Amendments to IFRS 17 *Insurance Contracts*
Issues paper

Introduction and Objective

1 The purpose of this paper is to provide the basis for EFRAG TEG to make a technical assessment of the IASB's tentative decisions for the topics that were included in the EFRAG letter to the IASB. The session aims at providing inputs to the Draft Comment Letter of the forthcoming Exposure Draft.

2 This paper is to be read in conjunction with:

(a) Agenda Paper 09-11 where the basis for the discussion are presented for each topic; and

(b) Agenda Paper 03-01 where the inputs from EFRAG IAWG meeting held on 16 May are reported for each topic.

3 EFRAG TEG is asked to assess the issues on the basis of the existing wording in the tentative decisions and the IASB staff papers and, where appropriate, the TRG papers. The assessment will have to be updated, in preparing the Draft Comment Letter, once the final wording of the Exposure Draft will be available, therefore the conclusions might be different at that stage.

4 The topics covered in this paper are:

(a) **Issue 1** - Transition (extent of relief offered by modified retrospective approach and challenges in applying fair value approach);

(b) **Issue 2** – Reinsurance

(i) **Issue 2A**: Onerous underlying contracts that are profitable after reinsurance;

(ii) **Issue 2B**: Contract boundary for reinsurance contracts where underlying contracts are not yet issued;

(c) **Issue 3** - CSM amortisation (impact on contracts that include investment services);

(d) **Issue 4** - Balance sheet presentation

(i) **Issue 4A**: Cost-benefit trade-off of separate disclosure of groups in an asset position; and

(ii) **Issue 4B**: Groups in a liability position and non-separation of receivables and/or payables;

(e) **Issue 5** - Acquisition costs (for costs incurred in expectation of contract renewals);

5 The topic of Annual cohort requirement cost-benefit trade-off, including for VFA contracts is discussed in agenda paper 09-03.

Overall approach to the DCL

6 The Draft Comment Letter will express support to the IASB for its deliberation process and the consideration of all the issues included in the letter sent by EFRAG to the IASB in September 2018.

7 The letter will express support for the tentative decisions to amend IFRS 17 as relevant with supporting reasoning for each amendment.

Issue 1 – Transition: Modified retrospective approach (MRA) and Fair Value (FVA) approach

EFRAG assessment

[To be completed]

Issue 1A: Modified retrospective approach

EFRAG TEG discussion in April 2019

8 One EFRAG TEG member noted that the FVA and MRA are two approaches different in nature and should not be compared with each other.

9 EFRAG TEG highlighted that different transition approaches could be applied within one portfolio, e.g., applying MRA and FVA to different groups within the same portfolio.

10 EFRAG TEG considered the solution proposed by the CFO Forum (to extend the relief available under the MRA) and some members considered that this proposal should be considered by the IASB. One member noted that further modifications would enable preparers to achieve an outcome closer to the Full Retrospective Approach (FRA) and that without such modifications, preparers would be forced to use a FVA, which will reflect a different measurement than the FRA.

11 A few members noted the view of the EFRAG IAWG that the available information on Market Consistent Embedded Value (MCEV) could be used as an initial datapoint to estimate CSM at inception (with possible adjustments) and then rolled forward in accordance with IFRS 17, using information sourced from the MCEV analysis of movements (adjusted as necessary). One member considered this as a Full Retrospective Approach (built using estimates sourced from MCEV results) rather than an alternative method.

12 In conclusion, EFRAG TEG members agreed that a key element of the debate was the interpretation of the "reasonable and supportable information" criterion.

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

13 Express agreement with the IASB decision to retain the requirements in IFRS 17 for the MFA to (i) prohibit an entity from using a specified modification to the extent that the entity has reasonable and supportable information to apply the related IFRS 17 requirement retrospectively; and (ii) permit an entity to use a specified modification only when the entity has reasonable and supportable information to apply that modification.

14 Support the IASB decision not to permit an entity to develop its own modifications.

15 Observe that the IASB noted the importance of the clarification in the paper that the existence of specified modifications does not preclude the normal use of estimation techniques. Therefore, a further clarification in the Standard is not needed.

16 In the absence of reasonable and supportable information available to apply the MRA (which is not considered to be a high hurdle), there is an important risk of earnings management and window dressing at transition.

17 Due to differences in current GAAPs IT-systems the available data differs from entity to entity. As a result, each entity will need a different solution in order be able to apply the MRA. Defining a general extension of the relief implies continuation of current practices (the labels are the same, but the underlying calculations and data availability differ) and results in non-comparable information.

18 Determination of whether reasonable and supportable information is available to apply the FRA or the MRA is an interpretative issue.

19 The application of the MRA at transition date includes the use of judgement and assumptions as does the application of IFRS 17 in general.

View 2 – Amendment needed to the standard to permit an entity to develop its own modifications to the MRA with the follow specific comments

20 Comparability is an issue when applying both the FVA and the MRA to different groups within the same portfolio.

21 FVA does not provide relevant information about future profitability.

22 Without further modifications (which could achieve an approach closer to the FRA, entities will be forced to use the FVA which will reflect a different measurement approach than the result of an FRA.

View 3 – Amendment needed to the standard to clarify that use of estimates is allowed

23 Amend the standard to clarify that the existence of specified modifications does not preclude the normal use of estimation techniques in the MRA and that the entity is not precluded to make estimates in the FRA.

Questions to EFRAG TEG

24 Does EFRAG TEG support view 1, 2 or 3? Please explain why.

25 Are there additional arguments that the EFRAG Secretariat should consider for inclusion in the DCL?

Issue 1B: Fair value approach

26 This topic is dealt with in paper 09-12 of this meeting.

Issue 1C: Retrospective application of risk mitigation approach

EFRAG TEG Discussion in April 2019

27 Regarding the risk mitigation option and OCI and more generally, on hedge accounting, some EFRAG TEG members noted that additional input from EFRAG IAWG would be appropriate; an ad hoc questionnaire on hedge accounting will be published. The IASB tentatively decided to permit an entity to apply the risk mitigation option prospectively from the IFRS 17 transition date (i.e. one year before the proposed IFRS 17 effective date of 1 January 2022).

28 Below is a summary of the views expressed during the discussion:

(a) Some EFRAG TEG members did not agree with the tentative decision of the IASB not to allow retrospective application of the risk mitigation option at transition. They considered that it would impair comparability between existing and future risk mitigation strategies;

(b) Some EFRAG TEG members questioned whether insurance contracts would in practice be eligible for IFRS 9 hedge accounting and, particularly for fact patterns not addressed by the risk mitigation option offered by IFRS 17.

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

29 Risk mitigation is typically applied at a higher level of aggregation (entity level) so assigning the effects to historic assessments of groups of insurance liabilities will result in artificial allocations.

30 Retrospective application of the risk mitigation approach results in the use of hindsight. The IASB observed that it is hard to see how the option could be applied

retrospectively without the use of hindsight, and without risking ‘cherry picking’ opportunities.

View 2 – Amendment needed to IFRS17 in order to allow for retrospective mitigation at transition with the following specific comments

31 Given that the contractual service margin (CSM) on transition will be allocated to profit or loss in future periods, some stakeholders are concerned that a CSM that does not reflect risk mitigation activities from previous periods may distort:

(a) the equity of entities on transition—because the effect of previous changes in the fair value of the derivatives will be included in the equity on transition, while the corresponding effect on the insurance contracts will be included in the measurement of the insurance contracts; and

(b) the revenue recognised for these groups of contracts in future periods—because the CSM on transition includes the changes in financial risks that would have been excluded had the risk mitigation option been applied retrospectively.

32 To avoid the use of hindsight, retrospective application should be allowed only for those transactions for which the entity has supportable evidence that the risk mitigation strategies would have met in past periods and meet at transition the requirements of IFRS 17.

Questions to EFRAG TEG

33 Does EFRAG TEG support view 1 or 2? Please explain why.

34 Are there additional arguments that the EFRAG Secretariat should consider for inclusion in the DCL?

Issue 1D: Setting OCI to nil at transition

EFRAG TEG discussions (April 2019)

35 One EFRAG TEG member considered that setting the cumulative amount of insurance finance income or expenses recognised in OCI at zero on transition would not reflect the way assets and liabilities are managed in practice and the impact of this would last for several years after transition.

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

36 IFRS 17 measures insurance liabilities as in their own right, there is no mirroring (even for contracts with direct participation features the measurement reflects in the first place the characteristics of the liabilities).

37 The following issues arise in setting the OCI-balance to zero for underlying assets:

(a) Due to the absence of a direct link between underlying assets and the insurance liabilities accounted for under the general model it may be difficult to demonstrate why a particular asset-OCI balance should equal a particular liability OCI-balance;

(b) Setting the asset-OCI balance to nil overrides the (long-term) business model of holding the related bonds which is based on collecting cash flows and selling and distorts performance of that long-term business model for many years after transition; however, on transition there is no selling or derecognition of the bonds;

(c) The asset-OCI balance includes expected credit losses related to the bonds. Setting that balance to nil would remove the recognition of credit risk relating to the underlying assets from the balance sheet;

(d) Permitting entities to deem the cumulative amount in OCI related to corresponding assets to nil at transition to IFRS 17 would involve an amendment to IFRS 9.

View 2 – Amendment needed to the standard with the following specific comments

38 From an economic standpoint, there is an issue in considering that changes in the discount rate have not yet been recognised on the asset side (for those assets measured at amortised cost FVOCI), whereas the insurance liability would be recognised on transition at a current value, e.g. implicitly considering that past changes in discount rate have been recorded in the retained earnings. UNESPA (Spanish Association of Insurers and Reinsurers) mentioned that '*this affects especially long-term insurance contracts where interest rates at transition date can be very different from interest rates at initial recognition of the contracts*.'

39 Not considering any impact of the OCI carried forward for the liabilities could significantly impact the result of future periods and then undermine the credibility of the transition which is a higher risk than the risk of hindsight created by allowing entities to retrospectively calculate former FCF.

40 It is noted that IFRS 17.116 considers the intention of insurers to match assets and liabilities, even for non-VFA contracts.

41 Different alternatives have been proposed (refer to paper 09-11 paragraphs 36 to 41).

Questions to EFRAG TEG

42 Does EFRAG TEG support view 1 or 2? Please explain why.

43 If you support view 2, which of the alternative modifications would you deem appropriate?

44 Are there additional arguments that the EFRAG Secretariat should consider for inclusion in the DCL?

Issue 2 – Reinsurance

Issue 2A: Reinsurance contracts – Onerous underlying contracts that are profitable after reinsurance

EFRAG Assessment

EFRAG supports the amendment for proportionate reinsurance.

[To be completed for non-proportionate reinsurance]

The amendment on proportionate reinsurance is supported

45 EFRAG welcomes the IASB proposals because:

(a) it resolves the accounting mismatches arising from the asymmetrical treatment between the CSM of a reinsurance contract held and the reinsured portion of underlying insurance contract that is covered on a proportionate basis; and

(b) there would be a reduction in complexity for users of financial statements in understanding the accounting.

Unaddressed issue: Non-proportionate reinsurance

46 EFRAG has been informed that there is still an outstanding issue about applying IFRS 17 to non-proportionate reinsurance.

<u>EFRAG TEG discussions (April 2019)</u>

47 EFRAG TEG:

(a) Considered the input of EFRAG IAWG that further accounting solutions would be needed for non-proportionate reinsurance.

(b) Questioned why the accounting treatment is different for proportionate and non-proportionate reinsurance.

(c) Noted the complexity of finding a possible accounting standard solution for aligning the accounting treatment of proportionate and non-proportionate reinsurance due to the difference in economic substance.

(d) Noted that non-proportionate reinsurance would require a different and more aggregated unit of account than proportionate reinsurance.

(e) Considered the view of EFRAG IAWG that the impact of reinsurance could be captured by a risk adjustment for the underlying business. Some members noted that this approach would result in a form of synthetic accounting.

(f) Noted that it was necessary to assess the final wording of the Exposure Draft and the definition of proportionate and non-proportionate reinsurance before reaching a conclusion.

View 1– *Agree with the IASB decision to amend IFRS 17 for proportionate reinsurance with the following specific comments*

48 Non-proportionate reinsurance and proportionate reinsurance are economically different.

(a) Under proportionate reinsurance the reinsurer participates in all risks the insurer is involved in (to the extent transferred), while under non-proportionate reinsurance the reinsurer takes on excess risk or a capped amount of risk.

(b) A net risk position (i.e. the extent to which the risks have been offloaded to a third party) may exist when relying on some proportionate reinsurance contracts (i.e. quota share treaties where the reinsurer covers a fixed proportion of every risk accepted by the direct insurer, no retention limits are applied), but does not arise when using other reinsurance contracts such as:

  (a) Proportionate, surplus treaty (i.e. the reinsurer only reinsures that portion of risk that exceeds the retention limit of the direct insurer); or

  (b) Non-proportionate reinsurance such as an excess of loss or stop loss reinsurance contracts.

49 A specific accounting solution should be defined to solve the issue. However, resolving the issue would create additional complexity and might increase the costs of implementation.

50 While being sympathetic to the “netting”- idea for particular reinsurance contracts held, EFRAG noted that such “netting” does not remove the need for identification of onerous contracts. In case only 40% of the risks is being reinsured, the remaining 60% may still be onerous.

51 IFRS 17 requirements are an important change to the netting practices that prevail today in several local GAAPs.

52 Non-proportionate reinsurance could also be dealt by impacting the risk adjustment rather than the CSM (as discussed in TRG issue S118).

Further considerations for EFRAG TEG

[This view* will be expanded based on *the final wording of the* ED *including the definitions of proportionate and non-proportionate reinsurance.]

53 It is not clear whether the word ‘proportionate’ as stated in the IASB’s tentative decisions means the same as ‘proportional’.

54 There is no definition of ‘proportionate’ in IFRS 17. However, for recognition purposes, IFRS 17 mentions that an entity shall recognise a group of reinsurance contracts held if the reinsurance contracts held provide proportionate coverage. Also, in the Basis for Conclusions of IFRS 17 paragraph 304, it is mentioned ‘*In some cases, the reinsurance contract held covers the losses of separate contracts on a proportionate basis. In other cases, the reinsurance contract held covers aggregate losses from a group of underlying contracts that exceed a specified amount.*’ Therefore, IFRS 17 provides a description of what is not a proportionate basis.

55 One EFRAG IAWG member understood that the word ‘proportionate’ was much broader than the word ‘proportional’. For example, a group excess of loss contract was considered proportionate but not proportional and non-proportional reinsurance contracts also shared in all the risks of the underlying contracts. Refer to the EFRAG IAWG report in agenda paper 03-01.

View 2 – *Amendment needed to IFRS 17 to add an accounting solution for non-proportionate reinsurance* with the following specific comments

56 IFRS 17 is incomplete without a solution for non-proportionate reinsurance.

57 When an insurer has taken non-proportionate reinsurance for its underlying business the accounting in accordance with IFRS 17 shows a mismatch that does not allow the entity to portray that the risks are (to some extent) transferred to a third party, the reinsurer. In order to solve this, the FCF or the risk adjustment of the underlying contracts or even profit or loss could be adjusted and therefore might help avoiding a mismatch.

58 There is no accounting issue with an *existing contract becoming onerous*: in such a case, it will show a loss on the underlying and a profit on the reinsurance. An issue first emerges on how to release the reinsurance gain when a *new onerous contract* is issued. This is because a non-proportionate reinsurance treaty does not relate to one contract but to all the contracts covered. When a new contract is added to a pool of existing contracts with the effect of triggering the reinsurance limit, it is unclear whether this should be attributed to the existing contracts or of the newly added one.

59 While the ANC proposal suggests not to differentiate between proportionate and non-proportionate reinsurance, the CFO Forum suggests do develop a specific accounting solution for non-proportionate reinsurance.

EFRAG supplementary assessment after the IASB tentative decisions

60 A questionnaire on non-proportionate reinsurance has been sent to EFRAG IAWG in order to obtain information on the remaining concerns about the treatment of non-proportionate reinsurance at inception where the underlying contracts are onerous.

61 The EFRAG Secretariat will provide a verbal update of the information received at the meeting.

Questions to EFRAG TEG

62 Does EFRAG TEG support view 1 or 2? Please explain why.

63 In case of view 2, should the suggested modification eliminate the difference between proportionate and non-proportionate or should a specific standard setting solution be suggested?

64 Are there additional arguments that the EFRAG Secretariat should consider for inclusion in the DCL?

Issue 2B: Reinsurance contracts - contract boundary

EFRAG Assessment

To be completed.

65 IFRS 17 requires insurance and reinsurance contracts to be recognised and measured as separate contracts. This implies that, in contrast to current practices, the contract boundary of reinsurance contracts held is determined independently of the underlying insurance contracts.

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

66 The IASB acknowledged that separate accounting for the reinsurance contracts and their underlying insurance contracts may create mismatches that some regard as purely accounting. However, the IASB concluded that accounting for a reinsurance contract held separately from the underlying insurance contracts gives a faithful representation of the entity's rights and obligations and the related income and expenses from both contracts.

67 Situations may occur where contract boundaries differ between reinsurance contracts held and the underlying insurance contracts, due to for example, differences in repricing frequency. This is a direct consequence of treating insurance contracts issued and reinsurance contracts held as separate contracts and it reflects the contractual positions.

68 Furthermore 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 counterparties.

69 Reflecting the entity's substantive right to receive services from the reinsurer in the measurement results is a faithful representation of information in the financial statements for users. Also, the general principle under IFRS 17 that all future cash flows within the contract boundary are reflected in the measurement of an insurance contract is respected.

70 The CSM recognised in a reporting period is determined considering the services received in the current period and expected to be received in future periods under the reinsurance contract held. This is consistent with the requirements for insurance contracts issued. 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.

71 It is acknowledged that estimating future contracts that will be covered by a reinsurance contract already written will require judgement. However, there will be evidence supporting the judgement, including:

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

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

View 2 – Amendment needed to the standard with the following specific comments

72 Treating a reinsurance contract held separately from the underlying insurance contracts issued is inconsistent with the treatment of risk mitigation, for which matching is allowed even if the derivative or reinsurance contract is a separate contract to the insurance contract issued.

73 From an economic point of view, reinsurance held aims at mitigating insurance risks in the underlying insurance contracts. Therefore, the requirements would cause inconsistencies in the following ways:

(a) Applying different discount rates result in mismatches in the financial result;

(b) Differences in the measurement of CSM and differences in allocation periods would lead to mismatches in the insurance result; and

(c) Including estimated underlying future new business within the reinsurance asset leads to disproportionately complex disclosures and mismatches on the statement of financial position.

74 Currently in practice, reinsurance contracts held and the underlying contracts issued are not treated separately, therefore entities match reinsurance contract revenue, costs, assets and liabilities to the underlying insurance contracts.

75 There may be a reduction in reliability estimating these contracts expected to be written in the future. Measuring future cash flows that relate to future underlying contracts not yet issued, is operationally complex in terms of estimating the volume of expected contracts and the different types of contracts expected to be sold and therefore there would be significant costs. This will result in measurement being unreliable, given that cash flows relating to future underlying contracts expected to be issued are uncertain.

76 The standard should be amended so that the measurement requirements in of paragraphs 32-36 of IFRS 17 are applied to reinsurance contracts held, only to the extent that the underlying contracts are recognised.

Questions to EFRAG TEG

77 Does EFRAG TEG support view 1 or 2? Please explain why.

78 Are there additional arguments that the EFRAG Secretariat should consider for inclusion in the DCL?

Issue 3 – Contractual service margin amortisation under the general model

EFRAG assessment

EFRAG supports the IASB proposals for some contracts, as it results in useful information taking into account both insurance and investment return services and requires a weighting (rather than a split) of the services being provided in order to amortise the CSM.

[To be completed for other contracts such as certain deferred annuity contracts]

Contracts with an investment component

79 For some contracts under the general model, in addition to insurance coverage, the entity provides a service to the policyholder in terms of providing both the policyholder's investment and an investment return that would not otherwise be available to the policyholder because of amounts invested, expertise, etc. Therefore, EFRAG assesses that the IASB proposals provide relevant information about the services being provided to the policyholder. Therefore, the resulting CSM amortisation provides a faithful representation of those services being provided.

Contracts without an investment component

IASB May 2019 decision

80 The IASB decided in May to amend the tentative decision made in January 2019 in order to broaden the definition of "investment-related services", so that an investment-return service exists if, and only if:

(a) there is an investment component, or the policyholder has a right to withdraw an amount;

(b) the investment component or amount the policyholder has a right to withdraw is expected to include a positive investment return; and

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

81 The IASB, in its May meeting, agreed with the IASB staff's recommendation under the premise that the Standard would explain what is meant by 'positive' investment return. The IASB emphasised that the criteria (a) to (c) [stated in paragraph 80 above] should be necessary but not determinative criteria for an investment-return service.[1]

View 1– Agree with the IASB decision with the following specific comments

82 The identification of investment return services could be complex and require significant judgement. There would be subjectivity in assessing 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. 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 will facilitate users' understanding on the entity's perspective when amortising CSM. This view has an additional advantage in avoiding additional complexity to the standard.

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[1] Source: IAS Plus as the May IASB Update was not yet available at the time of writing this paper.

View 2 – Going in the right direction but further amendments needed to the standard

83 During the accumulation phase, it could be argued that the entity invests in assets and manages those assets so there may be investment services being provided even though there are no investment components. The counter-argument is that this represents actions by the insurer itself to ensure its continued existence and progress in order to be able to stand ready when the accumulation phase starts.

84 There are merits in exploring the amortisation of the CSM absent an investment component even when the insurer considers that investment services are provided during the accumulation phase. However, the policyholder may not necessarily regard it as such. For example, with the purchase of a deferred annuity, the insurer will need to ensure that it can honour its obligations under the annuity contract, however, the policyholder is not concerned about the intervening period, but only the contractual outcome, i.e. the receipt of the annuity as agreed. The insurer's investment activity may not be seen as a service provided to the policyholder.

EFRAG supplementary assessment after the IASB tentative decisions

85 A questionnaire on CSM amortisation patterns has been sent to EFRAG IAWG in order to obtain information on fact patterns and CSM amortisation patterns for those contracts without investment components when applying the general model under IFRS 17 as to be amended.

86 The EFRAG Secretariat will provide a verbal update of the information received at the meeting.

Other comments

87 As a result of the IASB tentative decisions taken in January 2019, there are some insurance contracts that apply the general model, for example some deferred annuities, whereby the CSM is amortised only over the period when the annuity payments start and not amortised over the accumulation phase when the entity invests in assets and manages those assets.

88 In particular, often there may be no investment component as defined in IFRS 17 because the entity does not repay back to the policyholder in all circumstances. However, there may be an argument that even during the accumulation phase, insurance services are being provided to the policyholder as the entity is standing ready to provide sufficient funds in order for the policyholder to be able to live during the annuity phase. Therefore, there may be merit in considering some form of profit allocation also during the accumulation phase.

89 On the other hand, the service or investment benefit received by the policyholder can be questioned. For example, under some contracts, the policyholder/beneficiaries do not receive anything if the policyholder dies or the contract is terminated during the accumulation phase.

90 Some have indicated that when the insurance service is not priced the same if underwritten at the start of the annuity phase (compared to inception of the contract), this demonstrates the time value gained by the option offered to those policyholders surviving. Such an option could be considered as an insurance service.

(a) EFRAG acknowledges that contracts underwritten at the start of the annuity phase may not be priced the same as contracts that are underwritten at the inception of the contract (i.e. the start of the accumulation phase).

(b) Based on EFRAG's extensive case study, examples of components that are included in setting prices are:

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

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

(iii) Commissions;

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

(v) Existence of reinsurance;

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

(vii) Individual risk premiums based on underwriting questionnaire;

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

(ix) Regulatory technical rates;

(x) Tax; and

(xi) Impact on current IFRS results.

(c) Based on the above, pricing of contracts takes into account many different components. For example, an entity may take into account competitors' pricing when pricing its contracts. Therefore, there is not always a direct link between pricing and providing insurance services.

EFRAG TEG discussions (April 2019)

91 EFRAG TEG members discussed different types of annuity contracts and considered the presence of an investment service component in such contracts.

92 EFRAG TEG members were of view that, although the tentative decision of the IASB is a step in the right direction, the identification of investment services could be complex and require judgement.

93 Some members noted the importance of understanding the driver of CSM recognition.

94 Some members assessed that for certain deferred annuities, even though annuity payments only commence after a certain accumulation phase, there are merits to consider some form of profit allocation during the accumulation phase.

Questions to EFRAG TEG

95 Do EFRAG TEG support view 1 or view 2 after the IASB's tentative decision in May 2019? Please explain why.

96 Does EFRAG TEG agree with the May IASB tentative decisions?

97 Are there additional arguments that the EFRAG Secretariat should consider for inclusion in the DCL?

Issue 4 – Balance Sheet presentation

Issue 4A: Balance sheet presentation – asset/liability

EFRAG assessment

EFRAG assesses that the IASB's decision to change the presentation of insurance contract assets and liabilities in the statement of financial position to that on a portfolio basis rather than groups of contracts is an appropriate trade-off between reducing the burden on preparers and information to users.

98 EFRAG notes that the recognition of a group or portfolio of insurance contracts as an asset or liability does not relate to the profitability of such contracts. However, recognition of an asset reflects that overall, for such a group, the expected inflows exceed the expected outflows which may be of importance to users.

99 However, in the context of the concerns around the burden the requirements imposed, EFRAG considers the tentative decision of the IASB as a helpful and practical way to reduce costs of implementation without a significant impact on information available for users.

100 During the EFRAG user outreach of 2018, a specialist user considered that separate presentation based on groups of contracts to be useful, but not necessarily essential. A generalist noted that limiting of netting is important as netting can obscure important information.

101 There is no dissenting view on this topic.

Further considerations

102 An official observer noted that apart from the above amendment, the IASB would also need to change paragraph 99 in order to ensure that the reconciliations required by paragraphs 100 and 105 does not eradicate the benefit of the change. The IASB tentatively approved in March the staff's proposals on the consequential amendments. This will be confirmed once the Exposure draft is available.

Questions to EFRAG TEG

103 Does EFRAG TEG agree with the above assessment? Please explain.

104 Are there additional arguments that the EFRAG Secretariat should consider for inclusion in the DCL?

Issue 4B: Balance sheet presentation – receivables/payables

EFRAG assessment

[To be completed]

EFRAG TEG discussion (March 2019)

105 One EFRAG TEG member argued that the unit of account in IFRS 17 was conceptually flawed as cash inflows should be separated from cash outflows. Hence, there was a need to separately disclose receivables. This view was challenged by other members as the unit of account in IFRS 17 is considered as a bundle of rights and obligations and would include both inflows and outflows whether or not receivables and payables are separated.

106 EFRAG TEG suggested that a definition of receivables would be needed if receivables were to be separated given the current diversity in practice. A receivable was considered to be unconditional, in line with IFRS 15 *Revenue from Contracts with Customers*, while under current practices some receivables incorporated conditional right to receive a premium.

107 Based on background research the EFRAG Secretariat noted that receivables were not presented separately on the balance sheet under current practice by most insurers, even if they are separated from the insurance liabilities. EFRAG IAWG members advised that there was very little credit risk in the receivables taken as a whole. Thus, some questioned the purpose of the separate presentation.

108 Overall, it was thought that the issue was related to operational complexity due to the lack of existing integration between the cash collection systems and the accounting and actuarial systems.

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

109 EFRAG supports the IASB's tentative decision not to amend IFRS 17 for this requirement for the following reasons:

(a) Including premiums receivable and claims payable in a group of insurance contract asset/liability is consistent with the bundle of rights and obligations associated with the group of insurance contracts as a whole, i.e. as a package of cash inflows and outflows. Therefore, this would be consistent with the principle of IFRS 17[2] and also consistent with the *Conceptual Framework for Financial Reporting*[3];

(b) Separating premiums receivable, for example, from the insurance asset/liability may not lead to faithful representation and would be misleading because the cash flows are measured on an expected basis together with other insurance expected cash flows rather than the asset being measured as a standalone asset under IFRS 9 *Financial Instruments*;

(c) Comparability between entities could be affected if premiums receivable are separately presented because EFRAG acknowledges that, in practice, definitions differ such as: (a) an unconditional right to receive premiums due

[2] The principle of IFRS 17 recognises that a contract, and by extension groups of contracts, create a single bundle of rights and obligations.

[3] This states that the unit of account is the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition criteria and measurement concepts are applied.

including premiums due over more than one reporting period (as per the Accounting Directive); (b) any overdue premium as per the contract; and (c) the next contractually due premium including future instalments of an annual premium;

(d) Could disrupt implementation already under way for some preparers and risk undue delays in the effective date of IFRS 17 if the IASB were to develop a consistent definition of premiums receivable and claims payable;

(e) Paragraph 55 of IAS 1 *Presentation of Financial Statements* permits the presentation of additional line items including by disaggregation of required line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position. Therefore, an entity may choose to present a disaggregation which shows the components of each of those line items (for example, amounts of premiums receivable and claims payable);

(f) EFRAG is not aware that these amounts are material; and

(g) EFRAG considers that presenting premiums receivable/claims payable separately would affect measurement under IFRS 17 as the model requires the consideration of all expected cash flows whether these are contractually due or not. For example, different units of account or discount rate being used between the premiums receivable/claims payable and the rest of the insurance liability.

View 2 – Amendment needed to the standard with the following specific comments

110 EFRAG has considered the following concerns on not being required to separately present premiums receivable/claims payable in the balance sheet:

(a) The information required by IFRS 17 is not useful and do not justify the costs[4];

(b) Due to the lack of granular information about receivables in the reporting systems, an allocation method would have to be defined to groups of contracts and for example the insurance liability as basis of allocation would not be appropriate and other methods may be difficult.

(c) There would be a reduction of relevance as different components that have different levels of uncertainty are included within the same insurance asset/liability. Therefore, this obscures information about the different natures of these components. Under current insurance accounting practices, separate line items are presented for different amounts arising from insurance contracts and those line items reflect a level of aggregation that is consistent with the way that entities manage their operations and systems.

(d) Even though IAS 1 may allow disaggregation of line items, users would want a more harmonised way of disaggregation which would require standard setting (including a definition). The ANC has suggested a common definition of premium receivables based on IFRS 15 paragraph 105 as it considers the loss of information due to the change to current practice as a step backwards and reducing relevance of the information provided. The following excerpt from paragraph 108 of the same standard may be useful in this context: "A

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[4] The need to develop new systems to identify premiums receivable, claims incurred and other separately managed balances (such as insurance acquisition cash flows or collateral deposits related to reinsurance) to be allocated to each group of contracts. This represents a significant implementation challenge, is complex and costly as currently the actuarial systems are not linked to payments/receipt systems.

receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future." The EFRAG Secretariat emphasises that it is far from certain that all the preparers in Europe (or globally) are currently using a definition compliant with the above. Therefore, imposing such a definition may still require significant costs for preparers. It would also require a reassessment of previous implementation analysis to ascertain whether this would still be relevant or require re-working.

(e) For reinsurance contracts, the cedant is often obligated to provide funds withheld as collateral. IFRS 17 requires a presentation of reinsurance funds withheld on a net basis, i.e. the insurance contract liability is offset by the funds withheld. Furthermore, reinsurance contracts may be settled net on a quarterly or six-monthly basis. The IFRS 17 requirements would require arbitrary allocations due to these netting arrangements and also there would be a lack of transparency on the statement of financial position.

(f) Please refer to Agenda Paper 09-11 paragraphs 99/104 for possible wording for the amendment.

Questions to EFRAG TEG

111 Does EFRAG TEG support view 1 or 2? Please explain why.

112 Are there additional arguments that the EFRAG Secretariat should consider for inclusion in the DCL?

Issue 5 – Acquisition costs

EFRAG assessment

EFRAG assesses that the IASB proposals with regards to the treatment of acquisition costs are a step in the right direction, as the resulting financial information will better reflect the economic substance of these transactions.

[Depending on the final wording in the ED: EFRAG recommends the IASB to provide clear guidance on how the recoverability of acquisition cash flows should be assessed.]

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

114 EFRAG therefore assesses that the proposed amendments with regards to the treatment of acquisition is a step in the right direction because this will provide more relevant information to users of financial statements in order to better reflect the economic substance of these transactions.

Further considerations to be confirmed with the final ED wording

Impairment test

115 At the EFRAG TEG meeting in March 2019 a question was raised on how the recoverability of acquisition cash flows would be assessed as it is not clear whether this could be done of future renewals of existing contracts or also future new contracts.

116 The January 2019 IASB's tentative decision mentions *assess the recoverability of any asset recognised applying paragraph 27 of IFRS 17 each period before the related contracts are recognised'*.

117 If a full impairment test is preferred (as already expressed by IASB in its tentative decisions in January 2019), in the ANC's view an onerous test should be performed only if the change in the renewal pattern introduces a significant risk of group of contracts becoming onerous.

118 The ANC in its paper issued in May 2019 suggested to modify paragraph 27 of IFRS 17 as follows:

An entity shall recognise an asset or liability for any insurance acquisition cash flows relating to a group of issued insurance contracts issued or expected to be issued ~~that the entity pays or receives before the group is recognised~~, unless it chooses to recognise them as expenses or income applying paragraph 59(a). An entity shall derecognise the asset or liability resulting from such insurance acquisition cash flows ~~when~~ upon initial recognition of the group of insurance contracts and expected subsequent renewals to which the cash flows are allocated ~~is recognised~~ (see paragraph 38(b))

119 According to the ANC paper, the following specific requirement might be added if IFRS 17.26 as it stands is not considered sufficient to address the valuation test of the asset recognised according to IFRS 17.27:

An entity shall recognise an impairment loss of the carrying amount of the assets related to expected renewals to the extent such amount is related to future groups expected to be onerous.

120 As an alternative solution, the ANC also suggested the following specific requirement might be added if IFRS 17.26 as it stands is not considered sufficient to address the valuation test of the asset recognised according to IFRS 17.27:

An entity shall assess whether contract renewals are likely to happen as expected and where they did not, the associated not yet allocated acquisition costs being then released to profit or loss immediately.

121 In addition, in paragraph 40(b) of January 2019 IASB Agenda Staff paper 2A *Insurance acquisition cash flows for renewals outside the contract boundary* in January 2019, it states the following: '*Assess the recoverability of that asset, based on the fulfilment cash flows of the related contracts, each period before the related contracts are recognised. Consistent with the unit of account in IFRS 17, the staff recommend this assessment is performed on a group of insurance contracts basis—ie an entity will assess whether the fulfilment cash flows of the related group of contracts, comprising of anticipated contract renewals, is sufficient to recover the asset*.' Therefore, from the above wording, it seems that the recoverability of the acquisition cash flow asset is assessed based on expected renewals of existing contracts.

122 However, in June 2018, the IASB tentatively decided (as part of the IASB's annual improvements to IFRS Standards) to amend the terminology in paragraph 27 of IFRS 17 to include insurance acquisition cash flows relating to insurance contracts in the group yet to be issued. The amended wording in the June 2018 IASB staff paper 2A was as follows:

IFRS 17.27 *An entity shall recognise an asset or liability for any insurance acquisition cash flows relating to a group of ~~issued~~ insurance contracts issued or expected to be issued that the entity pays or receives before the group is recognised, unless it chooses to recognise them as expenses or income applying paragraph 59(a). An entity shall derecognise the asset or liability resulting from such insurance acquisition cash flows when the group of insurance contracts to which the cash flows are allocated is recognised (see paragraph 38(b)).*

123 Therefore, it seems that acquisition cash flows relate to both expected future new contracts and expected renewals of existing contracts and therefore recoverability of the acquisition cash flow asset seems to be assessed based on these two cash flows.

Question to EFRAG TEG

124 Do EFRAG TEG members consider that the recoverability of acquisition cash flows would be assessed based on future renewals of existing contracts only and not including future new contracts?

Question to EFRAG TEG

125 Do EFRAG TEG members agree with the above assessment?