

Mr Jean-Paul Gauzès
President
European Financial
Reporting Advisory Group
(EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: EFRAG's Draft Comment Letter on IASB's Exposure Draft *Amendments to IFRS 17*

Dear Mr Gauzès,



The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to EFRAG's due process regarding the draft comment letter on the IASB's Exposure Draft (ED) *Amendments to IFRS 17* which aims at proposing targeted changes to IFRS 17 *Insurance Contracts* in response to concerns and challenges raised by issuers while implementing this new Standard. We are pleased to provide you with the following comments with the aim of improving the enforceability and consistent application of IFRSs.

Like EFRAG, ESMA welcomes the IASB's approach to propose a limited set of amendments to timely address implementation challenges with IFRS 17, while ensuring that: the proposals do not change the fundamental principles in IFRS 17, do not unduly disrupt implementation efforts already underway and do not further delay the application of the new Standard beyond the one-year postponement already proposed in the ED. ESMA reiterates the importance of a swift finalisation of these amendments in order to proceed with a timely replacement of the current IFRS 4 *Insurance Contracts* which does not provide for the necessary transparency and comparability in relation to insurance contracts.

In this respect, unlike EFRAG, we support the IASB's decision not to propose amendments to the level of aggregation requirements including the annual cohort provisions that are necessary to pursue the following key objectives of performance reporting: (i) recognising profitability of insurance contracts as services are provided; (ii) recognising losses on onerous contracts as soon as an issuer determines that losses are expected; and (iii) reporting timely information about changes in profitability. However, should further evidence emerge that the effectiveness and efficiency of these requirements can be improved while still pursuing these objectives, we recommend the IASB to consider it as part of the post-implementation review of IFRS 17, or earlier if feasible without impacting the timely implementation of the Standard.

ESMA is generally supportive of the direction of the proposed amendments, however we have identified some concerns relating to two specific proposals which, in our view, should be addressed in order to provide users of financial information with more transparent and relevant information on insurance contracts.

Firstly, while we acknowledge the relevance of the proposal to recognise an asset for insurance acquisition cash flows relating to future contract renewals in order to better reflect the economics of the underlying business practices, unlike EFRAG, we are concerned that it would introduce an additional element of significant judgement in the Standard. We would therefore strongly suggest that the IASB provides guidance on the definition of renewals and on the methodology regarding the allocation of the insurance acquisition cash flows to future contractual renewals, in order to reduce the scope for arbitrary judgement in the implementation of the proposed requirements.

Secondly, we agree with the development of a model that reflects the economic matching between reinsurance contracts held and the related direct insurance contracts. However, unlike EFRAG, we note that there is a risk that the proposed approach would result in recognising the benefit of buying reinsurance immediately while shifting the recognition of larger losses over a longer period of time. Therefore, if feasible on a timely basis, we recommend that the IASB reconsiders how the proposals can ensure a more accurate matching. In the absence of such a timely solution, we recommend that, based on the experience of the implementation of the new standard, the IASB considers at a later stage, how an improved representation of the matching between insurance and reinsurance contracts – when economically relevant – can be better represented.

Finally, ESMA supports the proposed one-year postponement of the effective date of IFRS 17 that is intended to cater for the uncertainty arising from the proposed amendments. However, we strongly recommend that no further postponement of the effective date is envisaged. Similarly, we support the extension by one year of the applicability of the temporary exception from IFRS 9 *Financial Instruments* in order to ensure a coordinated application of this Standard with IFRS 17. However, we also strongly recommend against further delaying the application of IFRS 9. A further delay would prevent the provision of better information, most notably on credit risk, for significant balances of financial instruments held by issuers operating in the insurance industry.

Our detailed comments on the ED are set out in the Appendix to this letter. In case you have any questions or comments please do not hesitate to contact me or Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu).

Yours sincerely,

A handwritten signature in black ink, appearing to read "Steven Majoor", is written over a printed name. The signature is stylized and somewhat abstract, with a long, sweeping line extending downwards and to the left.

Steven Majoor

Appendix – ESMA’s detailed answers to the questions in the ED

Question 1—Scope exclusions—credit card contracts 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?

Credit card contracts

1. ESMA supports the proposed scope exclusion for credit card contracts. While, in our view, the IASB should preserve the principle that transactions meeting the definition of insurance contracts should be accounted for consistently within IFRS 17, ESMA acknowledges the cost-benefit arguments underlying the proposed scope exclusion of this type of contracts in cases in 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.
2. ESMA also understands that the scope of the exception is intended to remain rather limited to fact patterns that have been explicitly raised to the IASB where credit risk is a key feature of the contract. Nevertheless, ESMA recommends that the IASB further considers whether the proposed exception should not be applicable to other types of payment instruments, including those involving mobile means of payment, whose terms are equivalent to those of credit card contracts.
3. Finally, ESMA notes that in paragraph BC 13 of the ED the IASB explains that *‘If the entity acts as an agent in providing insurance coverage under such a contract, the contract is not an insurance contract issued by the entity. However, if the entity provides insurance coverage as a principal, the contract is an insurance contract issued by the entity’*.
4. In our view, in order to assess whether any contract falls into the scope of IFRS 17, an entity always need to determine in the first place whether it is acting as the insurer or as a mere agent for insurance contracts issued by another entity. Therefore, we do not believe that the basis for conclusions need to make reference to a specific principle-agent assessment as a qualifying feature of this specific scope exclusion.

Loan contracts

5. ESMA supports the proposed scope exclusion for loan contracts, however we recommend that the IASB further assesses whether the proposed wording that refers generically 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'*, does not unduly attract within the scope of this exception contracts that are beyond the types of transactions that have originally been envisaged by the IASB.

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?

6. ESMA understands that, as part of their business model, some insurers bear upfront the acquisition costs for both the issuance of insurance contracts and their future expected renewals. While ESMA agrees that the accounting model for insurance contracts should properly reflect the economic substance of such fact patterns, we are concerned that the proposed approach to recognise an asset for acquisition cash flows relating to contract renewals may be inconsistent with the measurement approach set out in IFRS 17 and result in additional significant judgement which may undermine the reliability and comparability across insurers.
7. First of all, the inclusion in the measurement model of cash flows arising from insurance contracts under IFRS 17 is based on the concept of the 'contract boundary'. In our view, the proposed approach departs from this key principle underlying the measurement approach in IFRS 17 as it results in the recognition of an asset for insurance acquisition cash flows for future contracts, even if these cash flows fall within the boundary of the existing contract. Furthermore, the IASB should carefully assess the risk of introducing additional significant judgement on how the allocation of those cash flows affects the measurement of insurance liabilities and, ultimately, performance reporting for insurers. In this respect, as highlighted by the IASB in paragraph BC182 of IFRS 17, the requirements in IFRS 17 relating to insurance acquisition cash flows already result in subjectivity due to the fact that they include cash flows that relate to more than one contract.

8. Particularly, we are concerned that the proposed amendments do not provide neither a definition of what should be understood as 'expected renewals', nor an objective basis on how to determine the contractual renewals to which the deferral of the acquisition cash flows should apply. In our view, the amendments should specify that expected renewals should be identified based on reasonable and supportable information, as indicated in paragraph B37 of IFRS 17.
9. Secondly, we note that Appendix A of IFRS 17 defines acquisition cash flows as '*cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts that are directly attributable to the portfolio of insurance contracts to which the group belongs*'. Given this rather broad definition, we are concerned that the proposed amendments do not indicate how an insurer should allocate the different components of acquisition cash flows to future renewals. In particular, the deferred recognition of some expenses associated to acquisition cash flows beyond the contract boundary puts pressure on the distinction between costs of selling, underwriting and starting a group of insurance contracts, which may result in significant divergence in practice.
10. In addition, we note that paragraph BC40 of the ED refers to the proposed requirement to allocate on a 'systematic and rational basis' the insurance acquisition costs to expected renewals. In the Board's view the reference to 'systematic and rational' provides sufficient guidance to perform this allocation as the same terminology is used in paragraph B65(I) of IFRS 17. ESMA highlights that paragraph B65(I) relates to the allocation of overheads to groups of contracts that are within the contract boundary. In our view, applying the same criterion and terminology for the allocation of acquisition expenses for future contracts that are beyond the contract boundary appears to be insufficient to limit the level of judgement involved in the application of IFRS 17.
11. Thirdly, ESMA is not convinced by the statement in paragraph BC39 of the ED which indicates that the information resulting from applying the proposed amendments would be comparable to the information provided by IFRS 15 for the incremental costs of obtaining a contract. While, at a high level, the proposals align the treatment of acquisition costs between the two standards, the underlying requirements would still result in significant differences. In fact, as opposed to IFRS 15, IFRS 17 considers cash flows (rather than costs) that are directly attributable to a portfolio of insurance contracts rather than referring to the incremental costs to obtain contracts. Furthermore, while IFRS 15 foresees the recognition of an asset for costs relating to services to be provided under renewal of an existing contract, these costs are those necessary to fulfilling – rather than obtaining or acquiring – a contract. In addition, IFRS 15 is not built around the notion of contract boundary whereas, as indicated in paragraph B63 of IFRS 17, the cash flows associated to some contractual renewals may already be part of the measurement of an existing contract.
12. In addition, regarding the presentation of the recognised asset for acquisition cash flows, we note that paragraph 79 of IFRS 17 has not been amended to require a separate presentation at portfolio level. In our view, separate presentation of this asset should be required.
13. Finally, we are concerned that the proposed amendments envisage an assessment of the recoverability of the asset recognised for the insurance acquisition cash flows only if facts

and circumstances indicate that the asset may be impaired. ESMA believes that the reference to 'facts and circumstances' is rather vague and that an explicit indication of which factors may be indicative of an impairment would provide more useful and comparable information. In the absence of such factors, ESMA believes that such test should be conducted at least on annual basis.

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?

14. ESMA supports the proposed amendments in relation to investment-return services and investment-related services as these amendments allow for performance reporting that better reflects an insurer's performance under the contract.

15. While we concur with the IASB's assessment that including investment-return services along with insurance coverage in the determination of the coverage units for insurance contracts without direct participation features may add subjectivity and complexity to the IFRS 17 model, we believe that the proposed quantitative disclosures will play a critical role in helping users understanding the pattern of both insurance and investment services.

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?

16. In principle, ESMA supports an approach to account for reinsurance contracts that aims at eliminating or reducing any accounting mismatches that may result from the combined representation of the direct insurance contracts issued and the related reinsurance held.
17. However, while we agree with the IASB's approach to limit any matching solution to contracts where there is a close, proportional linkage between the reinsurance and the direct insurance contracts, we are nevertheless concerned that the mechanics of the proposed amendment may give rise to a different accounting mismatch and mis-represent the economic relationship between the direct insurance contracts and the reinsurance held and potentially result in structuring opportunities.
18. In particular, the proposed amendments establish an offsetting relationship between the net loss arising from the direct contracts issued and the amounts that are recoverable from the reinsurer, irrespective of whether the reinsurance contract is loss-making or not. In our view, in order to avoid the creation of any accounting mismatches, either the net loss on the direct underlying contracts is matched with the net result of buying reinsurance or the claims expected to be paid on the direct contracts are matched with the claims recoverable from the reinsurance contract and the premiums paid to the reinsurer with the premiums retained by the insurer. The asymmetrical matching mechanism proposed in the ED, whereas the net loss is offset by the claims recoverable from the reinsurer, risks creating a mere deferral of losses with the result of incentivising potential structuring opportunities.
19. In the new proposed example provided in the ED and in the simplified example in the snapshot document available on the IASB's website¹ illustrating the ED proposals, in fact, it is shown that the proposals would result in shifting the recognition of losses arising from the direct insurance contracts over a longer period, i.e. in line with the pattern of recognition of the cost of reinsurance, rather than in the reflection of an economic matching between the reinsurance held and the underlying contracts.
20. In this respect, we note that paragraph BC83 of the ED acknowledges that the proposed amendments result in a pattern of recognition of recoveries that differs from the pattern of recognition of the cost of the recoveries which, according to the Board, could be regarded as an accounting mismatch. The IASB goes on with saying that '*essentially, an entity will recognise a benefit immediately and a larger cost over the service period*'.
21. We recommend that, the IASB explores a solution that can overcome the above-mentioned criticalities. In the absence of such solution, we recommend that the IASB considers based on the experience of the implementation of the new standard, at a later

¹ <https://www.ifrs.org/-/media/project/amendments-to-ifs-17/ed-amendments-to-ifs-17-snapshot.pdf>

stage, how an improved representation of the matching between insurance and reinsurance contracts – when economically relevant – can be represented.

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?

22. ESMA agrees with this proposed amendment.

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?

23. ESMA agrees with this proposed amendment.

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?

24. ESMA agrees with the proposal to defer the effective date of IFRS 17 to annual reporting periods beginning on or after 1 January 2022 in light of the need to provide certainty to market participants arising from the IASB's decision to explore possible amendments to IFRS 17. ESMA also agrees that the deferral shall be limited strictly to one year considering that the proposed amendments have been selected in order to avoid the risk of disrupting the implementation efforts that are already underway.
25. ESMA also highlights that, in order to improve the transparency and comparability of financial information for issuers in the insurance industry, it is absolutely necessary to avoid any further delays in the effective date of IFRS 17. Delays in the replacement of IFRS 4 *Insurance Contracts* would protract a situation in which accounting requirements that were intended to be in use only for a limited time when issued in 2004, would continue to apply with detrimental effect on the transparency and comparability for financial information relating to insurance contracts.
26. ESMA also concurs with the rationale underlying the IASB's proposal to propose an extension of the temporary exemption from applying IFRS 9 *Financial Instruments* by one additional year (for periods starting on or after 1 January 2022), so that the eligible issuers can apply this standard at the same time as IFRS 17.
27. However, ESMA reiterates the importance of not further delaying the application of IFRS 9. As explained in the IASB in paragraphs BC115 and BC116 of the ED, the issuers eligible for the temporary exemption would first apply IFRS 9 up to four years after the other entities and would delay the provision of better information, most notably on credit risk, for significant balances held by issuers operating in the insurance industry.

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?

28. ESMA agrees with the proposed amendments in relation to transition modifications and reliefs.
29. ESMA particularly agrees with the IASB's proposal to allow the application of paragraph B115 from the transition date, rather than the date of initial application. ESMA concurs with the IASB's assessment in paragraph BC128 of the ED that the retrospective application of the risk mitigation option should not be permitted in order to avoid the risk of hindsight and create opportunities for entities to decide the risk mitigation relationships to which the risk mitigation option shall apply based on the known outcome.
30. In general, ESMA would like to highlight that the transition requirements are particularly critical for long-duration liabilities that will be outstanding for several years after the transition date, as the transitional treatment will have persistent effects long after the first application of IFRS 17. Therefore, any simplifications should not constitute significant departures from the principles in IFRS 17, in order to avoid the postponement of the beneficial effects for users of financial statements arising from the application of the new standard. In this respect, ESMA agrees with the IASB's conclusion not to allow issuers to provide their own approximations of the retrospective application.
31. However, ESMA would suggest the IASB to include in the body of the authoritative guidance of IFRS 17 the clarifications provided in paragraph BC143 of the ED to provide further reassurance to issuers that, in line with the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, estimates can be applied in implementing the modifications required by the modified retrospective approach.

Question 9—Minor amendments (BC147–BC163) This Exposure Draft also proposes minor amendments (see paragraphs BC147–BC163 of the Basis for Conclusions).

Do you agree with the Board's proposals for each of the minor amendments described in this Exposure Draft? Why or why not?

32. ESMA agrees with this proposed amendment.

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 Board 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?

33. ESMA agrees with these proposed amendments, however we suggest that the IASB carefully considers whether the terminology used in the ED to refer to reinsurance contracts that provide 'proportionate' (instead of 'proportional') coverage effectively captures the population of reinsurance contracts that in existing market practices the Board intended to address with the proposed amendments.

Other comments

34. ESMA notes that in paragraph 55(a)(iii) the text reads as follows: '*55... (a) on initial recognition, the carrying amount of the liability is: ... (iii) plus or minus any amount arising from the derecognition at that date of the asset ~~or liability~~ recognised for insurance acquisition cash flows applying paragraph 28C 27.*' Our understanding is that the adjustment of the insurance liability to reflect the derecognition of the asset recognised for insurance acquisition cash flows should reduce the amount of the liability and therefore the text should only retain the word 'minus' and delete the word 'plus'.