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Amendments to IFRS 17 *Insurance Contracts*

Issues paper on the forthcoming Exposure Draft and EFRAG letter topics

Introduction and objective

- 1 The objective of this session is for EFRAG TEG to discuss the IASB tentative decisions and EFRAG letter topics, which are more controversial in nature, in preparation for EFRAG's draft comment letter relating to the forthcoming Exposure Draft on IFRS 17 *Insurance Contracts*. The topics in this issues paper are the following:

Appendix 1: Changes proposed by the IASB

- (a) Topic 7A - Attribution of profit to service relating to investment activities;
- (b) Topic 7B – Terminology;
- (c) Topic 8 - Reduced accounting mismatches for reinsurance;
- (d) Topic 9A - Deferral of effective date of IFRS 17 by one year; and
- (e) Topic 9B - Deferral of effective date for the temporary exemption of IFRS 9 in IFRS 4;

Appendix 2: Other comments, based on EFRAG's September 2018 letter to the IASB on issues that will not be addressed in the ED

- (f) Topic 10 - Balance sheet presentation: Non-separation of receivables and payables;
 - (g) Topic 11 - Transition: Modified retrospective approach and fair value approach;
 - (h) Topic 12 - Reinsurance contracts: contract boundary; and
 - (i) Topic 13 - Annual cohorts.
- 2 Written input was requested from EFRAG TEG on the following topics which are expected not to be controversial:
- (a) Topic 1A - Loans that transfer significant insurance risk;
 - (b) Topic 1B - Credit cards that provide insurance coverage;
 - (c) Topic 2 - Allocation of acquisition costs to expected contract renewals;
 - (d) Topic 3 - Simplified balance sheet presentation;
 - (e) Topic 4 - Extension of risk mitigation option;
 - (f) Topic 5A - Transition relief for business combinations;
 - (g) Topic 5B - Transition relief for risk mitigation – transition date and fair value approach; and

(h) Topic 6 - Annual improvements.

- 3 The text below has been prepared on the basis of the IASB Staff Papers and the IASB tentative decisions and starting from the outcome of the May EFRAG TEG discussion. The papers used for the joint EFRAG Board/TEG meeting of the 4th June provide additional background on the results of technical discussions at EFRAG IAWG and EFRAG TEG, leading to the positions to be discussed in this session.
- 4 The EFRAG Draft Comment Letter will be discussed and agreed by the EFRAG Board in the meeting the next 9th July. The Board discussion will leverage on the outcome of the feedback provided by EFRAG IAWG and EFRAG TEG to this document. Therefore, the final position and wording of the Draft Comment Letter may differ from this document.

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

Topic 7A - Attribution of profit to service relating to investment activities

Notes to constituents – Summary of proposals

- 5 *The Exposure Draft proposes two amendments relating to the identification of coverage units:*
- 6 *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.*
- 7 *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.*
- 8 *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.*
- 9 *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'.*
- 10 *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.*

EFRAG's response

- 11 **EFRAG supports the IASB proposals regarding contracts under the general model. Some contracts under the general model include investment activities and the proposal will ensure that the CSM that will be allocated to profit or loss will reflect both insurance and investment return services provided to the policyholder.**
- 12 **EFRAG also supports the IASB proposals regarding contracts under the variable fee approach because these contracts are substantially investment-related contracts.**
- 13 **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

- 14 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.
- 15 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 contractual service margin ('CSM') amortisation provides a faithful representation of those services being provided.

General model - Contracts without investment components

- 16 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.
- 17 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.
- 18 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

- 19 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.
- 20 Therefore, EFRAG supports that in addition to insurance coverage, these contracts also provide investment-related services to policyholders and the coverage units to release the CSM should reflect these services.

Disclosure requirements

- 21 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.
- 22 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 between types of contracts and 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.

- 23 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.

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Additional information about Spanish contracts, and their views on the proposed amendments to IFRS 17

The issue mentioned by a Spanish preparer

- 24 The requirements on coverage units to be used for the CSM amortisation are not appropriate for all types of contracts.
- 25 A key issue is that the CSM (of which the initial amount is impacted by investment spreads) cannot be amortised over the period in which investment services are provided for the Spanish long-term life-saving insurance contracts to be measured under the general model.
- 26 In some products, the insurers earn a financial margin during the entire duration of the contract, corresponding to the difference between the guaranteed customer profitability and performance of the investments made to achieve such profitability. In cases in which the coverage period does not coincide with the period during which the entity obtains the margin described above, the amortisation of the CSM under the current requirements of the standard is not consistent with the economic performance of the contract.
- 27 The amendments tentatively agreed by the IASB are insufficient, since they do not solve the issue for specific products, even when the companies provide the policyholder with access to an investment return and to an investment related service considered in the pricing. This is the case of the following products: (i) deferred life annuities without surrender value nor payment on death, and (ii) deferred capital during the term agreed (accumulation period) without payment on death in the accumulation period). In both types of products there is no investment component (as defined by the standard) nor the policyholder has a right to withdraw an amount.
- 28 Additionally, the May IASB's tentative decisions in relation to the "investment return service" requires that the investment component or amount the policyholder has a right to withdraw is expected to include a positive investment return. The IASB also decided that IFRS 17 will include guidance that a positive investment return can occur even when the absolute return is negative. There is a concern about the final wording of this guidance and expects that a surrender value linked to the market value of the underlying assets qualifies even that the policyholder could not get a positive investment return of the product in absolute terms in all cases. In order to assess the fulfilment of this requirement, there should be a more holistic approach to assess whether the insurance company provides an investment return service (holding the investments, adjusting them for duration/yield and providing an interest rate guarantee).
- 29 In particular, Spanish annuities are designed to provide the policyholder with access to an investment guaranteed return for the premium paid for the whole life of the policyholder, covering therefore the longevity risk. This is done through life periodic payments that ensure the policyholder a certain level of income until death. Although most annuities can be surrendered, these surrenders are unusual and in practice mostly linked to exceptional personal circumstances of the policyholder. The company links the surrender value to the market value of the assets in order to not incur in investment risk, but not with the objective to allow the policyholder to share the market value of the investments. The product is designed to provide the policyholder with access to a guaranteed investment return through the

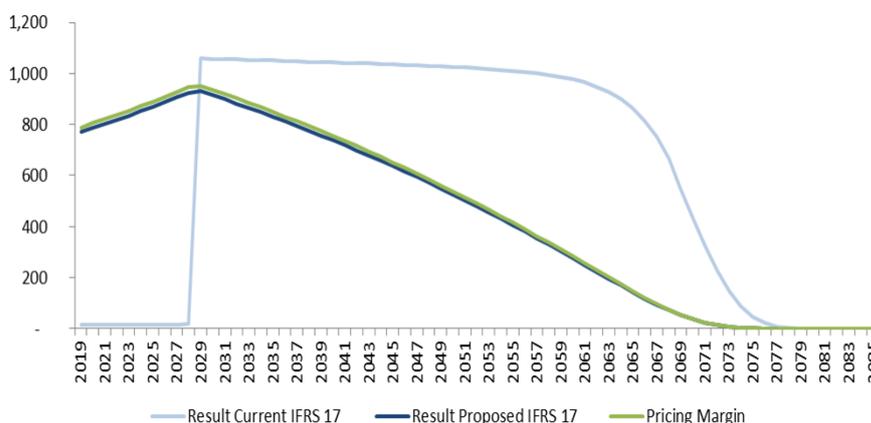
periodic payments until the event of death, not to share the market value of the assets through surrenders.

Significance of the issue as mentioned by a Spanish preparer

- 30 For insurance contracts held as at 31.03.2019 whose policyholder and beneficiary is a single person, the failing contracts represent 3% of the technical provisions, whereas for contracts whose policyholder is a company (pension schemes with employees), they represent 7% of the portfolio.

Proposal mentioned by a Spanish preparer

- 31 According to this Spanish preparer, the IASB should provide additional guidance that investment return services can also be present when for example, (i) the regulation enforceable for insurance companies require them to hold backing assets (regardless of whether the VFA or GMM is used), or (ii) the insurance contract has been designed with a saving purpose.
- 32 This entity believes an approach to expand the 'coverage units' to include more than only insurance benefits under the general measurement model could work. This could be achieved by permitting coverage units to include related activities performed to deliver the insurance benefits when they were assumed in the pricing of the contract. This would be driven by a principle-based assessment of the activities performed.



- 33 The result during the first years of the lifetime of the policy are more aligned with the business model as the investment management activity considered in the pricing is also considered to determine the coverage units, together with the insurance service.

Facts about the contracts affected

Immediate Annuities

- 34 For Immediate Annuities, there is no accumulation phase. The annuity starts as soon as the policyholder takes up the contract. The insurer invests the premium received from the policyholders in fixed rate bonds. The policyholder receives a fixed annuity (which includes a fixed guaranteed rate determined in pricing the contract) over time until death.
- 35 The entity may need to rebalance the assets in order to provide this guaranteed return to the policyholder.

Deferred Annuities/Deferred Capital contracts

- 36 Deferred Annuities/Deferred Capital contracts are similar to Immediate Annuities, except that:
- 37 For Deferred Annuities, there is an accumulation phase first and then the annuity phase. During the accumulation phase, if the policyholder dies, he does not receive anything. During the annuity phase, the policyholder receives a fixed annuity amount based on premiums/technical provisions;
- 38 Deferred Capital contracts are similar to Deferred Annuities in that there is also an accumulation phase where the policyholder does not receive anything upon death during this phase. The main difference is that annuities are paid out for Deferred Annuities while a lumpsum is paid out for Deferred Capital contracts. The policyholder will receive the capital and the agreed return only if he is alive at the date specified in the contract.
- 39 In these two products, there is not any fee charged to the policyholder, except for a penalty over the capital gains in order to discourage surrenders

Question to Constituents

- 40 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).*
- 41 Do you find this new definition helpful? Please explain.

Questions to EFRAG TEG

- 42 In addition to expressing support for the IASB decision, do members think that the EFRAG DCL should include additional comments on the criteria and definitions stated in the notes to constituents above?
- 43 Does EFRAG TEG agree with the drafting of this topic on attribution of profit to service relating to investment activities? Please explain.
- 44 Does EFRAG TEG consider that the issue of the Spanish deferred annuities explained above should be included in EFRAG's draft comment letter? If so, what services related to investment activities are being provided to the policyholder? How would it be possible to differentiate these contracts from other insurance contracts missing an investment component and an amount that the policyholder has the right to withdraw?

Topic 7B - Terminology

Notes to constituents – Summary of proposals

- 45 *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.*
- 46 *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.*

EFRAG's response

- 47 **To be completed.**
- 48 **EFRAG is consulting with Constituents to find out whether there are any unintended consequences.**
- 49 EFRAG is consulting with Constituents to find out whether there are any unintended consequences.

Question to Constituents

- 50 Do Constituents consider that there are any unintended consequences arising from the proposed terminology? Please explain.

Topic 8 - Reduced accounting mismatches for reinsurance

Notes to constituents – Summary of proposals

- 51 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.
- 52 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.
- 53 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.
- 54 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.

EFRAG's response

- 55 **EFRAG is of the view that the proposals of the IASB are too narrow and should allow to include surplus reinsurance contracts as these are generally considered as proportional reinsurance. EFRAG is requesting information from constituents about the cash flow patterns of non-proportionate reinsurance contracts that could possibly be included in the scope.**
- 56 EFRAG supports the proposals of the IASB aiming to reduce the accounting mismatches for reinsurance contracts held.
- 57 EFRAG notes that confusion exists about the scope of the amendments as the term “proportionate” is not read in the same way as “proportional” by insurers. The scope of proportionate in the Amendments excludes surplus reinsurance which are generally considered as proportional reinsurance. EFRAG recommends the IASB to adapt the wording of the Amendments so that it includes surplus reinsurance contracts where the proportion depends on the amount agreed in which the reinsurer takes over part of the claims. I.e. any claim that exceeds that fixed amount the reinsurer will participate in but this does not result in the same percentage of reinsurance cover for all contracts in a single group. EFRAG is of the view that the proposed solution by the IASB would have the same effects for these type of reinsurance contracts.
- 58 EFRAG understands that, under proportionate reinsurance, the reinsurer participates equally in all risks the insurer transfers to the reinsurer. In contrast, under non-proportionate reinsurance, the reinsurer takes some part of the risk such as excess risk or a capped amount of risk. It is noted that non-proportionate

reinsurance may represent very specific cash flow patterns where the reinsurance cover can be related to a number of insurance contracts and/or the use of several thresholds that are used to (de)activate the reinsurance cover. Considering these peculiarities, accounting for non-proportionate reinsurance may prove more complex than accounting for proportionate reinsurance.

Questions to Constituents

- 59 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, but there are many underlying contracts that are covered by a single reinsurance contract held. Addressing non-proportionate reinsurance may therefore require the need to identify a “link” between the reinsured risk and the underlying contracts.
- 60 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.
- 61 In your view, should non-proportionate reinsurance contracts be treated similarly to the proportionate, 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.
- 62 How would an accounting solution for non-proportionate reinsurance work?

Question to EFRAG TEG

- 63 At the May meeting EFRAG TEG members provisionally supported the decision to amend IFRS 17 for proportionate reinsurance. The majority of them were uncomfortable to suggest further changes to take into account non-proportionate reinsurance, because of lack of clarity about non-proportional reinsurance fact patterns. For this reason in this draft document we propose to consult constituents and to ask for clarifications to the IASB.
- 64 Does EFRAG TEG agree with the drafting of the topic on the reduction of accounting mismatches for reinsurance?

Topic 9A - Deferral of effective date of IFRS 17 by one year

Notes to constituents – Summary of proposals

- 65 *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.*
- 66 *The ED proposes an amendment in 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.*
- 67 *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.*

EFRAG's response

- 68 **EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17 by one year to 1 January 2022.**
- 69 EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17 by one year to 1 January 2022. EFRAG considers that this responds appropriately to the call for additional time to implement IFRS 17, including the amendments proposed in this ED.

Question to EFRAG TEG

- 70 Do EFRAG TEG members support the deferral of IFRS 17 effective date to 2022?
- 71 IFRS 17 represents a fundamental change to the accounting for insurance contracts for most entities that issue insurance contracts. The practical challenges of implementing IFRS 17 in the existing timeline include personnel shortages, the need for new processes and lack of software solutions. These challenges are particularly relevant for medium and small entities which are not well advanced in their implementation activities. In addition, EFRAG is concerned that the revised standard will require translation and/or endorsement in some jurisdictions, including Europe, which may not be feasible in time for 2022.
- 72 Considering the issues above, do members think that EFRAG should support a further deferral to 2023 (with earlier application permitted) or consult constituents on this specific point?

Topic 9B - Deferral of effective date for the temporary exemption of IFRS 9 in IFRS 4

Notes to constituents – Summary of proposals

- 73 *The ED proposes an amendment in 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.*

EFRAG's response

- 74 **EFRAG recommends that the effective date for IFRS 9 is aligned with the effective date of IFRS 17.**

75 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, it is important that IFRS 17 is applied together with IFRS 9.

76 EFRAG notes that, until IFRS 17 becomes effective, 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. Therefore, until IFRS 17 is effective, preparers will have to make an assessment of the expected impact of the standards in order to provide information to users.

Question to EFRAG IAWG/TEG on topic 9B

- 77 Does EFRAG IAWG/TEG agree with the drafting relating to the deferral of the effective date for the temporary exemption of IFRS 9 in IFRS 4? Please explain.

Question to EFRAG TEG on topic 9A and 9B

- 78 Some constituents have noted that the proposal to defer IFRS 17 to 2022 leave unresolved the issue of having different transition date for IFRS 9 and IFRS 17, due to the different requirements of the two standards with reference to comparative information (i.e. IFRS 17 requires to present comparative information for the previous year, while IFRS 9 does not require such comparative information). Assuming that the first year of initial application for IFRS 17 is 2022, the following possible alternatives would allow to address this issue:
- (a) Require to present comparative information for 2021 for IFRS 9, as entities will have to prepare such information for managerial reasons and in order to effectively communicate to the market;
 - (b) Do not require comparative information for 2021 for IFRS 17, but require to present in the notes information about financial performance for that year prepared according to IFRS 17 (*This was the preferred view by a majority of EFRAG IAWG members. Members also noted that they preferred unaudited comparative information for 2021 in the notes*);
 - (c) Postpone the date of initial application of IFRS 17 to 2023 and this would allow entities to practically have the time to prepare the comparative for IFRS 17;
 - (d) Require to present comparative for both IFRS 9 and IFRS 17 but postpone the effective date to 2023.
- 79 Which solution would you support and why?

Question to constituents

- 80 Same question as above.

Appendix 2 – Other comments based on EFRAG’s September 2018 letter to the IASB on issues that will not be addressed by the ED

Topic 10 - Balance sheet presentation: Non-separation of receivables and payables

Notes to EFRAG TEG

- 81 IFRS 17, as amended, will require separate presentation in the statement of financial position the carrying amounts of portfolios of:
- (a) Insurance contracts issued that are assets;
 - (b) Insurance contracts issued that are liabilities;
 - (c) Reinsurance contracts held that are assets; and
 - (d) Reinsurance contracts held that are liabilities.
- 82 The standard also requires separate reconciliations from opening to closing balances of the remaining coverage component, any loss component and the liability for incurred claims amongst others.
- 83 Some constituents are concerned about the loss of information as the IFRS 17 requirements will remove items currently commonly presented on the face of the balance sheet such as premium receivables, policy loans and reinsurance collateral (funds withheld) as well as claims payable. The CFO Forum also cited the considerable cost this would entail (Presentation to EFRAG TEG, March 2019 but not the topic was not in the priority list of June 2019).
- 84 The IASB considered this issue in the re-deliberation process and decided to not to change IFRS 17, as requiring a separate presentation would result in the need for the IASB to introduce a definition of “premium receivables” and “claims payable” and this would unduly disrupt implementation.
- 85 EFRAG TEG discussed this issue in May 2019
- 86 Seven EFRAG TEG members supported the IASB tentative decision to retain the requirements in the standard. They considered the following reasoning:
- 87 The presentation requirements in IFRS 17 were consistent with the unit of account and members agreed with the idea of presenting the bundle of rights and obligations of the insurance contract;
- 88 If separate presentation of components is deemed necessary to provide relevant information, IAS 1 provides a solution as entities may separately present on the face of the balance sheet the different components.
- 89 One EFRAG TEG member supported the view that amending IFRS 17 to require separate presentation of premium receivables/claim payables was necessary for conceptual reasons, as the current presentation requirements were obscuring relevant information. This member did not consider that measurement consequences were attached to this issue.
- 90 Three EFRAG TEG members did not explicitly express a view.
- 91 The following main points were mentioned during the discussion:
- (a) EFRAG TEG members observed that the remaining issue was about the operational costs of the presentation requirements; one EFRAG

TEG member considered that there was a conceptual issue about the loss of relevant information;

- (b) The operational costs related to the linkage of actuarial and finance system and this linkage was essential to achieve IFRS 17 measurement; however as mentioned in the IAWG report the use of practical expedients was possible.
- (c) EFRAG TEG members expressed concern about the range of definitions of premiums receivable currently used and that agreement on a definition would not be easy.
- (d) One EFRAG TEG member considered that IFRS 9 Financial Instruments should be applied to the premiums receivable. On credit risk, another EFRAG TEG member referred to the CFO Forum presentation to EFRAG TEG in March 2019 which said the credit risk is often negligible.
- (e) One EFRAG TEG member noted that if separate presentation is considered appropriate then the consequences under IFRS 9 and IFRS 15 Revenue from Contracts with Customers (contract asset accounting for premiums received in advance of services provided) should also be considered. This would then need to be consistently applied, i.e. everyone would be required to apply the expected credit loss model under IFRS 9.
- (f) Another EFRAG TEG member asked how the IFRS 15 definition of receivable would apply to a ten-year insurance contract and whether this meant that the premiums for the full period would be recognised as a receivable. It was not clear what the outcome would be.
- (g) Some EFRAG TEG members indicated that this was more a concern for the PAA than for life contracts, but others considered there was no conceptual reason for differentiation.

92 During the joint discussion of EFRAG TEG and EFRAG Board, members confirmed their understanding that the issue is only impacting presentation and does not have implications for measurement.

Questions to EFRAG TEG

93 One EFRAG Board member suggested that the issue is further considered by EFRAG TEG, in particular addressing the following questions:

- (a) As a result of IFRS 17 presentation requirements, some members considered that, on the face of the balance sheet, there will be an offsetting of a number of assets and liabilities whose nature may differ from the liability for remaining coverage, such as liability for incurred claims (including IBNR), premium receivables, reinsurance collateral etc. In addition, the offsetting will occur with respect to different counterparties.

Considering the general approach to presentation on the balance sheet, do EFRAG TEG members consider that from a conceptual point of view the IASB approach is appropriate?

- (b) IAS 1 provides a possible solution to further disaggregate insurance assets and liabilities on the face of the balance sheet, on a voluntary basis, when separating items such as premium receivables is considered relevant by the entity. This solution does not provide for comparability of the individual elements, as the disaggregation would be optional. However, as there is no measurement impact, the total

insurance contract liability calculated in accordance with IFRS 17 would be on a comparable basis.

Do EFRAG TEG members consider that there is a risk of loss in comparability? Should separate presentation be required?

- (c) The discussion has confirmed that there is currently not a common definition of “receivables”, which some consider to be relevant information for users. Does EFRAG TEG consider appropriate that the IASB provides for a common definition to be used in the notes and/or, depending on the answer to the previous question, to disaggregate receivables on the face of the balance sheet?

94 To support this discussion, the EFRAG Secretariat has researched disclosure practices for premium receivables and claims payable. The following is the outcome:

- (a) The top twenty European insurers by assets were selected as a proxy for size. One mutual entity did not report under IFRS Standards and there were four insurers from Switzerland which were also excluded from the analysis.
- (b) Of the remaining 15, five presented premiums and other amounts due from policyholders on the face of the balance sheet with others including it under other receivables with further descriptions in the notes. It was not always clear whether these amounts included policyholder loans or not.
- (c) Of the 15, two unequivocally mentioned policyholders under their credit risk discussion and in eight other cases, it was not clear whether policyholders were included or not. Five did not discuss policyholders and only referred to the issuers of bonds and reinsurers as sources of credit risk.
- (d) Six preparers provided amounts relating to IBNR (one mentioned that it only related to non-life) whereas others explained that the liability amounts include IBNR and/or how it is calculated. Five preparers made no mention of IBNR.
- (e) One preparer did not reflect either premiums receivable or claims payable separately from other receivables/payables even in the notes. Of the remaining 14, seven preparers did not separate the amounts receivable between those receivables directly from policyholders and those from intermediaries or brokers. Two of these presented amounts receivable from policyholders on the face of the balance sheet. Some EFRAG IAWG members emphasised the importance of this distinction as they considered the concentration risk relating to brokers to be more significant.
- (f) 14 preparers reflected the amounts payable to policyholders, but only three here distinguished between amounts due to policyholders and amounts due to brokers.
- (g) Amounts due from policyholders as a percentage of total assets was generally less than 1% whilst for the five preparers reflecting this amount on the balance sheet, the amount varied between 1.2 and 2.0%.
- (h) Amounts due to policyholders expressed as a percentage of total assets were less than 1.2% for 13 out of the 15 preparers with the remaining two being above 5%.

- (i) IBNR amounts varied significantly between those who provided amounts with three reporting amounts as a percentage of total assets below 1.5%, one around 4% and another 12%. Only six preparers provided amounts.

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

- 95 *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 response

- 96 **EFRAG agrees with the decision of the IASB to retain IFRS 17 requirements on balance sheet presentation, without a separate presentation for premium receivables and claims payable. [depending on the outcome of the discussion additional remark may be added on the need for a definition of receivables and/or of separate disclosure in the notes].**

- 97 EFRAG agrees with the decision of the IASB to retain IFRS 17 requirements on balance sheet presentation, without a separate disclosure for premium receivables and claims payable. 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.

- 98 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).

- 99 As current actuarial systems only include those expected amounts that are not yet considered to be due¹. Preparers have advised that changing their systems would be costly. In order to solve the cost concern and require this disclosure, a definition for receivables/amounts due would need to be developed (which would create costs for those entities that currently use a different definition).

- 100 EFRAG IAWG advised that there was very little credit risk in the receivables taken as a whole, which is supported by the limited disclosures currently provided in the discussion on credit risk by insurers. Furthermore, if separate presentation of components is deemed necessary, IAS 1 provides a solution as entities may disaggregate the different components on the face of the balance sheet.

Question to Constituents

- 101 Do constituents believe that the disclosure of separate information about receivables in the notes is essential for users?

- 102 If yes, should this information be mandatory?
- 103 If yes, how you would define “amounts receivable” that would overcome the differences in definitions currently used as highlighted in paragraph 98?

Questions to EFRAG TEG

- 104 Does EFRAG TEG have further comments on the drafting of this topic?
- 105 Do members believe that the reference to IAS 1 is appropriate, considering that more than disaggregating amounts on the balance sheet the issue is about “grossing-up” assets and liabilities?
- 106 Does EFRAG TEG have comments on the research into current disclosure practices?
- 107 If agreement for a definition for premiums receivable is required for disclosure purposes, which of the definitions mentioned in paragraph 98 do you prefer? What are the disadvantages of these definitions, i.e. in which situations would they not lead to comparable outcomes?
- 108 Please explain how amounts due under loans to policyholders would be treated.
- 109 In some financial statements we noted amounts due labelled as ‘premiums earned not yet written’ as well as ‘written premiums not yet earned’ – how would these be treated for purposes of such disclosures?
- 110 The ANC has suggested a common definition of premium receivables based on IFRS 15 paragraph 105 as it considers the loss of information due to the change to current practice as a step backwards and reducing relevance of the information provided. The following excerpt from paragraph 108 of the same standard may be useful in this context: “A receivable is an entity’s right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future.”
- 111 EFRAG TEG was not clear whether this would then mean the recognition of all future premiums as a receivable and was not convinced by the suggestion. In EFRAG IAWG’s view, would the definition be useful in this debate? How would it change your current practice and why?

Topic 11 - Transition: Modified retrospective approach and fair value approach

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

- 112 *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 be often 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.*
- 113 *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 response

- 114 **EFRAG observes 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 notes that application of the 'reasonable and supportable information' criterion involves judgement, as does the application of the fair value approach, which is expected to be a level 3 fair value in most cases.**
- 115 **EFRAG acknowledges the IASB decisions 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 recreate the missing information (e.g. missing data-points).**
- 116 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 the Standard.
- 117 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).
- 118 EFRAG notes that the limited volume of transactions observable in the market would often result in the fair value estimates being highly judgemental and belonging to the level 3 in the hierarchy of fair value, limiting the comparability among entities applying this method. This circumstance makes it even more important for entities to be able to reasonably approximate the retrospective application whenever it is possible.

- 119 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 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.
- 120 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.
- 121 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, this is the reason why 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 one that might be required to apply the specified modification).
- 122 EFRAG acknowledges the IASB decisions not to allow to the 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 to move this paragraph to the main text of the standard;
 - (b) when applying either 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 recreate the missing information.
- 123 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.

Questions to Constituents

- 124 EFRAG would like to receive feedback from constituents of specific prevalent fact patterns where the application of the modified retrospective approach is proving particularly challenging in practice. This would help in contextualising better the interpretation difficulties arising from obtaining reasonable and supportable information and from estimating missing amounts that are required to apply the modified retrospective approach.

Question to EFRAG TEG

125 Does EFRAG TEG agree with the drafting of this topic on transition modified retrospective and fair value approaches? Please explain.

DRAFT

Topic 12 - Reinsurance contracts: contract boundary

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

- 126 *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.*
- 127 *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.*
- 128 *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 response

View 1

- 129 **Even though EFRAG prefers a more holistic solution for reinsurance contracts held, 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.**

View 2

- 130 **EFRAG concurs with the IASB that measuring reinsurance contracts held based on expected future cash flows at inception is consistent with the general principles of IFRS 17. EFRAG however considers that there is a link between reinsurance contracts held and the underlying contracts and questions whether the costs exceed the benefits of such an approach.**

View 1: Agree with the IASB to retain the IFRS 17 requirements

- 131 EFRAG appreciates the IASB's further consideration of the contract boundary of reinsurance contracts held.
- 132 EFRAG considers that there should be a more holistic approach in developing a solution for reinsurance contracts held because entities use reinsurance as a form of mitigating risk and also because of the different types of reinsurance contracts that currently exist. However, bearing in mind the effective date of IFRS 17 and given the fact that a robust and complete solution might take a considerable amount of time to develop, EFRAG supports the IASB's tentative decision not to amend the standard regarding the contract boundary for reinsurance contracts held. Also, at this stage any further solution would risk to add complexity due to the many varieties of reinsurance contracts.
- 133 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.
- 134 Further, this approach is compliant 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 is respected.
- 135 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:
- (a) 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
 - (b) the estimation of these contracts would follow the same measurement principles as IFRS 17, i.e., probability-weighted estimate of the present value of cash flows.
- 136 EFRAG acknowledges that there is no material impact on the balance sheet up 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.
- 137 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.
- 138 EFRAG considers that the CSM for the reinsurance contracts held which reflects future expected contracts would provide useful information for investors. The price to obtain reinsurance is more volatile than the price charged to the policyholders, therefore investors would find it useful to know how well protected the insurers are.

View 2: Amendment needed to the IFRS 17 requirements

- 139 EFRAG appreciates the IASB's further consideration of the contract boundary of reinsurance contracts held. EFRAG agrees that, conceptually, expected future cash

flows for reinsurance contracts held and insurance contracts issued should be measured using similar and consistent assumptions. 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.

- 140 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, even if other approaches such as those referred in the risk mitigation, would also be compatible with IFRS 17 principles.
- 141 Measuring reinsurance contracts held based on expected future contracts could provide more relevant information than measurement based on recognised underlying contracts. It is however 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:
- (a) 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
 - (b) the estimation of these contracts would follow the same measurement principles as IFRS 17, i.e., probability-weighted estimate of the present value of cash flows.
- 142 EFRAG acknowledges that providing and updating such information might be complex and costly even if it has no impact material 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.
- 143 Furthermore, ERAG considers that there is a link between the reinsurance contracts held and the underlying items. That is, reinsurance obtained by the entity is dependent on the underlying contracts.
- 144 The benefits of identifying a difference in the composition of the fulfilment cash flows and the CSM between the reinsurance contracts held and the underlying insurance contracts issued will have thus to be carefully assessed.

Questions to Constituents

- 145 Do Constituents agree to support the IASB's tentative decision not to amend IFRS 17 for the contract boundary of reinsurance contracts held?
- 146 Do Users consider that CSM for the reinsurance contracts held which reflects future expected contracts would provide useful information for investors? Please explain.
- 147 EFRAG understands that there is no material impact on balance sheet and probably not a significant impact on P&L (until certain events occur as explained in paragraph 136 above). EFRAG would like to receive feedback on the prevalence of this issue, based on the assessment done by entities in their implementation activities of IFRS 17. How prevalent is this issue?

Question to EFRAG TEG

- 148 Which view does EFRAG TEG support and do you agree with the drafting of that view? Please explain.

Topic 13 - Annual cohorts

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

This issue has had a long process of deliberation and re-deliberation

- 149 *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.*
- 150 *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.*
- 151 *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 response

View 1

152 **EFRAG supports the requirement to restrict the groups through the annual cohorts requirement, as this requirement is a justified simplification.**

View 2

153 **EFRAG believes that restricting the groups through the annual cohorts requirement is a justified simplification in several cases. However, it does not work for contracts with cash flows that affect or are affected by cash flows to policy holders of other contracts. EFRAG recommends that the IASB (i) develops an exception for such contracts, starting from paragraph BC138 and (ii) requires additional disclosure in the notes when the exception is applied, including disclosure about the change in profitability of new versus old business.**

Before illustrating EFRAG's response, it is worth summarising the complex deliberation process for this topic, including the reasoning of the stakeholders that have expressed their concerns.

Introduction

154 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.

155 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.

156 Paragraph 22 of IFRS 17 requires additionally that an entity shall not include contracts issued more than one year apart in the same group.

157 EFRAG has heard major concerns from constituents that a group of contracts cannot include contracts issued more than one year apart. In particular, some 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.

March 2019 IASB re-deliberations

158 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.

159 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.
- 160 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.
- 161 In the 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).
- 162 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).
- 163 It is worth mentioning the following two exceptions are included in IFRS 17 at transition for the use of the annual cohorts:
- 164 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;

- 165 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.
- 166 No exception is granted in case of full retrospective approach.

Characteristics of the “mutualised” model

167 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 represent a common feature for a relevant share of the entire European insurance market. The following is a description of the peculiarities 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 relate 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 the 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

- 168 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 current 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 than one year apart is seen as artificial and different to how the business is organised: 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 would ignore 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: depending on how the requirement is interpreted, because 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) The annual cohorts are not required at transition in absence of reasonable and supportable information to apply it, for the FVA and the MRA. In 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 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.

EFRAG's response

- 169 EFRAG agrees with the IASB reporting objectives of IFRS 17: depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses from onerous contracts.
- 170 EFRAG focuses on the combination of the annual cohort requirement with the segregation of portfolios, as required by paragraph 16 of IFRS 17.
- 171 EFRAG understands that in order to meet the above 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. Key features of such a possible principle-based approach were detailed in the various exposure documents by the IASB as: (i) similar expected profitability; or (ii) cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions; or (iii) similar risks managed together as a single pool. In addition to the "similar profitability criterion", the IASB considered that, in order to ensure that there is no residual CSM after the expiry of contracts in the group (i.e. to avoid the "smoothing" of the CSM across generations), the contracts should have in principle similar contract inception dates, coverage periods and service profiles.

View 1: Agree with the IASB to retain the IFRS 17 requirements

- 172 The annual cohort requirement is 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. This results in some loss of information compared to CSM allocation on an individual contract basis but is a trade-off between costs/operational burden and appropriate accounting.
- 173 Without the annual cohort requirement, groups would remain open, resulting in a continuous re-averaging of the CSM and a loss or obfuscating of trend information. Disclosures are not a substitute for appropriate recognition and measurement and therefore, the loss of this information cannot be solved by disclosures.
- 174 IFRS 17 allows the intergenerational sharing of returns between cohorts to be reflected in the fulfilment cash flows. The allocation of cash flows as required by B68 avoids the recognition of losses on onerous contracts at inception which many believes is a better reflection of the business model.
- 175 The contractual terms relating to sharing of risk between policyholders should not impact or change the revenue recognition principles for the insurer beyond reflecting the contractual arrangements as per paragraph B68 described above. The sharing of risks between policyholders may mean the equal treatment of policyholders irrespective of when their specific contract started but does not mean the profitability (to the entity and its shareholders) relating to those contracts over time remains stable or similar.

- 176 In the case of intergenerational sharing of returns where the policyholders share all risks (i.e. technical, financial and expense risk) apart from a fee paid to the entity, it means that two of the three objectives of the IASB are met/partially met:
- (a) No sub-set of contracts will become onerous (in the sense that the entity will have to step in to make payments) unless population as a whole becomes onerous; and
 - (b) The derecognition requirements relating to CSM and coverage units ensure that CSM will not be recognised beyond the coverage period (although without annual cohorts, the impact of averaging will play a role, the significance of this depending on various factors).
- 177 However, the concern about the impact of re-averaging on the recognition of CSM remains. In the EFRAG case study, a preparer reflected that a significant pricing shock would mean that the results with or without the use of annual cohorts differ for two to three years before converging to similar numbers again. This means that at critical points users will lose crucial information for two to three years. Other preparers either found differences between using cohorts or not. One preparer, using a stable state portfolio, found only limited differences between using cohorts or not.
- 178 Therefore, intergenerational sharing of returns may help preparers to prove that the impact of annual cohorts are not material (for the reasons explained in paragraph 131) for a specific period, but does not negate users' need for information about profitability.
- 179 Where only some risks are shared such as financial returns but not insurance risk, the contracts in those groups can become onerous where pricing was inadequate and so the entity will have to bear that risk. It is anomalous in such cases for the entity to continue reflecting and amortising CSM as if such an event has not occurred which would be the case if annual cohorts are removed for these types of contracts.
- 180 Finally, contracts under both the General Model and the Variable Fee Approach (VFA) can share risks. With the VFA there is no accreting of interest to the CSM as it is considered that the CSM is updated to reflect current conditions through the workings of the model. This is not true in the General Model where CSM can accrete interest at rates that have not been an economic reality for decades. Therefore, in the General Model, the impact of re-averaging (i.e. not applying cohorts) will be more significant and harder to defend on a conceptual basis.
- 181 For these reasons EFRAG believes that annual cohort requirement is a justifiable simplification.

View 2: Amendment needed to the IFRS 17 requirements

- 182 EFRAG believes that such a simplification is not always justified: 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). The IASB has referred to these contracts as "contracts that fully share the risks" or as these are known in the industry - "fully mutualised".
- 183 EFRAG acknowledges and appreciates that the IASB considered in depth in its decision process find a solution for fully 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.
- 184 EFRAG questions why such a relevant conclusion has been presented in the Basis for Conclusions instead of being part of the main body of the Standard.
- 185 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 peculiarities of such contracts in IFRS 17, including in paragraphs B67-B71.
- 186 While being in agreement with the reporting objectives of IFRS 17 as stated above, EFRAG disagrees with 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.
- 187 Instead, EFRAG points out that, considering the relevance of mutualised contracts, it is of utmost importance for the IASB to provide a solution for this fact pattern, so to achieve an acceptable cost/benefits trade-off compared to the one resulting from the requirements in the Exposure Draft.
- 188 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.
- 189 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 [to which the VFA is applied] and that share in the same pool of assets applying the annual cohort requirement would not lead to a significantly different accounting outcome and, therefore, should not be applied.
- 190 In conclusion, EFRAG recommends that:
- (a) the IASB provides a solution 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;
 - (b) The IASB requires disclosure about the amounts of contracts to which the annual cohorts requirement is not applied and about the grouping criteria adopted.
- 191 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 EFRAG TEG members

Questions on the drafting

- 192 Which View do EFRAG TEG members support?
- 193 Do members agree with the suggested drafting?
- 194 Should the solution suggested in View 2 be limited to the contracts that apply the VFA and/or share the same pool of assets?

Additional disclosure appropriate?

- 195 The reason for supporting a specific solution as described in the text above is that for such contracts the accounting outcome would be the same with and without the annual cohorts, so in principle there is not loss of information from adopting this solution. However, 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 the standard)
 - (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 (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 on method used for assessing the profitability referred in (b)
- 196 Would member consider appropriate to suggest to the IASB to include these additional disclosures?

Actuarial techniques to compute CSM for each annual cohort

- 197 There are five actuarial techniques to compute the value of each annual cohort for contracts eligible to the IFRS 17 mutualisation. These techniques are currently being implemented:
- (a) The stand-alone method: the CSM of new business is calculated without taking into account the wealth of the stock;
 - (b) The adjusted stand-alone method: the CSM is calculated, regardless of the stock of contracts, by allocating some of the “wealth” of the underlying items to the new business;
 - (c) The marginal approach: the CSM of the new business corresponds to the difference between the CSM of the book of business stock with and without new business.
 - (d) The value in force method by generation: the CSM is calculated including new business and the CSM of new business is identified separately; and
 - (e) The value in force method allocated to new business: in each period, the CSM of the book (including new business) is calculated and a portion of CSM is allocated to new business.
- 198 Which of the methods above are most commonly used in practice? Which of the methods above would be operable and/or more relevant to provide additional disclosure for contracts to which the annual cohort would not be applied?

Questions to Constituents on proposed solutions

199 EFRAG has reviewed without taking a position (which is not in its mandate) the following proposals that have been put forward by constituents in order to overcome the concerns that have emerged on the IASB tentative decision to retain in the standard the annual cohort requirements.

200 EFRAG is willing to receive feedback from constituents on recent solutions that have been made public.

Solution proposed by the ANC in May 2019

201 “Current IFRS 17 provisions (and especially IFRS 17.B67-B71) make it possible to reflect the intergenerational mutualisation, even if removing cohorts would probably better reflect the business practice as well as the contractual and legal situation.

202 Adding annual cohort in that context is however a very burdensome route to follow with no conceptual substance. The additional information provided does not prove to be useful but artificial.

203 In our view, such case has already been addressed by the board, as mentioned in IFRS 17.BC 138. We therefore suggest crystallising that exception in an amendment to annual cohorts in that specific context.”

204 “An exception to the application of annual cohorts should be considered when (as acknowledged by IFRS 17.BC 138) contracts fully share risks, so that “the groups together will give the same results as a single combined risk-sharing portfolio”. The field test has demonstrated that applying annual cohorts in the case of intergenerational risk-sharing (mutualisation) is not conceptually necessary, does not provide useful information and adds complexity and costs. The concept of “fully shared risks” has to be defined in a broader way than contemplated by TRG staff (and rejected by TRG members) in order to address, for instance, life contracts with direct participation features where policyholders share financial and insurance risks. Limiting the use of the concept of “fully shared risks” to contracts where the CSM is nil or cannot be affected does not reflect reality.”

“Suggested definition of “fully shared risks”

205 Contracts where “risks are fully shared” are referred to in the extreme situation presented in the TRG where cash flows are 100% shared among policyholders so that the insurer’s share in the risks and returns is nil.

206 This feature is however not limited to that extreme scenario but should also be considered when:

- (a) the existence of an insurer’s share in the risks or in the returns on underlying items of a mutualised population of policyholders does not prevent from having first a genuine mutualisation (full risk sharing) among policyholders;
- (b) the existence of specific guarantees granted to certain policyholders, concentrating risks or returns on the underlying items on certain contracts, does not prevent from having also a genuine mutualisation (full risk sharing) among policyholders.

207 Some suggested that in a portfolio where “risks are fully shared” among policyholders, the insurer’s share should remain stable (i.e. 10%) rather than being nil. This may actually address many situations but would not be sufficient. The key criterion is in fact the onerous nature or not of the group of contracts: a population actually becomes onerous when the insurer’s

share in the risks increases to a point where the insurer is making or contemplating a loss.

- 208 We therefore suggest defining that risks are “fully shared” among policyholders when “policyholders share a significant amount of the financial returns and of the insurance risks across generations so that no set of contract within the group could possibly become onerous (alone)”.

“Suggested modification of paragraph 22 of IFRS 17

- 209 An entity shall not include contracts issued more than one year apart in the same group. **This provision does not apply to contracts belonging to a portfolio** where insurance and financial risks are fully shared among generations of policyholders. Risks are fully shared among policyholders when policyholders share a significant amount of the financial returns and of the insurance risks across generations so that no set of contract within the group could possibly become onerous alone”.

Solution proposed by the CFO Forum in June 2019

- 210 “The CFO Forum proposed to remove the requirement to group contracts by annual cohorts. This change was proposed as the current prohibition to aggregate contracts issued more than one year apart results in groupings that are inconsistent with the way firms manage their business and introduces significant implementation efforts and undue costs.

- 211 Considering the strong views at the IASB, we have now, in the interest of finding compromise solutions, limited the proposed amendments to:

- (a) business where conceptually annual cohorts are most inconsistent with how the business is managed, i.e. VFA business with mutualisation
- (b) the largest operational impact for other businesses, i.e. no annual cohorts at transition for in-force business (but no change for new business)”.

- 212 The CFO Forum has proposed the following amendments to the wording of the Standard (words in red are added to the Standard):

- 213 “IFRS 17 para 22 is modified as follows: An entity shall not include contracts issued more than one year apart in the same group **except as either permitted in paragraph C5A or for contracts with direct participating features when when i) the cash flows of contracts belonging to one cohort are significantly affected by the cash flows of other cohorts according to paragraphs B67-B71; and ii) the contracts share the same pool of underlying items.** To achieve this the entity shall, if necessary, further divide the groups described in paragraphs 16-21.

- 214 IFRS 17 para C5A is added as follows: **C5 A Regardless of the transition approach applied, an entity is not required at the transition date to apply paragraphs 1524, and may include in a group: (i) contracts issued more than one year apart; and (ii) contracts which would otherwise be divided by applying paragraph 16.”**

- 215 EFRAG understands that this proposal would result in the following accounting treatments:

- (a) The unit of account adopted for in-force business for all the approaches (FRA, MRA, FVA) and all the models (general model, PPA, VFA) would be the portfolio (with the word “portfolio” assuming the meaning of IFRS 17 paragraph 14);

- (b) Going forward, the annual cohort requirements is not applied for contracts under the VFA when there is mutualisation as described in paragraphs B67/B71 and the contracts refer to the same pool of assets.

Questions to Constituents

- 216 How would you assess for the two proposed solutions above the trade/off between achieving the reporting benefits of IFRS 17 and solving the complexities and costs of applying the annual cohort requirements for mutualised contracts?
- 217 Which specific aspects of the two proposals should be further adjusted and why?
- 218 Which of the above methods of calculating the CSM for mutualised contracts would in your view provide the best information? Why?

Questions to Constituents – subject to IAWG and TEG agreement that additional disclosure is needed

- 219 Do you agree with the proposed disclosures if the annual cohort requirement were to be removed in certain cases? How you would assess the trade-off between costs and benefits for the proposed disclosures?