New Zealand Society of Actuaries (Inc)

25 September 2019

International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Board members,

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

I am writing on behalf of the New Zealand Society of Actuaries ("NZSA") in in response to ED/2019/4, the proposed changes to IFRS 17 Insurance Contracts. The NZSA is the professional body governing actuaries and actuarial work in New Zealand; many members work for or advise insurers in New Zealand.

You will be aware New Zealand is one of the countries that has already adopted IFRS 17, yet many New Zealand insurers are still at relatively early stages in their IFRS 17 implementation projects. This is due especially to the uncertainty around a final version of the standard, which has led a number of insurers to defer the start of their projects. As a result, undue disruption of implementation projects is less of a concern in New Zealand than having a workable Insurance Contracts standard and a loss of useful information. Timely resolution of the remaining issues and finalisation of the standard, with sufficient time to address those changes and implement IFRS 17, is critical to enabling insurers to progress IFRS 17 with confidence.

We understand, and appreciate, the effort that has gone into deliberating the further 25 issues presented at the October 2018 IASB meeting. The discussion around each issue has been thorough and the IASB staff position has been made clear. We are supportive of the overall rationale behind most of the amendments as they address some of the potential difficulties, particularly the effective date and treatment of acquisition costs.

We have members who work with the Australian Accounting Standards Board (AASB) and its Transition Resource Group (AASB TRG). We have also considered the points raised in the AASB submission on the amendments and support, in principle, the comments made and suggested further amendments, along with the additional concerns raised by the AASB. The insurance industry in New Zealand has a number of common areas with that in Australia as many of the larger insurers here in New Zealand have Australian parents.

In Appendix A (attached), we have set out our brief responses to questions 2, 3, 4, 5 and 7. In terms of the other items, from a New Zealand perspective we are not aware of any concerns to the ED proposals specifically as the issues are less relevant for insurers in New Zealand.

Appendix B sets out some comment on issues discussed by the IASB that were not addressed in ED/2019/4. These are consistent with the AASB submission and we would encourage the IASB to consider these further.

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

Kind regards,

P.P.

John Smeed
President
New Zealand Society of Actuaries

Appendix A – Specific responses to questions raised in ED/2019/4

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:*
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> *(a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to any groups that include contracts that are expected to arise from renewals of the contracts in that group;*
>
> *(b) recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and*
>
> *(c) assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.*
>
> *Paragraphs 105A–105C propose disclosures about such assets.*
>
> *Do you agree with the proposed amendments? Why or why not?*

We agree with the proposed amendments as a practical and sensible approach to deal with situations commonly seen in New Zealand.

In particular, it is not uncommon for life insurers within New Zealand to pay high initial commissions (over 200% of the first year's premium) with the reasonable expectation of each contract renewing their insurance policy into the future. Whilst we do not comment on this practice, we are concerned that no amendment in this area would adversely affect the way a number of life insurers would report results. It would also in our view, be inconsistent with accounting treatments seen in other industries that use IFRS 15 for their revenue recognition.

In respect of the points raised in the AASB submission:

1. We support the allocation of acquisition costs to future renewals when the insurer expects to recover those acquisition costs from future contract renewals. We support the AASB proposal to amend the wording so that entities are not required to allocate acquisition costs to those groups where the insurer *does not expect* to recover acquisition costs from future renewals. This would be a more practical approach for insurers that do not allocate certain expenses to a portfolio level. Additional disclosures have been suggested in relation to the asset created as a result of deferring acquisition costs to future groups, that would allow users of financial statements to compare results across insurers on a like-for-like basis.

2. We strongly support providing transitional relief for the determination of the asset related to acquisition costs that is allocated to future groups. Without such transitional relief, it would not only be impractical to identify certain assumptions, it may actually be impossible for mature insurers writing long-term business due to data availability and existing systems.

3. We support the clarification of the number of assets under 28B (and in the corresponding application guidance) to make it clear that there should be a single asset recognised in respect of all existing or future groups. Multiple assets for *each* existing or future group would be very problematic due both to the operational complexity, and also as future groups are not independent to existing groups given the renewable nature of many insurance contracts (future renewals depend on the policies from a previous group alongside policy retention assumptions). A single asset is more practical to implement and achieves an outcome that is more consistent with the way goodwill intangible assets are tested under other accounting requirements.

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?

We agree with the principle behind the proposed amendments and disclosure requirements. These amendments should provide more useful information for contracts that have both insurance and investment related components.

We support the AASB submission point regarding the definition of investment return services in para B119B(b). The referral to a ‘positive investment return’ appears confusing to us and the proposed wording change suggested by the AASB is one way of addressing this. Alternatively, we suggest adding “positive investment return” to the defined terms under Appendix A of the standard and defining the term more clearly.

We also note it is important to include the words “for the policyholder” in the last part of the definition to make it clear that it is investment activity on behalf of the policyholder that matters, not other investment activities in respect of an insurer’s shareholder funds.

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 agree with the proposed amendment to reduce the potential inconsistency between the accounting of underlying contracts and the reinsurance contracts held.

However, we note that under the drafted amendment, this change would have very little impact on New Zealand insurers due to the potentially narrow definition of "proportionate" and therefore not applicable to many typical cases seen in the industry.

We support, in principle, the AASB comments on the extension of this provision to cover a wider range of reinsurance contracts. Our reasons for supporting this are:

1. New Zealand typically sees a high use of reinsurance, often with multiple layers or types of reinsurance, due to its size and exposure to natural catastrophes. Extension of the amendment to include non-proportional reinsurance contracts as well as proportional reinsurance contracts where not all the underlying contracts are covered by the same percentage (for example due to other existing reinsurance arrangements or specific treaty exclusions) is important.

2. In para 66(c)(ii), relating to subsequent measurement for reinsurance contracts, there is no distinction between proportionate or non-proportionate reinsurance. Extension of the amendment to apply to all types of reinsurance contracts provides consistency within the standard between the accounting of reinsurance contracts at initial recognition and at subsequent measurement.

Any wording changes would naturally need to be clear and avoid unintended consequences.

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

> ***Question 5***
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> *The proposed amendment to paragraph 78 would require an entity to present separately in the statement of financial position the carrying amount of portfolios of insurance contracts issued that are assets and those that are liabilities. Applying the existing requirements, an entity would present the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities. The amendment would also apply to portfolios of reinsurance contracts held that are assets and those that are liabilities.*
>
> *Do you agree with the proposed amendment? Why or why not?*

We agree with the proposed amendment. We see this change as a significant reduction to operational complexity and system changes for insurers, without any major loss of useful information.

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?

We agree with the proposed amendment to defer the effective date of IFRS 17 by one year to allow insurers more time to consider the impact of the proposed amendments.

We do not express a view on the temporary exemption from IFRS 9 requirements, as this does not apply to New Zealand. NZ IFRS 9 is applicable to all companies, insurers included, for balance dates beginning on or after 1 January 2019. Thus, all insurers would be compliant for reporting from the end of this calendar year. Maintaining consistency with the effective date for implementation of IFRS 9 is not a consideration in New Zealand.

With this in mind, support for the proposed amendment to defer the effective date of IFRS 17 by one year is heavily dependent on rapid issue resolution and finalisation of the standard. New Zealand insurers have been waiting on the finalisation of further amendments before making investments in their systems and processes. Should the finalisation of the IFRS 17 be delayed beyond current published timelines, for whatever reason, we would then support a later effective date for IFRS 17 to provide sufficient time for implementation. This is consistent with the AASB view.

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Appendix B – Areas considered for which amendments to IFRS 17 are not proposed but we suggest further consideration

B.1 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]

We support the AASB submission view that current discount rates should apply to all aspects of the insurance standard, including the Contractual Service Margin (CSM).

We understand the IASB's rationale for locked-in discount rates on accretion of the CSM. In theory, it provides a consistent and smooth recognition of profit over time based on the economic environment at the inception of the contract. This accounting approach would only work well when there is no significant changes to or volatility in discount rates over time.

However, making assumptions about the future is difficult especially economic assumptions and experience seldom emerges in line with initial views and assumptions about the future naturally change over time. The global economic environment has been particularly volatile and uncertain in recent years, small changes to interest rates can have a significant impact.

Using locked-in discount rates for accretion of the CSM, and current rates for present value of fulfilment cashflows, will result in different adjustments to the CSM and fulfilment cashflows from assumption changes to discount rates between inception and the relevant reporting period. Alongside profits or losses in the current financial year arising from non-economic assumption changes, there will be greater volatility of results in the income statement (or statement of comprehensive income) arising from economic assumption changes. This adds unnecessary volatility to the results, will inevitably be difficult to explain to investors, and makes the timing of any assumption changes more important.

We also agree with additional concerns raised in the AASB submission in regard to additional inconsistency created between underlying contracts and reinsurance contracts with different locked-in discount rates applying.

Therefore, consistent with the AASB view, we support a change to IFRS 17 that would reduce or eliminate the accounting inconsistency arising from the use of locked-in discount rates. We consider it would improve the validity of results and information reported by entities applying IFRS 17, if this accounting mismatch were eliminated.

B.2 Interim reporting [paragraphs BC214-BC216]

We support the AASB submission in respect of comments around interim reporting.

The requirement in IFRS 17 B137 would mean that interim reporting estimates could not be changed at the annual reporting date, which over-rides principles in IAS 34. We therefore disagree with this requirement and 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.

Adjustments to interim reporting estimates at a subsequent annual reporting date should be allowable on principle as it will be costly to maintain compliance with IFRS 17 B137 where contracts are grouped by year of issue and with more frequent reporting periods. The AASB comments relating to different reporting periods for parent companies from their subsidiaries is very relevant to New Zealand insurers where a large proportion of the insurers are overseas-owned.

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