policy can apply per policy, per portfolio or per event. The proposed amendment excludes all reinsurance contracts which have deductibles [paragraph BC304].

[4] The cedant retains a fixed maximum amount for each risk ('retention'). Amounts over the retention is ceded to the surplus reinsurance contract.

[5] They only cover a fixed percentage of claims up to the treaty limit.

[6] Assumes that the limit has commercial substance – in accordance with IFRS 17 paragraph 2, we would disregard terms that have no commercial substance.

2. Identifying reinsurance recoveries related to a loss recognised on underlying insurance contracts

2.1 We consider it to be clear that both proportionate and non-proportionate reinsurance contracts held provide a direct link between the expected recoveries and the loss recognised on underlying onerous contracts. This is acknowledged by the IASB in *Basis for Conclusions on ED Amendments* BC79[7].

2.2 The underlying expected cash flows, including expected claims, is estimated in accordance with IFRS 17.33, in an unbiased way using reasonable and supportable information, and by applying appropriate methods (e.g. probability weighted mean). The total reinsurance recoveries which an entity is entitled to recover in respect of those expected underlying claims can be reliably and factually determined for both proportionate and non-proportionate reinsurance based on the terms of the reinsurance contract (e.g. by applying the fixed percentage agreed in a proportionate reinsurance contract, or by applying the deductible / limits / surplus percentages / any other relevant terms agreed in a non-proportionate reinsurance contract). We note that many preparers already determine expected reinsurance recoveries on insurance contracts issued at all stages of the contract life cycle. This is done for local regulatory calculations, existing IFRS and other bases such as Market Consistent Embedded Value and will also need to be calculated for the application of the IFRS 17 measurement requirements.

2.3 We note that the IASB's reason for the limitation of the proposed amendment is based on a perceived inability to identify the amounts that the entity has the right to recover from the reinsurer in respect of the underlying onerous losses recognised[8] ('corresponding reinsurance recoveries'). We consider that the corresponding reinsurance recoveries in relation to non-proportionate reinsurance can be determined **without making additional arbitrary assumptions**[9] by applying the **recovery percentage** (determined as the total expected reinsurance recoveries as a proportion of the total expected underlying claims) to the onerous loss recognised in profit or loss**.** Every dollar of underlying claims is considered an equal contributor to the onerous loss recognised and therefore, an equal contributor to the calculation of the expected recovery percentage. That is, the **recovery percentage is the allocation of the insurer's right to recover under the reinsurance contract to each underlying claim**. This is also the basis on which compensation required from policyholders would be determined, i.e. prices charged to policyholders would not differ based on whether the relevant contracts are expected to trigger the deductible or not.

The examples in Appendix D – Section 2 (of this submission) address the specific concerns expressed by the IASB in *Basis for Conclusions on ED Amendments* BC86(a) and (b) and demonstrate that the extent to which reinsurance recoveries relate to a loss recognised on underlying contracts can be determined by using a simple methodology that:

- can be **applied consistently** by all entities for all types of reinsurance contracts;
- **does not require subjective judgment**; and
- **is well-established** as it is currently applied by many entities to estimate reinsurance recoveries.

The methodology we have proposed also does not result in reinsurance income being recognised early in respect of underlying groups of contracts that are profitable.

3. ***Recommendation***

3.1 We recommend an amendment to the proposals in paragraphs 66A–66B, B119C–B119F and BC67–BC90 of the ED to allow for application to all reinsurance contracts held for which there is a direct link between the expected recoveries and the loss recognised on underlying onerous contracts. We consider that this can be achieved by removing references to 'proportionate coverage' and have provided some suggested wording changes underlined below:

66A *An entity shall 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 underlying insurance contracts to that group. The amount of the adjustment and resulting income is determined applying paragraph B119D.*

~~*B119C Paragraph 66A applies to reinsurance contracts held that provide proportionate coverage. Such reinsurance contracts provide the entity with the right to recover from the issuer a fixed percentage of all claims incurred on a group of underlying insurance contracts. Such reinsurance contracts can also include cash flows, other than claims,*~~

[7] "…the Board observed that for all reinsurance contracts held there is a link between the expected recoveries and the loss recognised on underlying onerous contracts: they both depend on expected claims." [*Basis for Conclusions on ED Amendments* BC79]

[8] *"*…for reinsurance contracts held that do not provide proportionate coverage, although it is possible to identify the loss as being caused by claims, those claims **do not have a known recovery**…it is not possible to know whether those claims…would result in a recovery, or to what extent…" [*Basis for Conclusions on ED Amendments* BC80]

[9] "…an entity would be **required to make more arbitrary assumptions**, beyond the assumption that a loss is caused only by claims, to identify the extent to which expected recoveries relate to a loss recognised on underlying insurance contracts…" [*Basis for Conclusions on ED Amendments* BC86]

~~that are not proportionate to cash flows of the underlying groups of insurance contracts issued. For example, in such reinsurance contracts, the premiums due to the reinsurer might not be proportionate to premiums due from the policyholders of the groups of underlying insurance contracts.~~

B119D An entity shall determine the adjustment to the contractual service margin and the resulting income recognised applying paragraph 66A 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 insurance contracts the entity has a right to recover from the group of reinsurance contracts held**,** determined as the total expected reinsurance recoveries as a proportion of the total expected underlying claims for the group of underlying insurance contracts.

3.2 We recommend the following consequential amendments to paragraphs 62, B95B and C15A to reflect the proposed amendment above:

62 Instead of applying paragraph 25, unless paragraph 62A applies, an entity shall recognise:

(a) a group of reinsurance contracts held that provide proportionate coverage**,** ~~**(i)** unless paragraph 62(a)(ii) applies –~~ at the beginning of the coverage period of the group of reinsurance contracts held or at the initial recognition of any underlying contract, whichever is later~~; or~~

~~(ii) if the entity recognises an onerous group of underlying contracts before the beginning of the coverage period of the group of reinsurance contracts held – at the same time as the onerous group of underlying contracts.~~

(b) ~~in~~ all other groups of reinsurance contracts held ~~cases~~ from the beginning of the coverage period of the group of reinsurance contracts held.

62A If before the beginning of the coverage period of a group of reinsurance contracts held, the entity recognises an onerous group of underlying contracts in accordance with paragraph 25(c), the entity shall recognise the group of reinsurance contracts held at the same time as the onerous group of underlying contracts.

B95B For a group of reinsurance contracts held to which paragraphs 66A-66B apply at the date of the transaction, an entity shall determine the loss-recovery component of the asset for remaining coverage by multiplying:

(a) the loss component of the liability for remaining coverage of the group of underlying insurance contracts at the date of the transaction; and

(b) the ~~fixed~~ percentage of claims the entity has a right to recover from the group of reinsurance contracts held, determined as the total expected reinsurance recoveries as a proportion of the total expected underlying claims for the group of underlying insurance contracts.

C15A For a group of reinsurance contracts held that provides ~~proportionate~~ coverage for an onerous group of insurance contracts and was acquired before or at the same time that the insurance contracts were issued, an entity shall establish a loss-recovery component of the asset for remaining coverage at the transition date (see paragraphs 66A-66B). To the extent permitted by paragraph C8, an entity shall determine the loss-recovery component by multiplying:

(a) the loss component of the liability for remaining coverage for the group of underlying insurance contracts at the transition date (see paragraphs C16 and C20); and

(b) the ~~fixed~~ percentage of claims for the group of underlying insurance contracts the entity has a right to recover from the group of reinsurance contracts held, determined as the total expected reinsurance recoveries as a proportion of the total expected underlying claims for the group of underlying insurance contracts. The total expected underlying claims and reinsurance recoveries used to determine this percentage is measured in accordance with the measurement requirements of IFRS 17 as set out in paragraphs 32 to 38 and 63 to 68 respectively.

Presentation in the statement of financial position (paragraphs 78-79, 99, 132 and BC91-BC100)

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?

Based on feedback from the AASB TRG, we agree with the proposed change to require separate presentation of insurance assets and liabilities at a higher level of aggregation than 'group'. This has consistently been one of the most significant concerns raised by the AASB TRG members.

Based on feedback from preparers we are aware that:

- changes to systems to enable group-level presentation would impose significant costs [ED/2019/4.BC95]; and
- no useful information would be lost by presentation at a higher level of aggregation [ED/2019/4.BC96].

Portfolio-level presentation will help avoid the problem that an asset could arise simply due to deferred premium payments as at the reporting date, which is not a persistent state of affairs, and is potentially misleading for users.

However, AASB TRG members continue to be strongly supportive of using **entity** as the unit of account for presentation of insurance assets and liabilities on the balance sheet. We note the comments in the Basis for Conclusion that:

> *BC97 The Board considered some stakeholders' suggestions that presentation of insurance contracts in the statement of financial position should be at an entity level and rejected that suggestion because that would risk a greater loss of useful information for users of financial statements.*

However, preparers contend that there would be no loss of useful information for users because portfolios will be inconsistent between entities as they are based around the management construct of the entity, which can differ significantly by entity. Prepares can see no benefit for users in providing this information at portfolio level and, given the increased implementation costs of delivering this information it is strongly recommended aggregation at **entity** level is adopted to facilitate comparability.

Applicability of the risk mitigation option (paragraphs B116 and BC101-BC109)

> ***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?*

Based on feedback from the AASB TRG, we support the proposal to extend the scope of the risk mitigation exception to financial risk changes mitigated by reinsurance contracts held on the basis that it will help to mitigate accounting mismatches in affected jurisdictions [paragraph BC105].

We note this issue is not a major concern for our Australian insurance industry stakeholders.

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

> ***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?*

Comment on (a)

Based on feedback from the AASB TRG, we support the proposed one-year deferral, which is currently considered adequate to:

- implement IFRS 17
- restart aspects of implementation that are currently on hold pending the likely amendments from ED/2019/4.

This view assumes the IASB will not make additional significant changes to the existing IFRS 17 requirements on discount rate and measuring risk adjustments or any other unforeseen changes. In the event that there were fundamental changes to IFRS 17, the effective date would need to be reassessed.

Several constituents within Australia would specifically support a further one year deferral of IFRS 17 to 1 January 2023 to allow for a more strategic implementation approach to be adopted. Maintaining consistency with the effective date for implementation of IFRS 9 is not a material consideration in an Australian context.

We also concur with the IASB's views [paragraph BC117] on not using relief from presenting IFRS 17-compliaent comparative information as a substitute to deferral of IFRS 17 application.

Comment on (b)

Based on feedback from the AASB TRG, we support the proposed extension of the IFRS 9 exemption being in line with the mandatory application date of IFRS 17 on the basis that business models may need to be re-assessed and could, therefore, affect IFRS 9 measurement approaches adopted (or revised) on applying IFRS 17. However, feedback from preparers in Australia notes that a consistent mandatory application date for IFRS 9 and IFRS 17 is not relevant for all our constituents, particularly given that on transition to IFRS 17 decisions made on measurement model under IFRS 9 can be reconsidered as specified in paragraphs C29-C33.

Additional consideration

It is not clear how the IASB's current project on Primary Financial Statements would impact on the presentation requirements in IFRS 17, for example:

- 'insurance service result'; and
- 'insurance finance income and expenses'.

Indications are that changes to the Primary Financial Statements could be promulgated with mandatory application in 2023. Accordingly, insurers could find themselves adjusting their income statements in two consecutive years (once for IFRS 17 and again for PFS).

Feedback from preparers has highlighted a concern about the substantial duplication of effort and costs that could be involved.

Based on the IASB's tentative decisions, special requirements would apply to 'financial entities', which include insurers. We consider that the IASB needs to explain how it envisages the potential changes on Primary Financial Statements to affect insurers currently adopting IFRS 17, including any aspects of IFRS 17 that might subsequently be undone by those changes.

Transition modifications and reliefs (paragraphs C3(b), C5A, C9A, C22A and BC119-BC146)

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?

(a) Contracts acquired in the claims settlement stage

Based on feedback from the AASB TRG, we support the amendment to the modified retrospective approach requiring entities, subject to certain criteria, to classify as a liability for incurred claims (and not as a liability for remaining coverage) a liability for settlement of claims incurred before an insurance contract was acquired.

Feedback from preparers in relation to this issue, has highlighted the practical difficulties and high costs of applying IFRS 17.B5 to acquired contracts on an ongoing basis after transition to IFRS 17 based on the wide-ranging meaning of the term in IFRS 17.B5 “an insurance contract that provides coverage against an adverse development of an event that has already occurred” now conferred by paragraph BC120 to the Basis for Conclusions to ED/2019/4. Preparers consider that an adverse development cover is a specific type of cover underwritten to provide cover in the future for development of claims incurred in the past. This contrasts with acquired contracts which are generally not issued or underwritten to provide such cover but are often acquired as part of a broader strategic transaction with no intent to earn profit from the claims run-off element.

We consider that IFRS 17.B5 should be amended such that, on an ongoing basis, consistent with IFRS 3.15 *Business Combinations*, insurers are required to determine the nature of what they have acquired on the basis of the “**contractual terms, economic conditions, the entities operating or accounting policies and other pertinent conditions as they exist at the acquisition date”.**

Accordingly, when an insurer acquires contracts in their claims settlement period, unless the insurer acquires insurance contracts that, on acquisition, are intended to be in the nature of adverse development covers (e.g. purchase of a run-off portfolio for the purpose of making profit from that portfolio as opposed to the future renewal rights of that portfolio), they would be classified as a liability for incurred claims. This is consistent with the original wording of IFRS 17.B5; however, in proposing the addition of IFRS 17.C9A, paragraph BC120 could be inferred as implying that all contracts acquired in their claims settlement period (after transition) should be treated as adverse development covers. If this were the case, it would create potentially inconsistent accounting treatments for identical contracts purely due to the timing of when the portfolio was purchased, which is unhelpful for users of financial statements and creates additional complexity and cost in both applying and explaining the results of an insurer.

Furthermore, the treatment of the acquired portfolio could be potentially misleading for users by changing the classification of the contract. For example, an entity that measures its issued insurance contracts using the premium allocation approach may be required to apply the general model to identical contracts which have been acquired rather than issued (depending on the settlement period of the claims and the related volatility). Reclassifying the portfolio in this way may distort the business transaction for users by indicating the entity has changed its business focus to the management of run-off portfolios, as opposed to acquiring contracts as a means of increasing market share or entry into a new market through the rights to the renewal business. In addition, this approach would add significant operational complexity and cost with minimal benefit for users. Equally, a contract accounted for under the general model or the premium allocation approach could cease to meet the definition of an insurance contract if acquired later in the coverage period and be required to be measured under IFRS 9 Financial Instruments. Such **changes in classification would be confusing to users and investors as well as costly to apply**.

We contrast this treatment with the acquisition of financial instruments. On acquisition of financial instruments in a business combination, IFRS 3 requires re-measurement of financial instruments, but the **"classification"** of the financial instrument is determined by the acquirer based on the characteristics of the instrument and the acquirer's business model. Whereas the application of IFRS 3, in conjunction with IFRS 17B5 potentially **"reclassifies"** the insurance contract. This change in classification will confuse users and drive up costs of IFRS 17 implementation on an ongoing and lasting basis.

Feedback from preparers has emphasised that there is a clear distinction between underwriting contracts that provide adverse development coverage and entering into the acquisition of insurance contracts that are either partly or fully within their claim settlement stage. Such acquired contracts are often pooled with other contracts originated by the insurer to diversify the pool of risks and/or make good use of surplus claims management capacity. That is, they are managed and pose the same economic costs and benefits as originated contracts in their claim settlement period. These acquired contracts are still considered insurance contracts with the original policyholders, not adverse development contracts, and the nature of the underlying contract has not changed.

We therefore request the IASB to clarify IFRS 17.B5 to ensure that insurers account consistently for contracts acquired fully or partially in their claims-settlement stage in a manner that reflects their business model and which, whilst requiring the remeasurement requirements of IFRS 3 does not force unnecessary re-classification of insurance contracts.

We consider that only treating contracts in the nature of adverse development covers as being within IFRS 17.B5 is consistent with the work conducted by the IASB at its IFRS 17 Transition Resource Group (TRG) meeting noted below.

September 2018 Agenda paper 8

The work the IASB conducted through its TRG in September 2018 in respect of Agenda paper 1 *Group insurance policies*) involved identifying the policyholder when individual policies are sold under master arrangement and the flow-on consequences for determining contract boundaries. All the criteria applied in that Agenda paper relate to the original contract[10] which set the contract boundary. When an insurer acquires a contract in its settlement period, the policyholder does not change and nor should the contract boundary. IFRS 17.B5 should, therefore, only be read as being a limited exception to this principle when the contract acquired takes on the character of an adverse development cover from the perspective of the acquiring insurer.

Recommended solution

We consider that:

(a) insurers writing adverse development coverage be required to account for the adverse development of claims as coverage – because, in this case, adverse claims development is clearly the primary (and only) risk coverage being provided;

(b) insurers acquiring contracts in their claims settlement period that, on acquisition, change their character from the perspective of the acquiring insurer into an adverse development cover should be treated as such; and

[10] TRG Agenda paper 8, paragraph 20:

(a) the insurance coverage is priced and sold separately;

(b) other than being members of the association or customers of the bank the individuals are not related to one another; and

(c) purchasing the insurance coverage is an option for each individual.

(c) insurers should be able to exercise the same judgements in respect of these contracts about whether (or not) risks consequent to an incurred claim (as per September 2018 TRG Agenda paper 8) are treated as coverage, as they can for contracts they have issued. Whereby, the policy choice should be consistent with the acquiring entity's business model and/or objectives for the acquisition. (Which is aligned to the principles of IFRS 9).

We suggest the following clarifications to IFRS 17.B5:

> *B5 Some insurance contracts are issued to cover events that have already occurred, but the financial effect of which is still uncertain. An example is an insurance contract issued to ~~that~~ provide~~s~~ coverage against an adverse development of an event that has already occurred. In such contracts, the insured event is the determination of the ultimate cost of those claims. Contracts acquired either fully or partially in their claims settlement period would also be accounted for as adverse development covers when, from the acquiring insurer's perspective, the character of the portion of the contract in its claims settlement period is in the nature of an adverse development cover.*

We note that contracts might be acquired either fully or partially in their settlement period(s) either within a business combination or outside a business combination. We consider our proposed changes to be consistent with the requirements of IFRS 3, in particular IFRS 3.15, which says (emphasis added):

> 15 At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to apply other Australian Accounting Standards subsequently. **The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies and other pertinent conditions as they exist at the acquisition date**.

Comment on (b)

This has not been highlighted as a major concern for our Australian insurance industry stakeholders.

Comment on (c)

This has not been highlighted as a major concern for our Australian insurance industry stakeholders.

Minor amendments (BC147-BC163)

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?*

Based on feedback from the AASB TRG, we have no objection to the proposed minor amendments.

In particular, there is **support** for the amendment to specify that IFRS 17.39 applies only to business combinations within the scope of IFRS 3 Business Combinations on the basis that contracts acquired in business combinations under common control (BCUCC) should not be accounted for as if they had been acquired on the date of a BCUCC [ED/2019/4. BC151]. BCUCC may occur simply as part of an internal restructuring and it would pose an unnecessary cost to have to presume contracts are newly acquired at the time of a BCUCC.

Terminology

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?

Based on feedback from the AASB TRG, we **agree** with the IASB making consequential changes in terminology.

Appendix B - Areas the Board considered and for which amendments to IFRS 17 are not proposed on which AASB TRG proposes amendment

B.1 Cash flows in the boundary of a reinsurance contract held [paragraphs 34 and B61-B66 of IFRS 17 and ED/2019/4 BC180 – BC185] and Discount Rate used to determine adjustments to the contractual service margin [paragraphs 44 and B72 of IFRS 17 and ED/2019/4 paragraphs BC 193-BC199]

Based on feedback from the AASB TRG, we consider that the use of **current discount rates should apply to all aspects of the insurance standard, including the Contractual Service Margin (CSM).** This is consistent with the views set out in the AASB TRG's response to the IASB October 2018 Board Agenda ref 2D dated 27 November 2018 (with regard to the use of locked-in discount rates to adjust the contractual service margin (Topic 4) and Reinsurance contracts held: expected cash flows arising from underlying contracts not yet issued (Topic 14)).

Using locked-in discount rates for accretion of the CSM has been identified as inconsistent with the treatment of other elements of the standard that affect future service (e.g. discount rates applied to future claims payments, future claims handling rates or assumed rates of inflation). This not only creates an accounting mismatch but will also, in certain circumstances, be inconsistent with the economics of the contract.

Feedback from preparers has highlighted that this is primarily an issue where the insurance contract is measured using the general model, and particularly profound for long term (multi-year) reinsurance contracts held that cover shorter duration underlying insurance contracts issued. For these contracts, the inception date interest rate is used to accrete the CSM [IFRS 17.B72(b)] of the reinsurance contract held even though the cash flows and CSM reflected in the reinsurance contract held have a direct relationship to, and are constantly updated for, current underlying contracts – by contrast the CSM for underlying contracts will be accreted at rates relevant to each separate contract, or group of contracts, as they are issued in the future.

We contrast the need to use an inception date interest rate to accrete the CSM for a long-term reinsurance contract held with a contract which has participating features and uses the variable fee approach (VFA). The VFA allows for use of current discount rates to be applied to changes in fulfillment cash flows [IFRS 17.B113 (a)].

IFRS 17 is silent on how the difference between current and locked-in discount rates should be treated, however, the Basis for Conclusions [IFRS 17 BC275] indicates this discount rate differential would be recognised immediately through insurance finance income/expense in profit or loss (assuming the entity policy choice is to include insurance finance income and expense in profit or loss). Adopting this approach, feedback from preparers suggests that the impact on the insurance service result and insurance finance result can be material due to the accounting mismatch caused by the differing treatment of discount rates between the present value of future cash flows and the CSM.

Noting the arguments set out in ED/2019/4 BC 181 to BC 184 we understand that the logical extension of treating insurance contracts and reinsurance contracts separately is that expected future cash flows related to **future** underlying insurance contracts to be issued will be factored into the measurement of reinsurance contracts held. ED/2019/4.BC183 states the Board's view that differences arising between the reinsurance held and underlying insurance contracts are not accounting mismatches but predominantly relate to different timings of cash flows which are impacted by the different discount rates that would apply. AASB TRG members **disagree with the IASB's view that these 'differences' are not accounting mismatches.** The differences arise from inconsistent measurement rules on discount rates and do not reflect the underlying economics of the contracts and could be misleading to users of the financial statements.

We therefore support a change to IFRS 17 that would reduce or eliminate the accounting mis-match impact of using locked-in discount rates. We consider it would improve the information reported by entities applying IFRS 17 if this accounting mismatch were substantially mitigated or eliminated altogether.

Recommended solution

We request the IASB:

- Mandate the application of current interest rates in the CSM determination at each reporting period. If this approach is considered unacceptable by the IASB we consider that, for the purpose of accounting for reinsurance contracts held, the accounting mismatch that arises be significantly mitigated by allowing, or mandating, the use of discount rates based on the inception dates of underlying groups or cohorts of insurance contracts and not on the inception date of the reinsurance contract held. Suggested wording as follows;

  66. Instead of applying paragraph 44, an entity shall measure the contractual service margin at the end of the reporting period for a group of reinsurance contracts held as the carrying amount determined at the start of the reporting *period, adjusted for:*

(b) interest accreted on the carrying amount of the contractual service margin, measured at the discount rates specified in paragraph B72(b) except where paragraph 66C applies;

66C.

Where a reinsurance contract held provides coverage for underlying insurance contracts that have not yet been issued, the carrying amount of the contractual service margin should be re-measured at the discount rates specified in paragraph B72(b) as at the date of initial recognition of the underlying groups of insurance contracts attaching to the reinsurance contract held.

- Reconsider the approach of regarding the contract boundary of reinsurance contacts where the underlying contracts have not yet been written. The letter from the AASB TRG dated 27 November 2018 sets out our views on how this could be achieved.

B.2 Interim reporting [paragraphs BC214-BC216]

Based on feedback from the AASB TRG, we **agree** that the exception from IAS 34 should not be extended to internal interim reports [ED/2019/4.BC215]. Extending the exception from IAS 34 to internal interim reports would compound the problems already created by IFRS 17.B137.

We consider that fundamental principles in IFRS, such as the principle in IAS 34.28 (that the frequency of an entity's reporting shall not affect the measurement of its annual results) should only be overturned when there are:

(a) substantive reasons in favour of overturning the principle; and

(b) no substantive reasons against overturning the principle.

While we appreciate that the IASB included IFRS 17.B137 to assist some preparers of financial statements, there are substantive reasons against overturning IAS 34.28. Accordingly, we **disagree** with the requirement in IFRS 17.B137 and recommend it be amended.

We understand that some insurers may find it burdensome [ED/2019/4.BC214] to recalculate interim amounts, and that those insurers will have been preparing for the implementation of IFRS 17 on the basis that IFRS 17.B137 applies. We therefore consider that the ability to contravene IAS 34.28 should remain.

Therefore, we urge the IASB to **permit (rather than require)** the exception from IAS 34.28, so that not all insurers are forced to contravene IAS 34.

The costs of requiring insurers to contravene IAS 34.28 include the following:

(a) Most reporting entities information systems are designed to comply with IAS 34.28 in respect of all measurement and recognition requirements in IFRS. Mandating a contravention of this principle in the context of IFRS 17 alone, will create ongoing compliance costs for these entities and therefore we consider that the costs will significantly outweigh the benefits to users.

(b) Insurance companies typically already have systems and processes in place to re-assess assumptions on a frequent basis (as this is necessary in the operation of an insurer). Consequently, we consider that the cost of undertaking such re-assessments is likely lower than the cost of implementing and maintaining the exception to IAS34.28.

(c) When a parent entity reports on an interim basis and its subsidiaries do not, the requirement in IFRS 17.B137 will lead to different entities within the group having different accounting outcomes and multiple sets of books will need to be maintained. We appreciate that the IASB is aware of this problem (based on ED/2019/4.BC215) and we recognise that there are often differences between group and local reporting requirements but consider insufficient weight has been given to its potential magnitude. This could be a very costly exercise for Groups and the differential outcomes between reporting by the Group and its component reporting entities could be confusing for users. We note that, unlike the situation in respect of the EU Directive, IFRS-compliant reporting in Australia is required of some unlisted entities, which may be subsidiaries. This is certainly the case in the Australian insurance industry where Groups might include several registered insurance companies, each of which are required to prepare IFRS-compliant financial statements on an annual basis, while their listed parent entities report each half year.

We are aware of the approach taken in IFRIC 10 issued in 2006, to which we assume the IASB is drawing parallels in including IFRS 17.B137. IFRIC 10 does not allow an entity to reverse an impairment loss recognised in the half year result if this amount would have been smaller or zero impairment when calculated for the full year results as follows:

> *IFRIC 10.8 An entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill.*

However, we contend that this relates to isolated and individual transactions and is not a regular, consistent and recurring activity as it is for the purpose of measuring insurance contracts and, therefore, the impost of IFRS 17.B137 has much farther-reaching implication for insurance entities in terms of ongoing implementation.

In summary, the AASB TRG considers the contravention within IFRS 17 of this long-standing principle in IAS 34.28 for the benefit of some entities to be at the expense of other entities and to the detriment of users. Feedback from AASB TRG highlight that the costs associated with mandating the contravention exceed the benefits.

Possible unit of account impacts

IFRS 17.22 says an entity must not include contracts issued more than one year apart in the same group.

The requirements of IFRS17.B137 potentially contradict IFRS 17.22 as it is not clear whether an insurer reporting each half year, based on IFRS 17.B137, would be restricted to including contracts issued more than six months apart in the same group. That is, the annual cohort requirement would become a six-monthly cohort requirement.

This is because an entity that's prohibited from changing the treatment of accounting estimates made in previous interim financial statements in the annual reporting period would not be able to determine an initial measurement at year end of the CSM for contracts issued in the first half year.

We assume there was not an intent to override IFRS 17.22 and define the minimum cohort of contracts based on the extent to which an insurer lodges IFRS-compliant interim financial reports. Therefore, this needs to be clarified and explained. This would be the case even if the requirement in IFRS 17.B137 were changed to an accounting policy choice.

Appendix C - Areas the Board considered and for which amendments to IFRS 17 are not proposed on which AASB TRG agrees

C.1 Premium Allocation Approach (PAA): premiums received [paragraph BC98]

Based on feedback from the AASB TRG, we **support** no change to the basis for measuring PAA liabilities for remaining coverage as this could result in the PAA no longer approximating the general model [paragraph BC98] which would significantly impact implementation projects underway.

Feedback from preparers **notes** that many of the implementation challenges involved with the requirement to use premiums received rather receivable will be overcome by the proposed change to requiring separate presentation of insurance assets and liabilities by portfolio, rather than by group of contracts.

C.2 Level of aggregation of insurance contracts for measurement purposes [paragraphs BC164-BC179]

We **note** that level of aggregation issues in IFRS 17, other than those proposed to be addressed in relation to insurance asset versus liability presentation, have **not been identified as a major concern** for our Australian insurance industry stakeholders.

C.3 Discount rates and risk adjustment [paragraphs BC186-BC192]

Based on feedback from the AASB TRG, we **agree** with rejecting a rule-based approach to discount rates and risk adjustments [paragraph BC187] on the basis that it would not be feasible within IFRS 17 to cater for the impacts of the wide variety of insurance contract forms, terms and conditions.

We therefore **agree** with making no change in respect of determining risk adjustments within a Group of entities. The issue of whether risk adjustments can be different at different levels within a Group is not unique to insurance and, in principle, applies to any measure that might need to be applied at different levels within a Group of entities. We consider that, if the issue were to be addressed, the relevant project area would be consolidation accounting.

We **note** that other IFRS which include requirements to discount expected future cash flows include general principles on discounting, rather than detailed requirements.

We also **concur** with the IASB reasoning for rejecting more prescription to avoid implementation disruption [paragraph BC188].

Changes to IFRS 17 on these two fundamental topics at this stage would have a detrimental impact on the implementation of IFRS 17.

C.4 Other comprehensive income option for insurance finance income or expenses (paragraphs 88−89 and B129−B133) [paragraphs BC200 to BC202]

Based on feedback from the AASB TRG, we **support** retaining the OCI option for presenting the impact of changes in discount rates in profit or loss on the basis that some insurers may find the OCI option useful for some portfolios, particularly if they apply FVOCI in accounting for assets backing insurance liabilities.

The option will permit insurers to reflect their relevant business model(s), which may differ from portfolio to portfolio.

C.5 Insurance contract with direct participation features [paragraphs BC209-BC213]

Based on feedback from the AASB TRG, we **note** that not extending the definition of 'insurance contracts with direct participation features' to contracts that don't contractually specify the policyholder participates in a share of a clearly identified pool of underlying items (the criterion in IFRS 17.B101(a)) is **not a major concern** for our Australian insurance industry stakeholders.

Appendix D - Addendum to response to Question 4 on the treatment of reinsurance contracts held

Section 1: Examples to demonstrate that the proposed amendment results in different accounting treatment of reinsurance transactions which have the same economic effect

The simplified scenarios in Example 1 below demonstrate that:

(a) The exclusion of non-proportionate reinsurance from the proposed amendment results in two types of contracts which are of the same nature and are entered into to achieve the same outcomes being accounted for differently based on the mechanics of how the recoveries are triggered; and

(b) The narrow definition of 'proportionate coverage' results in a different treatment of proportional reinsurance contracts (where recoveries are determined based on a fixed percentage of underlying claims) based on how an entity's reinsurance programme is structured.

The wide range of reinsurance contracts available and the variety in the structure of reinsurance programs across entities highlights the need for the scope of the proposed amendment to include all types of reinsurance to appropriately reflect the economics of reinsurance transactions.

Example 1

Scenario 1: An entity issues a group of life insurance policies which are homogenous and have a total policy value of CU9m. The table below sets out the IFRS 17 implications of several possible reinsurance structures that may be entered into by the entity to achieve the same outcomes.

	Reinsurance structure	Implication / distribution of risks	Application of proposed amendment
1	The entity enters into 2 quota share (QS) reinsurance contracts which each pay recoveries of 33% of all claims.	• CU3m retained by the entity • CU3m (33% x 9m) retained by reinsurer 1 • CU3m (33% x 9m) retained by reinsurer 2	The two QS reinsurance contracts provide 'proportionate coverage' and will be in scope of the proposed amendment if the underlying contracts are onerous
2	The entity enters into a 75% QS for up to CU8m[11]. Therefore, the insurer retains 25% of the risks below CU8m and 100% of the risks beyond CU8m. The reinsurer retrocedes all claims above CU3m to a pool of retrocessionaires.	• CU3m retained by the entity[12] • CU3m retained by the reinsurer[13] • CU3m retained by retrocession pool	As the QS does not cover a fixed percentage of all claims in the group, it does not appear to be in scope of the proposed amendment.
3	The entity enters into an XOL reinsurance contract which pays recoveries for all claims above CU4m up to a limit of CU7m. The entity also enters into a QS reinsurance contract which pays recoveries of 50% on all claims not covered by the XOL.	• CU3m retained by the entity[14] • CU3m retained by the XOL reinsurer[15] • CU3m retained by QS reinsurer[16]	Both the QS and XOL contracts do not cover a fixed percentage of all claims in the group and therefore, does not appear to be in scope of the proposed amendment.

[11] The reinsurer will pay recoveries of 75% of all claims up to CU8m, i.e. maximum recoveries is CU6m (75% x CU8m)

[12] CU2m (25%*CU8m) + CU1m (CU9m – CU8m)

[13] CU6m (75%*CU8m) less CU3m retroceded to retrocessionaires.

[14] CU2m (CU4m XOL deductible x 50% QS percentage) + CU1m (CU9m less CU7m XOL limit x 50% QS percentage)

[15] CU7m limit less CU4m deductible

[16] See footnote 9

Scenario 2: Assume that there are two insurers both with total policy values of CU9m respectively (total collective policy value = CU18m).

4	Each insurer has a quota share with a reinsurer for 66% of all claims. The reinsurer enters into a 50% quota share (retrocession) for all of the risks it receives on a single life basis up to a maximum retention of CU3m. All amounts above the maximum retention is retroceded.	• CU3m retained by insurer 1 [17] • CU3m retained by insurer 2 • CU3m from insurer 1 retained by reinsurer • CU9m retained by retrocession pool: ○ CU3m from insurer 1 retroceded by reinsurer to retrocession pool. [18] ○ CU6m from insurer 2 retroceded by reinsurer as it is above retention limits.[19]	The two QS reinsurance contracts provide proportionate coverage for the insurers and will be in scope of the proposed amendment if the underlying contracts are onerous. From the reinsurer's perspective, the QS with surplus contract (retrocession) do not cover a fixed percentage of all claims in the group[20] and therefore, does not appear to be in scope of the proposed amendment.

Scenario 3: An entity issues two groups (Group A and Group B) of life insurance policies. At inception, the entity expects that:

- Group A will be profitable and will incur claims of CU3m; and
- Group B will be onerous and will incur claims of CU9m

The table below sets out the IFRS 17 implications of several possible reinsurance structures that may be entered into by the entity to achieve the same outcomes:

	Reinsurance structure	Implication / distribution of risks	Application of proposed amendment
1	The entity enters into a quota share reinsurance contract which covers both groups of contracts. It pays recoveries of 66% of all claims.	• CU4m retained by the entity [(CU3m + CU9m) x 33%] • CU8m [(CU3m + CU9m) x 66%] retained by the reinsurer	The QS reinsurance contract provides 'proportionate coverage' and will be in scope of the proposed amendment if the underlying contracts are onerous. In this example, a reinsurance income will be recognised when the onerous losses on Group B are recognised.
2	The entity enters into a 60% QS for up to CU10m with a surplus above CU10m fully reinsured. Therefore, the entity retains 40% of the risks before CU10m and none of the risks beyond CU10m.	• CU4m retained by the entity [CU10m x 40%] • CU8m [(CU10m x 60%) + (CU12m – CU10m)] retained by the reinsurer	As the QS does not cover a fixed percentage of all claims in the group, it does not appear to be in scope of the proposed amendment. Therefore, no reinsurance income will be recognised when the onerous loss on Group B are recognised.

[17] CU9m * 33% = CU3m

[18] 66% reinsured * CU9m = CU6m (reinsurer's share), CU6m *50% = CU3m (reinsurer's retained share)

[19] The limit of the reinsurers CU3m retention has been met so all new exposures to this single life are 100% retroceded.

[20] Assume that the reinsurance contracts with both insurers form a single group from the reinsurer's perspective.

Section 2: Examples to demonstrate that the reinsurance recoveries that correspond to the onerous underlying losses can be reliably estimated in a consistent manner without making arbitrary assumptions

The following examples address the specific concerns expressed by the IASB in *Basis for Conclusions on ED Amendments* BC86(a) and (b) and demonstrate that the corresponding reinsurance recoveries can be determined in a simple and consistent manner for all types of reinsurance contracts. The examples below are representative of a variety of reinsurance contracts that are used in the market but are not an exhaustive list of the available reinsurance contracts and structures – we consider that the methodology proposed in the examples for determining the reinsurance recoveries that correspond to the onerous losses may be applied in a consistent manner across all types of reinsurance contracts and structures.

Example 2 – Proportionate reinsurance contract (simple quota share) [example in pages 11-12 of the *Snapshot: Amendments to IFRS 17*)]

Discounting and risk adjustment ignored for simplicity.

An entity issues a group of insurance contracts that is expected to be onerous:

Insurance contracts issued (*Table 1*)	
Premiums	100
Claims	(150)
Expected loss (recognised immediately)	**(50)**

At the same time, the entity enters into a proportionate reinsurance contract which will pay recoveries of 80% of all underlying claims for a fixed reinsurance premium of CU125:

Proportionate reinsurance contract held (*Table 2*)		
Reinsurance premiums	(125)	
Claims recovered from reinsurance	120	Based on expectations of underlying claims in Table 1 above: CU150 x 80%
Net cost	**(5)**	
Recovery % = 80%		120 expected recoveries / 150 expected underlying clams
Recovery that corresponds to the onerous loss = 80% x CU50	**40**	

The underlying claims that cause the loss **have known recoveries** which can be estimated by applying the recovery % to the underlying loss (80% x underlying loss of CU50 = CU40).

Implication of the current IASB proposed amendment

- The entity recognises a loss of CU50 (Table 1) immediately for the insurance contracts issued.
- As the reinsurance contract is a proportionate reinsurance contract, a reinsurance income of CU40 (80% x underlying loss of CU50) is recognised in profit or loss at the same time as the recognition of the underlying losses.

Example 3 – facultative excess of loss (XOL) reinsurance contract covering a single underlying insurance contract

Discounting and risk adjustment ignored for simplicity.

An entity issues an insurance contract that is expected to be onerous:

Insurance contracts issued (*Table 1*)	
Premiums	100
Claims	(150)
Expected loss (recognised immediately)	**(50)**

At the same time, the entity enters into an excess of loss (XOL) reinsurance contract which will pay recoveries for all claims above a deductible of CU30 for reinsurance premiums of CU125:

Non-proportionate reinsurance contract held (XOL) (*Table 2*)		
Reinsurance premiums	(125)	
Claims recovered from reinsurance	120	Based on expectations of underlying claims in Table 1 above: CU150 less deductible of CU30
Net cost	**(5)**	
Recovery % = 80%		120 expected recoveries / 150 expected underlying clams
Recovery that corresponds to the onerous loss = 80% x CU50	**40**	

IASB's view in ED BC86(a): the entity would need to make an arbitrary assumption about which claims cause the contract to be onerous, because the reinsurance contract does not cover all claims

The underlying claims that cause the loss **have known recoveries** which can be estimated by applying the recovery % to the underlying loss (80% x underlying loss of CU50 = CU40). The recovery percentage is the allocation of the insurer's right to recover under the reinsurance contract to each underlying claim (including the claims that make up the underlying loss of CU50). This methodology can be applied without making subjective judgements or arbitrary assumptions as to which claims the loss of CU50 relates to.

Although the recovery % varies over time for a non-proportionate reinsurance contract (i.e. it is not a fixed percentage but varies as expectations of the underlying claims change), the recovery % (expected reinsurance recoveries that correspond to the underlying claims) can always be identified based on the expectations of underlying claims at each point in time. In this example, the expected underlying claims of CU150 (based on expectations at the point of recognition of the underlying loss) will trigger CU120 of reinsurance recoveries based on the terms of the XOL reinsurance contract. When there is a change in expectations of the underlying claims, the loss component of the group of underlying contracts is updated to reflect these changes in expectations and the corresponding reinsurance recovery % is also updated accordingly based on the revised expectations of underlying claims at the point of adjustment.

Implication of the current IASB proposed amendment

- The entity recognises a loss of CU50 (Table 1) immediately for the insurance contracts issued.
- As the reinsurance contract is a non-proportionate reinsurance contract[21], the net cost of CU5 (Table 2) is recognised in profit or loss over the coverage period of the reinsurance contract held.
- If the facts are modified so that the reinsurance contract held is a proportionate reinsurance contract which pays recoveries of 80% of underlying claims, a reinsurance income of CU40 (80% x underlying loss of CU50) is recognised in profit or loss at the same time as the recognition of the underlying losses. (refer to example in pages 11-12 of the *Snapshot: Amendments to IFRS 17*, or Example 2 above).

[21] based on the definition of 'proportionate coverage' in paragraph B119C

Example 4 – excess of loss (XOL) reinsurance contract covering an onerous and profitable group of contracts

Discounting and risk adjustment ignored for simplicity.

An entity issues two groups of insurance contracts:

Insurance contracts issued (*Table 1*)			
	Group 1	**Group 2**	**Total**
Premiums	100	100	200
Claims	(150)	(20)	(170)
Expected underlying gain / (loss)	**(50)**	**80**	**30**

At the same time, the entity enters into an excess of loss (XOL) reinsurance contract which will pay recoveries for all claims above a deductible of CU50 for reinsurance premiums of CU125. The **total expected cash flows** under the reinsurance contract held is as follows:

Non-proportionate reinsurance contract held (XOL) (*Table 2*)		
Reinsurance premiums	125	
Claims recovered from reinsurance	(120)	Based on expectations of underlying claims in Table 1 above: CU170 less deductible of CU50
Net cost	(5)	
Recovery % = 70.6%		120 expected recoveries / 170 expected underlying claims
Recovery that corresponds to the onerous loss = 70.6% x CU50	**35.3**	

The total expected underlying claims of CU170 (based on expectations at the point of recognition of the underlying loss – See Table 1) will trigger CU120 of reinsurance recoveries based on the terms of the XOL reinsurance contract.

IASB's view in ED BC86(b): the entity would need to make an arbitrary assumption about which contracts cause the entity to expect to reach the specified excess on the reinsurance contract held, because the specified excess is not likely to be exceeded by one insurance contract. For example, the question would arise as to whether any recovery of losses should be recognised when the first onerous insurance contract the entity issues is recognised.

The underlying claims that cause the loss **have known recoveries** which can be estimated by applying the recovery % to the underlying loss (70.6% x underlying loss of CU50 = CU35.3), i.e. the total expected recoveries of CU120 is apportioned across all underlying claims. As explained in Example 3 above, the recovery percentage is the allocation of the insurer's right to recover under the reinsurance contract to each underlying claim (including the claims that make up the underlying loss of CU50). This methodology can be applied without making subjective judgements or arbitrary assumptions as to which claims the loss of CU50 relates to.

Implication of the current IASB proposed amendment

- The entity recognises a loss of CU50 (Table 1) immediately for the onerous groups of insurance contracts issued (Group 1).
- As the reinsurance contract is a non-proportionate reinsurance contract[22], the net cost of CU5 (Table 2) is recognised in profit or loss over the coverage period of the reinsurance contract held.
- If the facts are modified so that the reinsurance contract held is a proportionate reinsurance contract which pays recoveries of 70.6% of underlying claims, a reinsurance income of CU35 (70.6% x underlying loss of CU50) is recognised in profit or loss at the same time as the recognition of the underlying losses.

[22] based on the definition of 'proportionate coverage' in paragraph B119C

Example 5 – surplus reinsurance contract covering a group of underlying insurance contracts

Discounting and risk adjustment ignored for simplicity.

An entity issues a group of insurance contracts that is expected to be onerous. The entity expects to incur 3 claims amounting to total claims of CU150 for that group of insurance contracts.

Insurance contracts issued (*Table 1*)	
Premiums	100
Claims	(150)
Expected loss (recognised immediately)	**(50)**

At the same time, the entity enters into a surplus reinsurance contract which will pay recoveries for all amounts above CU10 per claim for reinsurance premiums of CU125:

Non-proportionate reinsurance contract held (Surplus) (*Table 2*)		
Reinsurance premiums	(125)	
Claims recovered from reinsurance	120	Based on expectations of underlying claims in Table 1 above: 150 less (10 x 3 expected claims) = 120
Net cost	**(5)**	
Recovery % = 80%		120 expected recoveries / 150 expected underlying claims
Recovery that corresponds to the onerous loss = 80% x CU50	**40**	

IASB's view in ED BC86(a): the entity would need to make an arbitrary assumption about which claims cause the contract to be onerous, because the reinsurance contract does not cover all claims.

The underlying claims that cause the loss **have known recoveries** which can be estimated by applying the recovery % to the underlying loss (80% x underlying loss of CU50 = CU40). The recovery percentage is the allocation of the insurer's right to recover under the reinsurance contract to each underlying claim (including the claims that make up the underlying loss of CU50). This methodology can be applied without making subjective judgements or arbitrary assumptions as to which claims the loss of CU50 relates to.

Surplus contracts are common in the life industry and the stated surplus factor can be applied to each estimated claim at inception to determine an appropriate percentage of reinsurance recovery.

Implication of the current IASB proposed amendment

- The entity recognises a loss of CU50 (Table 1) immediately for the insurance contracts issued.
- As the reinsurance contract is a non-proportionate reinsurance contract[23], the net cost of CU5 (Table 2) is recognised in profit or loss over the coverage period of the reinsurance contract held.
- If the facts are modified so that the reinsurance contract held is a proportionate reinsurance contract which pays recoveries of 80% of underlying claims, a reinsurance income of CU40 (80% x underlying loss of CU50) is recognised in profit or loss at the same time as the recognition of the underlying losses. (refer to example in pages 11-12 of the *Snapshot: Amendments to IFRS 17*, or Example 2 above).

[23] based on the definition of 'proportionate coverage' in paragraph B119C

Example 6 – a 'proportionate'[24] reinsurance contract and an XOL covering a group of underlying insurance contracts

Discounting and risk adjustment ignored for simplicity.

An entity issues a group of insurance contracts that is expected to be onerous:

Insurance contracts issued (*Table 1*)	
Premiums	100
Claims	(150)
Expected loss (recognised immediately)	**(50)**

At the same time, the entity enters into the following reinsurance contracts:

- a proportionate reinsurance contract which will pay recoveries of 70% of underlying claims up to a limit of CU100 for reinsurance premiums of CU65 [Reinsurance contract 1]; and
- an XOL reinsurance contract which will pay recoveries for all claims above a deductible of CU100 for reinsurance premiums of CU60 [Reinsurance contract 2].

The **total expected cash flows** under the reinsurance contracts held is as follows:

Reinsurance contracts held (*Table 2*)		
Reinsurance premiums	(125)	65 (Reinsurance contract 1) + 60 (Reinsurance contract 2)
Claims recovered from reinsurance	120	Based on expectations of underlying claims in Table 1 above: 70 [70% x 100] (Reinsurance contract 1) + 50 [150 total claims less deductible of 100] (Reinsurance contract 2)
Net cost	**(5)**	
Recovery % = 80%		120 expected recoveries / 150 expected underlying claims
Recovery that corresponds to the onerous loss = 80% x CU50	**40**	

The underlying claims that cause the loss **have known recoveries** which can be estimated by applying the recovery % to the underlying loss (80% x underlying loss of CU50 = CU40), i.e. the total expected recoveries of CU120 is apportioned across all underlying claims. The recovery percentage is the allocation of the insurer's right to recover under the reinsurance contract to each underlying claim (including the claims that make up the underlying loss of CU50). This methodology can be applied without making subjective judgements or arbitrary assumptions as to which claims the loss of CU50 relates to.

Implication of the current IASB proposed amendment

- The entity recognises a loss of CU50 (Table 1) immediately for the insurance contracts issued.
- As the reinsurance contracts do not meet the definition of a 'proportionate reinsurance contract'[25], the net cost of CU5 (Table 2) is recognised in profit or loss over the coverage period of the reinsurance contract held.
- If the facts are modified so that the reinsurance contract held is a proportionate reinsurance contract which pays recoveries of 80% of underlying claims, a reinsurance income of CU40 (80% x underlying loss of CU50) is recognised in profit or loss at the same time as the recognition of the underlying losses. (refer to example in pages 11-12 of the *Snapshot: Amendments to IFRS 17*, or Example 2 above).

[24] We note that the 'proportionate' reinsurance contract in this example would not meet the definition of 'proportionate coverage' in paragraph B119C due to the existence of the limit.

[25] based on the definition of 'proportionate coverage' in paragraph B119C.