Institute and Faculty of Actuaries

23 May 2022

IASB Interpretation Committee – Comment on tentative agenda decision: “Transfer of Insurance Coverage under a Group of Annuity Contracts (IFRS 17)” – March 2022 Agenda Paper 2

IFoA Response

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

Key points

The IFoA welcomes the opportunity to comment on the tentative agenda decision made by the IASB IFRS Interpretation Committee on the ‘Transfer of Insurance Coverage under a Group of Annuity Contracts (IFRS 17 Insurance Contracts)’, at its March 2022 meeting.

In relation to the transfer of insurance coverage (the service) for an immediate annuity in payment (the ‘fact pattern’), we view that a range of methods could be permitted in a principles-based standard, and this is not limited to the two methods considered by the Committee in its March 2022 meeting.

IFRS 17 is not explicit on whose perspective to consider when considering the service provided from an insurer to a policyholder (or customer) and the policyholder’s perspective is likely to be very different to the insurer’s. For an immediate annuity in payment a policyholder may perceive a more continuous service at a different rate to that implied by discrete payments received each period.

The Committee concluded that providing a service to a policyholder can only occur during periods where valid claims are paid/ investigated. In our view IFRS 17 does not explicitly state this and it depends on the interpretation of the word ‘service’ and whose perspective this is considered from. We view that a policyholder could quite easily envisage an insurer providing a service during periods where no valid claims are paid.

We also observe:

- a potential inconsistency between the proposed treatment of insurance coverage through Method 1 compared to the treatment of investment-return (General Model) or investment-related (Variable Fee Approach) services; and
- there may be unintended consequences from the tentative agenda decision. For example, adopting Method 1 for a pure endowment would result in no CSM being released to profit or loss until the last day of the contract. Similarly, for contracts that provide guarantees at specific points in the policy lifetime (e.g. maturity) no related CSM would be released to profit or loss until the period in which the guarantee can be taken-up. This appears counter-intuitive to the policyholder’s view of service (and so CSM being released) throughout the contract lifetime.

In our experience within the UK and globally, we expect that there may be divergence in practice in the application of paragraph B119 of IFRS 17 across similar products and so the recognition of CSM to profit or loss. This is not limited to the fact pattern considered by the Committee. In our view, this is an area that the IASB should consider in any future Post Implementation Review of IFRS 17.

Hong Kong 1803 Tower One · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +852 2147 9418
London (registered office) 7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · **Tel**: +44 (0) 20 7632 2100
Oxford 1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · **Tel**: +44 (0) 1865 268 200
Singapore 163 Tras Street · #07-05 Lian Huat Building · Singapore 079024 · **Tel**: +65 6906 0889

www.actuaries.org.uk

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to comment on the tentative agenda decision made by the International Accounting Standards Board (IASB) IFRS Interpretation Committee (the 'Committee') on the 'Transfer of Insurance Coverage under a Group of Annuity Contracts (IFRS 17 *Insurance Contracts*)' (Agenda Paper 2), at its March 2022 meeting.

2. The tentative agenda decision of Committee is set out here: https://www.ifrs.org/news-and-events/updates/ifric/2022/ifric-update-march-2022/#1 and our comment is technical in nature based on this decision.

3. We have been actively engaged in the development of IFRS 17 for a number of years including responding to each Exposure Draft published by the IASB and through supporting the global IFRS 17 work of the International Actuarial Association (IAA).

4. It is important to note that, as for any IFoA response, we have considered the tentative agenda decision made by the Committee from an independent, public interest perspective.

Principles-based standards

5. Paragraph 1 of IFRS 17 notes that the standard '*establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts …'*. IFRS 17, consistent with other IFRSs, is principles-based and a range of approaches within the principles is permitted with disclosure required of material areas of judgement.

6. On the release of the Contractual Service Margin (CSM) to profit or loss through coverage units, the IASB's Transition Resource Group (TRG) in May 2018 noted the following in paragraphs 32 and 33 of the meeting summary[1] [emphasis in bold added]:

   *"32. TRG members discussed the analysis in Agenda Paper 5. They observed that IFRS 17 **established a principle** (to reflect the services provided in a period under a group of insurance contracts), **not detailed requirements**, and that it would not be possible to develop detailed requirements that would apply appropriately to the wide variety of insurance products existing globally.*

   *33. TRG members also observed the determination of coverage units is not an accounting policy choice **but involves judgement and estimates to best achieve the principle of reflecting the services provided in each period.** Those judgements and estimates should be applied systematically and rationally."*

7. In relation to the transfer of insurance coverage (the service) for an immediate annuity in payment (the 'fact pattern'), we view that a range of methods could be permitted in a principles-based standard and this is not limited to the two methods considered by the Committee in its March 2022 meeting.

Perspective of service when applying IFRS 17

8. The tentative agenda decision by the Committee focuses on the application of paragraph B119 of IFRS 17 and the definition of the 'Liability for Incurred Claims' and the 'Liability for Remaining Coverage' as defined in Appendix A to IFRS 17. In applying paragraph B119 of IFRS 17, an entity is required to identify the insurance contract services, in particular, the insurance coverage for the immediate annuity in payment fact pattern considered by the Committee. IFRS 17 is not explicit on whose perspective to consider when considering the service provided from an insurer to a

[1] https://www.ifrs.org/content/dam/ifrs/meetings/2018/may/trg-for-ifrs-17/trg-for-ifrs17-meeting-summary.pdf

policyholder (or customer) and the policyholder's perspective is likely to be very different to the insurer's. However, the IASB's TRG in May 2018 notes in paragraph 35(d) of the meeting summary[2]:

'determining the quantity of benefits provided under a contract requires an entity to consider the benefits expected to be received by the policyholder, not the costs of providing those benefits expected to be incurred by the entity.'

This is further expanded in the International Actuarial Association's (IAA's) IAN 100[3] para 6.14:

'c) The quantity of benefits is determined from the policyholder perspective and not the quantity of benefits expected to be incurred by the insurer;'

For an immediate annuity in payment a policyholder may perceive a more continuous service at a different rate to that implied by discrete payments received each period. This is noted in paragraph 4 of the executive summary of the submission made by the ICAEW[4] (18 November 2021) to the IASB:

'The differences in interpretation relate to different views on the service that is provided and this in turn results in a difference in the approach to releasing the CSM and revenue recognition. Some consider that service is represented by the benefits and commitments made by the insurer to the policyholder as described in the policyholder documentation described in section 2 of this paper. Others consider the payments made to the policyholder are the relevant measure of service under IFRS 17.'

9. The Committee's conclusion on Method 2 states [emphasis in bold added]:

    a. the present value of expected future annuity payments (Method 2) does not meet the principle in paragraph B119 of IFRS 17 of reflecting the insurance coverage provided in each period because it would:
        *i. assign a quantity of the benefits to **periods for which the entity has no obligation to investigate and pay valid claims** for the insured event (for example, to the deferral period of a deferred annuity contract)….*

    The decision concludes that providing a service to a policyholder can only occur during periods where valid claims are paid/investigated. In our view IFRS 17 does not explicitly state this and it depends on the interpretation of the word 'service' and whose perspective this is considered from. We view that a policyholder could quite easily envisage an insurer providing a service during periods where no valid claims are paid. For example, for an immediate annuity in payment the element of protection afforded to the policyholder from a guaranteed income for the rest of their life.

10. In addition, we observe:

    a. a potential inconsistency between the proposed treatment of insurance coverage through Method 1 compared to the treatment of investment-return (General Model) or investment-related (Variable Fee Approach) services. For the two types of investment service there is no prescription in IFRS 17 that a service is provided only where the policyholder has a right to withdraw '*in that period'* as it is recognised that the insurer provides such service over time through, for example, the management of assets for the policyholder. This seems contrary to Committee's view that insurance coverage can only be provided where valid claims are paid/investigated in the period.

    b. There may be unintended consequences from the tentative agenda decision. For example, adopting Method 1 for a pure endowment[5] would result in no CSM being released to profit or loss

[2] https://www.ifrs.org/content/dam/ifrs/meetings/2018/may/trg-for-ifrs-17/trg-for-ifrs17-meeting-summary.pdf
[3] https://www.actuaries.org/IAA/Documents/Publications/IANs/IAA_IAN100_31August2021.pdf
[4] https://www.icaew.com/-/media/corporate/files/technical/financial-services/ifrs17-and-iasb/ifrs-17-letter-to-the-iasb.ashx
[5] A pure endowment is a type of life insurance in which the insurer guarantees to pay the insured a specific sum of money if the life assured lives to the end of the policy's term.

until the last day of the contract. This appears contrary to the service that a policyholder would view as being provided throughout the contract lifetime. Similarly, for contracts that provide guarantees at specific points in the policy lifetime (e.g. maturity) no related CSM would be released to profit or loss until the period in which the guarantee can be taken-up. This appears counter-intuitive to the policyholder's view of service (and so CSM being released) throughout the contract lifetime.

Other considerations

Weighting of services

11. The Committee considered Method 1 and 2 in relation to the immediate annuity in payment fact pattern. A topic which was not explicitly considered by the Committee is the impact of each Method for more complex products where different services are required to be weighted when determining the insurance contract services in each period and so the coverage units (i.e. release in CSM to profit or loss). The need to make judgements is common throughout accounting standards and the weighting between different services was identified by the IASB to be a key judgement and so the disclosures requirements in paragraph 117(v) of IFRS 17 were developed.

12. Section 4 of the ICAEW submission[6] to the Committee sets out the impact of Method 1 and 2 for a deferred annuity where there is the requirement to weight between investment-return service (in the deferred period) and insurance coverage (when the annuity is in payment). In our experience, the requirement to apply Method 1 for insurance coverage is likely to result in less consistent practice between insurers in selecting the weighting of service for a deferred annuity than if Method 2 was adopted. As consequence, we expect that the adoption of Method 1 will result in less consistent recognition of profit between insurers for similar deferred annuity contracts. There are also likely to be practical barriers for insurers to convergence over time post-implementation of IFRS 17, for example, the potential need to reset transition balances determined on a fully retrospective approach.

Application of the risk adjustment

13. In line with IFRS 17 requirements the risk adjustment is determined based on the 'compensation' required for bearing the uncertainty about the amount and timing of the cash flows that arise from non-financial risk (which for an immediate annuity in payment would primarily reflect longevity risk). The implication of paragraph 41 of the IASB Staff Paper[7] presented to the Committee is that the element of protection afforded to the policyholder (from a guaranteed income for the rest of their life) may be part of the risk adjustment and that in Method 2 this influences the CSM release to profit or loss. In our experience this element is not part of the risk adjustment and, as set out in paragraph 7, above we view that a policyholder could envisage this as a service.

Post Implementation Review of IFRS 17

14. In our experience within the UK and globally, we expect that there may be divergence in practice in the application of paragraph B119 of IFRS 17 across similar products and so the recognition of CSM to profit or loss. This is not limited to the immediate annuity in payment fact pattern considered by the Committee. In our view, this is an area that the IASB should consider in any future Post Implementation Review of IFRS 17.

[6] https://www.icaew.com/-/media/corporate/files/technical/financial-services/ifrs17-and-iasb/ifrs-17-letter-to-the-iasb.ashx
[7] https://www.ifrs.org/content/dam/ifrs/meetings/2022/march/ifric/ap02-profit-recognition-for-annuity-contracts-ifrs-17.pdf

We trust that these comments will be useful to the IASB Interpretation Committee in relation to their tentative agenda decision. We would welcome the opportunity to discuss our comments with the IASB.

Should you want to discuss any of the points raised please contact me, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Steven Graham
On behalf of Institute and Faculty of Actuaries