This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

IASB ED/2019/4 Amendments to IFRS 17 – EFRAG draft comment letter

You can submit your comments on EFRAG's draft comment letter by using the 'Express your views' page on EFRAG's website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.

Comments should be submitted by [date].

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[XX September 2019]

Re: IASB ED/2019/4 Amendments to IFRS 17

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure draft ED/2019/4 Amendments to IFRS 17 *Insurance Contracts*, issued by the IASB on 26 June 2019 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG would like to express its appreciation for your consideration of the topics identified in our letter of 4 September 2018 ("our letter") as well as those from other constituents. EFRAG would also like to commend the Board for the thorough process to capture and analyse all the concerns and criticisms received. This course of action corroborated the willingness you expressed to act speedily as and when required. EFRAG also notes and acknowledges that during this process, you considered thoroughly all the issues highlighted in our letter and we appreciate the duty of care exercised in this regard.

Appendix 1 contains our responses to the questions in the ED. EFRAG is broadly supportive of many of the changes proposed. However, EFRAG is of the view that the following issues are worthy of further attention. These issues are:

(a) Reinsurance contracts held – scope of the offsetting requirement;

(b) Retrospective application of risk mitigation option on transition.

Appendix 2 addresses topics that were raised in our letter of 4 September 2018, together with some other issues, that we consider warrant further consideration.

EFRAG believes that it is worth re-considering whether restricting the groups through the annual cohorts requirement is always justified, in particular for contracts with cash flows that affect or are affected by cash flows to policy holders of other contracts. EFRAG

recommends that the IASB consider developing a special solution for such contracts, starting from paragraph BC138.

In addition, EFRAG also notes the decision not to allow at transition further modifications to the modified retrospective approach in the interest of comparability. EFRAG remains concerned about implementation challenges faced by preparers and the possibility of unduly strict interpretations that restricts the use of retrospective approaches. Therefore, EFRAG encourages the IASB to confirm in the main text of the final standard that the use of estimates is allowed, including those needed to approximate the missing information (e.g. missing data-points).

If you would like to discuss our comments further, please do not hesitate to contact Didier Andries, Fredré Ferreira, Sapna Heeralall, Joachim Jacobs or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

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Areas where questions have been raised to constituents in addition to the IASB's questions

1 Scope exclusions (paragraph 10, Appendix 1).

2 Contractual service margin attributable to investment-return service and investment-related service (paragraph 35, Appendix 1).

3 Reinsurance contracts held – recovery of losses on underlying insurance contracts (paragraphs 44 to 48 , Appendix 1).

4 Presentation in the statement of financial position (paragraphs 56 to 57, Appendix 1).

5 Applicability of the risk mitigation option (paragraphs 67 to 68, Appendix 1).

6 Transition modifications and reliefs (paragraph 93, Appendix 1).

7 Annual improvements (paragraphs 97 to 105, Appendix 1).

8 Terminology (paragraph 108, Appendix 1).

9 Annual cohorts (paragraphs 150 to 170, Appendix 2).

10 Transition: Modified retrospective approach and fair value approach (paragraph 181, Appendix 2).

11 Balance sheet presentation: Non-separation of receivables and payables (paragraphs 187 to 189, Appendix 2).

12 Reinsurance contracts: contract boundary (paragraphs 202 to 204, Appendix 2).

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Appendix 1 - EFRAG's responses to the questions raised in the ED

Question 1 – Scope exclusions (EFRAG Topics 1A and 1B)

Notes to constituents – Summary of proposals

Question 1A - Loans that transfer significant insurance risk

1 *The ED proposes to amend paragraph 8A proposes that an entity may choose to apply IFRS 9 Financial Instruments instead of IFRS 17 to contracts that meet the definition of an insurance contract but that limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract (for example, loan contracts with death waivers). The entity would be required to make that choice for each portfolio of insurance contracts and the choice for each portfolio would be irrevocable.*

Question 1B - Credit cards that provide insurance coverage

2 *The ED proposes to amend paragraph 7(h) proposes that credit card contracts that meet the definition of an insurance contract be excluded from the scope of IFRS 17 if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.*

Question 1 – Scope exclusions – credit card contract and loan contracts that meet the definition of an insurance contract (paragraphs 7(h), 8A, Appendix D and BC9-BC30)

(a) Paragraph 7(h) proposes that an entity would be required to exclude from the scope of IFRS 17 credit card contracts that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

Do you agree with the proposed amendment? Why or why not?

(b) If not excluded from the scope of IFRS 17 by paragraphs 7(a)–(h), paragraph 8A proposes that an entity would choose to apply IFRS 17 or IFRS 9 to contracts that meet the definition of an insurance contract but limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract (for example, loans with death waivers). The entity would be required to make that choice for each portfolio of insurance contracts, and the choice for each portfolio would be irrevocable.

Do you agree with the proposed amendment? Why or why not?

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EFRAG's response

Loans that transfer significant insurance risk:

EFRAG supports the proposal to permit entities, on portfolio level, to either apply IFRS 17 or IFRS 9 to insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract.

Credit cards that provide insurance coverage:

EFRAG agrees with the exclusion of certain credit cards that provide insurance coverage from the scope of IFRS 17. This is because the exclusion reduces the implementation costs and operational burden for entities that issue credit card contracts for which the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer. Furthermore, the exclusion is not causing a significant loss of useful information.

However, EFRAG is concerned that the term credit card excludes payment cards which have similar clauses as the credit cards in the scope exclusion.

EFRAG is also a concerned that in some countries the insurance element is not required by regulation and may therefore under IFRS 9 fail the solely payment of principle and interest (SPPI) test which could require measurement at fair value through profit or loss.

Question 1A - Loans that transfer significant insurance risk

3 EFRAG supports the proposals to either apply IFRS 17 or IFRS 9 for loans with a specific type of insurance risk on a portfolio level. This is because EFRAG considers that it would reduce the complexity around bifurcating certain loans from insurance contracts or treating such loans as insurance contracts. EFRAG also acknowledges that the proposed amendments would enable:

(a) an entity that mainly issues insurance contracts to apply IFRS 17 to these loans, permitting comparability with the other insurance contracts issued by the same entity; and

(b) an entity that mainly issues financial instruments to apply IFRS 9 to these loans, permitting comparability with the financial instruments issued by the same entity, without imposing IFRS 17 implementation costs for such contracts to the entity.

Question 1B - Credit cards that provide insurance coverage

4 EFRAG agrees with the proposed amendment to exclude from the scope of IFRS 17 those credit card contracts that provide insurance coverage for which the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

5 EFRAG notes that these products are aimed at providing a certain amount of coverage which includes protection for the quality of the goods sold as well coverage in the case that the seller fails to deliver under its non-financial obligations with respect to the sale.

6 EFRAG considers that when an entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, in such cases EFRAG is of the view that IFRS 9 would provide more useful information about those contracts. When the entity does reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, EFRAG is of the view that IFRS 17 would provide more useful information about those contracts.

7 EFRAG acknowledges that currently entities that issue certain credit card contracts typically account for:

(a) loans or loan commitments in credit card contracts (and any relevant interest revenue) applying IFRS 9;

(b) any insurance obligations applying IFRS 4 *Insurance Contracts*, in a similar manner to applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and

(c) any revenue for providing other services applying IFRS *15 Revenue from Contracts with Customers*.

8 It is for this reason that EFRAG considers that excluding from the scope of IFRS 17 these credit card contracts would:

(a) permit the continuation of the existing accounting practice and therefore reduce IFRS 17 implementation costs for some entities; and

(b) not result in a significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements. Other relevant IFRS Standards would apply to such credit card contracts and would provide relevant information about the components of those contracts to users of financial statements.

9 However, EFRAG is concerned that the use of the term credit card excludes payment cards which have similar clauses as the credit cards in the scope exclusion.

Question to Constituents

10 B.4.1.9.E of IFRS 9 allows to consider a regulated interest rate as a proxy for the time value of the money in doing the SPPI test, under certain conditions. EFRAG understands that in some countries the insurance element is not required by the regulation and, as a consequence, the financial instrument could fail the SPPI test and would have to be measured at fair value through profit or loss. How prevalent are these concern within your jurisdiction?

DRAFT

Question 2 - Expected recovery of insurance acquisition cash flows (EFRAG Topic 2)

Notes to constituents – Summary of proposals

11 *The ED proposes an amendment to the definition of insurance acquisition cash flows in Appendix A of IFRS 17 to clarify that insurance acquisition cash flows relate to groups of insurance contracts issued or expected to be issued. Cash flows paid before a related group of reinsurance contracts held are recognised are addressed in paragraph 65(a) of IFRS 17.*

12 *The ED also proposes that an entity would be required to:*

(a) *allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to groups that include contracts that are expected to arise from renewals of the contracts in that group;*

(b) *recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and*

(c) *assess the recoverability of any asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.*

13 *Finally, the ED proposes that an entity would be required to disclose:*

(a) *a reconciliation from the opening to the closing balance of any asset for insurance acquisition cash flows; and*

(b) *quantitative information about when the entity expects to derecognise an asset for insurance acquisition cash flows.*

Question 2 – Expected recovery of insurance acquisition cash flows (paragraphs 28A – 28D, 105A – 105C, B35A – B35C and BC31 -BC49)

Paragraphs 28A–28D and B35A–B35C propose that an entity:

(a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to any groups that include contracts that are expected to arise from renewals of the contracts in that group;

(b) recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and

(c) assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.

Paragraphs 105A–105C propose disclosures about such assets.

Do you agree with the proposed amendments? Why or why not?

EFRAG's response

EFRAG supports the IASB proposals with regards to the treatment of acquisition costs as the resulting financial information will better reflect the economic substance of these transactions.

EFRAG supports the allocation of the acquisition cost to the contracts to be a mandatory requirement. EFRAG agrees with the proposed recoverability assessment approach.

14 EFRAG notes that, from a commercial perspective, an insurer's decision to pay a certain level of acquisition costs might take into account its expectation of contract

renewals. EFRAG also acknowledges that some contracts would be treated as onerous due to the allocation of acquisition costs in full to them (i.e. ignoring the impact of renewals).

15 EFRAG supports the proposed amendments because this will provide more relevant information to users of financial statements by better reflecting the economic substance and general understanding of these transactions.

16 EFRAG supports the allocation of the acquisition cost to the contracts to be a mandatory requirement.

17 With regards to impairment, EFRAG notes that an entity would have to assess the recoverability of an asset recognised applying paragraph 27 of IFRS 17 at the end of each reporting period, if facts and circumstances indicate the asset may be impaired.

18 EFRAG agrees with the proposed recoverability assessment approach.

DRAFT

Question 3 - Contractual service margin attributable to investment-return service and investment-related service (EFRAG Topic 7A)

Notes to constituents – Summary of proposals

19 *The Exposure Draft proposes two amendments relating to the identification of coverage units:*

20 *The first proposed amendment would require an entity to identify coverage units for insurance contracts without direct participation features considering the quantity of benefits and expected period of investment-return service, if any, in addition to insurance coverage.*

21 *Insurance contracts without direct participation features may provide an investment-return service if, and only if:*

(a) *an investment component exists, or the policyholder has a right to withdraw an amount (this includes both policyholders' rights to a surrender value or premium refund on cancellation of a policy and policyholders' rights to transfer an amount to another insurance provider.*);

(b) *the entity expects the investment component or amount the policyholder has a right to withdraw to include a positive investment return (a positive investment return could be below zero, for example, in a negative interest rate environment); and*

(c) *the entity expects to perform investment activity to generate that positive investment return.*

22 *The second proposed amendment would clarify that an entity is required to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service.*

23 *The Exposure Draft proposes that insurance coverage, investment-return service (for insurance contracts without direct participation features) and investment-related service (for insurance contracts with direct participation features) are defined together as 'insurance contract services'.*

24 *For all insurance contracts, the Exposure Draft proposes to require an entity to disclose quantitative information about when the entity expects to recognise in profit or loss the contractual service margin remaining at the end of the reporting period. The IASB also proposes to require an entity to disclose the approach used to assess the relative weighting of the benefits from insurance coverage and investment-related service or investment-return service.*

Question 3 – Contractual service margin attributable to investment-return service and investment-related service (paragraphs 44-45, 109 and 117(c)(v), Appendix A, paragraphs B119-B119B and BC50-BC66)

(a) Paragraphs 44, B119–B119A and the definitions in Appendix A propose that an entity identify coverage units for insurance contracts without direct participation features considering the quantity of benefits and expected period of investment-return service, if any, in addition to insurance coverage. Paragraph B119B specifies criteria for when contracts may provide an investment-return service.

Do you agree with the proposed amendment? Why or why not?

(b) Paragraphs 45, B119–B119A and the definitions in Appendix A clarify that an entity is required to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service.

Do you agree with the proposed amendment? Why or why not?

(c) Paragraph 109 proposes that an entity disclose quantitative information about when the entity expects to recognise in profit or loss the contractual service margin remaining at the end of a reporting period. Paragraph 117(c)(v) proposes an entity disclose the approach used to determine the relative weighting of the benefits provided by insurance coverage and investment-return service or investment-related service.

Do you agree with the proposed disclosure requirements? Why or why not?

EFRAG's response

EFRAG supports the IASB proposals regarding contracts under the general model. Some contracts under the general model include investment activities and the proposal will ensure that the CSM that will be allocated to profit or loss will reflect both insurance and investment return services provided to the policyholder.

EFRAG also supports the IASB proposals regarding contracts under the variable fee approach because these contracts are substantially investment-related contracts.

EFRAG considers that the disclosure proposals related to CSM amortisation will provide useful information to users of financial statements.

General model

General model - Contracts with investment components

25 For some contracts under the general model, in addition to insurance coverage the entity provides a service to the policyholder in terms of returning to the policyholder both the policyholder's original investment and an investment return that would not otherwise be available to the policyholder because of amounts invested, expertise, etc.

26 EFRAG considers that the IASB's proposals will lead to the provision of relevant information about the services being provided to the policyholder. Therefore, the resulting contractual service margin ('CSM') amortisation provides a faithful representation of those services being provided.

General model - Contracts without investment components

27 Under many insurance contracts, the policyholder has a right to withdraw money (or to transfer an amount to another party). This right appears to indicate the entity is providing an investment-return service. EFRAG understands that investment-return services are most commonly found in certain deferred annuity contracts.

28 EFRAG considers that the identification of investment-return services could be complex and require significant judgement as to expectations and the terms of the insurance contract. There would be subjectivity in applying the proposed amendment and determining the weighting between the investment-return service and insurance coverage services in order to determine the coverage units and the release pattern of the CSM.

29 However, an entity is already required to make similar assessments for contracts which provide more than one type of insurance coverage and disclosures relating to this significant judgement, as further illustrated below. Therefore, EFRAG considers that this proposal will not require the excessive use of judgement and will facilitate users' understanding of the impact of all relevant services on the amortisation of CSM.

Variable fee approach

30 EFRAG agrees that insurance contracts with direct participation features provide both insurance coverage and investment-related service. IFRS 17 refers to these contracts as being substantially investment-related service contracts under which an entity promises an investment return based on underlying items.

31 Therefore, EFRAG supports that in addition to insurance coverage, these contracts also provide investment-related services to policyholders and the coverage units to release the CSM should reflect these services.

Disclosure requirements

32 Entities have to provide disclosures in terms of:

(a) quantitative information on the expected recognition in profit or loss of the contractual service margin remaining at the end of the reporting period, in appropriate time bands, and

(b) specific disclosure of the approach to assessing the relative weighting of the benefits provided by insurance coverage and investment-related services or investment-return services.

33 EFRAG considers that the quantitative disclosures about the amount of CSM expected to be recognised over time are important as these disclosures enable users of financial statements to monitor the profitability pattern and any changes to that profitability pattern, allowing informed comparisons between types of contracts and across entities. EFRAG considers that an entity needs to determine the coverage units (which includes services to be provided in the future) in order to determine the release pattern for the CSM. Therefore, EFRAG considers that preparers should be able to provide this quantitative information without undue cost or effort.

34 Currently, IFRS 17 requires entities to disclose significant judgements and changes to those judgements. EFRAG considers that disclosures on the weighting of the benefits would be considered to be significant judgements and consequently these should be disclosed. These disclosures are necessary to enable users to better understand the sources of profit and to make comparisons both between types of contracts and across entities and over time.

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Question to Constituents

35 EFRAG has been informed of possible fact patterns of deferred annuities for which there is no investment component as defined by the ED, nor a right to withdrawal; however, the insurance entity performs asset management activities, revenues of which would not be captured in the CSM release. For example, for particular Deferred Annuities, there is an accumulation phase first and then the annuity phase. During the accumulation phase, if the policyholder dies, he does not receive anything. During the annuity phase, the policyholder, if he survives, receives a fixed annuity amount based on premiums/technical provisions. In this product, there is not any fee charged to the policyholder, except for a penalty over the capital gains in order to discourage surrenders.

36 EFRAG is interested in receiving inputs on possible additional examples of investment activities that are not captured by the current IASB definition.

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Question 4 – Reinsurance contracts held — recovery of losses on underlying insurance contracts (EFRAG Topic 8)

Notes to constituents – Summary of proposals

37 *Generally, IFRS 17 requires changes in fulfilment cash flows that relate to future service to adjust the contractual service margin. However, applying the exception for reinsurance contracts held in paragraph 66(c)(ii) of IFRS 17, when a change in a group of underlying insurance contracts relates to future service but results in the group becoming onerous or more onerous, any corresponding change in the reinsurance contract held is also recognised in profit or loss immediately.*

38 *The ED proposes a further exception, that an entity would be required to adjust the contractual service margin of a group of reinsurance contracts held that provide proportionate coverage (that is, coverage for a fixed percentage of all claims from underlying contracts), and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. The amount of the adjustment and resulting income is determined as equal to the loss recognised on the group of underlying insurance contracts multiplied by the fixed percentage of claims on the group of underlying insurance contracts the entity has a right to recover from the issuer of the reinsurance contract.*

39 *The ED proposes that if an entity chooses to present separately the amounts recovered from the reinsurer and an allocation of the premiums paid applying paragraph 86 of IFRS 17, the income arising applying paragraph 66A of the ED would be included in amounts recovered from the reinsurer.*

40 *The ED proposes consequential amendments in paragraphs B95B – B95C for insurance contracts acquired and in paragraphs C15A and C20A for the transition requirements in IFRS 17. With respect to the transition requirements, a modification is added to the modified retrospective approach and a relief is added to the fair value approach.*

Question 4 – Reinsurance contracts held – recovery of losses on underlying insurance contracts (paragraphs 62, 66A-66B, B119C-B119F and BC67-BC90)

Paragraph 66A proposes that an entity adjust the contractual service margin of a group of reinsurance contracts held that provides proportionate coverage, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. The amount of the adjustment and resulting income is determined by multiplying:

(a) the loss recognised on the group of underlying insurance contracts; and

(b) the fixed percentage of claims on the group of underlying contracts the entity has a right to recover from the group of reinsurance contracts held.

Do you agree with the proposed amendment? Why or why not?

EFRAG's response

EFRAG welcomes the proposals of the IASB aiming to reduce the accounting mismatches for reinsurance contracts held.

EFRAG is requesting information from constituents about examples of proportionate reinsurance contracts that would be excluded from the scope of this amendment.

41 EFRAG welcomes the proposals of the IASB aiming to reduce the accounting mismatches for reinsurance contracts held.

42 EFRAG considers that an entity shall recognise a gain from the reinsurance contract held when it recognises a loss on initial recognition of an onerous group of underlying insurance contracts or on addition of onerous contracts to that group, to the extent that such reinsurance contract held covers a loss that is also recognised in profit or loss at the same time. This would happen when there is a direct association between the loss on the underlying contracts and the net gain on the reinsurance contract held. EFRAG observes that the wording in B119D, BC80 and in BC71 seem the exclude from the scope of this amendment a reinsurance contract that covers the surplus of a fixed percentage of the losses arising from each contract in a group of direct insurance contracts (also called surplus reinsurance contracts).

43 EFRAG recommends the IASB clarifies the wording of the Amendments so that it includes the fact pattern described in the paragraph above. EFRAG is of the view that the proposed solution by the IASB would have the same effects for these type of reinsurance contracts.

Questions to Constituents

44 For proportionate reinsurance contracts, EFRAG is requesting information about additional fact patterns that are not captured by the amendment but for which the proposed solution by the IASB would have the same accounting outcome.

45 In addition, the IASB has not addressed non-proportionate reinsurance contracts. A peculiarity of such contracts is that there is no one-to-one relationship between the direct underlying contract and the reinsurance contract held, but there are many underlying contracts that are covered by a single reinsurance contract held. Addressing non-proportionate reinsurance may therefore require the need to identify a “link” between the reinsured risk and the underlying contracts.

46 EFRAG understands that any accounting mismatch for non-proportionate contracts may, in practice, be reduced due to the impact on the risk adjustment rather than on the CSM.

47 In your view, should non-proportionate reinsurance contracts be treated similarly to the proportionate, i.e. gains in profit or loss when a loss is recognised on underlying contracts? If yes, please provide information about (i) the prevalence of such contracts, including volumes and jurisdictions where the issue arises and (ii) the cash flow pattern of these non-proportionate reinsurance contracts.

48 How would an accounting solution for non-proportionate reinsurance work?

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Question 5 - Presentation in the statement of financial position (EFRAG Topic 3)

Notes to constituents – Summary of proposals

49 The ED proposes to amend paragraph 78 of IFRS 17, which requires an entity to present separately in the statement of financial position the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities and the carrying amount of groups of reinsurance contracts held that are assets and those that are liabilities.

50 The proposed amendment would require an entity to instead present separately in the statement of financial position the carrying amount of portfolios of insurance contracts issued that are assets and those that are liabilities and portfolios of reinsurance contracts held that are assets and those that are liabilities. There are no proposed changes to the measurement requirements of IFRS 17 as a result of the proposed amendment.

51 In addition, consequential amendments to paragraphs 79 of IFRS 17 and to the disclosure requirements in paragraphs 99 and 132 of IFRS 17 to reflect a portfolio rather than a group level of presentation.

Question 5 – Presentation in the statement of financial position (paragraphs 78-79, 99, 132 and BC91-BC100)

The proposed amendment to paragraph 78 would require an entity to present separately in the statement of financial position the carrying amount of portfolios of insurance contracts issued that are assets and those that are liabilities. Applying the existing requirements, an entity would present the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities. The amendment would also apply to portfolios of reinsurance contracts held that are assets and those that are liabilities.

Do you agree with the proposed amendment? Why or why not?

EFRAG's response

EFRAG agrees with the proposed amendments, as they would simplify processes for preparers, decreasing the costs of implementation, without significantly reducing the information available to users.

52 The requirements in IFRS 17 raised concerns that the requirements around disclosures of groups of assets and liabilities may significantly increase the costs of implementation of IFRS 17 without providing commensurate benefits to users.

53 EFRAG considers that the amendment to paragraph 78 provides an operational relief to preparers of financial statements without significantly reducing the loss of useful information for users of financial statements.

54 EFRAG thus concludes while there is no conceptual basis for the proposed amendments, these are supported based upon a cost/benefit analysis.

55 Therefore, EFRAG supports the proposed amendments.

Questions to Constituents who are Users

56 Do Users agree with separate balance sheet presentation (of insurance contracts that are in an asset position from those that are in a liability position) on a portfolio level rather than at group level? Please explain.

57 Do Users agree that simplification in presentation is being pursued for cost/benefit purpose alone, without sufficient conceptual background? Please explain.

Question 6 - Applicability of the risk mitigation option (EFRAG Topic 4)

Notes to constituents – Summary of proposals

58 The Exposure Draft proposes to extend the risk mitigation option relating to the accounting treatment of some types of risk mitigation. That option currently existing in IFRS 17 permits an entity to reflect some or all of the changes in the effect of financial risk on insurance contracts with direct participation features that usually adjust the contractual service margin immediately in profit or loss. An entity may apply that option if, and only if, the entity mitigates those financial risks using derivatives and meets the conditions in paragraph B116 of IFRS 17. This risk mitigation option is only applicable to the variable fee approach. Without that exception, the variable fee approach would create an accounting mismatch when an entity uses derivatives to mitigate financial risk in insurance contracts.

59 That is, the accounting mismatch arises because:

(a) *the change resulting from financial risk in a reinsurance contract held would be recognised in profit or loss while*

(b) *the change resulting from financial risk in underlying insurance contracts with direct participation features would adjust the contractual service margin.*

60 The IASB rejected the broad application of the variable fee concept, after deciding that it is useful only for insurance contracts that are substantially investment-related service contracts.

61 The proposed amendment of the Exposure Draft would extend that option to be available when an entity mitigates financial risk on insurance contracts with direct participation features using reinsurance contracts held. This is also only applicable where the underlying contracts of an entity apply the variable fee approach.

62 The IASB acknowledged that the concern expressed by stakeholders for reinsurance contracts held is similar to the concern previously raised in relation to derivatives—i.e., the identified accounting mismatches are created by the variable fee approach.

Question 6 – Applicability of the risk mitigation option (paragraphs B116 and BC101-BC109)

The proposed amendment to paragraph B116 would extend the risk mitigation option available when an entity uses derivatives to mitigate financial risk arising from insurance contracts with direct participation features. That option would apply in circumstances when an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts with direct participation features.

Do you agree with the proposed amendment? Why or why not?

EFRAG's response

EFRAG supports the IASB proposals because it addresses an accounting mismatch that arises from using reinsurance held to mitigate financial risks. EFRAG is consulting its constituents on additional risk mitigation strategies.

63 EFRAG notes that the risk mitigation exception under IFRS 17 relating to the use of derivatives was created in order to address an accounting mismatch relating to financial risk introduced by the variable fee approach.

64 However, there may be an accounting mismatch similar to the accounting mismatch created when an entity uses derivatives as some entities purchase reinsurance to mitigate financial risks of underlying insurance contracts that apply the variable fee approach.

65 The accounting mismatch is most apparent when the effect of financial risk for the reinsurance held would be recognised in profit or loss but for the underlying contracts, the effect of financial risk would be recognised in the contractual service margin instead of being recognised also in profit or loss.

66 Therefore, in order to address this accounting mismatch, EFRAG supports the IASB proposals to extend the scope of the risk mitigation option to reinsurance contracts held.

Questions to Constituents

67 EFRAG has heard that the extension of the risk mitigation option is not sufficient and should be widened, for example, to include non-derivative instruments. Examples are hedging of interest rate risk is carried out using a combination of swaps, swaptions and fixed interest securities; for UK unit-linked business a unit-shorting technique is used.

68 Please explain the prevalence of the risk mitigation strategies stated in paragraph 67 above, including volumes and jurisdictions where the issue arises?

DRAFT

Question 7 – Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (EFRAG Topics 9A and 9B)

Notes to constituents – Summary of proposals

Deferral of effective date of IFRS 17 by one year

69 *Applying paragraph C1 of IFRS 17, an entity is required to apply IFRS 17 for annual reporting periods beginning on or after 1 January 2021. An entity can choose to apply IFRS 17 before that date but only if it also applies IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers.*

70 *The ED proposes an amendment in paragraph C1 of IFRS 17 to defer the effective date of IFRS 17 by one year so entities would be required to apply IFRS 17 for annual reporting periods beginning on or after 1 January 2022.*

71 *In addition, the ED proposes to delete the reference to IFRS 15 in paragraph C1 of IFRS 17 because IFRS 15 must be applied for annual reporting periods beginning on or after 1 January 2018.*

Deferral of effective date for the temporary exemption of IFRS 9 in IFRS 4

72 *The ED proposes an amendment in paragraph 20A of IFRS 4 to extend the temporary exemption from IFRS 9 by one year so that an entity applying the exemption would be required to apply IFRS 9 for annual reporting periods beginning on or after 1 January 2022.*

Question 7 – Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs C1 [Draft] Amendments to IFRS 4 and BC110-BC118)

IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. The amendments proposed in this Exposure Draft are such that they should not unduly disrupt implementation already under way or risk undue delays in the effective date.

(a) The proposed amendment to paragraph C1 would defer the effective date of IFRS 17 by one year from annual reporting periods beginning on or after 1 January 2021 to annual reporting periods beginning on or after 1 January 2022.

Do you agree with the proposed amendment? Why or why not?

(b) The proposed amendment to paragraph 20A of IFRS 4 would extend the temporary exemption from IFRS 9 by one year so that an entity applying the exemption would be required to apply IFRS 9 for annual reporting periods beginning on or after 1 January 2022.

Do you agree with the proposed amendment? Why or why not?

EFRAG's response

EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17 by one year to 1 January 2022.

EFRAG recommends that the effective date for IFRS 9 is aligned with the effective date of IFRS 17.

Deferral of effective date of IFRS 17 by one year

73 EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17 by one year to 1 January 2022. EFRAG considers that this responds appropriately to the call for additional time to implement IFRS 17, including the amendments proposed in this ED.

Deferral of effective date for the temporary exemption of IFRS 9 in IFRS 4

74 EFRAG supported the amendments to IFRS 4 *Insurance Contracts* in February 2016 and continues to consider that in order to provide relevant information to users of financial statements, it is important that IFRS 17 is applied together with IFRS 9.

75 EFRAG notes that, until IFRS 17 becomes effective, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, entities are required to disclose the effect of future IFRS Standards on the current period or any prior period, unless impracticable. Therefore, until IFRS 17 is effective, preparers will have to make an assessment of the expected impact of the standards in order to provide information to users.

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Question 8 – Transition modifications and reliefs (EFRAG Topics 5A and 5B)

Notes to constituents – Summary of proposals

Question 8A - Transition relief for business combinations

76 *The Exposure Draft proposes a modification to the modified retrospective approach that would permit an entity to classify such liabilities for insurance contracts acquired before the transition date as a liability for incurred claims rather than a liability for remaining coverage.*

77 *Consistent with the other requirements for the modified retrospective approach, an entity would be permitted to apply this modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach. The Exposure Draft proposes that an entity applying the fair value approach would have an option to classify such a liability as a liability for incurred claims.*

Question 8B - Transition relief for risk mitigation – transition date

78 *The ED proposes to extend the option in paragraphs B115-B116 of IFRS 17 relating to the accounting treatment of some types of risk mitigation. That option permits an entity to reflect some or all of the changes in the effect of financial risk on insurance contracts with direct participation features that usually adjust the contractual service margin immediately in profit or loss. An entity may apply that option if, and only if, the entity mitigates those financial risks using derivatives and meets the conditions in paragraph B116 of IFRS 17. Without that exception, the variable fee approach would create an accounting mismatch when an entity uses derivatives to mitigate financial risk in insurance contracts. Specifically:*

(a) *The change in the fair value of the derivative would be recognised in profit or loss applying IFRS 9; but*

(b) *The change in the insurance contract, the risk of which was mitigated by the derivative, would adjust the contractual service margin applying paragraph 45 of IFRS 17;*

79 *The proposed amendment in paragraph B116 of the ED extends that option to be available when an entity mitigates financial risk on insurance contracts with direct participation features using reinsurance contracts held.*

Question 8C – Fair value approach

80 *The ED proposes to extend the option in paragraphs B115-B116 of IFRS 17 relating to the accounting treatment of some types of risk mitigation. That option permits an entity to reflect some or all of the changes in the effect of financial risk on insurance contracts with direct participation features that usually adjust the contractual service margin immediately in profit or loss. An entity may apply that option if, and only if, the entity mitigates those financial risks using derivatives and meets the conditions in paragraph B116 of IFRS 17. Without that exception, the variable fee approach would create an accounting mismatch when an entity uses derivatives to mitigate financial risk in insurance contracts. Specifically:*

(a) *The change in the fair value of the derivative would be recognised in profit or loss applying IFRS 9; but*

(b) *The change in the insurance contract, the risk of which was mitigated by the derivative, would adjust the contractual service margin applying paragraph 45 of IFRS 17;*

81 *The proposed amendment in paragraph B116 of the ED extends that option to be available when an entity mitigates financial risk on insurance contracts with direct participation features using reinsurance contracts held.*

Question 8 – Transition modifications and reliefs (paragraphs C3(b), C5A, C9A, C22A and BC119-BC146)

(a) Paragraph C9A proposes an additional modification in the modified retrospective approach. The modification would require an entity, to the extent permitted by paragraph C8, to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired.

Paragraph C22A proposes that an entity applying the fair value approach could choose to classify such a liability as a liability for incurred claims.

Do you agree with the proposed amendments? Why or why not?

(b) The proposed amendment to paragraph C3(b) would permit an entity to apply the option in paragraph B115 prospectively from the transition date, rather than the date of initial application. The amendment proposes that to apply the option in paragraph B115 prospectively on or after the transition date, an entity would be required to designate risk mitigation relationships at or before the date it applies the option.

Do you agree with the proposed amendment? Why or why not?

(c) Paragraph C5A proposes that an entity that can apply IFRS 17 retrospectively to a group of insurance contracts be permitted to instead apply the fair value approach to that group if it meets specified criteria relating to risk mitigation.

Do you agree with the proposed amendment? Why or why not?

EFRAG's response

Transition relief for business combinations:

EFRAG supports the IASB's proposals on transition relief for business combinations for both the modified retrospective approach and fair value approach for practical reasons.

Transition relief for risk mitigation – transition date:

EFRAG notes that applying the risk mitigation approach from the transition date addresses accounting mismatches in comparative periods but not in periods prior to transition.

EFRAG considers retrospective application of the risk mitigation relief for variable fee contracts as providing more relevant information, if entities are able to prove using reasonable and supportable information that a hedging strategy was in place before application of IFRS 17.

EFRAG observes that the wording in the ED is unclear as to whether retrospective application of the risk mitigation according to B115 is allowed when using reinsurance for risk mitigation purposes.

Fair value approach:

EFRAG considers that the possibility to apply the risk mitigation option of B115 from the transition date and the option to apply the fair value approach when the entity meets the conditions for risk mitigation in C5A of the ED are a step in the right direction. However, if the IASB accepts EFRAG's suggestion to allow for a retrospective application of the risk mitigation in B115, these two options are not any more appropriate.

Question 8A - Transition relief for business combinations

82 EFRAG supports the IASB's proposals for both the modified retrospective approach and fair value approach because it will often be impracticable and entities may not

have sufficient information to classify contracts acquired in their settlement period before the transition date as either a liability for remaining coverage or a liability for incurred claims.

83 There would be cost/benefit challenges because at the time those contracts were acquired prior to transition, the entity may have managed together the claims for those contracts acquired with other contracts it issued and may have gathered data at a higher level than is required under IFRS 17 making it difficult to distinguish between claims from contracts issued and claims from contracts acquired.

Question 8B - Transition relief for risk mitigation – transition date

84 EFRAG notes that the risk mitigation relief is applicable prospectively as from the IFRS 17 transition date.

85 EFRAG considers that entities should be able to apply this risk mitigation relief retrospectively for contracts under the variable fee approach, provided that (1) entities are able to prove using reasonable and supportable information that a risk mitigation strategy was in place before application of IFRS 17 and (2) they met the criteria for the risk mitigation accounting in the relevant past reporting periods.

86 EFRAG considers that the application of risk mitigation is optional in nature, however once, elected, such retrospective application should be applied mandatorily to all the risk management strategies that existed in the relevant periods; entities would refer to information from their prudential or risk committees reporting.

87 EFRAG notes that without a retrospective application there would be accounting mismatches in periods prior to transition where a retrospective method is applied as it will result in a contractual service margin that does not reflect risk mitigation activities from previous periods, which would distort:

(a) the equity of entities - because the effect of previous changes in the fair value of the derivatives will be included in the equity, while the corresponding effect on the insurance contracts will be included in the measurement of the insurance contracts (through the contractual service margin); and

(b) the revenue recognised for these groups of contracts in future periods - because the contractual service margin includes the changes in financial risks that would have been excluded had the risk mitigation option been applied retrospectively.

88 EFRAG acknowledges that applying risk mitigation retrospectively gives rise to risk of hindsight, as entities could select which strategy would be designated retrospectively and which not. However, EFRAG considers that, provided that appropriate documentation on risk management strategies exists prior to the transition and that entities may prove with reasonable and supportable information that the conditions in B116 were met in the relevant past periods, there are no conceptual reasons not to allow retrospective application; in addition in such circumstances the risk of hindsight is reduced.

89 EFRAG considers that in these circumstances, the benefit in avoiding distorted financial information would overcome the risk of hindsight.

90 EFRAG observes that the wording in the ED is unclear as to whether retrospective application of the risk mitigation according to B115 is allowed when using reinsurance for risk mitigation purposes.

Question 8C – Fair value approach

91 EFRAG notes that the IASB has included in the ED two consequential amendments to the decision not to allow retrospective application of the risk mitigation option of B115, i.e. the possibility to apply the risk mitigation from the transition date (instead

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of from the effective date) and the option to apply the fair value approach when the conditions for risk mitigation in C5A of the ED are met.

92 EFRAG assesses these two consequential amendments to be a step in the right direction, however, would prefer that the IASB allows the retrospective application of the risk mitigation in B115. EFRAG considers that, if EFRAG's suggestion to allow for retrospective application of the risk mitigation is accepted by the IASB, the options granted by these two consequential amendments are not any more appropriate.

Question to Constituents

93 Do Constituents agree with the suggested approach, i.e. to prefer retrospective application of B115 instead of supporting the two consequential amendments? Please explain why.

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Question 9 – Minor amendments (EFRAG Topic 6)

Notes to constituents – Summary of proposals

94 The IASB proposes minor amendments to address a number of cases in which the drafting of IFRS 17 does not achieve the IASB's intended outcome. The IASB has not, and does not intend to, perform a comprehensive review of possible drafting improvements.

95 The following is a list of the minor amendments. Refer to the Basis for Conclusions of the ED paragraphs BC147 to BC163 for more details:

(a) *Scope and investment contracts with discretionary participation features;*

(b) *Recognition of contracts within a group;*

(c) *Business combinations outside the scope of IFRS 3;*

(d) *Adjusting the loss component for changes in the risk adjustment for non-financial risk;*

(e) *Disclosure of investment components excluded from insurance revenue and insurance service expenses;*

(f) *Risk adjustment for non-financial risk in disclosure requirements;*

(g) *Disclosure of sensitivity analyses;*

(h) *Definition of an investment component;*

(i) *Excluding changes relating to the time value of money and assumptions that relate to financial risk from changes in the carrying amount of the contractual service margin*

(j) *Changes in the risk adjustment for non-financial risk;*

(k) *Use of the risk mitigation option;*

(l) *Excluding changes from cash flows relating to loans to policyholders from revenue;*

(m) *Treatment of changes in underlying items;*

(n) *Amendment to IFRS 3 Business Combinations; and*

(o) *(o) Amendment to IFRS 7 Financial Instruments: Disclosures, IFRS 9 Financial Instruments and IAS 32 Financial Instruments: Presentation.*

Question 9 Minor amendments (BC147 – BC163)

This Exposure Draft also proposes minor amendments (see paragraphs BC147–BC163 of the Basis for Conclusions).

Do you agree with the Board's proposals for each of the minor amendments described in this Exposure Draft? Why or why not?

EFRAG's response

EFRAG is consulting with Constituents to find out whether there are any unintended consequences on the minor amendments.

96 EFRAG supports the IASB's proposals relating to the annual improvements as EFRAG agrees that they are intended to clarify the wording in the standard or to make corrections or to address minor unintended consequences/conflicts.

Questions to Constituents

97 Do Constituents consider that there are any unintended consequences arising from the minor amendments? Please explain.

98 EFRAG has heard of the following two concerns:

B128 of the amended IFRS 17

99 B128 of the amendments to IFRS 17 clarifies that changes in the measurement of a group of insurance contracts caused by changes in underlying items should be treated as changes in investments and hence as changes related to the time value of money or assumptions that relate to financial risk. The concern is that there would be a mis-presentation between insurance service result and finance result requiring to present items that are not financial in the financial result.

Paragraph 28 and paragraph 22 of the amendments to IFRS 17

100 Paragraph 28 of the amendments to IFRS 17 indicate that an entity shall include only contracts that individually meet one of the criteria set out in paragraph 25 of the amendments to IFRS 17. That is, based on:

(a) the beginning of the coverage period of the group of contracts;

(b) the date when the first payment from a policyholder in the group becomes due; and

(c) for a group of onerous contracts, when the group becomes onerous.

101 However, in paragraph 22 of the amendments to IFRS 17, an entity shall not include contracts issued more than one year apart in the same group.

102 Using the issue date in paragraph 22 of the amendments to IFRS 17 instead of the recognition date for the grouping would have implications on e.g. the discount rate and difficulties in terms of data availability causing operational issues and undue costs.

103 For the above two issues described above, please explain whether this is an issue for you and the prevalence of the issue, including volumes and jurisdictions where the issue arises?

Question 10 – Terminology (EFRAG Topic 7B)

Notes to constituents – Summary of proposals

104 The Exposure Draft proposes to add to Appendix A of IFRS 17 the definition 'insurance contract services' to be consistent with other proposed amendments in the Exposure Draft.

105 The IASB proposes to define 'insurance contract services' as:

"The following services that an entity provides to a policyholder of an insurance contract:

(a) *coverage for an insured event (insurance coverage);*

(b) *for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service); and*

(c) *for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service)."*

106 In the light of the proposed amendments in the Exposure Draft, the IASB is considering whether to make a consequential change in terminology by amending the terms in IFRS 17 to replace 'coverage' with 'service' in the terms 'coverage units', 'coverage period' and 'liability for remaining coverage'. If that change is made, those terms would become 'service units', 'service period' and 'liability for remaining service', respectively, throughout IFRS 17.

Question 10 Terminology

This Exposure Draft proposes to add to Appendix A of IFRS 17 the definition 'insurance contract services' to be consistent with other proposed amendments in this Exposure Draft.

In the light of the proposed amendments in this Exposure Draft, the Board is considering whether to make a consequential change in terminology by amending the terms in IFRS 17 to replace 'coverage' with 'service' in the terms 'coverage units', 'coverage period' and 'liability for remaining coverage'. If that change is made, those terms would become 'service units', 'service period' and 'liability for remaining service', respectively, throughout IFRS 17.

Would you find this change in terminology helpful? Why or why not?

EFRAG's response

EFRAG is consulting with Constituents to find out whether there are any unintended consequences.

107 EFRAG is consulting with Constituents to find out whether there are any unintended consequences.

Question to Constituents

108 Do Constituents consider that there are any unintended consequences arising from the proposed terminology? Please explain.

Appendix 2 – Other comments based on EFRAG's September 2018 letter to the IASB on issues that have not been addressed by the ED

Topic 1 - Annual cohorts (EFRAG Topic 13)

Notes to constituents – Summary of IFRS 17 requirements where no change is proposed by the IASB

This issue has had a long process of deliberation and re-deliberation

109 *In the 2010 Exposure Draft, the IASB proposed: (a) the risk adjustment be measured at the portfolio level; and (b) the CSM be measured at a lower level - the portfolio split into groups based on similar dates of inception and similar coverage periods. The IASB also proposed that the CSM recognised in profit or loss in each period be adjusted to reflect when fewer contracts than expected were in force at the end of a period, so that amounts related to contracts no longer in force would go to profit or loss immediately.*

110 *In the 2013 Exposure Draft, the IASB proposed a narrower definition of a portfolio of insurance contracts. That definition would be 'a group of insurance contracts that provide coverage for similar risks and that are priced similarly relative to the risk taken on and are managed together as a single pool'. The IASB proposed that the level of aggregation for both the measurement of expected cash flows and the contractual service margin should be the portfolio of insurance contracts. The IASB noted that the level of aggregation should not make a difference for the measurement of expected cash flows. However, the IASB did not specify a level of aggregation for recognising the contractual service margin. Instead, the IASB provided an objective that the contractual service margin should be recognised in profit or loss at a level of aggregation such that once the coverage period of the insurance contract has ended, the related contractual service margin has been fully recognised. The IASB noted that, in practice, this may result in a smaller unit of account than the portfolio that entities would generally use to manage contracts and may require entities to group together contracts that have similar contract inception dates, coverage periods and service profiles.*

111 *In the 2016 external review of IFRS 17, the IASB proposed that: (a) the definition of a portfolio of insurance contracts is a group of insurance contracts subject to similar risks and managed together as a single pool; (b) an entity is required to measure individual insurance contracts on initial recognition to determine what group they belong to. Those groups comprise contracts that on initial recognition have: (i) future cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions; and (ii) similar expected profitability. Similar profitability means similar contractual service margin as a percentage of the total expected revenue. As a practical expedient, an entity may instead assess whether the contracts have a similar expected return on premiums, i.e. the contractual service margin as a percentage of expected premiums; (c) an amount of the contractual service margin is recognised in the statement of profit or loss to reflect the service provided under the contract. In determining that amount, the objective is to allocate the contractual service margin for a group of contracts remaining (before any allocation) at the end of the reporting period over the coverage provided in the current period and expected remaining future coverage to be provided, on the basis of the passage of time. The allocation shall be based on coverage units, reflecting the expected duration and size of the contracts in the group.*

EFRAG's views

View 1

EFRAG supports the requirement to restrict the groups through the annual cohorts requirement, as this requirement is a justified simplification.

View 2

EFRAG believes that it is worth re-considering whether restricting the groups through the annual cohorts requirement is always justified, in particular for contracts with cash flows that affect or are affected by cash flows to policy holders of other contracts. EFRAG recommends that the IASB consider developing a special solution for such contracts, starting from paragraph BC138.

Before illustrating EFRAG's response, it is worth summarising the complex deliberation process for this topic, including the reasoning of the stakeholders that have expressed their concerns.

Introduction

112 The unit of account in IFRS 17 is a group of contracts at initial recognition; the same grouping is kept for (i) the determination of the CSM, (ii) its release pattern over the coverage period of the contracts in the group and (iii) the discount rate.

113 First, 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.

114 Paragraph 22 of IFRS 17 requires additionally that an entity shall not include contracts issued more than one year apart in the same group.

115 EFRAG has heard major concerns from constituents that a group of contracts cannot include contracts issued more than one year apart. In particular, some stakeholders 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.

March 2019 IASB re-deliberations

116 The IASB considered the requirements in IFRS 17 and acknowledged the cost implications but decided to retain the requirements in IFRS 17 and referred to the benefits of IFRS 17, the majority of which resides in the level of aggregation requirements. Some IASB members considered that abandoning those requirements would fundamentally change IFRS 17. In addition, the IASB considered that IFRS 17 already allows simplification compared to other IFRS Standards that require a contract by contract unit of account.

117 The reporting objectives of the level of aggregation requirements are:

(a) to appropriately depict trends in an entity's profit over time,

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

(c) timely recognition of losses from onerous contracts.

118 The IASB considered that the main obstacles to the reporting objectives of IFRS 17 if annual cohorts are eliminated are:

(a) averaging of profits; and

(b) 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.

119 In the re-deliberations, the IASB considered that the annual cohorts requirement is a simplification from previous principles-based proposals that had been envisaged using similar margins and contract duration in order to reduce the operational burden at implementation. In particular, the IASB concluded that the objective for the allocation of the contractual service margin could be achieved to an acceptable degree if, for each of the profitability buckets, an entity was restricted to grouping contracts that are issued within the same year. This would achieve the benefits of the reduced operational burden that results from removing the requirement for entities to group contracts according to similar profitability while still retaining the outcome the IASB desires for the allocation of the contractual service margin. Like the previous 'similar profitability' proposal in the draft IFRS 17, requiring annual cohorts would ensure that changes in profitability over time are more likely to be apparent because profits on contracts are allocated over a finite period, compared to open profitability buckets in which profits on contracts could be allocated over an infinite period (ref. paragraph 18 of agenda paper 2C of the IASB March 2019 meeting).

120 The IASB considered the effect on mutualised contracts of the requirement to restrict groups to contracts that are issued within one year. Contracts are mutualised if some policyholders have subordinated their claims to those of other policyholders, thereby reducing the direct exposure of the insurer to the collective risk of the group. The IASB considered whether applying annual cohorts to contracts that are fully mutualised (i.e. according to the IASB Staff paper contracts for which 100% of the risks are shared between policyholders) might result in a loss because an annual group is regarded as onerous even though the combined mutualised group (the portfolio) is profitable. The IASB concluded that, because the measurement and allocation of cash flows to groups consider the effect of mutualisation (so for example, cash flows are allocated across annual cohorts to reflect mutualisation), applying IFRS 17 to fully mutualised contracts would result in the same outcome with and without annual cohorts. The IASB considered whether to add an exception to annual cohorts for fully mutualised contracts, but concluded that to do so would add complexity, and create risk that the boundary would not be robust or appropriate in all circumstances. Nonetheless, the IASB noted in paragraph BC138 of the Basis for Conclusions on IFRS 17 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 apply annual cohorts to achieve the same accounting outcome in some circumstances (ref. paragraph 20 of Agenda Paper 2C of the IASB meeting of March 2019).

121 It is worth mentioning the following two exceptions are included in IFRS 17 at transition for the use of the annual cohorts:

122 Paragraph C10 states that when applying the modified retrospective approach at transition the entity shall not apply paragraph 22 to divide groups into those that do not include contracts issued more than one year apart, to the extent that it does not have reasonable and supportable information to apply the annual cohort requirement;

123 Paragraph C23 states that when applying the fair value approach to a group at transition the entity is not required to apply the annual cohort requirement but shall only divide groups into those including only contracts issued within a year or less if it has reasonable and supportable information to make the division.

124 No exception is granted in case of full retrospective approach.

Characteristics of the "mutualised" model

125 EFRAG understands that the transfer of wealth between generations of policyholders that participate to the same pool of assets is a key feature of life-saving business in several European jurisdictions, such as France, UK, Italy and Germany and therefore represent a common feature for a significant share of the entire European insurance market. The following is a description of the characteristics of such mutualised contracts:

(a) different generations of policyholders participate to the returns of a common underlying pool of assets;

(b) as a consequence, newly issued contracts join the existing population of beneficiaries of the total returns from the pool, so that the mutualisation mechanism lasts more than 1 year;

(c) the sharing of the risks among all policyholders relate to financial risk and, in some circumstances, also insurance risk and the financial risk accounts for substantially the entire variability of the cash flows of the insurance contracts;

(d) taking into account the inter-generational mutualisation model, in substance there is no single onerous contract until the group as a whole is onerous;

(e) in most cases in many jurisdictions these contracts are eligible to the VFA; and

(f) the potential loss for the insurer is generally limited to situations where the returns are not sufficient to cover guaranteed benefits.

The concerns expressed by constituents for mutualised contracts

126 EFRAG has heard the following main concerns expressed about the impact of the annual cohort requirement for the mutualised contracts described above:

(a) Costs and complexity of the requirements: significant changes to systems and increase costs (both at implementation and subsequently). Such changes will also lead to inconsistencies between accounting requirements and current business practices;

(b) The annual cohort requirement results in limited usefulness to users of the financial information. The splitting of 'mutualised' amounts into groups of contracts issued not more than one year apart is seen as artificial and different to how the business is organised and from the economics of the contracts: the initial allocation of cash flows on an annual cohort basis, which is artificial because there is a common underlying pool of assets, has to be compensated by further artificial allocations. As a consequence, the accounting would ignore the economic consequences of the contractual terms and not reflect reality;

(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) The costs of providing the demonstration suggested in paragraph BC138 may be as high as the cost of implementing the annual cohorts: depending on how the requirement is interpreted, because providing a detailed quantitative demonstration would entail building new systems and tracking data in a similar way to fully applying the annual cohorts requirement;

(e) The annual cohorts are not required at transition in absence of reasonable and supportable information to apply it, for the FVA and the MRA. In case of groups of mutualised contracts that share the results of the same pool, where the pool includes both recent generations of contracts (for which the FRA is practicable) and less recent generations of contracts (for which the FRA is not practicable), it would be logically possible to apply the transition exception to the annual cohorts requirement.

EFRAG's views

127 EFRAG agrees with the IASB reporting objectives of IFRS 17: depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses from onerous contracts.

128 EFRAG focuses on the combination of the annual cohort requirement with the segregation of portfolios, as required by paragraph 16 of IFRS 17.

129 EFRAG understands that in order to meet the above objectives, the annual cohort requirement has been retained as a practical simplification on a conventional basis. Such a convention derives from the difficulties to promote a principle-based approach. As a matter of fact, the IASB tried to develop a principle-based approach to identifying groups that would eliminate the loss of information, however such an approach was rejected because of feedback from stakeholders that it would be unduly burdensome. Key features of such a possible principle-based approach were detailed in the various exposure documents by the IASB as: (i) similar expected profitability; or (ii) cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions; or (iii) similar risks managed together as a single pool. In addition to the "similar profitability criterion", the IASB considered that, in order to ensure that there is no residual CSM after the expiry of contracts in the group (i.e. to avoid the "smoothing" of the CSM across generations), the contracts should have in principle similar contract inception dates, coverage periods and service profiles.

View 1: Agree with the IASB to retain the IFRS 17 requirements

130 The annual cohort requirement is a trade-off between tracking of individual contracts whilst ensuring the recognition of onerous contracts even where there are contracts with similar risks but different levels of profitability.

131 Without the annual cohort requirement, groups would remain open, resulting in a continuous re-averaging of the CSM and a loss or obfuscating of trend information. Disclosures are not a substitute for appropriate recognition and measurement and therefore, the loss of this information cannot be solved by disclosures.

132 IFRS 17 allows the intergenerational sharing of returns between cohorts to be reflected in the fulfilment cash flows. 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.

133 The contractual terms relating to sharing of risk between policyholders should not impact or change the revenue recognition principles for the insurer beyond reflecting the contractual arrangements as per paragraph B68 described above. The sharing of risks between policyholders may mean the equal treatment of policyholders irrespective of when their specific contract started but does not mean the profitability (to the entity and its shareholders) relating to those contracts over time remains stable or similar.

134 In the case of intergenerational sharing of returns where the policyholders share all risks (i.e. technical, financial and expense risk) apart from a fee paid to the entity, it means that two of the three objectives of the IASB are met/partially met:

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(a) No sub-set of contracts will become onerous (in the sense that the entity will have to step in to make payments) unless population as a whole becomes onerous; and

(b) The derecognition requirements relating to CSM and coverage units ensure that CSM will not be recognised beyond the coverage period (although without annual cohorts, the impact of averaging will play a role, the significance of this depending on various factors).

135 However, the concern about the impact of re-averaging on the recognition of CSM remains. In the EFRAG case study, a preparer reflected that a significant pricing shock would mean that the results with or without the use of annual cohorts differ for two to three years before converging to similar numbers again. This means that at critical points users will lose crucial information for two to three years. Other preparers either found differences between using cohorts or not. One preparer, using a stable state portfolio, found only limited differences between using cohorts or not.

136 Therefore, intergenerational sharing of returns may help preparers to prove that the impact of annual cohorts are not material (for the reasons explained in paragraph 131) for a specific period, but does not negate users' need for information about profitability.

137 Where only some risks are shared such as financial returns but not insurance risk, the contracts in those groups can become onerous where pricing was inadequate and so the entity will have to bear that risk. It is anomalous in such cases for the entity to continue reflecting and amortising CSM as if such an event has not occurred which would be the case if annual cohorts are removed for these types of contracts.

138 Finally, contracts under both the General Model and the Variable Fee Approach (VFA) can share risks. With the VFA there is no accreting of interest to the CSM as it is considered that the CSM is updated to reflect current conditions through the workings of the model. This is not true in the General Model where CSM can accrete interest at rates that have not been an economic reality for decades. Therefore, in the General Model, the impact of re-averaging (i.e. not applying cohorts) will be more significant and harder to defend on a conceptual basis.

139 For these reasons EFRAG believes that annual cohort requirement is a justifiable simplification.

View 2: Amendment needed to the IFRS 17 requirements

140 EFRAG believes it is worth re-considering whether such a simplification is always justified: in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts (in accordance with the heading of paragraph B67 to B71).

141 EFRAG acknowledges and appreciates that the IASB considered in depth in its decision process to find a solution for these mutualised contracts. However, the IASB decided not to add an exception to annual cohorts, as in its view to do so would add complexity and create a risk that the boundary would not be robust or appropriate in all circumstances. Instead of granting such an exception, the IASB noted in paragraph BC138 of the Basis for Conclusions on IFRS 17 that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. Accordingly, the IASB considered that it may not be necessary for an entity to apply the annual cohorts requirement to achieve the same accounting outcome in some circumstances.

142 EFRAG questions why such a relevant conclusion has been presented in the Basis for Conclusions instead of being part of the main body of the Standard.

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143 EFRAG observes that contracts where the cash flows significantly affect or are affected by the cash flows of other contracts are a common feature of a significant portion of the life insurance business in several European jurisdictions. The IASB has already factored in the peculiarities of such contracts in IFRS 17, including in paragraphs B67-B71.

144 While being in agreement with the reporting objectives of IFRS 17 as stated above, EFRAG disagrees with the conclusions of the IASB, in particular when in paragraph BC138 the IASB states that introducing an exception would add complexity and create the risk that the boundary would not be robust or appropriate in all circumstances.

145 Instead, EFRAG points out that, considering the relevance of mutualised contracts, it is of utmost importance for the IASB to provide a solution for this fact pattern, so to achieve an acceptable cost/benefits trade-off compared to the one resulting from the requirements in the Exposure Draft.

146 In fact, EFRAG assesses that, for contracts with intergenerational mutualisation, the application of the annual cohort requirement, while being operationally complex, would not necessarily provide additional useful information to users.

147 EFRAG believes that the technical elements needed to develop a solution are already present in the assessments that the IASB itself performed during the re-deliberation process: for contracts described in paragraphs B67-B71 and that share in the same pool of assets applying the annual cohort requirement would not lead to a significantly different accounting outcome and, therefore, should not be applied.

148 In conclusion, EFRAG recommends that the IASB re-considers providing a solution in the main text of the Standard for the contracts described in paragraphs B67-B71, starting from paragraph BC138, and acknowledging that for these contracts using the annual cohorts requirements is not necessary to achieve the same accounting outcome.

149 For contracts to which the annual cohorts are not applied, the transition provisions of IFRS 17 should be aligned, consistently with the recommendation above, including contracts for which the full retrospective application is applied.

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Questions to Constituents on proposed solutions

150 EFRAG has reviewed without taking a position (which is not in its mandate) the following proposals that have been put forward by constituents in order to overcome the concerns that have emerged on the IASB tentative decision to retain in the standard the annual cohort requirements.

151 EFRAG is willing to receive feedback from constituents on recent solutions that have been made public.

Solution proposed by the ANC in May 2019

152 "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.

153 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.

154 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."

155 "An exception to the application of annual cohorts should be considered when (as acknowledged by IFRS 17.BC 138) contracts fully share risks, so that "the groups together will give the same results as a single combined risk-sharing portfolio". The field test has demonstrated that applying annual cohorts in the case of intergenerational risk-sharing (mutualisation) is not conceptually necessary, does not provide useful information and adds complexity and costs. The concept of "fully shared risks" has to be defined in a broader way than contemplated by TRG staff (and rejected by TRG members) in order to address, for instance, life contracts with direct participation features where policyholders share financial and insurance risks. Limiting the use of the concept of "fully shared risks" to contracts where the CSM is nil or cannot be affected does not reflect reality."

"Suggested definition of "fully shared risks"

156 Contracts where "risks are fully shared" are referred to in the extreme situation presented in the TRG where cash flows are 100% shared among policyholders so that the insurer's share in the risks and returns is nil.

157 This feature is however not limited to that extreme scenario but should also be considered when:

(a) the existence of an insurer's share in the risks or in the returns on underlying items of a mutualised population of policyholders does not prevent from having first a genuine mutualisation (full risk sharing) among policyholders;

(b) the existence of specific guarantees granted to certain policyholders, concentrating risks or returns on the underlying items on certain contracts, does not prevent from having also a genuine mutualisation (full risk sharing) among policyholders.

158 Some suggested that in a portfolio where "risks are fully shared" among policyholders, the insurer's share should remain stable (i.e. 10%) rather than being nil. This may actually address many situations but would not be sufficient. The key criterion is in fact the onerous nature or not of the group of contracts: a population actually becomes onerous when the insurer's share in the risks increases to a point where the insurer is making or contemplating a loss.

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159 We therefore suggest defining that risks 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 contract within the group could possibly become onerous (alone)".

"Suggested modification of paragraph 22 of IFRS 17

160 An entity shall not include contracts issued more than one year apart in the same group. This provision does not apply to contracts belonging to a portfolio where insurance and financial risks are fully shared among generations of policyholders. Risks 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 contract within the group could possibly become onerous alone".

Solution proposed by the CFO Forum in June 2019

161 "The CFO Forum proposed to remove the requirement to group contracts by annual cohorts. This change was proposed as the current prohibition to aggregate contracts issued more than one year apart results in groupings that are inconsistent with the way firms manage their business and introduces significant implementation efforts and undue costs.

162 Considering the strong views at the IASB, we have now, in the interest of finding compromise solutions, limited the proposed amendments to:

(a) business where conceptually annual cohorts are most inconsistent with how the business is managed, i.e. VFA business with mutualisation

(b) the largest operational impact for other businesses, i.e. no annual cohorts at transition for in-force business (but no change for new business)".

163 The CFO Forum has proposed the following amendments to the wording of the Standard (words in red are added to the Standard):

164 "IFRS 17 para 22 is modified as follows: An entity shall not include contracts issued more than one year apart in the same group except as either permitted in paragraph C5A or for contracts with direct participating features when when i) the cash flows of contracts belonging to one cohort are significantly affected by the cash flows of other cohorts according to paragraphs B67-B71; and ii) the contracts share the same pool of underlying items. To achieve this the entity shall, if necessary, further divide the groups described in paragraphs 16-21.

165 IFRS 17 para C5A is added as follows: C5 A Regardless of the transition approach applied, an entity is not required at the transition date to apply paragraphs 1524, and may include in a group: (i) contracts issued more than one year apart; and (ii) contracts which would otherwise be divided by applying paragraph 16."

166 EFRAG understands that this proposal would result in the following accounting treatments:

(a) The unit of account adopted for in-force business for all the approaches (FRA, MRA, FVA) and all the models (general model, PAA, VFA) would be the portfolio (with the word "portfolio" assuming the meaning of IFRS 17 paragraph 14);

(b) Going forward, the annual cohort requirements is not applied for contracts under the VFA when there is mutualisation as described in paragraphs B67/B71 and the contracts refer to the same pool of assets.

Questions to Constituents

167 For contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts:

(a) How would you assess for the two proposed solutions above the trade/off between achieving the reporting benefits of IFRS 17 and solving the complexities and costs of applying the annual cohort requirements?

(b) Which other specific aspects of the two proposals should be further adjusted and why?

(c) Which of the above methods of calculating the CSM would in your view provide the best information? Why?

168 For contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts EFRAG is suggesting to the IASB to provide a special solution:

(a) Should such solution be limited to the contracts that apply the VFA?

(b) How should such solution be detailed, in order to ensure that:

(i) it is limited to an appropriate and robust boundary (e.g. limited to specific type of risk sharing patterns)?

(ii) the reporting objective of IFRS 17 are fully met (i.e. depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses from onerous contracts)?

169 Are there other types of contracts in the life insurance business, other than the contracts with cash flows that affect or are affected by cash flows to policyholders, that create similar complexity?

170 Some have observed that when a grouping approach broader than annual cohorts is applied, there is a benefit in providing additional information about trends in profitability. Such disclosure could include:

(a) Reconciliations for the CSM of those groups from the opening to the closing balances (according to paragraph 101 of the standard)

(b) Disclosure on profitability trends by presenting the CSM effect of new business joining the groups, extracted from (a), as a series of historical data (the last 3 years);

(c) Disclosure of the actuarial techniques applied for computing the CSM effect of new business joining the group as well as disclosure on method used for assessing the profitability referred in (b).

Would constituents consider appropriate to include these additional disclosures?

Topic 2 - Transition: Modified retrospective approach and fair value approach (EFRAG Topic 11)

Notes to constituents – Summary of IFRS 17 requirements where no change is proposed by the IASB

171 IFRS 17 requires retrospective application, consistent with IAS 8, unless retrospective application is impracticable. As explained in paragraph BC378, the IASB believes that it would be often impracticable for entities to measure several of the amounts needed for retrospective application and, in order to deal with such impracticability, the IASB has developed two alternative transition methods: the modified retrospective approach and the fair value approach.

172 If it is impracticable for an entity to apply the full retrospective approach, an entity can apply either the modified retrospective approach or the fair value approach. The modified retrospective approach has been developed with the objective of achieving the closest possible outcome to a retrospective application of the standard, using reasonable and supportable information; and includes a number of specified modifications, each of them available for use to the extent that the entity does not have reasonable and supportable information to apply the retrospective approach. When an entity is missing reasonable and supportable information to apply the modified retrospective approach, it is required to apply the fair value approach.

EFRAG's views

EFRAG observes that the modified retrospective approach and the fair value approach are two different measurement bases resulting in different outcomes that are not comparable, with the modified retrospective being the approach that aims to approximate the full retrospective approach which applies the most useful information.

EFRAG acknowledges the IASB decisions not to allow further modifications to the modified retrospective approach, as this would further reduce comparability. However, in order to address the implementation challenges and prevent that a strict interpretation unduly restricts the use of retrospective approaches, EFRAG recommends that the IASB acknowledges in the main text of the final standard that the use of estimates is allowed, including those needed to approximate the missing information (e.g. missing data-points).

173 EFRAG generally supports the retrospective application of IFRS 17 as with the adoption of a new standard.

174 EFRAG concurs with the IASB that, in the light of the diversity in previous insurance accounting practices and of the long duration of many types of insurance contracts, retrospective application provides the most useful information to users of financial statements, by allowing comparison between contracts written before and after the date of initial application of the Standard.

175 EFRAG observes that the modified retrospective approach has been designed to approximate the results of a retrospective application, while the fair value approach is a fall-back based on a different measurement basis, which is not designed to approximate the most useful financial information (i.e. the information resulting from the retrospective application).

176 EFRAG is strongly convinced that entities should maximise the use of the "full" retrospective approach or, when the full retrospective approach is impracticable, maximise the use the modified retrospective approach, in order to achieve to the extent possible useful financial information at transition and in the following years (until the maturity of the contracts existing at transition), before concluding that the fair value approach is the only practicable approach.

177 EFRAG is aware of the implementation challenges of both the full retrospective and the modified retrospective approach and in particular that the "reasonable and supportable information" criterion requires judgement to be applied.

178 One might consider that a full retrospective approach may be applied solely by collecting detailed data as if the standard had been applied from inception, which might lead to the conclusion that the full retrospective approach is often impracticable. As explained by the IASB in paragraph BC378, this is the reason why the modified retrospective approach has been designed, to approximate in these circumstances the accounting outcome of a full retrospective approach. EFRAG notes that the modified retrospective approach supplements the full retrospective approach with focused rules-based solutions where no reasonable and supportable information is available (except the one that might be required to apply the specified modification).

179 EFRAG acknowledges the IASB decisions not to allow to the entities to develop their own modifications, as adding more options to the transition provisions would further reduce comparability. However, in order to address the implementation challenges and prevent that a strict interpretation approach unduly restrict the use of retrospective and modified retrospective approach, EFRAG recommends that the IASB adds further clarifications in the final standard about the use of estimates and the assumptions in case of lack of data. To allay concerns about the difficulties in applying the modified retrospective approaches, EFRAG recommends that IFRS 17 should acknowledge in the main text of the standard that:

(a) the existence of specified modifications does not preclude the normal use of estimation techniques in the modified retrospective approach: paragraph BC143 of the Basis for Conclusions of the ED acknowledges that the use of estimates will often be needed in the modified retrospective approach. EFRAG suggests to move this paragraph to the main text of the standard;

(b) when applying either retrospective approach, the entity should search for reasonable and supportable information that is available without undue cost and effort to develop estimates and should apply judgement in making such estimates, as addressed by IAS 8, including those estimates needed to approximate the missing information.

180 EFRAG understands that the insurance industry has robust valuation practices developed by actuarial experts. Accordingly, it should be possible in many cases to appropriately recreate missing data using estimation techniques based on reasonable and supportable information.

Question to Constituents

181 EFRAG would like to receive feedback from constituents of specific prevalent fact patterns where the application of the modified retrospective approach is proving particularly challenging in practice. This would help in contextualising better the interpretation difficulties arising from obtaining reasonable and supportable information and from estimating missing amounts that are required to apply the modified retrospective approach.

Topic 3 - Balance sheet presentation: Non-separation of receivables and payables (EFRAG Topic 10)

Notes to constituents – Summary of IFRS 17 requirements where no change is proposed by the IASB

182 Apart from the presentation requirements for acquisition costs, the presentation requirements for the statement of financial position in paragraph 78 of IFRS 17 were amended to require an entity to instead present separately in the statement of financial position the carrying amounts of portfolios of insurance contracts issued that are assets and those that are liabilities and portfolios of reinsurance contracts held that are assets and those that are liabilities. There are no proposed changes to the measurement requirements of IFRS 17 as a result of this proposed amendment.

EFRAG's views

EFRAG agrees with the decision of the IASB to retain IFRS 17 requirements on balance sheet presentation, without a separate presentation for premium receivables and claims payable.

183 EFRAG agrees with the decision of the IASB to retain IFRS 17 requirements on balance sheet presentation, without a separate presentation for premium receivables and claims payable. The presentation requirements of IFRS 17 is consistent with its 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.

184 It has been noted that in practice varying definitions of premiums receivable are used. Some definitions encountered include overdue premiums (i.e. not paid on the contractual date); premiums due (i.e. the contractual payment date is in the next month) as well as annual premiums due (i.e. the full annual premium even if the amount has been transformed into monthly payments).

185 As current actuarial systems only include those expected amounts that are not yet considered to be due, preparers have advised that changing their systems would be costly. In order to solve the cost concern and require separate presentation on the face of the balance sheet or disclosure in the notes, a definition for receivables/amounts due would need to be developed (which would create costs for those entities that currently use a different definition).

186 EFRAG IAWG advised that there was very little credit risk in the receivables taken as a whole, which is supported by the limited disclosures currently provided in the discussion on credit risk by insurers. Furthermore, if separate presentation of components is deemed necessary, IAS 1 provides a solution as entities may disaggregate the different components on the face of the balance sheet.

Questions to Constituents

187 Do constituents believe that the presentation of separate information about receivables on the face of the balance sheet is essential for users?

188 Do constituents believe that disclosure of separate information about receivables in the notes is essential for users?

189 If yes, should this information be mandatory?

190 If yes, how you would define "amounts receivable" that would overcome the differences in definitions currently used as highlighted in paragraph 184?

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Topic 4 - Reinsurance contracts: contract boundary (EFRAG Topic 12)

Notes to constituents – Summary of IFRS 17 requirements where no change is proposed by the IASB

191 An entity applies the contract boundary requirements in paragraph 34 of IFRS 17 to the insurance contracts it issues and the reinsurance contracts it holds. That is:

(a) *the cash flows within the boundary of an insurance contract issued arise from the entity's substantive rights and substantive obligations as the issuer of that contract. These include the substantive right to receive amounts from the policyholder and the substantive obligation to provide services to the policyholder.*

(b) *the cash flows within the boundary of a reinsurance contract held arise from the entity's substantive rights and substantive obligations as the holder of that contract. These include the substantive right to receive services from the reinsurer and the substantive obligation to pay amounts to the reinsurer.*

192 Therefore, if an entity has a substantive right to receive services from the reinsurer relating to underlying contracts that are expected to be issued in the future, cash flows within the boundary of 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.

193 The IASB tentatively decided not to amend IFRS 17 for the following reasons. Modifying the IFRS 17 contract boundary requirements for reinsurance contracts held as proposed by stakeholders would result in a significant loss of useful information relative to that which would otherwise be provided by IFRS 17 for users of financial statements, because:

(a) *the measurement of reinsurance contracts held would not fully reflect the entity's substantive right to receive services from the reinsurer. This would reduce the relevance and faithful representation of information in the financial statements.*

(b) *the proposed amendment would go against the fundamental principle in IFRS 17 that all future cash flows within the contract boundary are reflected in the measurement of an insurance contract.*

(c) *the proposed amendment would add complexity to the contract boundary requirements.*

EFRAG's views

EFRAG supports the IASB's tentative decision not to amend IFRS 17 because IFRS 17 appropriately reflects the rights and obligations embedded in the reinsurance contracts held. EFRAG is consulting on the prevalence of any remaining issues.

194 EFRAG appreciates the IASB's further consideration of the contract boundary of reinsurance contracts held.

195 EFRAG supports the IASB's tentative decision not to amend the standard regarding the contract boundary for reinsurance contracts held.

196 EFRAG agrees that, conceptually, expected future cash flows for reinsurance contracts held and insurance contracts issued should be measured using a similar and consistent approach. This is because for both reinsurance contracts held and the underlying insurance contracts, measurement should reflect the entity's substantive rights and obligations created by the contract. Therefore, the contract

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boundary, risk adjustment and discount rate used for reinsurance contracts held compared to the underlying insurance contracts may differ as this reflects different contracts with different conditions.

197 Further, this approach is compliant with the general principle in IFRS 17 that all expected future cash flows within the contract boundary are reflected in the measurement of an insurance contract is respected.

198 It is acknowledged that estimating future contracts that will be covered by a reinsurance contract already written will require judgement. However, it is reasonable to expect that there will be evidence supporting the judgement needed, including:

(a) entities are likely to have budgets or forecasts which include expected new business and to have information about how reliable similar estimates were in the past; and

(b) the estimation of these contracts would follow the same measurement principles as IFRS 17, i.e., probability-weighted estimate of the present value of cash flows.

199 EFRAG acknowledges that there is no material impact on the balance sheet up until the entity pays or receives amounts relating to the reinsurance on future underlying contracts; or the underlying contracts are issued and the entity starts receiving reinsurance services relating to those contracts. However, the composition of the fulfilment cash flows and the CSM between the reinsurance contracts held and the underlying insurance contracts issued would be different.

200 Regarding CSM recognition in profit or loss, in circumstances that the service the entity receives from the reinsurer is proportionate to the service that the entity provides to the policyholder, the identification and allocation of coverage units for reinsurance contracts held will result in a pattern of CSM recognition which reflects that symmetry.

201 EFRAG considers that the CSM for the reinsurance contracts held which reflects future expected contracts would provide useful information for investors. The price to obtain reinsurance is more volatile than the price charged to the policyholders, therefore investors would find it useful to know how well protected the insurers are.

Questions to Constituents

202 Do Constituents agree to support the IASB's tentative decision not to amend IFRS 17 for the contract boundary of reinsurance contracts held?

203 Do Users consider that CSM for the reinsurance contracts held which reflects future expected contracts would provide useful information for investors? Please explain.

204 EFRAG understands that there is no material impact on balance sheet and probably not a significant impact on P&L (until certain events occur as explained in paragraph 199 above). EFRAG would like to receive feedback on the prevalence of this issue, based on the assessment done by entities in their implementation activities of IFRS 17. How prevalent is this issue?