Annual cohorts
Issues Paper

Introduction

1 For the calculation of the release of the contractual service margin, the unit of account is a group of contracts. There are various aspects[1] to this definition, however, this paper focuses on the requirement in IFRS 17 paragraph 22 that a group of contracts cannot include contracts issued more than one year apart.

2 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.

3 All the members of the IASB agreed with the IASB staff proposal not to amend the level of aggregation requirements (including the requirement for annual cohorts).

4 The discussion included the following points:

(a) Several IASB members acknowledged that level of aggregation is a fundamental issue given the importance of unit of account for accounting purposes;

(b) IASB members acknowledged the cost implications of the requirements but referred to the benefits of which the majority resides in the level of aggregation requirements. Some considered abandoning those requirements would fundamentally change IFRS 17.

(c) IFRS 17 already allows simplification compared to other standards requiring a contract by contract unit of account;

(d) The objectives of the level of aggregation requirements are:

(i) To appropriately depict trends in an entity's profit over time,

(ii) to recognise profits of contracts over the duration of those contracts, and

(iii) timely recognition of losses.

[1] 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.

All of this are to be balanced with the operational challenges such an approach poses. Therefore, the current requirements are considered best to accomplish these objectives.

(e) The annual cohort requirement is a compromise from previous principles-based proposals using similar margins and contract duration in order to reduce the operational burden at implementation. Paper 09-06 describes the long process of how the IASB concluded on the current requirements. The staff acknowledged that the grouping requirements represent a loss of information about timely recognition of losses and profit emergence within an annual cohort compared to accounting on a contractual basis.

(f) IASB members observed that the numeric examples were very useful in understanding the issue. The example showed a scenario where policyholders share in the returns of the underlying items in a way that no individual contract would become onerous until all the contracts in the portfolio became onerous. This, however, did not mean that the contracts contribute equally on average to the profit of the insurer.

(g) They also consider that without grouping, the result would be the averaging of profits and recognition of profits beyond the coverage period of the group which would distort the profit reporting from different generations of insurance contracts and obscure inherent risks of the business model. The annual cohort requirement therefore provides useful information for users of the financial statements.

(h) It was noted that the example is intended to illustrate the working of the requirements rather than to prescribe a particular approach. IASB members also commented that IFRS 17 paragraph BC138 allows different approaches to be applied if they arrive at the same outcome. The example is not meant to show a specific approach but rather the expected outcome.

(i) An IASB member commented on the 'artificial' cash flows in the example in the agenda paper, which were created to transfer cash flows from one group to another. The staff explained that these cash flows are not artificial as they are based on the contractual terms of the contract which allows that cash flows for one group of insurance contracts are paid to the policyholders of another group.

EFRAG case study results (see Appendix 2 for details)

5 In EFRAG case study results, in some cases, the annual cohort requirement made a significant difference in the amounts released to CSM compared to not applying cohorts while in other cases, there was not a significant difference. The portfolios significantly impacted by the application of the annual cohort requirement included those that share risks as meant by paragraphs B67 and B68.

6 Descriptions for mutualisation/intergenerational transfers in the case study included: a transfer of wealth between contracts issued at different points in time and unrealised gains being used as an intergenerational transfer to support future generations of policyholders[2]. However, most respondents from the case study did not provide quantifications of this mutualisation/intergenerational transfers as they did not have this information to hand. The few that did, showed very minor impacts.

[2] The ANC solution proposes that '[r]isks are fully shared among policyholders when policyholders share a significant amount of the financial returns and of the insurance risks across generations so that no set of contracts within the group could possibly become onerous alone.'

Illustration of the "mutualisation" business model

7 The following is a high level of illustration of how 'mutualisation' works in the French insurance sector. The EFRAG Secretariat understands that this business model applies similarly and with variations to other jurisdictions in continental Europe.

8 The illustration is based on the following assumptions:

(a) The entity operates 3 business lines:

(i) Health insurance (liability amount measured under local GAAP CU 200),

(ii) Life-saving business (liability amount under local GAAP CU 1000),

(iii) Unit linked (liability amount under local GAAP CU 500);

(b) There is only one pool of assets of CU 1300;

(c) Shareholders' equity is CU 100;

(d) For purposes of the example, assume the assets serving the unit linked liability is segregated and with a value of CU 500 (local GAAP);

(e) The cash flows from the investment activity from the General Fund for the period (dividends, coupons, realised net gains upon disposal) are 100 CU. This is the amount to be allocated between the policyholders and the shareholders;

(f) In the Life-saving business for a total amount of CU 100 CU are contractually entitled to a minimum return of 5% each year and the remainder have a 0% guaranteed minimum return.

9 The following is the simplified balance sheet

ASSETS		LIABILITIES	
Underlying assets	1,300	Equity	100
		Health insurance	200
		Life-saving insurance	1,000
Unit linked fund	500	Unit linked	500
	1,800		1,800

10 According to the French applicable regulation, 85% of the annual returns from the General Fund (CU 100) shall be allocated to policyholders (minimum distribution ratio). For example, for the Life-saving business, its share is determined in proportion of the liability (CU 1,000) on the total liability funding the General Fund (CU 1,300).

11 The allocation of the cash flow will be as follows:

(a) 85%*1000/1300*100 = CU 65 will be allocated to the Life-saving insurance policyholders;

(b) From the available CU 65, the first allocation goes to the minimum guaranteed, in this example 5%*100 = CU 5;

(c) Management has discretion over the allocation of the residual CU 60, which can be allocated either to existing or future policyholders that will be entitled to cash flows from the same pool of assets in the General fund, for up to 8 years in the future. The discretion is exercised by the management mainly considering commercial opportunities/risks and future loss-absorption capacity;

(d) The allocation is done at contract level based on the capital (i.e. premiums paid plus amounts allocated in previous years);

(e) Past allocation decisions cannot be revised in future years. If in a given period the realised return is negative, the payment of the minimum guaranteed will be funded by allocating the unallocated liability (as per c above) and, if necessary, eventually by the insurer;

(f) The regulator monitors the minimum distribution ratio, both from a cash flow perspective and from a solvency perspective.

12 From this example we may derive the following:

(a) Newly issued contracts join the population of beneficiaries of the total realised returns from the General fund;

(b) With the exception of the Unit-linked business, the mutualisation is done at entity level over the life of the contracts;

(c) The sharing of the risks among all policyholders (except the unit-linked holders) relate to both the technical and financial risk;

(d) The contracts in the Life-insurance business fully share the risks limited to the available distributable cash flow each year;

(e) Taking into account the running inter-generational mutualisation model, generally there will be no single onerous contract or group of onerous contracts until the life-saving business is onerous.

13 The EFRAG Secretariat understands that the contracts under this business model are mainly in the scope of the VFA but may also apply to contracts under the GM.

Different views presented

View 1– Agree with the decision to retain IFRS 17 requirements with the following specific comments

Financial reporting objective of IFRS 17 revenue recognition requirements

14 The major benefit that IFRS 17 is expected to bring, in addition to comparability, is to overcome the limits of the current accounting practices applied under IFRS 4. In particular with existing accounting for insurance contracts, investors and analysts find it difficult to identify which groups of insurance contracts are profit making or loss making; and analyse trend information about insurance contracts (see IFRS 17 Project Summary, May 2017).

15 As illustrated in paragraph 14 of Agenda Paper 09-06 (IASB Agenda Paper 2C March 2019), the revenue recognition outcome that the IASB wanted to achieve was that the contractual service margin should be allocated to periods in a way that reflects the service provided by the contracts. The annual cohort requirement has been designed to serve this objective.

16 Those that support the level of aggregation requirements agree that the IASB's objectives are appropriate and required for the recognition of revenue in the context of insurance contracts. They consider that these requirements achieve these objectives, i.e. the provision of trend information, timely recognition of onerous losses and avoidance of continued CSM recognition for derecognised insurance contracts.

(a) The annual cohort requirement is a trade-off between tracking of individual contracts whilst limiting cross-subsidisation between contracts with similar risks with different levels of profitability.

(b) As mentioned above, to provide trend information relating to profitability from one year to the next requires some mechanism to ensure closed groups. Without the annual cohort or some alternative mechanism, groups would remain open indefinitely, resulting in a continuous re-averaging of the CSM and a loss or obscuring of trend information.

(c) The annual cohort requirement is somewhat arbitrary and in and of itself results in the loss of some information compared to if the CSM allocation was done on an individual contract basis but is a trade-off between costs/operational burden and appropriate accounting.

(d) It should also be noted that the financial statements are not presented on a cohort level but are aggregated in order to provide an overall view of the entity's financial performance and position. Further, limiting the size of the group of insurance contracts (which the annual cohort requirement does) limits the extent to which contracts that become onerous subsequent to initial recognition are shielded by profitable contracts.

(e) Some argue that contracts (with similar profitability) but different durations included within a group, the contracts with the shortest duration do not comply with the objective of allocating the contractual service margin to reflect services provided under the contract. However, this ignores the mitigating impact of the coverage unit requirements as well as the derecognition requirements relating to CSM and coverage units, although the impact may not be fully countered.

(f) Disclosures are not a substitute for appropriate recognition and measurement and therefore, provision of trend information in the form of disclosures is insufficient.

17 Eliminating the annual cohort requirement, as proposed by the CFO Forum, does not prevent the re-averaging of CSM over time. The requirements in paragraphs 16, 17 and 19 of IFRS 17 does not relate to profitability but rather the likelihood of the contract to become onerous or not. For example different sets of contracts with differing profitability may still be classified in the same group; such as a group of contracts that are currently highly profitable may be considered to be highly sensitive to specific variables, resulting in it being classified in the remaining group of contracts rather than with those having no significant possibility of becoming onerous later.

18 The IFRS 17 approach is at a significantly higher level of aggregation than in other areas of IFRS (e.g. IFRS 9 and IFRS 15, which are based on individual contracts[3]). Furthermore, the accounting requirements often do not correspond to the way that businesses manage or view their results. For example, retailers may manage profitability on a departmental basis (such as clothing separately from fresh food separately from furniture) but would still need to recognise losses on individual items of inventory when the recoverable amount of these are below cost.

[3] Paragraph 4 of IFRS 15 states that as a practical expedient, an entity may apply IFRS 15 to a portfolio of contracts with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual contracts within that portfolio.

Intergenerational sharing of returns

19 IFRS 17 allows the intergenerational sharing of returns between cohorts to be reflected.

(a) This requires an allocation to the cohort level if the sharing of risks is determined at a higher level and that this may add to complexity although this is tempered by the fact that payments expected to be made to future policyholders do not need to be allocated to specific groups.

(b) The allocation of cash flows as required by B68 avoids the recognition of losses on onerous contracts at inception which many believes is a better reflection of the business model. This then results in the deferral of CSM from an 'earlier'/ 'different' cohort to the coverage period of the cohort receiving the expected cash flows. This is not the same as continual re-averaging.

It is not clear why contractual terms relating to sharing of risk between policyholders should impact or change the revenue recognition principles for the insurer beyond reflecting the contractual arrangements as per paragraph B68.

Observations on the CFO Forum examples:

Example 1

20 The comment is made that the liabilities should be measured at the rate of the assets. One of the fundamental principles in IFRS 17 is that the valuation of the liabilities is done separately from that of the related assets, even for assets using the VFA. This relates to the whole model of IFRS 17 and do not relate to the annual cohort requirement.

21 On annual cohorts, the example states that the fund should be considered in its entirety with no further division of policies as this represents the way the business is run and the only way the balance sheet can correctly reflect the contractual terms. IFRS 17 does not require the groups to be separately reflected on the balance sheet. See below for the analysis on the way the business is run and representing the contractual terms.

Example 2

22 The basis of selection of the two cohorts are not explained, but on the assumption that the preparer followed IFRS 17 paragraph 16, (and due to how the assets and liabilities are moving in different directions in the two cohorts) it seems that the cohort A (of 6 contracts) have a different susceptibility to becoming onerous compared to cohort B. Therefore, the example seems digress from the annual cohort issue per se but suffice to say that this highlights why the differing levels of aggregation are required in order to recognise onerous losses on a timely basis.

Example 3

23 In this case, the use of annual cohorts did not make a material or significant impact on the result. The EFRAG Secretariat agrees with the CFO Forum and the IASB as per paragraph BC 138, that as long a similar outcome is achieved, the use of annual cohorts would not be necessary. However, as mentioned below, in certain cases, the use of annual cohorts do make a difference.

View 2– Amend IFRS 17 annual cohort requirements for those portfolios with intergenerational mutualisation with the following specific comments

24 Today, most insurers use portfolios for the insurance liability where insurance contracts are added or removed continuously for as long as those insurers consider this consistent with the expected profitability, i.e. the way they manage the business.

The same applies for the underlying assets. This happens in particular for contracts with inter-generational mutualization.

25 EFRAG has heard the following concerns from preparers:

(a) The splitting of 'mutualised' amounts into groups of contracts is seen as artificial and different to how the business is managed. As the IASB pointed out in its discussion, the allocation of cash flows reflects the terms of the contract and what would happen in certain circumstances. Ignoring these transfers would ignore the economic consequences of the contractual terms and not reflect the reality.

(b) The proposed requirements would significantly change current practice of some insurers. Significant changes to systems and increase costs (both at implementation and subsequently) which will also lead to inconsistencies between accounting requirements and current business practices.

(c) The level of aggregation requirements will not reflect the level at which pricing, monitoring of profitability as well as risk management of insurance contracts is undertaken in most cases as this is generally done at a portfolio level.

(d) Applying IFRS 17 will change the identification of onerous contracts and may also affect the pricing of some contracts.

26 Numerous concerns have been expressed about the impact of the annual cohort requirement on complexity and cost, however, the costs related to this requirement has not been provided to the EFRAG Secretariat either in the case studies or through other outreach (including EFRAG IAWG meetings).

27 One user disagreed with the annual cohort requirement as it is not comparable with Solvency II and losses taken upfront may have a negative impact as it does not reflect the underlying earnings. Solvency II focuses on the ability of firms to continue under stress or unusual circumstances rather than performance reporting. The concept of early recognition of losses under onerous contracts are entrenched in IFRS and is prudent.

Summary of the EFRAG IAWG discussion – May 2019

28 The following comments were provided.

Determination of profit for B67-products[4]

29 Members indicated that for internal and regulatory purposes, profitability may be assessed on a 'stand-alone' basis, i.e. as if the contract has been issued without 'wealth sharing'. This then can be compared to the profit on a risk sharing basis. There are various ways of determining the profit for these contracts, i.e. similar to MCEV or net present value calculations.

30 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.

31 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.

[4] As mutualisation is often defined in very different ways, the discussion related to 'those contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts' as described in paragraph B67 of IFRS 17.

32 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. The products would include significant discretion around the timing of the payments to the policyholders. Pricing would calculate the expected profitability and in adverse scenarios the cost of guarantees etc would be taken from the free surplus.

33 A Spanish example discussed related to deferred annuities where the technical and financial risk is shared by the policyholders. The insurer's fee is based on the expected return of the assets less what has been promised to the policyholder. This calculation could be done on a contract-by-contract basis.

34 German contracts allocate returns to policyholders on a realised basis.

Do you agree with the objectives of the IASB of the annual cohort requirements?

35 One member discussed that the objectives are not necessarily disputed, but that you do not need the requirements as the 'profitability buckets'[5] would solve the onerous contracts issue. The EFRAG Secretariat pointed out that this would not solve the issue of contracts becoming onerous, however the member considers that the category that deal with contracts that may become onerous would deal with this. The member did not consider that the examples provided in various contexts are realistic that the annual cohorts may make a difference over time (as these are often based only on two or a few contracts). For profitability trends, the member argued that the most important aspect would be the profitability of new business which is visible due to the required reconciliation of CSM amounts. The member also pointed to their experience in the EFRAG Case Study where the use of annual cohorts did not make a significant difference to the calculated CSM release.

36 The EFRAG Secretariat pointed out that there may be situations where the profitability changes significantly (i.e. 'turning points' and the member thought that where you have significant changes which may indicate significant changes to risks may also result in different "paragraph 16" categories or portfolios.

37 Another member had the same experience in the case study and agreed that the objective can be achieved by coverage units. With intergenerational mutualisation, the complexity increases, and this is not clear from the IASB example with two groups. The member thought that the allocation of CSM 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.

38 An auditor IAWG member indicated that complying with the annual cohorts for the B67 type of contracts is very burdensome. The member indicated that whilst the concern around onerous contracts is resolved by the nature of the contracts, the interaction with coverage units is still unclear and how the CSM calculation would work in practice given if there is no annual cohort requirement. Others thought that as the coverage units consider the services provided, the size of the contract as well as the duration) the new CSM and coverage units would simply be added to the calculation which admittedly would result in re-averaging of the CSM over time, but in the context is not seen as a significant concern.

39 EFRAG IAWG members agreed that it is very important to show the profitability trend of new business from a strategic perspective but did not consider it necessary to continue tracking it post-issuance.

[5] This refers to the requirement in paragraph 16 to classify contracts into three categories based on their likelihood to becoming onerous or whether they are onerous at inception.

Can the issue be solved without changes to IFRS 17, e.g. by applying of BC 138[6]

40 The first discussion centred on whether one would need to arrive at exactly the same amounts as the literal wording of the paragraph. The EFRAG Secretariat pointed out that all the requirements of IFRS is in the context of materiality, i.e. if the answer does not differ materially, it does not matter.

41 Another member pointed out that the IASB staff indicated that 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.

42 Others pointed out that 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.

43 Other members questioned why this is only in the basis for conclusions. Another member questioned why mutual societies have to provide a profit and loss.

Other comments – EFRAG IAWG May 2019

44 As the surplus allocation described for French and other jurisdictions in continental Europe is performed at contract level, 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.

Further written inputs from the EFRAG IAWG

Prevalence

45 All insurance contracts (all territories and all product types) including both participating and non-participating contracts, regardless of whether risks are shared. The below table shows the volumes of business. (1 preparer)

Business subject to annual cohort issue (liabilities at 31/12/18, GBP million)[1]	
	Liabilities
With risk sharing	167,000
Without risk sharing	239,000
Total subject to annual cohort issue	406,000

[1] Liabilities for insurance contracts, investment contracts with DPF and unallocated surplus of with - profit funds

46 Regarding long-term life-saving contracts like annuities, the small volume of contracts in cohorts would increase the scope of potential "onerous" cohorts, not reflecting the business performance of the product (An example of this was provided as part of the response to the request for written input). The possibilities to mutualise between policies in the same cohort are more restricted if companies are not able to make mutualisation adjustments at a higher level (including because of operational implementation complexity). (1 preparer)

(a) Life insurance business is an important segment of the total insurance sector of Spain representing almost the half of the total written premiums (life and non-life) with a total amount of technical provisions of 191 billion € at Q3 2018.

[6] Extract from the paragraph: "Nonetheless, the Board noted that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. Therefore, it may not be necessary for an entity to restrict groups in this way to achieve the same accounting outcome in some circumstances."

(b) In particular, traditional life products that offer a guaranteed return to the policyholder represent an amount of 175 billion euros of managed savings (technical provisions at 30 September 2018).

47 For pure savings contracts - at least 1 000 B€ of statutory reserves and around 90 B€ for 2017 premiums reserves and for retirement contracts - 200 B€ of reserves and 23 B€ of premiums. (1 auditor)

48 The bulk of savings Euro contracts and retirement products are eligible to the legal participating scheme. (1 independent)

49 Most prevalent for participating business in France and Italy where there is sharing of profits across annual cohorts. The present value of new business premiums of France, Italy, Ireland and Poland was £12,625m in 2018. France and Italy are by far the largest components of this number with Italy showing strong growth in sales of participating products (Value of new business growth of 36% in 2018). In the UK, the entity's with profits participating business is largely closed to new business and so the issue of annual cohorts only arises on transition. (1 preparer)

Risk sharing

50 For contracts with risk sharing, all risks are shared (i.e. investment risk, mortality risk, persistency risk and expense risk). (1 preparer)

51 For pure savings contracts - sharing of financial risk (at least 85%) and for retirement contracts - sharing of financial risk (85%) and technical risk (90%) (1 auditor)

52 French insurance code depicts the legal and contractual scheme. There is an underwriting (or technical) result including acquisition and on-going costs that is shared with the policyholder (90% if positive). Financial mutualisation is another component of this scheme. (1 independent)

53 All of the business has risk sharing / sharing of cash flows as out line in B67 onwards of IFRS 17. (1 preparer)

Actuarial techniques to compute CSM for each annual cohort

54 There are five actuarial techniques to compute the value of each annual cohort for contracts eligible to the IFRS 17 mutualisation (1 independent). These techniques are not theoretical ones and are being implemented:

(a) The stand-alone method: the CSM of new business is calculated without taking into account the wealth of the stock;

(b) The adjusted stand-alone method: the CSM is calculated, regardless of the stock of contracts, by allocating some of the "wealth" of the underlying items to the new business;

(c) The marginal approach: the CSM of the new business corresponds to the difference between the CSM of the book of business stock with and without new business. If it is intuitive enough, it does not meet the constraint of annual cohorts;

(d) The value if force method by generation: the CSM is calculated including new business and the CSM of new business is identified separately;

(e) The value in force method allocated to new business: in each period, the CSM of the book (including new business) is calculated and a portion of CSM is allocated to new business.

55 In order to allocate to cohorts, one needs keys. The following are examples of such keys (currently being implemented):

(a) Portion of local reserves;

(b) Portion of IFRS17 Best estimate (with/without expenses);

(c) Portion of IFRS17 fulfilment cash flows IFRS17 (with/without expenses);

(d) Other.

Summary of the EFRAG TEG discussion – May 2019

56 EFRAG TEG members agreed with the IASB reporting objectives of providing information about timely recognition of losses on onerous contracts, profits on profitable contracts and trends in an entity's profitability from contracts over time.

57 They observed that the annual cohort requirements involve some practical compromises: the IASB tried to develop a principle-based approach to identifying groups that would eliminate that loss of information, however such an approach was rejected because of feedback from stakeholders that it would be unduly burdensome.

58 EFRAG TEG members considered the IASB decision not to add an exception to annual cohorts for fully mutualised contracts, as to do so would add complexity, and create risk that the boundary would not be robust or appropriate in all circumstances. Instead, the IASB explained in paragraph BC138 of the Basis for Conclusions on IFRS 17 that it may not be necessary for an entity to apply annual cohorts to achieve the same accounting outcome in some circumstances.

59 EFRAG TEG members noted the inputs from the EFRAG IAWG, in particular (i) that the share of returns between policyholders that was lower than 100% and (ii) the costs of providing the demonstration that the accounting outcome is the same; they noted as well the materiality judgement attached to this demonstration.

60 One member observed that, for the fact pattern in BC138, conditions may change over time and the entity may need to change the accounting if this happens.

61 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:

(a) are needed to achieve the benefits of IFRS 17, particularly in relation to information about trends in an entity's profitability over time;

(b) struck an appropriate compromise between costs for preparers and useful information for users of financial statements.

62 6 EFRAG TEG members assessed that, for contracts with intergenerational mutualisation:

(a) 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;

(b) a solution should be provided and paragraph BC138 seemed to provide an initial direction;

(c) providing information about the change in profitability of new versus old business is essential.

63 One EFRAG TEG member that was absent to the meeting provided subsequent written input supporting view 2.

64 3 EFRAG TEG members did not explicitly express a view.

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

(a) consequential amendments to the transitional provisions would be needed as well;

(b) 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.

66 2 observers (regulators) expressed the following respective views:

(a) 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;

(b) 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 topic 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.

Question for EFRAG Board and EFRAG TEG

67 Members are invited to note:

- the characteristics of “mutualisation” business model as described in this paper;
- the feedback of IAWG as presented above;
- the solutions proposed by the CFO forum and the ANC as presented in the Appendix;
- 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.

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

Appendix: other information

ASAF Meeting April 2019

1 While commenting on the IASB's tentative decisions, three ASAF members (ANC, ASBJ and OCI) mentioned that stakeholders in their jurisdictions have remaining concerns about the implementation challenges of the level of aggregation requirement.

May 2019 paper from the ANC

2 The ANC analysed the issue in several papers since November 2018 and has updated their considerations in response to the IASB's discussions in two ways:

(a) A detailed paper with other discussion papers in a letter to the IASB and EFRAG (agenda paper 09-09); and

(b) A separate letter to the IASB (agenda paper 09-07, also on 6 May 2019 on level of aggregation. This letter updates its analysis for the discussion and conclusions of the IASB at its board meeting in March 2019, with a summary in paragraphs 1 to 29.

3 The detailed analysis of the ANC is set out as follows:

(a) The level of aggregation requirements in the standard as well as TRG discussions in paragraphs 1-71 (pages 1 to 16);

(b) A description of the issue in respect of the business model, an illustrative example as well as a comparison of IFRS 17's consistency with other standards in paragraphs 72 to 133 (pages 17 to 24);

(c) Suggested solutions in paragraphs 133 to 154 (pages 25 to 28); and

(d) Examples in paragraphs 155-234 and 235-304.

4 In the letter to the IASB commenting the analysis and conclusions of the IASB's Board meeting, the ANC summarises the following conclusion and suggestions:

(a) *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.*

(b) *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.*

(c) *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).*

Extracts from extensive case study on pricing

Question 9: Do you price contracts at individual contract level or at a higher level of aggregation?

5 This paper contains an overall description about those contracts priced at individual contract level and those that are priced at a higher level of aggregation.

6 For some contract types mixed approaches are being used; some risks are assessed and priced on individual level (eg. demographic), others are assessed and priced on a higher level of aggregation (eg. financial risks, costs).

7 About half of the selected portfolios were priced at individual contract level, the other half was priced at a higher level of aggregation. Examples of contracts that were priced individually were: annuities, personal motor, life business and reinsurance. Examples of contracts that were priced at a higher level of aggregation were annuities, life and health contracts, unit-linked contracts and credit insurance.

8 One participant did not answer this question.

Explain which components are included in setting a price;

9 The price setting differs between contract type. Examples of components that are included in setting prices are:

(a) Investment return assumptions; target asset mix or spread assumptions;

(b) Expenses, expense inflation, claims, acquisition costs per contract unit;

(c) Commissions;

(d) Capital assumptions and application of the risk margin;

(e) Existence of reinsurance;

(f) Biometric assumptions (e.g. mortality or longevity assumptions);

(g) Individual risk premiums based on underwriting questionnaire;

(h) Competitors' pricing, specific marketing goals of the own company;

(i) Regulatory technical rates;

(j) Tax; and

(k) Impact on current IFRS results.

10 One respondent did not answer the question.

Specify whether and how expected asset returns are considered when setting a price for the contract; and

11 Examples of contracts where asset returns are considered were annuities, unit-linked contracts, life and health contracts and savings contracts. Examples of contracts where assets returns were (almost) not considered were property and casualty business, life business, unit-linked contracts and credit insurance.

12 One respondent did not answer the question.

In pricing insurance contracts, does the price charged considers automatic periodic renewal options of the contract by the policyholder?

(i) If yes, how many automatic renewals do you consider in setting your price? How do determine this number?

(ii) If yes, how do such automatic renewals affect the price charged?

(iii) Decrease the price that would otherwise be charged for one period by a range of:

- 0%-20%
- 21%-40%
- More than 40%

(iv) Increase the price that would otherwise be charged for one period by a range of:

- 0%-20%
- 21%-40%

- More than 40%

13 Five respondents did not answer the question. Generally, renewals are not considered relevant for the life business (three respondents). One respondent noted that renewals for the life business considered automatic periodic renewals with no fixed upper limit to the number of renewals.

14 In contrast for property and casualty business, one respondent noted that they consider renewals and so profitability is considered over the expected lifetime of the policy plus renewals measured at a portfolio level rather than an individual contract level. Performance of a portfolio is projected, allowing for the expected mix of new business and renewals. Optimisation techniques are used to determine the premiums charged. Another respondent noted that a full repricing is required for every renewal risk. Another respondent noted that renewals were not common. In most cases the price that would otherwise be charged for one period decreases by a range of 0%-20% from the previous period. In cases of contracts with guarantees provided by the reinsurer the price may increase by more than 40%.

Question 10: For each of the selected portfolios, please describe how the use of annual cohorts and the grouping requirements of IFRS 17 affect, if at all, your pricing methodologies.

15 For some respondents, pricing is not expected to be impacted by IFRS 17. For example, one respondent stated that a policy by policy approach will be applied in all portfolios, which has greater granularity than annual cohorts. The current pricing methodology will continue under IFRS 17. Another respondent noted that pricing of life business in the US already follows a cohort approach today (one respondent). Other comments included that mutualisation between generations will be taken into account under IFRS 17 (in the fulfilment cash flows) as is already taken into account in the current pricing.

16 One respondent noted that the use of annual cohorts and the grouping requirements under IFRS 17 will give rise to increased maintenance costs and the identification of some business as onerous does not reflect the pricing of the portfolio which is done on expected renewals basis.

17 Some respondents noted that it is too early to have a clear insight on the impact on pricing.

Appendix 2: Summary of information and EFRAG TEG/Secretariat analysis as at August 2018

Introduction

1 The following is the EFRAG TEG/Secretariat analysis on level of aggregation during August 2018. The information includes findings from the extensive case study as well as a summary of the debate by EFRAG TEG on the analysis of the EFRAG Secretariat on the topic.

Findings from the case study

2 Number of respondents addressing one or more aspects of these issues: 9

Level of aggregation

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

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

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

6 In all these cases no calculations (only the results of the calculation and/or graphic representations) were provided in the case study results.

7 Two respondents calculated the impact on their portfolios only for one year which did not illustrate the effect on reported trends.

Costs relating to the annual cohort requirement

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

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

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

Sharing of risks (also known as mutualisation)

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

11 The following table provides an overview of the amount of the selected liabilities that were subject to risk sharing.

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

12 Two respondents provided a description for the term "intergenerational transfer":

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

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

Separating components within insurance contracts

13 Only one respondent encountered the issue from their selected portfolios in the case study. This respondent noted that certain participating contracts (written in a ring-fenced fund) have attaching insurance riders (written in a separate non-profit fund) that are funded by additional premiums. While there is significant uncertainty in the treatment of such riders under IFRS 17, particularly in light of recent discussion at the TRG, their initial assessment is that because a rider lapses if its host contract lapses the riders are sufficiently closely related to the host contract to prevent them being separated. However, the riders do not form part of the underlying items of the participating contract (shareholders receive 100% of the profits on the riders). It would therefore not be meaningful to include rider cash flows within the fulfilment cash flows of the host participating contract for which profits are shared between policyholders and shareholders on a 90:10 basis. As such, the separation requirements of IFRS 17 result in an outcome that does not reflect the economics of the business.

14 Four other respondents also raised the concern that some contracts issued by them include multiple types of insurance risk. For these respondents, the issue did not arise from their selected portfolios. These respondents were also of the view that an individual contract is not the lowest level of account as it is not in all circumstances consistent with how insurance risk is managed. They considered that the necessary flexibility needs to be achieved in order to also reflect the way insurance risks are managed and reported to the management for financial reporting purposes.

Other feedback regarding the level of aggregation

15 Although current practice does not include the level of aggregation requirements of IFRS 17, it is noteworthy that portfolios under current practice may be more granular than required by IFRS 17. Of the 40 portfolios where information was provided,

(a) 12 portfolios were smaller than required by IFRS 17;

(b) 19 portfolios were of a similar size to that required by IFRS 17;

(c) 9 were larger than the portfolios required by IFRS 17; and

(d) 11 portfolios were not specified.

16 To the extent that grouping is undertaken under current practice, 45 groups were reported, whereas under IFRS 17 this would increase to 343 in aggregate.

(a) Five respondents provided grouping details for one year resulting in 26 groups under current accounting and 56 groups under IFRS 17; and

(b) Four respondents provided grouping details for five years, i.e. over the testing period, resulting in 19 groups under current accounting and 287 groups under IFRS 17.

17 The type of contracts where onerous groups could arise were:

(a) VFA – unit linked;

(b) General model – long-term contracts;

(c) General model – other; and

(d) PAA motor and other.

18 One respondent stated that an onerous contract provision on the personal motor book would need to be recognised on day one representing 17% of profit on that book.