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Directorate General Financial Stability, Financial Services and Capital Markets Union

ACCOUNTING AND FINANCIAL REPORTING
Head of Unit

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Jean-Paul Gauzès
President
EFRAG
Square de Meeûs 35
B-1000 Brussels

Subject: Endorsement advice on IFRS 17 *Insurance Contracts*

Dear Mr Gauzès,

Following the publication by the International Accounting Standard Board (IASB) of IFRS 17 *Insurance Contracts* on 18 May 2017, the European Commission would like to request the European Financial Reporting Advisory Group (EFRAG) to deliver its opinion, on the new standard.

The opinion of EFRAG should be based upon the following conditions, against which endorsement is assessed in the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of International Accounting Standards, i.e. that the standard:

- is not contrary to the principle set out in Article 4(3) of Directive 2013/34/EU and is conducive to the European public good, and
- meets the criteria of understandability, relevance, reliability and comparability required of financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG should support its advice by an impact analysis, including a cost-benefit analysis and an analysis of broader economic impacts. This impact analysis should be independent, objective and Europe-focused. *Annex 1* to this letter describes a standard structure of this assessment.

As you are aware, members of the Accounting Regulatory Committee (ARC) vote on the adoption of each standard taking into consideration the endorsement advice provided by EFRAG to the European Commission. Accordingly, members of ARC have been asked to identify matters which they consider to be important in reaching their conclusions on whether to endorse IFRS 17. *Annex 2* to this letter describes the matters raised by some ARC members together with other issues that have been brought to the attention of the Commission services by European stakeholders. I would like to request that EFRAG take these matters into consideration, as appropriate, in its reply to this letter.

I should be grateful if EFRAG would provide its opinion by the end of 2018 taking into account the need to address the matters raised and appropriate due process and consultation with European stakeholders as well as the outcome of the work of the IFRS 17 Transition Resource Group.

We thank you in advance for your cooperation.

Yours sincerely,

Alain DECKERS

cc.: Andrew Watchman (EFRAG TEG Chairman)

Annex 1

Impact Analysis – Standard structure

EFRAG shall advise the European Commission on the adoption of the new Insurance contracts standard for undertakings in the mandatory scope of Regulation 1606/2002. *It shall also assess IFRS in respect of companies' financial statements prepared under IFRS as a result of a Member State option (Article 5 of the Regulation. Such an analysis would be limited to the effects resulting from the use of these options, on which Member States have no means of action (e.g. it would exclude national tax and social legislation).* *EFRAG is not expected to consider theoretical scenarios such as amending a proposed standard or its predecessor. As such, in the present document, the "**options**" to be considered by EFRAG are the baseline scenario (existing situation) and the new IASB standard.* *The details of an impact analysis shall be proportional to the importance of the relevant IFRS.*

The endorsement advice letter would be structured based on the following:

- The cover letter, containing the endorsement advice on the standard and the bases for conclusion.
- An appendix describing the reasons for a new standard and how it responds to the problem. In particular it will cover:
    - **The problem definition.** This includes the answer to the following questions: what is the problem the new standard aims at solving, who is affected and how, what is the magnitude of the problem, what are the causes and consequences, what will happen without further EU action?
    - **The objectives of the new standard,** how it responds to the problems identified.
- An appendix on EFRAG's analysis of whether the new IFRS is not contrary to the principle set out in Article 4(3) of Directive 2013/34/EU (**true and fair view principle**) and whether it meets the **technical qualitative criteria** (understandability, relevance, reliability and comparability required of financial information needed for making economic decisions and assessing the stewardship of management). This analysis will cover the new standard as well as its interaction with the other set of adopted standards.
- An appendix on EFRAG's **impact analysis of the options**[1], including whether the new IFRS is conducive to the **European public good**. This will include:

[1] The options are the baseline scenario (existing situation) and the new IASB standard

- A description of the impacts and of the stakeholders affected. Impacts will cover, economic aspects and where relevant environmental and social aspects, in addition to financial reporting aspects.
- A comparison between the options in terms of their effectiveness and efficiency (benefits and costs);
- Whether the new standard would not endanger financial stability, would not hinder economic development and what the impact on the competitiveness of European undertakings would be.

Annex 2 details a list of matters to be considered for the specific standard going through endorsement.

Annex 2

Impact Assessment – Scope

1 General

IFRS 17 is the first comprehensive and truly international IFRS Standard establishing the accounting for insurance contracts issued by a company. The standard currently applied, IFRS 4, was intended to be an interim Standard and it does not prescribe the measurement of insurance contracts but instead allows companies to use local accounting requirements (national GAAP) or variations of those requirements for the measurement of their insurance contracts issued. Differences in accounting treatments across jurisdictions and insurance products make it difficult for investors and analysts to understand and compare insurers' results. It also allows different accounting policies to be applied across a group in consolidated financial statements.

We would like EFRAG to analyse some general issues relating to the content IFRS 17 taking into account the context mentioned above. What will be the benefits brought by this harmonisation compared to the existing situation? Will IFRS 17 deliver consistent and understandable reporting of financial performance for insurance contracts within a group? How does IFRS 17 take into account the specificities of the insurance sector? Do the different accounting methods reflect properly the different business models and is the delineation between these different accounting methods such as the scope of the variable fee approach clear? Is the level of aggregation striking the right balance between the usefulness of the information and the complexity and costs of its implementation? How does the pattern of release of the Contractual Service Margin ("CSM") for insurance contracts with direct participation features reflect the business models of the insurance sector?

2 Potential effects on financial stability

The insurance industry fulfils a central role in the global economy and insurers, like other institutional investors, are important long-term investors. Improved transparency resulting from IFRS 17 is expected to contribute to long-term financial stability by revealing useful information that will enable actions to be taken in a timely way.

On 17 July 2017 the Financial Stability Board (FSB) issued a press release welcoming the final publication of the standard, which was identified as a high priority at the FSB Plenary meeting of 25 September 2015.

At the same time IFRS 17 will standardise the accounting for insurance contracts, resulting in a different depiction of the financial position and performance of (some) insurance companies. The additional transparency is likely to have an impact on market confidence and hence financial stability.

Notwithstanding the FSB's position, we would like EFRAG to analyse the impacts, both positive and negative, with a view to assessing how IFRS 17 is expected to affect financial stability. To the extent that is deemed feasible and useful, the analysis should cover sensitivity analyses as well as stress testing of the impact on the financial statements.

3 Potential effects on competitiveness

We would like EFRAG to analyse 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.

4 Potential impact on the insurance market

We would like EFRAG to analyse the potential impact of the new standard on the range of insurance products available to policyholders, the design and pricing of insurance products as well as prospective impact on the demand for various products. In this respect, it would be useful to make a clear distinction between life and non-life insurance products.

Additionally, we would like EFRAG to analyse the potential impact of IFRS 17, taking into account its interaction with IFRS 9, on long-term investment including the investments held by insurance groups.

5 Cost-benefit analysis

The assessment should separately identify one-off costs of implementing the standard, ongoing incremental costs of applying it and possible cost savings e.g. resulting from simplifications, synergies with existing IT systems, potential ability for the companies to benefit from the work undertaken in reporting under Solvency II regime (following the comparison of the estimated impact on the financial statements with the information provided under Solvency II to understand the size of the differences between IFRS 17 and Solvency II) or possible savings in case of insurance companies operating in multiple jurisdictions. The assessment should also consider whether the complexity of the standard is justified in terms of costs of application, in particular as regards the subdivision of products into subgroups (onerous, non-onerous and the remaining contracts) and annual cohorts. The assessment shall also consider the consequences of the requirement to provide comparative numbers for the year preceding the application date of IFRS 17.

In terms of benefits, the analysis should cover those resulting from improved quality of financial information, increase in comparability of financial statements with the EU insurance industry and globally, an accounting level playing-field for companies, increased understanding of the sector by capital providers, possible increased attractiveness of the sector to investors, possible positive effect on the cost of capital of insurers.

The assessment should also take into account the elements mentioned above. To the extent possible, the conclusions reached by EFRAG should be supported by numerical evidence.