EFRAG
European Financial Reporting Advisory Group

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Amendments to IFRS 17

Analysis of the comment letters received and proposed directions for drafting FCL

1 Based on the comments received, the EFRAG Secretariat has developed a revised draft EFRAG final comment letter that is presented as agenda paper 05-03.

2 A summary of the key messages received is provided in the presentation attached as agenda paper 05-06.

Structure of the paper

3 This comment letter analysis contains:

(a) Appendix 1 - detailed analysis of responses to questions in EFRAG's draft comment letter, EFRAG Secretariat's recommendations and questions to EFRAG members; and

(b) Appendix 2 – list of respondents.

Appendix 1 - Detailed analysis of responses to questions in EFRAG's draft comment letter, EFRAG Secretariat recommendations and questions to EFRAG members

Question 1

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?

Proposals in the ED

4 The ED proposes to amend paragraph 8A so 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.

5 The ED proposes to amend paragraph 7(h) with the effect that credit card contracts that meet the definition of an insurance contract are 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.

EFRAG's tentative position

> <u>Loans that transfer significant insurance risk:</u>
>
> 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.
>
> <u>Credit cards that provide insurance coverage:</u>
>
> 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 expected to lead to 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.

Summary of constituents' comments

6 Generally, constituents agreed with EFRAG comments both for loans that transfer significant insurance risk and credit cards that provide insurance coverage.

7 Some constituents added particular conditions to exclude payment card contracts from the scope of IFRS 17. I.e. payment card should be excluded:

(a) 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;

(b) if the insurance coverage is limited to indemnities related to the use of the facility;

(c) When they are financial instruments.

> *Question to constituents:*
>
> 8 Paragraph B.4.1.9.E of IFRS 9 allows a regulated interest rate as a proxy for the time value of the money in applying 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 concerns within your jurisdiction?

Summary of constituents' comments on question to constituents

9 Two constituents shared EFRAG's concern that there may be unintended consequences in those countries where the insurance element is not required by law or regulation (e.g. by requiring to measure the financial instrument at fair value through profit and loss if it fails the SPPI test). As the objective of the amendment is to reduce the operational burden for entities issuing these credit card contracts and to achieve the same accounting outcome as prior to IFRS 17 (i.e. no measurement at fair value through profit or loss), it is worth considering how to maintain their current accounting policies independently on whether the entity is obliged or chooses to provide such insurance coverage.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

10 The EFRAG Secretariat proposes no changes to the current text, except with regard to the treatment of the payment cards that are not credit cards. For these cards, the

conditions proposed by constituents in order to benefit from an exclusion from the scope of IFRS 17 seem not compatible. Hence, the EFRAG Secretariat proposes to discuss with EFRAG members, which one of the conditions, if one at all, should be preferred before concluding.

Questions for EFRAG members

11 Which of the criteria listed in paragraph 7 above do EFRAG members prefer in order to accommodate the exclusion of payment cards from the scope of IFRS 17? Please explain.

Question 2

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?

Proposals in the ED

12 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.

13 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.

14 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.

EFRAG's tentative position

> EFRAG supports the IASB's proposals with regards to the treatment of acquisition cash flows as the resulting financial information will better reflect the economic substance of these transactions.
>
> EFRAG supports the allocation of the acquisition cash flows to the contracts to be a mandatory requirement. EFRAG agrees with the proposed recoverability assessment approach.

Summary of constituents' comments

15 17 constituents agreed with/supported the IASB's proposed amendments and provided the following additional reasons to EFRAG's draft response:

(a) Increase in consistency with IFRS 15 (four respondents). One of these constituents added that comparability and understandability would be enhanced when comparing to other industries and standards;

(b) Users will benefit from appropriate information about the expected contract renewals through the reconciliation from opening to closing of the related assets and the quantitative disclosure of their expected inclusion in the measurement of the group of contracts to which they are allocated. (one constituent)

(c) The recoverability assessment ensures the asset for insurance acquisition cash flows to be impaired timely in case of events affecting the recoverability of the underlying cash flows and it strikes the right balance in the principle-based standard. (two constituents)

(d) The additional complexity is justified because a deferral better reflects the economic substance of the transactions and hence provides more relevant information (one national standard setter ('NSS')

(e) They better depict the underlying profitability of the contracts in line with the current practices of commissioning (one constituent).

16 However, two of these constituents – including an NSS - were concerned with paragraph 79[1] of the ED because the asset resulting from the insurance acquisition cash flows would most likely be presented as part of a liability as most portfolios of insurance contracts are expected to be in a liability position. As a result, this would reduce the quality of financial information available for users. Therefore, these assets should be separately disclosed on the face of the statement of financial position.

17 A constituent from the actuarial profession, reported concerns expressed by others that allocating insurance acquisition cash flows to future groups of contracts might create significant scope for judgement, both in terms of allocation to future groups and in terms of measurement, which may lead to diversity in practice. However, they note that observations of relevant needed parameters can be expected to provide a basis for economically systematic and rational allocation. They add that actuaries are experienced in preparing well-argued assumptions and judgements in areas which will be relevant to the IFRS 17 framework.

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[1] Paragraph 79 states that the asset resulting from insurance acquisition cash flows paid prior to the recognition of the groups of insurance contracts they relate to is included in the carrying amount of the related portfolios of insurance contracts issued. This is also applicable for reinsurance contracts held.

18 Another of these constituent added that to alleviate unnecessary implementation costs, the entity should be capable of measuring the asset for deferred acquisition costs by using estimates under the modified retrospective approach.

19 Another of these constituents stated that it was unclear how the transition requirements would be applied to the asset for insurance acquisition cash flows for future groups of contracts. They indicated that they are considering providing suggestions for transitional relief for cases where full retrospective application is impracticable.

20 One of these constituents – an NSS - noted concerns from some jurisdictions where acquisition costs did not make the first cohort of contracts onerous. The concern was that the entities would have to spread the acquisition costs over the anticipated renewal period. However, it was believed that many (if not most) would use the PAA approach where there is a choice to either expense the acquisition costs or to capitalise them and this would help mitigate the concerns.

21 One constituent, while agreeing with the direction of the proposed amendments, had the following concerns:

(a) Paragraph B35A of the ED can be misinterpreted to limit entities to only allocate to future groups of contracts, acquisition cash flows that are directly attributable at a group level. However, Appendix A of the ED defines insurance acquisition cash flows as those that are directly attributable at a portfolio level to be allocated to groups of contracts. There is a suggestion to revise paragraph B35A of the amendments to IFRS 17; and

(b) Paragraph B35B(b) of the ED requires an additional impairment test for the subset of the group's DAC in addition to paragraph B35B(a) of the ED. This additional impairment test adds significant complexity to implementation by adding an aspect of measurement within group and considered unnecessary.

22 Two constituents indicated that the allocation of acquisition costs to expected renewals should be optional, not mandatory. This is because the amendment might introduce the obligation each year to demonstrate, in case there is no allocation to renewals, that the expected renewals have effectively not been considered in the decision to incur in certain acquisition cash flows, particularly for the P&C business. Also, having it as an option would solve the loss of comparability due to the use of FV approach in transition (there would not be DAC asset recognised for this item) in relation to any of the retrospective approaches (in which there might).

23 One constituent – an NSS - indicated that there is an option in the PAA to recognise acquisition costs as an expense. A cost/benefit analysis would be needed if there is support to delete this option.

24 One constituent (a user organisation) agreed that the allocation of acquisition costs to expected renewals should be mandatory, because it would improve the comparability between different companies and renewable insurance contracts when considering the allocation of insurance acquisition cash flows sale costs.

25 One constituent – an NSS - indicated that it would be useful if there was some consistency in the presentation of the disclosure relating to determination of appropriate time-bands for the disclosure of the expected derecognition of the unallocated insurance acquisition cash flows. This respondent suggested that this should be assessed as part of the IFRS 17 post-implementation review.

Question to constituents:

26 Insurance contract renewals are not a defined term which may lead to diversity in practice when allocating insurance acquisition cash flows. Do you consider that

insurance contract renewals should be defined in order to achieve comparability and, if so, how would you define them?

Summary of constituents' comments on question to constituents

27 13 constituents did not consider that insurance contract renewals needed to be defined for the following reasons:

(a) The definition of the contract boundaries should be sufficient guidance. Also, future contract renewals may belong to different groups of insurance contracts which makes the issue complex but would not impact on the principle (one respondent);

(b) Contract renewals have not been defined in IFRS 15 (for example the pattern of amortisation of contract costs assets) (six respondents);

(c) IFRS 17 should remain principles based to avoid any unintended consequences (six respondents);

(d) It was considered that there is no significant divergence in practice (six respondents);

(e) The renewals to be considered in the allocation of acquisition costs would be entity–specific as it will depend on the expectation of contract renewals considered by the entity in the decision to incur in a certain initial amount of acquisition costs (two respondents)

(f) The proposed disclosures provide insight into the deferred cost and their expected derecognition and will provide some insight into the judgements applied. (one respondent)

28 One respondent indicated that the definition of insurance contract renewals is a specific issue of the entity's accounting policy. If a part of the costs is incurred to increase the business in future years, the corresponding depreciation and, if applicable, impairment should be registered so they represent the substance of the transaction.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

29 Based on the feedback from respondents that contract renewals do not need to be defined and that there is no significant divergence in practice, the EFRAG Secretariat proposes to delete the words 'However, EFRAG notes that 'expected renewals' is subjective and may result in divergent application in practice'.

<u>Allocation of the acquisition cash flows to the contracts to be mandatory?</u>

30 The EFRAG Secretariat proposes to make clear in the comment letter that EFRAG does not suggest changing the option under IFRS 17 to recognise insurance acquisition cash flows as expenses for the premium allocation approach ('PAA'). This is because EFRAG considers that this is a useful simplification of the measurement of some groups of contracts.

31 The EFRAG Secretariat proposes to make clear that under the PAA, if an entity chooses to capitalise the insurance acquisition cash flows (instead of expensing them), then the consistent allocation in future periods of the acquisition cash flows to the contracts (and hence the impairment test) should be mandatory. The entity should not have the ability to switch between expensing or capitalising the insurance acquisition cash flows. The reasons are the same as in the draft comment letter – i.e., in order to avoid entities choosing whether to do the impairment test or not, i.e., to increase comparability and reliability of the resulting information.

Questions for EFRAG members

32 Do EFRAG members agree with the suggested changes to the comment letter in paragraph 29 to 31 above? Please explain.

Question 3

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?

Proposals in the ED

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

34 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.

35 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.

36 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.

37 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'.

38 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.

EFRAG's tentative position

EFRAG supports the IASB's proposals regarding contracts under the general model. Some contracts under the general model include investment activities and the proposal will ensure that the contractual service margin (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's 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.

Summary of constituents' comments

39 Constituents held the following views of the amendments:

(a) There were no comments on the requirements for contracts with investment components under the general model;

(b) For contracts without investment components under the general model, 11 constituents considered the restrictions in respect of transferal or withdrawal to be inappropriate and asked for these to be removed; and

(c) Constituents were supportive of the changes for contracts under the VFA, with two requesting a clarification that these contracts may provide both investment-related and investment-return services.

40 On disclosure requirements some considered the quantitative disclosures commercially sensitive and/or could be covered adequately by the qualitative disclosures only, whilst others thought it was unfair compared to that required of other industries. However, others agreed with the requirement and/or indicated that they do not consider these as commercially sensitive.

General model – Contracts without investment components

41 Two constituents – including a national standard setter agreed with the EFRAG DCL and another also pointed out that endowment contracts also have the right to withdrawal or transfer of the contract.

42 A standard-setting constituent considered it important that the conditions for the identification of investment return services distinguish between contracts where an investment service is provided to the policyholder and those where investment activities are carried out to ensure the payment of expected claims. This constituent considers that the IASB has identified relevant conditions to achieve that objective. However, the constituent suggests an amendment to paragraph B119B to clarify that meeting these conditions is both necessary and sufficient – i.e. to remove uncertainty as to what other factors should be considered.

43 However, another constituent agreed with the IASB's proposal as it reflects the investment return provided to policyholders that they would not otherwise receive because of the amounts invested, their liquidity, complexity as well as the expertise of the insurer ("investment return service"). Taking this service into account when determining coverage units would provide useful information to users about the services that the entity regards itself as providing to the policyholder. Paragraph B119B should be amended on a more principled basis, i.e. to permit to determine coverage units based on insurance benefits and related non-insurance services performed to deliver those benefits and (a), (b), (c) should be labelled as indicators.

44 Similarly, several constituents expressed concern that the definition of investment return service in the ED is too prescriptive and too narrow as economically similar contracts could result in differing accounting results. Examples of where the amendment does not work are:

(a) Spanish deferred annuities without payment on death in the accumulation phase or the pay-out phase (or in both);

(b) deferred capital during the term agreed (accumulation period) without death benefit; and

(c) French saving products related to retirement where the right to withdrawal or to transfer can be very limited in practice;

(d) contracts with direct participation feature that has a second phase where there are no underlying assets;

(e) deferred annuity contracts where the surrender value, being also the investment component, might be half of the carrying value which is used to calculate the annuity payment. The investment-service definition would be limited to half of the carrying value. If half is surrendered, does the definition of the investment-service mean that there is no more investment-service after the surrender even though the rest of the carrying amount develops as before?

(f) There might be restrictions, e.g. withdrawal not allowed in the first two years or only in cases of divorce, long-term unemployment or long-term disability. For instance, in the case of the two-year restriction, is the investment service only considered to be included in the contract after two years?

45 The following example was provided by a constituent: a deferred annuity contract in Country A offers the policyholder an option to transfer to a new annuity provider on retirement. In practice, even if this option is never utilised, the contract would meet the criteria for an investment-return service in paragraph B119B of the Exposure Draft. A nearly identical deferred annuity contract in Country B, which is managed in the same way during both the accumulation and annuity pay-out periods, but does not offer a policyholder the option to transfer out, cannot include investment-return services during the deferral period because it fails the requirement proposed in paragraph B119B(a) for "the policyholder [to have] a right to withdraw an amount.

46 A proposal to revise the wording of paragraph B119B as follows was supported by four constituents:

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

a) the contract provides (on an expected basis at group level) a positive investment return (which could be below zero, for example in a negative interest rate environment); and

b) the entity expects to perform investment activity to generate that positive investment return."

Under this definition an investment-return service would either be absent, or present throughout the lifetime of a contract, and so the operational difficulties associated with changes in coverage units once investment return services are deemed to have ceased, or investment management expenses being only partly included in the fulfilment cash flows, are avoided. The above proposed definition should be considered on the assumption that policyholders will exercise their options only when they are economically beneficial for them.

47 Another constituent consider the definition of investment-return service too restrictive, as the generation of an investment return is essential also to annuities which have neither direct participation features nor withdrawal rights. They propose that IFRS 17 paragraph B119(b) be amended to remove references to investment components and withdrawals and to rather refer to benefits expected to depend on:

(a) the investment activities performed under the insurer's own account, or

(b) services specified in contracts such as unit-linked and other savings contracts.

48 Another standard-setting constituent confirmed that there are isolated concerns around the definition of investment-return services, the surrender and transferability criteria and suggest that the IASB revisit the necessity of these criteria in the definition. This is to ensure that, if the economics of the contracts otherwise are the same or very similar to contracts that meet these criteria, these should be treated alike.

49 Other constituents are concerned that based on the amendment, any type of long-term contract where the surrender value is linked to the market value of certain underlying assets (even though the contracts are not eligible under the VFA) could not qualify as providing an investment-return service depending on the interpretation of "expected positive return". They consider that an investment return service is present where the contract provides the policyholder with a positive expected investment return in contrast to contracts that provide only insurance services.

50 Furthermore, a constituent pointed out that this distinction (contracts with investment-return services or not) would also have balance sheet measurement consequences due to the in- or exclusion of the investment management expenses in the fulfilment cash flows of the relevant contract.

51 The EFRAG Secretariat agrees that economically similar transactions should be treated in the same way. However, the EFRAG Secretariat also considers it important to distinguish between services to the policyholder which should be reflected in revenue and actions as part of the business model and obligation to manage premiums received in a way to be able to make payments (often many years later) which do not meet the definition of revenue. The EFRAG Secretariat also notes that it is not clear why the right to withdraw or transfer does have an economic impact. For example, an insurance contract with the right to surrender is economically dissimilar to one without such a right to both the policyholder and insurer. The example provided around transferal of contracts ignore that a policyholder could benefit from another insurer's pricing for the annuity phase and the risk to the insurer if it chooses to do so.

<u>Variable fee approach</u>

52 Eight constituents agreed with the amendments and the EFRAG DCL.

53 One constituent noted that mortality or expense surpluses can also result in an underlying item that provides return to policyholders.

54 Two constituents are concerned that paragraph B119B may mean that VFA contracts cannot provide investment-return services. However, certain insurance contracts with direct participation features contain non-participating features and

therefore a clarification that VFA contracts may provide both investment-related and investment-return services is required.

Disclosure requirements

55 Two constituents expressed concern that the quantitative requirement in paragraph 109 places a burden on insurers whilst there is no similar requirement of future performance disclosure for other industries. For example, while banking groups have to provide information related to the net interest margin (such as a sensitivity analysis to interest rate changes) but this is not provided in time-buckets as will be expected of insurance.

56 Furthermore, these constituents disagree with the proposed amendment in paragraph 117(c)(v) as this depends on the driver used to allocate CSM and so it may be difficult to distinguish between insurance coverage and investment return service while not being useful to users.

57 Two other constituents consider the quantitative information to be provided may be commercially sensitive and therefore ask for the option to only provide qualitative information on this point as it can equally achieve the disclosure objective in this regard. A standard setter agrees as it considers that qualitative disclosures should provide similar information to quantitative disclosures, but it agrees with the other additional proposed disclosures.

58 At the same time one of the two constituents suggests qualitative information only, and considers that the proposal in the ED to provide quantitative forecasts on future expected CSM allocation would provide useful compensative information if the exception for the annual cohorts would be finally developed.

59 Two other standard-setting constituents agrees with the proposed disclosure requirements and a user organisation considers that these would be very useful to users.

60 Three constituents stated that they are not opposed to providing this information with another two constituents stated that they are not opposed to providing this information if it is not considered as highly sensitive.

61 A preparer constituent agrees with the requirement to disclose the approach used to assess the relative weighting of the benefits from insurance coverage and investment-return service or investment-related services as important for users.

62 An actuarial organisation noted that the information in paragraph 109 will be partial as the significant sensitivity of IFRS 17 metrics to market environment, it would not be sufficient to monitor the profitability pattern and allow comparisons across entities.

Minor amendment: Definition of an investment component (Appendix A of the ED, BC156)

63 One respondent indicated that the proposed amendment to the definition of an investment component is unhelpful. Their understanding of one of the conclusions from the TRG discussion on this topic was that as long as the contracts include cash surrender value and/or account or unit balances, it could be assumed that an investment component exists in these contracts.

64 One national standard setter had been informed that reinsurance contracts are specifically negotiated such that the current definition of investment component would often give rise to investment components, which does not appear to have been the intention of the IASB. They therefore ask the IASB to reconsider the proposed wording and to clarify it accordingly.

Questions to constituents:

65 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 followed by the annuity phase. The policyholder's beneficiaries receive no return if the policyholder dies during the accumulation phase. During the annuity phase, a surviving policyholder receives a fixed annuity amount based on premiums/technical provisions. In these deferred annuities the policyholder does not have a right to withdraw during either the accumulation phase or the annuity phase. Do you have additional examples of investment activities that are not captured by the proposals in the ED?

66 Entities have to provide quantitative disclosures 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. Do user constituents agree with this disclosure requirement? Do preparer constituents consider that this information is commercially sensitive? Please explain.

Summary of constituents' comments on questions to constituents

Definition of investment services

67 Another constituent identified the following contracts that would not benefit from the amendments: deferred annuities without payment on death in the accumulation phase or the pay-out phase (or in both), and deferred capital during the term agreed (accumulation period) without death benefit.

68 Two constituents were concerned that French saving products related to retirement where the right to withdrawal or to transfer can be very limited in practice may not qualify for the amendment.

Amendment to contract boundary (paragraph B65(la))

69 One respondent did not fully agree with the amendment of paragraph B65(la)in as far as it relates to unit-linked contracts. There is a concern that as asset managers account their investment service costs with IFRS 15 this means that inconsistency between how these are accounting for under IFRS 17. The concern is that the amendment could cause double counting where the covering assets are under the entity's management as these are currently included in the profit or loss on investments. Similar situations could occur in accounting for pension insurance contracts in accordance with IFRS 17 with the employer's pension benefits accounted for under IAS 19 *Employee Benefits*.

70 The EFRAG Secretariat considers the amendment to be aligned with the logic of the other amendments and the overall framework of the model. The situation described by the respondent would need to be adjusted for in any case due to the principles of consolidation that requires elimination of intra-group transactions. The EFRAG Secretariat also notes that an insurance contract issued by a related party to the reporting entity would not be a qualifying insurance policy in terms of IAS 19.

Inclusion of paragraph B119A

71 Three constituents did not agree that the period over which investment-return or investment-related service is provided is limited to the lifetime of the contracts giving rise to the related CSM. One provided the example that where the insurer has discretion to allocate the participation to policyholders within a defined time (such as in France it is 8 years), the exclusion of payments to future policyholders is not relevant for such contracts.

72 The EFRAG Secretariat notes that this paragraph does not alter the mechanics of applying IFRS 17 to contracts that share cash flows as described in paragraphs B67 to B71.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

73 The EFRAG Secretariat proposes the following changes to the current text:

(a) to reflect that economically similar transactions should be treated the same with respect to investment-return services,

(b) to request clarification around the existence of both investment-related and investment-return services for contracts under the VFA; and

(c) to note that while the quantitative disclosure may be useful to user, it only provides a partial picture of the future possible performance of the entity especially for contracts under the VFA.

Questions for EFRAG members

74 Would you consider appropriate that EFRAG proposes an alternative definition, such as one of those proposed in **paragraphs 46 and 47** above?

75 With refer to the requirement added by the ED to disclosure quantitative information of the forecasts of when entities expect to recognise in profit or loss the remaining CSM. The actuarial profession thinks that due to significant volatility of IFRS 17 metrics to market environment, quantitative information would not be considered sufficient by users to monitor profit pattern and allow comparisons across entities. But on the other side, an industry association points out the interest of users of having this disclosure in particular if the cohorts are eliminated.

76 Would you consider that, despite it being partial, EFRAG should suggest maintaining this requirement when amending the final standard for the exception to the annual cohorts requirement?

Question 4

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?

Proposals in the ED

77 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.

78 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.

79 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.

80 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.

EFRAG's tentative position

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

Summary of constituents' comments

81 Sixteen respondents agreed with the proposed amendment in paragraph 66A of IFRS 17. These respondents noted that the current definition of "proportionate reinsurance" is too narrow and restrictive and would therefore be limited to a small population of contracts which is not very common in practice.

82 Three respondents also noted that they do not agree with the calculation of the reinsurance adjustment in paragraph B119D, as this amendment can result in the recognition of reinsurance income that does not reflect the expected profits or losses on a reinsurance contract; they would prefer a principles-based approach where each entity may define its own methodology to calculate the risk adjustment. On the same issue an association of actuaries consider it as over-simplistic, but they conclude that it is a practical assumption that is consistent with BC79.

83 One respondent acknowledged that it would be preferable to have the same requirements for onerous contracts at inception and those that become onerous subsequently. However, bringing in new restrictions to paragraph 66(c)(ii), would disrupt ongoing implementation and we therefore do not recommend alignment. Nevertheless, this should be an area of review during the post-implementation review of IFRS 17.

84 The other three respondents did not specifically answer the question on whether they agree or disagree with the proposed amendments.

> *Questions to constituents:*
>
> 85 For proportionate reinsurance contracts, please provide fact patterns that are not captured by the amendment but for which the solution proposed by the IASB would be relevant.
>
> 86 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, for example because there are many

underlying contracts that are covered by a single excess loss reinsurance contract held. Addressing non-proportionate reinsurance may therefore require the need to identify a "link" between the reinsured risk and the underlying contracts. 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.

87 In your view:

(a) Should non-proportionate reinsurance contracts be treated similarly to proportionate reinsurance contracts, 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.

(b) How would an accounting solution for non-proportionate reinsurance work?

Summary of constituents' comments on question to constituents

Fact patterns not captured by the amendment for which the solution proposed by the IASB would be relevant

88 From the [three] respondents that answered the question provided the following examples of contracts providing proportionate coverage for which the solution proposed by the IASB would be relevant:

(a) Surplus reinsurance, where the insurer engagement is limited, stop-loss or excess-loss reinsurance treaties;

(b) Loss occurring contracts (the fixed percentage applies to all claims that occur on the underlying portfolio of risks –as opposed to a group of contracts);

(c) Single reinsurance contract covering different underlying groups of insurance contracts;

(d) Multiple reinsurance contracts covering a single group of underlying insurance contracts but in different proportions;

(e) A proportional reinsurance contract that only reinsures some but not all underlying contracts or some but not all risks in a group of contracts; and

(f) A proportional reinsurance contract sets minimum and/or maximum limits on the reinsurance cover, for example contracts that provide proportionate reinsurance above and below a fixed level;

Solution for proportionate reinsurance

89 Respondents proposed several different wordings for the definition of proportionate reinsurance:

(a) Two industry associations didn't see the need to have a definition. One of them observed that otherwise it may drive changes in the products and influence reinsurance business unduly, including financial stability implications.

(i) One of them proposed, if definition is included, to refer to a specified proportional share of individual underlying contracts;

(ii) The other one proposes to focus on the right to recover from the issuer a contractually defined portion of **each claim** incurred on individual underlying insurance contracts within a group of contracts. Reinsurance contract held that provides proportionate coverage ensures that, to meet the definition, the reinsurance contract must cover a specified, proportional share of each underlying insurance contract that is reinsured but there is no requirement for it to cover all contracts in a

single underlying unit of account in the same proportion. Amendments should be made to B119D and B119(c) as necessary to uphold the principle that there must be the ability to objectively measure the impact on individual insurance contracts within a group.

(b) Another industry association proposed a similar approach: modify paragraph 66A as follows:

   (i) An entity shall adjust the CSM of a group of reinsurance contracts held that provides coverage, and as a result recognize income to the extent the entity recognizes a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contacts to that group. The amount of the adjustment and resulting income is determined applying paragraphs B119D.

   (ii) Modify the definition on page 29 as follows: a reinsurance contract held that provides an entity with the right to recover from the issuer a contractually defined percentage of each claim incurred on individual underlying insurance contracts within a group of contracts.

   (iii) Modify paragraph B119C as follows: Paragraph 66A applies to reinsurance contracts held that provide proportionate coverage. Such reinsurance contracts provide the entity with the right to recover from the issuer a contractually defined percentage of each claim incurred on an individual underlying insurance contract within a group of contracts.

   (iv) Modify paragraph B19D: an entity shall determine di adjustment to the CSM and the resulting income recognized applying par. 66A as the portion of claims on the group of underlying insurance contracts that the entity has a right to recover from the group of reinsurance contracts held.

   (v) Eliminate the new footnote on page 56 of the ED to BC304.

(c) Similarly, an association of auditors proposed alternative approach to proportional offsetting: whether the reinsurer actually assumes the losses of the underlying insurance contracts and whether it can be allocated one to one to onerous contracts.

(d) One actuarial association proposed a definition based on the right to recover a percentage of all claims incurred during the coverage period of the reinsurance contract held (instead of all claims incurred on groups of underlying insurance contracts); this would allow to properly account for “Loss occurring contracts”. They suggest modifying paragraph B119B in order to take into account effects that apply at the level of each underlying contract. They provide an illustration of how the offsetting would work, including the proposal of recognizing a deferred asset in anticipation of future renewals of loss occurring contracts for which the treaty provides reinsurance coverage; the asset would be depreciated and the entity would assess recoverability if facts and circumstances indicate that the asset may be impaired (e.g. change or the reinsurance structure of the entity).

90 Two NSS expressed concerns that the assumption made in the ED that all losses arise from claims:

(a) The formula disregards that other expenses or the risk adjustment could contribute to a loss on the group of underlying insurance contracts, which are non-recoverable from reinsurance. We therefore have reservations against the assumption underlying this proposal that all losses arise from claims (paragraph BC79 of the ED);

(b) The definition of proportionate reinsurance coverage proposed in the ED are limited to contracts that provide “the right to recover from the issuer a

percentage of all claims incurred on a group of underlying insurance contracts". This definition disregards all other contractual terms such as reinsurance commissions and may therefore not adequately capture the economic substance of the reinsurance arrangement.

<u>Non-proportionate vs proportionate reinsurance contracts</u>

91 One respondent reported the following on prevalence of non-proportionate reinsurance treaties:

(a) in Life business, as a protection for clearly identified risks (pandemic risk) or guarantees (Guaranteed Minimum Death Benefit in the unit-linked contracts),

(b) in P&C business, for risks with a low frequency and high intensity, or to cap the loss on severe claims.

92 Seven respondents noted that the amendment should be extended to 'proportionate' contracts as not only improve the consistency between the accounting treatment of proportionate and non-proportionate reinsurance contracts but also increase the relevance of information provided to users on the effects of the reinsurance coverage put in place. Otherwise, the economics of these contracts and the reality of the risk management policies of the entities will not be appropriately reflected in the financial statements.

93 Two respondents – including an NSS - acknowledged that it may be harder to ascertain the exact level of offset achieved for non-proportionate reinsurance contracts, the economic fact that an offset exist is hardly disputable.

94 One NSS acknowledged that an insurer accepting to issue onerous contracts would generally expect to recover a gain from the reinsurance contract. Accordingly, the entity should be in a situation to identify the link between the reinsured risk and the underlying contracts and even assess the expected losses as well as the expected gain. Therefore, the possible increased operational complexity (not necessarily more complex than others in the standard) shall not prevent from having a broader solution conceptually funded. They consider that no difference exists in substance between proportionate and non-proportionate.

95 One NSS would not oppose if a solution for non-proportionate treaties can be identified in time for issuance of the standard in 2Q20.

Risk adjustment

96 One NSS acknowledged the issue, observed that the risk adjustments helps to reduce the practical consequences and understood the decision not to amend the standard for this issue. Similarly, another NSS would consider the risk adjustment as a possible solution.

97 On respondent from (actuarial profession) observed that the risk mitigation effect provided by non-proportionate reinsurance contracts is more linked to the occurring of exceptional events (and not to the expected losses on the underlying contracts) and should be captured by risk adjustment of the reinsurance contracts held.

98 Other respondents did not express their view on the topic.

<u>Accounting solution for non-proportionate reinsurance</u>

99 Two respondents noted that the accounting treatment should be determined based on the analysis of the contractual term of the reinsurance contract.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

100 With reference to the proportionate reinsurance, the EFRAG Secretariat proposes to amend the draft comment letter to:

(a) note that the ED has to be modified for proportionate reinsurance on the basis of similar economics;

(b) include the examples of proportionate contracts that are not captured by the amendment for which the solution proposed by the IASB would be relevant;

(c) suggest a possible approach to define eligible proportionate coverage. In order to define such an approach EFRAG Secretariat would like **to discuss with members TEG** the proposed reported above in paragraphs 89 and 90.

101 With reference to non-proportionate reinsurance, the EFRAG Secretariat proposes to not to modify the position in the draft comment letter, as it is aligned with the feedback from the actuarial profession. We propose to simply specify that the approach has been confirmed by constituents from the actuarial profession

Questions for EFRAG members

102 Identify possible alternative approach to proportionate reinsurance on the basis of the proposals in paragraphs 87 and 88 above.

103 Does EFRAG members agree with the suggestion to change the comment letter as noted in paragraph 100? Please explain.

Question 5

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?

Proposals in the ED

104 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.

105 The proposed amendment would 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 the proposed amendment.

106 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.

EFRAG's tentative position

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.

Summary of constituents' comments

107 Fifteen constituents agreed with the proposed amendment.

108 Three constituents noted that the standard should be amended to include premiums and claims on an accrual basis in the measurement of insurance liabilities, with separate premiums receivable and claims payable balances included separately on the balance sheet (potentially as an option). Benefits of this change include improvements in the quality of financial information presented and reduced implementation costs.

109 One constituent asks that the EFRAG letter on these points be substantially rewritten. Two points in particular need to be incorporated.

(a) On the separate asset and liability point, relief needs to be at a higher level than portfolio.

(b) The EFRAG comment letter should include a discussion of the wider aspects of presentation than just the statement of financial position, in particular the dual accounting point for subsidiaries versus groups for interim reporting.

Question to constituents:

110 Do Constituents that are Users agree that 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 will not significantly reduce the information available? Please explain.

Summary of constituents' comments on question to constituents

111 Six constituents noted there would be no (significant) loss of information. One constituent noted that the cost-benefit analysis was the main reason for asking for the amendment. One constituent noted that presentation at portfolio level rather than at group level was an adequate compromise. They added that from a conceptual point of view, the cash flows from insurance contracts, whether due, or not, are now aggregated in one balance sheet item for accounting purposes, which limits transparency.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

112 No changes proposed.

Questions for EFRAG members

113 Does EFRAG members agree with the suggestion not to change the comment letter? Please explain.

Question 6

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?

Proposals in the ED

114 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.

115 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.

116 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.

117 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 only applicable where the underlying contracts of an entity apply the variable fee approach.

118 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.

EFRAG's tentative position

EFRAG supports the IASB proposals because it addresses an accounting mismatch that arises from using reinsurance held to mitigate financial risks.

Summary of constituents' comments

119 Fifteen constituents agreed with the proposed amendment.

120 One constituent agreed with EFRAG's comments on the risk mitigation option.

121 One constituent noted that the hedge operations used to mitigate risks arising from insurance contracts issued must not generate accounting mismatches, irrespective of the financial instruments that are being used for this.

Question to constituents:

122 EFRAG has heard that the extension of the risk mitigation option should be widened, for example, to include non-derivative instruments such as when hedging of interest rate risk is carried out using a combination of swaps, swaptions and fixed interest securities.

123 Please explain the prevalence including volumes and jurisdictions involved, of the risk mitigation strategies identified in paragraph 64 above.

Summary of constituents' comments on question to constituents

124 Four constituents noted that non-derivative instruments to should be included in the risk mitigation option.

125 Two constituents noted the option should be extended to include all financial instruments at fair value through profit or loss.

126 Three constituents noted that the risk mitigation should be extended to include instruments used in hedging strategies which could include mix between fixed rate and variable rate instruments together with swaps, options and IRS. One constituent noted that the following instruments were being used: a combination of fixed income securities, mortgage loans, equity investments and (interest rate or equity) derivatives. Along the same lines, one constituent noted the risk mitigation scope should be enlarged to include risks other than financial risks, e.g. climate-related derivatives accounted for at fair value through profit or loss.

127 Other proposed changes to the risk mitigation option were the following:

(a) Application to insurance contracts under the general model separately and in combination with insurance contracts under the variable fee approach;

(b) Accounting of the volatility of hedging instruments in OCI, in particular because credit spread changes are not necessarily reflected equally in the IFRS 17 liability. Other mismatches could result from a company decision, based on ALM objectives, not to hedge financial risks in full;

(c) Retrospective application of the risk mitigation option (on transition);

(d) Treatment of products that have both "participating" and "non-participating" components but which meet the criteria for the Variable Fee Approach. Such products are common in Asia and North America and include variable annuities, which frequently have a non-trivial "fixed" component. For the "non-participating" component of such contracts, the asset investment result (i.e. interest accretion and change in value) impacts the statement of financial performance while the corresponding IFRS 17 liability effect is offset by the contractual service margin. This results in accounting volatility and can create an earnings pattern that is inappropriately front-ended.

128 One constituent provided the following information about the prevalence of risk mitigation strategies being used. The strategies reported were:

(a) Natural catastrophe risks mitigated with the help of climate derivatives;

(b) Non-VFA participating contracts applying the OCI option, with minimum guarantees hedged with the help of financial derivatives;

(c) Annuities resulting from PAA incurred claims applying the OCI-option hedged with financial derivatives (e.g. interest rate swaps).

129 One constituent noted the following. We are aware of the viewpoint that either current IFRS 9 hedge accounting or the IASB's dynamic risk management project should address the above issues. However, there are a number of issues that complicate the ability of insurers to use hedge accounting in IFRS 9, in particular:

(a) Hedge accounting requires the hedged item to be separately identifiable and reliably measurable, which is not possible where investment and insurance components of an insurance contract are highly interrelated.

(b) Insurers generally hedge open portfolios and, even in case of closed portfolios, hedging is regularly carried out dynamically. Consequently, both

hedged items and hedging instruments constantly change over the hedge term.

(c) Policyholder behaviour and other future expectations (e.g. lapses, surrenders, new business sales, and mortality) are intertwined with the impact of financial market variables. It is not evident how these items could be excluded from the hedging relationship. The hedge effectiveness requirements to qualify for hedge accounting are operationally onerous to comply with.

130 This constituent notes that IFRS 9 hedge accounting is not well suited for the more macro approach that is common within the insurance industry, and the dynamic risk management project has, to date, not contemplated many of the issues of concern. Moreover, the dynamic risk management project will not be finalised for at least a few more years. Therefore, we believe that additional changes to IFRS 17 are necessary. Since the mismatches described above result from the requirements of IFRS 17 (e.g. the variable fee approach and liability OCI accounting), it is appropriate that these are resolved within the IFRS 17 standard. The current IFRS 4 includes several mechanisms to reduce the accounting volatility in profit or loss (e.g. shadow accounting, accounting for the impact of guarantees at fair value through profit or loss, etc.) which are not available within IFRS 17.

Reinsurance – Eligibility for the VFA

131 Seven respondents noted that the reinsurance contracts held and issued should have been considered for the VFA, especially when the underlying insurance contracts are eligible for the VFA. One respondent noted that this is particularly prevalent in groups where subsidiaries routinely transfer the commercial substance of direct VFA business written in one subsidiary to another where, absent the IFRS 17 constraint, the reinsurance contract meets the criteria for qualification for the VFA.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

132 The EFRAG Secretariat proposes to change the comment letter for the following issues, for which there is no clear conceptual rationale for exclusion from the requirements already existing in the ED or in the standard:

(a) Treatment of financial instruments measured at fair value through profit or loss;

(b) Treatment of reinsurance contracts held and issued that qualify for the VFA.

133 With reference to the remaining strategies, we consider that the development of an appropriate accounting solution would conflict with the purpose to rapidly complete the finalization of the standard.

Questions for EFRAG members

134 Do EFRAG members think that it should be operable to account for reinsurance contracts held in accordance with the VFA? Do EFRAG members think these contracts occur often in practice?

135 Do EFRAG members agree with the proposed change to the comment letter? Please explain.

136 The feedback from the comment letters has reported several strategies other than derivatives, financial instruments at FVTP and reinsurance.

137 How prevalent are such strategies?

138 Do you consider that the IASB should consider starting a project on hedging for insurance entities? Additional evidence will however be available after the consultation on the EFRAG questionnaire on hedge accounting.

Question 7

> 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?

Proposals in the ED

Deferral of effective date of IFRS 17 by one year

139 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.

140 The ED proposes to amend 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.

141 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

142 The ED proposes to amend 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.

EFRAG's tentative position

> EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17, but it does not have a view at this stage on the appropriate extension of the effective date of IFRS 17.
>
> EFRAG agrees with the IASB that the effective date for IFRS 9 should continue to be aligned with the effective date of IFRS 17.
>
> EFRAG considers that the necessary amendments to IFRS 4 Insurance Contracts extending the optional deferral of IFRS 9 need to be published as early as possible and, at the latest, before the end of June 2020 so as to enable timely endorsement within Europe before the current expiry date of 1 January 2021.

Summary of constituents' comments

143 Nine respondents indicated that they prefer an effective date of 1 January 2022.

144 Seven respondents indicated that they prefer an effective date of 1 January 2023.

145 Five respondents either had divided views or did not indicate a preferred effective date. 1 NSS that did not indicate a date explain that the priority is to have a standard of high quality.

146 Fifteen respondents agreed with the EFRAG position that the effective date or IFRS 9 should continue to be aligned with the effective date of IFRS 17. One respondent specifically noted that IFRS 9 is needed for financial institutions as investments in credit assets are an increasing risk in the insurance sector particularly in countries where government bonds have registered low interest rates for years and rates remain low as insurers have increased their investments in this asset class. They also would require additional disclosure on asset quality prepared according to IFRS 9 until IFRS 9 is applied.

147 Five respondents raised their concern about the tight timeline for EU endorsement and emphasised the importance of timely endorsement specifically with regards to the extension for the IFRS 4 temporary exemption of IFRS 9.

148 Three respondents also emphasised the importance of a global effective date as it would a number of operational issues for multinationals operating in various jurisdictions.

<u>Comparative information</u>

149 Three respondents asked that the presentation of comparative information should be made optional.

150 Two respondents noted that comparative information at transition to IFRS 17 should be reconsidered.

151 One respondent suggested that in case of delay over 2022, it should be permitted to early adopt 17, to accommodate entities that need to apply IASB-issued IFRSs as well as EU-endorsed IFRSs.

152 An NSS noted that they also agree with the IASB proposal for the option to adopt IFRS 9 without comparative information and suggest that preparers do present comparative information under IFRS 9 to avoid accounting mismatches and to enhance comparability between insurers and non-insurers who already apply IFRS 9.

153 An NSS observed that applying IFRS 9, an entity deciding to restate the comparative year (2021) will have to apply both standards (i) IAS 39 on financial instrument derecognised before transition and (ii) IFRS 9 on financial instrument that have not been derecognised before transition. They would instead suggest offering the option to also retrospectively apply IFRS 9 to financial instrument that have been derecognised before transition.

Questions to constituents:

154 Do you consider that the proposed deferral of the effective date to 1 January 2022 is sufficient or would you support an additional year (i.e. 1 January 2023)?

155 Arguments in favour of accepting the proposed effective date of 1 January 2022 include:

(a) Further delaying the application of IFRS 17 beyond 2022 will be disruptive, as will increase the costs of their implementation processes; and

(b) A delay beyond 2022 may encourage entities to defer their implementation efforts rather than using the extended period to better implement the Standard.

156 Arguments in favour of further delaying the effective date to 1 January 2023 include:

(a) Some entities, mainly small and medium sized ones, often rely on third IT systems providers and so far there are no IT solutions for IFRS 17 available on the market, thereby making it difficult to meet the proposed 2022 effective date;

(b) The IASB expects to finalise the amendments by mid-2020. As a result, there will only be six months before the comparative period for IFRS 17 starts and this may be challenging for some entities; and

(c) Entities that would like to apply IFRS 17 earlier would be able to do so.

Summary of constituents' comments on questions to constituents

157 The following remarks were made by the nine respondents who indicated that they prefer an effective date of 1 January 2022:

(a) Ongoing project implementation efforts are strongly aligned with the effective date proposed in the ED, a further deferral would inevitably create unnecessary costs. In particular relevant IT systems would have to be sustained and maintained.

(b) Deferral beyond the date proposed in the ED will enhance uncertainty in the project implementation for those topics that are linked to judgement and, as consequence, will lead to more discussions in the industry and increase cost for alignment with auditors.

158 The following remarks were made by the six respondents who indicated that they prefer an effective date of 1 January 2023, noted the following reasons:

(a) It is necessary to clarify the controversial issues in the standard.

(b) The timeliness of concluding the final amendments is crucial as a delay beyond Q2 might imply further delays.

(c) Complexity of the standard

(d) Operational challenges such as a lack of skilled personnel and IT solutions

(e) The need for reaching consensus between insurers and their auditors.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

159 The main advantage of 2022 is the avoidance of an additional year of implementation costs. At the same time, small entities seem to be less prepared. Feedbacks show a Geographical split, with Germany preferring 2022 and France, Spain and Italy preferring 2023.

160 Should the suggested date be 2022, we would express sympathy for optionality of the comparatives.

161 The letter will be amended to reflect the outcome of EFRAG TEG discussion.

Questions for EFRAG members

Questions to EFRAG TEG members

162 EFRAG DCL did not express a preference of effective date. On the basis of the feedback reported above, which date is appropriate?

163 In order to enhance the quality of the information provided in the comparatives, would members consider appropriate to suggest an option to retrospectively apply IFRS 9 to financial instrument that have been derecognised before transition?

164 In case of deferral after 2022, do members consider that the requirement in IAS 8 to disclose the effects of standards not yet applied would be sufficient to mitigate the concerns of the users? What additional information could be reasonably prepared?

Question 8

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?

Proposals in the ED

Question 8A - Transition relief for business combinations

165 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.

166 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

167 The ED proposes to permit to apply the risk mitigation option applicable to contracts with direct participation features prospectively from the transition date, rather than the date of initial application.

168 In order to apply this as from the transition date, entities would have to designate risk mitigation relationships at or before the date that the option is applied.

Question 8C – Fair value approach

169 An entity that applies the full retrospective approach cannot apply the risk mitigation approach retrospectively.

170 Therefore, the ED proposes to permit the application of the fair value approach for entities who use the full retrospective approach to a group of insurance contracts. The fair value approach can be used if the specified criteria relating to risk mitigation are met.

EFRAG's tentative position

<u>Transition relief for business combinations:</u>

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

<u>Transition relief for risk mitigation – transition date:</u>

EFRAG assesses that the amendment to IFRS 17 to extend the option in paragraphs B115 to B116 of IFRS 17 is a step in the right direction.

However, EFRAG considers that retrospective application of the risk mitigation relief for contracts accounted for under the variable fee approach would provide more relevant information if entities are able to prove, using reasonable and supportable information, that a risk mitigation strategy was in place at the inception of the risk mitigation activity.

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

<u>Fair value approach:</u>

EFRAG considers that the possibility to apply the risk mitigation option of paragraph B115 from the transition date and the option to apply the fair value approach when the entity meets the conditions for risk mitigation in paragraph C5A of the ED are a step in the right direction. However, if the IASB accepts EFRAG's suggestion to allow retrospective application of the risk mitigation in paragraph B115, these two options are no longer necessary.

Summary of constituents' comments

<u>Transition relief for business combinations</u>

171 Ten respondents supported the proposed amendment regarding the transition relief for business combinations. However, they have noted the following:

172 Such a relief would also be useful for business combinations:

(a) which will *take place after transition* because liabilities for incurred claims are usually managed by the entity in the same way whether they have arisen from current activity or have been acquired in a business combination (two respondents);

(b) *before and after transition date* - similar amendments should be introduced to treat insurance contracts consistently, e.g. whatever the date of the business combination and the transition approach applied (four respondents); These respondents also noted that:

(i) Treating incurred claims as a liability for remaining coverage after the acquisition date would confuse users, impair comparability with other portfolios existing pre-acquisition as well as comparability with peers and distort well-established Key Performance Indicators (KPIs) that users ask for (e.g., combined ratio). Given the frequently significant settlement time of insurance claims, the impact on the financial statements would maintain over many years (two respondents).

(ii) From an economic perspective, there is no real "contract" behind the insurance coverage for adverse development. It is questionable who is receiving this insurance coverage. From the perspective of the original policyholder, the underlying insured event does not change. To treat liability for incurred claims as liability for remaining coverage after the business combination will impair the information relevance, as insurance revenue would be generated without transferring insurance coverage to the original policyholder. Therefore, they believe that the character of the claims in payment at the acquisition date should stay as it is before the acquisition, i.e. they should be treated as liability for incurred claims (LIC) instead of liability for remaining coverage (LRC) (two respondents).

(iii) It would be operationally complex to determine CSM and revenue for loss reserves, which is not foreseen in current systems/processes (two respondents).

(iv) a business combination would require the acquiring group to reassess the classification and the measurement model of the acquired contracts which could lead to further operational challenges when the group and subsidiary have different classification and accounting treatments for such contracts (four respondents).

(c) to entities who apply the full retrospective approach at transition.

<u>Transition relief for risk mitigation - transition date</u>

173 Eleven respondents agreed with EFRAG's response.

<u>Fair value approach</u>

174 Five respondents support the fact that the amendment is a step in the right direction.

Questions to constituents:

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

176 If you expect to apply the risk mitigation retrospectively under the approach proposed by EFRAG, how would you find the required evidence in practice? What would be the starting point for collecting the evidence and what process would you use?

Summary of constituents' comments on questions to constituents

<u>Retrospective application of paragraph B115</u>

177 Ten respondents indicated that the retrospective application of paragraph B115 instead of supporting the two consequential amendments should be available. These respondents noted the following:

(a) The retrospective use of risk mitigation should also be clearly allowed for reinsurance of contracts measured under the Variable Fee Approach, since the use of the VFA remains forbidden for reinsurance contracts (one respondent).

(b) The risk mitigation option should also be available where the risk mitigation has been applied by use other non-derivative financial instruments (one respondent).

(c) IFRS 17 should be amended to require an entity to apply the risk mitigation option of IFRS 17 to all transactions that meet the conditions in paragraph B116 (five respondents).

(d) One respondent noted suggested that the retrospective application of the risk mitigation option relating to reinsurance should be mandatory applied.

(e) One respondent acknowledges the risk of using hindsight and selective usage of the option. They therefore noted that absent another solution, they support the proposed amendment by the IASB.

(f) One respondent gave greater weight to the argument that retrospective application would provide more relevant information because it makes pre- and post-transition reporting of the contractual service margin more consistent and comparable.

Required evidence in practice

178 Only two respondents answered the question. They have noted the following:

(a) One respondent noted that entities issuing insurance contracts (notably due to the regulated nature of these activities) already require such a documentation to be in place, where such risk mitigation policies exist.

(b) Another respondent is of the view that documentation on the risk-management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts referred to in IFRS 17 paragraph B116 may already exist prior to the transition.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

179 EFRAG Secretariat notes the frequency of the concern about relevance of the information resulting from reclassification of a LIC acquired as LRC in the balance sheet of the acquirer. As such, we propose to discuss with EFRAG members the opportunity to suggest an amendment.

Questions for EFRAG members

180 Considering the comments received, do EFRAG members consider appropriate to amend the draft comment letter in order to:

(a) extend relief on business combinations to acquisitions after the transition date, limited to the classification as "liability for incurred claims" VS "liability for remaining coverage";

(b) specify that the requirements to apply IFRS 3 Purchase Accounting Method to measure acquired contracts would still apply?

Question 9

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 IASB's proposals for each of the minor amendments described in this Exposure Draft? Why or why not?

Proposals in the ED

181 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.

182 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) Amendment to IFRS 7 Financial Instruments: Disclosures, IFRS 9 Financial Instruments and IAS 32 Financial Instruments: Presentation

EFRAG's tentative position

EFRAG supports the IASB's proposal.

Summary of constituents' comments

183 16 respondents either did not answer this question and/or indicated that they agreed with the minor amendments except for concerns raised below relating to the minor amendments or focussed only on the concerns raised below.

184 Three respondents agreed with EFRAG's view that supported the IASB's proposals.

185 One respondent commented that only absolutely necessary changes in the wording should be approached at this stage of the process in order to avoid any disruptive impact on the ongoing and well-advanced implementation projects.

186 One respondent stated that they were still assessing the minor amendments.

Questions to constituents:

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

188 EFRAG has heard two concerns which are described in the following paragraphs.

B128 of the amended IFRS 17

189 Paragraph B128 of the amendments to IFRS 17 clarifies that changes in the measurement of a group of insurance contracts caused by changes in the fair value of underlying items should be treated as changes in investments and hence as changes in the time value of money and financial risk. The concern is that there would be a misclassification between insurance service result and finance result requiring the presentation of non-financial items in the financial result.

Paragraph 28 of the amendments to IFRS 17 and paragraph 22 of IFRS 17

190 Paragraph 28 of the amendments to IFRS 17 indicate that in recognising a group of insurance contracts in a reporting period 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.

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

192 Using the issue date in paragraph 25 of the amendments to IFRS 17 instead of the recognition date for the grouping would have implications on, for example, for the discount rate and could create difficulties in terms of data availability causing operational issues and undue costs.

193 If you agree with either of the above two issues, please explain why this is an issue for you and the prevalence of the issue, including volumes and jurisdictions where the issue arises?

Summary of constituents' comments on questions to constituents

Unintended consequences from the minor amendments

Change to the level at which the variable fee approach eligibility test is performed (B107(b)(ii))

194 The Exposure Draft proposes to change paragraph B107(b)(ii) so that the assessment of the variability in the amounts payable to the should be performed "over the duration of the insurance contract," whereas previously it was "over the duration of the group of insurance contracts."

195 Eight respondents were concerned of the assessment being done at individual contract level rather than at groups of contracts as this would be inconsistent with the unit of account for IFRS 17 measurement and would unduly disrupt the implementation projects and therefore significantly increase costs. Also, mutualisation effects would also need to be allocated to contract level in all scenarios. One of them suggested to reinstate the previous wording.

196 Another respondent indicated that they would ask the IASB to clarify which level the assessment for the variable fee approach should be performed.

Consequential amendment to IFRS 9 paragraph 2.1(e)(iii)

197 Three respondents noted that the consequential amendment to IFRS 9 paragraph 2.1(e)(iii) as worded ("However this standard applies to: …(iii) insurance contracts that meet the definition of a financial guarantee contract.") is likely to bring financial

guarantees received in the scope of IFRS 9. These respondents had the following comments:

(a) Clarifying that only "(iii) **issued** insurance contracts that meet the definition of a financial guarantee contract." are in the scope of IFRS 9 would avoid unintended consequences (such as for example for financial guarantees received in the context of a loan agreement whether these are integral to the lending arrangement or not). (two respondents)

(b) Such contracts, if accounted for in accordance with IFRS 9, would most likely fail the existing requirements in IFRS 9 in respect of contractual cash flow characteristics, and result in all purchased financial guarantees being accounted for at fair value through profit or loss resulting in a significant change to current practice. (one respondent)

198 One respondent stated that unintended consequences may have arisen related to minor amendments to financial guarantee contracts but did not explain further.

Amendment to IFRS 3 Business Combinations (Appendix D of the ED, BC162)

199 Three respondents did not concur with the requirement to re-assess the classification of acquired contracts on the business combination date, rather than retaining the classification made at inception for the following reasons:

(a) Due to further operational challenges, especially if the new subsidiary includes contracts that change in nature during their life. This would result in significantly different accounting treatments between the group and subsidiary financial statements. (two respondents)

(b) There was a concern with contracts that are acquired during the settlement period, it appeared counter-intuitive to ignore the substance upon execution of a business combination and to be required to treat that run-off contract as if it was a newly issued insurance contract. The insurer would have to artificially assign a CSM to a contract as if there was a period of remaining coverage where, in substance, no such coverage exists anymore. In addition, treating liabilities for incurred claims in the books of the acquiree as liabilities for remaining coverage in the books of the acquirer does not only give rise to completely different accounting but also does not positively contribute to the understanding of the business to an outside reader. (one respondent)

200 One of these respondents proposed to limit the relief provided by IFRS 3.64(N) to legacy contracts only.

Definition of an investment component (Appendix A of the ED, BC156)

201 The comments on this are included in the response to question three on allocation of CSM.

Definition of LIC/LRC definitions (Appendix A of the ED, Defined Terms)

202 One respondent stated that the additional language (provision b) added to the definition of liability for incurred claims and liability for remaining coverage is difficult to understand. In their view, the added provision is appropriate for the LRC definition, but is not appropriate or necessary for LIC. They were concerned that the language included for LIC meant that if an investment-return or investment-related service is no longer provided but has yet to incur an insurance claim (e.g. a policyholder elects a life-contingent annuitisation), it may be required to classify the obligation as LIC and write off the CSM. This was considered not appropriate in the example, as insurance coverage is still being provided to the policyholder. They suggested to remove part (b) for the LIC definition.

Experience adjustments for premium receipts in P&L vs. CSM – (Paragraphs 106(iv) and B124(d); conflict with B96(a) of the ED?)

203 One respondent commented that the proposed amendments indicate that "experience adjustment for premium receipts" should be presented as insurance revenue, but this appears to be in conflict with IFRS 17.B96(a), which indicates that "experience adjustments arising from premium received in the period that relate to future service" should adjust CSM.

Investment contracts with discretionary participation features (paragraph BC149 and 11(b) [2] of ED)

204 One respondent stated that it would be helpful if it would be clarified that an investment contract with discretionary participation features may contain a distinct investment component that could be separated and measured under IFRS 9; for example, a unit linked contract with a unitised with profit component attached.

205 Another respondent asked the IASB to have a second look as to what the intended treatment for contracts with distinct participation features was and how that treatment could be articulated more clearly.

BC148(a): Use of the term "issued" – editorial comment

206 One respondent reported that paragraph BC148(a) of the ED refers to a change in a paragraph that has been deleted.

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 (paragraph B96, BC157 of the ED)

207 The IASB proposes to exclude changes in relation to the time value of money and to assumptions relating to financial risk from adjusting the carrying amount of the CSM and to amend paragraph 96(d) accordingly.

208 Two respondents, referring to paragraph B96(c)[3] of the ED, mentioned that the paragraph implies a segregation of any unexpected investment component payments into a part which is due to a change in financial variables, and a part which is due to a change in non-financial variables. From an operational perspective, the determination of the actual investment component is already very complex and the segregation of the two effects would further increase the operational complexity. In addition, they would rarely expect material effects in practice.

209 These two respondents and one additional respondent stated that there is a knock-on question as to where such changes relating to the time value and financial risk should then be presented in the statement of profit or loss (i.e. as finance or investment income). They preferred that presenting such changes in full as finance income is appropriate to achieve consistency with the corresponding income from investments.

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[2] Paragraph 11(b) of the ED states that a distinct investment component should be separated from the insurance component and measured under IFRS 9 unless it is an investment component with discretionary participation features.

[3] Paragraph B96(c) of IFRS 17 states not to adjust the contractual service margin for any differences between investment components expected to become payable in the current period and the actual investment component, if those differences arise from changes in fulfilment cash flows due to the effect of the time value of money and changes in the time value of money and the effect of financial risk and changes in financial risk.

Mutual entities

210 Three respondents welcomed the clarification 'that not all entities that may be described as mutual entities have the feature that the most residual interest of the entity is due to a policyholder'. However, one of these respondents stated that it would be much clearer to amend BC264-269 instead adding a footnote to explain that. Two of these respondents added that on the dissolution of a mutual or demutualisation, in some cases the net assets may distributed among member policyholders but in other cases the net assets may not be distributed to the policyholders and are instead transferred to another mutual insurance company or to a foundation.

211 In addition, one of these respondents commented that the IASB's separately published educational material, *Insurance contracts issued by mutual entities*, wrongly makes the same assumption as BC264-269 with the result that it is misleading as a whole and should be withdrawn.

<u>Issue mentioned in EFRAG DCL – Treatment of changes in underlying items - Paragraph B128/ BC161 of the amendments to IFRS 17</u>

212 Eleven respondents did not support the proposed amendment (specifically relating to B128(c)) and had the following comments:

(a) Referring to paragraph BC161[4] of the ED, the underlying items were not defined for contracts without direct participation features (one respondent).

(b) It is unclear whether the amendment introduces the concept of underlying items to contracts measured using the general model or whether it is only for the variable fee approach. Also, there is a concern about the potential accounting mismatch if the underlying items are non-financial – to avoid this, the change in financial risk and associated movement in underlying items should be reported together in insurance finance result. (two respondents).

(c) Three respondents did not agree that the amendment is effective only when all underlying items are assets – it should be modified to fit different combinations of underlying items (three respondents).

(d) Showing all changes in underlying items in financial result would result in mispresentation in both insurance service results and insurance finance results/ would heavily distort the presentation of the different sources from which the profits are generated. (four respondents)

(e) Any potential solutions should be reviewed in light of paragraphs 88 and 89 of IFRS 17 to ensure an adequate OCI solution is available to avoid further accounting mismatches. (one respondent)

(f) A change in cash flows from participation in non-financial items, e.g. the risk result, is not related to the financial results and therefore, they believe these changes in underlying items should not be treated as changes in investments. Also, it was questioned how it would work with the "book yield approach". (one respondent)

(g) It was understood that the IASB intended to resolve an accounting mismatch for contracts with policyholder participation in non-financial underlying items accounted for under the general model but a solution should be more targeted. (two respondents)

[4] Paragraph BC161 states that "otherwise, changes in the underlying items could adjust the contractual service margin of insurance contracts without direct participation features".

(h) It implied that underlying items can only be financial instruments which is not always the case. Since underlying items can also relate to reinsurance or mortality for example, this respondent did not consider the amendment appropriate. (four respondents)

(i) It provides a rules-based presentation of "changes in underlying items" as insurance financial result in the P&L and creates an ambiguity on how to apply these requirements to non-VFA contracts. In addition, it introduces a non-conceptually funded presentation of non-financial changes in insurance financial results and creates a mismatch in the P&L. (one respondent)

213 One of these respondents suggested that if the change was non-financial and thus exogenous to the investment, it should be presented as insurance income (and not as finance income); conversely, if the change was financial, it should be presented as finance income.

214 One respondent indicated that there appeared to be no negative or unexpected effects in Spain.

215 One respondent supported the concern but indicated that they have not yet assessed the potential consequences in terms of costs or consistency.

216 One respondent mentioned that it was not clear whether the amendment to paragraph B128(c)[5] of the ED applied to all contracts or only to contracts with direct participation features.

217 One of the national standard setters indicated that it was not clear what alternative was suggested to the IASB proposal.

<u>Issue mentioned in EFRAG DCL – Recognition of contracts within a group - paragraph 28/BC 150 of amendments to IFRS 17 and paragraphs 22/25 of IFRS 17</u>

218 Four respondents shared the same concerns described in EFRAG's draft comment letter for the following reasons:

(a) To build up a group of contracts and therefore track them based on the issue date would require a database which is not available in systems so far. An implementation of the "issued" approach would require significant change to the current systems and unduly disrupt the implementation projects (two respondents).

(b) To keep the date for the grouping consistent with the recognition date fits better to the way of how the entity manages its business. For example, for motor insurance, the tariff 2019 would be completely in one annual cohort, not divided in different groups because of different issue dates (two respondents).

(c) The requirement would require substantial additional implementation costs which outweigh significantly any benefits (two respondents).

219 One national standard setter had been notified by his constituents that BC150 would cause disruption and system changes that were not foreseen previously because a different locked-in rate would apply (one respondent)

220 Two respondents indicated that IFRS 17 should be consistent in referring to either the recognition date or the date of issue throughout.

221 Four respondents indicated that paragraph 22 should refer to the time of initial recognition rather than issue date. The following provided proposed suggestions to the IFRS 17 wording:

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[5] Paragraph B128(c) refers to "changes in the measurement of a group of insurance contracts caused by changes in the fair value of underlying items".

(a) Two of them provided the following suggestion.

IFRS 17.22 "An entity shall not include contracts initially recognized, i.e. that meet one of the criteria set out in paragraph 25, ~~issued~~ more than one year apart in the same group."

(b) One of them suggested to refer to 'contracts initially recognised more than one year apart' in paragraph 22 of IFRS 17.

222 One respondent indicated that there appeared to be no negative or unexpected effects in Spain. They added that the premium is usually paid at the same moment the entity issues the contract.

223 Two respondents supported the concern but indicated that they have not yet assessed the potential consequences in terms of costs or consistency.

224 One respondent indicated that the practical consequences of the amendment and interaction between paragraph 22 and 25 of IFRS 17 have not been detailed in the ED. Therefore, they were not able to make the assessment at this stage.

225 One national standard setter indicated that it should be clarified with stakeholders their concerns and their alternative proposals.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

226 The EFRAG Secretariat proposes to amend the comment letter to ensure that financial guarantees held are not within the scope of IFRS 9.

227 For the other issues, the EFRAG Secretariat proposes to describe them in an appendix to the comment letter but mentioning that EFRAG has not developed a view as to whether standard setting is needed for these issues.

Questions for EFRAG members

228 Do EFRAG members agree with the suggested changes to the comment letter in paragraphs 226 to 227 above? Please explain.

Question 10

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 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.

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

Proposals in the ED

229 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.

230 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)."

231 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.

EFRAG's tentative position

EFRAG agrees with the IASB making consequential changes in terminology as the CSM allocation now reflects services provided rather than being limited to insurance coverage.

Summary of constituents' comments

232 Nine respondents provided feedback on unintended consequences below.

233 Seven respondents did not answer this question or indicated that they did not have specific comments.

234 Four respondents agreed with/welcomed the proposed changes. However, one of them considered that there were more terminology improvements that were more critical related to, for e.g., the application of the level of aggregation provisions to reinsurance contracts.

235 One respondent did not consider a change was essential to the understanding of IFRS 17 but concurred that the terminology would make it clearer that an insurance contracts can provide more than just insurance cover.

Question to constituents:

236 Do constituents consider that there may be unintended consequences arising from the proposed change in terminology? Please explain.

Summary of constituents' comments on question to constituents

237 Three respondents did not identify or were not aware of unintended consequences.

238 Six respondents were concerned or not supportive, in general, of the terminology changes as this would be confusing, would imply undue time for entities to update their internal documentation already prepared, e.g., guidelines, reporting package and chart of accounts and would be disruptive at the late stage of the implementation projects.

239 Two of these respondents indicated that the term 'insurance contract services' has the following unintended consequences:

(a) Paragraph 34 of the ED – The definition of contract boundary has been changed by the restriction to "insurance contract services". This change would be significant (as well as disruptive) (two respondents). One of these respondents stated that paragraph 34 of the ED should also refer to re-pricing of investment related or investment return service, otherwise this could affect the contract boundary of contracts;

(b) Paragraphs 41(a), 83 of the ED – The amendments to these paragraphs conflict with the supporting paragraph B120 of the ED (one respondent);

(c) Appendix A (LRC) – Restricting the LRC to "insurance contract services" would be a significant and disruptive change (one respondent);

(d) One of the respondents suggested that the new term “insurance contract services” should be reversed from paragraphs 12, 34, 41(a), 83, 103, 104, Appendix A (LIC, LRC) and B65. Also, the amended definition of “coverage period” should not be used in paragraph 25 (recognition) or paragraphs 53-59 (PAA).

240 One of these respondents provided the following specific unintended consequence where the changed definition of coverage period should be considered - Given the fact that the proposed amended definition of the coverage period refers to insurance contract services, a different recognition date for an investment contract with DPF from the default cases is not necessary. Therefore, it was recommended to delete paragraph 71(a).

241 One of these respondents supported a change from the term ‘coverage units’ to ‘service units’.

EFRAG Secretariat’s recommendations to EFRAG members on EFRAG’s proposed final position

242 The EFRAG Secretariat proposes to describe the concerns on terminology in an appendix to the comment letter but mentioning that EFRAG has not developed a view as to whether standard setting is needed for these issues.

Questions for EFRAG members

243 Do EFRAG members agree with the suggested changes to the comment letter in paragraph 242 above? Please explain.

Topic 1 - Annual cohorts

Questions to Constituents

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

(a) EFRAG is suggesting to the IASB to provide an exception to the requirement to restrict the grouping of contracts using the annual cohorts. Would Constituents agree with this proposal? Please explain why or why not.

(b) Please provide fact patterns - and their prevalence - for which the application of the annual cohorts requirement results in added complexity that is not justified and, as a consequence, should be captured in such an exception. For example:

(i) Contracts to which the VFA applies compared to other contracts;

(ii) Contracts with full sharing of risks compared to other contracts that only share a substantial or significant part of the risks;

(iii) Contracts that share all risks or only particular risk types; and

(iv) Contracts with sharing of asset returns of underlying pools compared to other contracts.

245 As reported in paragraph 129, the exception should meet the reporting objectives of IFRS 17 (i.e. depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses onerous contracts).

With reference to the pattern of recognition of the CSM, EFRAG in its case study received mixed results as to whether the resulting information would be impacted by the removal of the annual cohorts.

In your opinion, how would you ensure that the CSM release pattern would be in line with the IFRS 17 stated objectives? Do you envisage any loss of information as

contemplated by the IASB in paragraph BC177 of the ED? If so, how would you address that loss of information?

246 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?

247 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 IFRS 17)

(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 (for example, 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 about the method used for assessing the profitability referred in (b).

Would Constituents consider it appropriate to include these additional disclosures?

Proposals in the ED

248 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.

249 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.

250 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 tentative position

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

EFRAG acknowledges that the annual cohort requirement is a trade-off between tracking individual contracts and ensuring the recognition of onerous contracts even where there are contracts with similar risks but different levels of profitability. Nonetheless, EFRAG considers that the requirement leads to unnecessary cost in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts.

EFRAG therefore believes that it is worth re-considering whether in certain cases the annual cohorts requirement is justified for such contracts. EFRAG recommends that the IASB consider developing an exception for such contracts, starting from paragraph BC138; the exception should be reflective of the reporting objectives of the level of aggregation requirements in IFRS 17.

Summary of constituents' comments

251 Constituents generally supported the qualitative objectives of the IASB with significant support for the IASB to reconsider the position for mutualised portfolios (generally seen as those under paragraphs B67 to B71) under the VFA as set out in the EFRAG DCL. However, one standard setter did not consider this scope as sufficiently specific for such an exception and with another considers that if a solution will delay delivery of the final standard beyond the communicated finalisation date of Q2 2020, the requirements should remain as is. Another standard setter supports the EFRAG position but wants the exception to apply to all mutualised portfolios, not just those under the VFA whilst a user organisation considers the annual cohort as not useful to those contracts under the VFA in contrast to those under the PAA and the general model.

252 There were mixed views on the need for additional disclosures if an exception the annual cohort requirement is agreed.

253 Six constituents agreed with the three qualitative objectives of the IASB as outlined by EFRAG in its DCL, but considered that

- (a) these could be achieved by additional disclosures in the notes rather than an arbitrary accounting process that may not give a true and fair view of the underlying profitability of the contracts (one constituent);
- (b) the costs of the implementation of the annual cohorts is excessive (two constituents); and
- (c) the use of coverage/service units would allow a CSM release pattern in line with these objectives (three constituents).

254 13 constituents agreed that the justification for the annual cohort requirement should be reconsidered for mutualised portfolios using the VFA as:

(a) the annual cohort requirement would not be effective if the fulfilment cash flows cannot be reliably allocated to each cohort based on metrics consistent with the economics and characteristics of the cash flows in some large Continental European jurisdictions (notably France, Germany, Italy). Furthermore, the techniques and tools required to model the cross-subsidies between generations do not exist in local GAAP or Solvency 2 and would therefore be very costly and the cost-benefit analysis not appropriate. (eight constituents);

(b) policyholders are not entitled to a subset of the underlying items and that the fair value returns from the latter are shared across generations of policyholders through management's allocation of discretionary benefits. The annual cohort requirement should be eliminated otherwise the CSM amortisation may not appropriately reflect the economics or the way they are managed and so would be of little value to users. Furthermore, the initial allocation of benefits would need to reconsider the actual, new and subsequent allocations as determined by the entity to all mutualised contracts regardless of the underwriting year (three constituents);

(c) the entity does not "earn" higher or lower profits from different generations of contracts, but "earn" over time an average profit from these different generations based on the return of the mutualised underlying pool of assets. Grouping these contracts into annual cohorts is not consistent as it does not reflect the legal framework, the contractual terms of these contracts and their economics which determine the way such businesses are managed. Furthermore, no one or group of contracts can become onerous until the portfolio as a whole is onerous such as where the return of the underlying pool of items would not be sufficient to cover the average guaranteed benefits of this portfolio. Therefore, the same accounting outcome as currently requested by IFRS 17 could be achieved for these contracts without annual cohorts when the contractual margin is determined at the level of the portfolio. (one constituent); and

(d) for many European saving contracts such as in France, Italy and Luxembourg under the VFA which share investment returns of the same pool of underlying items. These are managed together without the concept of an annual cohort and the annual cohort mechanism will not correctly reflect the legal obligation of sharing the return between the policyholders whatever the underwriting date. (two constituents).

255 A standard setter suggests introducing an exception to the annual cohort requirement for intergenerational mutualised insurance which are defined as "contracts with cash flows that affect or are affected by cash-flows to policyholders of other contracts" per paragraphs B67-B71. However, this constituent would focus any proposed exception on achieving the same accounting objectives rather than the same outcome as currently referred to in BC138.

256 This is echoed by an auditor who is finalising a principle-based solution for entities that issue mutualised insurance contracts without focussing on the same outcome but a similar outcome. This proposal is envisaged to give rise to groups of mutualised business consisting of **a number of annual cohorts (rather than an open-ended group)** without differing significantly from the measurement if annual cohorts were applied. The proposal may include a one-off test at initial recognition of a layer of new business that would not be revisited in subsequent periods, similar to the requirements of assessing the criteria for the PAA or the VFA. This means that the assessment would be required on an annual basis for the respective new business added to the group so that if facts and circumstances change, entities would be required to establish annual cohorts in respect of the current and future

business. Entities would not be required to establish annual cohorts retrospectively for their historical groups of business at transition.

257 This constituent referred to the basis for conclusions where the IASB indicates that in some cases the annual cohort is not required and encourages the IASB to find an ex ante criterion to enable a decision at inception which types of contracts, given their characteristics do not require the annual cohort requirement. However, if this was not possible by the previously communicated finalisation date of the amended standard (Q2 2020), the advice would be to maintain the current standard.

258 The practical challenges of the annual cohort requirement especially for contracts that share risk was highlighted by another constituent. Whilst an alternative solution would be desirable, the constituent considered proposals to define the scope along the lines of paragraph B67 of IFRS 17 as not sufficiently specific to ringfence any exception to the use of annual cohorts. The constituent does not support open portfolios that allow for new contracts to be added indefinitely as this could mask profitability trends. Finally, the constituent resides with the IASB's decision not to change the standard given the lack of alternative proposals and a desire to finalise amendments by mid-2020, no change can be made.

259 A user organisation agreed with EFRAG's concern and position as stated in the DCL and commented that annual cohorts are useful to analyse and evaluate non-life insurance products that are classified as a General Model or Premium Allocation Approach (PAA) from a users' perspective. However, a classification based on group of contracts without split by annual cohorts would be preferable for the mutualised life insurance contracts under the VFA.

260 Some constituents thought that the annual cohort requirement should be reconsidered for a broader range of contracts:

(a) due the significant efforts required on transition, the annual cohorts should not be required for all in-force business at transition regardless of the measurement model and the transition approach (five constituents);

(b) due the costs and for example referred to the matching adjustment technics allowed under Solvency 2 for the Spanish market as these impose comprehensive requirements on investments designed to fulfil the obligations from insurance contracts. This strong link between assets and liabilities means that the annual cohort requirement could not reflect the substance of the transaction as the cash flows generated by the entire portfolio of matched assets are used to settle the obligations arising from the insurance portfolio without considering when they were issued. (three respondents); and

(c) as the adjustments to CSM may have a more significant impact on older cohorts who may have a small number of surviving contracts. This may introduce variability to the CSM that is not a result of a negative deviation of actuarial assumptions but due to the smaller number of contracts in senior cohorts. This contradicts the principles of actuarial techniques such as statistical probabilities that require a sufficient number of policyholders in order to function per design. Therefore, the proposal is to remove annual cohorts, whilst maintaining the profitability groups currently required. The revision should also include a principle to require the unit of account based on the nature of its business and management (two constituents); and

(d) all contracts under B67 to B71 whether under the VFA or not (one constituent).

261 Constituents thought that the elimination of the annual cohort requirement would not result in a material loss of information as

(a) the most important information to be report refers to whether the profitability of the portfolio of assets assigned to cover the obligations from the insurance contracts is enough to cover the guaranteed interest rates to the policyholder.

This will be fulfilled by the definition of coverage units as it ensures the recognition of profits of the contracts over the duration of those contracts (one constituent); and

(b) the assessment of profitability implies either using the cross-subsidy techniques or sharing the overall profit among cohorts using an allocation method. These methods will not have an economic substance nor a legal or contractual basis, and thus the corresponding information at cohort level will be irrelevant to the users due to the lack of comparability. (three constituents).

262 Three constituents agreed with the disclosure examples suggested in the DCL with one constituent noting that the amount of CSM contributed by new business is already required in the reconciliation of the CSM providing information on profitability trends. However, if this information was not considered sufficient, more information could be provided such as those proposed in the EFRAG DCL.

263 Four constituents considered that profitability trend information is already provided by the combination of the existing requirements such as the CSM contributed by new business and the movements in the CSM balance for in-force portfolios.

264 One constituent additionally suggested qualitative disclosure about the portfolios of mutualized contracts, their grouping criteria and the underlying supporting items as well as information about the allocation of underlying items between back-book and new business.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

265 The final comment letter will be updated to reflect feedback received:

(a) from users and actuaries that annual cohorts are not necessary;

(b) amend the proposed scope for an exception from those contracts described in B67 to "contracts with cash flows that *significantly* affect or are affected by cash flows to policyholders of other contracts", including reference to the feedback that the majority of the issue relate VFA contracts;

(c) a proposal for additional disclosures.

266 EFRAG Secretariat intends to discuss with EFRAG TEG the feedback from constituents reported in paragraph 256 above, including the fact that this proposal would result in avoiding cohorts that are not open-ended.

267 EFRAG Secretariat intends to discuss with EFRAG TEG the opportunity to better specify in the DCL, on the basis of the feedback in paragraph 257 above, further details useful to develop the exception and the ex-ante test.

Questions for EFRAG members

268 What do EFRAG TEG members think about the feedback provided in paragraphs 255 to 256?

269 Do EFRAG TEG members consider appropriate to further expand the proposal in the FCL to include the following:

270 *Feedback from constituents from the consultation to EFRAG Draft Comment Letter include the following direction of travel for the definition of the exception, which we recommend that the IASB consider in the finalisation of the standard:*

(a) *Contracts should be exempted by the annual cohorts requirements if the expected accounting outcome does not differ significantly (as opposed to being the same as referred to in the BC). Alternatively, the standard could refer to same accounting objective (as opposed to the same accounting outcome referred to in the BC).*

(b) *Entities would perform a test at initial recognition of a layer of new business that would not be revisited in subsequent periods, similar to the assessment of the PAA or the VFA.*

(c) *If facts and circumstances change unexpectedly over time and the method applied does not have the same outcome as if annual cohorts had applied, the exception would not be applicable to current and future business, but entities would not be required to establish annual cohorts retrospectively for their historical groups of business (this means that, a company should be protected then from being required to go back for decades and establish the annual cohorts retrospectively).*

(d) *The use of relevant coverage/service units would allow the CSM release pattern to be in line with the IFRS 17 stated objectives.*

Topic 2 - Transition: Modified retrospective approach and fair value approach

Question to Constituents

271 Please provide specific prevalent fact patterns where the application of the modified retrospective approach is proving particularly challenging in practice. This would assist EFRAG in understanding better the interpretation difficulties arising in obtaining reasonable and supportable information and in estimating missing information that is required to apply the modified retrospective approach.

Proposals in the ED

272 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 often be 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.

273 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 tentative position

EFRAG is aware 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 decision 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.

EFRAG also suggests that the IASB clarify that the 'reasonable and supportable information' criterion is not intended to change the judgement ordinarily required in IAS 8 to make estimates.

Summary of constituents' comments

274 Seven respondents noted that the modified retrospective approach is too restrictive, unduly complex and rules due the following reasons:

(a) Difference in discount rate - because assets will be discounted at the interest rate at the date of purchase of the asset while liabilities will be discounted at the interest rate fixed at the date of transition (much lower than the first rate), there will be a significant misallocation of the financial result (two respondents).

(b) Lack of available data and the inability to generate reasonable and reliable estimates with information currently available for calculating fulfilment cash

flows, risk adjustment, coverage units, annual cohort requirement, amortisation of CSM (six respondents).

(c) One respondent were unsure whether the 'use of estimates' will solve the problem of the lack of availability of the modified retrospective approach in practice (one respondent).

(d) The requirements of paragraph B137 of IFRS 17, which require separate measurement of interim and annual reporting periods, increase the cost and complexity of all retrospective transition approaches. This is even more difficult for entities that have changed their frequency of external reporting over time (one respondent).

As a result they can only apply the fair value approach at transition which:

(a) leads to significantly different results from those achieved with the other two approaches; (two respondents)

(b) result in a lower level of CSM at transition compared to the retrospective approaches; (one respondent)

(c) is a helpful practical expedient in some cases, it may not provide an appropriate profit recognition pattern in all cases, depending on the final interpretation of the fair value; and (two respondents)

(d) requires techniques and estimates that would have to be applied to arrive at a fair value and absent liquid markets the fair value would be a level 3 type measure as defined by IFRS 7 *Financial Instruments: Disclosures.* (one respondent)

275 Three respondents specifically noted that they support the comments made by EFRAG while others did not provide an answer to the question.

276 Possible solutions proposed by respondents were the following:

(a) Consistent with EFRAG's comment, five respondents noted that the IASB could better clarify that the inclusion of specified modifications in IFRS 17 does not imply that an entity cannot make its own estimates in applying IFRS 17 retrospectively. It has been proposed that the wording in BC 144 of the ED commenting on IFRS 17 paragraph C12 that estimates will often be needed as proxies for cash-flows that are known to have occurred should however be placed directly in the standard (e.g. amending IFRS 17.C12) instead of in the Basis for Conclusions.

(b) The modified retrospective approach should be more principles-based to allow more flexibility in practice.

(c) The approach should allow future cash flows at the date of initial recognition to be estimated as the amount of cash flows at the transition date without adjusting for known cash flows before the transition date and to apply a retrospective calculation only when possible (e.g. for the estimation of the discount rate.

277 The following illustration of specific challenges when applying the MRA in practice have been reported:

(a) One preparer reported that flexibility is all the more needed considering the diverging interpretations currently observed on the level of CSM using the Fair value approach compared to the Modified Retrospective Approach. In particular for:

(i) the starting date of the retrospective calculations (it may be impractical to reconstitute the date for the oldest contracts which have a limited weight in contracts in force at transition date);

   (ii) the use of estimates to reconstitute past margins consistent with the new IFRS 17 grouping.

(b) One industry association reported this list of challenges:

   (i) Full information on acquisition cash flows broken down by the cohorts under IFRS 17 is unlikely to be available retrospectively. Under the current modified retrospective approach requirements, insurers would not be permitted to estimate the allocation of acquisition costs by cohorts and thus would be forced into the fair value approach

   (ii) In order to estimate cash flows and risk adjustment entities need to know all adjustments made between the initial recognition and transition dates. Such information is unlikely to be available for older portfolios of long term life insurance contracts.

   (iii) It is often impracticable to estimate the amortisation of the CSM based on coverage units between the initial recognition and transition dates given that for older life insurance policies such information is unlikely to be available and cannot be estimated reasonably.

   (iv) The proposed amendment made in paragraph 62 of the Exposure Draft only allows part of the initial gain on reinsurance to be recognised immediately in profit or loss if the reinsurance contract is entered into either before, or at the same time as, the onerous underlying insurance contracts are issued. This may cause problems for insurers who re-tender reinsurance arrangements on a regular basis, for example annually. Whilst it would be possible to apply the requirements prospectively we believe that applying it pre-transition would add significant additional complexity to the transition process.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

278 The EFRAG Secretariat proposes not to change the wording in the final comment letter.

Questions for EFRAG members

279 Do EFRAG members agree with not changing the comment letter? Please explain.

Topic 3 - Balance sheet presentation: Non-separation of receivables

Question to Constituents

280 Do Constituents support the presentation of separate information about premiums receivable? If so, should information about premiums receivable:

(a) be mandatory?

(b) be based on a predefined definition of "premium receivables" and in this case, how should premiums receivable be defined?

(c) be provided on the face of the balance sheet or in the notes?

(d) be separated by insurance portfolio?

Proposals in the ED

281 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 tentative position

EFRAG agrees with the decision of the IASB to retain the requirements in IFRS 17 on balance sheet presentation, without a mandatory separate presentation of premiums receivable.

Summary of constituents' comments

282 Overview 1

Separate presentation: in favour	8
Separate presentation: in favour but accepting IASB position	1
Separate presentation: against	2
Separate presentation: optional	1
Separate presentation depending on materiality	1

283 Overview 2

Mandatory?	Yes	3
	No	1
Based on a predefined definition?	Yes	2
	No	0
Provided on balance sheet or notes?	Balance sheet	5
	Notes	1
Per insurance portfolio?	Yes	0
	No	1

Other information provided by constituents:

284 One constituent noted that receivable premiums should be measured as a credit that forms part of the asset. Also, incurred and past due claims must also be separated from the overall provision, they should constitute an existing payment obligation that will form part of the liability.

285 One constituent considered that premium receivables are usually defined as all premiums that have been issued for payment from the policyholder (and, therefore, excluded from the insurance liability), but not yet received. They suggest avoiding the reference to "premiums due" because it would only cover the case when the payment is enforceable.

286 One constituent noted that premium receivables should be defined as all premiums that are due from the policyholder (and, therefore, excluded from the insurance liability) but not yet received.

287 One constituent noted that premium receivables and claim payables should be included on an accrual basis in the measurement of the related groups of insurance contracts.

288 One constituent provided the following definition of premium receivable: *represents the unconditional right of the entity to consideration for the coverage to be provided. It takes into account the effective, not the theoretical, period before policyholder's rights coverage actually lapse.*

289 One constituent suggested a distinction should be made between premiums due to be paid by the policyholder after the financial reporting date, and those premiums which the policyholder is already due, and are either in the process of being collected, are late or are with an intermediary. Premiums due to be paid by the policyholder after the financial reporting date relate to remaining coverage, and we agree with the IASB that these should be included within the liability for remaining coverage (LRC). Premiums which are already due would normally relate to coverage already provided, and we consider these should be presented as a financial receivable.

290 One constituent noted that the presentation of insurance liabilities and assets at portfolio level provided relief so that actuarial systems would not necessarily need to be upgraded just for generating information required for presentation.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

291 No change proposed.

Questions for EFRAG members

292 Do EFRAG members agree with not changing the comment letter? Please explain.

Topic 4 - Reinsurance contracts: contract boundary

Questions to Constituents

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

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

295 EFRAG understands that there is no material impact on the balance sheet and probably not a significant impact on profit or loss (until certain events occur as

explained in paragraph 169 above). Please explain the prevalence of holding reinsurance contracts that relate to underlying contracts that have not yet been issued, including volumes and the jurisdictions where the issue arises.

Proposals in the ED

296 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.

297 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.

298 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 tentative position

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.

Summary of constituents' comments

299 Ten respondents disagreed with the IASB's decision not to amendment IFRS 17 for some of the following reasons:

(a) The actuarial profession observes that the cedant has no substantive rights or obligations under an underlying insurance contract expected to be written in future and there is no information concerning such contracts on its financial statement. Similarly, the cedant has no substantive rights under the reinsurance contract held to receive coverage regarding that underlying insurance contract until it is written.

(b) The requirement is operationally complex and costly (one respondent).

(c) As a result of using estimates the information provided on the face of the statement of financial position or profit and loss is questionable (one respondent).

(d) It is believed that reflecting potential future insurance contracts in the reinsurance asset does not provide useful information.

There is a conceptual rationale to re-adjust the contract boundary as it would be more appropriate and more understandable to refer only to the underlying contracts already recognised when measuring reinsurance contracts held (one respondent).

300 One respondent agreed with the IASB proposal not to amend IFRS 17 with regards to the contract boundary requirements for reinsurance contracts held and issued.

301 One respondent noted that both approaches (symmetry between reinsurance held and insurance issued, or between reinsurance held and reinsurance issued) lead to the same effect in the balance sheet and limited differences in profit or loss and disclosures, therefore they recommend considering a cost benefit analysis rather then introducing a conceptual debate at this stage.

302 Six respondents did not answer the question.

303 One respondent acknowledged that they are considering how to address concerns regarding contract boundaries for reinsurance contracts held.

EFRAG Secretariat's recommendations to EFRAG members on EFRAG's proposed final position

304 The EFRAG Secretariat proposes to discuss with TEG the feedback obtained by constituents.

Questions for EFRAG members

305 Do EFRAG members consider appropriate to amend the letter, in order to consider the observation by the actuarial professional that the cedant does not have substantive rights under the reinsurance contract held to receive coverage regarding that underlying insurance contract until it is written?

306 Considering that both the approaches to the reinsurance contract boundary (including and excluding contracts that are not yet recognized) have the same effects on balance sheet and limited differences in P&L and disclosures, EFRAG could keep unchanged the conclusion (agree with the IASB not amending the standard) or, in order to avoid additional costs and complexities to the preparers, ask for an amendment. What is the opinion of members?

Topics that have been raised with EFRAG which may need to be considered when finalizing the Amendments to IFRS 17

307 EFRAG has been informed about a number of topics that may potentially need to be addressed when finalizing the Amendments to IFRS 17. These topics are listed below with the sole aim of informing the IASB and EFRAG has not developed a view as to whether standard setting is needed.

Topics part of the 25 issues discussed by IASB

308 Consistently with the decision taken by the EFRAG Board in preparing the DCL to focus on the 6 issues in the letter sent to the IASB in September 2018, these topics have not been included in the FCL.

Exception to IAS 34 *Interim Financial Reporting*

309 Eight constituents noted the exception to IAS 34 that exists in IFRS 17 should be removed or made optional. Recalculating the carrying amount of the contractual service margin on a year to date basis will result in entities treating accounting estimates made in previous interim financial statements similarly and ensure comparability among entities whatever the frequency in the reporting.

Use of comparatives

310 Seven constituents consider that entities should be permitted to not present adjusted comparative information on initial application of IFRS 17, as it was authorized for the first application of IFRS 9. One constituent considered revisiting the requirements on comparatives useful in order to safeguard the implementation deadline.

Scope of the standard – contracts that change in nature over time

311 Two constituents believe there is another relevant scope issue, related to contracts that change in nature over time. The insurance industry issues products that change significantly in nature during their life due to the execution of an option by the policyholder (for example, products with a savings phase with profit sharing that may become an annuity). As the classification between general model and variable fee approach occurs at inception and is irrevocable, certain products may have to be accounted for under the variable fee approach, whereas, after the execution of the option, the variable fee approach model is not suitable and not comparable to similar products with a different ‘history’. They propose a solution that treats a significant change in the nature of a contract due to the execution of an option by the policyholder as a contract modification. The ‘new’ contract post execution of the option by the policyholder could be reassessed and treated under the appropriate measurement model for its new features.

Setting OCI to nil at transition

312 One constituent noted that because assets will be discounted at the interest rate at the date of purchase of the asset while liabilities will be discounted at the interest rate fixed at the date of transition (much lower than the first rate), there will be a significant misallocation of the financial result.

313 In this sense, we understand that additional amendments to the fair value approach are necessary in order to homogenize the results achieved by applying the different methods.

314 One of the reliefs that we propose to eliminate the asymmetry described, resulting from the different requirements under IFRS 9 and IFRS 17 at the transition date, would be to consider that the interest rate applicable to the portfolio of the assigned

assets is a good approximation of the interest rate to be applied to the portfolio of insurance contracts. In this way, the amounts allocated in OCI of assets and liabilities would be offset and the financial result would better reflect the reality of the operation.

Volatility of OCI introduced by IFRS 17 discount rates

315 One constituent is concerned about the variability in OCI introduced by IFRS 17 for Spanish long-term life-saving contracts that are not eligible to be measured under the variable fee approach. Under the general measurement model (both PL and FV-OCI option) changes in the IFRS 17 discount rate after initial recognition do not lead to a remeasurement of the CSM, given that the CSM is measured at inception with the locked-in rate and not remeasured to reflect changes in this rate. Even if the expected cash flows from an insurance contract are economically and perfectly matched with non-contractually disclosed financial assets that replicate those cash flows, including any long-term interest rate guarantee, an insurer will recognise in P&L/OCI amounts that go beyond the credit risk spread. This arises as a consequence of the CSM not being remeasured at each reporting date for changes in the discount rate. The fact that the CSM is not remeasured for changes in the IFRS 17 discount rate is equivalent to having a portion of the insurance liability not measured on a current basis, giving rise to amounts recognised in P&L/OCI that do not offset completely (assuming there is not a spread credit risk) with the remeasurement at fair value of the corresponding financial instruments. This constituent believes such a difference in measurement leads to an accounting mismatch that does not portray the economic net financial situation of Spanish long-term life-saving products. Spanish insurers will mainly apply the OCI option for the presentation of the insurance finance result, as their related assets will be mainly classified in FV-OCI portfolios under IFRS 9. In this context, This constituent is significantly concerned about the variability that will be recognised in OCI for these products under the general measurement model. It is important to highlight that Spanish users of insurers' financial statements place much emphasis on understanding the trend and evolution of the profit and loss and OCI statements, not expecting significant variability for the current business model under an economically matched balance sheet. In order to solve this variability, a re-measurement of the CSM at each reporting date for changes in the discount rate should be permitted, including the effect in OCI, while keeping the other IFRS 17 current requirements unchanged. Such re-measurement would mitigate these accounting mismatches in OCI between IFRS 9 and IFRS 17. This proposal would apply to companies that apply the OCI option under the general measurement model, and some type of conditions or constraints could be set up to limit the remeasurement to certain types of insurance contracts (managed under matching adjustment techniques, for example). The above suggestion would not change other current IFRS 17 requirements (i) to use the locked-in rate to accrete interest on the CSM, and (ii) to use the same locked-in rate to determine the adjustments to the CSM for changes in non-financial assumptions that affect future cash flows would remain unchanged under the new proposal. At the same time, we believe it would not affect any core principle of IFRS 17. In particular, the amounts recognised in OCI would naturally reverse over time and insurance service result would be shown separately from the insurance finance result.

Interaction between IFRS 17 and IFRS 9

316 One constituent noted there is a source of mismatch generated for some Spanish insurance products, backed by an important part of equities regarding the asset side. In these cases, under current accounting standards, the companies were selling part of their equity-portfolio (allocated to this product) getting realized gains from such equities which were accounted through P&L. The increase of the

technical provision were also accounted through P&L. Therefore an adequate matching was reached. Under IFRS 9 realized gains from mentioned equity will be kept in OCI. However, under IFRS 17 the increase of the technical provision will be accounted through P&L. Here there is an evident source of mismatch. We are aware that there is a fair value option (FVO), but it does not exist a "partial" FVO for the liability, thus this option will also affect all the fixed income assets portfolio (6 times bigger). Consequently, this option will transmit a huge volatility to P&L, namely, this will create a non-manageable P&L in the industry. Please, recall non realized gains amounted almost 20% of the market value. This type of market movements have been reflected historically in OCI in order to avoid distortions in P&L. Thus, this option is not suitable for this type of traditional retirement products. Therefore the most suitable solution for this mismatch would be to fix IFRS 9 allowing recycling for these type of equity investments.

General model – Locked-in interest rate for CSM

317 Two constituents continue to disagree with the use of a locked-in discount rate for measuring the CSM under the general model as it is inconsistent with the measurement of expected cash flows which are discounted using a current discount rate. This adds to the complexity of IFRS 17 and may distort the financial results in a given period.

Amendment to IFRS 3 Business Combinations (Appendix D of the ED, BC162)

318 Four constituents did not agree with the requirement to re-assess the classification of acquired contracts on the business combination date, rather than retaining the classification made at inception.

319 Refer to paragraphs 172, 199 and 200 above for the feedback.

New topics

Current and prospective measurement model inadequate in some cases

320 Three constituents noted that under specific economic conditions, a current and prospective measurement model may not appropriately portray the mechanism of some long-term contracts. For valuation purposed, IFRS 17 requires using stochastic methods that capture a large number of scenarios, in order to measure the associated time value of financial options and guarantees (TVOG). Because the changes in the TVOG are recorded against the contractual service margin (CSM) it can represent a significant part of the variation of the CSM, all the more because the sensitivity of the TVOG is closely linked to the exposure to investments in equities.

321 In stressed market conditions (for instance, durable low interest rates), the VFA model may not correctly reflect in the IFRS financial statements the annual performance of these contracts because the change in the value of the options and guarantees may drastically reduce (and even offset) the CSM although it is very unlikely that these options and guarantees may be paid to the policyholders, due to these stressed market conditions. As a result, companies may consider changing their investment policy to reduce their equities exposures, in order to limit the induced volatility and thus secure their IFRS financial performance to the detriment of their statutory results, which nevertheless remain the basis of policyholders' participation benefits and dividends payable to the shareholders.

Presentation of collateral deposits

322 One constituent noted that collateral deposits related to reinsurance issued and held, these amounts are usually presented for separately under IFRS 4. Under IFRS 17, when a reinsurer provides funds withheld as a collateral with the ceded insurer,

these funds will be included in the measurement of the liabilities. This offset will not fairly portray the economics of these deposits, because from a contractual point of view, these amounts correspond to funds transferred as guarantees to cover a risk of default by the reinsurer, and not to an advance payment. Offsetting the deposits with the reinsurance liability (for the reinsurer) or the asset (for the ceding company) will incorrectly reflect a compensation which may never exists if no default occurs.

VFA – Unlocking of CSM for changes in non-underlying cash flows

323 Three constituents noted the following relating to contracts under the VFA but that contain also certain non-participating features. The cash flows arising from these features are not covered by underlying items.

324 These products qualifies for the VFA based on an assessment against the criteria in IFRS 17.B101 at inception, even though there is a non-trivial part of future cash flows which may not vary based on changes in the underlying item. For example, at the time of eligibility assessment the non-variable annuity pay-out phase of the variable annuity may have had less weight compared to the variable cash flows in the participating accumulation phase.

325 Applying the current requirements to these contracts containing cash flows not arising from underlying items would result in significant accounting mismatches in profit or loss. Because according to IFRS 17.B113(b), the changes in the time value of money (TVoM) and financial risk not arising from underlying items shall adjust the CSM, while the investment result from the general account investments back-ing the non-participating future cash flows is directly recognized in profit or loss in the current period. Consequently, the CSM might be eaten up rapidly, giving rise to a loss component, although economically the contract is not onerous.

326 We understand and acknowledge that any solution to this issue might be difficult to develop. However, we consider a solution to this issue an absolute necessity in order to obtain a consistent, reasonable accounting framework for such insurance contracts that have been described in the fact pattern. Otherwise, applying the current requirements to these contracts containing cash flows not arising from un-derlying items would result in significant accounting mismatches in profit and loss.

327 The accounting issue presented above is not just a theoretical issue, but it is a “real-world” problem affecting a multitude of common insurance contracts in different jurisdictions.

Accounting for time value of money in VFA

328 One constituent noted that IFRS 17.B113(b) requires changes in the effect of the time value of money and financial risks not arising from the underlying items to adjust the CSM for contracts with direct participation features. The scope of this paragraph extends to all changes in the effect of the time value of money and financial risks. Some have interpreted this as including the effect of unwinding of the discounting of relevant fulfilment cash flows. We are concerned that this interpretation will cause distortions in the financial statements, particularly as a result of the unwinding of the discounting of the insurance contract liabilities being included in the CSM. We believe this interpretation is conceptually incorrect, as the time value of money effect arising purely as a result of the passage of time (i.e., unwinding of the discounting of the liability) relates to current service and should be included in insurance finance expense for the period. We suggest the IASB to amend B113(b) to require the unwinding of the discounting of the liabilities to be recognised in insurance finance income or expense.

Re-classification of OCI

329 One constituent identified a potential accounting mismatch in equity for contracts accounted for under the variable fee approach resulting from investments in equities accounted for under FVOCI:

330 The accounting policy choice in paragraph 89(b) is chosen; therefore the insurance finance income or expense in the period is disaggregated to include in profit and loss an amount that eliminates accounting mismatches with income or expenses included in profit or loss on the underlying items held.

Non-distinct investment components

331 One constituent considers the current prevalence of non-distinct investment components (with often small non-distinct investment components being identified in everything from funeral plans to reinsurance treaties) is operationally extremely onerous for preparers. We consider that in certain cases (funeral plans being a good example), the measurement of non-distinct investment components is arbitrary and likely to lead to a lack of comparability between entities, and consequently non-useful information for users.

332 We consider increasing the comparability of the income statement to other industries such as banking and fund management where products have deposit features, can be achieved by revising the definition of an investment component to include only contracts where the policyholder has the right to make withdrawals. We consider the defining features of a deposit is the right of the policyholder to withdraw their deposit (adjusted as appropriate by investment return added and fees deducted from the deposited amount), and in the absence of this right to withdraw a deposit does not exist. We believe such a change would better meet the needs of users.

333 We believe the original intention of the IASB was that non-distinct investment components only need to be identified and measured when a claim occurs. We note changes to the definition of an investment component, have created uncertainty around when a non-distinct investment component is identified and measured. We ask the IASB to resolve the uncertainty around identification by clarifying that non-distinct investment components are identified based on facts and circumstances at initial recognition of the contract.

334 The accounting policy choice in paragraph B5.7.1. in IFRS 9 for respective FVOCI underlying items is chosen; therefore the amounts presented in OCI will not be subsequently transferred to profit and loss, but the cumulative gain or loss will be transferred within equity.

335 Implication:

336 As referred in IFRS 9 B5.7.1 (Gains and losses, regarding investments FVOCI) …" Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss within equity." We believe reclassifying the cumulative gain or loss at disposal from accumulated OCI to retained earnings provides better information because it ensures that ultimately all gains or losses from the investment are presented in retained earnings and no amounts remain in accumulated OCI after the investment has been derecognized.

337 Where such FVOCI investments are underlying items, the fair value changes in the investments (underlying items) are reflected in the insurance liability OCI. Paragraph B134 of IFRS 17 provides clear guidance for direct participating contracts which amounts to include in profit or loss. In particular the insurance liability OCI reflecting the cumulative gain or loss shall not be reclassified or reflected in to profit

or loss at any time. Furthermore, paragraph 91(b) explicit prohibit recycling of liability OCI to P/L for certain cases of contract derecognition.

338 If the respective reclassification option from accumulated OCI to retained earnings within equity for IFRS 9 investments accounted for at FVOCI is chosen, we would like to apply a similar reclassification option to the respective liability OCI: reclassification of any remaining liability OCI from other comprehensive income to retained earnings within equity. This reclassification would mirror the corresponding reclassification in IFRS 9 and ensure that ultimately all gains or losses from the investment are presented in retained earnings and no amounts remain in accumulated OCI after the insurance contract has been derecognized.

339 However, the Standard does not explicitly state whether or not such a reclassification from accumulated OCI to retained earnings is permitted for IFRS 17. A reclassification is supported by the basis for conclusion for IFRS 9 on the implementation of the FVOCI accounting policy choice for investments which emphasizes the conceptual consistency in presentation between IFRS 9 investments and IFRS 17 insurance contract liabilities: BC4.148 of IFRS 9 details the initial decision of the IASB to implement the FVOCI accounting model which is partly due to concerns of accounting mismatches with insurance contracts liability accounting. A similar reasoning is brought forward in BC 44 of the Basis of Conclusion of IFRS 17.

340 However, we recommend to clarify in IFRS 17 that a similar reclassification option for insurance contract liabilities exists as in IFRS 9 B5.7.1 (i.e., providing the accounting policy choice to reclassify any remaining liability OCI after derecognition of the group of contracts from accumulated OCI to retained earnings within equity).

Treatment of LIC in contract modifications

341 A contract modification according to IFRS 17.72 requires de-recognition of the old, and recognition of the new, amended contract. This treatment makes sense for the LRC relating to the old contract. The Standard does not clearly prescribe how to deal with an LIC recognized on the old contract. There could be three possible interpretations:

(a) The LIC remains in the group of contracts covering the old contract;

(b) The LIC is transferred to the new group of contracts as a LIC; or

(c) The LIC is derecognized and needs to be reflected when determining the LRC for the modified contract.

342 Based on our understanding, interpretation 1 is adequate. The modification relates to future service only (i.e., a new premium is charged for a new/different coverage/service). The LIC relates to past service and thus relates to revenues already earned for the old contract in the old group of contracts in prior periods. These claims are not reflected in the premiums for the modified contracts, nor do they refer to “remaining coverage” for the new/modified contract. Reflecting these claims in the LRC for the modified contract would result in a misstatement of the financials:

343 Derecognizing the LIC would result in a positive run-off, without economic substance; and

344 Reflecting the LIC in the fulfilment cash flows (LRC) of the new contract would impair the CSM, and potentially even result in a loss component for an economically profitable contract.

Consequential amendments to IAS 16 Property, Plant and Equipment

345 The consequential amendments to IAS 16 as laid out in paragraph 29A of IAS 16 provides an option to measure some owner-occupied properties which are included in a fund or are underlying items of groups of insurance contracts with direct participation features using the fair value model.

346 We welcome the amendments. However, this amendment to IAS 16 is limited to the owner-occupied property. Some insurers invest in alternative assets, e.g. wind park, which are underlying items of insurance contracts with direct participation features. There is no clear guidance in IAS 16, whether such assets can be classified as owner-occupied properties. However, paragraph 5 of IAS 40 implies that property is land or a building – or part of a building – or both. Based on this, it appears difficult to classify the wind park as a whole as property. Consequently, the option provided in IAS 16.29A is not applicable to such assets. As a result, accounting mismatch will arise, because part of the underlying items of contracts accounted for under the VFA are not measured at fair value.

347 We recommend that the option granted in IAS 16.29A should be applicable to Property, Plant and Equipment accounted for under IAS 16 rather than limited to owner-occupied properties. Against the background that the investments in infrastructure will be noticeably increasing in the low interest rate environment, our recommendation would facilitate investment in infrastructure that would be beneficial for the whole economy.

Measurement inconsistencies – IFRS 17 implies applying a fair value measurement to assets

348 Since insurance contracts are measured at current value, any corresponding asset is best matched when also measured at current value, leading to application issues (for instance by segregating assets into ring-fenced pools or accepting the created mismatch). One constituent suggested targeted improvements facilitating the alignment of the measurement of underlying assets with the measurement of the insurance contract: e.g. by allowing measuring loans at FVOCI even if the IFRS 9 business model is held-to-collect; by splitting investment property providing returns to different types of contracts.

Technical correction to VFA Illustrative Examples (not in the ED)

349 One respondent stated that the Illustrative Example paragraphs 112(e) and 185(b) make reference to paragraph 87(c) in support of why an entity recognises changes in the fair value of underlying items as insurance finance income or expenses. However, section (c) of Paragraph 87 is specific to loss component requirements. As such, the reference in the IE.112(e) and IE.185(b) should be corrected (likely to just paragraph 87 in general, or paragraph 87(a) and (b), if that is what the IASB intended).

Mutual entities

350 One constituent notes that if IASB intends to clarify how IFRS 17 applies to certain mutual entities it should do it in the standard itself (and not in the BC) and also explicitly highlight the specific contractual/legal circumstances deserving such a treatment (neither CSM nor equity).

351 Refer also to feedback relating to question 9 on minor amendments – paragraphs 210 and 211.

Additional terminology improvements

352 One respondent would like to see additional terminology improvements introduced in items such as in contract “duration”.

353 The EFRAG Secretariat notes that the following issues are reported by several respondents:

(a) Complexity of IAS 34 interim reporting;

(b) Setting OCI to nil at transition;

(c) Contracts changing nature during their life, from VFA to GM; and

(d) Topics related to interaction between IFRS 9 and IFRS 17

Question to EFRAG TEG members

354 Do EFRAG TEG members want to include these comments as a main part of the EFRAG final comment letter? Please explain.

Appendix 2 – List of respondents

1 Respondents whose comment letters were considered by the EFRAG Board before finalisation of the comment letter were as follows.

Name of constituent	***Country***	***Type / Category***
Actuarial Association of Europe	Europe	Preparer organisation
Spanish Insurance Supervisor and Accounting and Auditing Institute (ICAC)	Spain	Regulator/Standard Setter
Groupement Français des Bancassureurs	France	Preparer organisation
BNP Paribas	France	Preparer
UNESPA – draft	Spain	Preparer organisation
Fédération Française de l'Assurance	France	Preparer organisation
HUB global insurance group	Global	Preparer organisation
Allianz	Germany	Preparer
Institut der Wirtschaftsprüfer	Germany	Audit organisation
KPMG	Europe	Auditor
Prudential	UK	Preparer
GDV	Germany	Preparer organisation
ANC	France	Standard Setter
CFO Forum and Insurance Europe	Europe	Preparer organisation
AFME-draft	Europe	Preparer organisation
ESBG-draft	Europe	Preparer organisation
DRSC-draft	Germany	Standard Setter
EFFAS	Europe	Investor organisation
FRC - draft	UK	Standard Setter
Institut des Actuaires	France	Actuarial organisation
OIC	Italy	Standard Setter