The LIAJ's Comments on the ED
Amendments to IFRS 17

25 September 2019

The Life Insurance Association of Japan (LIAJ)

Contents

I. General comments on the Exposure Draft

1. We, The Life Insurance Association of Japan (LIAJ), would like to extend our gratitude to the International Accounting Standards Board (IASB) for providing us with an opportunity to submit comments on the Exposure Draft, *Amendments to IFRS 17* (hereinafter referred to as 'the ED'), published in June 2019.

2. The LIAJ is a trade association comprised of all 42 life insurance companies operating in Japan. Its aim is to promote the sound development of the life insurance industry in Japan, to maintain its reliability, and thereby to contribute to improving the quality of national life. The LIAJ would like to respectfully request that the IASB carefully consider the comments submitted from the sole representative body of the life insurance industry in Japan, accounts for around 12%[1] of the world life insurance premiums.

3. The LIAJ welcomes the decision of the IASB to publish the ED, which proposes targeted amendments to IFRS 17 *Insurance Contracts* (issued in May 2017) to respond to concerns and challenges raised by stakeholders as IFRS 17 is being implemented. The LIAJ also highly appreciates the IASB's efforts towards publishing the ED, taking into account comments received from a number of interested parties including the LIAJ.

4. With regard to amendments to IFRS 17 proposed in the ED, the LIAJ largely agrees with the proposals as stated below in the comments to each question, even though the LIAJ has comments on some proposals.

5. On the other hand, regarding to areas the IASB considered in the Board Meeting held after October 2018 and for which amendments to IFRS 17 are not proposed, the LIAJ is concerned about the level of aggregation described in IFRS 17 and the Basis for Conclusion on the ED. Please refer to the LIAJ's comments below in 'Ⅲ. Comments on the level of aggregation'.

6. The LIAJ expects the IASB to closely examine again in cost-benefit perspective the comments received from stakeholders on the ED, and appreciates IASB's efforts towards developing further improved International Financial Reporting Standards.

[1] Swiss Re Institute, *sigma* No 3/2019.

II. Responses to the questions

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

7. The LIAJ understands that some insurance contracts without direct participation features provide an investment service, similar to insurance contracts with direct participation features. Therefore, the LIAJ agrees with IASB's proposed amendment that require an entity to 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.

8. As for insurance contracts without direct participation features and provide an investment-return service, the LIAJ was concerned that the requirements to recognise the contractual service margin (CSM) considering only insurance coverage would fail to faithfully represent the entity's financial performance across periods when such contracts that have an insurance coverage period that differ from the period in which the policyholder benefits from an investment-return service, as illustrated in paragraph BC55 of the ED.

9. Accordingly, with regard to contracts that have an insurance coverage period that differ from the period in which the policyholder benefits from an investment-return service, the LIAJ understands that as proposed amendment in the ED, requiring an entity to recognise the CSM in profit or loss considering both the insurance coverage and an investment–return service, would increase usefulness of information provided to users of financial statements.

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?

10. In the ED, it is proposed to amend IFRS 17 by adding paragraph 66A, stating that "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." Consequently, the LIAJ understands that at initial recognition, the entity may recognise losses on underlying insurance contracts to the extent it has a right to recover recognised losses from reinsurers, and at the same time, the entity may recognise income that represent expected recoverable amount. The LIAJ agrees with IASB's objective of proposing this amendment, as this would contribute to reduce accounting mismatch. However, with regard to reinsurance contracts subject to the proposed amendment in the ED, the LIAJ would like to comment as below, on the scope of reinsurance contracts that is limited to 'reinsurance contract held that provides proportionate coverage.'

11. 'Reinsurance contracts held that provide proportionate coverage' that are subject to the proposed amendment is defined in the ED as "reinsurance contracts that 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." On the other hand, in practice, there may be some types of reinsurance contracts, for example, reinsurance contracts that provide the entity with the right to recover from the issuer a fixed percentage of 'certain types of claims incurred' on a group of underlying insurance contracts, rather than 'all claims incurred', even if it is reinsurance contract held that provides proportionate coverage, as well as reinsurance contract held that covers claims in excess of a specified amount, but does not provide proportionate coverage. Within those reinsurance contracts, the LIAJ believes that there may be some reinsurance contracts presenting the same economic reality with reinsurance contract held that provides proportionate coverage. Therefore, the LIAJ is concerned that if such reinsurance contracts in above example would be excluded uniformly from the subject of proposed amendment in the ED, this would fail to contribute reducing accounting mismatch.

12. Accordingly, the LIAJ would like to suggest the IASB to amend the definition of reinsurance contracts that are subject to the proposed amendment in the ED to “reinsurance contracts that provide the entity with the right to recover from the issuer a part of claims incurred on a group of underlying insurance contracts”, in the light of enhance probability of appropriately presenting the economic reality of reinsurance contracts held.

Question 7—Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs C1, [Draft] Amendments to IFRS 4 and BC110–BC118)
IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. The amendments proposed in this Exposure Draft are such that they should not unduly disrupt implementation already under way or risk undue delays in the effective date. (a) The proposed amendment to paragraph C1 would defer the effective date of IFRS 17 by one year from annual reporting periods beginning on or after 1 January 2021 to annual reporting periods beginning on or after 1 January 2022. Do you agree with the proposed amendment? Why or why not? (b) The proposed amendment to paragraph 20A of IFRS 4 would extend the temporary exemption from IFRS 9 by one year so that an entity applying the exemption would be required to apply IFRS 9 for annual reporting periods beginning on or after 1 January 2022. Do you agree with the proposed amendment? Why or why not?

13. The LIAJ believes that an insurer may be imposed on additional cost to establish practice and need more lead time for applying amendments to IFRS 17, following the feedback on the ED. Hence, as for the IASB's proposed amendment that defer effective date of IFRS 17 by one year and require an entity to apply IFRS 17 for annual reporting periods beginning on or after 1 January 2022, the LIAJ agrees with the deferral of effective date, but as for whether one year deferral is sufficient or not, would like to present below its views.

14. As stated above, the LIAJ is concerned that an insurer may be imposed on additional cost to establish practice and need more lead time for applying amendments to IFRS 17, following the feedback on the ED. In addition, according to the Next steps in the ED, the IASB plans to publish any resulting amendments to IFRS 17 in mid-2020, the LIAJ is afraid that there are only half year or so until the transition date (the opening of the annual reporting period beginning on or after 1 January 2021).

15. For this reason, the LIAJ thinks that an entity without sufficient resource to prepare for applying the finalised IFRS 17, particularly small and mid-sized insurer may be exposed difficulty in applying it even if the effective date would be deferred by one year. Thus, the LIAJ believes that the IASB should have due regards on the feasibility of applying IFRS 17 by such an entity and the timing of endorsement in each jurisdiction, as well as concerning about potential increase of implementation cost due to the deferred effective date, when determining the effective date of IFRS 17.

16. The LIAJ also agrees with the IASB's proposed amendment regarding the temporary exemption from IFRS 9 that the Board considered on balance the benefit of extending the period that the relief is available by one year, so insurers can apply IFRS 17 and IFRS 9 at the same time, outweighs the disadvantage of an additional one year delay to the improved information that will result from insurers applying IFRS 9.

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

17. In principle, an entity shall apply full retrospective approach that can provide the most useful information about insurance contracts on transition to IFRS 17, however, if the entity choses to apply full retrospective approach, it needs to capture historical cash flows including those of distinguished contracts, as the entity needs to measure CSM at initial recognition and subsequently calculate amortised amount of such margin. The LIAJ is afraid that, it would often be impracticable for entities to apply full retrospective approach.

18. In this context, the LIAJ understands that modified retrospective approach is proposed in IFRS 17 with the objective of achieving the closest outcome to full retrospective approach using reasonable and supportable information available without undue cost or effort. The LIAJ believes that retrospective approach may allow comparisons between contracts written before and after the first date of initial application of the Standard, and may provide useful information than the fair value approach that is not designed to provide closed information that would result from retrospective application.

19. Accordingly, the LIAJ thinks that some insurers plan to choose the modified retrospective approach at the date of applying IFRS 17, however, the LIAJ is concerned that it would be impracticable for insures to apply modified retrospective approach due to strict requirement to apply the Standard. In applying modified retrospective approach, some stakeholders suggested

that an entity should be permitted to develop its own modifications that the entity thinks would achieve the closest possible outcome to full retrospective application. The LIAJ appreciates the suggestion as this would likely to enhance the practicability of modified retrospective approach, however, as stated in paragraph BC142 of the Basis for Conclusions on the ED, the IASB rejected this suggestion because entities could use different modifications, which would reduce comparability and increase complexity for users of financial statements.

20. On the other hand, as stated in paragraph BC143 of the Basis for Conclusion on the ED, the IASB noted that paragraph 51 of IAS 8 specifically acknowledges the need for estimates in retrospective application and that this paragraph applies to entities applying IFRS 17 for the first time just as it does to entities applying other IFRS Standards for the first time. Besides, the IASB also noted that it expects that estimates will often be needed when applying a specified modification in the modified retrospective approach.

21. The LIAJ appreciates the IASB’s views described in paragraph BC143 of the Basis for Conclusion on the ED, as this clarified that an entity can make estimates in applying modified retrospective approach. The LIAJ believes that the feasibility of applying modified retrospective approach by the entity would be enhanced because the entity would be able to establish flexible practice following the permission for using estimates, and thereby, more likely to represent the economic reality of insurers.

22. Nevertheless, in the light of clarifying that an entity can use estimates, the LIAJ would like to suggest the IASB’s views described in paragraph BC143 of Basis for Conclusion on the ED to be also included in the Standards for IFRS 17. Recognising that an entity can use estimates in IFRSs as a whole, however, the LIAJ believes that permitting an entity to use estimates in applying modified retrospective approach is significantly important concept, and describing this in the Standard for IFRS 17 would be useful so that not to be incorrectly thought that an entity cannot make estimates in applying IFRS 17 retrospectively.

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?

<Treatment of refunds of premium relating to the definition of an investment component>

23. In the ED, the definition of an investment component is amended. The LIAJ understands that this amendment was considered to clarify the intention of the IASB described in paragraph BC34 of the Basis for Conclusion on IFRS 17. However, given the various component of insurance products in each country, the LIAJ believes that whether this amendment might have unintended impact or not need to be considered.

24. With regard to the Staff Paper AP01, which was used in the discussion about definition of an investment component at the meeting of Transition Resource Group for IFRS 17 (TRG) held in April 2019, it is described that "a payment amount calibrated to reflect outstanding future periods in which a service is provided that may indicate that the policyholder is entitled to a premium refund reflecting its consumption of service over the life of the contract. In this case, the payments may represent a refund of premiums for unused coverage rather than an investment component." The LIAJ believes that this description represent the case where an entity may account for some amounts that do not meet the definition of investment components as refunds of premiums, leading to an appropriate accounting for contracts that are determined as contracts without investment components.

25. In addition, the ED proposes to amend paragraph 103(c) and clarify that an entity is not required to disclose refunds of premiums separately from investment components in the reconciliation. While the LIAJ understands that this amendment is in response to the above mentioned discussion at TRG, the LIAJ is concerned that the 'refunds of premiums' is not defined in the ED.

26. Therefore, with regard to the description about refunds of premiums included in the Staff Paper AP01 for the meeting of TRG in April 2019, the LIAJ believes that describing it in the IFRS 17 will help an entity in appropriately recognising and accounting refunds of premiums.

<Treatment of the effect arising from changes in underlying items>

27. According to the description in paragraph BC161 of the Basis for Conclusion on the ED, the purpose of proposed amendment to paragraph B128 of IFRS 17 is "to clarify that changes in the measurement of a group of insurance contracts caused by changes in underlying items are changes arising from the effect of the time value of money and assumptions that relate to financial risk." The paragraph also notes that without amending paragraph B128, "changes in underlying items could adjust the CSM of insurance contracts without direct participation features."

28. On the other hand, in practice, changes in the measurement of a group of insurance contracts caused by changes in underlying items may include changes other than those arising from the

effect of the time value of money and assumptions that relate to financial risk. For example, the LIAJ thinks that changes in cash flows for dividends to policyholders would be changes in the measurement of a group of insurance contracts caused by changes in underlying items, as for changes in cash flows for dividends relating to profits from risk taking and expense profits, the LIAJ thinks that such changes would be changes other than those arising from the effect of the time value of money and assumptions that relate to financial risk in most cases.

29. In judging whether changes in the measurement of a group of insurance contracts caused by changes in underlying items would be changes arising from the effect of the time value of money and assumptions that relate to financial risk, the result may vary depending largely on the feature of insurance products and dividend distribution systems of each insurer. Besides, in some situation, changes other than those arising from the effect of the time value of money and assumptions that relate to financial risk may account for most of the changes. Therefore, the LIAJ is concerned that setting out one-size-fits-all approach to treat changes in underlying items might cause difficult situation for insurers in appropriately presenting economic reality of their business.

30. Considering that features of insurance products, dividend distribution systems and practices may vary in each insurer, there may be a case where, with regard to changes in the measurement of a group of insurance contracts caused by changes in underlying items, considering all of it as changes arising from the effect of the time value of money and assumptions that relate to financial risk is not appropriate. Accordingly, the LIAJ believe that in the treatment of changes in underlying items, various practical approach relevant to capture reality should be permitted taking into account situations of each insurer.

III. Comments on the level of aggregation

31. The LIAJ is concerned about the requirement included in Basis for Conclusion on both IFRS 17 and the ED that requires an entity to achieve 'same accounting outcome' regardless of the methodology to be used. Therefore, the LIAJ would like to present below its views on such a requirement.

32. Paragraph B68 of IFRS 17 requires that 'mutualisation' of insurance contracts to be reflected in the fulfilment cash flows of each group. However, as for life insurance business, mutualisation of insurance contracts are used in multiple ways between a number of contracts, and therefore, there are many cases where an entity might not be able to identify each cash flow allocation. Actually, the IASB recognises that in some cases, an entity might be able to identify the change in the underlying items and resulting change in the cash flows only at a higher level of aggregation than the groups, as stated in paragraph B70 of IFRS 17. In such cases, as also stated in the same paragraph, the entity shall allocate the effect of the change in the underlying items to each group on a systematic and rational basis. In practice, the LIAJ understands that resulting cash flows might be vary to some extent.

33. This is because, where an insurer uses annual cohorts in grouping contracts and in case where such portfolio works as mutualisation across generations, the insurer needs to have discretion over mandatory allocation of CSM for each annual cohort based on the requirements in IFRS 17. That is, as the profitability of each contract is assessed in practice at the level where mutualisation works, thus, the insurer usually does not determine CSM in order to provide information at cohort level. Therefore, if an insurer were to be required to determine CSM in order to allocate the effect of mutualisation to each cohort, the insurer would be forced to determine CSM in artificial way.

34. In this regards, paragraph BC178 of the Basis for Conclusions on the ED quotes an example used in IASB meeting agenda March 2019 AP2A, to demonstrate that separate identification of CSM for each annual cohort is not arbitrary. However, allocating positive CSM to annual cohorts for which the coverage period includes only periods in which the fair value returns are 1 per cent ('group 2' in the example) is as a result of artificially generated cash flows, the LIAJ believes that there may be another approaches in the light of providing users of financial statements with useful information. In the quoted example, group 2 is regarded as not onerous due to the effect of mutualisation with Group 1, thus, the LIAJ concerns that recognising returns from such cohorts by allocating positive CSM on them might mislead users into believing the cohorts generate returns without mutualising other cohorts. Therefore, the LIAJ understands that such an example is for the purpose of deepening the understanding of annual cohort requirements, rather than describing the only approach to determine accurate measurements of CSM.

<Table 1> Example quoted from AP2A (IASB meeting agenda used in March 2019, page 13)

	A	B	C		D		E
	Initial recognition of Group 1	Remeasurement of Group 1 before recognition of Group 2	Immediately after group 2 contracts issued, without applying paragraphs B67–B71 of IFRS 17		Immediately after Group 2 contracts issued, applying paragraphs B67–B71 of IFRS 17		Immediately after Group 2 contracts, if groups 1 and 2 were combined
	Group 1	Group 1	Group 1	Group 2	Group 1	Group 2	
FCF	9,567	11,734	10,828	15,761	11,734	14,855	26,589
CSM	433	531	1,437	(761)	531	145	676
Insurance contracts	**10,000**	**12,265**	**12,265**	**15,000**	**12,265**	**15,000**	**27,265**
Underlying items	**10,000**	**12,265**	**12,265**	**15,000**	**12,265**	**15,000**	**27,265**

<Table 2> Outcome based on another measurement approach[2] using same example

	D’	
	Immediately after Group 2 contracts issued, applying paragraphs B67–B71 of IFRS 17	
	Group 1	Group 2
FCF	11,589	15,000
CSM	676	0
Insurance contracts	**12,265**	**15,000**
Underlying items	**12,265**	**15,000**

35. On the other hand, it is stated in paragraph BC138 of the Basis for Conclusions on IFRS 17 that, “the Board noted that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. Therefore it may not be necessary to an entity to restrict groups in this way to achieve the same accounting outcome in some circumstances.” Besides, as stated in paragraph BC175 of the Basis for Conclusions on the ED that “An entity would be required to apply judgement in concluding whether it could achieve the same accounting outcome without annual cohorts, including considering whether profitability is the same considering all possible scenarios for future expectations”, the IASB requires the entity to achieve ‘same accounting outcome’ regardless of the methodology to be used.

[2] This approach measures each FCF, where shortage of claims for Group 2 occur due to no cash flow transfer from Group 1 to Group 2, defining that the effect of mutualisation (i.e. cash flow transfer equal to the portion of shortage for Group 2, covered by Group 1) may occur. The measurement result of CSM will be zero, as Group 2 that have the effect of mutualisation would not receive cash flows that exceed actual amount payable for Group 2. Under this approach, revenue resulting from amortised CSM would not be recognised.

36. However, the LIAJ concerns that entity might be forced to allocate artificially the effect of mutualisation to each cohort where mutualisation works, as noted above, and considering the description in paragraph B70 of IFRS 17 which states that entity might be able to identify the effect of mutualisation only at a higher level of aggregation than the groups, there may be various natures of mutualisation. Thus, the LIAJ believes that accounting outcome might vary depending on the nature of mutualisation. Accordingly, as stated in the last sentence of paragraph BC138 of the Basis for Conclusions on IFRS 17, "Therefore, it may not be necessary for an entity to restrict groups in this way to achieve same accounting outcome in some circumstances", this description may be taken as requiring the entity to achieve same accounting outcome with the outcome derived based on one nature out of several mutualisation natures, when the entity use simplified approach without annual cohorts. On the other hand, the sentence may be wrongly taken as requiring the entity to achieve same accounting outcome not depending on nature the entity based within several mutualisation natures. However, as stated above, the LIAJ believes that accounting outcome might vary depending on the nature of mutualisation. Therefore, the LIAJ believes that there is no way to regard the sentence as requiring an entity to achieve same accounting outcome whichever nature the entity based.