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Mr. Hans Hoogervorst
Chairman
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30 Cannon Street
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RE: ED/2019/4 Amendments to IFRS 17

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organized standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on IFRS Standards Exposure Draft ED/2019/4 *Amendments to IFRS 17* (the 'ED'), issued by the International Accounting Standards Board (IASB) in June 2019.

Principal authors of this comment letter were Christoph Krischanitz, Andreas Rauter and Guido Sopp. In order to assure a balanced Austrian view on the ED, the professional background of these authors is diverse.

GENERAL REMARKS

AFRAC welcomes and supports the efforts of the IASB to propose targeted amendments to IFRS 17 to assist companies implementing the Standard, without unduly disrupting implementation or diminishing the usefulness of financial information. We appreciate your consideration of topics and issues identified by preparers of financial statements and other stakeholders resulting in the targeted amendments relating to seven areas.

AFRAC supports the proposed one-year postponement of the effective date of IFRS 17 to provide for the uncertainty arising from the potential amendments. We recommend to consider no further postponement of the effective date of IFRS 17 in order to proceed with a timely replacement of the current IFRS 4 Insurance Contracts which does not provide the necessary transparency and comparability in relation to insurance contracts. Nevertheless, we see a time pressure due to the mandatory requirement to present comparatives at transition in order to allow more time for implementation work as well as for the endorsement processes around the globe. Moreover, this postponement is in line with the requirement in IFRS 9 for financial instruments. As to the details we broadly support many changes proposed.

Our detailed comments and responses to the questions raised in the ED are set out in the appendix.

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

Kind regards,

Romuald Bertl

AFRAC
AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

EXPOSURE DRAFT AMENDMENTS TO IFRS 17

Specific Remarks - Questions for respondents

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

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

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

<u>AFRAC's response:</u>

We welcome the proposed amendments. While, in our view, the IASB should preserve the principle that transactions meeting the definition of insurance contracts should be accounted for consistently within IFRS 17, AFRAC acknowledges the cost-benefit arguments underlying the proposed scope exclusion of this type of contract in those cases, in which 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.

AFRAC notes that in paragraph BC 13 of the ED the IASB explains that 'If the entity acts as an agent in providing insurance coverage under such a contract, the contract is not an insurance contract issued by the entity. However, if the entity provides insurance coverage as a principal, the contract is an insurance contract issued by the entity'. It is not clear whether the IASB determines this principal-agent assessment as a necessary, additional step for the assessment of the eligibility of the scope exclusion. If this is the case, AFRAC recommends that this condition is added to the text of the standard. If this assessment is not intended as a condition for the eligibility of the scope exclusion, we recommend that the IASB clarifies this fact.

(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?

<u>AFRAC's response:</u>

We welcome the proposed amendments.

Question 2—Expected recovery of insurance acquisition cash flows (paragraphs 28A–28D, 105A–105C, B35A–B35C and BC31–BC49)

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

(a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to any groups that include contracts that are expected to arise from renewals of the contracts in that group;

(b) recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and

(c) assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.

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

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

AFRAC's response:

AFRAC understands that it is market practice for some insurers to bear upfront the acquisition costs for the issuance of insurance contracts and for future expected renewals. AFRAC agrees that the accounting model for insurance contracts should be able to reflect this fact pattern.

However, AFRAC is concerned that the proposal to recognise an asset for acquisition cash flows relating to contract renewals, as suggested, could result in excessive judgement which may undermine the reliability and comparability across insurers.

We are concerned that the proposed amendments do neither provide a definition of what should be understood as 'expected renewals', nor an objective basis on how to determine the contractual renewals to which the deferral of the acquisition cash flows should apply.

In order to clarify the objective of the amendment and to guide entities on its application, we would recommend to define and specify the 'renewals' to which the acquisition costs have to be allocated. Here, we could imagine to refer to 'future renewals' within the 'related groups' in paragraph 28B (as set out in proposed paragraph B35A(b)) and, thus, to clearly limit the scope of this change.

In addition, the IASB could consider to enhance the disclosure requirements in order to help users of the financial statements and in order to facilitate the comparison between firms. In particular, enhanced disclosures could help users to understand the impact of the firm's approach of capitalising acquisition costs on its profitability, the consequences of changes to relevant estimates for such assets as well as the implications of ceasing to write particular business lines. For example, the IASB could consider to require firms to outline their approach of allocating acquisition costs to future renewals, the evidence available to support such an allocation and the amounts allocated by major product lines.

We note that Appendix A of IFRS 17 defines acquisition cash flows as ‘cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts that are directly attributable to the portfolio of insurance contracts to which the group belongs’. Given this rather broad definition, we are concerned that the proposed amendments do not indicate how an insurer should allocate the different components of acquisition cash flows to future renewals. In particular, the deferred recognition of some expenses associated with acquisition cash flows within the contract boundary puts pressure on the distinction between costs of selling, underwriting and starting a group of insurance contracts, which may result in significant divergence in practice.

Finally, we recognise that the proposed amendments envisage an assessment of the recoverability of the asset recognised for the insurance acquisition cash flows only if facts and circumstances indicate that the asset may be impaired. AFRAC believes that the reference to ‘facts and circumstances’ is rather vague and that an explicit indication of those factors, which may be indicative of an impairment, would provide more useful and comparable information. In the absence of such factors, AFRAC believes that such tests should be conducted at least on an annual basis.

Question 3—Contractual service margin attributable to investment-return service and investment-related service (paragraphs 44–45, 109 and 117(c)(v), Appendix A, paragraphs B119–B119B and BC50–BC66)

(a) Paragraphs 44, B119–B119A and the definitions in Appendix A propose that an entity identifies 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?

AFRAC’s response:

We welcome the amendment to require investment-return services to be considered when allocating the contractual service margin (“CSM”) using coverage units. This amendment recognises that also many insurance contracts that qualify for measurement under the general measurement model have significant elements of both insurance coverage and investment-return services. The CSM established for these types of contracts at the inception includes expected profit from both insurance and investment-related activities. We agree that the profit from these services should be recognised in line with the service provision over the life of the contract. In our view the proposed amendments significantly improve the relevance of the income statement for these contracts.

(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?

AFRAC's response:

We support the requirement to identify coverage units for insurance contracts with direct participation features (variable fee approach contracts) considering the quantity of benefits and the expected period of both insurance coverage and investment-related service.

(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?

AFRAC's response:

AFRAC believes that the proposed quantitative disclosures will help users to understand the pattern of both insurance and investment services. We, therefore, support the proposed amendments.

Question 4—Reinsurance contracts held—recovery of losses on underlying insurance contracts (paragraphs 62, 66A–66B, B119C–B119F and BC67–BC90)

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

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

(b) the fixed percentage of claims on the group of underlying contracts the entity

has a right to recover from the group of reinsurance contracts held.

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

AFRAC's response:

We support the direction of change that is proposed in the Exposure Draft, which is based on the principle that a gain on proportionate reinsurance should be recorded in profit or loss to the extent that it (partially) offsets a loss on onerous underlying insurance contracts.

In addition, we are of the opinion that relevant disclosures would help the reader of the financial statements to differentiate between the income from reinsurance held in respect of losses incurred at inception of an insurance contract and losses originating from subsequent measurement and experience adjustments.

Question 5—Presentation in the statement of financial position (paragraphs 78–79, 99, 132 and BC91–BC100)

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

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

AFRAC's response:

We welcome the proposed amendments which require to present each portfolio, rather than group, of insurance contracts as an asset or liability. We believe that this proposed amendment is a significant improvement that will reduce the operational burden to preparers, with no material loss of information to users.

Question 6—Applicability of the risk mitigation option (paragraphs B116 and BC101–BC109)

The proposed amendment to paragraph B116 would extend the risk mitigation option available when an entity uses derivatives to mitigate financial risk arising from insurance contracts with direct participation features. That option would apply in circumstances when an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts with direct participation features.

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

AFRAC's response:

We welcome the proposed amendment to extend the risk mitigation option, that is currently available only when an entity uses derivatives to mitigate financial risk, to circumstances when an entity uses reinsurance contracts held to mitigate financial risk.

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

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

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

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

AFRAC's response:

We welcome the proposed deferral of the effective date of IFRS 17 and IFRS 9.

Taking into account the changes that are still being proposed to IFRS 17, the time necessary to establish clarity for the endorsement of IFRS 17 in Europe and the significant operational challenges that insurers face in implementing the complex requirements, we believe that the deferral of the effective date is needed. However, the deferral shall be limited to one year considering that the proposed amendments have been selected in order to avoid the risk of disrupting the implementation efforts that are already in progress.

(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?

AFRAC's response:

We welcome the proposed deferral of the effective date of IFRS 17 and IFRS 9. It is of high importance to focus on the timely finalization of the revised IFRS in order to have a harmonized approach for the ongoing implementation projects. In this context, we recommend to remove the mandatory requirement to present comparatives at transition as this would be in line with the requirement in IFRS 9 for financial instruments.

Question 8—Transition modifications and reliefs (paragraphs C3(b), C5A, C9A, C22A and BC119–BC146)

(a) Paragraph C9A proposes an additional modification in the modified retrospective approach. The modification would require an entity, to the extent permitted by paragraph C8, to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired. Paragraph C22A proposes that an entity applying the fair value approach could choose to classify such a liability as a liability for incurred claims.

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

<u>AFRAC's response:</u>

We welcome the proposed amendments regarding business combinations prior to transition, which allow claims in payment at the acquisition date to be treated as incurred claims. However, we believe that this should be permitted even if it is practicably possible to apply the standard without the relief as it will represent a considerable workload whilst it would not result in more useful information.

(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?

<u>AFRAC's response:</u>

We welcome the proposed amendments to apply the risk mitigation option prospectively from the transition date instead of the effective date, thereby allowing comparative financial information to be prepared on the same basis in the first IFRS 17 financial statements. We also support the proposed amendment to permit an entity to apply the fair value approach at transition when it used derivatives or reinsurance to mitigate financial risk before the transition date.

AFRAC concurs with the IASB's assessment in paragraph BC128 of the ED that the retrospective application of the risk mitigation option should not be permitted in order to avoid the risk of hindsight and create opportunities for entities to decide the risk mitigation relationships to which the risk mitigation option shall apply based on the known outcome.

(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?

<u>AFRAC's response:</u>

We support the proposed amendments.

Question 9—Minor amendments (BC147–BC163)

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

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

AFRAC's response:

We support the proposed amendments set out in paragraphs BC147-BC163.

Question 10—Terminology

This Exposure Draft proposes to add to Appendix A of IFRS 17 the definition 'insurance contract services' to be consistent with other proposed amendments in this Exposure Draft. In the light of the proposed amendments in this Exposure Draft, the Board is considering whether to make a consequential change in terminology by amending the terms in IFRS 17 to replace 'coverage' with 'service' in the terms 'coverage units', 'coverage period' and 'liability for remaining coverage'. If that change is made, those terms would become 'service units', 'service period' and 'liability for remaining service', respectively, throughout IFRS 17.

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

AFRAC's response:

We understand the rationale for such a change, but we strongly recommend to carefully align all accompanying documents and educational material in the same way.