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EFRAG Secretariat: Insurance team

This document has been prepared by the EFRAG project team on the basis of the contents of the Comment Letters received, including letters still in draft and subject to change.

The cover letter will be updated following EFRAG TEG discussion.

The EFRAG Final Comment Letter will be discussed and agreed by the EFRAG Board in the meeting on 24th September. The Board discussion will leverage on the outcome of the feedback provided by EFRAG IAWG and EFRAG TEG to this document. Therefore, the final position and wording may differ from this document.

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

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

[XX September 2019]

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

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

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

EFRAG would like to express its appreciation for your consideration of the topics identified in our letter of 3 September 2018 ("our letter") as well as those from other Constituents. EFRAG would also like to commend the IASB for the thorough process to capture and analyse all the concerns and criticisms received. This course of action corroborated the willingness you expressed to act speedily as and when required.

Appendix 1 contains our responses to the questions in the ED. EFRAG is broadly supportive of many of the changes proposed. However, EFRAG is of the view that the retrospective application of risk mitigation option on transition is worthy of further attention. In addition, 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.

In addition […]

Appendix 2 addresses topics that were raised in our letter of 3 September 2018 that we consider warrant further consideration. In particular:

a) EFRAG acknowledges that the annual cohort requirement is a trade-off between tracking of 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 this 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 believes that it is worth re-considering whether the annual cohorts requirement is justified for such contracts and recommends that the IASB consider developing an exception for them, starting from paragraph BC138; the exception should be reflective of the reporting objectives of the level of aggregation requirements in IFRS 17.

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

c) […]

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

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

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

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?

EFRAG's response

<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.

Question 1A - Loans that transfer significant insurance risk

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

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

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

Question 1B - Credit cards that provide insurance coverage

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

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

4 EFRAG considers that when an entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, IFRS 9 would provide more useful information about those contracts.

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

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

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

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

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

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

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

7 However, EFRAG is concerned that the use of the term 'credit card' excludes payment cards with clauses similar to the credit cards in the scope exclusion.

Question 2 - Expected recovery of insurance acquisition cash flows

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

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

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

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

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

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

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

EFRAG's response

EFRAG supports the IASB'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 existing option to recognise insurance acquisition cash flows as expenses for the premium allocation approach. If an entity chooses to capitalise the insurance acquisition cash flows (instead of expensing them), then the allocation of the acquisition cash flows to the contracts and hence the impairment test should be a mandatory requirement

EFRAG agrees with the proposed recoverability assessment approach.

8 EFRAG notes that, from a commercial perspective, an insurer's decision to pay a certain level of acquisition cash flows might take into account its expectation of contract renewals. EFRAG also acknowledges that some contracts would be treated as onerous due to the allocation of acquisition cash flows in full to them (i.e. ignoring the impact of renewals).

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

10 EFRAG understands that the concern relating to acquisition cash flows relates to contracts that fall under the premium allocation approach ('PAA') given the short contract boundary. EFRAG supports the option that is already under IFRS 17 to recognise insurance acquisition cash flows as expenses for the PAA because this simplifies the measurement for some groups of contracts.

11 EFRAG is of the view that, under the PAA, if an entity chooses to capitalise the insurance acquisition cash flows (instead of expensing them), then the allocation in future periods of the acquisition cash flows to the contracts (and hence the impairment test) should be a mandatory requirement as would be the case for the general model and the variable fee approach. The entity should not have the ability to switch between expensing or capitalising the insurance acquisition cash flows. This is 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.

12 With regards to impairment, the Exposure Draft proposes that an entity would have to assess the recoverability of an asset recognised applying paragraph 28D of IFRS 17 at the end of each reporting period, if facts and circumstances indicate the asset may be impaired. EFRAG agrees with the proposed recoverability assessment approach.

Question 3 - Contractual service margin attributable to investment-return service and investment-related service

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

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

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

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

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

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

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

EFRAG's response

EFRAG supports the IASB'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.

However, EFRAG notes that the definition of investment-return services, in particular the surrender and transferability criteria (in paragraph B119B(b)), could potentially result in economically similar transactions being treated differently. If this is the case, we suggest the IASB reconsiders the necessity of these criteria in the definition, to ensure that substance over form prevails.

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 but notes that, given the sensitivity of the CSM under the variable fee approach to market conditions, this will only provide users with a partial picture of the future performance of the entity.

EFRAG also notes concerns around the minor amendment for the definition of investment component.

General model

General model - Contracts with investment components

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

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

General model - Contracts without investment components

15 Under many insurance contracts, the policyholder has a right to withdraw money (or to transfer an amount to another party). This right appears to indicate the entity is providing an investment-return service.

16 EFRAG has been informed that the criteria of transferability and surrender could result in economically similar transactions being treated differently with the following contracts not qualifying for recognition of investment-return services:

(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 withdraw or to transfer can be very limited in practice;

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

(e) deferred annuity contracts where the surrender value, which is 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) The existence of 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?

17 We suggest the IASB reconsiders the necessity of these criteria in the definition, to ensure that substance over form prevails.

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

19 However, an entity is already required to make similar assessments for contracts which provide more than one type of insurance coverage and disclosures relating

to this significant judgement, as further illustrated below. Therefore, EFRAG considers that this proposal will not require the excessive use of judgement and will facilitate users' understanding of the impact of all relevant services on the amortisation of CSM.

Variable fee approach

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

21 Therefore, EFRAG supports that, in addition to insurance coverage, these contracts provide investment-related services to policyholders and the coverage units to release the CSM should reflect these services. In addition, EFRAG supports a clarification that these contracts can provide both investment-return and investment-related services.

Disclosure requirements

22 Entities have to provide disclosures in terms of:

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

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

23 EFRAG considers that the quantitative disclosures about the amount of CSM expected to be recognised over time are important as these disclosures enable users of financial statements to monitor the profitability pattern and any changes to that profitability pattern, allowing informed comparisons across entities. However, EFRAG also notes that the information in paragraph 109 will only provide partial information on the potential future performance of the entity given the sensitivity of the CSM under the variable fee approach to changes in the market environment.

24 EFRAG considers that an entity needs to determine the coverage units (which includes services to be provided in the future) in order to determine the release pattern for the CSM. Therefore, EFRAG considers that preparers should be able to provide this quantitative information without undue cost or effort.

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

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

26 In paragraph BC156, the IASB explains the rationale for amending the definition of an investment component in Appendix A. Specifically, the current BC contains additional characteristics that were not reflected in the definition. The IASB now proposes to clarify and amend the definition such that "an investment component is the amount an insurance contract requires an entity to repay to the policyholder in all circumstances, regardless of whether an insured event occurs."

27 EFRAG has been informed that reinsurance contracts are specifically negotiated such that the current definition would often give rise to investment components,

which does not appear to have been the intention of the IASB. We therefore ask the IASB to reconsider the proposed wording and to clarify it accordingly.

28 EFRAG has also been informed that the proposed amendment to the definition of an investment component is more limiting that appears to be intended by the IASB. The definition could be read in some cases to state that even contracts with explicit account balances do not contain investment components. This does not seem to be in line with the outcome of the TRG meeting in April 2019. 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.

Question 4 – Reinsurance contracts held — recovery of losses on underlying insurance contracts

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

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

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

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

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

EFRAG's response

EFRAG welcomes the proposals of the IASB aiming to reduce the accounting mismatches for reinsurance contracts held. However, EFRAG suggests that the proposed text for the definition of 'proportionate' in the ED should be revisited and reconsidered for inclusion of other types of reinsurance contracts based on the economic substance of those contracts.

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

30 EFRAG considers that an entity should recognise a gain from the reinsurance contract held when it recognises a loss on initial recognition of an onerous group of underlying insurance contracts or on addition of onerous contracts to that group, to the extent that such reinsurance contract held covers a loss that is also recognised in profit or loss at the same time. This would happen when there is a direct association between the loss on the underlying contracts and the net gain on the reinsurance contract held.

31 EFRAG is of the view that the proposed definition of 'proportionate' is too narrow, capturing only contracts which are not commonly used in practice, as the wording in paragraphs B119D, BC80 and BC71 seem to exclude from the scope of this amendment the following examples of reinsurance treaty that are considered to provide proportionate reinsurance in the market:

(a) a reinsurance contract that covers the surplus of a fixed percentage of the losses arising from each contract in a group of direct insurance contracts (also called surplus reinsurance contracts), 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 in a group; and

(f) A proportional reinsurance contract that only reinsures some but not all risks in a group of underlying contracts.

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

33 EFRAG notes that the definitions of 'proportionate' and 'proportional' have different meanings (which vary by jurisdiction). Accordingly, EFRAG recommends that the definitions used in IFRS 17 should be clarified to avoid confusion.

34 EFRAG notes that 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. This has been confirmed by constituents from the actuarial profession.

Question 5 - Presentation in the statement of financial position

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

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

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

EFRAG's response

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

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

36 EFRAG considers that the amendment to paragraph 78 provides an operational relief to preparers of financial statements without significantly reducing the loss of useful information for users of financial statements. Further, during the user outreach that EFRAG conducted on the Amendments to IFRS 17, a majority of the users did not object to a presentation at portfolio level.

37 Therefore, EFRAG supports the proposed amendments.

Question 6 - Applicability of the risk mitigation option

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

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

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

EFRAG's response

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

EFRAG considers that financial instruments at fair value through profit or loss should also be eligible for the risk mitigation, as there are no conceptual reasons to exclude them.

Similarly, reinsurance contracts (held and issued) should be eligible for the VFA provided that they meet the relevant conditions, in the absence of a clear rationale why this should not be the case.

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

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

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

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

42 These proposals do not solve all issues however and EFRAG is of the view that further changes should be considered. EFRAG notes that insurers use not only derivatives but also non-derivative financial instruments in their hedging strategies. In our view, there is no conceptual reason why these non-derivative financial instruments (when measured at fair value through profit or loss) should be excluded from the risk mitigation option.

43 Further, EFRAG sees no conceptual reason why reinsurance contracts, both issued and held, would not be able to qualify as VFA-contracts, provided that they have all the characteristics of contracts with direct participation features.

44 EFRAG is also in favour of retrospective application of the risk mitigation on transition as explained in paragraphs 50 to 57 below.

Question 7 – Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4

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

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

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

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

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

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

EFRAG's response

EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17, 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.

45 **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.**EFRAG supported the amendments to IFRS 4 *Insurance Contracts* in February 2016 and continues to consider that, in order to provide relevant information to users of financial statements, IFRS 17 and IFRS 9 should be applied together with the same effective date.

46 Until both IFRS 17 and IFRS 9 are effective, preparers will have to make an assessment of the expected impact of the standards in order to provide information to users. That is, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, entities are required to disclose the effect of future IFRS Standards on the current period or any prior period, unless impracticable.

47 EFRAG further 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.

Question 8 – Transition modifications and reliefs

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

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

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

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

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

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

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

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

EFRAG's response

<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.

Question 8A - Transition relief for business combinations

48 EFRAG supports the IASB's proposals for both the modified retrospective approach and fair value approach because it will often be impracticable and entities may not have sufficient information to classify contracts acquired in their settlement period before the transition date as either a liability for remaining coverage or a liability for incurred claims.

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

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

50 EFRAG assesses that the amendment to extend the option in paragraphs B115 to B116 is a step in the right direction; as a result of this amendment the risk mitigation relief is applicable prospectively as from the IFRS 17 transition date.

51 However, EFRAG considers that entities should apply this risk mitigation relief retrospectively for contracts under the variable fee approach, provided that (1) the entity met the criteria in paragraphs B115 to B116 for the risk mitigation accounting in the relevant past reporting periods and that (2) they are able to prove using reasonable and supportable information that a risk mitigation strategy was in place before the application of IFRS 17, starting from the inception of the mitigation strategy.

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

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

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

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

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

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

56 Therefore, in this instance EFRAG is supportive of retrospective application of hedge accounting under IFRS 17 even though EFRAG did not support such a position with the retrospective application of hedge accounting under IFRS 9. This is because EFRAG considers that risk mitigation under IFRS 17 is different from IFRS 9 retrospective application of hedge accounting as under IFRS 17 the choice to exercise the risk mitigation option influences the determination of the contractual service margin which could have long-term impacts on the financial statements.

57 EFRAG observes 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.

Question 8C – Fair value approach

58 EFRAG notes that the IASB has included in the ED two consequential amendments to the decision not to allow retrospective application of the risk mitigation option of paragraph B115, i.e. the possibility to apply the risk mitigation from the transition date (instead of from the effective date) and the option to apply the fair value approach when the conditions for risk mitigation in paragraph C5A of the ED are met.

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

Question 9 – Minor amendments

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?

EFRAG's response

EFRAG welcomes the IASB's proposals. However, EFRAG is of the view that only issued financial guarantees should be brought within the scope of IFRS 9.

60 EFRAG welcomes the IASB's proposals relating to the minor amendments as EFRAG agrees that lack of clarity, corrections or minor unintended consequences or conflicts should be addressed.

61 EFRAG notes that as currently worded, the consequential amendment to paragraph 2.1(e) (iii) of IFRS 9 *Financial Instruments* would result in all financial guarantees being included within the scope of IFRS 9. We are of the view that this is not the intention of the IASB Board and this should only be the case for issued financial guarantees. EFRAG therefore requests that the consequential amendment to IFRS 9 is amended accordingly.

62 In addition, the ED 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,". EFRAG considers that the assessment at individual contract level rather than at the level of groups of contracts would be inconsistent with the unit of account for IFRS 17 measurement. In addition, it would disrupt the implementation projects and therefore increase costs.

63 Furthermore, EFRAG has been informed about a number of topics that may potentially need to be addressed when finalising the amendments to IFRS 17. These topics are listed in Appendix 3 with the sole aim of informing the IASB and EFRAG has not developed a view as to whether standard setting is needed.

Question 10 – Terminology

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?

EFRAG's response

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.

64 EFRAG agrees with the IASB making consequential changes to the identified definitions as the CSM allocation now reflects services provided rather than being limited to insurance coverage. In addition, a change in terminology will highlight the impact of the change and reduce the possibility of it being overlooked.

65 EFRAG has been informed about two terminology changes that may potentially need to be addressed when finalising the Amendments to IFRS 17, i.e. insurance contract services and service period. These are described in Appendix 3 with the sole aim of informing the IASB and EFRAG has not developed a view as to whether standard setting is needed.

Appendix 2 – Other comments arising from topics in EFRAG's September 2018 letter to the IASB that have not been addressed by the ED

Topic 1 - Annual cohorts

EFRAG's view

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.

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

67 First, insurers have to identify "portfolios" of contracts that are subject to similar risks and that are managed together. The portfolios are then divided into three groups:

(a) onerous contracts, if any;

(b) contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and

(c) other contracts, if any.

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

69 EFRAG has heard major concerns from Constituents that a group of contracts cannot include contracts issued more than one year apart. In particular, stakeholders consider that:

(a) the requirements will not provide users of financial statements with useful information;

(b) implementing the requirements is a major challenge and the benefits do not outweigh the costs; and

(c) the requirements are unnecessary because an entity can achieve the same outcome without applying those requirements.

Characteristics of the "mutualised" model

70 EFRAG understands that the transfer of wealth between generations of policyholders that participate to the same pool of assets is a key feature of life-saving business in several European jurisdictions, such as France, UK, Italy and Germany and therefore represents a common feature for a significant share of the

entire European insurance market. The following is a description of the characteristics of such mutualised contracts:

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

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

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

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

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

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

The concerns expressed by Constituents for mutualised contracts

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

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

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

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

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

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

March 2019 IASB re-deliberations

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

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

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

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

(c) timely recognition of losses from onerous contracts.

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

(a) averaging of profits; and

(b) recognition of profits beyond the coverage period of the group, which would distort the profit reporting from different generations of insurance contracts and obscure inherent risks of the business model.

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

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

reported, not the methodology to be used to arrive at those amounts; therefore it may not be necessary for an entity to apply annual cohorts to achieve the same accounting outcome in some circumstances (ref. paragraph 20 of Agenda Paper 2C of the IASB meeting of March 2019).

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

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

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

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

EFRAG's view

81 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.

82 EFRAG understands that in order to meet those objectives, the annual cohort requirement has been retained as a practical simplification on a conventional basis. Such a convention derives from the difficulties to promote a principle-based approach. As a matter of fact, the IASB tried to develop a principle-based approach to identifying groups that would eliminate the loss of information, however such an approach was rejected because of feedback from stakeholders that it would be unduly burdensome. The annual cohort requirement is, therefore, a trade-off between tracking of individual contracts whilst ensuring the recognition of onerous contracts even where there are contracts with similar risks but different levels of profitability.

83 EFRAG believes it is worth re-considering whether the annual cohort requirement is justified in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts (in accordance with the heading of paragraph B67 to B71).

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

85 EFRAG suggests that this conclusion in paragraph BC138 be elevated to the main body of the Standard.

86 EFRAG observes that contracts where the cash flows significantly affect or are affected by the cash flows of other contracts are a common feature of a significant portion of the life insurance business in several European jurisdictions. The IASB

has already factored in the characteristics of such contracts in IFRS 17, including in paragraphs B67-B71.

87 EFRAG has noted the conclusions of the IASB, in particular when in paragraph BC138 the IASB states that introducing an exception would add complexity and create the risk that the boundary would not be robust or appropriate in all circumstances. However, EFRAG believes that the added complexity is justified if it leads to achieving the same benefit at less cost.

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

89 Feedback received during the consultation on EFRAG Draft Comment Letter have further shown that:

(a) specialised users consider the annual cohorts requirement an unnecessary complexity for contracts managed under the mutualised model as described above;

(b) actuaries consider that reaching the three IASB reporting objectives of the level of aggregation requirements in IFRS 17 can be dealt by additional disclosures in the notes rather than through an overly complex, costly, judgemental and potentially arbitrary accounting process that may not give true and fair view of the underlying profitability of these contracts.

90 EFRAG believes that the technical elements needed to develop a solution are already present in the assessments that the IASB itself performed during the re-deliberation process: for contracts described in paragraphs B67-B71 and that share in the same pool of underlying items applying the annual cohort requirement would not lead to a significantly different accounting outcome and, therefore, should not be applied. In any case, an exception to the annual cohort requirement should always be reflective of the three IFRS 17 reporting objectives stated above.

91 In conclusion, EFRAG recommends that the IASB re-consider providing an exception in the main text of the Standard starting from paragraph BC138. The scope should be defined as relating to “contracts with cash flows that *significantly* affect or are affected by cash flows to policyholders of other contracts”. In other words, mutualised contracts are those for which policyholders significantly share in the returns and risks of a pool of underlying items. In most cases such contracts also are eligible to the VFA. In EFRAG’s view, this is likely to achieve a better cost/benefit trade-off;

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

93 In addition to the information about the reconciliations for the CSM from the opening to the closing balances (according to paragraph 101 of the standard) and the information provided by paragraph 109 of the ED (quantitative forecasts of when the entities expect to recognise in profit or loss the CSM remaining at the end of the period), the following disclosure would enhance the information provided for contracts that are in the scope of the exception:

(a) qualitative disclosure describing the grouping criteria for contracts to which the annual cohort requirement is not applied;

(b) disclosure on profitability trends by presenting the CSM effect of new business joining the groups, derived by the quantitative information presented according to paragraph 101 for previous years (e.g. 3 in the last 3 years);

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

(d) explanation (including values of the key parameters) of the actuarial techniques for measuring the value of the new business and the allocation of the underlying items between existing business and new business.

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

EFRAG's view

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.

94 EFRAG generally supports the retrospective application of IFRS 17 as with the adoption of any new standard.

95 EFRAG concurs with the IASB that, in the light of the diversity in previous insurance accounting practices and of the long duration of many types of insurance contracts, retrospective application provides the most useful information to users of financial statements, by allowing comparison between contracts written before and after the date of initial application of IFRS 17.

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

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

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

99 EFRAG considers that the IASB should clarify that the 'reasonable and supportable information' criterion is not intended to change the judgement ordinarily required in IAS 8 in making estimates. Therefore, it is not intended to add extra burden or difficulty in allowing the application of the modified retrospective approach compared to the use of retrospective application in other IFRS Standards.

100 One might consider that a full retrospective approach may be applied solely by collecting detailed data as if the standard had been applied from inception, which might lead to the conclusion that the full retrospective approach is often impracticable. As explained by the IASB in paragraph BC378, the modified retrospective approach has been designed to approximate in these circumstances the accounting outcome of a full retrospective approach. EFRAG notes that the modified retrospective approach supplements the full retrospective approach with

focused rules-based solutions where no reasonable and supportable information is available (except the information that might be required to apply the specified modification).

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

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

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

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

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

EFRAG's view

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.

103 EFRAG agrees with the decision of the IASB to retain IFRS 17 requirements on balance sheet presentation, without a mandatory separate presentation for premiums receivable. The presentation requirements of IFRS 17 is consistent with its measurement principle i.e. a current estimate of all expected cash flows within the contract boundary. The balance sheet reflects the combination of rights and obligations created by the contract as a whole.

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

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

106 EFRAG has been advised that there is very little credit risk in premiums receivable taken as a whole, which is supported by the limited disclosures currently provided by insurers on credit risk. Furthermore, if separate presentation of premiums receivable is deemed necessary, IAS 1 paragraph 55 provides a solution as entities may disaggregate the different components on the face of the balance sheet.

Topic 4 - Reinsurance contracts: contract boundary

EFRAG's view

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.

107 EFRAG supports the IASB's tentative decision not to amend the standard regarding the contract boundary for reinsurance contracts held. EFRAG agrees that, conceptually, expected future cash flows for reinsurance contracts held and insurance contracts issued should be measured using a similar and consistent approach. This is because for both reinsurance contracts held and the underlying insurance contracts, measurement should reflect the entity's substantive rights and obligations created by the contract. Therefore, the contract boundary, risk adjustment and discount rate used for reinsurance contracts held compared to the underlying insurance contracts may differ as this reflects different contracts with different conditions.

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

109 It is acknowledged that estimating future contracts that will be covered by a reinsurance contract already written will require judgement. However, it is reasonable to expect that there will be evidence supporting the judgement needed, including that entities are likely to have budgets or forecasts which include expected new business and to have information about how reliable similar estimates were in the past; and the estimation of these contracts would follow the same measurement principles as IFRS 17.

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

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

112 EFRAG considers that the CSM for the reinsurance contracts held which reflects future expected contracts provides useful information for investors. When the price to obtain reinsurance is more volatile than the price charged to the policyholders, investors would find it useful to know how well the primary insurer is protected against a future increase in the price of purchasing reinsurance coverage.

Appendix 3 – Question 9: Minor amendments and Question 10: Terminology

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

Question 9: Minor amendments

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

114 This has been discussed in response to question 3 on Investment-return and investment-related services.

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

115 EFRAG has been informed that the additional wording (provision (b)) added to the definition of liability for incurred claims (LIC) and liability for remaining coverage (LRC) is difficult to understand. The added provision is appropriate for the LRC definition but is not appropriate for LIC.

116 There is a concern that the wording included for LIC means that if an investment-return or investment-related service is no longer provided but there has not yet been an insurance claim unde the policy (e.g. a policyholder elects a life-contingent annuitisation), the entity may be required to classify the obligation as LIC and write off the CSM. This was not considered to be appropriate in the example, as insurance coverage is still being provided to the policyholder. It was 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 paragraphs B96(a) of the ED?)

117 EFRAG has been informed 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 paragraph 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 (paragraphs BC149 and 11(b) of ED)

118 Paragraph 11(b) of the Exposure Draft 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.

119 EFRAG has been informed that it is not clear as to whether the amended paragraph is now stating that, for investment contracts with discretionary participation features, separation of and accounting for the investment component under IFRS 9 is forbidden, or separation as such is not necessary in these cases.

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)

120 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 B96 accordingly.

121 EFRAG has been informed that there is a knock-on question as to where such changes should then be presented in the statement of profit or loss (i.e. as finance or investment income). EFRAG's constituents seek clarification that presenting such changes in full as finance income is appropriate to achieve consistency with the

corresponding income from investments. A separation of the investment component into finance and investment income would not seem cost-beneficial, as it would require complex system changes.

Treatment of changes in underlying items - Paragraphs B128/ BC161 of the ED

122 The IASB proposes amending paragraph B128 such that changes in the measurement of a group of insurance contracts caused by changes in underlying items be treated as changes arising from the effect of the time value of money and assumptions that relate to financial risk for the purposes of IFRS 17. In essence, this would mean that changes in underlying items should always be treated as finance income, regardless of whether the cause that gave rise to the change related or not to the investment.

123 Underlying items are not necessarily financial instruments: they may relate to reinsurance, to mortality, etc. Therefore, EFRAG has been informed that treating any changes in the underlying items as finance income does not appear appropriate as it would comingle different sources of income. Such an outcome does not positively contribute to the understanding of an insurer's performance.

124 EFRAG has been informed that if the change was non-financial and thus related 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.

Recognition of contracts within a group - paragraph 28/BC 150 of the ED and paragraphs 22/25 of IFRS 17

125 In paragraph BC150 of the ED, the IASB justifies the change proposed to paragraph 28 of the Standard such that inclusion of insurance contracts to a group of contracts depends solely on meeting the recognition criteria and independent of their issuance date.

126 However, EFRAG has been informed that the text then goes on to contrast the treatment in the amended paragraph 28 with paragraph 22 of IFRS 17, which is unchanged.

127 EFRAG has been advised by constituents that the interpretation of the text before the Amendments were issued has been that paragraphs 22 and 28 were aligned and to be understood in the same way: Recognition of and inclusion into (a) a group of contracts and (b) an annual cohort would depend upon meeting the recognition criteria and not upon the issuance date.

128 The statement in the sentence of BC150 of the ED would cause disruption and system changes that were not foreseen previously. This is partly due to the fact that the allocation of contracts to cohorts when issued means that a different locked-in rate would apply.

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

129 EFRAG has been informed that paragraph BC148(a) of the ED refers to a change in paragraph 27 but paragraph 27 has been deleted.

Question 10: Terminology

Insurance contract services

130 EFRAG has been informed that a clarification is needed to paragraph 34 of the ED that the cash flows within the contract boundary should include re-pricing of investment related or investment return service.

131 EFRAG has been informed that paragraphs 41(a) and 83 of the ED seem to conflict with paragraph B120 of the ED.

132 EFRAG has been advised that paragraph 71 of IFRS 17 specifies that for investment with discretionary participation features (DPF) "the date of initial recognition (see paragraphs 25 and 28) is the date the entity becomes party to the contract." The reason for the deviation of the initial recognition date for an investment contracts with DPF from paragraph 25, as the standard was developed, was that these contracts do not have a "coverage period" based on the original definition.

133 Given the fact that the proposed amended definition of the coverage period refers to insurance contract services, i.e. including also investment-return services and investment-related services, a different recognition date for an investment contract with DPF from the default cases is not necessary. Therefore, constituents recommend deleting paragraph 71(a) of the ED.

134 EFRAG has also been notified by constituents that the following paragraphs should be reconsidered as to whether the term 'insurance contract services' is needed - paragraphs 12, 34, 41(a), 83, 103, 104, Appendix A (liability for incurred claims, liability for remaining coverage) and B65 of the ED.

Service period

135 EFRAG has been informed that the term 'service period' should not be used in paragraph 25 (recognition) or paragraphs 53-59 (PAA) of the ED.