Transition: Fair value approach
Issues Paper

Introduction

1 This paper deals with the challenges in the application of the FVA following the IFRS 17 transition requirements. Please refer to the introduction in paper 06-03 “Modified Retrospective Approach” as this issue refer to the same IASB tentative decision.

Concerns raised

2 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.

3 It is expected that many portfolios at transition will have to apply the fair value approach.

4 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.

5 Some preparers agreed that the fair value calculation resulted in a broader range of profitabilities.

6 Some members observed that the FVA and FRA are two different concepts and mentioned the acquisition costs as one example of difference in the two approaches.

Different views presented

7 For this issue no different views are being presented.

IAWG conclusions

8 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.

9 It is expected that many portfolios at transition will have to apply the fair value approach.

10 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.

11 Some preparers agreed that the fair value calculation resulted in a broader range of profitabilities.

12 Some members observed that the FVA and FRA are two different concepts and mentioned the acquisition costs as one example of difference in the two approaches.

13 Auditors disagreed with the calculations put forward in the technical paper (reflecting how case study participants had calculated fair value at transition) submitted to EFRAG IAWG and EFRAG TEG. It was noted that:

(a) A fair value approach gives room for adjustments when duly justified, currently preparers are too strict in their application of fair value;

(b) The profitability in a fair value approach should be the profitability of new business;

(c) Current fair value calculations rely too much on actuarial and Solvency II calculations;

14 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.

15 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 *Fair value measurement* is the contract liability, i.e. not the business nor the assets.

EFRAG TEG input April 2019

16 Please refer to paper 06-03 uploaded for this meeting.

EFRAG TEG input May 2019

17 The objective of discussing this issue was partly educational and partly identifying whether further clarification was necessary on how fair value is being applied.

18 EFRAG TEG members 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 Measurement*, fair value allowed to demonstrate a normal profit margin.

19 One EFRAG TEG member observed that in their national working group fair value was not discussed in detail. This member added that applying fair value was useful in particular cases (such as onerous contracts) and allowed to show differences in magnitude of profitability. The member added that it was difficult to find observable market prices and it was level 3 fair values.

20 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.

21 One EFRAG TEG member noted that the use of level 3 fair values strengthened the case for a relaxation of the MRA.

Questions for EFRAG Board and TEG

22 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).

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

Appendix: background information

Comments by UNESPA

24 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

25 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).

26 Application of fair value can present challenges (Presentation of CFO Forum – March 2019).

Input received from the extensive case study

27 Please refer to paper 06-03 uploaded for this meeting.

28 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.

Input received from the simplified case study

29 Comments focused on the impact on retained earnings on transition (outside the scope of this paper).

Input received from the User Outreach

30 Please refer to paper 06-03 uploaded for this meeting.