Phase 2: Results of the Limited Update to the Case Studies – Costs and benefits – Text for DEA

Objective

1 This paper summarises the results of the cost-benefit analysis of the Limited Update to the Case Studies, as included in the DEA of IFRS 17.

Costs and benefits

2 Comments on the cost and benefits of IFRS 17 as amended were received from 21 participants.[1]

Costs

3 The following are the updated costs of implementing IFRS 17 as amended:

	€ millions	Range € millions (minimum – maximum)	No. of participants
Europe (excluding UK)			
One-off costs	2,332	10 - 395	15
Ongoing costs	180	4 - 50	8
Cost savings	(68)	(3) – (50)	4
UK			
One-off costs	744	38 – 326	4
Ongoing costs	13	0.1	1
Cost savings	(76)	(76)	1

4 Mid 2020, almost half of the budgets for the one-off costs have already been spent, on average: the costs incurred to date are 42% of the updated one-off costs ranging from 13% - 70% of the one-off costs.

5 When comparing cost estimates of EFRAG's enquiries in 2018 and 2020, there is a significant increase in costs reported. The main reason for the increase in costs related to the IT systems for accounting and reporting and due to complexity of the calculations (44% of the increase). Also, the change in the effective date contributed to the increase in costs (21% of the increase). The IFRS 17 amendments did not

[1] In July 2020 EFRAG organised an additional survey with the participants that had an initial negative assessment of costs/benefits, in order to better understand how they assessed the benefits. In particular they were asked to clarify how their opinion would be impacted when focusing on two scenarios: a long-term perspective and IFRS 17 with an exception for annual cohorts for intergenerationally-mutualised and cash flow matched contracts. Inputs from this are referred to as "Additional Survey".

contribute significantly to the increase in costs except for the effective date just mentioned nor did they result in a significant decrease in costs.

(a) On average, there is an increase of *one-off* costs by 42%;

(b) On average, there is an increase of *ongoing* costs by 27%;

(c) A large majority of the participants did not have a significant cost reduction.

Cost savings

6 Only 21% of the participants identified material cost savings. This mainly related to internal changes made by entities, e.g., increased use of automation, switch to internal solution being developed interfaced between and group and local entities and operational efficiencies. Other cost savings related to some changes made in the IFRS 17 amendments, e.g., presenting a portfolio of contracts in an asset or liability position rather than at group level.

Benefits

7 Participants were asked to agree or disagree with the statement that the introduction of the new standard will result in better reporting than the current IFRS 4 regime. The table below reports scores for this assessments, comparing the benefits between IFRS 17 as issued and IFRS 17 as amended on a scale from 1: totally disagree to 5: fully agree. In general, the scores in the two columns are not significantly different. This means that there is a perception by the preparers that participated to the study of limited incremental benefits introduced by the Amendments.

	Weighted average	
	IFRS 17 as issued	**IFRS 17 as amended**
Reflecting the economics of the business	2.4	2.4
Current accounting	2.4	2.5
More comparable financial reporting information	2.7	2.7
Enhanced integration between risk management and financial reporting	2.0	2.0
Reasonable approximation under the Premium Allocation Approach	3.3	3.0
Resolving accounting mismatches	2.6	2.8
Availability of options	2.8	2.8
Specific measurement guidance	3.2	3.2
Reduced cost of capital	2.3	2.6
Uniform Chart of Accounts	1.7	1.8

8 Overall, for IFRS 17 as amended, based on the table above, the following are the largest benefits:

(a) *Reasonable approximation under the Premium Allocation Approach* as it allows to reduce implementation costs and reduce complexity. However, one considered that the PAA implementation is more complex than anticipated;

(b) *Resolving accounting mismatches* – same as above. However, a few indicated that more quantitative assessments are needed and there is a lack of sufficient interaction between IFRS 9 and IFRS 17;

(c) *Availability of options* – However, a few participants noted that there is no option that both reflects economic substance and reduces costs;

(d) *Specific measurement guidance leading to more uniform measurement basis than IFRS 4* – however, some considered that under IFRS 17, there would be a lack of comparability and uniformity because of multiple options, the complexity and also entities would also be reporting under local gaap; and

(e) *More comparable financial reporting information* – improvement in the treatment of reinsurance contracts. However, some indicated the potential lack of comparability between peers when judgement, different policies and accounting options are selected.

9 In contrast, more than half of the participants considered that IFRS 17 as amended compared to IFRS 4:

(a) *is unlikely to improve quality of information via disclosures and is unlikely to have an increased understanding of the insurance sector by other stakeholders.* This is due to non-gaap measures/alternative methods that needs to be used to explain performance. Also, due to entities adopting different approaches due to principles-based nature of IFRS 17. Half of the participants in the Additional Survey were more positive and noted that quality of financial information would improve through the disclosures of IFRS 17. Notwithstanding this, participants found the disclosures burdensome, time consuming and detailed.

(b) *is unlikely to increase attractiveness of the insurance sector to investors*. This is because of IFRS 17 not providing information on cash emergence; it would take many years for investors to be specialised in understanding IFRS 17 financial statements; and due to key metrics being inconsistent with other industries, e.g. Return on Equity. Half of the participants in the Additional Survey noted that IFRS 17 could lead to an increased attractiveness of the insurance sector but this would depend on a number of factors such as the increase in volatility or the application of annual cohorts.

(c) *is unlikely to have a significant positive effect on cost of capital of insurers*. This is because cost of capital would mainly be driven by Solvency II and due to an increase in volatility in P&L and OCI. EFRAG notes the impact of Solvency II is outside the scope of this endorsement advice. The relation between the cost of capital and volatility is addressed in the economic study as well as in the chapter "Competitiveness".

10 There were mixed views on whether IFRS 17 as amended *is likely to have an increased understanding of the insurance sector by capital providers.*

(a) 38% of the participants thought it unlikely because General insurance business is currently well understood; challenging for non-specialists; not always depicting economics/busines model; while

(b) 33% of the participants thought it likely because applying IFRS 17 would lead to greater comparability / transparency once the users have gained sufficient knowledge.

(c) Most of the participants in the Additional Survey noted that IFRS 17 was too complex to lead to an increased understanding of investors in the short term. But they were more positive when considering the long term.

11 In addition, 67% of the participants considered the above in paragraphs 9 and 10 unlikely due to the complexity of IFRS 17 and calculations.

Overall consideration of costs and benefits

12 Overall, 29% of the participants from Continental Europe (which correspond to 38% of the participants from Continental Europe that provided a specific answer to this question) considered that the benefits outweighed the expected benefits. An additional 10% and 6% of participants (respectively 13% and 8% of those that provided a specific answer to the question) from Continental Europe considered that the expected benefits outweighed the costs respectively if (i) a solution was found

for annual cohorts for intergenerationally-mutualised and cash flow matched contracts and (ii) a long-term perspective was taken.

13 **In summary this brings to 46% the share of participants from Continental Europe that provided a specific answer to the question having a positive overall cost/benefit appreciation in the long term. This share would increase to 59% if the standard had a solution for annual cohorts for intergenerationally-mutualised and cash flow matched contracts.**

14 The perception was considerably more negative in UK than in continental Europe. In the UK all participants were negative. In continental Europe 41% was negative but a quarter of those participants (10% of the total number of participants) would change their view if there was a solution for annual cohorts. In addition, 6% of the participants were negative in the short term but could see a more positive perception on the mid to long term. The breakdown is as follows:

No. of participants	Benefits outweigh costs	Benefits do not outweigh costs	Depends	No response/ no overall view mentioned
Europe (excluding UK)	**29%**	**41% (10% would change the view because of annual cohorts)**	**6% (no in the short term- perhaps in the longer term)**	**24%**
Total (including UK)	24%	52%	5%	19%
UK	-	100%	-	-

15 The outcomes if non-responses are excluded:

No. of participants	Benefits outweigh costs	Benefits do not outweigh costs	Depends
Europe (excluding UK)	**38%**	**54% (13% would change the view because of annual cohorts)**	**6% (no in the short term- perhaps in the longer term)**
Total (including UK)	29%	65%	6%
UK	-	100%	-

16 The reasons for expected costs outweighing the expected benefits were mainly due to complexities arising from IFRS 17 and concerns still remaining.

17 A large minority with Europe (excluding UK) considered that expected benefits outweighed the expected costs as even if the standard is complex, there is an improvement in quality / consistent and comparable accounting; and a global standard would increase uniformity in accounting.