

## **IASB ED/2019/4 Amendments to IFRS 17 – EFRAG draft comment letter**

**You can submit your comments on EFRAG's draft comment letter by using the [‘Express your views’](#) page on EFRAG’s website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.**

**Comments should be submitted by 2 September 2019.**

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

[XX September 2019]

### **Re: IASB ED/2019/4 Amendments to IFRS 17**

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure draft ED/2019/4 Amendments to IFRS 17 *Insurance Contracts*, issued by the IASB on 26 June 2019 (the ‘ED’).

This letter is intended to contribute to the IASB’s due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG would like to express its appreciation for your consideration of the topics identified in our letter of 3 September 2018 (“our letter”) as well as those from other Constituents. EFRAG would also like to commend the IASB for the thorough process to capture and analyse all the concerns and criticisms received. This course of action corroborated the willingness you expressed to act speedily as and when required. EFRAG also notes and acknowledges that during this process, you considered thoroughly all the issues highlighted in our letter and we appreciate the duty of care exercised in this regard.

Appendix 1 contains our responses to the questions in the ED. EFRAG is broadly supportive of many of the changes proposed. However, EFRAG is of the view that the retrospective application of risk mitigation option on transition is worthy of further attention. In addition, EFRAG considers that the necessary amendments to IFRS 4 Insurance Contracts extending the optional deferral of IFRS 9 need to be published as early as possible and, at the latest, before the end of June 2020 so as to enable timely endorsement within Europe before the current expiry date of 1 January 2021. Appendix 2 addresses topics that were raised in our letter of 3 September 2018 that we consider warrant further consideration. In particular:

- a) EFRAG acknowledges that the annual cohort requirement is a trade-off between tracking of individual contracts and ensuring the recognition of onerous contracts even where there are contracts with similar risks but different levels of profitability. Nonetheless, EFRAG considers that this requirement leads to unnecessary cost in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts. EFRAG believes that it is worth re-considering whether the annual cohorts requirement is justified for such contracts and recommends that the IASB consider developing an exception for

them, starting from paragraph BC138; the exception should be reflective of the reporting objectives of the level of aggregation requirements in IFRS 17.

- b) EFRAG also notes the decision not to allow at transition further modifications to the modified retrospective approach in the interest of comparability. EFRAG remains concerned about implementation challenges faced by preparers and the possibility of unduly strict interpretations that restricts the use of retrospective approaches. Therefore, EFRAG encourages the IASB to confirm in the main text of the final standard that the use of estimates is allowed, including those needed to approximate the missing information. EFRAG also suggests that the IASB clarify that the 'reasonable and supportable information' criterion is not intended to change the judgement ordinarily required in IAS 8 to make estimates.

If you would like to discuss our comments further, please do not hesitate to contact Didier Andries, Fredré Ferreira, Sapna Heeralall, Joachim Jacobs or me.

Yours sincerely,

Jean-Paul Gauzès  
**President of the EFRAG Board**

**Areas where questions have been raised to Constituents in addition to the IASB's questions**

*It would be most helpful if you answer only those questions that are relevant to you.*

- 1 Scope exclusions (paragraph 10, Appendix 1).
- 2 Expected recovery of insurance acquisition cash flows (paragraph 18, Appendix 1)
- 3 Contractual service margin attributable to investment-return service and investment-related service and disclosures about the profit recognition patterns (paragraphs 35 and 36, Appendix 1).
- 4 Reinsurance contracts held – recovery of losses on underlying insurance contracts (paragraphs 45 to 47, Appendix 1).
- 5 Presentation in the statement of financial position (paragraph 54, Appendix 1).
- 6 Applicability of the risk mitigation option (paragraphs 64 - 65, Appendix 1).
- 7 Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs 73 to 75, Appendix 1).
- 8 Transition modifications and reliefs (paragraphs 94 to 95, Appendix 1).
- 9 Minor amendments (paragraphs 99 to 105, Appendix 1)
- 10 Terminology (paragraph 110, Appendix 1).
- 11 Annual cohorts (paragraphs 140 to 143, Appendix 2).
- 12 Transition: Modified retrospective approach and fair value approach (paragraph 155, Appendix 2).
- 13 Balance sheet presentation: Non-separation of receivables and payables (paragraph 161, Appendix 2).
- 14 Reinsurance contracts: contract boundary (paragraphs 172 to 174, Appendix 2).

## Appendix 1 - EFRAG's responses to the questions raised in the ED

### Question 1 – Scope exclusions

#### Notes to Constituents – Summary of proposals

##### Question 1A - Loans that transfer significant insurance risk

- 1 The ED proposes to amend paragraph 8A so that an entity may choose to apply IFRS 9 Financial Instruments instead of IFRS 17 to contracts that meet the definition of an insurance contract but that limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract (for example, loan contracts 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.

##### Question 1B - Credit cards that provide insurance coverage

- 2 The ED proposes to amend paragraph 7(h) with the effect that credit card contracts that meet the definition of an insurance contract are excluded from the scope of IFRS 17 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.

**Question 1 – Scope exclusions – credit card contract 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?

- (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?

*EFRAG's response*

**Loans that transfer significant insurance risk:**

**EFRAG supports the proposal to permit entities, on portfolio level, to either apply IFRS 17 or IFRS 9 to insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract.**

**Credit cards that provide insurance coverage:**

**EFRAG agrees with the exclusion of certain credit cards that provide insurance coverage from the scope of IFRS 17. This is because the exclusion reduces the implementation costs and operational burden for entities that issue credit card contracts for which the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer. Furthermore, the exclusion is not expected to lead to a significant loss of useful information.**

**However, EFRAG is concerned that the term 'credit card' excludes payment cards which have similar clauses as the credit cards in the scope exclusion.**

*Question 1A - Loans that transfer significant insurance risk*

- 3 EFRAG supports the proposals to apply either IFRS 17 or IFRS 9 on a portfolio level for loans with a specific type of insurance risk. This is because EFRAG considers that it would reduce the complexity around bifurcating certain loans from insurance contracts or treating such loans as insurance contracts. EFRAG also acknowledges that the proposed amendments would enable:
- (a) an entity that mainly issues insurance contracts to apply IFRS 17 to these loans, permitting comparability with the other insurance contracts issued by the same entity; and
  - (b) an entity that mainly issues financial instruments to apply IFRS 9 to these loans, permitting comparability with the financial instruments issued by the same entity, without imposing IFRS 17 implementation costs for such contracts to the entity.

*Question 1B - Credit cards that provide insurance coverage*

- 4 EFRAG agrees with the proposed amendment to exclude from the scope of IFRS 17 those credit card contracts that provide insurance coverage for 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.
- 5 EFRAG notes that these products are aimed at providing a certain amount of coverage which includes protection for the quality of the goods sold as well coverage in the case that the seller fails to deliver under its non-financial obligations with respect to the sale.
- 6 EFRAG considers that when an entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, in such cases EFRAG is of the view that IFRS 9 would provide more useful information about those contracts. When the entity does reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, EFRAG is of the view that IFRS 17 would provide more useful information about those contracts.
- 7 EFRAG acknowledges that currently entities that issue certain credit card contracts typically account for:
- (a) loans or loan commitments in credit card contracts (and any relevant interest revenue) applying IFRS 9;

- (b) any insurance obligations applying IFRS 4 *Insurance Contracts*, in a similar manner to applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
  - (c) any revenue for providing other services applying IFRS 15 *Revenue from Contracts with Customers*.
- 8 It is for this reason that EFRAG considers that excluding from the scope of IFRS 17 these credit card contracts would:
- (a) permit the continuation of the existing accounting practice and therefore reduce IFRS 17 implementation costs for some entities; and
  - (b) not result in a significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements. Other relevant IFRS Standards would apply to such credit card contracts and would provide relevant information about the components of those contracts to users of financial statements.
- 9 However, EFRAG is concerned that the use of the term 'credit card' excludes payment cards which have similar clauses as the credit cards in the scope exclusion.

**Question to Constituents**

- 10 Paragraph B.4.1.9.E of IFRS 9 allows a regulated interest rate as a proxy for the time value of the money in applying the SPPI test, under certain conditions. EFRAG understands that in some countries the insurance element is not required by the regulation and, as a consequence, the financial instrument could fail the SPPI test and would have to be measured at fair value through profit or loss. How prevalent are these concerns within your jurisdiction?

## Question 2 - Expected recovery of insurance acquisition cash flows

### Notes to Constituents – Summary of proposals

- 11 *The ED proposes an amendment to the definition of insurance acquisition cash flows in Appendix A of IFRS 17 to clarify that insurance acquisition cash flows relate to groups of insurance contracts issued or expected to be issued. Cash flows paid before a related group of reinsurance contracts held are recognised are addressed in paragraph 65(a) of IFRS 17.*
- 12 *The ED also proposes that an entity would be required to:*
- (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 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 any asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.*
- 13 *Finally, the ED proposes that an entity would be required to disclose:*
- (a) *a reconciliation from the opening to the closing balance of any asset for insurance acquisition cash flows; and*
  - (b) *quantitative information about when the entity expects to derecognise an asset for insurance acquisition cash flows.*

#### **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?

#### *EFRAG's response*

**EFRAG supports the IASB's proposals with regards to the treatment of acquisition cash flows as the resulting financial information will better reflect the economic substance of these transactions.**

**EFRAG supports the allocation of the acquisition cash flows to the contracts to be a mandatory requirement. EFRAG agrees with the proposed recoverability assessment approach.**

- 14 EFRAG notes that, from a commercial perspective, an insurer's decision to pay a certain level of acquisition cash flows might take into account its expectation of contract renewals. EFRAG also acknowledges that some contracts would be treated

as onerous due to the allocation of acquisition cash flows in full to them (i.e. ignoring the impact of renewals).

- 15 EFRAG supports the proposed amendments because this will provide more relevant information to users of financial statements by better reflecting the economic substance and general understanding of these transactions.
- 16 EFRAG understands that the concern relating to acquisition cash flows relates to contracts that fall under the premium allocation approach ('PAA') given the short contract boundary. As there is already an option under the PAA to immediately expense these cash flows, EFRAG supports the allocation of the acquisition cash flows to the initial and renewal contracts to be a mandatory requirement in order to avoid entities choosing whether to do the impairment test or not, i.e., to increase comparability and reliability of the resulting information. However, EFRAG notes that 'expected renewals' is subjective and may result in divergent application in practice.
- 17 With regards to impairment, the Exposure Draft proposes that an entity would have to assess the recoverability of an asset recognised applying paragraph 28D of IFRS 17 at the end of each reporting period, if facts and circumstances indicate the asset may be impaired. EFRAG agrees with the proposed recoverability assessment approach.

**Question to Constituents**

- 18 Insurance contract renewals are not a defined term which may lead to diversity in practice when allocating insurance acquisition cash flows. Do you consider that insurance contract renewals should be defined in order to achieve comparability and, if so, how would you define them?

**Question 3 - Contractual service margin attributable to investment-return service and investment-related service**

**Notes to Constituents – Summary of proposals**

- 19 *The Exposure Draft proposes two amendments relating to the identification of coverage units:*
- 20 *The first proposed amendment would 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.*
- 21 *Insurance contracts without direct participation features may provide an investment-return service if, and only if:*
- (a) *an investment component exists, or the policyholder has a right to withdraw an amount (this includes both policyholders' rights to a surrender value or premium refund on cancellation of a policy and policyholders' rights to transfer an amount to another insurance provider.);*
  - (b) *the entity expects the investment component or amount the policyholder has a right to withdraw to include a positive investment return (a positive investment return could be below zero, for example, in a negative interest rate environment); and*
  - (c) *the entity expects to perform investment activity to generate that positive investment return.*
- 22 *The second proposed amendment would 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.*
- 23 *The Exposure Draft proposes that insurance coverage, investment-return service (for insurance contracts without direct participation features) and investment-related service (for insurance contracts with direct participation features) are defined together as 'insurance contract services'.*
- 24 *For all insurance contracts, the Exposure Draft proposes to require an entity to disclose quantitative information about when the entity expects to recognise in profit or loss the contractual service margin remaining at the end of the reporting period. The IASB also proposes to require an entity to disclose the approach used to assess the relative weighting of the benefits from insurance coverage and investment-related service or investment-return service.*

**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?

*EFRAG's response*

**EFRAG supports the IASB's proposals regarding contracts under the general model. Some contracts under the general model include investment activities and the proposal will ensure that the contractual service margin (CSM) that will be allocated to profit or loss will reflect both insurance and investment return services provided to the policyholder.**

**EFRAG also supports the IASB's proposals regarding contracts under the variable fee approach because these contracts are substantially investment-related contracts.**

**EFRAG considers that the disclosure proposals related to CSM amortisation will provide useful information to users of financial statements.**

*General model*

General model - Contracts with investment components

- 25 For some contracts under the general model, in addition to insurance coverage the entity provides a service to the policyholder in terms of returning to the policyholder both the policyholder's original investment and an investment return that would not otherwise be available to the policyholder because of amounts invested, expertise, etc.
- 26 EFRAG considers that the IASB's 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.

General model - Contracts without investment components

- 27 Under many insurance contracts, the policyholder has a right to withdraw money (or to transfer an amount to another party). This right appears to indicate the entity is providing an investment-return service. EFRAG understands that investment-return services are most commonly found in certain deferred annuity contracts.
- 28 EFRAG considers that the identification of investment-return services could be complex and require significant judgement as to expectations and the terms of the insurance contract. There would be subjectivity in applying the proposed amendment and determining the weighting between the investment-return service and insurance coverage services in order to determine the coverage units and the release pattern of the CSM.
- 29 However, an entity is already required to make similar assessments for contracts which provide more than one type of insurance coverage and disclosures relating to this significant judgement, as further illustrated below. Therefore, EFRAG considers 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.

*Variable fee approach*

- 30 EFRAG agrees that insurance contracts with direct participation features provide both insurance coverage and investment-related service. IFRS 17 refers to these contracts as being substantially investment-related service contracts under which an entity promises an investment return based on underlying items.
- 31 Therefore, EFRAG supports 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.

*Disclosure requirements*

- 32 Entities have to provide disclosures in terms of:
- (a) quantitative information on the expected recognition in profit or loss of the contractual service margin remaining at the end of the reporting period, in appropriate time bands, and
  - (b) specific disclosure of the approach to assessing the relative weighting of the benefits provided by insurance coverage and investment-related services or investment-return services.
- 33 EFRAG considers 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 and any changes to that profitability pattern, allowing informed comparisons across entities. EFRAG considers that an entity needs to determine the coverage units (which includes services to be provided in the future) in order to determine the release pattern for the CSM. Therefore, EFRAG considers that preparers should be able to provide this quantitative information without undue cost or effort.
- 34 Currently, IFRS 17 requires entities to disclose significant judgements and changes to those judgements. EFRAG considers that disclosures on the weighting of the benefits would be considered to be significant judgements and consequently these should be disclosed. These disclosures are necessary to enable users to better understand the sources of profit and to make comparisons both between types of contracts and across entities and over time.

**Questions to Constituents**

- 35 EFRAG has been informed of possible fact patterns of deferred annuities for which there is no investment component as defined by the ED, nor a right to withdrawal; however, the insurance entity performs asset management activities, revenues of which would not be captured in the CSM release. For example, for particular Deferred Annuities, there is an accumulation phase followed by the annuity phase. The policyholder's beneficiaries receive no return if the policyholder dies during the accumulation phase. During the annuity phase, a surviving policyholder receives a fixed annuity amount based on premiums/technical provisions. In these deferred annuities the policyholder does not have a right to withdraw during either the accumulation phase or the annuity phase. Do you have additional examples of investment activities that are not captured by the proposals in the ED?
- 36 Entities have to provide quantitative disclosures on the expected recognition in profit or loss of the contractual service margin remaining at the end of the reporting period, in appropriate time bands. Do user constituents agree with this disclosure requirement? Do preparer constituents consider that this information is commercially sensitive? Please explain.

#### **Question 4 – Reinsurance contracts held — recovery of losses on underlying insurance contracts**

##### **Notes to Constituents – Summary of proposals**

- 37 Generally, IFRS 17 requires changes in fulfilment cash flows that relate to future service to adjust the contractual service margin. However, applying the exception for reinsurance contracts held in paragraph 66(c)(ii) of IFRS 17, when a change in a group of underlying insurance contracts relates to future service but results in the group becoming onerous or more onerous, any corresponding change in the reinsurance contract held is also recognised in profit or loss immediately.
- 38 The ED proposes a further exception, that an entity would be required to adjust the contractual service margin of a group of reinsurance contracts held that provide proportionate coverage (that is, coverage for a fixed percentage of all claims from underlying contracts), 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 as equal to the loss recognised on the group of underlying insurance contracts multiplied by the fixed percentage of claims on the group of underlying insurance contracts the entity has a right to recover from the issuer of the reinsurance contract.
- 39 The ED proposes that if an entity chooses to present separately the amounts recovered from the reinsurer and an allocation of the premiums paid applying paragraph 86 of IFRS 17, the income arising applying paragraph 66A of the ED would be included in amounts recovered from the reinsurer.
- 40 The ED proposes consequential amendments in paragraphs B95B – B95C for insurance contracts acquired and in paragraphs C15A and C20A for the transition requirements in IFRS 17. With respect to the transition requirements, a modification is added to the modified retrospective approach and a relief is added to the fair value approach.

#### **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?

##### *EFRAG's response*

#### **EFRAG welcomes the proposals of the IASB aiming to reduce the accounting mismatches for reinsurance contracts held.**

- 41 EFRAG welcomes the proposals of the IASB aiming to reduce the accounting mismatches for reinsurance contracts held.
- 42 EFRAG considers that an entity should recognise a gain from the reinsurance contract held when it recognises a loss on initial recognition of an onerous group of underlying insurance contracts or on addition of onerous contracts to that group, to

the extent that such reinsurance contract held covers a loss that is also recognised in profit or loss at the same time. This would happen when there is a direct association between the loss on the underlying contracts and the net gain on the reinsurance contract held. EFRAG observes that the wording in paragraphs B119D, BC80 and BC71 seem to exclude from the scope of this amendment a reinsurance contract that covers the surplus of a fixed percentage of the losses arising from each contract in a group of direct insurance contracts (also called surplus reinsurance contracts).

- 43 EFRAG recommends the IASB clarifies the wording of the Amendments so that it includes the fact pattern described in the paragraph above. EFRAG is of the view that the proposed solution by the IASB would have the same effects for these types of reinsurance contracts.
- 44 EFRAG notes that the definitions of ‘proportionate’ and ‘proportional’ have different meanings (which vary by jurisdiction). Accordingly, EFRAG recommends that the definitions used in IFRS 17 should be clarified to avoid confusion.

#### **Questions to Constituents**

- 45 For proportionate reinsurance contracts, please provide fact patterns that are not captured by the amendment but for which the solution proposed by the IASB would be relevant.
- 46 The IASB has not addressed non-proportionate reinsurance contracts. A peculiarity of such contracts is that there is no one-to-one relationship between the direct underlying contract and the reinsurance contract held, for example because there are many underlying contracts that are covered by a single excess loss reinsurance contract held. Addressing non-proportionate reinsurance may therefore require the need to identify a “link” between the reinsured risk and the underlying contracts. EFRAG understands that any accounting mismatch for non-proportionate contracts may, in practice, be reduced due to the impact on the risk adjustment rather than on the CSM.
- 47 In your view:
  - (a) Should non-proportionate reinsurance contracts be treated similarly to proportionate reinsurance contracts, i.e. gains in profit or loss when a loss is recognised on underlying contracts? If yes, please provide information about (i) the prevalence of such contracts, including volumes and jurisdictions where the issue arises and (ii) the cash flow pattern of these non-proportionate reinsurance contracts.
  - (b) How would an accounting solution for non-proportionate reinsurance work?

## Question 5 - Presentation in the statement of financial position

### Notes to Constituents – Summary of proposals

- 48 *The ED proposes to amend paragraph 78 of IFRS 17, which requires an entity to present separately in the statement of financial position the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities and the carrying amount of groups of reinsurance contracts held that are assets and those that are liabilities.*
- 49 *The proposed amendment would require an entity to instead present separately in the statement of financial position the carrying amounts of portfolios of insurance contracts issued that are assets and those that are liabilities and portfolios of reinsurance contracts held that are assets and those that are liabilities. There are no proposed changes to the measurement requirements of IFRS 17 as a result of the proposed amendment.*
- 50 *In addition, consequential amendments to paragraphs 79 of IFRS 17 and to the disclosure requirements in paragraphs 99 and 132 of IFRS 17 to reflect a portfolio rather than a group level of presentation.*

#### **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?

#### *EFRAG's response*

**EFRAG agrees with the proposed amendments, as they would simplify processes for preparers, decreasing the costs of implementation, without significantly reducing the information available to users.**

- 51 The requirements in IFRS 17 raised concerns that the requirements around disclosures of groups of assets and liabilities may significantly increase the costs of implementation of IFRS 17 without providing commensurate benefits to users.
- 52 EFRAG considers that the amendment to paragraph 78 provides an operational relief to preparers of financial statements without significantly reducing the loss of useful information for users of financial statements.
- 53 Therefore, EFRAG supports the proposed amendments.

#### **Question to Constituents who are Users**

- 54 Do Constituents that are Users agree that separate balance sheet presentation (of insurance contracts that are in an asset position from those that are in a liability position) on a portfolio level rather than at group level will not significantly reduce the information available? Please explain.

## Question 6 - Applicability of the risk mitigation option

### Notes to Constituents – Summary of proposals

- 55 *The Exposure Draft proposes to extend the risk mitigation option relating to the accounting treatment of some types of risk mitigation. That option currently existing in IFRS 17 permits an entity to reflect some or all of the changes in the effect of financial risk on insurance contracts with direct participation features that usually adjust the contractual service margin immediately in profit or loss. An entity may apply that option if, and only if, the entity mitigates those financial risks using derivatives and meets the conditions in paragraph B116 of IFRS 17. This risk mitigation option is only applicable to the variable fee approach. Without that exception, the variable fee approach would create an accounting mismatch when an entity uses derivatives to mitigate financial risk in insurance contracts.*
- 56 *That is, the accounting mismatch arises because:*
- (a) *the change resulting from financial risk in a reinsurance contract held would be recognised in profit or loss while*
  - (b) *the change resulting from financial risk in underlying insurance contracts with direct participation features would adjust the contractual service margin.*
- 57 *The IASB rejected the broad application of the variable fee concept, after deciding that it is useful only for insurance contracts that are substantially investment-related service contracts.*
- 58 *The proposed amendment of the Exposure Draft would extend that option to be available when an entity mitigates financial risk on insurance contracts with direct participation features using reinsurance contracts held. This is only applicable where the underlying contracts of an entity apply the variable fee approach.*
- 59 *The IASB acknowledged that the concern expressed by stakeholders for reinsurance contracts held is similar to the concern previously raised in relation to derivatives—i.e., the identified accounting mismatches are created by the variable fee approach.*

#### **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?

#### *EFRAG's response*

**EFRAG supports the IASB proposals because it addresses an accounting mismatch that arises from using reinsurance held to mitigate financial risks.**

- 60 EFRAG notes that the risk mitigation exception under IFRS 17 relating to the use of derivatives was created in order to address an accounting mismatch relating to financial risk introduced by the variable fee approach.
- 61 However, there may be an accounting mismatch similar to the accounting mismatch created when an entity uses derivatives as some entities purchase reinsurance to mitigate financial risks of underlying insurance contracts that apply the variable fee approach.

- 62 The accounting mismatch is most apparent when the effect of financial risk for the reinsurance held would be recognised in profit or loss but for the underlying contracts, the effect of financial risk would be recognised in the contractual service margin instead of being recognised also in profit or loss.
- 63 Therefore, in order to address this accounting mismatch, EFRAG supports the IASB proposals to extend the scope of the risk mitigation option to reinsurance contracts held.

**Questions to Constituents**

- 64 EFRAG has heard that the extension of the risk mitigation option should be widened, for example, to include non-derivative instruments such as when hedging of interest rate risk is carried out using a combination of swaps, swaptions and fixed interest securities.
- 65 Please explain the prevalence including volumes and jurisdictions involved, of the risk mitigation strategies identified in paragraph 64 above.

## Question 7 – Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4

### Notes to Constituents – Summary of proposals

#### *Deferral of effective date of IFRS 17 by one year*

- 66 Applying paragraph C1 of IFRS 17, an entity is required to apply IFRS 17 for annual reporting periods beginning on or after 1 January 2021. An entity can choose to apply IFRS 17 before that date but only if it also applies IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers.
- 67 The ED proposes to amend paragraph C1 of IFRS 17 to defer the effective date of IFRS 17 by one year so entities would be required to apply IFRS 17 for annual reporting periods beginning on or after 1 January 2022.
- 68 In addition, the ED proposes to delete the reference to IFRS 15 in paragraph C1 of IFRS 17 because IFRS 15 must be applied for annual reporting periods beginning on or after 1 January 2018.

#### *Deferral of effective date for the temporary exemption of IFRS 9 in IFRS 4*

- 69 The ED proposes to amend paragraph 20A of IFRS 4 to 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.

### **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?

#### *EFRAG's response*

**EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17, but it does not have a view at this stage on the appropriate extension of the effective date of IFRS 17.**

**EFRAG agrees with the IASB that the effective date for IFRS 9 should continue to be aligned with the effective date of IFRS 17.**

**EFRAG considers that the necessary amendments to IFRS 4 *Insurance Contracts* extending the optional deferral of IFRS 9 need to be published as early as possible and, at the latest, before the end of June 2020 so as to enable timely endorsement within Europe before the current expiry date of 1 January 2021.**

- 70 EFRAG supported the amendments to IFRS 4 *Insurance Contracts* in February 2016 and continues to consider that, in order to provide relevant information to users

of financial statements, IFRS 17 and IFRS 9 should be applied together with the same effective date.

- 71 Until both IFRS 17 and IFRS 9 are effective, preparers will have to make an assessment of the expected impact of the standards in order to provide information to users. That is, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, entities are required to disclose the effect of future IFRS Standards on the current period or any prior period, unless impracticable.
- 72 EFRAG further considers that the necessary amendments to IFRS 4 *Insurance Contracts* extending the optional deferral of IFRS 9 need to be published as early as possible and, at the latest, before the end of June 2020 so as to enable timely endorsement within Europe before the current expiry date of 1 January 2021.

**Questions to Constituents**

- 73 Do you consider that the proposed deferral of the effective date to 1 January 2022 is sufficient or would you support an additional year (i.e. 1 January 2023)?
- 74 Arguments in favour of accepting the proposed effective date of 1 January 2022 include:
- (a) Further delaying the application of IFRS 17 beyond 2022 will be disruptive, as will increase the costs of their implementation processes; and
  - (b) A delay beyond 2022 may encourage entities to defer their implementation efforts rather than using the extended period to better implement the Standard.
- 75 Arguments in favour of further delaying the effective date to 1 January 2023 include:
- (a) Some entities, mainly small and medium sized ones, often rely on third IT systems providers and so far there are no IT solutions for IFRS 17 available on the market, thereby making it difficult to meet the proposed 2022 effective date;
  - (b) The IASB expects to finalise the amendments by mid-2020. As a result, there will only be six months before the comparative period for IFRS 17 starts and this may be challenging for some entities; and
  - (c) Entities that would like to apply IFRS 17 earlier would be able to do so.

## Question 8 – Transition modifications and reliefs

### Notes to Constituents – Summary of proposals

#### Question 8A - Transition relief for business combinations

- 76 *The Exposure Draft proposes a modification to the modified retrospective approach that would permit an entity to classify such liabilities for insurance contracts acquired before the transition date as a liability for incurred claims rather than a liability for remaining coverage.*
- 77 *Consistent with the other requirements for the modified retrospective approach, an entity would be permitted to apply this modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach. The Exposure Draft proposes that an entity applying the fair value approach would have an option to classify such a liability as a liability for incurred claims.*

#### Question 8B - Transition relief for risk mitigation – transition date

- 78 *The ED proposes to permit to apply the risk mitigation option applicable to contracts with direct participation features prospectively from the transition date, rather than the date of initial application.*
- 79 *In order to apply this as from the transition date, entities would have to designate risk mitigation relationships at or before the date that the option is applied.*

#### Question 8C – Fair value approach

- 80 *An entity that applies the full retrospective approach cannot apply the risk mitigation approach retrospectively.*
- 81 *Therefore, the ED proposes to permit the application of the fair value approach for entities who use the full retrospective approach to a group of insurance contracts. The fair value approach can be used if the specified criteria relating to risk mitigation are met.*

### **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?

*EFRAG's response*

**Transition relief for business combinations:**

**EFRAG supports the IASB's proposals on transition relief for business combinations for both the modified retrospective approach and the fair value approach for practical reasons.**

**Transition relief for risk mitigation – transition date:**

**EFRAG assesses that the amendment to IFRS 17 to extend the option in paragraphs B115 to B116 of IFRS 17 is a step in the right direction.**

**However, EFRAG considers that retrospective application of the risk mitigation relief for contracts accounted for under the variable fee approach would provide more relevant information if entities are able to prove, using reasonable and supportable information, that a risk mitigation strategy was in place at the inception of the risk mitigation activity.**

**EFRAG considers that the wording in the ED is unclear as to whether retrospective application of the risk mitigation according to paragraph B115 is allowed when using reinsurance for risk mitigation purposes.**

**Fair value approach:**

**EFRAG considers that the possibility to apply the risk mitigation option of paragraph B115 from the transition date and the option to apply the fair value approach when the entity meets the conditions for risk mitigation in paragraph C5A of the ED are a step in the right direction. However, if the IASB accepts EFRAG's suggestion to allow retrospective application of the risk mitigation in paragraph B115, these two options are no longer necessary.**

*Question 8A - Transition relief for business combinations*

- 82 EFRAG supports the IASB's proposals for both the modified retrospective approach and fair value approach because it will often be impracticable and entities may not have sufficient information to classify contracts acquired in their settlement period before the transition date as either a liability for remaining coverage or a liability for incurred claims.
- 83 There would be cost/benefit challenges because at the time those contracts were acquired prior to transition, the entity may have managed together the claims for those contracts acquired with other contracts it issued and may have gathered data at a higher level than is required under IFRS 17 making it difficult to distinguish between claims from contracts issued and claims from contracts acquired.

*Question 8B - Transition relief for risk mitigation – transition date*

- 84 EFRAG assesses that the amendment to extend the option in paragraphs B115 to B116 is a step in the right direction; as a result of this amendment the risk mitigation relief is applicable prospectively as from the IFRS 17 transition date.
- 85 However, EFRAG considers that entities should apply this risk mitigation relief retrospectively for contracts under the variable fee approach, provided that (1) the entity met the criteria in paragraphs B115 to B116 for the risk mitigation accounting in the relevant past reporting periods and that (2) they are able to prove using reasonable and supportable information that a risk mitigation strategy was in place before the application of IFRS 17, starting from the inception of the mitigation strategy.
- 86 EFRAG considers that the application of risk mitigation is optional in nature, however once, elected, such retrospective application should be applied mandatorily to all the risk management strategies that existed in the relevant

periods; entities would refer to information from their prudential or risk committee reporting.

- 87 EFRAG notes that without retrospective application there would be accounting mismatches in periods prior to transition where a retrospective method is applied as it will result in a contractual service margin that does not reflect risk mitigation activities from previous periods, which would distort:
- (a) the equity of entities - because the effect of previous changes in the fair value of the derivatives will be included in the equity, while the corresponding effect on the insurance contracts will be included in the measurement of the insurance contracts (through the contractual service margin); and
  - (b) the revenue recognised for these groups of contracts in future periods - because the contractual service margin includes the changes in financial risks that would have been excluded had the risk mitigation option been applied retrospectively.
- 88 EFRAG acknowledges that applying risk mitigation retrospectively gives rise to the risk of hindsight being used, as entities could select which strategy would be designated retrospectively and which would not. However, EFRAG considers that, provided that appropriate documentation on risk management strategies exists prior to the transition and that entities may prove with reasonable and supportable information that the conditions in paragraph B116 were met in the relevant past periods, there are no conceptual reasons not to allow retrospective application; in addition in such circumstances the risk of hindsight is reduced.
- 89 EFRAG considers that, in these circumstances, the benefit in avoiding distorted financial information would overcome the risk of hindsight.
- 90 Therefore, in this instance EFRAG is supportive of retrospective application of hedge accounting under IFRS 17 even though EFRAG did not support such a position with the retrospective application of hedge accounting under IFRS 9. This is because EFRAG considers that risk mitigation under IFRS 17 is different from IFRS 9 retrospective application of hedge accounting as under IFRS 17 the choice to exercise the risk mitigation option influences the determination of the contractual service margin which could have long-term impacts on the financial statements.
- 91 EFRAG observes that the wording in the ED is unclear as to whether retrospective application of the risk mitigation according to paragraph B115 is allowed when using reinsurance for risk mitigation purposes.

*Question 8C – Fair value approach*

- 92 EFRAG notes that the IASB has included in the ED two consequential amendments to the decision not to allow retrospective application of the risk mitigation option of paragraph B115, i.e. the possibility to apply the risk mitigation from the transition date (instead of from the effective date) and the option to apply the fair value approach when the conditions for risk mitigation in paragraph C5A of the ED are met.
- 93 EFRAG assesses these two consequential amendments to be a step in the right direction, however, would prefer that the IASB allows the retrospective application of the risk mitigation in paragraph B115. EFRAG considers that, if EFRAG's suggestion to allow for retrospective application of the risk mitigation is accepted by the IASB, the options granted by these two consequential amendments are not any more appropriate.

**Questions to Constituents**

- 94 Do Constituents agree with the approach suggested by EFRAG, i.e. to prefer retrospective application of paragraph B115 instead of supporting the two consequential amendments? Please explain why.
- 95 If you expect to apply the risk mitigation retrospectively under the approach proposed by EFRAG, how would you find the required evidence in practice? What would be the starting point for collecting the evidence and what process would you use?

## Question 9 – Minor amendments

### Notes to Constituents – Summary of proposals

- 96 *The IASB proposes minor amendments to address a number of cases in which the drafting of IFRS 17 does not achieve the IASB's intended outcome. The IASB has not, and does not intend to, perform a comprehensive review of possible drafting improvements.*
- 97 *The following is a list of the minor amendments. Refer to the Basis for Conclusions of the ED paragraphs BC147 to BC163 for more details:*
- (a) *Scope and investment contracts with discretionary participation features;*
  - (b) *Recognition of contracts within a group;*
  - (c) *Business combinations outside the scope of IFRS 3;*
  - (d) *Adjusting the loss component for changes in the risk adjustment for non-financial risk;*
  - (e) *Disclosure of investment components excluded from insurance revenue and insurance service expenses;*
  - (f) *Risk adjustment for non-financial risk in disclosure requirements;*
  - (g) *Disclosure of sensitivity analyses;*
  - (h) *Definition of an investment component;*
  - (i) *Excluding changes relating to the time value of money and assumptions that relate to financial risk from changes in the carrying amount of the contractual service margin*
  - (j) *Changes in the risk adjustment for non-financial risk;*
  - (k) *Use of the risk mitigation option;*
  - (l) *Excluding changes from cash flows relating to loans to policyholders from revenue;*
  - (m) *Treatment of changes in underlying items;*
  - (n) *Amendment to IFRS 3 Business Combinations; and*
  - (o) *Amendment to IFRS 7 Financial Instruments: Disclosures, IFRS 9 Financial Instruments and IAS 32 Financial Instruments: Presentation.*

#### **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 IASB's proposals for each of the minor amendments described in this Exposure Draft? Why or why not?

#### *EFRAG's response*

#### **EFRAG supports the IASB's proposal.**

- 98 EFRAG supports the IASB's proposals relating to the annual improvements as EFRAG agrees that they clarify wording or make corrections or address minor unintended consequences or conflicts.

**Questions to Constituents**

99 Do Constituents consider that there are any unintended consequences arising from the minor amendments? Please explain.

100 EFRAG has heard two concerns which are described in the following paragraphs.

*B128 of the amended IFRS 17*

101 Paragraph B128 of the amendments to IFRS 17 clarifies that changes in the measurement of a group of insurance contracts caused by changes in the fair value of underlying items should be treated as changes in investments and hence as changes in the time value of money and financial risk. The concern is that there would be a misclassification between insurance service result and finance result requiring the presentation of non-financial items in the financial result.

*Paragraph 28 of the amendments to IFRS 17 and paragraph 22 of IFRS 17*

102 Paragraph 28 of the amendments to IFRS 17 indicate that in recognising a group of insurance contracts in a reporting period an entity shall include only contracts that individually meet one of the criteria set out in paragraph 25 of the amendments to IFRS 17. That is, based on:

- (a) the beginning of the coverage period of the group of contracts;
- (b) the date when the first payment from a policyholder in the group becomes due; and
- (c) for a group of onerous contracts, when the group becomes onerous.

103 However, in paragraph 22 of IFRS 17, an entity shall not include contracts issued more than one year apart in the same group.

104 Using the issue date in paragraph 25 of the amendments to IFRS 17 instead of the recognition date for the grouping would have implications on, for example, for the discount rate and could create difficulties in terms of data availability causing operational issues and undue costs.

105 If you agree with either of the above two issues, please explain why this is an issue for you and the prevalence of the issue, including volumes and jurisdictions where the issue arises?

## Question 10 – Terminology

### Notes to Constituents – Summary of proposals

- 106 *The Exposure Draft proposes to add to Appendix A of IFRS 17 the definition ‘insurance contract services’ to be consistent with other proposed amendments in the Exposure Draft.*
- 107 *The IASB proposes to define ‘insurance contract services’ as:*
- “The following services that an entity provides to a policyholder of an insurance contract:*
- (a) coverage for an insured event (insurance coverage);*
  - (b) for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service); and*
  - (c) for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service).”*
- 108 *In the light of the proposed amendments in the Exposure Draft, the IASB 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.*

#### **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 IASB 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?

#### *EFRAG’s response*

**EFRAG agrees with the IASB making consequential changes in terminology as the CSM allocation now reflects services provided rather than being limited to insurance coverage.**

- 109 EFRAG agrees with the IASB making consequential changes to the identified definitions as the CSM allocation now reflects services provided rather than being limited to insurance coverage. In addition, a change in terminology will highlight the impact of the change and reduce the possibility of it being overlooked.

#### **Question to Constituents**

- 110 Do Constituents consider that there may be any unintended consequences arising from the proposed change in terminology? Please explain.

## **Appendix 2 – Other comments arising from topics in EFRAG’s September 2018 letter to the IASB that have not been addressed by the ED**

### **Topic 1 - Annual cohorts**

#### **Notes to Constituents – Summary of IFRS 17 requirements where no change is proposed by the IASB**

- 111 *In the 2010 Exposure Draft, the IASB proposed: (a) the risk adjustment be measured at the portfolio level; and (b) the CSM be measured at a lower level - the portfolio split into groups based on similar dates of inception and similar coverage periods. The IASB also proposed that the CSM recognised in profit or loss in each period be adjusted to reflect when fewer contracts than expected were in force at the end of a period, so that amounts related to contracts no longer in force would go to profit or loss immediately.*
- 112 *In the 2013 Exposure Draft, the IASB proposed a narrower definition of a portfolio of insurance contracts. That definition would be ‘a group of insurance contracts that provide coverage for similar risks and that are priced similarly relative to the risk taken on and are managed together as a single pool’. The IASB proposed that the level of aggregation for both the measurement of expected cash flows and the contractual service margin should be the portfolio of insurance contracts. The IASB noted that the level of aggregation should not make a difference for the measurement of expected cash flows. However, the IASB did not specify a level of aggregation for recognising the contractual service margin. Instead, the IASB provided an objective that the contractual service margin should be recognised in profit or loss at a level of aggregation such that once the coverage period of the insurance contract has ended, the related contractual service margin has been fully recognised. The IASB noted that, in practice, this may result in a smaller unit of account than the portfolio that entities would generally use to manage contracts and may require entities to group together contracts that have similar contract inception dates, coverage periods and service profiles.*
- 113 *In the 2016 external review of IFRS 17, the IASB proposed that: (a) the definition of a portfolio of insurance contracts is a group of insurance contracts subject to similar risks and managed together as a single pool; (b) an entity is required to measure individual insurance contracts on initial recognition to determine what group they belong to. Those groups comprise contracts that on initial recognition have: (i) future cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions; and (ii) similar expected profitability. Similar profitability means similar contractual service margin as a percentage of the total expected revenue. As a practical expedient, an entity may instead assess whether the contracts have a similar expected return on premiums, i.e. the contractual service margin as a percentage of expected premiums; (c) an amount of the contractual service margin is recognised in the statement of profit or loss to reflect the service provided under the contract. In determining that amount, the objective is to allocate the contractual service margin for a group of contracts remaining (before any allocation) at the end of the reporting period over the coverage provided in the current period and expected remaining future coverage to be provided, on the basis of the passage of time. The allocation shall be based on coverage units, reflecting the expected duration and size of the contracts in the group.*

*EFRAG's view*

**EFRAG agrees with the IASB's reporting objectives of the level of aggregation requirements in IFRS 17: depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses from onerous contracts.**

**EFRAG acknowledges that the annual cohort requirement is a trade-off between tracking individual contracts and ensuring the recognition of onerous contracts even where there are contracts with similar risks but different levels of profitability. Nonetheless, EFRAG considers that the requirement leads to unnecessary cost in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts.**

**EFRAG therefore believes that it is worth re-considering whether in certain cases the annual cohorts requirement is justified for such contracts. EFRAG recommends that the IASB consider developing an exception for such contracts, starting from paragraph BC138; the exception should be reflective of the reporting objectives of the level of aggregation requirements in IFRS 17.**

- 114 The unit of account in IFRS 17 is a group of contracts at initial recognition; the same grouping is kept for (i) the determination of the CSM, (ii) its release pattern over the coverage period of the contracts in the group and (iii) the discount rate for accretion of interest on the CSM in the General Model.
- 115 First, insurers have to identify “portfolios” of contracts that are subject to similar risks and that are managed together. The portfolios are then divided into three groups:
- (a) onerous contracts, if any;
  - (b) contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
  - (c) other contracts, if any.
- 116 Paragraph 22 of IFRS 17 requires additionally that an entity shall not include contracts issued more than one year apart in the same group.
- 117 EFRAG has heard major concerns from Constituents that a group of contracts cannot include contracts issued more than one year apart. In particular, stakeholders consider that:
- (a) the requirements will not provide users of financial statements with useful information;
  - (b) implementing the requirements is a major challenge and the benefits do not outweigh the costs; and
  - (c) the requirements are unnecessary because an entity can achieve the same outcome without applying those requirements.

*Characteristics of the “mutualised” model*

- 118 EFRAG understands that the transfer of wealth between generations of policyholders that participate to the same pool of assets is a key feature of life-saving business in several European jurisdictions, such as France, UK, Italy and Germany and therefore represents a common feature for a significant share of the entire European insurance market. The following is a description of the characteristics of such mutualised contracts:
- (a) different generations of policyholders participate to the returns of a common underlying pool of assets;

- (b) as a consequence, newly issued contracts join the existing population of beneficiaries of the total returns from the pool, so that the mutualisation mechanism lasts more than 1 year;
- (c) the sharing of the risks among all policyholders relates to financial risk and, in some circumstances, also insurance risk, and the financial risk accounts for substantially the entire variability of the cash flows of the insurance contracts;
- (d) taking into account the inter-generational mutualisation model, in substance there is no single onerous contract until the group as a whole is onerous;
- (e) in most cases in many jurisdictions these contracts are eligible to apply the variable fee approach (VFA); and
- (f) the potential loss for the insurer is generally limited to situations where the returns are not sufficient to cover guaranteed benefits.

*The concerns expressed by Constituents for mutualised contracts*

119 EFRAG has heard the following main concerns expressed about the impact of the annual cohort requirement for the mutualised contracts described above:

- (a) Costs and complexity of the requirements: significant changes to systems and increase costs (both at implementation and subsequently). Such changes will also lead to inconsistencies between accounting requirements and business practices;
- (b) The annual cohort requirement results in limited usefulness to users of the financial information. The splitting of 'mutualised' amounts into groups of contracts issued not more than one year apart is seen as artificial and different to how the business is organised and from the economics of the contracts: the initial allocation of cash flows on an annual cohort basis, which is artificial because there is a common underlying pool of assets, has to be compensated by further artificial allocations. As a consequence, the accounting ignores the economic consequences of the contractual terms and not reflect reality;
- (c) The level of aggregation requirements will not reflect the level at which pricing, monitoring of profitability as well as risk management of insurance contracts is undertaken in most cases as this is generally done at a portfolio level;
- (d) The costs of providing the demonstration suggested in paragraph BC138 may be as high as the cost of implementing the annual cohorts requirement: depending on how the requirement is interpreted, providing a detailed quantitative demonstration would entail building new systems and tracking data in a similar way to fully applying the annual cohorts requirement;
- (e) Annual cohorts are not required at transition in the absence of reasonable and supportable information to apply it, for both the fair value approach and the modified retrospective approach. In the case of groups of mutualised contracts that share the results of the same pool, where the pool includes both recent generations of contracts (for which the full retrospective approach (FRA) is practicable) and less recent generations of contracts (for which the FRA is not practicable), it would be logically possible to apply the transition exception to the annual cohorts requirement.

*March 2019 IASB re-deliberations*

120 The IASB considered the requirements in IFRS 17 and acknowledged the cost implications but decided to retain the requirements in IFRS 17 and referred to the benefits of IFRS 17, the majority of which resides in the level of aggregation requirements. Some IASB members considered that abandoning those requirements would fundamentally change IFRS 17. In addition, the IASB

considered that IFRS 17 already allows simplification compared to other IFRS Standards that require a contract by contract unit of account.

- 121 The reporting objectives of the level of aggregation requirements are:
- (a) to appropriately depict trends in an entity's profit over time,
  - (b) to recognise profits of contracts over the duration of those contracts, and
  - (c) timely recognition of losses from onerous contracts.
- 122 The IASB considered that the main obstacles to the reporting objectives of IFRS 17 if annual cohorts are eliminated are:
- (a) averaging of profits; and
  - (b) recognition of profits beyond the coverage period of the group, which would distort the profit reporting from different generations of insurance contracts and obscure inherent risks of the business model.
- 123 In its re-deliberations, the IASB considered that the annual cohorts requirement is a simplification from previous principles-based proposals that had been envisaged using similar margins and contract duration in order to reduce the operational burden at implementation. In particular, the IASB concluded that the objective for the allocation of the contractual service margin could be achieved to an acceptable degree if, for each of the profitability buckets, an entity was restricted to grouping contracts that are issued within the same year. This would achieve the benefits of the reduced operational burden that results from removing the requirement for entities to group contracts according to similar profitability while still retaining the outcome the IASB desires for the allocation of the contractual service margin. Like the previous 'similar profitability' proposal in the draft IFRS 17, requiring annual cohorts would ensure that changes in profitability over time are more likely to be apparent because profits on contracts are allocated over a finite period, compared to open profitability buckets in which profits on contracts could be allocated over an infinite period (ref. paragraph 18 of agenda paper 2C of the IASB March 2019 meeting).
- 124 The IASB considered the effect on mutualised contracts of the requirement to restrict groups to contracts that are issued within one year. Contracts are mutualised if some policyholders have subordinated their claims to those of other policyholders, thereby reducing the direct exposure of the insurer to the collective risk of the group. The IASB considered whether applying annual cohorts to contracts that are fully mutualised (i.e. according to the IASB Staff paper contracts for which 100% of the risks are shared between policyholders) might result in a loss because an annual group is regarded as onerous even though the combined mutualised group (the portfolio) is profitable. The IASB concluded that, because the measurement and allocation of cash flows to groups consider the effect of mutualisation (so for example, cash flows are allocated across annual cohorts to reflect mutualisation), applying IFRS 17 to fully mutualised contracts would result in the same outcome with and without annual cohorts. The IASB considered whether to add an exception to annual cohorts for fully mutualised contracts, but concluded that to do so would add complexity, and create risk that the boundary would not be robust or appropriate in all circumstances. Nonetheless, the IASB noted in paragraph BC138 of the Basis for Conclusions on IFRS 17 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 for an entity to apply annual cohorts to achieve the same accounting outcome in some circumstances (ref. paragraph 20 of Agenda Paper 2C of the IASB meeting of March 2019).
- 125 It is worth mentioning the following two exceptions are included in IFRS 17 at transition for the use of the annual cohorts:

- 126 Paragraph C10 states that when applying the modified retrospective approach at transition the entity shall not apply paragraph 22 to divide groups into those that do not include contracts issued more than one year apart, to the extent that it does not have reasonable and supportable information to apply the annual cohort requirement;
- 127 Paragraph C23 states that when applying the fair value approach to a group at transition the entity is not required to apply the annual cohort requirement but shall only divide groups into those including only contracts issued within a year or less if it has reasonable and supportable information to make the division.
- 128 No exception is granted in case of full retrospective approach.

*EFRAG's view*

- 129 EFRAG agrees with the IASB's reporting objectives of the level of aggregation requirements in IFRS 17: depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses from onerous contracts.
- 130 EFRAG understands that in order to meet those objectives, the annual cohort requirement has been retained as a practical simplification on a conventional basis. Such a convention derives from the difficulties to promote a principle-based approach. As a matter of fact, the IASB tried to develop a principle-based approach to identifying groups that would eliminate the loss of information, however such an approach was rejected because of feedback from stakeholders that it would be unduly burdensome. The annual cohort requirement is, therefore, a trade-off between tracking of individual contracts whilst ensuring the recognition of onerous contracts even where there are contracts with similar risks but different levels of profitability.
- 131 EFRAG believes it is worth re-considering whether the annual cohort requirement is justified in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts (in accordance with the heading of paragraph B67 to B71).
- 132 EFRAG acknowledges and appreciates that the IASB considered in depth in its decision process to find a solution for these mutualised contracts. However, the IASB decided not to add an exception to annual cohorts, as in its view to do so would add complexity and create a risk that the boundary would not be robust or appropriate in all circumstances. Instead of granting such an exception, the IASB noted in paragraph BC138 of the Basis for Conclusions on IFRS 17 that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. Accordingly, the IASB considered that it may not be necessary for an entity to apply the annual cohorts requirement to achieve the same accounting outcome in some circumstances.
- 133 EFRAG suggests that this conclusion in paragraph BC138 be elevated to the main body of the Standard.
- 134 EFRAG observes that contracts where the cash flows significantly affect or are affected by the cash flows of other contracts are a common feature of a significant portion of the life insurance business in several European jurisdictions. The IASB has already factored in the characteristics of such contracts in IFRS 17, including in paragraphs B67-B71.
- 135 EFRAG has noted the conclusions of the IASB, in particular when in paragraph BC138 the IASB states that introducing an exception would add complexity and create the risk that the boundary would not be robust or appropriate in all circumstances. However, EFRAG believes that the added complexity is justified if it leads to achieving the same benefit at less cost.

- 136 In fact, EFRAG assesses that, for contracts with intergenerational mutualisation, the application of the annual cohort requirement, while being operationally complex, would not necessarily provide additional useful information to users.
- 137 EFRAG believes that the technical elements needed to develop a solution are already present in the assessments that the IASB itself performed during the re-deliberation process: for contracts described in paragraphs B67-B71 and that share in the same pool of underlying items applying the annual cohort requirement would not lead to a significantly different accounting outcome and, therefore, should not be applied. In any case, an exception to the annual cohort requirement should always be reflective of the three IFRS 17 reporting objectives stated above.
- 138 In conclusion, EFRAG recommends that the IASB re-consider providing an exception in the main text of the Standard for the contracts described in paragraphs B67-B71, starting from paragraph BC138, and acknowledging that for these contracts using the annual cohorts requirements is not necessary to achieve the same accounting outcome. In EFRAG's view, this is likely to achieve a better cost/benefit trade-off.
- 139 For contracts to which the annual cohorts are not applied, the transition provisions of IFRS 17 should be aligned, consistently with the recommendation above, including contracts for which the full retrospective application is applied.

#### Questions to Constituents

- 140 For contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts:
- (a) EFRAG is suggesting to the IASB to provide an exception to the requirement to restrict the grouping of contracts using the annual cohorts. Would Constituents agree with this proposal? Please explain why or why not.
  - (b) Please provide fact patterns - and their prevalence - for which the application of the annual cohorts requirement results in added complexity that is not justified and, as a consequence, should be captured in such an exception. For example:
    - (i) Contracts to which the VFA applies compared to other contracts;
    - (ii) Contracts with full sharing of risks compared to other contracts that only share a substantial or significant part of the risks;
    - (iii) Contracts that share all risks or only particular risk types; and
    - (iv) Contracts with sharing of asset returns of underlying pools compared to other contracts.
- 141 As reported in paragraph 129, the exception should meet the reporting objectives of IFRS 17 (i.e. depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses onerous contracts).

With reference to the pattern of recognition of the CSM, EFRAG in its case study received mixed results as to whether the resulting information would be impacted by the removal of the annual cohorts.

In your opinion, how would you ensure that the CSM release pattern would be in line with the IFRS 17 stated objectives? Do you envisage any loss of information as contemplated by the IASB in paragraph BC177 of the ED? If so, how would you address that loss of information?

- 142 Are there other types of contracts in the life insurance business, other than the contracts with cash flows that affect or are affected by cash flows to policyholders, that create similar complexity?
- 143 Some have observed that when a grouping approach broader than annual cohorts is applied, there is a benefit in providing additional information about trends in profitability. Such disclosure could include:
- (a) Reconciliations for the CSM of those groups from the opening to the closing balances (according to paragraph 101 of IFRS 17)
  - (b) Disclosure on profitability trends by presenting the CSM effect of new business joining the groups, extracted from (a), as a series of historical data (for example, the last 3 years);
  - (c) Disclosure of the actuarial techniques applied for computing the CSM effect of new business joining the group as well as disclosure about the method used for assessing the profitability referred in (b).

Would Constituents consider it appropriate to include these additional disclosures?

## Topic 2 - Transition: Modified retrospective approach and fair value approach

### Notes to Constituents – Summary of IFRS 17 requirements where no change is proposed by the IASB

- 144 *IFRS 17 requires retrospective application, consistent with IAS 8, unless retrospective application is impracticable. As explained in paragraph BC378, the IASB believes that it would often be impracticable for entities to measure several of the amounts needed for retrospective application and, in order to deal with such impracticability, the IASB has developed two alternative transition methods: the modified retrospective approach and the fair value approach.*
- 145 *If it is impracticable for an entity to apply the full retrospective approach, an entity can apply either the modified retrospective approach or the fair value approach. The modified retrospective approach has been developed with the objective of achieving the closest possible outcome to a retrospective application of the standard, using reasonable and supportable information; and includes a number of specified modifications, each of them available for use to the extent that the entity does not have reasonable and supportable information to apply the retrospective approach. When an entity is missing reasonable and supportable information to apply the modified retrospective approach, it is required to apply the fair value approach.*

#### *EFRAG's view*

**EFRAG is aware that the modified retrospective approach and the fair value approach are two different measurement bases resulting in different outcomes that are not comparable, with the modified retrospective being the approach that aims to approximate the full retrospective approach which applies the most useful information.**

**EFRAG acknowledges the IASB decision not to allow further modifications to the modified retrospective approach, as this would further reduce comparability. However, in order to address the implementation challenges and prevent that a strict interpretation unduly restricts the use of retrospective approaches, EFRAG recommends that the IASB acknowledges in the main text of the final standard that the use of estimates is allowed, including those needed to approximate the missing information.**

**EFRAG also suggests that the IASB clarify that the 'reasonable and supportable information' criterion is not intended to change the judgement ordinarily required in IAS 8 to make estimates.**

- 146 EFRAG generally supports the retrospective application of IFRS 17 as with the adoption of any new standard.
- 147 EFRAG concurs with the IASB that, in the light of the diversity in previous insurance accounting practices and of the long duration of many types of insurance contracts, retrospective application provides the most useful information to users of financial statements, by allowing comparison between contracts written before and after the date of initial application of IFRS 17.
- 148 EFRAG observes that the modified retrospective approach has been designed to approximate the results of a retrospective application, while the fair value approach is a fall-back based on a different measurement basis, which is not designed to approximate the most useful financial information (i.e. the information resulting from the retrospective application).
- 149 EFRAG is strongly convinced that entities should maximise the use of the full retrospective approach or, when the full retrospective approach is impracticable, maximise the use of the modified retrospective approach, in order to achieve to the extent possible useful financial information at transition and in the following years

(until the maturity of the contracts existing at transition), before concluding that the fair value approach is the only practicable approach.

- 150 EFRAG is aware of the implementation challenges of both the full retrospective and the modified retrospective approach and in particular that the “reasonable and supportable information” criterion requires judgement to be applied.
- 151 EFRAG considers that the IASB should clarify that the ‘reasonable and supportable information’ criterion is not intended to change the judgement ordinarily required in IAS 8 in making estimates. Therefore, it is not intended to add extra burden or difficulty in allowing the application of the modified retrospective approach compared to the use of retrospective application in other IFRS Standards.
- 152 One might consider that a full retrospective approach may be applied solely by collecting detailed data as if the standard had been applied from inception, which might lead to the conclusion that the full retrospective approach is often impracticable. As explained by the IASB in paragraph BC378, the modified retrospective approach has been designed to approximate in these circumstances the accounting outcome of a full retrospective approach. EFRAG notes that the modified retrospective approach supplements the full retrospective approach with focused rules-based solutions where no reasonable and supportable information is available (except the information that might be required to apply the specified modification).
- 153 EFRAG acknowledges the IASB decisions not to allow entities to develop their own modifications, as adding more options to the transition provisions would further reduce comparability. However, in order to address the implementation challenges and prevent that a strict interpretation approach unduly restrict the use of retrospective and modified retrospective approach, EFRAG recommends that the IASB adds further clarifications in the final standard about the use of estimates and the assumptions in case of lack of data. To allay concerns about the difficulties in applying the modified retrospective approaches, EFRAG recommends that IFRS 17 should acknowledge in the main text of the standard that:
- (a) the existence of specified modifications does not preclude the normal use of estimation techniques in the modified retrospective approach: paragraph BC143 of the Basis for Conclusions of the ED acknowledges that the use of estimates will often be needed in the modified retrospective approach. EFRAG suggests moving this paragraph to the main text of the standard;
  - (b) when applying either the full retrospective or the modified retrospective approach, the entity should search for reasonable and supportable information that is available without undue cost and effort to develop estimates and should apply judgement in making such estimates, as addressed by IAS 8, including those estimates needed to approximate the missing information.
- 154 EFRAG understands that the insurance industry has robust valuation practices developed by actuarial experts. Accordingly, it should be possible in many cases to appropriately recreate missing data using estimation techniques based on reasonable and supportable information.

**Question to Constituents**

- 155 Please provide specific prevalent fact patterns where the application of the modified retrospective approach is proving particularly challenging in practice. This would assist EFRAG in understanding better the interpretation difficulties arising in obtaining reasonable and supportable information and in estimating missing information that is required to apply the modified retrospective approach.

### Topic 3 - Balance sheet presentation: Non-separation of receivables

#### Notes to Constituents – Summary of IFRS 17 requirements where no change is proposed by the IASB

156 *Apart from the presentation requirements for acquisition costs, the presentation requirements for the statement of financial position in paragraph 78 of IFRS 17 were amended to require an entity to instead present separately in the statement of financial position the carrying amounts of portfolios of insurance contracts issued that are assets and those that are liabilities and portfolios of reinsurance contracts held that are assets and those that are liabilities. There are no proposed changes to the measurement requirements of IFRS 17 as a result of this proposed amendment.*

#### EFRAG's view

**EFRAG agrees with the decision of the IASB to retain the requirements in IFRS 17 on balance sheet presentation, without a mandatory separate presentation of premiums receivable.**

- 157 EFRAG agrees with the decision of the IASB to retain IFRS 17 requirements on balance sheet presentation, without a mandatory separate presentation for premiums receivable. The presentation requirements of IFRS 17 is consistent with its measurement principle i.e. a current estimate of all expected cash flows within the contract boundary. The balance sheet reflects the combination of rights and obligations created by the contract as a whole.
- 158 It has been noted that in practice varying definitions of premiums receivable are used. Some definitions encountered include overdue premiums (i.e. not paid on the contractual date); premiums due (i.e. the contractual payment date is in the next month) as well as annual premiums due (i.e. the full annual premium even if the amount has been transformed into monthly payments).
- 159 As current actuarial systems only include those expected amounts that are not yet considered to be due, preparers have advised that changing their systems would be costly. In order to solve the cost concern and require separate presentation on the face of the balance sheet or disclosure in the notes, a definition for premiums receivable would need to be developed (which would create costs for those entities that currently use a different definition).
- 160 EFRAG has been advised that there is very little credit risk in premiums receivable taken as a whole, which is supported by the limited disclosures currently provided by insurers on credit risk. Furthermore, if separate presentation of premiums receivable is deemed necessary, IAS 1 paragraph 55 provides a solution as entities may disaggregate the different components on the face of the balance sheet.

#### Questions to Constituents

- 161 Do Constituents support the presentation of separate information about premiums receivable? If so, should information about premiums receivable:
- (a) be mandatory?
  - (b) be based on a predefined definition of “premium receivables” and , in this case, how should premiums receivable be defined?
  - (c) be provided on the face of the balance sheet or in the notes?
  - (d) be separated by insurance portfolio?

#### Topic 4 - Reinsurance contracts: contract boundary

##### Notes to Constituents – Summary of IFRS 17 requirements where no change is proposed by the IASB

- 162 *An entity applies the contract boundary requirements in paragraph 34 of IFRS 17 to the insurance contracts it issues and the reinsurance contracts it holds. That is:*
- (a) *the cash flows within the boundary of an insurance contract issued arise from the entity's substantive rights and substantive obligations as the issuer of that contract. These include the substantive right to receive amounts from the policyholder and the substantive obligation to provide services to the policyholder.*
  - (b) *the cash flows within the boundary of a reinsurance contract held arise from the entity's substantive rights and substantive obligations as the holder of that contract. These include the substantive right to receive services from the reinsurer and the substantive obligation to pay amounts to the reinsurer.*
- 163 *Therefore, if an entity has a substantive right to receive services from the reinsurer relating to underlying contracts that are expected to be issued in the future, cash flows within the boundary of the reinsurance contract held will include cash flows relating to those future underlying contracts. However, cash flows within the boundary of the underlying contract issued do not include these contracts expected to be issued in the future.*
- 164 *The IASB tentatively decided not to amend IFRS 17 for the following reasons. Modifying the IFRS 17 contract boundary requirements for reinsurance contracts held as proposed by stakeholders would result in a significant loss of useful information relative to that which would otherwise be provided by IFRS 17 for users of financial statements, because:*
- (a) *the measurement of reinsurance contracts held would not fully reflect the entity's substantive right to receive services from the reinsurer. This would reduce the relevance and faithful representation of information in the financial statements.*
  - (b) *the proposed amendment would go against the fundamental principle in IFRS 17 that all future cash flows within the contract boundary are reflected in the measurement of an insurance contract.*
  - (c) *the proposed amendment would add complexity to the contract boundary requirements.*

##### *EFRAG's view*

**EFRAG supports the IASB's tentative decision not to amend IFRS 17 because IFRS 17 appropriately reflects the rights and obligations embedded in the reinsurance contracts held.**

- 165 EFRAG appreciates the IASB's further consideration of the contract boundary of reinsurance contracts held.
- 166 EFRAG supports the IASB's tentative decision not to amend the standard regarding the contract boundary for reinsurance contracts held. EFRAG agrees that, conceptually, expected future cash flows for reinsurance contracts held and insurance contracts issued should be measured using a similar and consistent approach. This is because for both reinsurance contracts held and the underlying insurance contracts, measurement should reflect the entity's substantive rights and obligations created by the contract. Therefore, the contract boundary, risk adjustment and discount rate used for reinsurance contracts held compared to the

underlying insurance contracts may differ as this reflects different contracts with different conditions.

- 167 Further, this approach is consistent with the general principle in IFRS 17 that all expected future cash flows within the contract boundary are reflected in the measurement of an insurance contract.
- 168 It is acknowledged that estimating future contracts that will be covered by a reinsurance contract already written will require judgement. However, it is reasonable to expect that there will be evidence supporting the judgement needed, including that entities are likely to have budgets or forecasts which include expected new business and to have information about how reliable similar estimates were in the past; and the estimation of these contracts would follow the same measurement principles as IFRS 17.
- 169 EFRAG acknowledges that there is no material impact on the balance sheet until the entity pays or receives amounts relating to the reinsurance on future underlying contracts; or the underlying contracts are issued and the entity starts receiving reinsurance services relating to those contracts. However, the composition of the fulfilment cash flows and the CSM between the reinsurance contracts held and the underlying insurance contracts issued would be different.
- 170 Regarding CSM recognition in profit or loss, in circumstances that the service the entity receives from the reinsurer is proportionate to the service that the entity provides to the policyholder, the identification and allocation of coverage units for reinsurance contracts held will result in a pattern of CSM recognition which reflects that symmetry.
- 171 EFRAG considers that the CSM for the reinsurance contracts held which reflects future expected contracts provides useful information for investors. When the price to obtain reinsurance is more volatile than the price charged to the policyholders, investors would find it useful to know how well the primary insurer is protected against a future increase in the price of purchasing reinsurance coverage.

#### **Questions to Constituents**

- 172 Do Constituents support the IASB's tentative decision not to amend IFRS 17 for the contract boundary of reinsurance contracts held?
- 173 Do Constituents that are Users consider that CSM for the reinsurance contracts held which reflects future expected contracts would provide useful information? Please explain.
- 174 EFRAG understands that there is no material impact on the balance sheet and probably not a significant impact on profit or loss (until certain events occur as explained in paragraph 169 above). Please explain the prevalence of holding reinsurance contracts that relate to underlying contracts that have not yet been issued, including volumes and the jurisdictions where the issue arises.