IFRS 17 - Summary of points raised by the IAWG and TEG members
Issues Paper

Objective

1 The objective of this paper is to provide EFRAG TEG with an overview and summary of all points raised by members of the EFRAG IAWG and EFRAG TEG related to IFRS 17 *Insurance Contracts*. It also indicates the EFRAG Board meetings or proposed meetings at which such topics were or will be presented.

Background

2 This paper has been developed to inform EFRAG TEG of points raised by members of the IAWG since IFRS 17 was issued. These have been incorporated in the education material prepared for the EFRAG Board and EFRAG TEG and, where relevant, included in the draft endorsement advice currently under development.

3 Members of the EFRAG IAWG continue to raise issues as they develop a greater understanding of the requirements and impact of IFRS 17. EFRAG TEG will be advised as further issues emerge.

Summary of issues received

4 The issues summarised below have been classified into three categories:

(a) those that are criticising IFRS 17;

(b) interpretation issues that might be sent to the IASB's IFRS 17 Transition Resource Group; and

(c) points raised where the purpose of raising the point is not clear.

Issues criticising IFRS 17

5 Below is a summary of points raised by EFRAG IAWG members, together with the relevant references to IFRS 17. Where relevant, similar issues raised by different IAWG members have been combined.

6 In some cases, those who raised an issue also suggested ways of addressing the issue. These solutions have been provided for information for EFRAG TEG. However, in most cases, the EFRAG Secretariat has not analysed the proposed solution(s) because either:

(a) the solution proposed was to amend IFRS 17, which is outside the scope of an endorsement advice; and/or

(b) the solutions were not developed in sufficient detail to enable assessment by the EFRAG Secretariat.

7 The issues criticising IFRS 17 are:

(a) *Level of aggregation and mutualisation*:

1) The annual cohort requirement does not reflect the nature of insurance business and is costly. IFRS 17, paragraph 22.

2) The aggregation requirements will lead to a significant number of groups and it is unclear how it applies to mutualisation. It will increase implementation and operational costs. IFRS 17, paragraphs 16 and 22.

<u>Solutions proposed</u>:

- Ask the Transition Resource Group (TRG) to provide an interpretation that reduces the issues raised.
- Disregard the annual cohort requirement if the principle in paragraph BC138 of IFRS 17 is satisfied (i.e. the groups together provide the same result as a single combined risk-sharing portfolio).
- From mutuals' side:
  - Be permitted to defer the acquisition costs.
  - Be permitted to use mutualisation to decrease the loss before calculating a new CSM amortisation.
- Delete the annual cohort requirement.
- Rely on the roll-forward of the CSM to disclose the profitability of the new annual business based on MCEV-practices (MCEV = market consistent embedded value).
- Use coverage units instead of the annual cohorts to reflect trend information.
- Group contracts based on maturity date instead of upon inception date.

October 2017

(b) *Investment component*: The requirement to update CSM with differences between the expected and actual investment component is operationally complex. IFRS 17 paragraph B96(c).

October 2017

(c) *CSM at locked-in rate*: Under the general model, CSM is accreted using the discount rate at inception. This is operationally complex and burdensome. IFRS 17, paragraphs 44(b) and B72(b).

October, November and December 2017

(d) *CSM and coverage units*: The CSM allocation is mechanical (rather than principle-based) under both the general model and the variable fee approach. IFRS 17, paragraph B119.

October 2017

(e) *Scope of variable fee approach (VFA)*:

1) The scope of the VFA means that similar contracts will be treated in different ways. Constructive obligations should be included in the scope of the VFA. IFRS 17, paragraphs 2, B101, B104 and B105.

2) To apply the VFA, it is required that '*a substantial proportion of any change in the amounts due to the policyholder vary with the change in fair value of the underlying items*', but this may not apply to contracts that require payments in terms of local GAAP rather than change in fair value. The scope of the VFA needs to be extended. IFRS 17, paragraphs B101 and B102.

November 2017

(f) *Reinsurance*:

1) For proportional reinsurance held, the treaty is considered as a single contract, even when it relates to underlying contracts not yet written by the cedant, leading to subjective estimates as well as a difference in recognition between the underlying contracts and the reinsurance contract. Reinsurance contracts should be recognised and measured to match the underlying in-force contracts. IFRS 17, paragraph 34

2) The treatment of reinsurance contracts leads to accounting mismatches due to differing treatment of CSM and the fact that the reinsurance asset does not necessarily equal the liability of the underlying contracts. IFRS 17, paragraphs 65 and B109.

3) Reinsurance contracts are not eligible for the VFA. IFRS 17, paragraphs 65 and B109.

November 2017

(g) *Discounting for incurred claims under PAA*: To determine the insurance finance income or expenses to be included in profit or loss, the requirement to discount the liability for incurred claims is not practical as entities do not know when claims have been incurred (incurred, but not reported yet – IBNR) and thus which discount rate to use. IFRS 17, paragraphs 88(b), B133 and B72(e)(iii).

November 2017

(h) *Presentation of groups of insurance contracts*: Entities are required to present groups of insurance contracts that are in an asset position separately from groups of insurance contracts that are in a liability position. This is not consistent with the business model of insurers and operationally burdensome. As a result of the required presentation, IFRS 17 will amend IAS 1 paragraph 54. IFRS 17, paragraphs 40 and 78-79.

December 2017

(i) *Risk mitigation*: There is no risk mitigation solution for indirect participation contracts. The hedging solutions in IFRS 9 are not considered appropriate. IFRS 17, paragraphs B115-B116.

December 2017

(j) *Transition*:

1) At transition to IFRS 17, applying the fair value approach will lead to a zero, or very small contractual service margin. IFRS 17, paragraph C5.

2) A fair value approach could result in a lower CSM on adoption than if the full retrospective approach is used which would influence the profitability of insurance entities with long-term business over a significant period. The concern is that the modified retrospective approach may be too onerous to be used. IFRS 17, paragraphs C6-C9.

3) Risk mitigation for contracts that apply the VFA is to be applied prospectively at transition. This is considered inappropriate for existing hedge relationships. IFRS 17, paragraphs B115-B116.

4) The modified retrospective approach should be changed to allow for the calculation of a meaningful CSM. IFRS 17, paragraphs C6-C19.

December 2017

(k) *Disclosure*: The disclosure requirements are not aligned with Solvency II which affects their relevance. IFRS 17, paragraphs 93 to 132.

December 2017

(l) *SMEs*: small insurers will not have the resources to apply IFRS 17.
December 2017

Issues potentially requiring interpretation

8 Certain points raised are more interpretative in nature and may be referred to the IASB's IFRS 17 TRG by members of the EFRAG IAWG or other industry participants.

(a) *Separating components from an insurance contract*: For unit-linked contracts with an option of waiving the premium, it is unclear whether the investment component can be separated and accounted for in accordance with IFRS 9. IFRS 17, paragraphs 11(b) and B31-32.
October 2017

(b) *Identification of onerous contracts at inception*: The level at which onerous contracts at inception should be identified is unclear. IFRS 17, paragraphs 16 and 17.

(c) *Unbundling of insurance contracts*: It is unclear whether IFRS 17 allows the unbundling of different insurance components. IFRS 17, paragraphs 10-13.
December 2017

(d) *Coverage units - quantity of benefits*: The interpretation of quantity of benefits is unclear. IFRS 17, paragraphs 44(e) and B119(a).
December 2017

(e) *Insurance contracts that are eligible for VFA*: It is unclear at what level of aggregation the assessment is to be performed. IFRS 17, paragraph 62.
December 2017

(f) *PAA – eligibility*: It is unclear how to assess materiality in assessment of eligibility for the Premium Allocation Approach. IFRS 17, paragraph 53.
December 2017

Other comments

9 Certain requirements of IFRS 17 were raised, but no further details were provided about the reason from raising the requirement, even upon request from the EFRAG Secretariat:

(a) Paragraph 164 of the Basis for Conclusions to IFRS 17 requires the contract boundary to be reassessed in each reporting period.

Questions for EFRAG TEG

10 Does EFRAG TEG have any additional points that they would like to raise?

11 Does EFRAG TEG consider that any of the points raised should be further analysed by the EFRAG Secretariat and returned for discussion? Please identify the importance of the issue as it may take time for the EFRAG IAWG member raising the issue to provide further information.