This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Summary and analysis of the EFRAG IAWG questionnaires received

Introduction and Background

1 In May 2017, the EFRAG Secretariat submitted a questionnaire to EFRAG IAWG members relating to current insurance accounting practices. The results of the questionnaire, which are summarised in this paper, are meant to provide information that:

(a) Describes insurance accounting as applied by European insurers today considering necessary nuances and different types of insurance business (based upon materiality). Knowledge of the current position of each insurer helps in identifying the impact of IFRS 17 *Insurance Contracts*; and

(b) Supports an assessment of IFRS 17 to identify the challenges relating to implementation of the Standard. The assessment of IFRS 17 is expected to build upon the information gathered in the questionnaire.

2 The results of the questionnaire are currently in draft and will be presented as such to the EFRAG IAWG. This allows for:

(a) Potential questions from EFRAG TEG members to develop particular areas in more detail;

(b) Potential requests from EFRAG IAWG members to improve the summary of the answers received; and

(c) Adding additional information from future IFRS 17 testers, as the questionnaire is an inherent part of the testing process.

Summary of respondents

3 At the time of writing, 14 respondents have participated in the questionnaire. In addition to 9 EFRAG IAWG members, 5 non-EFRAG IAWG members participated.

Summary of respondents' views

Understanding current GAAP of insurance contracts

GAAPs used

4 Respondents were requested to provide information on the European GAAPs that they used and whether or not they used US GAAP. In terms of European and US GAAPS, most respondents used a range of GAAPs in their financial statements:

(a) 3 respondents used 1 GAAP;

(b) 2 respondents used 2 GAAPs;

(c) 6 respondents used 3 GAAPs or more; and

(d) 3 respondents did not complete the question or it was not applicable to them.

5 The range of the weighting of the insurance liabilities not measured in accordance with European and US GAAP is as follows:

Main GAAPs referred to	Weighting
Asian GAAP	15%
Switzerland, Japan and Hong-Kong GAAP	22%
Russian GAAP	2%

6 The weighted average per product type of insurance liabilities accounted for according to the European and US GAAP is as follows:

	Respondents	Weighted average %
Life and health contracts	12	50%
Non-life contracts	10	10%
Investment contracts	8	13%
With-profits contracts	1	2%
Unit-linked contracts	12	25%
Reinsurance Ceded	10	-4%
Reinsurance Assumed	4	4%
		100%

Unit of account

7 Respondents used different units of account for different purposes. Except for reinsurance and with-profit contracts, the (large) majority of respondents used the individual contract as the unit of account for different insurance contract types. However other units of account were used for each insurance contract type. For example:

(a) Line of business or group level (life insurance business);

(b) Portfolio or group level for measurement and impairment testing of deferred acquisition costs (non-life contracts);

(c) By risk or group of contracts for specific technical provisions to cover targeted deficiencies (investment contracts); and

(d) Total fund level for unallocated distributable surplus (unit-linked contracts).

8 For both reinsurance ceded and assumed, only a minority referred to the individual contract level. Others referred to portfolio or group level or based the unit of account on the underlying insurance contracts.

Prudence

9 The use of prudence was highlighted through different measures: the fact that insurance provisions need to be sufficient; the use of specific discount rates, mortality tables or the use of a flashing light reserve[1], specific adjustments for prudence, and the provision for incurred but not reported (IBNR) claims.

10 On the other hand, not all insurers rely on specific adjustments for prudence. For contracts where the policyholder bears the full risk such as investment contracts or

[1] Reserve required by local GAAP to create an additional buffer to cover the low interest rate risk i.e. comparing government bond yields to guaranteed contract rate. Since 2009 the liability adequacy test indicated that this is not required under IFRS.

DRAFT

unit-linked contracts, no adjustment for prudence was applied. In addition, the use of a best estimate measurement was not considered to include prudence by some respondents.

Identification of onerous contracts

11 Some respondents noted that there was no current requirement to identify onerous contracts. However, respondents pointed out different methods to ensure sufficient reserves such as the liability adequacy test in IFRS 4 *Insurance Contracts*, the unexpired risk reserve and loss recognition test. It was also noted that deferred acquisition costs were tested for impairment and written off where no longer recoverable.

Risk sharing

12 Products fully sharing risks were identified as with-profit funds, traditional participating contracts in Continental Europe or closed portfolios created at demutualisation. Three respondents indicated that there is no full sharing of risks between products.

13 In terms of applying discretion:

(a) seven respondents provided information on the risk-sharing bases;

(b) two respondents stated that there is no discretion as to sharing the return on assets, but there may be discretion to allocate the excess of the maximum participation between contracts/portfolios; and

(c) three respondents stated that discretion is not applicable.

Definition of revenue

14 Practices of identifying revenue varied amongst respondents and per insurance liability category:

(a) Premiums are recognised as revenue in full when due;

(b) Only the margin of the deposit premium is recognised for unit-linked contracts;

(c) Premiums are recognised as revenue in proportion to the cover provided for short-term contracts;

(d) Premiums are recognised in line with the net premium reserve for long-term life insurance contracts;

(e) Insurance revenue comprises for all business: earned premiums, net of reinsurance, other income, interest income and other investment return; or

(f) Premiums are recognised as revenue net of policy cancellations or after an adjustment for estimated earned portion of premiums not yet written on group contracts with death cover.

15 Although some insurers recognised revenue at inception of specific types of insurance contracts, a majority of respondents did not defer revenue.

Treatment of accounting mismatches

16 Respondents were divided about the existence of accounting mismatches under current GAAP with seven of them indicating that no (significant) accounting mismatches were identified, while the other seven indicated accounting mismatches did exist. Only a few respondents identified material accounting mismatches. Of the respondents that identified accounting mismatches, most identified these at entity level or at consolidated level, but a few others identified them on segment level.

17 A minority of respondents provide disclosures about their accounting mismatches.

DRAFT

18 Respondents relied upon the fair value option, the AFS measurement category under IAS 39 *Financial Instruments: Recognition and Measurement* and shadow accounting to reduce accounting mismatches.

Long-term liability driven business model

19 A majority of respondents noted that their current GAAP does not support the long-term liability-driven business model and therefore additional non-GAAP measures were needed to reflect it. A minority of respondents was of the view that their national GAAP reflects their long-term liability-driven business model.

Hedge accounting

20 A large majority of respondents economically hedge several risks relating to their insurance liabilities but only one applied hedge accounting. Reasons provided for not applying hedge accounting were:

(a) Similar measurement bases are applied to insurance contract liabilities and the underlying assets backing them;

(b) Hedge accounting is not needed due to the options available under IFRS 4 to reduce accounting mismatches;

(c) The hedge accounting rules are overly complex and difficult to apply; and

(d) The scope exemption of IAS 39 for insurance contracts.

Specific elements of managing the insurance business

Key performance indicators

21 Key performance indicators relied upon by most respondents were gross written premiums, total revenues, return on equity, earnings per share, dividends per share, IFRS operating result, investment performance and annual premium equivalent.

Changes in technology

22 Almost all respondents noted that changes in technology affect or will affect their product offerings in the future. Half of the respondents did not expect any effect of technological changes on their systems for preparing financial statements. However, the other half expected an impact but not everyone had analysed the impact.

Low interest rate and impact on products

23 Almost all respondents noted that their products would be affected, for example, a switch to more unit-linked products as an impact of the low interest environment on their products.

Solvency II and impact on products

24 The impact of Solvency II on products was less pronounced. Nearly half of the respondents saw no impact, whilst the remaining respondents noted an impact, for example, a reduction of guaranteed products and a shift to unit-linked type contracts. Also, on creation of new products, capital requirements were considered.

Non-GAAP measures used to explain the insurance business

25 A large majority of respondents indicated that they rely upon non-GAAP measures to explain the economics of their business. Examples provided were: European Embedded Value operating profit; return on regulated capital and gross written premiums reported by business segment and line of business.

DRAFT

Adequacy of current financial statements

26 Half of the respondents noted that their financial statements only partially reflect the economics of their business. Three respondents found the current financial statements reflected the economics of their business while three others disagreed.

Mutual entities

27 Of the two mutual entities that participated in the questionnaire, one respondent indicated that it does not have equity under the GAAP it applies. Their unallocated divisible surplus (UDS) was presented as a liability. This liability is presented alongside the insurance and investment contract liabilities but separate from them. This allows the company to explain its performance as the movement in the UDS reflects the profit for the period. The other respondent noted that all profits and discretionary participation features were accounted for as equity.

28 One of the respondents noted that there were no material accounting mismatches, whilst the other respondent indicated that accounting mismatches are recognised in profit or loss.

Reinsurance

Reinsurance ceded

29 Half of the respondents indicated that they account for reinsurance contracts ceded in the same way as the underlying direct insurance contracts. This was in line with the requirements of several national GAAPs used by respondents.

30 Respondents used different practices to recognise revenue related to reinsurance ceded. For example, the premium ceded is (a) reported as a reduction of the premium earned; (b) recognised as revenue when due; or (c) recognised as revenue on an earned basis.

31 A large majority of respondents did not encounter accounting mismatches or reported them as non-significant.

Reinsurance assumed

32 Some respondents indicated that they account for reinsurance contracts assumed in the same way as the direct insurance business. Respondents used different practices to recognise revenue, for example, (a) recognised as revenue when due; (b) recognised as revenue on an earned basis; or (c) recognised consistently with the direct business.

33 Several respondents did not encounter accounting mismatches or reported them as non-significant.

Solvency II

34 The use of Solvency II in the preparation of financial statements was split: half of the respondents indicated that they did not use Solvency II information and almost half indicated they had done so. Several respondents noted that their IT systems had been adapted when implementing Solvency II while a similar number made no or limited accounting system changes.

35 In describing the differences between the Solvency II and IFRS reporting, only two respondents noted similarities between the two frameworks whilst other respondents provided anecdotal differences. Two respondents noted that the two frameworks differed significantly.

Asset-liability management

36 The five main principles supporting asset-liability management for insurance contracts were identified by respondents as:

DRAFT

(a) Asset-liability matching;

(b) Long-term return and performance;

(c) Impact on regulatory capital and broader regulatory requirements;

(d) Risk appetite and respecting risk limits on adverse events; and

(e) Interest rate risk, including performing a sensitivity analysis.

37 Connecting these principles to the long-term business model, few respondents explained how the investments are linked to the expected cash outflows from the liabilities. For example, cash flow matching is used to manage low interest rates and investments in real estate are considered as a long-term economic hedge against inflation risk.

38 One respondent explained that, in addition to determining a risk-neutral position, the entity defines a strategic asset-liability mismatch which reflects the strategic risk appetite of the company and allows it to benefit from economic mismatches between assets and liabilities, however with respect to different risk parameters.

What do insurers invest in?

39 Debt securities are the biggest investment category for most insurance products. Other important investment categories are equities, investment funds, mortgages and real estate.

40 However, for investment type products and unit-linked contracts, equities represent a higher proportion of investments than for life or non-life insurance contracts.

Reallocation of assets[2]

41 Reallocation between asset portfolios supporting different insurance liabilities occurs frequently as part of active asset management. Reasons for doing so are diverse, e.g. credit related events linked to the macro economic environment or business considerations, risk bearing capacity and overall capital allocation process of the group.

Questions to EFRAG TEG

42 Does EFRAG TEG require further information from EFRAG IAWG on certain topics? Please specify.

[2] Reallocation implies that the returns of the asset will no longer be assigned to liability A but to liability B instead.

DRAFT