IFRS 17: Impact on long-term investment
Issues Paper

Objective

1 The objective is for the EFRAG Board to consider the impact of IFRS 17 *Insurance Contracts* on long-term investment.

Background

2 The EFRAG Secretariat conducted further research into the investments of European insurance entities[1] with equities listed on a regulated market.

Table 1: Analysis of investments by listed European insurers:

Type: debt versus equity		Classification	
Equity and equity type investments	1,020	Available-for-sale investments	2,333
Fixed and variable debt instruments	3,147	Held-to-maturity investments	75
Not classified	412	Trading investments	2,171
Total	**4,579**	**Total**	**4,579**

All amounts in EUR billions

Table 2: Analysis of investment type by country:

	Equity investments	Debt investments	Not classified	Total
United Kingdom	606	716	74	1,396
France	215	813	6	1,034
Germany	83	742	124	949
Netherlands	19	404	51	474
Italy	76	247	139	462
Belgium	5	61	-	66
Spain	4	44	4	52
Other countries	12	120	14	146
Total	**1,020**	**3,147**	**412**	**4,579**

All amounts in EUR billions

[1] The information was extracted using the S&P CapitalIQ database.

Table 3: Analysis of the accounting classification of investments by country:

	Available-for-sale	Held-to-maturity	Trading	Total
United Kingdom	64	-	1,332	1,396
France	718	10	306	1,034
Germany	787	27	135	949
Netherlands	367	7	100	474
Italy	217	1	244	462
Belgium	61	5	-	66
Spain	43	2	7	52
Other countries	76	23	47	146
Total	**2,333**	**75**	**2,171**	**4,579**

All amounts in EUR billions

EFRAG Secretariat analysis

Assessment of CapitalIQ numbers

3 As per the tables 1 and 2 above, currently more than half of investments in equities by listed European insurance entities are held by UK insurers. If all the Available-for-sale (AFS) investments are equity instruments, these would be about 10% of the total equities held by UK insurers with the rest being classified as fair value through profit or loss (FVPL) (Table 3). In discussions with UK respondents to the extensive case study, they indicated that they expect to continue to use FVPL rather than fair value through OCI (FVOCI), but this may change over the implementation period.

4 The ten insurers with the highest amounts of investments classified as AFS has total AFS investments of EUR 2,050 billion, with the top five a total of EUR 1,686 billion (Table 3). Overall, there is not a significant amount of investments classified as held-to-maturity although for individual entities it may be more relevant. The five insurers with the largest investments classified as Trading or FVPL holds in total EUR 1,687 billion in this classification, with the top ten investments equalling EUR 2,075 billion (Table 3).

Information from the extensive case study

5 At this stage of the implementation process, it is reasonable to assume that preparers have focussed on the details of IFRS 17 and have not yet necessarily considered all the implications of IFRS 9 *Financial Instruments* and its interaction with IFRS 17.

6 However, respondents to the extensive case study from France, Italy and Spain indicated concerns that given the new requirements of IFRS 9, more items will have to be carried at FVPL rather than Available for Sale (AFS) under IAS 39 today. Few details were provided, but these seem to centre around equity-like investments such as UCITs[2] and structured or complex bonds. Presumably, for the latter, any embedded derivative was separated with the host then classified separately. This option is not available under IFRS 9. Some respondents also briefly commented that FVOCI with recycling would be more appropriate for equities, but without providing further reasons or explanations. For further details, please refer to Appendix 1.

[2] Undertakings for the Collective Investment of Transferable Securities

EFRAG's project on the accounting treatment of equity instruments under IFRS 9 from a long-term investment perspective

7 During the public consultation on the assessment phase of this project, eleven insurance entities responded.

8 The top reasons for investment in equities were strategic asset mix/allocation and economic return/risk expectation; asset liability management (mainly duration and liquidity but also currency and inflation); and Solvency II capital requirements and accounting rules.

9 Seven insurance entities expect to use the FVOCI election mainly for strategic or long-term investments.

Table 4: Expected classification of equity instruments under IFRS 9

% of equity instruments for which the FVOCI election is expected to be used	Nr. of respondents
Less than 1%	1
5%-10%	1
25%-35%	-
60%-80%	1
100%	3
Not specified percentage	2
Total	***11***

10 The respondents indicated that the main factors impacting holding periods are asset/liability management/matching (duration, currency and sensitivity to inflation) and the rebalancing needs for investment strategies (for tactical reasons or passive benchmark tracking) of asset managers. Eight insurers do not expect to modify their holding period for equities following the introduction of IFRS 9. Only three entities expect to shorten their holding period to avoid the potential volatility.

11 Eight insurance entities expect to modify their asset allocation decisions, although most did not specify to what extent. They referred mainly to contracts with participation features under the VFA whilst some indicated possible shifts of significant parts of their equity portfolio from listed to non-listed/private equity entities. Some observed that returns from non-listed investments are mostly collected as dividends which are recognised in profit or loss. One insurance entity suggested that unlisted investments are less volatile. One respondent noted that it will invest less in small caps/growth stocks and other classes of alternative assets mentioned were real estate, infrastructure and entities in the renewables industry, as less volatile than other equities.

12 Some insurance entities also expect to replace part of their investments in equity instruments with credit investments, loans or bonds, but one insurance entity reported that its asset allocation decisions are not affected by accounting requirements.

13 The EFRAG letter to the European Commission[3] refers to other available sources that indicate that asset allocation is changing for a variety of reasons that do not

[3] https://www.efrag.org/News/Project-303/EFRAGs-report-to-the-European-Commission-on-the-assessment-of-the-impact-of-IFRS-9-on-long-term-investments-in-equity-instruments

relate to accounting, notably the search for yield in the prevailing economic environment.

14 The *2017 European Asset Allocation Survey* published by Mercer indicates that the weight of equity instruments decreased marginally to 30% of the total assets (representing approximately 330 billion Euros), with domestic equity representing 11%. The decrease was mostly driven by the reduction of the exposure by UK defined-benefit plans. From 2007, the weight of equities for UK plans in the survey decreased from 61% to 29% in line with a strategy of de-risking. Bonds have stayed relatively stable at 51% with other investments now representing 15% of the total allocation.

15 EIOPA published an *Investment Behaviour Report* in November 2017, which analyses the investment behaviour of European insurers over the past five years based on the submissions of supervisory data from 87 large insurance groups and four solo undertakings across 16 EU Member States. These groups are not necessarily reporting under IFRS Standards. The report identifies the following trends in Europe:

(a) a trend towards lower credit rating quality fixed income bonds with lower credit rating quality, while at the same time, there were many sovereign and corporate downgrades during the period;

(b) a trend towards more illiquid investments such as non-listed equity and loans excluding mortgages and a decrease in (the value of) property investments;

(c) an increase of the average maturity of the bond portfolio;

(d) an increase of the weight of new asset classes, such as infrastructure, mortgages, loans, real estate;

(e) a small decrease in the debt portfolio and a small increase in 'other investments' between 2015 and 2016. Equity allocation has remained unchanged. Changes in all three main investment categories from 2011 to 2016 have only been marginal; and

(f) the volume of non-unit linked and non-index linked assets has significantly increased in the last years. The majority of the insurers mentioned the intention to further extend the product range and the selling of more such products in the next three years.

Economic study

16 The [draft] economic study commissioned by EFRAG as input into EFRAG's impact analysis finds that the aggregate data from EIOPA on the investments of EU insurers (not necessarily only IFRS preparers) do not show a significant decrease in investments in debt securities at an EU wide level from 2005 to 2015.

17 Most stakeholders interviewed the economic consultants (i.e. supervisory authorities, insurers and external investors) thought that IFRS 17 alone will not impact the asset allocation of insurance undertakings. Most of the stakeholders interviewed did not consider that there would be a significant impact on asset allocation as the focus is on asset-liability management and return, but, some stakeholders disagreed and thought the combination of that IFRS 17 with IFRS 9 will have an impact on asset allocation[4]. The changes introduced by IFRS 17 and IFRS 9 are not expected to involve significant changes in accounting and investment practices to manage accounting volatility in jurisdictions where existing accounting practices tend to measure insurance contract liabilities on a current value basis.

[4] This part of the [draft] economic study is still subject to further clarification.

18 Some thought that investments in equity and structured funds will become less attractive following the adoption of IFRS 17 and IFRS 9, given the possibility of higher profit or loss volatility.

In summary:

19 In EFRAG Secretariat's view:

(a) The broad overall pattern of asset allocation among the key investment categories by European insurers has remained fairly stable over the past decade, despite significant changes in regulation and economic conditions over this time horizon. Asset allocation decisions are driven by a plurality of factors, among which external financial reporting requirements might play some part but do not appear to be a key driver.

(b) There is no indication that IFRS 17 in isolation would lead to any significant changes in European insurers' decisions on asset allocation or holding periods. However, some insurers have indicated that the combination of IFRS 17 and IFRS 9 may lead to changes. The main explanation provided relates to the removal of IAS 39's AFS category in relation to equity and equity-type instruments. Entities that are concerned the combination of IFRS 17 and IFRS 9 does not always portray the perceived economic linkage between their holdings of equity investments and some of their liabilities.

(c) EFRAG's previous investigations on the use of the AFS category found that there is a high level of concentration of holdings of instruments classified as AFS in a relatively small number of entities. Some insurers make little or no use of the AFS classification and classify most or all of their equity instruments at FVPL: such entities should not be affected by IFRS 9's requirements (on the assumption that the classification does not change because of IFRS 17).

(d) There is anecdotal evidence that investments in structured funds may become less attractive due to more significant profit or loss volatility whilst some consider the non-recycling of equity instruments measured at FVOCI under IFRS 9 to be detrimental (while FVPL would lead to unwelcome volatility).

20 At this stage, it can be said that some entities expect to modify their asset allocation decisions as a result of the combination of IFRS 17 and IFRS 9. While others do not. The extent of change expected by those entities that anticipate modifications, and the specific mechanism of effect that causes the change, is not clear.

Questions for EFRAG Board

21 Does EFRAG Board have comments on this analysis?

Appendix 1: Details of Case study responses

1 This appendix provides further details of information received from respondents in the extensive case study.

2 Under the extensive case study, respondents were asked to identify the asset-types that correspond to those liabilities and how these are accounted for today and under IFRS 17/IFRS 9. Respondents had the following remarks:

(a) Three respondents indicated that they are making use of the following measurement basis;

Asset types	**Accounted for today**	**Accounted for going forward**
Bonds	AFS (three respondents)	FVOCI
Loans	AC (one respondent)	FVPL
Equities	FVOCI (three respondents)	FVPL of FVOCI
Real estate	AC (one respondent)	FVPL
Derivatives	FVPL (one respondent)	FVPL
Illiquid instruments	AFS or cost (one respondent)	FVPL or cost
UCITS	FVOCI (one respondent)	FVPL

(b) Apart from the above, two respondents only provided their current measurement basis for their assets and did not indicate how this will change with the introduction of IFRS 9 and IFRS 17.

(i) One of the respondents indicated that apart from their one portfolio where most asset types are measured as available-for-sale investments, all these asset types are measured at FVTPL: Debt, equities, unit trusts, real estate, deposits, cash, loans, derivatives.

(ii) The other respondent noted that their government bonds are currently