

Exposure Draft ED/2019/4 *Amendments to IFRS 17 Insurance Contracts*
Comment Letter
European Financial Reporting Advisory Group
35 Square de Meeûs
Brussels B-1000
Belgium

Dear Madam/Sir,

The Spanish Insurance Supervisor (Dirección General de Seguros y Fondos de Pensiones, DGSFP, depending on the Ministry of Economy and Business) and the Accounting and Auditing Institute (ICAC) welcome the opportunity to comment on the Exposure draft ED/2019/4 Amendments to IFRS 17 Insurance Contracts, issued by the IASB on 26 June 2019.

This letter pretends to contribute to the IASB's due process and to discuss some topics that we understand to be especially significant for the Spanish market. We appreciate IASB's work considering the different challenges that have been appeared during the implementation phase.

We believe that IFRS 17 is a high quality standard, that it will improve the quality of the reported information and the comparability of the financial statements between insurance undertakings. However, we understand that there are some issues that should be considered.

Particularly, we understand that, given the characteristics of the Spanish market of long-term life insurance contracts, the requirements of the standard do not reflect properly these products, especially when they are managed under cash flow matching adjustment.

From this perspective, we highlight four concerns:

1. Level of aggregation: in some types of contracts, annual cohorts involve an excessive cost without improving the quality of the information reported. In addition to those contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts, there are also other contracts in which could be justified to eliminate annual cohort's requirement.

In Spanish market, long-term life-saving contracts are managed with matching adjustment technics; it means that a joint management is applied for asset and liability. The strong link between assets and liabilities implies that the additional information provided by the annual cohorts could not be material, since the cash flows generated by the entire portfolio of matched assets are used to settle the obligations arising from the insurance portfolio without considering when they were issued.

2. Transition: we welcome the transition modifications and reliefs; nevertheless we consider that the amendments proposed by the IASB for transition do not solve all the arisen issues. It is complicated to support that, depending on the transition approach the entity applies, the equity situation is substantially different. This situation implies an



important lack of comparability in the transition date and subsequently. Particularly, if an entity applies the fair value approach, that entity shall use the discount rate existing at the transition date. This discount rate will be materially different from the discount rate which would be used if the full retrospective approach or the modified retrospective approach could be applied.

3. Receivables premiums: we consider that the presentation of separate information about premiums receivable and claims to be paid provides relevant information, and we therefore consider that this separation should be mandatory in order to achieve comparability.
4. Transition date: we believe that, for achieving the objectives setting on the standard, it is necessary an adequate implementation. In that sense, controversial issues shall be resolved to aim that objective and an appropriate implementation period should be regarded. One more year of postponement should be considered for an appropriate implementation.

Please, don't hesitate to contact us if you would like to clarify any point of this letter.

Yours sincerely,

Enrique Rubio Herrera
Chairman of ICAC

Sergio Álvarez Camiña
Director General DGSFP

Madrid, 2nd September 2019



DGSFP and ICAC's responses to the questions raised in the DCL

Our responses to the questions in the Draft Comment Letter are explained below.

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?

There are not detected mayor impacts.

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?

The comparability of financial statements is an essential aspect.

The definition of insurance contract renewals is a specific issue of the entity's accounting policy. When an entity recognize an asset for insurance acquisition cash flows, the part of these costs, which are linked to future expected renewals of the existing contracts, should be perfectly identified. In any case, impairment test is required at least annually. If a part of the costs is incurred to increase the business in future years, the corresponding depreciation and, if applicable, impairment should be registered so they represent the substance of the transaction.

Question 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?



There are insurance contracts that provide an investment-return service although they do not include a non-distinct investment component or the right of the policyholder to withdraw an amount. For instance the proposed amendment could not apply to deferred annuities without payment on death in the accumulation phase or the payout phase (or in both), and deferred capital during the term agreed (accumulation period) without death benefit. Therefore, the proposed amendment could not include all the related cases.

Question to Constituents

- 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.

The required quantitative disclosures can be operationally complicated in the case, for example, of the contractual service margin derived from both the insurance component and the investment component. Enough information could be provided applying a more qualitative approach.

Question 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.

We understand that there are some kind of reinsurance contracts held that are not in the scope of the proposed modification. For example, reinsurance contracts held that include a minimum amount that will always be covered by the cedent, in addition to the right to recover from the issuer a percentage of the claims incurred on groups of underlying insurance contracts.

Question to Constituents

- 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?

There are so many types of reinsurance contracts held hence it is complicated to establish which of them should be eligible for the exception and which of them should be treated as independent contracts. For some non-proportionate reinsurance contracts held, it could be justified treating them in a similar way proportionate reinsurance contracts held are registered.

In that sense, we understand that for improving comparability, it would be better to register them like independent contracts and to reduce the possible accounting mismatch by adjusting the risk adjustment for non-financial risk.

Question to Constituents

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.

We understand that balance sheet presentation on a portfolio level rather than at group level does not have a negative effect on faithful representation. This proposed modification will reduce some part of the implementation costs. Cost-benefit analysis was the main reason for being proposed.

Question 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.

The hedge operations used to mitigate risks arising from insurance contracts issued must not generate accounting mismatches.

Different financial instruments can be used for this purpose and these instruments are not held for trading. These financial instruments are held to match the cash outflows expected to be generated by the liabilities with the cash inflows expected to be received from the financial asset portfolio. These risk mitigation techniques must be considered by the standard in order to avoid the appearance of accounting mismatches.

Question 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.

An adequate implementation of the standard is critical to meet its objective. Therefore, the effective date on 1st January 2023 should be considered in order to favour a robust implementation. In that sense, it is necessary clarify the controversial issues of the standard.

Question 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?

Retrospective application of paragraph B115 should be available for those situations in which the entity has all reasonable and sustainable information required.

Question 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.
- 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.



- 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 for 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?

At first glance, none of the two proposed amendments seems to have negative or unexpected effects in Spain.

In relation with paragraph 28, in our market the premium is usually paid at the same moment the entity issues the contract.

Question to Constituents

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

The proposed change in terminology arises from the proposed amendment that establishes an entity shall consider the investment-return service when it allocates the contractual service margin remaining at the end of the reporting period. So far, we have not identified unintended consequences arising from the proposed modification.

Question 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.

We believe that there are some types of contracts or some types of business models for which the implementation of annual cohorts could imply excessive costs and complexity without improving the quality of the reported information. In these cases, we agree with the EFRAG



proposed amendment. Furthermore, in such cases, annual cohorts do not reflect current management practices for long-term life contracts.

Question to Constituents

140 For contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts:

(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

We agree with the IASB's reporting objectives: depicting profit trends over time, recognizing profits of contracts over the duration of those contracts and applying principle of prudence when an insurance contract is onerous.

However, in some types of contracts, annual cohorts could involve an excessive cost without improving the quality of the information reported, so the application of annual cohorts should be reconsidered. In addition to contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts, there are other contracts in which could be justified to eliminate annual cohort's requirement.

In the Spanish market, long-term life-saving contracts are managed with matching adjustment technics, it means an asset liability joint management is applied. This way of management legally imposes comprehensive requirements on investments designed to fulfil obligations arising from insurance contracts.

The strong link between assets and liabilities implies that the implementation of the annual cohorts could not reflect the substance of the transaction. Since, the cash flows generated by the entire portfolio of matched assets are used to settle the obligations arising from the insurance portfolio without considering when they were issued.

Question to Constituents

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?

We consider that the loss of information could not be material. As far as, the significant information to be reported refers to whether the real profitability of the portfolio of assets, assigned to fulfill the obligations that arise from the insurance contracts, is enough to cover the guaranteed interest rate to the policyholder.

In any case, the release of the contractual service margin shall ensure recognizing profits of contracts over the duration of those contracts. In that sense, the definition of the coverage units should fulfill this objective.

Question to Constituents

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?.

As it has been mentioned, in long-term life contracts as annuities, the requirement to implement annual cohorts is not consistent with the business management model. This requirement could generate an excessive cost that does not lead to an improvement in financial information.

In those cases in which assets and liabilities are managed jointly, the additional information provided by the annual cohorts could not be significant. We consider that enough information could be provided by aggregating contracts issued in different years, under the condition that they can only be aggregated if they are in the same profitability group.

Question to Constituents

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?

We consider such disclosure requirements are adequate to complement the information reported about the profitability of those contracts.



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.

Given the characteristics of the Spanish market of long-term life insurance contracts, there are not enough available data to be able to apply the full retrospective approach or the modified retrospective approach. As the application of the full retrospective approach or the modified retrospective approach is not possible, Spanish entities can only apply the fair value approach. The fair value approach leads to significantly different results from those achieved with the other two approaches. In this sense, we consider it is inconsistent that, depending on the method applied, significantly different results are achieved. This fact also implies a lack of comparability that is contrary to the objective of the standard.

On the other hand, the application of the fair value approach results in information that does not faithfully represent the financial position and the financial performance of an entity. Obligations arising from insurance contracts, as well as the assets in the portfolio included in the matching adjustment, are usually assessed at fair value with changes in OCI. Applying the fair value approach at the transition date, these amounts recognized in OCI pass to be nil. In other words, technical provisions are measured using the interest rate existing at the transition date. Considering that, the amounts recognized in OCI, derived from such assets, are kept in application of IFRS 9, there is an accounting mismatch with important consequences. These consequences are aggravated by the fact that the interest rates at the issue date of the contracts and the current interest rates are very different.

The first of these consequences is that the amounts recognized in OCI arising from liabilities are transferred to the first-time application reserve (negative). This implies a change in the composition of own funds that does not faithfully represent the conditions at the implementation date.

Secondly, because assets will be discounted at the interest rate at the date of purchase of the asset while liabilities will be discounted at the interest rate fixed at the date of transition (much lower than the first rate), there will be a significant misallocation of the financial result. In this sense, we understand that additional amendments to the fair value approach are necessary in order to homogenize the results achieved by applying the different methods.

One of the reliefs that we propose to eliminate the asymmetry described, resulting from the different requirements under IFRS 9 and IFRS 17 at the transition date, would be to consider that the interest rate applicable to the portfolio of the assigned assets is a good approximation of the interest rate to be applied to the portfolio of insurance contracts. In this way, the amounts allocated in OCI of assets and liabilities would be offset and the financial result would better reflect the reality of the operation.

To extend the scope of the modified retrospective approach, it would be desirable to allow future cash flows at the date of initial recognition to be estimated as the amount of cash flows at the transition date without adjusting for known cash flows before the transition date and to apply a retrospective calculation only when possible (e.g. for the estimation of the discount rate). Simplifying the modified retrospective approach in order to reduce the information required for its application could be an alternative solution to the issues stated above.



Question 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?

The presentation of separate information about receivable premiums and claims to be paid provides relevant information, and we therefore consider that this separation should be mandatory in order to achieve comparability.

The search for a uniform definition is a complicated task but it is necessary.

Receivable premiums should appear on the balance sheet. In particular, they shall be measured as a credit that forms part of the Asset. The usefulness of this information is based on the different risks to which an incurred cash flow is subject, in relation to a probable and future cash flow. In view of the above, incurred and past due claims must also be separated from the overall provision, they should constitute an existing payment obligation that will form part of the Liability.

We do not understand the solution proposed by IAS 1 is enough. That is because, it only allows items to be disaggregated within the existing item. In other words, it makes possible to separate in sublines the receivable premiums from the rest of the elements that are part of the provision. However, it does not allow to disaggregate elements outside the overall provision. In addition, the lack of enforceability, as well as the lack of a uniform definition, would mean the absence of the intended comparability.

Question to Constituents

- 172 Do Constituents support the IASB’s tentative decision not to amend IFRS 17 for the contract boundary of reinsurance contracts held?

We support the standard approach of treating the reinsurance contract held as a separate contract and, therefore, the contract boundary must include the rights and obligations arising from the contract.

Question to Constituents

- 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.



We subscribe to EFRAG's opinion, especially in cases where the insurer is required to keep the contract, as well as in cases where, as EFRAG has pointed out, reinsurance prices vary more than direct insurance prices.

Question to Constituents

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.

We understand that the approach reflects the nature of the transaction. If there were changes in the expected cash flows arising from underlying insurance contracts expected to be issued, that changes would adjust the contractual service margin.

On the other hand, linking the coverage units to the number of contracts underwritten and expected to be issued, the release of the contractual service margin would be consistent with the implemented underwriting policy.