IFRS 17 *Insurance Contracts*
Issues identified by the EFRAG Board

Objective and Introduction

1 The objective of this session is for EFRAG Board to consider the paper to be sent to the IASB to support the issues identified in the letter from the EFRAG President of the EFRAG Board to the Chairman of the IASB dated 3rd September 2018. These specific issues were selected taking into consideration issues identified by EFRAG Board members and by the CFO Forum from the extensive and simplified case studies.

2 In the letter to the IASB Chairman, the issues considered by the EFRAG Board that merit further consideration by the IASB were described briefly as follows:

(a) Acquisition costs (for costs incurred in expectation of contract renewals);

(b) CSM amortisation (impact on contracts that include investment services);

(c) Reinsurance (onerous underlying contracts that are profitable after reinsurance, contract boundary for reinsurance contracts where underlying contracts are not yet issued);

(d) Transition (extent of relief offered by modified retrospective approach and challenges in applying fair value approach);

(e) Annual cohorts (cost-benefit trade-off, including for VFA contracts); and

(f) Balance sheet presentation (cost-benefit trade-off of separate disclosure of groups in an asset position and groups in a liability position and non-separation of receivables and/or payables).

3 Each issue is summarised in the paper, together with the evidence from the case studies. The reasons for the EFRAG Board identifying the issue is included, based on the discussion by the EFRAG Board.

4 As a recap, eleven respondents participated in EFRAG's extensive case study and 49 in EFRAG's simplified case study.

Questions for EFRAG Board

5 Does the EFRAG Board have comments and suggestions on this paper?

A. Acquisition costs

Description of the issue

1 Acquisition cash flows on new business cannot be allocated beyond the contract boundary even if it is expected that the contract will be renewed.

2 Constituents argue that this results in incorrect matching of income and expenses over time. This treatment can also lead to some contracts being regarded as onerous for accounting purposes, even if the customer relationship is expected to be profitable once anticipated renewals are considered.

3 Some constituents also note that other industries are permitted, in accordance with IFRS 15 *Revenue from Contracts with Customers*, to amortise incremental acquisition costs over periods that include expected renewals.

Findings from the case studies

EFRAG's extensive case study

4 The evidence obtained included the following:

(a) A respondent illustrated the impact of the treatment of acquisition costs on a property and casualty portfolio. The respondent found limited losses on onerous contracts, while demonstrating an overall profit on the line of business (the results were based on a combination of two portfolios). The respondent noted that the pricing reflects expected renewals.

(b) A respondent described the situation for property and casualty business where acquisition costs are unconditionally paid, i.e. without any claw-back clause if the contract is not renewed after the first year. The respondent notes there are strong historical records of persistence of the contracts (i.e. many of the policyholders continue the contract beyond the first year). Hence, the respondent argues that the economic duration of the contracts is longer than the contract boundary as defined in IFRS 17. This respondent quantified the difference between assigning the acquisition costs to new clients only, or to new clients and renewals. The respondent found that attributing acquisition costs to new clients only can lead to more onerous contracts. Further, this respondent noted that renewals can indirectly impact pricing as profitability assumptions are based on the expectation that contracts will be renewed over several years.

This respondent provided the following effect of IFRS 17 for its portfolio.

Acquisition costs allocated to	**A. New clients only**	**B. Renewals only**	**A+B New business (new clients and renewals together**
Pre-tax profit	-- 21.4 mio Euro	+ 50.0 mio Eur	+ 29.8 mio Eur

The respondent explained that when acquisition costs are allocated to the new business in their entirety (new clients and renewals together), the portfolio is overall profitable. However, when the acquisition costs are allocated between new clients and renewals, the allocation to new clients makes their contracts onerous. Also, what can be drawn from this example is that the major part of the acquisition costs is attributed to renewals of the contracts from a commercial perspective.

EFRAG's simplified case study

5 Some respondents indicated that the IFRS 17 requirements do not reflect either the long-term business model of insurers or the economic reality of transactions as this

requirement would likely result in onerous contracts. They stated that there are high acquisition costs relating to the first premiums payment, however, they expect that the business will renew thereby recuperating the initial acquisition costs.

6 A respondent stated that due to the CSM being released over a very long period of time for annuity business, IFRS 17 would cause a significant mismatch between the expenses being incurred and the CSM being released to pay for those expenses.

7 Another respondent indicated that since this requirement would lead to onerous contracts, this respondent would expect some changes in products and product trends.

EFRAG Board basis for identifying this issue

8 In identifying this issue as one that merited further consideration by the IASB, the EFRAG Board notes that acquisition costs are frequently incurred on the expectation, based on experience, that contracts will be renewed. It can be argued that reflecting this industry practice in the financial statements would contribute to providing relevant information for users. The EFRAG Board also notes that the unit of account for IFRS 17 purposes is not a single contract but a group of contracts. While there might be a high level of uncertainty as to whether any single contract will renew, expected renewal patterns can be estimated with more confidence at a higher level of aggregation.

9 The EFRAG Board notes that one of the IASB's arguments for the approach required by IFRS 17 is that *"… an entity typically charges the policyholder a price the entity regards as sufficient to compensate it for undertaking the obligation to pay for insured losses and for the cost of originating the contracts*" [IFRS 17 paragraph BC176]. The EFRAG Board believes that the case study findings described above cast doubt on this assertion.

10 Further, during our outreach, EFRAG has heard that that the current requirements of IFRS 17 could affect industry commissions and pricing practices. The EFRAG Board has not ascertained whether any forthcoming changes to current practices would result solely from the application of IFRS 17 or could also be affected by other factors.

11 The EFRAG Board acknowledges that markets are in a state of flux with various disruptive technologies, including artificial intelligence. It is not clear to the EFRAG Board whether such influences will affect the reliability of estimated future renewal patterns based on past experience.

12 The EFRAG Board noted that, if IFRS 17 were changed to defer the expensing of acquisition costs on the expectation of contract renewals, it may be necessary to introduce some form of impairment requirements, which would add complexity to IFRS 17.

B. CSM Amortisation

Description of issue

13 Whilst constituents agree with the IASB's decision to include investment services as a driver for coverage units for the Variable Fee Approach ('VFA'), there is a view that this should also apply to some contracts under the General Model. The concern is that profit recognition based solely on the provision of insurance coverage does not provide a faithful representation of the insurer's performance for certain products that are not eligible for the VFA but that still include an investment service.

Findings from the case studies

EFRAG's extensive case study

14 The evidence obtained included the following.

15 For ten of the twenty-six portfolios tested under the General Model, concerns were raised that investment services should be considered in contractual service margin ('CSM') amortisation by seven respondents. Of these ten portfolios, eight were annuity products, the remainder was an indirect participating contract and a savings type product. Information about the CSM release per cohort was not provided for these products.

16 One respondent calculated the CSM release based on actual insurance cash flows as suggested by the IASB's IFRS 17 Transition Resource Group ('TRG'), i.e. CSM release only during the insurance coverage period of the annuities. In this case more than 60% of the CSM was released over years 25-30 of a 30-year annuity contract.

17 Respondents expressed support for the proposed IASB amendment to IFRS 17 to include investment services when allocating CSM under the VFA.

EFRAG's simplified case study

18 Two respondents indicated that not including the investment services in the coverage units would bring profit recognition forward ("upfronting"). For example, one of these respondents has a significant block of unit-linked products for which the insurance services (in this case, accidental death benefits) are provided on a temporary basis, while the provision of investment related services continues until the expiry of the contract.

19 One respondent indicated that it was not clear how CSM amortisation applies to contracts that provide both insurance and investment benefits.

EFRAG Board basis for identifying this issue

20 In identifying this issue as one that merited further consideration by the IASB, the EFRAG Board considered that some contracts that do not qualify for the VFA, in particular indirect participating contracts, involve the provision of an investment service to the policyholder as well as insurance coverage. The EFRAG Board noted that policyholders in such products share in a pool of investment returns. The EFRAG Board questions whether using insurance coverage as the only 'driver' of CSM amortisation is representationally faithful of the insurer's performance in delivering service to its policyholders.

21 For some other types of contract, such as annuities, the EFRAG Board notes that existence of an identifiable investment service is open to debate. Nonetheless the EFRAG Board also noted that some constituents express concern over the back-loading of CSM amortisation that results from the application of IFRS 17's General Model for annuities (including the lack of CSM amortisation during the accumulation and deferral phases).

22 The EFRAG Board noted that, if IFRS 17 were to be changed, guidance would be needed to define investment services and how to determine how measures of investment service and insurance coverage would interact to determine the pattern of release of the CSM. The EFRAG Board acknowledges that this could add complexity to IFRS 17.

C. Reinsurance

Description of issue

23 Constituents considered that the approach to reinsurance in IFRS 17 gives rise to the following accounting mismatches:

(a) For an underlying contract that is onerous, a cedant has to recognise a loss component through profit and loss whereas the related gain from a corresponding reinsurance contract held is deferred over the coverage period.

(b) Contract boundaries for reinsurance contracts held are inconsistent with those of the underlying insurance contracts, meaning that the reinsurance held accounting requires including an estimate of underlying insurance business that is not yet written/recognised.

24 There is a concern that the inconsistencies between insurance and reinsurance held accounting will mean that the financial statements do not appropriately reflect the net risk position after reinsurance and, as a result, will show a distorted profit recognition pattern.

Findings from the case studies

EFRAG's extensive case study

25 The evidence obtained included the following.

26 Of the respondents providing information:

(a) Some respondents provided qualitative and quantitative input.

(i) Two respondents provided an example relating to protection business that is onerous but becomes profitable after considering external reinsurance. These respondents explained that direct protection was written in collaboration with reinsurance partners for that reason. One of these respondents noted a loss of 165 to 210 mio Euro per annum recognised on day 1, with the offsetting profit, reflecting the risk transferred at reporting date, was deferred.

(ii) A respondent provided an example relating to a savings fund that was proportionally reinsured for 10%.

(iii) A respondent supported the exclusion of reinsurance assumed from the VFA. However, for intercompany purposes the respondent deemed it beneficial for reinsurance assumed to mirror the mechanics of the underlying business.

(b) Some respondents noted that the combination of direct insurance and reinsurance was not applicable to them.

27 For reinsurance contracts held, some respondents mentioned the accounting mismatch and raised concerns about the effect of intragroup reinsurance.

EFRAG's simplified case study

Onerous underlying contracts that are profitable after reinsurance

28 Of the respondents providing information, six respondents limited themselves to identifying the accounting mismatch, and one of these identified it only for proportionate reinsurance contracts held.

29 Other respondents provided the following views:

(a) IFRS 17 bases the accounting on the contract an insurer has with a reinsurer. This is viewed as breaking the matching principle. One respondent added that some insurance contracts were only underwritten depending on the ability to purchase reinsurance;

(b) The reinsurance approach in IFRS 17 was not identical to what is done in US GAAP, Solvency II and current local statutory/regulatory GAAP;

(c) The reinsurance approach in IFRS 17 could result in considerable noise to understand insurer performance and may reduce investor confidence;

(d) Retrocession was not appropriately reflected by the IFRS 17 requirements.

Contract boundary for reinsurance contracts where underlying contracts are not yet issued

30 Respondents provided the following views:

(a) The quarterly IFRS closings will be different than the aggregated monthly closings;

(b) IFRS 17 bases the accounting on the contract an insurer has with a reinsurer. This is viewed as breaking the matching principle and has effects relating to the recognition of the insurance contracts and the allowance for future new business.

(i) If the reinsurance treaty commenced before the starting date of the direct insurance contracts (which in practice can be a few years) different locked-in rates need to be used for the reinsurance contract and the insurance contract. This is not reflecting commercial realities where the same discount rate is applied to all cash flows arising from a policy to assess profitability;

(ii) The difference in contract boundary has an effect that allowance for reinsurance cash flows over the full term of the reinsurance policy has to be taken, including future new business within the contract boundary of the reinsurance treaty (typically 3 months). This is seen as not reflecting commercial reality as a policy is assessed today in its entirety; will require important changes to the current systems with an expected small financial impact and will require making assumptions for future new business.

(c) Operationally, reinsurance would typically be written at a later date than the front contract due to grouping of risk. This is often in different calendar years.

(d) IFRS 17 differs from local GAAP around the world and Solvency II and would not reflect the actual ceding percentage.

EFRAG Board basis for identifying this issue

31 In identifying this issue as one that merited further consideration by the IASB, the EFRAG Board noted the following.

Onerous underlying contracts that are profitable after reinsurance

32 While appreciating that a reinsurance contract is a separate contract from the underlying insurance contract, it appears anomalous to recognise a loss on one contract when the two contracts are related and, taken together, the net position is not onerous. Specifically, it would appear that there is an accounting mismatch with the loss on the underlying contract being recognised immediately while the profit on the reinsurance contract is deferred.

33 The EFRAG Board notes the IASB's expectation (in IFRS 17 paragraph BC310) that net gains on purchasing reinsurance will be rare. The EFRAG Board considers that its case study findings cast doubt on the IASB's expectation. The IASB's arguments do not seem to take into account the effect of separating a portfolio of underlying

insurance contracts into groups, including a group of onerous contracts. The EFRAG Board understands that reinsurance contracts held commonly relate to multiple underlying contracts some of which might be onerous at initial recognition even if the group is profitable overall.

34 The EFRAG Board noted that changing IFRS 17 would lead to the need to provide guidance on issues such as how to address any 'netting' between a reinsurance contract held and the underlying insurance contract when the risk reinsured is less than 100%. This is likely to add complexity to IFRS 17.

Contract boundary for reinsurance contracts where underlying contracts are not yet issued

35 The EFRAG Board understands that current practice is to recognise only that part of a reinsurance contract held that relates to an insurance contract that is already written. IFRS 17 may lead to a reduction in understandability as a result of recognising the entirely of the cover provided by a reinsurance contract. Further, the EFRAG Board noted that there is a question over the relevance of recognising the assets and liabilities arising from a reinsurance contract held when the underlying insurance contracts are not yet written (as this component of the reinsurance contract is, in effect, an executory contract).

D. Transition

Description of issue

36 Constituents consider the modified retrospective approach to be very restrictive and so will not provide the simplifications that make the modified retrospective approach possible in practice.

37 In addition, constituents have indicated that the option to set other comprehensive income ('OCI') to nil under the fair value approach is not available to assets accounted at fair value through OCI when applying IFRS 9 *Financial Instruments*.

38 The concern is that if the modified retrospective method is not further simplified, insurers will need to apply the fair value approach for many portfolios. These constituents also argue that whilst the fair value approach is a helpful practical expedient in some cases, it may not provide an appropriate profit recognition pattern in all cases.

39 In addition, there is a concern that setting OCI on the liabilities to nil at transition, whilst maintaining the historical OCI on related assets, will distort equity at transition and results going forward significantly.

Findings from the case studies

EFRAG's extensive case study

40 The evidence obtained included the following

41 Of the 40 portfolios where information on transition was provided:

(a) 9 used the full retrospective approach;

(b) 13 used the modified retrospective approach;

(c) 14 used the fair value approach; and

(d) 4 applied the Premium Allocation Approach.

42 For the liabilities at transition, the approaches used were as follows:

(a)	Full retrospective	5.5%
(b)	Modified retrospective	63.2%
(c)	Fair value	30.5%
(d)	PAA	0.8%

43 The following insights into the difficulties in applying the requirements of the modified retrospective approach were provided:

(a) The requirements in IFRS 17 paragraphs C12, C17(c)(i) and C17(c)(ii) to make adjustments for amounts between initial recognition and transition (or earlier) date will prove to be very difficult (three respondents)

(b) The requirement in IFRS 17 paragraph C9(a) to split portfolios by profitability group (onerous, no significant possibility of becoming onerous, other) is likely to mean that they need to identify cash flows at a lower level than the portfolio level (i.e. individual contract or sub-groups within portfolios). This significantly increases the granularity of the data required (two respondents).

(c) The requirement in IFRS 17 paragraph C10 to produce transition figures by annual cohort is potentially significantly more onerous than if cohorts can be grouped together (two respondents).

(d) The simplifications in respect of loss components in IFRS 17 paragraphs C11-C17 should be consistent between the VFA and General Model (one respondent).

(e) A respondent noted that under IFRS 17 paragraph C6 the modified retrospective approach would require taking into account the past margins, therefore it would not reflect a simple prospective vision of the insurance contracts profitability. This respondent considered the valuation of such past margins to be extremely heavy to perform precisely, looking at the reduced time available to implement IFRS 17.

(f) Another respondent is still investigating whether this approach provides sufficient simplifications to make it operationally feasible.

44 Of the fourteen portfolios measured under the fair value approach, respondents indicated the following with regards to the option of setting OCI to nil:

(a) For three portfolios OCI will be equal to the cumulative amount recognised in OCI from the underlying items.

(b) For two portfolios, OCI will be set at nil as they are not restricted by IFRS 17 paragraph C24(c) from applying the option. Also, the selected portfolios were measured under the General Model.

(c) For the remaining selected portfolios, no information was provided on the treatment of OCI at transition.

EFRAG's simplified case study

45 Regarding the modified retrospective approach:

(a) Respondents expressing concerns that this approach might be difficult to apply provided the following input:

(i) This modified retrospective approach may not result in much less efforts than the fully retrospective approach. The method still has many operational challenges in terms of data gaps, in particular the need to gather historical data and they may have to use hindsight;

(ii) This approach would not be used due to the cost as it requires to retrieve actual cash flows starting from the inception of the contracts; and

(iii) Certain disclosures appear to be unnecessarily burdensome, for example the disclosure related to the modified retrospective approach which is required even years after the transition has occurred.

46 Regarding the fair value approach:

(a) A respondent stated that the inability to reset the OCI on assets to nil may result in a significant overstatement of OCI at transition and, consequently, future IFRS profits;

(b) Another respondent stated that the application of the Fair Value Approach could be different among insurers depending on the interpretation of the "fair value" of the insurance contracts; and

(c) Another respondent indicated that certain disclosures appear to be unnecessarily burdensome, for example the disclosure related to the fair value approach which is required even years after the transition has occurred.

EFRAG Board basis for identifying this issue

47 In identifying this issue as one that merited further consideration by the IASB, the EFRAG Board retained the view that EFRAG generally supports retrospective

application of new standards. This may not be possible for insurance contracts written well before the application date of IFRS 17.

48 The EFRAG Board is concerned that the impact of the transition to IFRS 17 will be material for an extended time, given the nature of certain insurance products. The EFRAG Board supports the IASB's efforts to find a pragmatic way to introduce some form of retrospective application. However, the EFRAG Board has been advised that further simplifications to the modified retrospective approach might permit more contracts to be subject to some form of retrospective application at the date of transition.

49 The EFRAG Board acknowledges the concern about the treatment of OCI under the fair value approach while also noting that insurers can avoid any mismatch by not taking the option provided in IFRS 17.

E. Annual cohorts

Description of issue

50 Constituents have indicated that the prohibition to aggregate contracts that are issued more than one year apart is unduly complex. The concern is that the annual cohorts requirement will lead to an excessive level of granularity, major implementation challenges, and is costly.

51 The operationality of providing ‘relief’ from the annual cohort requirement for VFA contracts being included in the Basis for Conclusions rather than in IFRS 17 itself is also questioned.

Findings from the case studies

EFRAG’s extensive case study

52 The evidence obtained included the following.

Annual cohort requirement

53 Some respondents did not find material differences between the pattern of CSM release using annual cohorts and the equivalent pattern using only coverage units for specific portfolios (savings, unit-linked portfolios, fully or significantly mutualised contracts). One respondent applied the coverage units method to a fully mutualised portfolio in which the profit margin declined with 29% over a 4-year period and found little difference between using coverage units and cohorts. These respondents argued that the annual cohort requirement adds cost and complexity and is unnecessary to provide a faithful representation.

54 However, other respondents demonstrated or acknowledged that the use of annual cohorts does or at least could change the pattern of CSM release. Of those respondents that used coverage units, one noted that their findings were based on a mature portfolio and acknowledged that bundling together all cohorts may not necessarily lead to the same outcome since, as cohorts are spread over time, more differences in the volume of business, its profitability as well as in the percentage of the CSM to be recognised in a given year are observed. Another respondent noted that, even in a mutualised portfolio, material differences were found between using cohorts or coverage units.

55 Finally, a respondent used assets under management, sums insured, expected profit/variable fee as coverage units and found significantly different outcomes between the methods used.

<u>Costs relating to the annual cohort requirement</u>

56 Four respondents quantified the costs specifically associated with applying the subdivision of products into subgroups and annual cohorts:

	Millions euros	% costs over total IFRS 17 costs for respondents that quantified	# of respondents who quantified
One-off costs	19.3	between 4% and 23%	3
Ongoing costs	17.4	10% and 75%	2

57 The respondent with 23% of one-off costs indicated that this was due to the need for a contractual service margin IT module by product (that will require a “pseudo P&L” at product level).

Sharing of risks (also known as mutualisation)

58 Most respondents did not provide information about the quantification of risk sharing/intergenerational transfers or indicated they were not able to quantify that effect. Those that provided information showed very minor impacts in 2016 ranging from 0.2% till 1% of the liabilities in the portfolios measured, even when indicating that 100% of risks were being shared.

59 The following table provides an overview of the amount of the selected liabilities that were subject to risk sharing (in mio euro).

Fully sharing risks	Partially sharing risks	Benefit from intergenerational transfers
478,462	104,410	669,469

60 Two respondents provided a description for the term “intergenerational transfer”:

(a) One respondent defined intergenerational transfer as the transfer of wealth between contracts issued at different points in time.

(b) Another respondent noted that unrealised gains are used as an intergenerational transfer to support future generations of policyholders.

EFRAG’s simplified case study

61 Several respondents considered the annual cohort requirement to be burdensome and/or operationally complex. Examples of the requirements being burdensome and/or complex include:

(a) Complexity arises due to mutualisation with policyholders sharing risks between policy generations and between different policies within the same year introducing an additional effort to reallocate contracts into annual groups (six respondents). Three of these respondents highlighted that these requirements were not appropriate for VFA contracts because of intergenerational risk sharing and the asset and liability management policy;

(b) Accident year reporting and not per underwriting year is the more generally accepted practice for financial reporting (three respondents);

(c) The recognition of the time value of money effect on the level of groups of insurance contracts (two respondents);

(d) The necessary calculation steps to use the OCI option and the implementation of the CSM (one respondent);

(e) The effects of assumption changes have to be assigned to each cohort, and each cohort must be separately tracked over time (one respondent);

(f) Systems and processes will need to be developed that will split product revenue by annual cohort (one respondent); and

(g) Introduces a new disaggregation of financial information (one respondent).

62 Several respondents considered that the annual cohort requirement would not provide useful information or any potential benefit to stakeholders including users of financial statements. Some of the respondents further explained that the business is managed a much higher level that the level of granularity of IFRS 17 and/or the business model will not be properly reflected. A respondent stated that they manage their business at portfolio level and a fundamental way for insurers to manage their business is to spread risk over a longer period of time.

63 Another respondent indicated that the requirements may have an impact on the overall pricing and solidarity currently being applied.

64 On the other hand, a respondent stated that aggregation of insurance contracts on a year basis under IFRS 17 will be useful for internal and external stakeholders.

EFRAG Board basis for identifying this issue

65 In identifying this issue as one that merited further consideration by the IASB, the EFRAG Board noted that some constituents have identified the annual cohort requirement as specifically leading to significant costs. Concerns have also been raised that the societal good from inter-generational mutualisation should not be hampered by financial reporting requirements.

66 However the EFRAG Board also acknowledges the view that the annual cohort requirement provides relevant information on performance, including any onerous contracts issued, trends in profitability and any cross-subsidisation.

67 This raises the question as to whether the objective of the annual cohort requirement, in particular in relation to trend information, can be achieved at a lower cost and with less potential disruption to established mutualisation practices. For example, it might be possible to achieve some of the benefits through disclosures such as amounts held for future policyholders rather than through measurement.

68 Concerns have also been raised that an annual cohort may include insurance contracts with significantly different durations which may lead to an unintended degree of “smoothing” of performance, thus limiting the benefits of the information on profitability trends.

69 Some constituents have suggested that IFRS 17 would be clearer if the relief from the annual cohorts requirement for VFA contracts were to be included in IFRS 17 rather than being mentioned only in the Basis for Conclusions.

F. Balance sheet presentation

Description of issue

71 IFRS 17 requires a group of contracts to be presented as an asset or a liability. Constituents have indicated that currently, different components, such as claims liabilities to be settled, unearned premiums, receivables/payables, etc are managed separately and administered in different systems. Groups of contracts as defined in IFRS 17 may frequently switch from an asset to liability position.

72 EFRAG has been informed that the approach required by IFRS 17, which only impacts presentation, would require major and costly system changes compared to the current approach. IFRS 17 would also lead to insurance receivables, policy loans and reinsurance collateral (funds withheld) no longer being separately visible on the balance sheet.

Findings from the case studies

Separate presentation of assets and liabilities

EFRAG's extensive case study

73 A respondent indicated that the cost of compliance with this requirement was estimated to be between 21 and 27 million Euros, representing between 9 and 12% of this respondent's one-off costs.

74 Comments/explanations from the other respondents were:

(a) A respondent confirmed the concerns on tracking groups of insurance contracts if they are in an asset or a liability position, via modelling of their testing.

(b) A number of respondents provided qualitative comments summarised as follows:

(i) This requirement will require integration – at insurance contract group level – administration, technical accounting, actuarial, claims and cash management systems. All these systems are running at different granularity levels and reconciliation of information is granted only at a higher level than the group.

(ii) The requirement to present groups of insurance contracts distinguishing those that are assets and those that are liabilities requires duplication of all accounts related to the Insurance contracts liabilities in the Chart of Accounts and posting schemes between the feeder systems and the accounting systems to capture all possible scenarios.

EFRAG's simplified case study

75 Respondents did not support the requirement for separate presentation of groups of contracts that are asset and groups of contracts that are liabilities because the requirement will:

(a) add complexity and costs without providing clear or only limited benefits for stakeholders;

(b) lead to less understandability;

(c) reduce the flexibility to follow risk sharing;

(d) require significant changes to cash and policy administration systems in order to produce premium information at a granular enough level to calculate the liability for remaining coverage separately for groups of insurance contracts in an asset position and in a liability position;

(e) not accurately represent the economics of the transactions; and

(f) require additional changes in IT systems and processes.

Non-separate presentation of receivables and payables

EFRAG's extensive case study

76 A respondent quantified estimates of the cost implications of prohibiting separate presentation of receivable and payables as being in a three-digit million Euro range in order to link payment information with cash management systems or to change the mechanics of policy administration systems

77 Comments/explanations provided by other respondents were:

(a) A respondent indicated, supported by one of the portfolios, that there would be a lack of transparency and undue cost;

(b) A number of respondents provided qualitative comments explaining the issue which can be summarised as follows:

(i) Under IFRS 17, liabilities have to be calculated at the level of group of contracts and have to be netted from receivables due by policyholders from this same group of contracts. The netting has to be done on a cash basis, which is not possible in the timeframe of an accounting closing.

(ii) Insurance accounting systems are equipped to know what is due from each client on a given date whilst cash is managed on a global basis and not on a client basis. In practice, this is because, based on contract terms, it is possible to know in advance when a client has the obligation to pay what is owed to the insurance company but it is not possible to know with certainty in advance when the client will pay (at least when considering the short timeline of an accounting closing). As a consequence, measuring liabilities on a cash basis is not manageable without significant IT changes.

(iii) Actuarial systems today are not set-up to model data stemming from the cash management systems. Modelling is based on data from the technical feeder systems with no granular link to the cash management systems. Balancing of receivables and payables and reconciliation with the cash management system is dealt with in the general accounting systems. Nevertheless, during the stretched timeline of the closing process of our IFRS consolidated financial statements, this reconciliation is performed at a much less granular level than the group of contracts level.

(iv) In the case study, one respondent used an allocation key for each portfolio for receivables and payables, as the IASB staff proposed in the paper preceding the May 2018 TRG meeting. While that might be considered a feasible simplification, they had encountered difficulties. This respondent also stated that this approach does not reflect the actual receivables and payables of the group of contracts and would lead to a systematic underestimation of the related receivables and payables for new annual cohorts.

Insurance funds withheld

78 Some respondents from the case studies mentioned the lack of clarity whether funds withheld should be included in the fulfilment cash flows. In addition, the issue is similar to the above issue relating to separate presentation of receivables and payables.

EFRAG Board basis for identifying this issue

79 In identifying this issue as one that merited further consideration by the IASB, the EFRAG Board noted the anomaly in IFRS 17. That is, requiring separate disclosure of groups of contracts in an asset position and groups of contracts in a liability position appears onerous and unlikely to lead to relevant information, given that each group can contain a mix of individual contracts in an asset position and in a liability position. Further, this separation will not necessarily provide useful information about exposure to credit risk, liquidity risk or solvency risk.

80 The EFRAG Board was also advised that it may be difficult for users to understand that this requirement does not identify that groups of contracts in an asset position are onerous. Further, the non-separation of receivable and payables will eliminate information that was considered useful in the past.