IFRS 17 *Insurance Contracts*

SUMMARISED TECHNICAL DISCUSSION – EFRAG LETTER TOPICS

Paper 06-02 EFRAG BOARD AND TEG MEETING 4 JUNE 2019

European Financial Reporting Advisory Group

DISCLAIMER

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EFRAG BOARD AND TEG MEETING – JUNE 2019

- In preparation of the Draft Comment Letter (DCL) on the forthcoming exposure draft (ED) of the IASB's intended changes to IFRS 17 Insurance Contracts, the objective of this session is to illustrate to the EFRAG Board the results of the technical discussions of the IAWG and of TEG, collect comments and orientations where appropriate form EFRAG Board members and have a joint discussion of EFRAG TEG and EFRAG Board.
- The purpose of this document is to provide a high level summary of the status update of the technical discussions by EFRAG IAWG and EFRAG TEG according to EFRAG's project plan on IFRS 17.
- The document focuses on the issues that were included in the letter sent by EFRAG to the IASB in September 2018.
- It is intended to be used as a navigation tool to the technical papers discussed in the meetings of the two groups, thus it has to be read in conjunction with those papers.
- IAWG has discussed the topics in this paper in its meetings from January to May. TEG has discussed the same topics in March, April and May.
- EFRAG TEG members have expressed in the May meeting their preliminary views on the basis of the wording of the tentative decisions and of the IASB Staff papers. As such these views are subject to be updated once the final wording is released.

EFRAG LETTER TOPICS

Topic	Agenda Paper for the 4th June
Annual cohorts Cost–benefit trade-off	06-03
Transition - Modified retrospective approach – extent of relief	06-04
Transition - Fair value approach – challenges	06-05
Reinsurance - Onerous underlying contracts profitable after reinsurance	06-06
Reinsurance - Contract boundary where underlying contracts are not yet issued	06-07
CSM amortisation - Contracts that include investment services	06-08
Balance sheet presentation - Separate presentation of asset and liability groups	06-09
Balance sheet presentation - Non-separation of receivables and payables	06-10
Acquisition costs - Costs incurred in expectation of contract renewals	06-11

ANNUAL COHORTS

ANNUAL COHORTS - COST-BENEFIT TRADE-OFF (1/6)

IFRS 17 requirements	Insurers have to identify portfolios of contracts that are subject to similar risks and that are managed together. The portfolios are then divided into three groups: (a) onerous contracts, if any, (b) contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any and (c) other contracts, if any. A group of contracts cannot include contracts issued more than one year apart.
IASB re-deliberation (December 2018)	Some stakeholders were concerned about the requirements as they consider that: (a) the requirements will not provide users of financial statements with useful information; (b) implementing the requirements is a major challenge and the benefits do not outweigh the costs; and (c) the requirements are unnecessary because an entity can achieve the same outcome without applying those requirements. The IASB tentatively decided not to amend the requirements in IFRS 17 as it considers that the requirements provide fundamental information about trends in an insurer's profits over time; prevent onerous insurance contracts from being offset against profitable ones; and ensure that profits associated with insurance contracts are fully recognised in profit or loss over the coverage period of those contracts.
Evidence from EFRAG case studies (August 2018 EFRAG TEG meeting)	Some of the respondents did not find material differences for selected portfolios between the pattern of CSM release using annual cohorts and the equivalent pattern using only coverage units whilst others demonstrated or acknowledged that the use of annual cohorts does or at least could change the pattern of CSM release. The tested portfolios included a mutualised portfolio, where material differences were found between using annual cohorts or coverage units. Four respondents quantified the costs specifically associated with applying the disaggregation into subgroups and annual cohorts as follows: the one-off costs were 4-23% of total IFRS 17 implementation costs and the ongoing costs amounted to 10-75% of total IFRS 17 implementation costs.
Views from the insurance industry	The CFO Forum indicated that this issue relates to increased operational complexity and cost. • Prohibition to aggregate contracts issued more than one year apart results in groupings that are inconsistent with the way insurers manage their business • It will require the capture of cash flow and other data at annual cohort level and subsequent annual updating of output at each reporting date. *(Presentation of CFO Forum – March 2019)*

ANNUAL COHORTS - COST-BENEFIT TRADE-OFF (2/6)

Suggested modifications	**CFO Forum**	**ANC**
	• Remove the requirement to group contracts by annual cohorts, under the condition that contracts issued in different years would be in the same profitability group.	• Current IFRS 17 provisions (and especially IFRS 17.B67-B71) make it possible to reflect the intergenerational mutualisation, even if removing cohorts would probably better reflect the business practice as well as the contractual and legal situation. • Adding annual cohort in that context is however a very burdensome route to follow with no conceptual substance. The additional information provided does not prove to be useful but artificial. • In our view, such case has already been addressed by the board, as mentioned in IFRS 17.BC 138. We therefore suggest crystallising that exception in an amendment to annual cohorts in that specific context (see also our draft paper on the Level of Aggregation). • *Ref. to the ANC draft paper (IFRS 17 issues – Level of aggregation), second release May 2019* • *Ref. to the ANC draft paper (IFRS 17 issues – Example of level of aggregation), second release May 2019*

ANNUAL COHORTS - COST-BENEFIT TRADE-OFF (3/6)

EFRAG IAWG discussions (May 2019) *How in insurance entities measure profitability for contracts in scope of paragraph B67?*	For internal and regulatory purposes, profitability may be assessed on a 'stand-alone' basis, without 'wealth sharing'. This then can be compared to the profit on a risk sharing basis. The calculation would include the time and intrinsic value of options and guarantees. Where payments need to be made under the guarantees, the unallocated reserve or unrealised capital gains would be used. If there are insufficient funds, the shareholders would fund this; Members from other jurisdictions (Italy and Germany) confirmed that the approach was similar to that applied in France. In some jurisdictions there is no sharing of the technical risk, but the financial risk would be shared between policy holders. For UK products, the allocation to policyholders are done on the fair value of the underlying assets rather than the realised returns as done on the continent.
Comments with reference to the IASB decision to retain the annual cohort for such contracts	The objectives are not necessarily disputed, but you do not need the requirements as the 'profitability buckets' would solve the onerous contracts issue. The experience in the EFRAG Case Study where the use of annual cohorts did not make a significant difference to the calculated CSM release. For profitability trends, the most important aspect would be the profitability of new business which is visible due to the required reconciliation of CSM amounts. The allocation of CSM to annual cohorts will become mechanical and may become continuous (to resolve any 'onerous' groups as no group will be onerous until the whole population is onerous) and not lead to useful information. Removing the annual cohort the new CSM would be added to the calculation which admittedly would result in re-averaging of the CSM over time, this was not seen as a concern by members. However a member (auditor) was concerned hat removing the annual cohort would obscure relevant information about trends. It was discussed whether applying IFRS 17 at contract level would be less or more costly of applying the annual cohort requirement. IAWG members observed that at contract level it would be even more burdensome.
Can the issue be solved without changes to IFRS 17, e.g. by applying of BC 138?	BC 138 only works in the context where there is no CSM, i.e. for mutual societies only and therefore, not applicable to the contracts where shareholders share in in 80 to 90% of the returns as is the case in Europe; Proving that the difference is not material will in most cases involve having to do a calculation using annual cohorts which means that the systems have to be updated to be able to do the calculation; Questioned why this is only in the basis for conclusions.

ANNUAL COHORTS - COST-BENEFIT TRADE-OFF (4/6)

EFRAG TEG discussions (May 2019)

4 EFRAG TEG members on balance supported the IASB tentative decision to retain IFRS 17, as they considered that the annual cohort requirements in IFRS 17:

- are needed to achieve the benefits of IFRS 17, particularly in relation to information about trends in an entity's profitability over time;
- struck an appropriate compromise between costs for preparers and useful information for users of financial statements.

6 EFRAG TEG members assessed that, for contracts with intergenerational mutualisation:

- the application of the annual cohort requirement, while being operationally complex, would not necessarily provide additional useful information, as the value transfer from existing policyholders to new policyholders is an integral feature of such contracts, as recognized by the relevant local regulations;
- a solution should be provided and paragraph BC138 seemed to provide an initial direction;
- providing information about the change in profitability of new versus old business is essential.

3 EFRAG TEG members did not explicitly express a view.

Two EFRAG TEG member observed respectively that, in case of a specific treatment for intergenerational mutualised contracts,

- consequential amendments to the transitional provisions would be needed as well;
- the possible consequences of a change to IFRS 17 including the length of time for the industry to adopt IFRS 9 would have to be carefully considered.

2 observers (regulators) expressed the following respective views:

- The annual cohort requirement is a good practical expedient to aggregate contracts into groups of similar profitability in many cases, but not in all cases. For the contracts that were discussed by EFRAG TEG, the managerial discretion about how to allocate the benefits between existing and future generations was exercised with the objective to achieve a fair transfer between generations and this transfer created a smoothing effect;
- The inter-generationally mutualised contracts are a significant portion of insurance contracts. EFRAG TEG expressed two views, one of which was to consider a specific solution for such contracts. A specific solution that would contemplate indefinitely open portfolios and CSM allocated as to contracts after their coverage period would be contrary to the objectives of IFRS 17, as it would have the potential in substance to retain the limits of IFRS 4 for these contracts. In addition, in order to be as specific as possible, any proposal made by EFRAG on this issue should spell out what additional/new technical elements should have been taken into account by the IASB as part of its work on the proposed amendments.

Of the TEG members that was absent to the meeting provided subsequently written inputs supporting to ask for a standard setting solution for intergenerational mutualisation contracts.

ANNUAL COHORTS - COST-BENEFIT TRADE-OFF (5/6)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	No benefits identified for contracts under the scope of paragraph B67/71.
Cons	• Annual cohort: complying with annual cohorts is very burdensome and would not result in useful information for contracts with intergenerational mutualisation; • BC138 may be applicable or not depending on how mutualisation is defined. • BC138: proving that the difference is not material will in most cases involve having to do a calculation using annual cohorts which means that the systems have to be updated to be able to do the calculation.

ANNUAL COHORTS - COST-BENEFIT TRADE-OFF (6/6)

VIEWS OF EFRAG TEG

Impact of the IASB tentative decisions	
Pros	Annual cohorts are: • needed to achieve the benefits of IFRS 17, particularly in relation to information about trends in an entity’s profitability over time; and • struck an appropriate compromise between costs for preparers and useful information for users of financial statements.
Cons	• For contracts with intergenerational mutualisation the application of the annual cohort requirement, while being operationally complex, would not necessarily provide additional useful information, as the value transfer from existing policyholders to new policyholders is an integral feature of such contracts, as recognized by the relevant local regulations.

QUESTION FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note:

- the characteristics of “mutualisation” business model as described in paper 06-03;
- the feedback of IAWG as presented above;
- the solutions proposed by the CFO forum and the ANC as presented in the Appendix to paper 06-03;
- that TEG preliminary views indicated that members were divided in supporting the two views;
- that views expressed by the regulators as observers to EFRAG TEG discussion.

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process?

TRANSITION: MODIFIED RETROSPECTIVE APPROACH

TRANSITION: MODIFIED RETROSPECTIVE APPROACH - EXTENT OF RELIEF (1/6)

IFRS 17 requirements	IFRS 17 is applied retrospectively (FRA) unless impracticable. When impracticable an entity applies either the modified retrospective approach (MRA) or the fair value approach (FVA) . The objective of the MRA is achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. IFRS 17 describes a limited number of permitted modifications when applying the MRA .
IASB deliberation (January 2019)	Stakeholders were concerned that the existence of specified modifications prohibits to make estimates that are necessary to retrospectively apply IFRS 17 to those requirements to which the entity does not apply the specified modifications. Stakeholders asked to amend IFRS 17 to permit the use of a principle-based approach that will allow entities to develop their own modifications that they think are consistent with the objective of the modified retrospective approach. The IASB largely retained the IFRS 17 requirements as issued, with one exception relating to the settlement of claims incurred before an insurance contracts was acquired. Reasons for not amending IFRS 17: The objective of applying proxies is to achieve what the IASB thinks is the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. If an entity was permitted to apply further unspecified modifications, those additional proxies would move the outcome further away from a FRA.
Evidence from EFRAG case studies (August 2018 EFRAG TEG meeting)	**Extensive case study –** when comparing the different transition methods, most respondents identified that the full retrospective approach could not be applied because of the lack of availability of historical data due to for example IT migrations. Two respondents explained which requirements of the MRA they were not able to fulfil. The impact on retained earnings came from the elimination of (i) deferred acquisition costs and (ii) day one profit or deferred recognition of profit. **Simplified case study -** views were divided as to whether retained earnings would be impact negatively or positively. Sources of impact were recognition of CSM and risk adjustment, discounting and the recognition of loss components.
EFRAG User outreach (October 2018)	Many specialist and generalist users were uncomfortable with the range of transition approaches offered by IFRS 17 as it would cause comparability concerns and confusion. Specialist users noted the possibility of window dressing, eg double counting of profits at transition.
Suggested modifications	**CFO Forum -** Extend relief available to enable widespread capability to use the MRA and remove requirements to allocate contracts between separate profitability groupings.

TRANSITION: MODIFIED RETROSPECTIVE APPROACH - EXTENT OF RELIEF (2/6)

Suggested modifications	**ANC** - Not restricting the requirements in transition but using them as illustrative examples, for example applying a mixed FRA and FVA approach when sufficient reasonable and supportable information is not available There is no need for detailed guidance on how to apply the principle set in IFRS 17 paragraph C8, but examples may be useful. Also asked for a better explanation within IFRS 17 paragraph C8 that a retrospective approach (either FRA or MRA) does not prohibit from making estimates and further to clarify to which extent an estimates stops and becomes a departure to the retrospective approach. The ANC suggested not restricting the MRA requirements on the transition but instead presenting them as illustrative example of the principle. Consequently, when an entity: • has no reasonable and supportable information available without undue cost or effort to apply the FRA, • but has reasonable and supportable information available without undue cost or effort to modify the FRA in a way that would achieve "the closest outcome to retrospective application possible", The entity could use such modifications when applying the MRA, provided these additional modifications are duly disclosed in the notes. For instance, applying a mixed approach on transition: full retrospective as long as reasonable and supportable information is available (i.e. for the last 10 years) and a FVA as initial value for the period before, when sufficient reasonable and supportable information is not available. Introducing specific transition provisions (whatever the methodology retained) on the possibility to classify: • groups of acquired contracts (General Model vs. VFA; General Model vs. PAA) as of the date of issuance instead of the date of transfer; • as "liabilities for incurred claims" claims acquired in their settlement period before transition. *Ref: to the ANC draft paper (IFRS 17 issues – Transition), second release May 2019*
Views from the insurance industry	Implications if issues remain unresolved: (i) increase in operational complexity and cost and (ii) financial reporting impact • This will lead to increased use of fair value therefore impacting the level of comparability between old and new business. • Relevance of fair value is dependent on characteristics of the contract. (Presentation of CFO Forum – March 2019).

TRANSITION: MODIFIED RETROSPECTIVE APPROACH - EXTENT OF RELIEF (3/6)

EFRAG IAWG discussion (March 2019)	EFRAG IAWG members expressed their concern that the modified retrospective approach is difficult to apply. Members noted the complexities in trying to find reasonable and supportable information in order to utilise the different modifications. Members specifically noted that data gaps forces them to use the fair value approach. EFRAG IAWG members assessed that the relief provided for business combinations is useful.
EFRAG TEG discussion (April 2019)	• One EFRAG TEG member noted that the two approaches are different in nature and should not be compared with each other. • 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. • 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. One member noted that further modifications would enable preparers to achieve an outcome closer to the Full Retrospective Approach and that without such modifications, preparers would be forced to use a fair value approach, which will reflect a different measurement than the Full Retrospective Approach. • A few 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) and then rolled forward in accordance with IFRS 17, using information sourced from the MCEV analysis of movements (adjusted as necessary). One member considered this as a Full Retrospective Approach (built using estimates sourced from MCEV results) rather than an alternative method. • In conclusion, EFRAG TEG members agreed that a key element of the debate was the interpretation of the “reasonable and supportable information” criterion.

TRANSITION: MODIFIED RETROSPECTIVE APPROACH - EXTENT OF RELIEF (4/6)

EFRAG IAWG discussion (May 2019)	EFRAG IAWG members expressed their concern that the modified retrospective approach is difficult to apply. Members noted the complexities in trying to find reasonable and supportable information in order to utilise the different modifications. Members specifically noted that data gaps force them to use the fair value approach. The issue in practice does not relate only to the freedom to make estimates, but also to approximate the inputs needed in case of data gaps, using proxies. When asked whether the issue can be solved without amendments to the standard, the following were noted: • Most EFRAG IAWG members were of the view this is not possible; and • 8 IAWG members composed of both preparers and auditors expressed the view to support a view of changing the standard. An observer considered that this issue could be solved through implementation and practice. It was fair to rely on reasonable and supportable information. While it was expected this would result in negotiations between an entity and its auditor, there was a fear that the most strict interpretation would be retained. It would be helpful to provide a direction reducing the risk of an interpretation that is considered to be too strict.
EFRAG TEG discussion (May 2019)	• 8 EFRAG TEG members supported the IASB tentative decisions not to allow entities to develop their own modifications, as they considered that there are too many transition methods and adding more options would further reduce comparability. One EFRAG TEG member noted as well that other industries did not benefit from the flexibility that IFRS 17 offers at transition. • In order to address the implementation challenges, 6 of these members supported asking the IASB to consider adding further clarifications in the final standard about the use of estimates and assumptions in case of lack of data. Other 2 EFRAG TEG members supported as well the need for further clarification. A possible starting point for the suggested wording was to clarify that the existence of specified modifications does not preclude the normal use of estimation techniques in the MRA and that the entity is not precluded to make estimates in the FRA. • One EFRAG TEG member which supported the need for further clarification saw that it was so important to prevent that the strictest approach is used and to avoid unduly restrictions of the use of MRA that he could consider supporting an amendment to the standard. • 1 EFRAG TEG member did not explicitly express a view. • One of the TEG members that was absent to the meeting provided subsequently written inputs supporting view 2 (amendments are needed to the standard).

TRANSITION: MODIFIED RETROSPECTIVE APPROACH - EXTENT OF RELIEF(5/6)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	The relief for the business combinations is useful.
Cons	Limited applicability of MRA due to the lack of relevant data would force to use more frequently FVA which is not an approximation of the FRA, with consequences in terms of comparability between the old and the new business and in terms of meaningful information provided in the future reporting periods. The standard should be amended in order to include a principle-based objective for the MRA, to achieve the closest possible outcome to the FRA.

TRANSITION: MODIFIED RETROSPECTIVE APPROACH - EXTENT OF RELIEF(6/6)

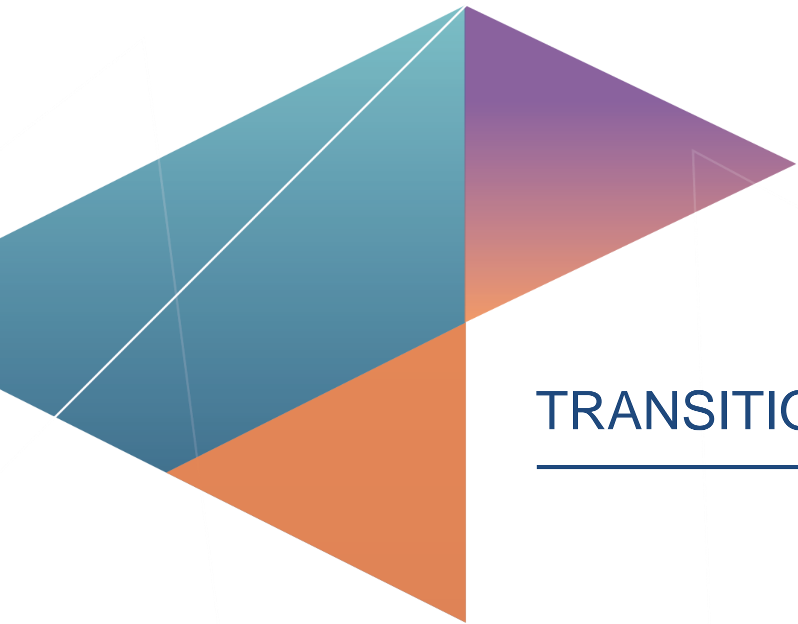
VIEWS FROM EFRAG TEG

Impact of the IASB tentative decisions	
Pros	There are too many transition methods and adding more options would further reduce comparability. Other industries did not benefit from the flexibility that IFRS 17 offers at transition.
Cons	In order to address the implementation challenges, further clarifications is needed in the final standard about the use of estimates and assumptions in case of lack of data. A possible starting point for the suggested wording: • clarify that the existence of specified modifications does not preclude the normal use of estimation techniques in the MRA; and • the entity is not precluded to make estimates in the FRA.

QUESTION FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note the views of IAWG (support view 2 - ask changes to the standard) and TEG preliminary views (8 members support view 1 and/or view 3 – ask for further clarifications in order to address the remaining interpretation challenges but do not ask for further standard setting; one member supporting view 2).

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process?



TRANSITION: FAIR VALUE APPROACH

TRANSITION: FAIR VALUE APPROACH - CHALLENGES (1/5)

IFRS 17 requirements	IFRS 17 is applied retrospectively unless impracticable. When impracticable an entity applies either the modified retrospective approach (MRA) or the fair value approach (FVA) . The FVA must be applied when an entity has no reasonable and supportable information available without undue cost or effort to apply the MRA.
Transition Resource Group (April 2019)	The submission on whether the FVA is to reflect non-performance risk is considered not meeting the submission criteria for the TRG. The issue is only indirectly related to the 'low CSM when applying fair value' issue.
Evidence from EFRAG case studies	**Extensive case study -** 14 of 40 portfolios used the fair value approach on transition for different product types. When asked about the impact on retained earnings on transition the impact was between (830mn) and 1.2bn. Reasons for the impact cited were: different valuation of insurance liabilities, impact of IFRS 9, the fact that netting of insurance contracts and associated reinsurance contracts is not permitted as well as the fact that the previous practice of recognising a day-one profit for individual annuities is no longer permitted. The measurement of the fair value at transition was mentioned as one of the 'other issues' for which time will be needed for industry and auditor consensus to emerge. **Simplified case study -** when asked about the impact on retained earnings on transition, 4 respondents (of which 3 used fair value as a transition method) noted no or non-significant impact. 5 respondents (of which 2 used fair value as a transition method) noted retained earnings would go down. No respondent noted retained earnings would go up.
Suggested modifications	**CFO Forum -** N/A **UNESPA -** The application of the FVA will not portray the profitability underlying the current business model in long-term life contracts.
Views from the insurance industry	While the fair value approach is a useful expedient in some cases, it may not always provide an appropriate profit recognition pattern. Testing indicates that this approach results in a lower CSM on transition than a retrospective approach (for onerous contracts it may result in a higher CSM). • Application of fair value can present challenges (Presentation of CFO Forum – March 2019).

TRANSITION: FAIR VALUE APPROACH – CHALLENGES (2/5)

EFRAG IAWG discussion (March 2019)	EFRAG IAWG members were divided on whether the FVA resulted in a lower CSM at transition in all cases. One EFRAG IAWG member thought so and stated that this was demonstrated in the case study, another one thought the CSM could be close to the MRA approach. On the question why under the FVA market participants would accept a lower profitability in all cases compared to an insurer itself, one EFRAG IAWG noted that when defining fair value: • It was determined based on the assumption that the buyer would not be willing to pay for the profit of the insurer; • In most cases, insurance liabilities were not bought in isolation, rather a business which was expected to deliver synergies and expectations of future business to be developed. In earlier discussions, EFRAG IAWG members noted that in many cases insurance liabilities were not bought in isolation, but with the corresponding assets.
EFRAG IAWG discussion (May 2019)	When applying the fair value approach at transition, there is concern that the CSM is low or lower than compared to the full or modified retrospective approach. It is expected that many portfolios at transition will have to apply the fair value approach. Concerns were expressed about the level of judgement of measuring at FV insurance liabilities in the absence of a substantial market activity in order to observe fair values. Some preparers agreed that the fair value calculation resulted in a broader range of profitabilities. Some members observed that the fair value approach and full retrospective approach are two different concepts and mentioned the acquisition costs as one example of difference in the two approaches. Auditors noted that: • A fair value approach gives room for adjustments when duly justified, currently preparers are too strict in their application of fair value; • The profitability in a fair value approach should be the profitability of new business; • Current fair value calculations rely too much on actuarial and Solvency II calculations. A preparer noted that paragraph C20 of IFRS 17 was too strict in explaining what fair value implies. In accordance with paragraph C20 fair value (sic) is seen as the difference of the fair value of insurance contracts at transition date and the fulfilment value of insurance contracts at that date. They were looking purely at the insurance liability, no associated assets. As a result, there is no value in force (Solvency II) as only the liability was being looked, not the assets. One user noted that goodwill should not be included in the fair value calculation. It was as well considered that the unit of account in IFRS 13 is the contract liability, i.e. not the business nor the assets.

TRANSITION: FAIR VALUE APPROACH – CHALLENGES (3/5)

EFRAG TEG discussion (May 2019)	The objective of discussing this issue was partly educational and partly identifying whether further clarification was necessary on how fair value is being applied. EFRAG TEG members agreed that issues related to implementation challenges as there is a need to develop a market practice for applying IFRS 13 *Fair Value Measurement* to insurance liabilities, but there was no need to consider further clarifications or amendments to the standard, which in this case would have to be IFRS 13 rather than IFRS 17. Members noted the exit perspective and the market-approach needed in developing the estimate. They noted that it was difficult to find observable market prices and it was level 3 fair values. • One EFRAG TEG member noted the judgement attached to the calculation, similar to the judgement in applying the MRA; • One EFRAG TEG member noted that the current calculations of fair value relied too much on Solvency II inputs. In addition, it was noted that, applying IFRS 13, fair value included a profit margin. • One EFRAG TEG member observed that in their national working group fair value was not discussed in detail, as the main focus had been on how to achieve what was considered a more conceptually appropriate approach, i.e. the MRA as a proxy for the FRA. This member added that in practice applying fair value was useful in particular cases (such as onerous contracts) and allowed to show differences in magnitude of profitability; applying the FVA had the advantage of not requiring historical cash flows data. EFRAG TEG members also noted that there were some conceptual questions about applying a fair value approach such as the identification of credit or liquidity risk. It was added that the TRG could play a role in discussing examples of how to apply fair value to insurance liabilities. One EFRAG TEG member noted that the use of level 3 fair values strengthened the case for a relaxation of the MRA.

TRANSITION: FAIR VALUE APPROACH – CHALLENGES (4/5)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	No positive impact identified for non-onerous contracts.
Cons	For non-onerous contracts, lower CSM compared to applying MRA or full retrospective approach .

TRANSITION: FAIR VALUE APPROACH – CHALLENGES (5/5)

VIEWS FROM EFRAG TEG

Impact of the IASB tentative decisions	
Pros	Not applicable
Cons	Issues related to implementation challenges of applying IFRS 13 to insurance liabilities.

QUESTION FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note the preliminary views from EFRAG TEG (no need to consider further clarifications or amendments to the standard in order to address the implementation challenges of applying IFRS 13 to insurance liabilities).

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process?\?

REINSURANCE – ONEROUS UNDERLYING CONTRACTS PROFITABLE AFTER REINSURANCE

REINSURANCE – ONEROUS UNDERLYING CONTRACTS PROFITABLE AFTER REINSURANCE (1/6)

IFRS 17 requirements	Onerous contracts issued by the cedant are immediately recognised as a loss in profit or loss, whereas for the reinsurance contract held by the cedant, any net cost or gain is recognised over the coverage period.
IASB re-deliberation (January 2019)	The IASB discussed the issue because of the following concern of preparers**:** This IFRS 17 requirement gives rise to accounting mismatches. The IASB tentatively decided to amend the requirements in IFRS 17 so that an entity can recognise a gain for reinsurance contracts held in profit or loss when the entity recognises losses on onerous underlying insurance contracts to the extent those losses are covered on a proportionate basis.
Evidence from EFRAG case studies (August 2018 EFRAG TEG meeting)	**Extensive case study** – 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. Some respondents mentioned the accounting mismatch and raised concerns about the effect of intragroup reinsurance. **Simplified case study** - Of the respondents providing information, six limited themselves to identifying the accounting mismatch, and one of these identified it only for proportionate reinsurance contracts held.
EFRAG User outreach (October 2018)	Concerns were raised by some specialist users regarding: - the mismatch for a primary insurer who obtains reinsurance, how that will work and whether users would be able to understand; - the mismatch between reinsurance and insurance not considered helpful and the net position would be preferred. Reinsurance and insurance are not considered separate businesses: the net effect is considered.
Suggested modifications	**CFO Forum** – For onerous contracts at inception, recognise a gain on proportionate reinsurance to the extent reinsurance covers the loss. **ANC** - Immediate recognition of the gain on reinsurance. The recognition of reinsurance contracts held and their related CSM is closely related to the recognition of the underlying contracts. There is no reason for differentiating proportional from non-proportional reinsurance held even if the measurement of the latter may prove more complex. *Ref. to the ANC draft paper (IFRS 17 issues – Reinsurance), second release May 2019*

REINSURANCE – ONEROUS UNDERLYING CONTRACTS PROFITABLE AFTER REINSURANCE (2/6)

1st EFRAG IAWG discussion (February 2019)	EFRAG IAWG members were generally positive about the tentative decisions taken. Practice would have to determine what proportional reinsurance meant. The situation where direct insurance was reinsured through both proportional and non-proportional reinsurance would have to be analysed. Further accounting solutions were to be developed for non-proportional reinsurance.
Views from the insurance industry	The change is expected to solve the issue for proportional reinsurance. (Presentation of CFO Forum – March 2019).
2nd EFRAG IAWG meeting (March 2019)	One member at the March 2019 EFRAG IAWG meeting indicated that the impact of reinsurance when determining the risk adjustment is especially helpful in the case of non-proportionate reinsurance. Therefore, in most cases, where the primary insurance contract is onerous, having a non-proportionate reinsurance contract in place will resolve the issue.
EFRAG TEG discussion (March 2019)	The majority of EFRAG TEG members assessed that the IASB tentative decision is a step in the right direction, but some EFRAG TEG members wanted further information on the use of non-proportional reinsurance. One EFRAG TEG member noted that a first loss reinsurance treaty was not common. For excess loss reinsurance treaties, once the limit was reached it implied the insurer made a loss on the contracts and the recognition of an onerous contract was necessary.

REINSURANCE – ONEROUS UNDERLYING CONTRACTS PROFITABLE AFTER REINSURANCE (3/6)

EFRAG TEG discussion **(April 2019)**	EFRAG TEG: • Considered the input of EFRAG IAWG that further accounting solutions would be needed for non-proportional reinsurance. • Questioned why the accounting treatment is different for proportional and non-proportional reinsurance. • 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. • Noted that non-proportional reinsurance would require a different and more aggregated unit of account than proportional reinsurance. • Considered the view of EFRAG IAWG that the impact of reinsurance could be captured by a risk adjustment for the underlying business. Some members noted that this approach would result in a form of synthetic accounting. • 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.
EFRAG IAWG discussion **(May 2019)**	• Prior to the IASB tentative decisions, onerous contracts issued by the cedant were immediately recognised as a loss in profit or loss, whereas for the reinsurance contract held by the cedant, any net cost or gain was recognised over the coverage period. Preparers have indicated that this IFRS 17 requirement gives rise to accounting mismatches. A concern remains regarding the application of IFRS 17 to non-proportionate reinsurance. For one EFRAG IAWG member the non-proportional reinsurance represented 80% of their reinsurance contracts held. In the past EFRAG IAWG members indicated that the occurrence of non-proportional reinsurance was as prevalent as proportional reinsurance. • EFRAG IAWG members noted that there is a remaining issue that still exists whereby one member expressed that in practice risk mitigation strategies use proportional and non-proportional reinsurance treaties without necessarily making this distinction. One EFRAG IAWG member noted that the current IFRS 17 accounting treatment would not allow to reflect in P&L the offsetting of the two components, which was the business objective to have both types of reinsurance: non-proportional reinsurance was used to protect profit or loss at a certain level. • EFRAG IAWG indicated that the issue can be solved without amendments to the standard by considering the existence of non-proportional reinsurance in the calculation of the risk adjustment. • Two preparers support a change to the standard on non-proportional reinsurance. Other IAWG members did not support a change to the standard.

REINSURANCE – ONEROUS UNDERLYING CONTRACTS PROFITABLE AFTER REINSURANCE (4/6)

EFRAG TEG discussion (May 2019)	7 EFRAG TEG Members decided to wait for the final wording before taking a firm position. They provisionally supported the decision to amend IFRS 17 for proportionate reinsurance only and not to ask the IASB to develop specific accounting solutions for non-proportionate reinsurance at this stage. • The majority of these members were uncomfortable with the changes that were sought, because of the lack of clarity about non-proportional reinsurance fact patterns; • Some suggested to consult constituents on relevant fact patterns and information about prevalence; such information could assist the IASB to finalise the wording; • One EFRAG TEG member suggested the IASB to include in the Basis for Conclusions an illustration of the difference between proportionate and non-proportionate reinsurance; • One EFRAG TEG member considered that in practice there are many different terms and conditions not always symmetrical with the direct contracts. Accordingly, the risk mitigation strategies are difficult to frame into an accounting solution without adding complexity; • One EFRAG TEG member considered that the IASB had to consider holistically in a subsequent phase the topic of accounting for risk mitigation instead of adding single exceptions for selected fact patterns. 2 TEG Members supported to require an amendment to the standard. • One of them proposed to remove the difference between proportionate and non-proportionate; • One of them supported to develop a specific form of hedge accounting for non-proportionate reinsurance. 2 TEG members did not explicitly express a view. One observer (regulator) noted that in order to be as specific as possible, any proposal made by EFRAG on this issue should spell out what additional/new technical elements should have been taken into account by the IASB as part of its work on the proposed amendments. One of the TEG members that was absent to the meeting provided subsequently written inputs supporting view 2, ie to remove the difference between proportionate and non proportionate reinsurance.

REINSURANCE – ONEROUS UNDERLYING CONTRACTS PROFITABLE AFTER REINSURANCE (5/6)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	• Eliminates accounting mismatches for proportional reinsurance. • The impact of reinsurance on the risk adjustment for the underlying business provide a solution to a certain degree for non-proportionate business.
Cons	• Further accounting solutions needed for non-proportional reinsurance. • Clarification is needed on the definition of “non proportionate” once the final wording will be available.

REINSURANCE – ONEROUS UNDERLYING CONTRACTS PROFITABLE AFTER REINSURANCE (6/6)

VIEWS FROM EFRAG TEG

Impact of the IASB tentative decisions	
Pros	Provides a solution for proportionate reinsurance.
Cons	Does not provide a solution for non-proportionate reinsurance. Unclear definition of "non proportionate", to be assessed once the final wording will be available.

QUESTIONS FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note:

(a) the views from IAWG (only 2 members supporting view 2 (change in the standard) and the rest of the group supporting view 1 (no changes);

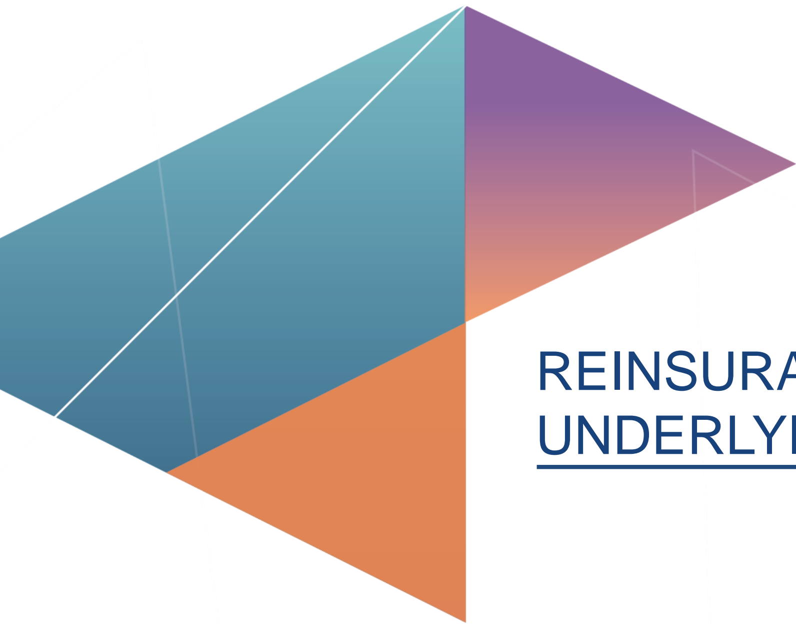
(b) preliminary views from TEG (7 members preferred to wait for the final wording before concluding and provisionally supported view 1; 2 (+1) members supported view 2 but indicated two different solutions);

(c) the proposal from TEG to consult constituents on relevant fact patterns and prevalence;

(d) the possibility contemplated in the TEG discussion that the IASB addresses holistically in a subsequent phase the topic of hedge accounting.

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process?

Do members agree that in the draft comment letter EFRAG should consult its constituents on relevant fact patterns and prevalence?



REINSURANCE - CONTRACT BOUNDARY WHERE UNDERLYING CONTRACTS ARE NOT YET ISSUED

REINSURANCE - CONTRACT BOUNDARY WHERE UNDERLYING CONTRACTS ARE NOT YET ISSUED (1/6)

IFRS 17 requirements	Contract boundaries for reinsurance are inconsistent with those of the underlying insurance contracts, meaning that the reinsurance accounting requires including an estimate of underlying insurance business that is not yet written/recognised.
IASB re-deliberation (December 2018)	Some stakeholders are concerned that the requirement is unduly complex, will create a gross up for reinsurance coverage when the direct contracts have not yet been recognised, creating a mismatch, and they think the CSM will be recognised in an inconsistent manner as compared to the direct contract CSM. The IASB tentatively decided not to amend the requirements in IFRS 17 as this would not fully reflect the substantive right to receive services from the reinsurer and the amendments would add complexity to the contract boundary requirements.
Evidence from EFRAG case studies	Some participants reported that the accounting mismatch due to the difference in contract boundaries means that IFRS 17 would not reflect the business model or risk management processes. (August 2018 EFRAG TEG meeting)
EFRAG User outreach (October 2018)	This concern was not specifically raised by constituents.
Suggested modifications	**CFO Forum -** Proportional reinsurance to include cash flows in respect of recognised underlying contracts. **ANC -** suggested that the recognition principles for reinsurance contracts are changed so that they are recognised only to the extent that the underlying contracts are recognised. *Ref. to the ANC draft paper (IFRS 17 issues – Reinsurance), second release May 2019*

REINSURANCE - CONTRACT BOUNDARY WHERE UNDERLYING CONTRACTS ARE NOT YET ISSUED (2/6)

EFRAG IAWG discussion (January 2019)	• The IASB staff example was simplistic and in more complex situations mismatches would arise. Examples of mismatches were differences in measurement model (PAA vs General Model), discount rates (and so changes to these would lead to differences in the measurement) and the risk adjustment. • EFRAG IAWG noted that the estimation uncertainty relating to the outcome of an insurance contract and the volume, mix and size of future insurance contracts to be sold, differs significantly. It may also result in undue disclosure of commercially sensitive information. • IASB approach is considered to be inconsistent to risk mitigation with derivatives (where matching is allowed even if the derivative is an independent contract to the insurance contract). • EFRAG IAWG considered that the requirements did not lead to reliable and relevant information.
EFRAG TEG discussion (February 2019)	Some EFRAG TEG members agreed with consistency in IFRS 17 for reinsurance contracts held and the underlying contracts therefore supporting the IASB's reasoning . However, others shared the EFRAG IAWG's concerns on the relevance of the IFRS 17 requirements.
EFRAG IAWG discussion (February 2019)	EFRAG TEG asked EFRAG IAWG to provide further information on possible risk adjustment mismatch between underlying contracts and reinsurance contracts held. • Several factors may impact the risk adjustment amount including: − that different risks (or only some of the risks) may be reinsured, − differing contract boundaries (but may be immaterial) and − uncertainty as to whether risk adjustment includes the risk of non-performance of reinsurer or not. Also the inclusion of cashflows on business not written yet, leads to accounting mismatches when discount rates change.
Views from the insurance industry	Implications if issues remain unresolved would result in an increase in operational complexity and cost; and financial reporting impact (Presentation of CFO Forum – March 2019). • Differences in measurement between reinsurance contracts held and the underlying contracts reduces transparency • Accounting mismatches when discount rates change over time.

REINSURANCE - CONTRACT BOUNDARY WHERE UNDERLYING CONTRACTS ARE NOT YET ISSUED (3/6)

EFRAG IAWG discussion (May 2019)	There is a concern that the reinsurance contract held will include cash flows relating to those future underlying contracts. However, cash flows within the boundary of the underlying contract issued do not include these contracts expected to be issued in the future. Some EFRAG IAWG members have indicated that this issue impacts the quality of information, i.e. relevance, for e.g., there would be an impact in P&L and CSM would be blown up on the Balance Sheet. They indicated as well that the resulting accounting would be diverging from Solvency II and managerial reporting, thus adding complexity to derive from the systems the required accounting figures. Some EFRAG IAWG members indicated that this issue is not a top priority one. Some EFRAG IAWG members indicated that the industry is trying to cope with this IASB requirement. One member indicated that the issue cannot be solved with a marginal change to the standard. 6 preparers supported a change being made to the standard while one did not support a change to the standard. Two members did not support a change to the standard.

REINSURANCE - CONTRACT BOUNDARY WHERE UNDERLYING CONTRACTS ARE NOT YET ISSUED (4/6)

EFRAG TEG discussion (May 2019)	5 EFRAG TEG members supported the IASB decision to retain IFRS 17, mentioning the following reasons: • The need to depict the rights and obligations under the contract; • The issue is broad as there are many different types of reinsurance contracts (e.g. there could be issues relating to proportionate versus non-proportionate reinsurance) and allowing for an exception could offer structuring opportunities; • There is no impact on the balance sheet but there is a difference in the split between the fulfilment cash flows and CSM for reinsurance contracts held compared to the underlying contracts. The CSM for the reinsurance contracts held would reflect future expected contracts and this provides useful information for investors. The price to obtain reinsurance is more volatile than the price charged to the policyholders. Investors would like to know how well protected the insurers are; • One EFRAG TEG member considered that the linkage with the previous issue (symmetric accounting for non-proportionate reinsurance contracts) related to the possible need for a holistic approach to hedge accounting in a subsequent phase. There is a need for a robust hedging model, instead of fixing single issues. 2 EFRAG TEG members supported the need to amend the standard in order to align the contract boundary of the reinsurance contracts to that of the underlying contracts. The following reasons were mentioned: • There was a conceptual issue on whether symmetry should be between the reinsurer and insurer or between reinsurance contracts held and the underlying contracts; • There is no impact on the balance sheet and probably not a significant impact on profit or loss. Therefore, one should not increase complexity by adding future contracts within the contract boundary of reinsurance contracts held; and Some EFRAG TEG members considered that it would be appropriate to consult constituents, as these members needed to understand the magnitude of the issue. 4 EFRAG TEG members did not explicitly express a view. One of the EFRAG TEG members that was absent from the meeting provided subsequently written inputs supporting the need to amend the standard order to align the contract boundary of the reinsurance contracts to that of the underlying contracts. One observer stated that in order to be as specific as possible, any proposal made by EFRAG should spell out what additional/new technical elements should have been taken into account by the IASB as part of its work on the proposed amendments.

REINSURANCE - CONTRACT BOUNDARY WHERE UNDERLYING CONTRACTS ARE NOT YET ISSUED (5/6)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	The issue cannot be solved with a marginal change to the standard.
Cons	The inconsistency in the contract boundary of reinsurance (including future business) and underlying contracts (recognized contracts only) result in accounting treatment that would be diverging from Solvency II and managerial reporting, thus adding complexity to derive from the systems the required accounting figures.

REINSURANCE - CONTRACT BOUNDARY WHERE UNDERLYING CONTRACTS ARE NOT YET ISSUED (6/6)

VIEWS FROM EFRAG TEG

Impact of the IASB tentative decisions	
Pros	Need to depict the rights and obligations under the contract. CSM for the reinsurance contracts held would reflect future expected contracts and this provides useful information for investors.
Cons	The different contract boundary will not have impact on the balance sheet and probably will not have a significant impact on profit or loss. Therefore, one should not increase complexity by adding future contracts within the contract boundary of reinsurance contracts held.

QUESTION FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note that:

- in both EFRAG IAWG and EFRAG TEG both views attracted support of members of that groups (view 1 supported by 2 EFRAG IAWG members and by 5 EFRAG TEG members; view 2 supported by 6 EFRAG IAWG members and by 2 EFRAG TEG members);
- that 4 EFRAG TEG members did not explicitly express a view at this stage; and
- some EFRAG TEG members suggested to consult constituents on this issue.

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process??

Does the EFRAG Board agree to consult constituents on this issue?

CSM AMORTISATION

CSM AMORTISATION – CONTRACTS THAT INCLUDE INVESTMENT SERVICES (1/6)

IFRS 17 requirements	Under the General Model, CSM is amortised to profit or loss over the period during which the entity provides coverage for insured events based on insurance coverage only.
IASB deliberation (January 2019)	The IASB discussed the issue because of the following concern of preparers: IFRS 17 requirements are only appropriate for certain types of contracts. CSM cannot be amortised over the period in which investment services are provided.
	The IASB tentatively decided to amend the requirements in IFRS 17 so that in the General Model, the CSM is amortised in profit or loss based on both insurance coverage and investment return service (only if an investment component exists).
Evidence from EFRAG case studies **(August 2018 EFRAG TEG meeting)**	**Extensive case study -** For ten of the twenty-six portfolios tested under the General Model, concerns were raised that investment services should be considered in CSM amortisation by seven respondents. One respondent calculated the CSM release based on insurance coverage of annuities and more than 60% of the CSM was released over years 25-30 of a 30-year annuity contract. **Simplified case study -** Two respondents indicated that not including the investment services in the coverage units would bring profit recognition forward.

CSM AMORTISATION – CONTRACTS THAT INCLUDE INVESTMENT SERVICES (2/6)

EFRAG User outreach (October 2018)

Nine specialist users noted that profit earned based on services provided was useful information to them. One user thought it was too early to tell. Of the ones that thought it was useful, the profit recognition pattern was considered more intuitive and made more sense than under current practices.

Suggested modifications

CFO Forum - CSM amortisation should reflect insurance and investment activity, including related activities performed to deliver the insurance benefits.

ANC - Extending the definition of the coverage period and the amount of CSM to be recognised in profit or loss in order to take into consideration investment-return services.

Proposed to define investment return services as the service providing the policyholder with access to an investment return that would not otherwise be available to the policyholder because of the amounts invested, liquidity, complexity and expertise.

Ref. to the ANC draft paper (IFRS 17 issues – CSM allocation to investment services), second release May 2019

1st EFRAG IAWG discussion (February 2019)

EFRAG IAWG members indicated that the IASB was moving in the right direction but further work needed to make the amended requirements work in practice.

Some EFRAG IAWG members indicated that there are situations where there is an investment-related service but no investment component or vice-versa.

With reference to some specific fact patterns such as certain UK Annuities, it was questioned what service is being provided to the policyholder.

Some members considered that profits should be recognised in the accumulation phase and not only during the insurance coverage period.

CSM AMORTISATION – CONTRACTS THAT INCLUDE INVESTMENT SERVICES (3/6)

Views from the insurance industry	Implications if issue unresolved – financial reporting impact and decrease in comparability amongst reporting entities. (Presentation of CFO Forum – March 2019). • Current solution does not address the issue for all contract types, e.g., deferred annuities • For contracts with significant related activities but no investment component, the pattern of profit recognition will not reflect the provision of services • Comparability – economically similar contracts treated differently • Increased use of APMs
EFRAG TEG discussion (March 2019)	EFRAG TEG members generally assessed that the IASB tentative decision is a step in the right direction. EFRAG TEG members had no remarks on the comments of EFRAG IAWG members.
EFRAG TEG discussion (April 2019)	EFRAG TEG members discussed different types of annuity contracts and considered the presence of an investment service component in such contracts. 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. Some members noted the importance of understanding the driver of CSM recognition. Some members assessed that for certain deferred annuities, even though annuity payments only commence after a certain accumulation phase, there are merits to consider some form of profit allocation during the accumulation phase.

CSM AMORTISATION – CONTRACTS THAT INCLUDE INVESTMENT SERVICES (4/6)

EFRAG IAWG discussion (May 2019)	On the basis of the IASB tentative decisions in January 2019 for some contracts, such as deferred annuities, the CSM could not be amortised over the period in which investment services are provided. On the basis of the IASB tentative decision in May those EFRAG IAWG members who had this issue have indicated that, subject to the wording of the upcoming Exposure Draft, the issue has been resolved. Some EFRAG IAWG members questioned the meaning of certain criteria in assessing whether an investment return service exists: (a) What was meant by a positive investment return; and (b) What was meant by a right to withdraw an amount.
EFRAG TEG discussion (May 2019)	EFRAG TEG indicated that, before expressing a final view, the final wording of the criteria in assessing whether an investment return exists is needed. 9 TEG members agreed with the tentative decisions of the IASB including the decision taken in May 2 TEG members did not explicitly express a view.

CSM AMORTISATION – CONTRACTS THAT INCLUDE INVESTMENT SERVICES (5/6)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	Subject to the wording of the upcoming Exposure Draft, CSM amortisation would achieve a meaningful path.
Cons	Subject to the wording of the upcoming Exposure Draft, no negative remarks arise.

CSM AMORTISATION – CONTRACTS THAT INCLUDE INVESTMENT SERVICES (6/6)

VIEWS FROM EFRAG TEG

Impact of the IASB tentative decisions	
Pros	Subject to the wording of the upcoming Exposure Draft, CSM amortisation would achieve a meaningful path.
Cons	Subject to the final wording of the criteria in assessing whether an investment return exists, no negative remarks arise.

QUESTIONS FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note that EFRAG TEG in May 2019, agree with the IASB tentative decisions, subject to the final wording.

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process?

SEPARATE PRESENTATION OF ASSET GROUPS AND LIABILITY GROUPS

SEPARATE PRESENTATION OF ASSET GROUPS AND LIABILITY GROUPS (1/4)

IFRS 17 requirements	IFRS 17 requires separate presentation of groups of insurance contracts in an asset position and those in a liability position and prohibits the offsetting of groups of insurance contracts in an asset position with groups of insurance contracts in a liability position.
IASB re-deliberation (December 2018)	Preparers were concerned that the presentation requirement in IFRS 17 would significantly increase implementation costs. Furthermore, users indicated that providing the same information on a portfolio basis would not significantly reduce the usefulness of the information. The IASB tentatively decided to amend the requirements in IFRS 17 so that the presentation of insurance contract assets and liabilities in the statement of financial position is determined using portfolios of insurance contracts rather than groups of insurance contracts.
Evidence from EFRAG case studies	Three respondents considered this requirement to be one of the significant cost drivers; Two respondents indicated that the complexity of IFRS 17 in this area cannot be justified by a reduction in the costs of application; Scenarios where groups may be temporarily in asset position: claims have been incurred, but still a period of receiving premiums and claims have been paid, but recoveries such as subrogation are still outstanding.
EFRAG User outreach (October 2018)	One specialist user considered that separate presentation of groups of contracts in asset and liability positions could be useful but not necessarily essential. One generalist user noted that it is useful to limit the netting of groups of contracts that are in an asset position and groups of contracts that are in a liability position as netting can obscure important information.
Suggested modifications	**CFO Forum -** remove the requirement and require separate disclosure for liability for remaining coverage and incurred claims as well as the related amounts for reinsurance held. **ANC –** Delete reference to groups *Ref. to the ANC draft paper (IFRS 17 issues – Balance sheet presentation), second release May 2019*

SEPARATE PRESENTATION OF ASSET GROUPS AND LIABILITY GROUPS (2/4)

EFRAG IAWG discussion (January 2019)	Some EFRAG IAWG members stated that the proposed amendments were feasible by using simplifications. It was noted that groups of insurance contracts are static as they are created from inception, however portfolios can change over time. EFRAG IAWG members agreed with the IASB's tentative decision as an improvement over IFRS 17, however, they do not consider that the information on portfolio level adds value or are useful for users.
EFRAG TEG discussion (February 2019)	EFRAG TEG assessed that the IASB's tentative decision is a step in the right direction.
Views from the insurance industry	The IASB proposal to present these a portfolio rather than "group" basis for this requirement went some way to addressing the issue although operational challenges still remain.(Presentation of CFO Forum – March 2019).
EFRAG TEG discussion (May 2019)	EFRAG TEG members noted that EFRAG IAWG members fully agreed with the IASB's tentative decision that the presentation of insurance contract assets and liabilities in the statement of financial position should be determined using portfolios of insurance contracts rather than groups of insurance contracts. All EFRAG TEG members present (11) agreed, with one member pointing out that given that most portfolios are likely to be in a liability position, the outcome is unlikely to differ from considering this on an entity rather than portfolio basis.

SEPARATE PRESENTATION OF ASSET GROUPS AND LIABILITY GROUPS (3/4)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	Useful simplification.
Cons	N/A

SEPARATE PRESENTATION OF ASSET GROUPS AND LIABILITY GROUPS (4/4)

VIEWS FROM EFRAG TEG

Impact of the IASB tentative decisions	
Pros	The relief to allow separate presentation of portfolios in an asset and liability position is helpful.
Cons	N/A

QUESTION FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note the views of EFRAG IAWG and TEG support the changes proposed by the IASB.

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process?

NON-SEPARATION OF RECEIVABLES AND PAYABLES

NON-SEPARATION OF RECEIVABLES AND PAYABLES (1/6)

IFRS 17 requirements	IFRS 17 will require separate presentation of portfolios of insurance contracts in an asset and liability position. This is on the basis of all the cash flows expected to arise from fulfilling the contracts in the portfolio, including premiums receivable and claims payable. IAS 1 permits disaggregation where this provides useful information.
IASB re-deliberation (December 2018)	Insurers are concerned about the loss of information as the IFRS 17 requirements will remove items currently commonly presented on the face of the balance sheet such as premium receivables, policy loans and reinsurance collateral (funds withheld) as well as claims payable. The IASB tentatively decided not to amend the requirements in IFRS 17 consistently with the fundamental measurement principle i.e. a current estimate of all expected cash flows within the contract boundary. The balance sheet reflects the combination of rights and obligations created by the contract as a whole.
Evidence from EFRAG case studies (August 2018 EFRAG TEG meeting)	(a) One respondent assessed with evidence of one portfolio that there would be a lack of transparency and undue cost; (b) Four respondents indicated that this was an issue and highlighted the following practical considerations: (i) Meeting reporting deadlines given the lack of granular interaction between modelling and cash systems. (ii) Due to the lack of granular information about receivables at contract level in the reporting systems, an allocation method would have to be defined. The weighting of a group of contracts and its allocations would change over time and allocations could lead to a systematic underestimation of receivables and payables for new annual cohorts.
EFRAG User outreach (October 2018)	No specific input received.
Suggested modifications	**CFO Forum -** require separate disclosure for liability for remaining coverage and incurred claims as well as the related amounts for reinsurance held. **ANC -** Present separately premium receivables, liabilities for remaining coverage, contractual service margin, liabilities for incurred claims and collateral in the B/S rather than the notes. *Ref. to the ANC draft paper IFRS 17 issues – Balance sheet presentation), second release May 2019*

NON-SEPARATION OF RECEIVABLES AND PAYABLES (2/6)

IAWG discussion (January 2019)	• The lack of granular mapping between actuarial and accounting at a group level is a significant challenge. Member generally considered the cost of IFRS 17 presentation requirements to be greater than the benefits. One member mentioned a cost of 20 million euros to reflect cash amounts required for the roll-forward disclosures. • Prefers current accounting practice even if terminology for premiums receivable is inconsistent. These are currently separate units of account unlike IFRS 17. One member thought IFRS 9 impairment should apply to premium receivables. One member stated that IFRS 17 reduces relevance as different components have different levels of uncertainty. • One member mentioned that IAS 1 may allow disaggregation of line items and users would want a harmonised approach which would require standard-setting (requirement versus optionality). • One member reported that for reinsurance business (but not only this) IFRS 17 requirements would require arbitrary allocations due to netting arrangements.
TEG discussion (February 2019)	• Some EFRAG TEG members considered that including premiums receivable and claims payable in the insurance contract asset/liability is consistent with the bundle of rights and obligations associated with an insurance contract as a whole. • Other EFRAG TEG members disagreed and suggested to further consider the costs and benefits, relevance and whether it is only a presentation or also a measurement issue. • Certain questions were posed to the EFRAG IAWG – see next slide for the rest of the discussions.
EFRAG IAWG discussion (February 2019)	PREMIUMS RECEIVABLE: • In practice, definitions differ such as: (a) An unconditional right to receive premiums due including premiums due over more than one reporting period (as per Accounting Directive); (b) Any overdue premium as per the contract; and (c) The next contractually due premium including future instalments of an annual premium • Credit risk for life premiums are minimal, but could be higher for general insurers given the use of intermediaries, although this is mitigated by the short duration. CLAIMS PAYABLE: • The operational complexity is similar to that of premiums receivable. REINSURANCE PRESENTATION CONCERNS: • Similar operational complexity concerns as premiums receivable, with netting and funds withheld as a complicating factors.

NON-SEPARATION OF RECEIVABLES AND PAYABLES (3/6)

Views from the insurance industry	The CFO Forum considered this has financial reporting impact as the removal of insurance receivables from the balance sheet reduces the value of information presented in respect of both life and general insurers. There would also be increased complexity and cost. (Presentation of CFO Forum – March 2019).
EFRAG TEG discussion (March 2019)	• EFRAG TEG agreed separate presentation would require a definition • EFRAG TEG acknowledged operational problems relating to the lack of systems integration. • The EFRAG Secretariat noted that receivables are omitted from current IFRS 7 credit risk disclosures. Given EFRAG IAWG concerns about materiality, some EFRAG TEG members questioned the purpose of the separate presentation. • Different views as to whether further clarification from EFRAG IAWG is required. • Different views about the conceptual merits of having separate presentation.
EFRAG IAWG discussion (May 2019)	Currently, amounts such as premiums due or reinsurance amounts are disclosed separately as part of assets on the balance sheet. Under IFRS 17, these amounts form part of the liability for insurance contracts. Some are concerned about the loss of information while others indicate that there would be significant costs required to their systems in order to meet the presentation requirements of IFRS 17. This impacts all entities. Current actuarial systems only include those expected amounts that not yet considered to be due . Therefore, in order to solve the cost concern, the following would need to happen: • A definition for receivables/amounts due would need to be developed. • IFRS 17 would have to then deal with the remaining future cash flows. Preparers indicated that they may be able to solve the concern by proxies or short cuts such as including the amounts receivable in the insurance liability.

NON-SEPARATION OF RECEIVABLES AND PAYABLES (4/6)

EFRAG TEG discussion (May 2019)	7 EFRAG TEG members supported the IASB tentative decision to retain the requirements in the standard. They considered the following reasoning: • The presentation requirements in IFRS 17 were consistent with the unit of account and members agreed with the idea of presenting the bundle of rights and obligations of the insurance contract; • If separate presentation of components is deemed necessary to provide relevant information, IAS 1 provides a solution as entities may separately present on the face of the balance sheet the different components. 1 EFRAG TEG member supported the view that amending IFRS 17 to require separate presentation of premium receivables/claim payables was necessary for conceptual reasons, as the current presentation requirements were obscuring relevant information. This member did not consider that measurement consequences were attached to this issue. 3 EFRAG TEG members did not explicitly express a view.

NON-SEPARATION OF RECEIVABLES AND PAYABLES (5/6)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	Avoid the need to introduce a definition of receivables as there is no common market practice. The use of proxies may help to solve the issue.
Cons	The cost of IFRS 17 presentation requirements are greater than the benefits.

NON-SEPARATION OF RECEIVABLES AND PAYABLES (6/6)

VIEWS FROM EFRAG TEG

Impact of the IASB tentative decisions	
Pros	Consistent with IFRS 17 unit of account If separate presentation of components is deemed necessary to provide relevant information, IAS 1 provides a solution as entities may separately present on the face of the balance sheet the different components.
Cons	Obscuring information about the different nature of items. Operational complexities and cost.

QUESTION FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note the views of IAWG (the issue may be solved by proxies or short cuts) and of TEG (support view 1 to not change the standard).

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process?

ACQUISITION COSTS

ACQUISITION COSTS – EXPECTATION OF CONTRACT RENEWALS (1/5)

IFRS 17 requirements	Acquisition cash flows are directly attributable to the portfolio of insurance contracts to which the group belongs and they are within the contract boundary if they arise from substantive rights and obligations that exist during the reporting period. However, depending on specific facts and circumstances and the related assessment of substantive rights and obligations, some contract renewals may be within the contract boundary of a newly issued contract and other contract renewals may not.
IASB deliberation (January 2019)	The IASB discussed the issue because of the following concern of preparers**:** Acquisition cash flows on new business that is expected to renew cannot be allocated to future periods. This results in incorrect matching of income and expenses over time and contracts being onerous in accounting (but not in economic reality). The IASB tentatively decided to amend IFRS 17 to capitalise insurance acquisition cash flows directly attributable to expected contract renewals and recognise them until the renewed contracts are recognised. Assess the recoverability of any asset recognised applying paragraph 27 of IFRS 17 and recognise any unrecoverable amount or reversal of impairment in profit or loss.
Evidence from EFRAG case studies	Respondents noted that attributing acquisition costs to new clients only can lead to more onerous contracts and overstated future earnings. Another shared that immediate expensing can indirectly impact pricing which reflects expected renewals. (August 2018 EFRAG TEG meeting)
EFRAG User outreach (October 2018)	The specific matter was not raised as a discussion point in the individual user interviews.
Suggested modifications	**CFO Forum -** amend the wording to permit acquisition costs to be amortised over the expected economic benefit period (initial contract and expected renewals), in combination with an impairment test.

ACQUISITION COSTS – EXPECTATION OF CONTRACT RENEWALS (2/5)

Suggested modifications	**ANC** An interpretation does not appear sufficient to properly address the issue. Amending IFRS 17.27 in order to separately recognise as an asset acquisition costs that (i) actually relate to the creation of a new customer relationship, (ii) are expected to generate benefits for the initial period and subsequent periods, (iii) provided that an impairment test is performed and (iv) disregarding the date of payment. A suggested alternative solution is to assess whether contract renewals are likely to happen as expected and where they did not, the associated not yet allocated acquisition costs being then released to profit or loss immediately. If a full impairment test is preferred (as already expressed by IASB in its tentative decisions in January 2019), in our view, an onerous test should be performed only if the change in the renewal pattern introduces a significant risk of group of contracts becoming onerous. *Ref. to the ANC draft paper (IFRS 17 issues-acquisition cash flows), second release May 2019*
EFRAG IAWG discussion (February 2019)	All EFRAG IAWG members present agreed with the IASB's tentative decisions.
Views from the insurance industry	The IASB proposed amendment is expected to resolve the issue (Presentation of CFO Forum – March 2019).
EFRAG TEG discussion (March 2019)	EFRAG TEG members assessed that the IASB tentative decision is a step in the right direction. An observer raised the question how the recoverability of acquisition cash flows would be assessed. It was currently not clear whether this could be done based on future renewals of existing contracts or also future new contracts and needs to reassessed once the Exposure Draft is available.

ACQUISITION COSTS – EXPECTATION OF CONTRACT RENEWALS (3/5)

EFRAG IAWG discussion (May 2019)	EFRAG IAWG did not discuss the topic but were asked to provide written comments. When asked whether EFRAG IAWG members agree with the proposed amendments to IFRS 17, all the respondents who answered the question indicated that they agree with the assessment made. When asked whether EFRAG IAWG members consider that the recoverability of acquisition cash flows would be assessed based on future renewals of existing contracts only and not including future new contracts: • 4 respondents agreed that it should only be future renewals of existing contracts; • 1 disagreed and indicated it could also be future new contracts; and • Others did not specifically answer the question.
EFRAG TEG discussion (May 2019)	All EFRAG TEG members present (11) agreed with the proposals made by the IASB with regards to acquisition costs. However, EFRAG TEG members questioned what the final wording in the ED will be with regards to the recoverability assessment of acquisition costs. EFRAG TEG members were unsure whether the assessment will be based on future renewals of existing contracts only or future new contracts as well.

ACQUISITION COSTS – EXPECTATION OF CONTRACT RENEWALS (4/5)

VIEWS FROM EFRAG IAWG

Impact of the IASB tentative decisions	
Pros	Better reflects the economic substance of the transactions.
Cons	N/A

ACQUISITION COSTS – EXPECTATION OF CONTRACT RENEWALS (5/5)

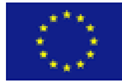
VIEWS FROM EFRAG TEG

Impact of the IASB tentative decisions	
Pros	Subject to the wording of the final standard with specific reference to the recoverability assessment, the tentative decision better reflects the economic substance of the transactions.
Cons	N/A

QUESTION FOR OF EFRAG BOARD AND EFRAG TEG

Members are invited to note the views of EFRAG IAWG and EFRAG TEG support the changes proposed by the IASB.

Based on the technical discussions presented above, what are your comments and orientation at this stage of the process??



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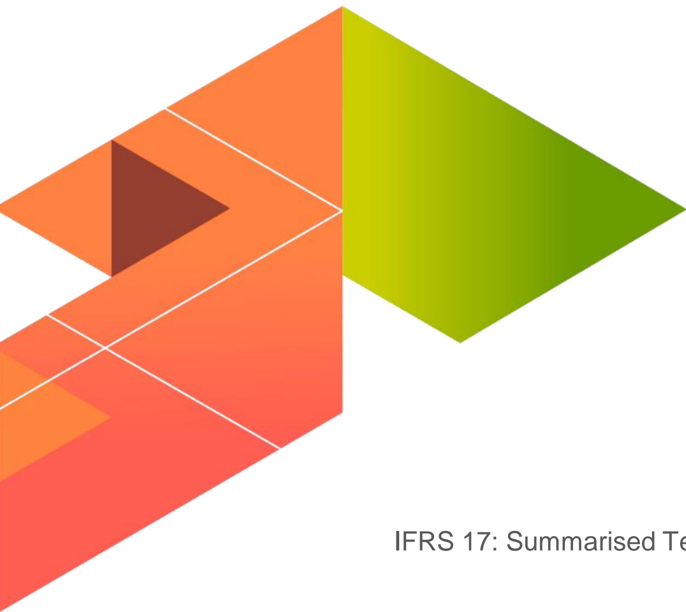
Thank you!



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