IFRS 17 *Insurance Contracts* Project Update

Objective

1 The objective of this session is to:

(a) provide the EFRAG Board with an update on the discussions at the April 2019 meeting of EFRAG TEG and collect questions, if any, to raise with EFRAG TEG; and

(b) seek comments from the EFRAG Board on the project plan for the next six months.

2 The EFRAG Board's views on the EFRAG letter topics as input into the draft comment letter will be asked in the June 2019 EFRAG TEG/Board joint meeting.

A Feedback from EFRAG TEG

3 The IFRS 17 topics discussed at the April 2019 EFRAG TEG meeting comprised:

(a) Preliminary views of EFRAG TEG on issues/tentative decisions considered by the IASB at its February and certain topics from the March 2019 meeting, having noted the inputs of EFRAG IAWG on these issues; and

(b) On the basis of the wording available at this stage, preliminary views as input into the draft comment letter on the forthcoming IASB Exposure Draft of amendments to IFRS 17 *Insurance Contracts* ('ED') relating to some of the EFRAG letter topics that EFRAG IAWG and EFRAG TEG had already discussed in past meetings.

EFRAG TEG considered the following inputs of EFRAG IAWG

4 EFRAG IAWG had discussed the following at its March 2019 meeting:

(a) The IASB Transition Resource Group issues for the meeting of 4 April 2019;

(i) Investment components within an insurance contract;

(ii) Reporting on other questions submitted;

(b) The IASB's tentative decisions on the following topics:

(i) Transition: optionality and comparative information (February IASB meeting);

(ii) Transition: loans that transfer significant insurance risk (March IASB meeting);

(iii) Transition: modified retrospective approach (February IASB meeting);

(iv) Transition: risk mitigation option and OCI (February IASB meeting); and

(v) Loans that transfer significant insurance risk (February IASB meeting).

5 Regarding interim reporting considered in the TRG paper on *Reporting on other questions submitted* - item (a) (ii) above - one EFRAG TEG member observed that the outcome of the interim financial reporting issue will be dual reporting for subsidiaries and groups and noted the related costs both at transition as well as ongoing costs. IFRS 17 requires that an entity should not change its accounting estimates, made in previous interim financial statements, in subsequent reporting periods.

6 Regarding optionality and comparative information – item (b) (i) above - IFRS 17 requires one year of comparative information. One EFRAG TEG member noted that IFRS 9 *Financial Instruments* requires no comparatives but SEC registrants, who volunteer to provide such comparatives, would need to provide comparative information for two years including for profit and loss etc. This member considered that alignment between IFRS 9 and IFRS 17 would have been preferable and questioned if a cost/benefit perspective should be included. Another EFRAG TEG member noted that it was a part of the ordinary implementation efforts.

7 Regarding the risk mitigation option and OCI - item (b) (iv) above – and more generally, on hedge accounting, some EFRAG TEG members noted that additional input from EFRAG IAWG would be appropriate; an ad hoc questionnaire on hedge accounting will be published. The IASB tentatively decided to permit an entity to apply the risk mitigation option prospectively from the IFRS 17 transition date (i.e. one year before the IFRS 17 effective date of 1 January 2022). Below is a summary of the views expressed during the discussion:

(a) Some EFRAG TEG members did not agree with the tentative decision of the IASB not to allow retrospective application of the risk mitigation option at transition. They considered that it would impair comparability between existing and future risk mitigation strategies;

(b) Some EFRAG TEG members questioned whether insurance contracts would in practice be eligible for IFRS 9 hedge accounting and, particularly for fact patterns not addressed by the risk mitigation option offered by IFRS 17.

EFRAG TEG preliminary views as input into the draft comment letter on the forthcoming ED

8 The EFRAG Board, in its April 2019 meeting, agreed that the draft comment letter on the forthcoming ED should address all the changes to IFRS 17 proposed by the IASB and, where the IASB does not propose to change IFRS 17, EFRAG's views on the topics raised by EFRAG in the letter of 3 September 2018 to the IASB.

9 In its April 2019 meeting, EFRAG TEG focussed on the EFRAG letter topics, particularly on the following:

(a) CSM amortisation: contracts that include investment services;

(b) Reinsurance: onerous underlying contracts profitable after reinsurance; and

(c) Transition: extent of relief for the modified retrospective approach and challenges related to the fair value approach.

10 The remaining EFRAG letter topics will be discussed at the next EFRAG TEG meeting.

IASB tentative decisions to amend IFRS 17

<u>CSM amortisation: contracts that include investment services</u>

11 The IASB has tentatively decided that the contractual service margin ('CSM') under the general model should be amended to require allocation of CSM based on coverage units that considers both insurance coverage and investment return services. According to the IASB tentative decisions, an investment return service

can exist only when an insurance contract includes an investment component[1]. Also, one of the April Transition Resource Group topics was investment components within an insurance contract.

12 EFRAG TEG members were of view that, although the tentative decision of the IASB is a step in the right direction, the identification of investment services could be complex and requires judgement.

13 Some EFRAG TEG members noted the importance of understanding the driver(s) of CSM recognition.

14 Some EFRAG TEG members assessed that for certain deferred annuities, even though annuity payments only commence after a certain accumulation phase, there are merits in considering some form of profit allocation during the accumulation phase.

KEY FEEDBACK FROM EFRAG IAWG ON THE SAME TOPIC

15 EFRAG IAWG members, in its March 2019 meeting, discussed the example of deferred annuities in more detail. Some EFRAG IAWG members noted that the insurer should be able to recognise investment result during the accumulation period.

Reinsurance: onerous underlying contracts profitable after reinsurance

16 The IASB has tentatively decided to amend IFRS 17 to require an insurer that recognises losses for onerous contracts at initial recognition, to also recognise a gain at the same time in profit or loss on reinsurance contracts held, to the extent that the reinsurance contracts cover the losses of the underlying contracts on a proportionate basis. Such a gain would apply only to reinsurance contracts entered into before – or at the same time as – the onerous underlying contracts are issued. The amendments would apply to contracts measured under the premium allocation approach and the general model.

17 Some EFRAG TEG members questioned why the accounting treatment is different for proportional and non-proportional reinsurance. However, they noted the complexity of finding a possible accounting standard solution for aligning the accounting treatment of proportional and non-proportional reinsurance due to the difference in economic substance.

18 EFRAG TEG noted that non-proportional reinsurance would require a different and more aggregated unit of account than proportional reinsurance. EFRAG TEG considered the view of EFRAG IAWG that the impact of reinsurance could be captured by a risk adjustment for the underlying business. Some EFRAG TEG members noted that this approach would result in a form of synthetic accounting.

19 EFRAG TEG noted that it was necessary to assess the final wording of the Exposure Draft and the definition of proportional and non-proportional reinsurance before reaching a conclusion.

KEY FEEDBACK FROM EFRAG IAWG ON THE SAME TOPIC

20 One EFRAG IAWG member, in its March 2019 meeting, indicated that the IASB staff clarification on estimation of the risk adjustment will solve the issue relating to non-proportionate reinsurance. This is being followed up with members of the EFRAG IAWG.

[1] An investment component is an amount that the insurer has to pay to the policyholder in all circumstances (and not only when an insurance claim has occurred).

IASB tentative decision to largely retain the requirements in IFRS 17

Transition: extent of relief for the modified retrospective approach and challenges related to the fair value approach

21 The IASB tentatively largely retained the IFRS 17 requirements as issued for the modified retrospective approach and fair value approach, with one exception relating to the settlement of claims incurred before an insurance contract was acquired.

22 EFRAG TEG highlighted that different transition approaches could be applied within one portfolio, e.g., applying MRA and FVA to different groups within the same portfolio.

23 EFRAG TEG considered the solution proposed by the CFO Forum (to extend the relief available under the MRA) and some members considered that this proposal should be debated.

24 A few EFRAG TEG members noted the view of the EFRAG IAWG that the available information on Market Consistent Embedded Value (MCEV) could be used as an initial datapoint to estimate CSM at day one (with possible adjustments).

25 In conclusion, EFRAG TEG members agreed that a key element of the debate was the interpretation of the "reasonable and supportable information" criterion.

26 This topic will be further discussed at the next EFRAG TEG meeting.

KEY FEEDBACK FROM EFRAG IAWG ON THE SAME TOPIC

27 The main takeaway at the March 2019 EFRAG IAWG meeting was that:

(a) EFRAG IAWG members had expressed concerns around the practicality of the modified retrospective approach which may lead to increasing use of fair value on transition. The latter transition method was considered to provide financial information at transition and in subsequent periods different from the full retrospective application.

(b) They thought the proposed amendment that liabilities that relate to the settlement of claims incurred before an insurance contract was acquired could be classified as liabilities for incurred claims on transition was a step in the right direction.

28 EFRAG IAWG members expressed their concern that the modified retrospective approach it is difficult to apply in practice. Members also noted the complexities in trying to find reasonable and supportable information in order to use the different modifications, including having data gaps.

29 EFRAG IAWG noted that the application of all the modifications are costly to apply and did not necessarily produce the required result.

30 There was agreement by the EFRAG IAWG members that one should not move too far away from the principle of a full retrospective approach, however increased flexibility would allow for greater use of the modified retrospective approach.

31 Regarding the fair value approach, some EFRAG IAWG members were concerned that this approach will result in a lower CSM than a retrospective approach but did not explain why.

Question for the EFRAG Board

32 Does the EFRAG Board have any questions to EFRAG TEG on the above update?

B Project plan

33 The EFRAG Board, in its April 2019 meeting, agreed that the draft comment letter on the forthcoming ED should address all the changes to IFRS 17 proposed by the IASB and for no changes made to IFRS 17 EFRAG's views on the topics raised by EFRAG in the letter of 3 September 2018 to the IASB.

34 During the next few months the work on the IFRS 17 project will focus on preparation for the forthcoming IASB ED, with a special focus on the six topics that EFRAG identified in its letter to the IASB as meriting further consideration.

35 At its January 2019 meeting, the EFRAG Board agreed to a workplan where input from the EFRAG IAWG on the IASB's tentative decisions have been requested for purposes of both a draft comment letter and ultimately, a draft endorsement advice. EFRAG TEG considers the input received and requests further information as required. The outcome of the discussions is then reported to the EFRAG Board at its next meeting.

36 So far, the project has worked as planned:

Topic	EFRAG IAWG	EFRAG TEG	EFRAG Board
Issues discussed at the IASB meeting December 2018	January 2019	February 2019	Update February 2019
Presentation by EIOPA		February 2019	Planned: April Deferred to June
Questions from EFRAG TEG to EFRAG IAWG (new action)	February 2019	March 2019	
Issues discussed at the IASB meeting January and February 2019	February 2019	March 2019	Update April 2019
CFO Forum explanation of issues		March 2019	Update April 2019
Issues discussed at the IASB meeting February and March 2019	March 2019	April 2019	Update May 2019
Issues discussed at the IASB TRG meeting April 2019	March 2019	April 2019	Update May 2019

37 The EFRAG IAWG discussions on the IASB tentative decisions will continue in May as scheduled.

38 The discussion will be based on the available IASB's tentative decisions. The working assumption is that starting from July the discussion will be based on the Exposure Draft.

39 The remainder of the topics for discussion per the work plan is as follows:

Topic	EFRAG IAWG	EFRAG TEG	EFRAG Board
Detailed analysis of EFRAG topics	May 2019	May 2019	June 2019 joint meeting
IASB ED – preliminary discussion			June 2019 joint meeting
IASB ED draft comment letter	Consideration June 2019	Recommendation July 2019	Approval July 2019
IASB ED final comment letter	Consideration September 2019	Recommendation September 2019	Approval October 2019

Question for the EFRAG Board

40 Does the EFRAG Board have comments on the project plan?