EFRAG
European Financial Reporting Advisory Group

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS ON IFRS 17 INSURANCE CONTRACTS AS AMENDED IN JUNE 2020

Once filled in, this form should be submitted by 29 January 2021 using the 'Comment publication link' available at the bottom of the respective news item. All open consultations can be found on EFRAG's web site: Open consultations: express your views.

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IFRS 17 *Insurance Contracts* as amended in June 2020 ('IFRS 17' or 'the Standard'). In order to do so, EFRAG has been carrying out an assessment of IFRS 17 against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of IFRS 17 is set out in Appendix I.

Before finalising its assessment, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interests of transparency, EFRAG will wish to discuss the responses it receives in a public meeting, so it is preferable that all responses can be published.

In order to facilitate the EFRAG process, it is strongly recommended to use the structure below in your responses.

EFRAG's initial assessments, summarised in this questionnaire, will be updated for comments received from constituents when EFRAG is in the process of finalising its *Letter to the European Commission* regarding endorsement IFRS 17.

Your details

1 Please provide the following details:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

UNESPA

(b) Are you a:

☐ Preparer ☐ User ☒ Other (please specify)

Industry organization representing Spanish insurance and reinsurance companies.

(c) Please provide a short description of your activity:

UNESPA is the representative body of more than 280 private insurers and reinsurers that stand for approximately 98% of the Spanish insurance market. Spanish insurers and reinsurers generate premium income of more than €55 billion, directly employ 60,000 people and invest more than €317 billion in the economy.

(d) Country where you are located:

Spain

(e) Contact details, including e-mail address:

economia.finanzas@unespa.es

Part I: EFRAG's initial assessment with respect to the technical criteria for endorsement

Note to the respondents: *Appendix II presents EFRAG's reasoning with reference to all requirements in IFRS 17 apart from the application of the annual cohorts requirement to some contracts specified in paragraph 6 of Annex A within Annex 1 (those contracts are conventionally referred to in this questionnaire, in the Cover Letter, in its Appendices and Annex as 'contracts with intergenerationally mutualisation and cash-flow matched contracts*[1]*, or 'intergenerationally mutualised and cash flow matched contracts'. Annex 1 presents content of this requirement that contribute positively or negatively to the technical criteria on this matter.*

2 EFRAG's initial assessment of IFRS 17 is that:

- The EFRAG Board has concluded on a consensus basis that, apart from the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts, as explained in the attached Cover Letter, on balance, all the other requirements of IFRS 17 meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support 'economic decisions and the assessment of stewardship and raise no issues regarding prudent accounting. EFRAG has concluded that all the other requirements of IFRS 17 are not contrary to the true and fair view principle.
- EFRAG Board members were split into two groups about whether the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts meet the qualitative characteristics described above.
  (i) Nine EFRAG Board members consider that overcoming in a timely manner the issues of IFRS 4 brings sufficient benefits despite the concerns on annual cohorts. They believe that, in the absence of an alternative principles-based approach to grouping of contracts, on balance the annual cohorts requirement provides an acceptable conventional approach that enables to meet the reporting objectives of the level of aggregation of IFRS 17.
  (ii) Seven EFRAG Board members consider that in many cases in Europe the requirement to apply annual cohorts for insurance contracts with intergenerational mutualisation and cash-flow matched contracts will result in information that is neither relevant nor reliable. This is because the requirement does not depict an entity's rights and obligations and results in information that represents neither the economic characteristics

[1] For a description of the affected contracts please refer to paragraphs 8 to 28 of Annex A to Annex 1 of the endorsement package relating to IFRS 17.

of these contracts nor the entity's underlying business model. These EFRAG Board members also consider that this requirement is not conducive to the European public good because it (i) adds complexity and cost and does not bring benefits in terms of the resulting information, (ii) may lead to unintended incentives to change the way insurers cover insurance risks and (iii) may produce pro-cyclical reporting effects.

EFRAG's reasoning and observations are set out in Appendix II, Annex 1 and the Cover Letter regarding endorsement of IFRS 17.

(a) Do you agree with this assessment for all the other requirements of IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts?

☐ Yes ☒ No

If you do not agree, please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.

While we do not fully agree with EFRAG's assessment with regard to all issues other than annual cohorts, we do agree with EFRAG's assessment that these topics should not block the endorsement of IFRS 17 in the European Union in time for the 2023 effective date, therefore for these 'other issues' our 'No' responses should be viewed in this context.

In 2019, UNESPA identified several priority issues in the response to *EFRAG's Draft Comment Letter on the IASB's ED/2019/4 "Amendments to IFRS 17"* (Annex I) with proposed solutions for each of these issues.

Several of these other remaining priority issues have not been resolved by the IASB in the 'Amendments to IFRS 17' published in June 2020. We acknowledge that these remaining unresolved priority issues should not block the endorsement of IFRS 17 by the European Union but note that the final proposed standard does not address all Spanish undertakings' concerns in several areas. Addressing the concerns on these unresolved issues with our proposed solutions would have significantly improved the quality and usefulness of IFRS 17. However, we agree that these remaining issues (including mismatches that arise at transition under Fair Value approach, CSM amortization, scope of hedging and interaction with IFRS 9) should not block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date and, therefore, should not lead to amendments to IFRS 17 as part of the European endorsement process. We recommend to re-evaluate these issues in the context of a post implementation review of IFRS 17.

(b) Having considered the technical arguments for those that support and those that oppose the application of annual cohorts to intergenerationally-mutualised contracts, as described in Annex 1, and having considered the two views from the EFRAG Board above does the requirement to apply annual cohorts to intergenerationally-mutualised contracts (within the context of paragraphs B67-B71 of IFRS 17) meet the qualitative characteristics described above? Please explain your technical reasons for supporting your view.

☐ Yes ☒ No

Regarding intergenerationally-mutualised contracts, we have participated in the preparation of *Insurance Europe* and *CFO forum* joint response, and we fully support their view.

(c) Having considered the technical arguments for those that support and those that oppose the application of annual cohorts to cash-flow matched contracts, as described in Annex 1, and having considered the two views from the EFRAG Board above does the requirement to apply annual cohorts to cash-flow matched contracts meet the qualitative characteristics described above? Please explain your technical reasons for supporting your view.

☐ Yes ☒ No

In September 2019, UNESPA issued a response to *EFRAG's Draft Comment Letter on the IASB's ED/2019/4 "Amendments to IFRS 17"* (Annex I) highlighting that the annual cohorts requirement for Spanish long-term saving-products (cash-flow matched products) is not justified and consistent with the principles that underpin the insurance business, it leads to an artificial variability in the adjustments of the CSM in senior cohorts and increases the scope of potential onerous cohorts.

In May 2020, the Spanish standard setter (ICAC) submitted a document (Annex II) to EFRAG proposing a practical solution to define the scope of an exception to the annual cohorts' requirement to reflect mutualization of Spanish long term life savings products measured through the Building Block Approach model.

We believe that this significant issue should be resolved as part of the endorsement of IFRS 17 by the European Union. We believe that the solution developed to resolve this annual cohorts issue should be optional (to allow users to also comply with IFRS as issued by the IASB) and furthermore should not delay IFRS 17's effective date of 1 January 2023.

(d) Are there any issues that are not mentioned in Appendix II, Annex 1 and the Cover Letter regarding the endorsement of IFRS 17 that you believe EFRAG should take into account in its technical evaluation of IFRS 17? If there are, what are those issues and why do you believe they are relevant to the evaluation?

During Spanish insurers work in implementing IFRS 17 (in combination with IFRS 9) we have encountered several issues that demonstrate the (unnecessary) complexity of IFRS 17 and the misalignment between the detailed requirements in IFRS 17 and the fundamental nature of insurance business in certain areas. It should be mentioned that during December 2020 and January 2021 several meetings regarding Hedge Accounting for insurance companies are being held between IASB and audit firms, therefore this is a "work in progress" issue in which more work should be developed.

Whilst this implies that financial results under IFRS 9 and IFRS 17 will not always be reflective of the economics of the underlying businesses, we do not believe that these issues are sufficient to block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date. However, we do believe that a thorough post implementation review will be needed.

Part II: The European public good

Note to the respondents: *EFRAG's reasoning and conclusions with reference to all the other requirements of IFRS 17 is presented in Appendix III, apart from the observations on the requirement to apply annual cohorts to intergenerationally mutualised and cash flow matched contracts, which are presented in Annex 1 (refer to the section titled Appendix III in Annex 1).*

3 In its assessment of the impact of IFRS 17 on the European public good, EFRAG has considered a number of issues that are addressed in Appendix III and Annex 1 regarding the endorsement of IFRS 17.

- The EFRAG Board has on a consensus basis assessed that, apart from the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts, all the other requirements of IFRS 17 would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified any other requirements of IFRS 17 that could have major adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that all the other requirements in IFRS 17 are, on balance, conducive to the European public good.

(a) Do you agree with this assessment for all the other requirements apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts?

☐ Yes ☒ No

If you do not agree, please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.

In 2019, UNESPA identified several priority issues in the response to *EFRAG's Draft Comment Letter on the IASB's ED/2019/4 "Amendments to IFRS 17"* (Annex I) with proposed solutions for each of these issues.

Several of these other remaining priority issues have not been resolved by the IASB in the 'Amendments to IFRS 17' published in June 2020. We acknowledge that these remaining unresolved priority issues should not block the endorsement of IFRS 17 by the European Union but note that the final proposed standard does not address all Spanish undertakings' concerns in several areas. Addressing the concerns on these unresolved issues with our proposed solutions would have significantly improved the quality and usefulness of IFRS 17. However, we agree that these remaining issues (including mismatches that arise at transition under Fair Value approach, CSM amortization, scope of hedging and interaction with IFRS 9) should not block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date and, therefore, should not lead to amendments to IFRS 17 as part of the European endorsement process. We recommend to re-evaluate these issues in the context of a post implementation review of IFRS 17.

- EFRAG Board members were split between two groups, as described in the Cover Letter and above, with reference to the requirement to apply annual cohorts for contracts with intergenerational mutualisation and cash-flow matched contracts.

(b) Having considered the technical arguments for those that support and those that oppose the application of annual cohorts to intergenerationally-mutualised contracts, as described in Annex 1, and having considered the two views from the EFRAG Board above, is the requirement to apply annual cohorts to intergenerationally-mutualised contracts (within the context of paragraphs B67-B71 of IFRS 17) conducive to the European public good? Please explain your technical reasons for supporting your view.

☐ Yes ☒ No

Regarding intergenerationally-mutualised contracts, we have participated in the preparation of *Insurance Europe* and *CFO forum* joint response, and we fully support their view.

(c) Having considered the technical arguments for those that support and those that oppose the application of annual cohorts to cash-flow matched contracts, as described in Annex 1, and having considered the two views from the EFRAG Board above, is the requirement to apply annual cohorts to cash-flow matched contracts conducive to the European public good? Please explain your technical reasons for supporting your view.

☐ Yes ☒ No

In September 2019, UNESPA issued a response to *EFRAG's Draft Comment Letter on the IASB's ED/2019/4 "Amendments to IFRS 17"* (Annex I) highlighting that the annual cohorts requirement for Spanish long-term saving-products (cash-flow matched products) is not justified and consistent with the principles that underpin the insurance business, it leads to an artificial variability in the adjustments of the CSM in senior cohorts and increases the scope of potential onerous cohorts.

In May 2020, the Spanish standard setter (ICAC) submitted a document (Annex II) to EFRAG proposing a practical solution to define the scope of an exception to the annual cohorts' requirement to reflect mutualization of Spanish long term life savings products measured through the Building Block Approach model.

We believe this significant issue should be resolved as part of the endorsement of IFRS 17 by the European Union. We believe that the solution developed to resolve this annual cohorts issue should be optional (to allow users to also comply with IFRS as issued by the IASB) and furthermore should not delay IFRS 17's effective date of 1 January 2023.

Part III: The questions in Part III relate to all the other requirements in IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts

Notes to the respondents: *In this Part, "IFRS 17" or "requirements in IFRS 17" or "the Standard" is intended to be referred to all the other requirements in IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts (your views on the latter requirement are to be covered in Part IV).*

The European Commission and the European Parliament asked EFRAG to provide its views on a number of specific matters, that are presented below.

Improvement in financial reporting

4 EFRAG has identified that, in assessing whether the endorsement of IFRS 17 is conducive to the European public good, it should consider whether the Standard is an improvement over current requirements across the areas which have been subject to changes (see paragraphs 15 to 27 of Appendix III). To summarise, for all the other requirements in IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts, EFRAG considers that they provide better financial information than IFRS 4.

Do you agree with this assessment?

☐ Yes ☒ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

> We have participated in the preparation of *Insurance Europe* and *CFO forum* joint response, and we fully support their view.
>
> We believe that, excluding the annual cohorts issues for intergenerationally mutualised and cash-flow-matched contracts, the remaining IFRS 17 requirements provide better overall financial information than IFRS 4. However, some specific requirements of IFRS 17 do not provide better information than IFRS 4 for that specific topic and therefore we do not agree that <u>all</u> other requirements of IFRS 17 provide better information.
>
> As overall these other requirements do provide better financial information, the requirements which do not provide better financial information should not block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date.

Costs and benefits

5 EFRAG's initial assessment is that taking into account the evidence obtained from the various categories of stakeholders, the benefits of all the other IFRS 17 requirements in IFRS 17 exceeds the related costs.

Do you agree with this assessment?

☐ Yes ☒ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

> We have participated in the preparation of *Insurance Europe* and *CFO forum* joint response, and we fully support their view.
>
> We believe that the requirements in IFRS 17 are unnecessarily complex and that the benefits of more consistency in financial reporting amongst insurers could have been achieved at a much lower cost. At the same time, we find it very difficult to quantify and measure the benefits of IFRS 17. In any case, given the significant implementation work that has already been undertaken, with the related significant costs having already been incurred, we do not believe that the cost/benefit assessment should block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date, other than in the context of annual cohorts as set out above.
>
> In any case, as this is the only question regarding costs and benefits, we would like to point out that our 'no' response is derived mainly by the costs of the annual cohort's requirement.

Other factors

Potential effects on financial stability

6 EFRAG has assessed the potential effects on financial stability based on the ten criteria set out in the framework developed by the European Central Bank "*Assessment of accounting standards from a financial stability perspective*" in December 2006. Based on this assessment, EFRAG is of the view that, on balance, IFRS 17 does not negatively affect financial stability (Appendix III paragraphs 428 to 482).

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

> We have participated in the preparation of *Insurance Europe* and *CFO forum* joint response, and we fully support their view that, on balance, IFRS 17 does not negatively affect financial stability.

Potential effects on competitiveness

(Appendix III paragraphs 227 to 286)

7 EFRAG has assessed how IFRS 17 could affect the competitiveness of European insurers taking into account the diversity in their business models vis-à-vis their major competitors outside Europe.

EFRAG concludes that the underlying economics and profitability will always be more decisive in taking up a business in a particular region or a particular insurance product than changes to the accounting that is used to report on it.

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

> We have participated in the preparation of Insurance Europe and CFO forum joint response, and we fully support their view.
>
> We disagree with the assessment that accounting is not relevant to the competitiveness of European insurers vis-à-vis their major competitors outside Europe. We regret that the implementation of IFRS 17 will not lead to world-wide harmonisation in accounting for insurance contracts and, as such, may put some European insurers at a competitive disadvantage to their competitors that are not required to apply IFRS 17. However, we do not believe that the assessment of competitiveness should block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date, other than in the context of annual cohorts as set out above.

Potential impact on the insurance market (including impact on social guarantees)

8 EFRAG has assessed the potential impact on the insurance market in Appendix III paragraphs 287 to 325.

EFRAG commissioned a study from an economic consultancy. This study ('Economic Study') stated that entities may re-consider both their pricing methodologies and product offers when applying IFRS 17 for the first time. The effect on pricing may be more significant than the effect on product offers. However, EFRAG does not have any quantification of the extent of changes in pricing or product design that would result from it.

As per the Economic Study, a majority of stakeholders interviewed (i.e. supervisory authorities, insurers and external investors) agreed that IFRS 17 alone would not impact the asset allocation of insurance undertakings, because this activity is more driven by risk management and/or asset/liability management.

Furthermore, EFRAG has considered how IFRS 17 could affect small and medium-sized entities (SMEs). EFRAG concludes that the number of small insurers that would be affected by IFRS 17 in producing their individual financial statements is very limited (between 27 and 35 depending on the option chosen based on the proposed[2] EIOPA quantitative thresholds).

(a) Do you agree with the assessment on pricing and product offerings?

☒ Yes ☐ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

N/A

(b) Do you agree with the assessment on asset allocation?

☒ Yes ☐ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

N/A

(c) Do you agree with the assessment on SMEs?

☐ Yes ☒ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

We have participated in the preparation of *Insurance Europe* and *CFO forum* joint response, and we fully support their view.

EFRAG's analysis on SMEs affected by IFRS 17 is misleading. To define "small" insurers, EFRAG uses EIOPA's definition of small insurers for which Solvency II requirements do not apply. This means that EFRAG's analysis focuses only on extremely small insurers and fails to consider the large number of small and medium unlisted insurers which apply IFRS as part of the option under article 5 of the IAS regulation in Europe. In addition, for those small and medium sized insurers for whom Solvency II does apply there are a range of exemptions and proportionality principles which are intended to facilitate a significant reduction in burden. There is no such relief in IFRS 17, so all insurance companies in Europe who will be under IFRS 17 will have to apply the full standard irrespective of their size.

[2] Reference is made to EIOPA's publicly consulted Consultation Paper on the Opinion on the 2020 review of Solvency II to amend the thresholds for applying Solvency II.

Presentation of general insurance contracts

9 EFRAG is of the view the presentation requirements of IFRS 17 would provide relevant information. EFRAG also concludes that providing separate information for contracts that are in an asset, from those in a liability, position would provide useful information to users. (Appendix II paragraphs 118 to 125, 360 to 362).

Do you agree with this assessment?

☐ Yes ☒ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

We have participated in the preparation of Insurance Europe and CFO forum joint response, and we fully support their view.

We refer to the earlier communicated issues by CFO forum (that remain largely unresolved) and proposed solutions that, amongst others, also relate to the separate presentation of contracts that are in an asset and in a liability position. However, we do not believe that these should block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date.

Interaction between IFRS 17 and Solvency II

10 EFRAG concludes that in implementing IFRS 17, there are possible synergies with Solvency II, but the extent of such synergies varies between insurers. In addition, no synergies are expected for building blocks that are specific to IFRS 17 such as the contractual service margin which is not an element of the measurement approach for insurance liabilities under Solvency II. Synergy potential is available in areas that have a high degree of commonality under the two frameworks, i.e. the building blocks for the measurement of the insurance liability needed to establish the cash flow projections, and actuarial systems to measure insurance liabilities. The potential depends, to an extent, on the differences in the starting position of insurers and the investments already made in the implementation of Solvency II. It also depends on the amount of effort to adapt existing actuarial systems, that were developed for the Solvency II environment, to the IFRS 17 reporting requirements. (Appendix III paragraphs 401 to 412).

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

N/A

Impact of the new Standard on financial stability, long-term investment in the EU, procyclicality and volatility

11 On financial stability, refer to the conclusions in paragraph 6 of this Invitation to Comment.

On long-term investment in the EU, EFRAG's view is that asset allocation decisions are driven by a variety of factors, among which external financial reporting requirements might play some part but do not appear to be a key driver. There is no indication that IFRS 17 in isolation would lead to any significant changes in European insurers' decisions on asset allocation or holding periods (Appendix III paragraphs 96 to 123).

On procyclicality and volatility, EFRAG believes that IFRS 17 has mixed effects on procyclicality. IFRS 17 may result in more volatile financial performance measures because of the use of a current measurement. However, from the evidence collected, it is not likely that this volatility has the potential to play a specific role in producing pro-cyclical or anti-cyclical effects. EFRAG also assesses that IFRS 17 does not have the potential to reinforce economic cycles, such as overstating profits and thus allowing dividends and bonus distributions in good times, as there is no linkage between the accounting equity (cumulative retaining earnings) and amounts available for distributions, which are defined within the requirements of Solvency II or within the requirements at national level, independently from the IFRS accounting. Finally, EFRAG notes that the transparent nature of the IFRS 17 information has the benefit for investors to be able to react timely to any changes at hand, thereby avoiding cliff-effects. (Appendix III paragraphs 483 to 507).

(a) Do you agree with the assessment on long-term investment?

☐ Yes ☒ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

There is a source of mismatch generated for some Spanish Insurance contracts with participating features and not immunized through cash flow matching techniques, backed by an important part of equities regarding the asset side.

In these cases, under current accounting standards, the companies were selling part of their equity-portfolio (allocated to this product) getting realized gains from such equities which were accounted through P&L.

The increase of the technical provision was also accounted through P&L. Therefore, an adequate matching was reached.

Under IFRS 9 realized gains from mentioned equity will be kept in OCI. However, under IFRS 17 the increase of the technical provision will be accounted through P&L. Here there is an evident source of mismatch.

We are aware that there is a fair value option (FVO), but it does not exist a "partial" FVO for the liability, thus this option will also affect all the fixed income assets portfolio (6 times bigger).

Consequently, this option will transmit a huge volatility to P&L, namely, this will create a non-manageable P&L in the industry. Please, recall non realized gains amounted almost 20% of the market value. This type of market movements has been reflected historically in OCI in order to avoid distortions in P&L. Thus, this option is not suitable for this type of traditional retirement products.

Therefore, the most suitable solution for this mismatch would be to fix IFRS 9 allowing recycling for these type of equity investments.

However, we agree that this remaining issue should not block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date and, therefore, should not lead to amendments to IFRS 17 as part of the European endorsement process. We recommend to re-evaluate this issue in the context of a post implementation review of IFRS 17.

(b) Do you agree with the assessment on procyclicality and volatility?

☐ Yes ☒ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

UNESPA is concerned about the variability in OCI introduced by IFRS 17 for Spanish long-term life-saving contracts that are not eligible to be measured under the variable fee approach.

Under the general measurement model (both PL and FV-OCI option) changes in the IFRS 17 discount rate after initial recognition do not lead to a remeasurement of the CSM, given that the CSM is measured at inception with the locked-in rate and not remeasured to reflect changes in this rate.

Even if the expected cash flows from an insurance contract are economically and perfectly matched with non-contractually disclosed financial assets that replicate those cash flows, including any long-term interest rate guarantee, an insurer will recognise in P&L/OCI amounts that go beyond the credit risk spread. This arises as a consequence of the CSM not being remeasured at each reporting date for changes in the discount rate.

The fact that the CSM is not remeasured for changes in the IFRS 17 discount rate is equivalent to having a portion of the insurance liability not measured on a current basis, giving rise to amounts recognised in P&L/OCI that do not offset completely (assuming there is not a spread credit risk) with the remeasurement at fair value of the corresponding financial instruments.

UNESPA believes such a difference in measurement leads to an accounting mismatch that does not portray the economic net financial situation of Spanish long-term life-saving products. Spanish insurers will mainly apply the OCI option for the presentation of the insurance finance result, as their related assets will be mainly classified in FV-OCI portfolios under IFRS 9. In this context, UNESPA is significantly concerned about the variability that will be recognised in OCI for these products under the general measurement model. It is important to highlight that Spanish users of insurers' financial statements place much emphasis on understanding the trend and evolution of the profit and loss and OCI statements, not expecting significant variability for the current business model under an economically matched balance sheet.

In order to solve this variability, a re-measurement of the CSM at each reporting date for changes in the discount rate should be permitted, including the effect in OCI, while keeping the other IFRS 17 current requirements unchanged. Such re-measurement would mitigate these accounting mismatches in OCI between IFRS 9 and IFRS 17. This proposal would apply to companies that apply the OCI option under the general measurement model, and some type of conditions or constraints could be set up to limit the remeasurement to certain types of insurance contracts (managed under matching adjustment techniques, for example).

The above suggestion would not change other current IFRS 17 requirements (i) to use the locked-in rate to accrete interest on the CSM, and (ii) to use the same locked-in rate to determine the adjustments to the CSM for changes in non-financial assumptions that affect future cash flows would remain unchanged under the new proposal.

At the same time, we believe it would not affect any core principle of IFRS 17. In particular, the amounts recognised in OCI would naturally reverse over time and insurance service result would be shown separately from the insurance finance result.

However, we agree that this remaining issue should not block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date and, therefore, should not lead to amendments to IFRS 17 as part of the European endorsement process. We recommend to re-evaluate this issue in the context of a post implementation review of IFRS 17.

IFRS 17 and IFRS 9

12 EFRAG is of the view that mismatches reported by preparers that contributed to EFRAG's assessment do not arise solely from the application of IFRS 17 and IFRS 9 but are mostly economic in nature. EFRAG considers that reporting the extent of the economic mismatches in profit or loss provides useful information.

In EFRAG's view, asset allocation decisions are driven by a variety of factors and disentangling the impact of accounting requirements from other factors is difficult. When defining the accounting for financial assets under IFRS 9, an insurer would not apply business models determined in isolation, but rather business models that are supportive of or complementary to their business model for managing insurance contracts. EFRAG notes that the interaction between each of an entity's internal policy decisions will determine the importance of any accounting mismatches remaining in the financial statements and this may differ largely from one insurer to another.

EFRAG has assessed the different tools that both standards offer to mitigate accounting mismatches. EFRAG assesses that:

(a) there is no conceptual barrier against the application of hedge accounting in the context of IFRS 17. However, given the lack of experience and systems by the industry, it would require significant investment both in time and systems development to achieve hedge accounting in this context (Appendix III, Annex 5);

(b) the treatment of OCI balances and risk mitigation at transition will not, on balance, negatively impact the usefulness of the resulting information.

(a) Do you agree with the assessment on the application of hedge accounting?

☐ Yes ☒ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

There is a source of mismatch generated for some Spanish Insurance contracts with participating features and not immunized through cash flow matching techniques, backed by an important part of equities regarding the asset side.

In these cases, under current accounting standards, the companies were selling part of their equity-portfolio (allocated to this product) getting realized gains from such equities which were accounted through P&L.

The increase of the technical provision was also accounted through P&L. Therefore, an adequate matching was reached.

Under IFRS 9 realized gains from mentioned equity will be kept in OCI. However, under IFRS 17 the increase of the technical provision will be accounted through P&L. Here there is an evident source of mismatch.

We are aware that there is a fair value option (FVO), but it does not exist a "partial" FVO for the liability, thus this option will also affect all the fixed income assets portfolio (6 times bigger).

Consequently, this option will transmit a huge volatility to P&L, namely, this will create a non-manageable P&L in the industry. Please, recall non realized gains amounted almost 20% of the market value. This type of market movements has been reflected historically in OCI in order to avoid distortions in P&L. Thus, this option is not suitable for this type of traditional retirement products.

Therefore, the most suitable solution for this mismatch would be to fix IFRS 9 allowing recycling for these type of equity investments.

We do not agree with the assessment that the application of hedge accounting is only hindered by the lack of experience and systems in the insurance industry and could be resolved by investing significant time and systems development. As we have demonstrated before, applying the hedge accounting requirements in IFRS 9 to insurance liabilities as the hedged item results in several fundamental issues that are caused by the limitations and constraints in IFRS and not just by the lack of experience and systems.

However, we agree that these remaining issues should not block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date and, therefore, should not lead to amendments to IFRS 17 as part of the European endorsement process. We recommend to re-evaluate this issue in the context of a post implementation review of IFRS 17.

(b) Do you agree with the assessment on the treatment of OCI-balances and risk mitigation?

☐ Yes ☒ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

We have participated in the preparation of *Insurance Europe* and *CFO forum* joint response, and we fully support their view.

We disagree with the assessment for both OCI balances and risk mitigation at transition that these would not negatively impact the usefulness of the resulting information.

Risk mitigation is an integral part of normal business operations in the insurance industry and is routinely planned and documented. There should be no significant difficulty in providing the evidence in practice to support the retrospective application of the risk mitigation option, as all risk mitigation documentation should be readily available.

While the fair value and modified retrospective approaches allow the accumulated OCI balance on insurance liabilities to be set to nil on transition, as stated in paragraph C24(b) of IFRS 17, no such relief is available to assets measured at fair value through OCI. Setting OCI on the liabilities to nil at transition, whilst maintaining the historical OCI on related assets may significantly distort equity at transition and future results. Assets will generate a yield based on the historical effective interest rate, whilst liabilities will unwind at the market rate at transition date.

As we have indicated before, both of these issues could lead to material distortion of financial results under IFRS 17 and we have already provided proposed solutions to both.

Application of IFRS 15

13 In some instances, an entity (including insurers) may choose to apply IFRS 15 instead of IFRS 17 to contracts that meet the definition of an insurance contract but that have as their primary purpose the provision of services for a fixed fee. EFRAG concludes that this option would probably be made by those entities that do not operate in the insurance business. EFRAG concludes that for these entities accounting for these contracts in the same way as for other contracts would provide useful information and that applying IFRS 17 to these contracts would impose costs for no significant benefit (Appendix III paragraphs 68 to 76).

Do you agree with this assessment?

☒ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

N/A

Implications of transitional requirements

14 Considering the extent of the information available for each particular group of insurance contracts at transition, EFRAG assesses that the existence of three transition approaches does not result in a lack of relevant information. The alleviations granted under the modified retrospective approach are still leading to relevant information as they enable achieving the closest outcome to a full retrospective application without undue cost or effort. In addition, EFRAG acknowledges that the possible use of three different transition methods may affect comparability among entities and, for long-term contracts, over time. However, the practical benefits of the modified retrospective and fair value approach, which were introduced by the IASB to respond to operational concerns of the preparers, may justify the reduced comparability (Appendix II paragraphs 129 to 155, 228 to 237, 300 to 303, 372 to 374, 398 to 400).

Do you agree with this assessment?

☐ Yes ☒ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

We have participated in the preparation of Insurance Europe and CFO forum joint response, and we fully support their view. We support the existence of the modified retrospective approach and fair value approach as practical expedients for transition where obtaining the information required for the fully retrospective approach is impracticable. However, we believe that the modifications permitted under the modified retrospective approach, as set out in paragraphs C9 to C19 of IFRS 17, are too restrictive and do not provide the simplifications that make retrospective application possible in practice. Insurers will be forced to use the fair value approach for many portfolios, potentially reducing the level of comparability between the basis of reporting for in-force business at the date of transition and new business written thereafter. As such, we continue to believe that changes to IFRS 17 are needed to allow for extended use of the modified

retrospective approach in practice. However, we do not believe that these issues should block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date.

Impact on reinsurance

15 EFRAG concludes that the separate treatment under IFRS 17 of reinsurance contracts held and underlying direct contracts reflects the rights and obligations of different and separate contractual positions. Furthermore, EFRAG acknowledges that reinsurance contracts issued or held may meet the variable fee criteria even though IFRS 17 states that they cannot be insurance contracts with direct participation features. However, EFRAG assesses that the risk mitigation option would largely address the accounting mismatches, thereby balancing relevant information. In addition, for reinsurance contracts held that are used to recover losses from the underlying contracts, EFRAG considers that the Amendments provide relevant information as they aim at reducing accounting mismatches which is present under the original version of the Standard (Appendix II paragraphs 63 to 74, 210 to 216, 274 to 275, 349 to 352, 395 to 397).

Do you agree with this assessment?

☐ Yes ☒ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

We have participated in the preparation of Insurance Europe and CFO forum joint response, and we fully support their view.

Despite the welcome recent improvements made by the IASB in IFRS 17, we still have remaining concerns about the IFRS 17 reinsurance requirements that result in significant accounting mismatches in several areas. We have provided proposed solutions to each of these issues before. As such, we continue to believe that changes to IFRS 17 are needed to resolve the resulting accounting mismatches. However, we do not believe that these concerns should block the endorsement of IFRS 17 by the European Union in time for the 2023 effective date.

Implementation timeline

16 Feedback from the Limited Update to the Case Studies shows that the delay to the effective date of IFRS 17 to 1 January 2023 results in higher one-off implementation costs for preparers. However, the delay is also helping preparers to adjust their project approaches to the operational difficulties of the Covid-19 crisis. EFRAG understands from preparers that they may choose to avoid these costs by revisiting solution designs or may make more use of internal (cheaper) resources. Furthermore, according to the Limited Update to the Case Studies and other feedback from insurance associations, most of the participants did not intend to early apply IFRS 17, whereas a small minority wanted to have this possibility. EFRAG is not aware of any European insurer having taken a firm commitment to early apply the Standard. Finally, EFRAG notes that IFRS 17 requires a presentation of restated comparative information when applying the Standard for the first time. However, IFRS 9 does not have similar requirements for financial assets and liabilities (Appendix III paragraphs and 609 to 613).

(a) Do you agree with the assessment relating to delay of IFRS 17 implementation till 2023?

☒ Yes ☐ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

N/A

(b) Do you agree with the assessment relating to early application?

☒ Yes ☐ No

(i) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

N/A

17 Do you agree that there are no other factors to consider in assessing whether the endorsement of the Standard is conducive to the European public good?

☒ Yes ☐ No

If you do not agree, please identify the factors, provide your views on these factors and indicate how this could affect EFRAG's endorsement advice.

N/A

Part IV: The questions in Part IV aim at collecting constituents' inputs (Questions to constituents in Annex 1) and views relating to the requirement in IFRS 17 to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts

Notes to the respondents: *Respondents are reminded that responses to this Invitation to Comment will be made public on EFRAG's website. EFRAG is also inviting respondents to share quantitative data and to allow confidentiality of this information, constituents are kindly invited to submit these data separately from the Invitation to Comment. Such quantitative data can be sent to ifrs17secretariat@efrag.org. Only aggregated resulting data will be made public in the subsequent steps of the due process and will be presented in an anonymous way.*

The intergenerationally-mutualised and cash-flow matched contracts are specified in paragraph 6 of Annex A within Annex 1.

18 As stated in paragraphs 5 to 9 of Annex 1:

(a) What is the portion of intergenerationally-mutualised contracts and cash-flow matched contracts of all life insurance liabilities and all insurance liabilities? Please report the results for these two types of contracts separately where relevant.

Please refer to information submitted by Spanish insurers in response to the 2018 Case Study and 2020 Limited Update. Regarding cash-flow matched contracts, they represent around 51% of the life in-force portfolio as of 31st December 2019 for the Spanish market.

(b) Please indicate the proportion of contracts with intergenerational mutualisation (within the context of paragraphs B67-B71 of IFRS 17) for which the requirement around annual cohorts is considered a significant issue. Please specify the share that would qualify for VFA.

> Please refer to information submitted by Spanish insurers in response to the 2018 Case Study and 2020 Limited Update.

(c) Please describe the approach you envisage to implement the annual cohorts requirement to contracts with intergenerationally-mutualised contracts (within the context of paragraphs B67-B71 of IFRS 17).

> We are unable to answer this question as we do not envisage an approach to implementing the current annual cohort requirements for these types of contracts that will provide meaningful results. We believe this significant issue should be resolved as part of the endorsement of IFRS 17 by the European Union.

(d) Please indicate the proportion of cash-flow matching contracts for which the requirement around annual cohorts is considered a significant issue. Please specify how the features of the contracts compare with the description provided in Annex A of Annex 1.

> Please refer to information submitted by Spanish insurers in response to the 2018 Case Study and 2020 Limited Update.

(e) Please describe the approach you envisage to implement the annual cohorts requirement to cash-flow matched contracts.

> We are unable to answer this question as we do not envisage an approach to implementing the current annual cohort requirements for these types of contracts that will provide meaningful results. We believe this significant issue should be resolved as part of the endorsement of IFRS 17 by the European Union.

Part V: Questions to Constituents raised in Appendix III

19 As stated in paragraphs 532 to 534 of Appendix III:

(a) In your view, how will the Covid-19 pandemic affect the impacts of IFRS 17 on the insurance market (see a description of some expected impacts in paragraphs 518 to 527 in Appendix III) and indirectly, on the European economy as a whole?

> In our opinion, at this time, the Covid-19 pandemic should not impact the decision on endorsement of IFRS 17 by the European Union in time for the 2023 effective date.

(b) Is the Covid-19 pandemic affecting your implementation process for IFRS 17 and IFRS 9? Please explain in detail the impacts such as project ambitions, budget for implementation and ongoing costs, resources, speed of implementation. Please also explain whether this relates to the IT systems implementation, or rather the actuarial or accounting aspects of implementation.

No. In our opinion, at this time, the Covid-19 pandemic should not impact the decision on endorsement of IFRS 17 by the European Union in time for the 2023 effective date.

(c) Are there other aspects around the implications of Covid-19, not yet addressed in the DEA that you want to expand on?

No. In our opinion, at this time, the Covid-19 pandemic should not impact the decision on endorsement of IFRS 17 by the European Union in time for the 2023 effective date.

Part VI: EFRAG's overall advice to the European Commission

20 Do you have any other comment on, or suggestion for, the advice that EFRAG is proposing to give to the European Commission?

We support the endorsement of IFRS 17 in the European Union, provided that there is an adequate solution to the issue of 'annual cohorts' as part of the endorsement process.

For Spanish Insurers the application of annual cohorts to cash flow-matched contracts is of particular importance. The level of aggregation requirement in these long-term saving-products is not justified and consistent with the principles that underpin the insurance business, it leads to an artificial variability in the adjustments of the CSM in senior cohorts and increases the scope of potential onerous cohorts. The CFO Forum, the French standard setter and particularly the Spanish standard setter regarding cash flow-matched products have already provided potential solutions which can be used as a basis for solving this issue. We believe this significant issue should be resolved as part of the endorsement of IFRS 17 in the European Union. We believe that the solution developed should be optional (to allow insurers to also comply with IFRS as issued by the IASB) and furthermore should not delay IFRS 17's effective date of 1 January 2023. Several other issues remain unresolved but should not impact the endorsement process.

Whilst these other issues should not impact the endorsement process of IFRS 17 in the European Union, several priority issues (including mismatches that arise at transition under Fair Value approach, CSM amortization, scope of hedging and interaction with IFRS 9), for which solutions have been proposed by UNESPA, have also not been resolved by the IASB in the final IFRS 17 published in June 2020. Spanish Insurers have also encountered several other issues during their work in implementing IFRS 17 and we disagree with a number of assessments in the Draft Endorsement Advice (as highlighted in Appendix 1). Addressing these concerns would have significantly improved the quality and usefulness of IFRS 17. However, we do not believe that these issues should block the endorsement of IFRS 17 in the European Union in time for the 2023 effective date and, therefore, should not lead to amendments to IFRS 17 as part of the European endorsement process. We believe a thorough post implementation review, addressing all these issues (excluding issues only relevant at transition), will be needed.