This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of the EFRAG Board. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

# IFRS 17 – *Insurance contracts* – analysis of issues reported in the LUCS

## Objective and introduction

1 The purpose of this paper is to assess the issues reported in the LUCS.

2 The issues have been divided in three categories:

(a) Issues, to be considered for inclusion in the DEA subject to relevance considerations;

(b) Issues that are already included in the DEA; and

(c) Issues that are not to be included in the DEA and the reason why.

3 The executive summary consists of three tables in accordance with the above categories. Each issue is described and analysed in the detailed overview.

4 This paper was discussed by EFRAG IAWG on 25 June 2020 and by EFRAG TEG on 2 July 2020.

*Summary of EFRAG TEG discussions*

5 With reference to the first category:

(a) EFRAG TEG members agreed with the text proposal for the issue 27b incorporating EFRAG IAWG's comments.

(b) Some EFRAG TEG members asked to further develop the analysis of the issue 34 without changing the conclusion. They suggested to explain the concerns and to use the Basis for Conclusions relating to the IFRS 17 amendments. It was agreed to check the final wording with two EFRAG TEG members, so to avoid an additional discussion at TEG.

6 EFRAG TEG agreed with the analysis made by the EFRAG Secretariat on the second and third categories (i.e. issues that were already included in the DEA and those that were not to be included).

*Summary of EFRAG IAWG discussions*

7 There were some requests for clarifications of wording, but ultimately no disagreements about whether topics should be included or not in the DEA. The most important discussion related to issue 38 lack of comprehensive testing by the IASB. Some noted that the IASB had only done limited testing on some aspects of the standard while others noted that an IFRS standard was different from Solvency II and a comprehensive pre-implementation testing was not done for any IFRS standard.

8 On Issue 27b business combinations at transition it was requested to adjust the wording by adding that not many insurers would be able to benefit from this relief as

they would have reasonable and supportable information to apply a retrospective approach.

9 On Issue 34 business combinations it was requested to adjust the wording of the text to be included in the DEA by removing the word “however” in the second last sentence.

**Questions for EFRAG Board**

10 Does the EFRAG Board have comments on the analysis provided and consequent drafting changes to the DEA? Please explain.

## Executive summary

### Issues to be considered for additional inclusion in the DEA subject to relevance and materiality considerations: overview

11 EFRAG Secretariat recalls the general drafting principle of the DEA, i.e. only fundamental issues that have been deeply debated during the due process are to be included in the DEA.

12 It is not surprising to see new issues emerging in an implementation project of the complexity and dimension of the transition to IFRS 17.

13 When assessing each of the new issues, EFRAG secretariat believes that implementation issues and interpretation issues do not necessarily pertain to standard setting, so they are not necessarily relevant for the DEA. If material and widespread in European jurisdictions, they may relate in the first case (implementation issue) to the overall cost/benefit assessment and in the second case (interpretation issue) they relate to the process of developing a common practice and may be discussed among preparers and auditors and do not relate to standard setting nor to the DEA.

14 We note that EFRAG TEG discussed already the issues arising from the business combination requirements in IFRS 17 and decided to re-consider the inclusion of a possible section in the DEA depending on the outcome of this LUCS. Strictly speaking, these are not “new” issues.

| Issue | Text proposal DEA |
|---|---|
| Issue 24 - Annual cohorts for intergenerational sharing of risks between policyholders | One participant commented that for contracts with an intergenerational sharing of risks, the annual cohort is the main issue, specifically for the contracts under the VFA. In France or Italy (two countries where the bank insurers represent a large part of the life reserves), the regulation require this intergenerational sharing of risks. Applying the annual cohorts' requirement will be largely artificial and will not provide a relevant information to the users, as it will not appropriately model the economics of these contracts and their legal and contractual terms and the requirement should therefore be removed for these contract. Otherwise, the allocation of the Contractual Service Margin by annual cohort to comply with IFRS 17 requirement will be costly, may not correctly reflect their economics and the way they are managed for legal and contractual purposes, and thus will be of little value for the users.<br><br>Another participant considers this to add operational complexity as it does not align with management of mutualised business with intergenerational sharing of profits and the cost/benefit test is not met.<br><br>This issue is reported in this paper for completeness but it will not be discussed at this stage. |
| Issue 25 - Annual cohorts for general model products | The implementation issues relating to annual cohorts for general products remain after the IASB's re-deliberations for one respondent. Therefore, it suggests continuance of discussing the challenges to find an industry solution.<br><br>This issue is reported in this paper for completeness but it will not be discussed at this stage. |
| Issue 27b - Transition – business combinations | *The text below has not been updated after TEG. TEG members have agreed on developing further the wording making reference to previous papers already discussed by TEG. Subject to these inputs the EFRAG Secretariat will update the text accordingly.*<br><br>Appendix II – relevance<br><br>It is noted by some that the with regard to the transition requirements IASB has rejected several mismatches or presentation issues which have been pointed out by the respondents to the ED, such as the |

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| | treatment of liabilities for incurred claims in business combinations or portfolio transfers.<br><br>At transition, entities are allowed to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired in a transfer that do not form a business or a business combination in the scope of IFRS 3. EFRAG notes that this aligns the treatment of insurance contracts that have been acquired by means of a business combination or a business combination in the scope of IFRS 3. Hence, EFRAG thinks this leads to relevant information for the same reasons as discussed in paragraphs xx to xx.<br><br>For insurance contracts that are part of transfer that does not form a business or a business combination, EFRAG notes this is a relief that has been granted because it may be often impracticable to apply IFRS 17 retrospectively due to a lack of data. EFRAG assesses that this practical expedient does not reduce the relevance of information because of this reason. |
| Issue 34 - Business combinations – contracts in settlement | *The text below has not been updated after TEG. TEG members have agreed on developing further the wording making reference to previous papers already discussed by TEG. Subject to these inputs the EFRAG Secretariat will update the text .*<br><br>Appendix II – relevance<br><br>Applying IFRS 17, contracts acquired which are in their settlement period are classified as liability for remaining coverage and a contractual service margin is calculated as the difference between the consideration received or paid and the fulfilment cash flows. It is noted by some that this leads to a difference in treatment of these insurance contracts in the financial statements of the acquirer compared to the financial statements of the acquiree. EFRAG acknowledges that insurance contracts in their settlement period are of a different nature than contracts for which the insurance risk has not materialised yet. Hence EFRAG has sympathy for the argument that such insurance contracts should not be treated the same. However, EFRAG notes that the alignment with IFRS 3 results in a “resetting the clock” at the date of the acquisition and acknowledges that bringing an exception to this general principle may confuse readers of financial statements. So on balance, EFRAG is of the view that accounting for contracts acquired in their settlement period as a liability for remaining coverage results in relevant information.<br><br>Appendix II – comparability<br><br>Applying IFRS 17, contracts acquired which are in their settlement period are classified as liability for remaining coverage and a contractual service margin is calculated as the difference between the consideration received or paid and the fulfilment cash flows. It is noted by some that this leads to a difference in treatment of these insurance contracts in the financial statements of the acquirer compared to the financial statements of the acquiree. EFRAG acknowledges that insurance contracts in their settlement period are of a different nature than contracts for which the insurance risk has not materialised yet. Hence EFRAG has sympathy for the argument that such insurance contracts should not be treated the same. However, EFRAG notes that the alignment with IFRS 3 results in a “resetting the clock” at the date of the acquisition and acknowledges that bringing an exception to this general principle may confuse readers of financial statements. Hence, on balance EFRAG is of the view that the requirements result in comparable information.<br><br>Appendix II – understandability<br><br>Applying IFRS 17, contracts acquired which are in their settlement period are classified as liability for remaining coverage and a contractual service margin is calculated as the difference between the consideration received or paid and the fulfilment cash flows. It is noted by some that this leads to a difference in treatment of these insurance contracts in the financial statements of the acquirer compared to the financial statements of the acquiree and thus would not be understandable. EFRAG acknowledges that insurance contracts in their settlement period are of a different nature than contracts for which the insurance risk has not |

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| | materialised yet. Hence EFRAG has sympathy for the argument that such insurance contracts should not be treated the same. However, EFRAG notes that the alignment with IFRS 3 results in a "resetting the clock" at the date of the acquisition and acknowledges that bringing an exception to this general principle may confuse readers of financial statements. Hence, on balance EFRAG is of the view that the requirements result in understandable information. |
| Issue 46a – appropriate level for onerous contracts | One participant noted that an appropriate level of aggregation is needed for recognition of onerous business.<br>This issue is reported in this paper for completeness but it will not be discussed at this stage |

## Issues reported already discussed in the DEA: overview

| Issue | Where? |
|---|---|
| Issue 1a: Burdensome presentation and disclosure requirements | Appendix III – cost and benefits section |
| Issue 4 – compliance costs for recognition of acquisition costs | Appendix III – cost and benefits section |
| Issue 7 – Annuities – separation of insurance and investment return services | Appendix III – cost and benefits section |
| Issue 8 – unit-linked contracts with different riders | Appendix III – cost and benefits section |
| Issue 11 – Reinsurance contracts do not qualify for the variable fee approach. | Appendix II |
| Issue 12 - include particular investment services in the insurance result | Appendix II |
| Issue 14 – reinsurance and underlying contracts – differences in contract boundary | Appendix II |
| Issue 16 – reinsurance – simplify calculation of net gain after reinsurance | Appendix III – cost and benefits section |
| Issue 23 - Contracts that change nature over time | Appendix II |
| Issue 26 - Proportional reinsurance held with underlying VFA contracts | Appendix II |
| Issue 27a - Transition and other topics | Appendix II |
| Issue 28 – Current measurement and profit recognition | Appendix II. |
| Issue 30 - Locked-in discount rate | Appendix II |
| Issue 31 - Non-distinct investment components | Appendix II |
| Issue 33 - Setting OCI balances to nil | Appendix III |
| Issue 35 – Annual cohorts for PAA business | Appendix III – cost and benefits section |
| Issue 37 – Complexity of the standard. | Appendix III |
| Issue 40 – Cost of PAA | Appendix III – cost and benefits section |

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| Issue 42 – Disclosures costly to implement | Appendix III – cost and benefits section |
| Issue 43 – Costly implementation of the OCI approach for indirect par contracts | Appendix III – cost and benefits section |
| Issue 44 – VFA mechanics create volatility | Appendix II |
| Issue 46b – more volatility due to financial markets | Appendix III – applying IFRS 9 and 17 together |
| Issue 47 – applying IFRS and local gaap by a bancassurer | Appendix II – cost and benefits section |
| Issue 49 – annual cohorts and procyclicality | Appendix III - procyclicality |

## Issues not to be included in the DEA: overview

| Issue | Reason |
|---|---|
| Issue 1b: measurement of asset remains constant | The issue is based upon assumptions that remain theoretical and do not incorporate economic, social or regional trends. |
| Issue 2: interaction impairment test acquisition cash flow asset and reinsurance | Operational issue. |
| Issue 3 – allocation of costs to renewals to be optional | Optionality reduces comparability. |
| Issue 5 –management fees not reflected in CSM run-off | Relates to internal analytical accounting which falls out of scope of IFRS. |
| Issue 6 – Annuities – insurance coverage linked to cash flows | Accounting is the result of information provided to the IASB by preparers. |
| Issue 9 – reinsurance – provision of investment activity without surrender | The argumentation that contracts are economically similar irrespective whether an amount can be withdrawn or not, is not supported. |
| Issue 10 – Inclusion of costs related to investment services into contract boundary – requirement unclear | Interpretation issue. |
| Issue 13 – disclosure of solely qualitative information on expected recognition of CSM no longer allowed | The proposed disclosure is the result of a balancing exercise between faithful representation, comparable information and cost-benefit. |
| Issue 15 – reinsurance - retendering | Similar to annual repricing of insurance contracts which is already discussed in Appendix II. |
| Issue 17 – reinsurance contracts held do not qualify for the VFA | Already covered in DEA Appendix II under relevance |
| Issue 18 – hedging of the variable fee | Not a widespread or IFRS 17 specific issue as already a problem under IFRS 4. |
| Issue 19 – extension of scope of risk mitigation option to fair value OCI instruments | This was already included in paper on 'Contracts that change nature over time' and had no support from EFRAG TEG. |

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| Issue 20 – risk mitigation option cannot be used in Italy | Regulatory issue and therefore outside the scope of the DEA |
| Issue 21 – risk mitigation option should be extended to general model contracts | Hedge accounting position in Appendix III |
| Issue 22 – retrospective application of the risk mitigation option | Extensively discussed in Appendix II and III |
| Issue 29 - Treatment of equity instruments | Relates to IFRS 9 and thus falls outside of scope of IFRS 17 DEA |
| Issue 32 - Scope of the VFA: para B107 | Interpretation issue. |
| Issue 36 – products where financial risk has a substantial effect on policyholder returns | Effects are reflective of economic changes in the measurement of assets. |
| Issue 38 – lack of comprehensive testing by IASB | There was extensive outreach and testing in accordance with the effects analysis. |
| Issue 39a – Differences in probability in default on both sides of balance sheet | Differences are economic mismatches |
| Issue 39b – Application of the current period book yield | Implementation issue |
| Issue 41 – Application of paragraph B107 and business combinations | Similar to issue 32 – interpretation issue. |
| Issue 45 – Participating contracts with non-participating elements | Standard not changed because of avoiding disruption of the implementation. |
| Issue 48 – cash-based measurement of insurance liabilities | Comment is incorrect. |

# Detailed overview: issues reported in the LUCS

### Acquisition cash flows

*Issue 1a: Burdensome presentation and disclosure requirements*

*Issue 1b: Measurement of asset remains constant*

15 One participant noted the presentation of an asset for insurance acquisition cash flows as well as the related disclosure requirements are extremely burdensome. The resulting additional costs and efforts are not in a reasonable relation compared to the information generated. Furthermore, and assuming that the duration of the renewals remains rather constant over time, effects from setting up the "new" asset and amortization of the "already existing" asset over time will lead to compensatory effects after a couple of years.

16 Another participant noted that presenting an asset for acquisition cash flows is complex and costly; comparative figures is very complex and leads to substantial costs and workload on the organisation; premiums received meaning premiums actually received at the reporting date, not including premiums due or premiums expected leads to additional costs.

17 Another participant noted the amendment for Acquisition Cash Flows Assets linked to renewals will require a dedicated tracking to proceed to the impairment tests, and will probably be of limited use

18 *EFRAG Secretariat analysis Issue 1a*: in its comment letter to the IFRS 17 Amendments EFRAG supported the changes relating to insurance acquisition cash flows as these lead to more relevant information. The EFRAG Secretariat notes that the cost and benefit section in Appendix III includes these issues.

19 *EFRAG Secretariat analysis Issue 1b:* The participant is assuming that client behaviour does not change over time and hence results in a stable insurance acquisition asset over time. The EFRAG Secretariat notes that such assumptions remain theoretical and do not incorporate economic, social or regional trends. Examples are changes driven by internet shopping or the fact that in different countries the same insurance product is either subject to acquisition cash flows and in other countries these are absent. Hence, the EFRAG Secretariat proposes not to take on board this comment.

*Issue 2: interaction impairment test acquisition cash flow asset and reinsurance*

20 One participant noted that the deferred acquisition cost impairment test does not appropriately interact with the revisions made to reinsurance. If the underlying contracts are onerous but the reinsurance contracts are profitable such that the net position is profitable, there is a requirement to write off the related DAC whenever the impairment test were performed. This would then mean that the reinsurance gain which can be reflected in the period immediately after the impairment test would be reduced, distorting the result. The financial impact of this distortion is related to the length of the underwriting process and the size of acquisition costs.

21 *EFRAG Secretariat analysis*: IFRS 17 foresees a double impairment test for insurance acquisition cash flows: i) an impairment test at insurance contracts group level and ii) and impairment test to cash flows for expected contract renewals. The second test was introduced by the IASB in order to avoid that cash flows from future profitable policyholder contracts might prevent the recognition of an impairment loss.

22 The scenario explained by the participant is highly similar to the one the IASB wanted to address by introducing the second impairment test.[1] Only, in this scenario profitability of future renewals is achieved by adding a layer of reinsurance.

23 The EFRAG Secretariat notes that the asset for acquisition cash flows results from existing insurance contracts, part of which will be renewed in future periods. However, future groups of insurance contracts are not composed solely of renewals of current insurance contracts but also include new insurance contracts. Hence, determining the impairment loss based on comparing the acquisition cash flows with the net cash inflows of the expected renewals only results in relevant information. The EFRAG Secretariat further notes that the scenario also differs from the recognition of recovery of losses by reinsurance contracts held because this applies only when the reinsurance contracts held are recognised before or at the same time of the underlying onerous contracts.

24 The EFRAG Secretariat is of the view this is an operational challenge that should not be included in the DEA.

*Issue 3 – allocation of costs to renewals to be optional*

25 One participant believed that the allocation of costs to renewals should be optional. This to avoid the obligation each year to demonstrate, in case there is no allocation to renewals, that the expected renewals have effectively not been considered in the decision to incur in certain acquisition cash flows.

26 *EFRAG Secretariat analysis*: The EFRAG Secretariat is of the view that optionality will reduce comparability.

*Issue 4 – compliance costs for recognition of acquisition costs*

27 One participant expected significant accounting compliance costs in the following areas.

28 Recognition of a separate asset for insurance acquisition cash flows for the groups of insurance contracts acquired in a business combination or in a transfer that does not form a business combination.

29 The proposed amendments require an entity that acquires insurance contracts in a business combination or in a transfer that does not form a business combination to recognise a separate asset for insurance acquisition cash flows measured at fair value at the acquisition date. Even it is consistent with the general measurement and accounting rules for the directly attributable insurance acquisition costs as set by IFRS 17, this requirement is likely to generate additional operational complexity.

30 According to the current 'purchase GAAP' accounting practice, the profits that are expected to be generated from future renewals of the insurance contracts acquired in a business combination are accounted for via corresponding customer intangible assets.

31 Following the new IFRS 17 requirements, the entities will be required to retrospectively identify, within such a customer intangible asset, the part corresponding to the asset for acquisition cash flows for future renewals. We assume the implementation of this requirement to be operationally complex while not expected to generate any material impact on the consolidated financial statements.

32 Two-step recoverability test for insurance acquisition cash flows assets. According to the proposed amendments, the recoverability of the acquisition cash flows assets should be assessed applying a twostep procedure that includes:

[1] See IASB Staff paper 2B of December 2019

(a) an impairment test at the level of a group of insurance contracts (group level impairment test); and

(b) an additional impairment test specific to insurance acquisition cash flows allocated to expected contract renewals (additional impairment test).

33 This approach appears to be complex and will imply higher costs. The additional impairment test will require a complex tracking of renewals for each individual annual cohort of new business. The information needed to perform this test is not easily available and the existing tools and procedures will need to be adapted in order to implement this additional impairment test. However, the operational burden is alleviated by the requirement to test an asset for insurance acquisition cash flows for impairment only when facts and circumstances indicate the asset may be impaired.

34 One participant noted the amendment for Acquisition Cash Flows Assets linked to renewals will require a dedicated tracking to proceed to the impairment tests, and will probably be of limited use.

35 *EFRAG Secretariat analysis:* The EFRAG Secretariat is of the view these costs are part of the cost-benefit analysis.

**Contractual service margin attributable to investment-return service and investment related service**

*Issue 5 –management fees not reflected in CSM run-off*

36 Several participants noted that the use of [investment] management fees assigned to internal asset managers are not reflected in the run-off of the CSM [these do not always correspond to an investment component]. Difficulties also arise in aligning the solo profit of the investment manager and the profit of the solo insurer with the consolidated result.

37 *EFRAG Secretariat analysis*: The EFRAG Secretariat notes that the internal analytical accounting is out of scope of the IFRS. Hence, it is proposed not to include this issue in the DEA.

*Issue 6 – Annuities – insurance coverage linked to cash flows*

38 One participant noted that for immediate and deferred annuities, the TRG discussions on the recognition of CSM for insurance service within annuity contracts are inconsistent with other types of contract where the sum assured changes with time and therefore insurance cover is also not reflected appropriately for insurance services.

39 We believe that investment service is earned over the whole contract duration and should reflect the pricing investment margin earned in line with the expected size of the backing asset portfolio. The insurance service should be earned over the contract duration reflecting the sum assured – ie. the expected future amount that would be lost if the insured event (death) where to occur.

40 *EFRAG Secretariat analysis*: The EFRAG Secretariat has considered the following:

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

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

(ii) …

(b) An investment component is/are the amounts that an insurance contract requires the entity to repay to a policyholder in all circumstances, regardless of whether an insured event occurs;

(c) The requirements of the Standard exclude investment components from insurance revenue and incurred claims. **To achieve this without separating the investment component for measurement purposes** (highlight added), the IASB decided to identify the investment components only at the time revenue and incurred claims are recognised, and to exclude the amounts so identified.

(d) The EFRAG Secretariat recalls that in developing the standard, preparers had indicated that tracking non-distinct investment components separately was too complex, for example an expected future amount (which is changing over time as it depends on:

  (i) when the insured event occurs in time; and

  (ii) the evolution of the investments including their volatility;

  (iii) interdependencies between components, with the result that the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition.

(e) The EFRAG Secretariat supports the IASB view that an investment-return service cannot exist if the contract does not include an investment component or the policyholder does not have a right to withdraw an amount in order to benefit from that service. Also, the EFRAG Secretariat is of the view that contracts that provide a right for the policyholder to benefit from an investment return are economically dissimilar from contracts without such a right.

(f) The EFRAG Secretariat has sympathy for the argument that investment services are being provided over the entire duration of the contract, i.e. both in the accumulation phase of a deferred annuity as well as in the pay-out phase.

(g) However, the EFRAG Secretariat notes that in the many years of development of the Standard, choices have been made based on information gathered from preparers (for example the difficulty to track non-distinct investment components). As a result, the outcome of running-off the CSM for deferred annuities may be perceived as suboptimal but it has to be balanced against the costs for developing an alternative solution.

41 Based on the above analysis, the EFRAG Secretariat proposes not to add this topic to the DEA.

*Issue 7 – Annuities – separation of insurance and investment return services*

42 For UK annuities, the requirement to separately identify insurance and investment return services does not align with how the contracts operate in practice increasing the operational burden.

43 Investment return service: The change which enabled profits to be recognised associated with an investment return service substantially mitigates the problem. However the revised approach remains operationally complex to implement and still does not fully reflect that in practice the insurance service and investment return service of an annuity are provided concurrently throughout the life of the contract and not for discrete periods which the IASB's solution envisages.

44 *EFRAG Secretariat analysis*: issues about operational complexity are covered by the cost-benefit analysis.

*Issue 8 – unit-linked contracts with different riders*

45 For unit-linked contracts with several insurance riders it is difficult to determine the insurance coverage metric. This leads to costs and complexity.

46 *EFRAG Secretariat analysis*: The EFRAG Secretariat notes that when contracts are complex, reflecting economic reality through accounting may lead to complex accounting requirements. The EFRAG Secretariat is of the view this is covered in the cost and benefits section of the DEA.

*Issue 9 – reinsurance – provision of investment activity without surrender*

47 One participant noted that in some reinsurance contracts the long-lasting final settlement of contractual obligations is combined with interest charges relating to reference investment portfolios which should not extend the provision of services beyond the economic substance of the contracts. They would have appreciated further extending the proposed amendment to cases where products cannot be surrendered/transferred and do not contain any investment component, but for which investment activities are also performed. This would avoid a different accounting treatment for economically similar primary insurance contracts.

48 *EFRAG Secretariat analysis*: In accordance with the IASB an investment-return service cannot exist if the contract does not include an investment component or the policyholder does not have a right to withdraw an amount from the entity, because, in that case, the policyholder does not have the right to benefit from investment returns. In the EFRAG Secretariat's view this criterion allows to determine whether contracts are economically similar or not. The argument that contracts are similar irrespective whether there is a right to withdraw an amount is not supported. Hence, the EFRAG Secretariat does not propose to include this issue in the DEA.

*Issue 10 – Inclusion of costs related to investment services into contract boundary – requirement unclear*

49 One participant welcomes the amendment that requires an entity to include, as cash flows within the boundary of an insurance contract, costs related to investment activities to the extent the entity performs such activities to enhance benefits from insurance coverage for the policyholder, even if the entity has concluded that the contract does not provide an investment-return service. However, this last amendment, as currently drafted, can be subject to different interpretations. Its scope is unclear and may, if strictly applied, be extended even to short-term P&C insurance contracts eligible to the measurement under the premium allocation approach. Even though there is a consensus to consider that for these contracts the investment activities could potentially generate premium reductions but not increase in payments to policyholders (that, strictly speaking, would not qualify for 'enhanced benefits from insurance coverage'), in order to avoid any misinterpretation, they believe that the IASB should clarify the wording currently drafted. Finally, they note that this amendment will potentially require some implementation processes to be adjusted and so increase implementation costs.

50 *EFRAG Secretariat analysis*: This is an interpretation issue and should not be included in the DEA.

*Issue 11 – Reinsurance contracts do not qualify for the variable fee approach.*

51 The non-ability to apply the VFA approach to reinsurance contracts.

52 EFRAG Secretariat analysis: this is already part of the DEA.

*Issue 12 - include particular investment services in the insurance result*

53 One participant noted that in many of their products the average period of time that elapses from when the customer is due to pay premium until they receive the service is long and, consequently, the financial performance is relevant in the price and margin of the product. For the same reason, the investment management service is a main component of the entity's expected result. This characteristic does not always correspond to the concept of an investment component, as defined in the

amended IFRS 17. For this reason, they would consider desirable that the IASB revisits the definition of "the return on investment service" in paragraph B119B with the aim that investment component of these insurance products could be presented/disclosed as a part of the insurance result and not in the financial result. They believe that the "CSM run-off" as the investment component of these products should be included within the insurance service section.

54 *EFRAG Secretariat analysis*: Currently Appendix II notes the following: The insurance revenue and incurred claims exclude any investment components. EFRAG considers this exclusion relevant because the investment component does not depict revenue earned by the entity in exchange for services provided but an amount that the entity has to pay back to the policyholder in all circumstances. The EFRAG Secretariat subscribes to this view, and considers that this is thus covered in the DEA.

*Issue 13 – disclosure of solely qualitative information on expected recognition of CSM no longer allowed*

55 One participant was concerned about the removal of the option in paragraph 109 of IFRS 17 to provide only qualitative information in relation to the expected recognition in profit or loss of the contractual service margin remaining at the end of the reporting period. As there is not a similar requirement of future performance disclosure in other industries this fact should be considered before removing this option under IFRS17.

56 *EFRAG Secretariat analysis*: This change is a consequential change from broadening the range of services considered when identifying coverage units and allocating the contractual service margin to coverage units. In the view of the IASB it is part of a balancing exercise between faithful representation, comparable information and cost-benefit. The EFRAG Secretariat subscribes to that reasoning.

57 In addition, the EFRAG Secretariat rejects the argument that there is no similar requirement for other industries. The same is true for the unit of account where insurance entities enjoy a benefit compared to other industries that account for their financial instruments on individual contract level. As a result the EFRAG Secretariat proposes not to include this issue in the DEA.

**Reinsurance contracts held – recovery of losses on underlying insurance contracts**

*Issue 14 – reinsurance and underlying contracts – differences in contract boundary*

58 Contract boundary requirements will in many cases result in reinsurance assets including direct contracts not yet written giving rise to accounting mismatches between the liability in respect of direct contracts and the related reinsurance contract asset.

59 *EFRAG Secretariat analysis*: Currently Appendix II states: EFRAG considers that the estimation of these contracts would follow the same measurement principles as required IFRS 17 by in general, i.e., a probability-weighted estimate of the present value of cash flows. The fact that estimates of future contracts entail the use of some different techniques when compared to estimating cash flows of existing contracts is counterbalanced by the use of probability-weighted estimates. Hence EFRAG disagrees that this leads to a reduction in reliability of the resulting information. The EFRAG Secretariat subscribes to that analysis.

*Issue 15 – reinsurance - retendering*

60 It is prohibited to recognize the ceded loss liability in case the reinsurance treaty begins after the inception of the underlying contracts, this will lead to accounting mismatches. In addition, certain forms of reinsurance coverage (such as risk premium reinsurance on protection business) may be retendered over the lifetime

of the underlying contracts. When retendering occurs, as it stands, the remaining offset loss on the underlying contracts would be recognised. It is noted that this is not an economically faithful representation, and to the extent the % of claims on the underlying recoverable from the reinsurance has not decreased, no loss should be recognised at this point.

61 *EFRAG Secretariat analysis*: Currently, Appendix II states the following about contracts with annual repricing mechanisms: The contract boundary ends when the insurer has the practical ability to reassess the risks of the underlying insurance contract or the portfolio that contains that insurance contract and as a result can set a price or level of benefits that fully reflects the risk of that portfolio. As a consequence, when an insurer uses annual repricing mechanisms that are closely related to the underlying risks, the cash flows resulting from the renewal terms are not part of the boundary of the existing insurance contract but belong to a new insurance contract instead. EFRAG assesses that accounting for this change as a new contract leads to relevant information because it reflects the changed economics of the contracts.

62 EFRAG assesses that an entity is no longer bound by the existing contract at the point at which the contract conveys to the entity the practical ability to reassess the risk presented by a policyholder. Therefore, only including cash flows in the contract boundary if they arise from substantive rights and obligations that exist during a reporting period provides relevant information.

63 The EFRAG Secretariat is of the view that retendering of reinsurance contracts is similar to the repricing mechanism already described in Appendix II. Hence, it is proposed not to include this issue in the DEA.

*Issue 16 – reinsurance – simplify calculation of net gain after reinsurance*

64 The calculation of the net gain after reinsurance could be simplified by removing the text that requires the initial reinsurance CSM offset to be calculated as a product of the loss and proportion reinsured. This would give additional flexibility to insurers in defining the approach to be used.

65 *EFRAG Secretariat analysis*: The EFRAG Secretariat understands this is as a compliance issue which is covered in the DEA under costs and benefits.

**Applicability of the risk mitigation option**

*Issue 17 – reinsurance contracts held do not qualify for VFA*

66 Four participants mentioned that the extension of the scope of the risk mitigation option was necessitated by or the remaining concerns (apart from retrospective application – see paragraph 78 below) relates to the non-application of reinsurance contracts held for VFA.

67 *EFRAG Secretariat analysis*: Currently Appendix II says EFRAG acknowledges that there may be reinsurance contracts issued or held that may meet the variable fee criteria even though these contracts are not allowed to apply the variable fee approach. EFRAG assesses that the risk mitigation option also applicable to reinsurance contracts would largely address the accounting mismatches, thereby balancing relevant information.

68 The EFRAG Secretariat is of the view that LUCS confirms the position in the DEA and do not propose to change the DEA.

*Issue 18 - hedging of variable fee*

69 One participant considers that ability to hedge the entity's variable fee is possibly not dealt with under the amendments but would need confirmation under the final wording. This is the same as the position under IFRS 4 where the volatility due to the hedging is managed through disclosure in the existing operating profit metric.

The latest amendment around non-derivatives at FVPL does not deal with this situation.

70 *EFRAG Secretariat analysis*: This does not seem to be a widespread issue and is no worse than the position under IFRS 4. Therefore, the Secretariat is of the view that this does not need to be added to the DEA.

*Issue 19 – extension of scope of risk mitigation option to fair value OCI instruments*

71 One participant considers that the scope extension should also include non-derivative financial instruments measured at FVOCI as this would remove a mismatch in an operationally efficient way. This mismatch relates to VFA contracts being covered by general account assets including bonds measured at FVOCI.

72 *EFRAG Secretariat analysis*: This was discussed as part of the EFRAG TEG paper on contracts changing nature over time. EFRAG Secretariat notes that the IASB concluded that it would be inconsistent with the approach in IFRS 9 for hedge accounting which does not allow FVOCI items to act as hedging instruments. Furthermore, it would require complexity in identifying ineffectiveness and would not eliminate accounting mismatches in most cases. The latter would only be consistent where the related asset and the insurance contract started and ended at the same time, otherwise the unwind of the discount would progress differently.

73 Therefore, the EFRAG Secretariat proposes that this is not added to the DEA.

*Issue 20 – risk mitigation option cannot be used in Italy*

74 A participant stated that risk mitigation cannot be achieved in Italy due to existing regulatory constraints and approaches.

75 *EFRAG Secretariat analysis*: The participant has not communicated details of the regulatory requirements it refers to and contradicts comments from other Italian stakeholders. Conflicts between regulatory requirements and the IFRS 17 fall outside the scope of the DEA.

*Issue 21 – risk mitigation option should be extended to general model contracts*

76 Four participants consider that the risk mitigation option should be extended to contracts under the general model. Two participants stated that the hedge accounting requirements may be difficult to comply with as:

(a) Investment and insurance components of an insurance contract are highly interrelated, which may not be consistent with the requirement for the hedged item to be separately identifiable and reliably measurable.

(b) Both hedged items and hedging instruments constantly change over the hedge term, so hedging is regularly carried out dynamically.

(c) Variables related to the policyholder behaviour and market trends (e.g. lapses, surrenders, mortality, new business sales) are intertwined with the impact of financial market variables and cannot be isolated from the hedging relationship.

(d) The hedge effectiveness requirements to qualify for hedge accounting are operationally onerous to perform. E.g. allocating derivatives between VFA and general model products as the current hedging programme is set up at a higher level covering all products exposed to similar risk types. This issue can be further exacerbated when the programme is rebalanced due to mortality or policyholder behaviour.

Therefore, hedge accounting would require recourse to the EU carve-out option to bypass some of the requirements in the standards and so the extension of the risk mitigation option with some modifications, is required for contracts under the general model.

77 *EFRAG Secretariat analysis*: The issue is discussed expansively in Annex 4 to Appendix III and was confirmed by the analysis of ACE. It also forms part of the 21 topics discussed by the EFRAG Board and therefore, the EFRAG Secretariat proposes no further work at this stage.

*Transition relief for risk mitigation*

*Issue 22 – retrospective application of the risk mitigation option*

78 Five participants considered that the prohibition on retrospective application of the risk mitigation option would result in a misstatement of shareholder equity at the transition date with a consequential inappropriate level of underwriting result and revenue thereafter, thereby impacting the relevance of the financial statements.

79 One participant disagreed and considered that this would have a negligible impact at transition with another one commenting that reinsurance contracts held are generally underlying items in Germany and therefore not a concern. One participant indicates that the inclusion of non-derivatives at fair value in the scope of risk mitigation reduces mismatches in this regard.

80 *EFRAG Secretariat analysis*: The DEA Appendix II says the following under relevance:

81 *The risk mitigation option cannot be applied retrospectively. EFRAG is aware that the issue significantly impacts some insurers but for other insurers, this is not a significant concern. Preparers are concerned that if they were allowed to apply the risk mitigation option retrospectively at transition, the changes in the fair value of the risk mitigating instruments would adjust the CSM (indirectly) however, as retrospective application is not allowed, the changes in these instruments are recognised in retained earnings rather than CSM.*

82 *EFRAG acknowledges that for those who are significantly impacted, not being able to apply the risk mitigation option retrospectively reduces the relevance of the information as it would distorts the equity and CSM balances at transition and the related revenue recognition pattern subsequently.*

83 *However, EFRAG also acknowledges the IASB's reasoning, i.e., that if an entity was permitted to apply the option retrospectively, it could freely decide the extent to which to reflect risk mitigation activities in the contractual service margin based on a known accounting outcome. The entity could do this in a way that would not reflect how the entity would have applied the option in previous periods, without hindsight, had it always applied IFRS 17. Such a risk would affect the credibility of information presented on transition to IFRS 17 and in subsequent periods in which those groups of insurance contracts continue to exist.*

84 *Therefore, considering the above, on balance, EFRAG is of the view that not applying the risk mitigation option retrospectively will result in useful information*.

85 The following is in Appendix III:

86 *Risk mitigation provisions in IFRS 17 allow for recording in the P&L instead of in the CSM the financial risk's component of changes in the CSM, in order to match the corresponding changes in the derivatives or non-derivative risk mitigating financial instruments. IFRS 17 prohibits a retrospective application of the risk mitigation option. In the view of some stakeholders, permitting retrospective application of the option would be the optimal approach to achieve comparability between the information provided about risk mitigation activities that took place before and after the transition date. In particular those stakeholders mention that it would affect the CSM and retained earnings at transition and as a result also the profit recognition in the years after transition.*

87 *The IASB noted that if an entity was permitted to apply the option retrospectively, it could decide the extent to which to reflect risk mitigation activities in the contractual*

*service margin based on a known accounting outcome. The entity could do this in a way that would not reflect how the entity would have applied the option in previous periods, without hindsight, had it always applied IFRS 17. Such a risk would affect the credibility of information presented on transition to IFRS 17 and in subsequent periods in which those groups of insurance contracts continue to exist. In the IASB's view, these costs would outweigh the benefits of permitting retrospective application of the option - particularly considering feedback that the amendments described in paragraph88 made by the IASB addressed the concerns about the prohibition from applying the option retrospectively.*

88 *The IASB decided to change the risk mitigation requirements as follows:*

(a) *to permit an entity to apply the risk mitigation option prospectively from the transition date, rather than the date of initial application; and*

(b) *to permit an entity that can apply IFRS 17 retrospectively to a group of insurance contracts to instead apply the fair value approach subject to specific conditions.*

89 *Other arguments that were considered by EFRAG are:*

90 *There is no conceptual reason for excluding the retrospective application of risk mitigation as long as the same documentation requirement applies. Risk mitigation is derived from a corporate strategy and does not result from a deliberate choice. Moreover, some consider that the reference to the use of 'reasonable and supportable information available without undue cost or effort' should be a general principle ensuring an adequate financial information in the very specific and temporary situation of a transition.*

91 *Also some consider the possibility to apply the fair value approach is not a solution to preferable retrospective application and the possibility to apply the risk mitigation on transition date is limited to the effect during the comparative period, but not addressing the opening effect on CSM and retained earnings.*

92 *On balance EFRAG is of the view that not applying the risk mitigation option retrospectively will result in useful information. EFRAG's detailed assessment of the risk mitigation option is discussed in Appendix II.*

93 Therefore, the EFRAG Secretariat proposes no changes to the DEA.

## Other comments received

*Issue 23 - Contracts that change nature over time*

Accounting mismatches

94 As IFRS 17 does not allow re-assessment of the contract for changes due to time, it could result in such a contract being treated under the VFA even though for a significant part of the life of the contract there will be no underlying items or participation features. The participant mitigates its exposure to discount rates with appropriate assets to achieve a well matched position, but under the annuity phase, as the assets are not underlying items, the changes with respect to financial risk is not recognised in CSM (as would happen for the insurance liability) and so volatility would exist. This would not be the case, if for this phase, the contracts would fall under the general model. The general model would not be appropriate if the contract does not qualify for the VFA given the participation features during the accumulation phase.

95 On transition, the FVA may be followed due to lack of reasonable and supportable information of conditions at inception date. At such a date the with-profit accumulation phase will make a smaller proportion of the contract meaning that the contract may not qualify for the VFA.

Inconsistent treatment of annuities

96 Where the annuities are purchased by the policyholders, these do not have an accumulation phase with participation features and so these would fall under the general model. As discussed above, the participation features in a contract with a GAO may fall under the VFA.

97 This would impair comparability of economically the same contracts within the same entity and the participant envisages needing the use of alternative performance metrics in order to explain the results internally and externally. This would lead to greater costs on implementation and on an ongoing basis.

Reduced availability of options at transition

98 For contracts that have converted already to an annuity, the participant would need to identify the inception date and not the conversion date for the fully retrospective approach on transition. The current systems only record the date the savings contract was changed into an annuity and not the original inception date.

99 The participant suggests that under the MRA it may be able to assess for VFA eligibility at the transition date due to a lack of reasonable and supportable information to assess at inception date and given the conversion to annuities, these would fall under the general model on transition. However, as there is no such specific relief in the MRA, further analysis would be required to determine whether the history of the accumulation phase can be ignored. This would add to implementation costs and effort and would be disruptive to the implementation programme.

Operational concerns

100 The systems are set-up to facilitate current accounting treatment and so have separate policy administration systems for the accumulation and annuity phases. However, the contract boundary requirements under IFRS 17 would require significant changes and will be disruptive to the IFRS 17 implementation programme. The participant would also need to develop methodology and modelling solutions for the treatment of annuity contracts under the VFA or the accumulation phase under the general model.

101 Furthermore, as there is no data as to whether current annuities were purchased or are the result of exercise of an option ending the accumulation phase, if the participant is unable to conclude that an annuity did not result from a GAO, these annuities may also have to follow the fair value option at transition. This could potentially result in the whole annuity portfolio and not those resulting from vested GAOs having to be fair valued at transition. The participant believes that this would impair the usefulness of the information.

102 *EFRAG Secretariat analysis*: Currently Appendix II states: EFRAG notes that the IASB has previously considered requiring separation and separate measurement of components of insurance contracts. However, stakeholders indicated that this would be difficult, and the separation of interrelated cash flows may be arbitrary and lead to different valuations depending on such arbitrary decisions. Therefore, all the cash flows related to the contract and within the contract boundary are treated as a single item without separation if interrelated.

103 Where these contracts form a significant part of the population of contracts, the preparers can and should provide further information to users to understand the peculiarities of the contractual terms. EFRAG considers that the information provided would still be relevant and notes that the risk mitigation option has been expanded to include non-derivative financial instruments at fair value through profit or loss to minimise this problem.

104 The EFRAG Secretariat subscribes to this analysis.

*Issue 24 - Annual cohorts for intergenerational sharing of risks between policyholders*

105 One participant commented that for contracts with an intergenerational sharing of risks, the annual cohort is the main issue, specifically for the contracts under the VFA. In France or Italy (two countries where the bank insurers represent a large part of the life reserves), the regulation require this intergenerational sharing of risks. Applying the annual cohorts' requirement will be largely artificial and will not provide a relevant information to the users, as it will not appropriately model the economics of these contracts and their legal and contractual terms and the requirement should therefore be removed for these contract. Otherwise, the allocation of the Contractual Service Margin by annual cohort to comply with IFRS 17 requirement will be costly, may not correctly reflect their economics and the way they are managed for legal and contractual purposes, and thus will be of little value for the users.

106 Another participant expressed appreciation for EFRAG's highlighting of the issue and the significant investment to find a potential issue. However, it would prefer a resolution on a global level rather than a Europe-only solution. Furthermore, it believes, the discussions need to end now in the context of different views and that global standards requires compromises. In 2019 it tested IFRS 17 systems with more than 80% of its life insurance segment with a significant portion of European subsidiaries and the numbers were in line with expectations. Operationally, the test reflects that implementation of IFRS 17 is challenging but feasible and on the whole, the participant believes that IFRS 17 is fit for endorsement in the EU.

107 Another participant considers this to add operational complexity as it does not align with management of mutualised business with intergenerational sharing of profits and the cost/benefit test is not met.

108 *EFRAG Secretariat analysis*: this issue was one of the 6 EFRAG issues addressed to the IASB. It is currently included in the DEA.

*Issue 25 - Annual cohorts for general model products*

109 The implementation issues relating to annual cohorts for general products remain after the IASB's re-deliberations for one respondent. Therefore, it suggests continuance of discussing the challenges to find an industry solution.

110 *EFRAG Secretariat analysis*: this issue was one of the 6 EFRAG issues addressed to the IASB. It is currently included in the DEA.

*Issue 26 - Proportional reinsurance held with underlying VFA contracts*

111 One participant considers that permitting to use of the VFA for proportional reinsurance held when the underlying contracts are measured using the VFA would be more cost effective and provide a more relevant information, compared to the risk mitigation option now allowed by the IASB. For assumed reinsurance, the use of the VFA may be relevant if the ceding insurer benefits from the return of the underlying assets held by the reinsurer.

112 *EFRAG Secretariat analysis*: Currently Appendix II states: EFRAG acknowledges that there may be reinsurance contracts issued or held that may meet the variable fee criteria even though these contracts are not allowed to apply the variable fee approach. EFRAG assesses that the risk mitigation option also applicable to reinsurance contracts would largely address the accounting mismatches, thereby balancing relevant information.

113 The EFRAG Secretariat subscribes to this analysis and does not propose a further change to the DEA.

*Issue 27a – Transition and other topics*

*Issue 27b – Transition – business combinations*

114 Some improvements have been provided to make the transition easier. Yet the modified retrospective approach remains excessively complex and rules based. A more principle-based approach would avoid disproportionate costs. Finally, the IASB has rejected several mismatches or presentation issues which have been pointed out by the respondents to the ED, such as the presentation for receivables or payables related to insurance contracts, the boundaries of reinsurance contracts held (which may differ from that of the underlying contracts), or the treatment of liabilities for incurred claims in business combinations or portfolio transfers.

115 Another two participants consider that use of the modified retrospective approach remains highly restrictive and unachievable which creates inconsistency on transition

*Issue 27a – Transition and other topics*

116 *EFRAG Secretariat analysis*: Currently Appendix II states:

(a) *Modified transition approach*: EFRAG notes that paragraph 51 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors acknowledges the need for estimates in retrospective application which is also applicable to first-time adopters of IFRS 17 who will apply the modified retrospective approach. In order to achieve the above objective, EFRAG considers that an insurer may need to make use of information the entity gathered in the past for other purposes. Applying the above, EFRAG considers the modified retrospective approach, which offers alleviations compared to the full retrospective approach, as still leading to relevant information as they allow to achieve the closest outcome to a full retrospective application without undue cost or effort.

(b) *Non-separation of receivables and payables*: EFRAG has considered the views from users and EFRAG considers that the presentation requirements of IFRS 17 are 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. Therefore, based on this, EFRAG considers that the information arising from non-separation of receivables and payables is still relevant.

(c) *Boundary of reinsurance contracts*: see issue 14.

(d) *Business combinations - liability for incurred claims*:

117 The EFRAG Secretariat subscribes to the analysis already present. For business combinations, please refer to issue 27b.

*Issue 27b – Transition – business combinations*

118 *EFRAG Secretariat analysis*: it is noted that the transition requirements allow to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired in a transfer that do not form a business or a business combination in the scope of IFRS 3. When applying the modified retrospective approach this is done only when an entity does not have reasonable and supportable information to apply a retrospective approach.

119 The EFRAG Secretariat notes that this relief has been included in the standard as it would often be impracticable for entities to apply IFRS 17 retrospectively to contracts acquired before the transition date. The relief is valid for insurance contracts acquired in a transfer that does not form a business or a business combination in the scope of IFRS 3. This aligns the transition requirements with the

requirements that are valid for business combinations in IFRS 17 generally, independent from transition.

120 The EFRAG Secretariat is of the view this leads to relevant information and proposes to include this in the DEA.

*Issue 28 – Current measurement and profit recognition*

121 For one participant, in its “euro” saving contracts, the policyholders’ participation is based on the financial and technical results as arising in the French (or Italian) statutory accounts, which is fully mutualized between the generations. The policyholders will only benefit from gains and losses on financial instruments when they are realized. Therefore, the amortization of the CSM should reflect the investment-related service provided in these contracts, where gains or losses are only definitively allocated to the policyholders when they have been realized. If a sudden decrease in the fair value of the assets occurs (as it is the case with the Covid 19 crisis), there is a risk that some contracts may be presented as onerous under IFRS 17, due to the double effect on the CSM of the change in the fair value of the underlying assets, and the change in the Time Value of Options and Guarantees (TVOG). The participant believes more work is required to determine a driver for the amortization of the CSM, and also if some kind of smoothing on market assumptions could be found to avoid the volatility of the CSM when the insurer can demonstrate that he has the capacity to hold the underlying assets (avoiding forced sales in a depressed market). As an illustration, if 18 March 2020 (the day when the French CAC 40 dropped by –5.94% and extreme equity volatility was observed) had been a reporting date under IFRS 17, support to the measures in favour of the French economy would certainly have been hampered.

122 Another participant pointed out that defining and weighting services within a single contract for certain key products is unnecessarily complex.

123 *EFRAG Secretariat analysis*: It is noted that the CAC40 had a 52-week high of 6111 points and a 52-week low of 3632 points. The decline in March 2020 was thus about 40%. The EFRAG Secretariat is unaware of the portion of equity investments that support these particular insurance contracts but assuming that equities form 10% of the coverage assets, it implies that a decline of 4% in the current measurement of the coverage assets is sufficient to result in onerous contracts.

124 In addition to this it is noted that insurers have an active asset and liability management as part of their business model. This implies that, i) upon the decline happening, they may have taken additional actions to benefit from the drop in market prices (selling assets at the onset of the decline, buying protection, smoothening out the higher acquisition prices of supporting assets pre-Covid19 by buying additional assets at lower prices, …) and ii) the ALM function may find it wise to diversify its equity investments wider than only the CAC40.

125 The EFRAG Secretariat understands the comment from the participant as to whether the accounting should take over the smoothening role of the ALM function and thus whether a current measurement is justified.

126 Currently, Appendix II of the DEA states the following: EFRAG is of the view that the use of current updated estimates at the end of each reporting period for the fulfilment cash flows provides relevant information about the entity's contractual obligations and rights by reflecting information about the amounts, timing and uncertainty of the cash flows generated by those obligations and rights. Updated estimates also provide relevant information because these take into consideration current developments which may impact the fulfilment cash flows. Therefore, the users of financial statements can better assess the predictability of cash flows and can also better assess the adequacy of the liability.

127 The EFRAG Secretariat subscribes to the analysis already present and hence proposes no further changes to the DEA.

*Issue 29 - Treatment of equity instruments*

128 One participant is concerned that the lack of recycling under IFRS 9 for equity where increases to policyholders are expensed but there is a lack of offset from the gains realised on the assets. An alternative would be to allow an equity instrument at fair value through OCI be a hedging instrument in terms of IFRS 9.

129 *EFRAG Secretariat analysis*: This topic relates to IFRS 9 and thus falls outside the IFRS 17 DEA.

*Issue 30 -Locked-in discount rate*

130 Two participants regard the use of a locked-in discount rate on CSM for contract under the general model do not reflect the economic position.

131 *EFRAG Secretariat analysis*: Currently Appendix II states that:

132 Some argue that insurance contracts without direct participation features should also use current rates to accrete the contractual service margin because using locked-in rates is not responsive to changes in economic conditions in the way that the fulfilment cash flows is. Changes in the value of future cash flows, following changes to market conditions, are recognised immediately through changes in the fulfilment cash flows. However, these changes in value also give rise to changes in the value of future margins which should give rise to a recalibration of the contractual service margin. However, due to use of a mixture of locked-in and current measurement approaches, this gives rise to an accounting mismatch and therefore artificial volatility in shareholder equity and total comprehensive income.

133 Although the locked-in rate may generate volatility, for example in OCI, EFRAG does not agree that such volatility is artificial because:

(a) the contractual service margin does not represent future cash flows; it represents the unearned profit in the contract, measured at the point of initial recognition and adjusted only for specified amounts;

(b) accreting interest for a period at a current rate without also remeasuring the contractual service margin at the start of the period would create an internally inconsistent measurement of the contractual service margin; and

(c) of the different economics of these contracts without direct participation features compared to the contracts with direct participation features for reasons explained in paragraphs xx to xx above.

134 The EFRAG Secretariat subscribes to the analysis already present and hence proposes no further changes to the DEA.

*Issue 31 - Non-distinct investment components*

135 One participant considers that these are not well defined for contracts without account balances and so the determination of revenue will be highly judgemental.

136 *EFRAG Secretariat analysis*: Currently Appendix II states that:

*Investment component*

137 An insurance contract may also contain both insurance and non-insurance elements, for example, an investment component or a non-insurance service component. Under IFRS 17, an entity has to apply IFRS 9 to determine whether there is an embedded derivative to be separated. An entity also has to separate from a host insurance contract an investment component only if it is distinct and also separate any promise to transfer to a policyholder distinct goods and services (other

than insurance contract services). IFRS 17 is then applied to the remaining components.

138 EFRAG considers that this provides relevant information because it considers interdependencies between insurance and non-insurance components.

*Application of judgement*

139 Measurement of insurance liabilities in IFRS 17 requires judgement in estimating the fulfilment value of an insurance contract. Judgement and interpretation may be required including accounting policy choices which may affect the reliability of information. EFRAG acknowledges that judgement is inherent in the insurance business and in the complexity of the products and as a result, it is inherent in the measurement of insurance contracts. Therefore, EFRAG considers that estimating future cash flows would not lead to reduced reliability.

140 In addition, EFRAG considers that reliability would not be reduced because entities have experience in applying judgement when applying other IFRS Standards and in managing their business.

141 Also, IFRS 17 is a new standard and as a certain market practice will develop over time, this would increase the reliability of information.

142 The EFRAG Secretariat subscribes to the analysis already present and hence proposes no further changes to the DEA.

*Issue 32 - Scope of the VFA: para B107*

143 Another participant considers the amendment to require the assessment of eligibility for the VFA on individual contract level rather than group level to be inconsistent with recognition and measurement requirements of the standard. The amendment is also disruptive that requires system changes and will be challenging to explain to users where the portfolios of business are accounted for under more than one measurement model.

144 *EFRAG Secretariat analysis*: in accordance with the EFRAG TEG discussion of 26 March 2020 this is seen as an interpretation issue and thus not to be included in the DEA.

*Issue 33 - Setting OCI balances to nil*

145 One participant points out the mismatch for contracts under the general model where the assets are carried at FVOCI, but the OCI on the liability may be set to zero. If this were to be implemented as a local gaap it could restrict the distribution of dividends. The participant suggests that the locked in rate to be used at transition should be based on the purchase rate of the underlying assets for contracts under the general model and managed through cash flow matching techniques. Where the OCI is determined retrospectively, this distorts OCI where the underlying assets have been restructured during the life of the policies.

146 Another participant suggests that the setting the OCI balance to nil under the VFA should be extended to general model contracts where the business is managed with asset-liability management techniques.

147 *EFRAG Secretariat analysis*: This issue is already discussed in Appendix III.

*Issue 34 - Business combinations – contracts in settlement/incurred claims*

148 One participant highlighted their concerns around the treatment of contracts in settlement period and that insurance revenue would be recognised twice as well as inconsistent treatment of the presentation of portfolios of contracts acquired in their settlement period compared to portfolios issued by the insurer as well as reduced comparability with other entities.

149 Another participant agreed with the comment around comparability while yet another participant highlighted the operational complexity of requiring use of the general model for contracts that could use PAA otherwise.

150 *EFRAG Secretariat analysis*: IFRS 3 *Business combinations* resets the accounting performed by the acquirer and all transactions before the business combinations is ‘translated’ to as if it were entered into on the date of the acquisition. The treatment here is application of this fundamental principle under IFRS 3 and paragraph B5[2] of IFRS 17 relating to adverse claims development insurance.

151 The EFRAG Secretariat also notes that applying fair value to these contracts rather than fulfilment value as required by IFRS 3 is likely to give rise to a CSM as one would expect for contracts giving rise to a liability for remaining coverage. Concerns about the additional work the run-off of this CSM are not substantiated as for each portfolio acquired, there would be only one group per assessed profitability bucket for the allocation of the CSM. The reason for this is that the inception date of the contracts from a group perspective is the acquisition date irrespective of when the insurance contract was originated by the subsidiary.

152 The EFRAG Secretariat has not received evidence as to why the result is inappropriate as it seems the industry accepts paragraph B5 in general. As with other aspects of a new standard, these would need to be explained internally and externally and may take time to find acceptance.

153 In accordance with the EFRAG TEG discussion of 26 March 2020, the EFRAG Secretariat proposes to include this issue in the DEA.

*Issue 35 – Annual cohorts for PAA business*

154 One participant noted that certain aspects of the PAA are more complex and add little value (i.e. the need to split PAA Liability for remaining cover into various annual cohorts).

155 *EFRAG Secretariat analysis:* The EFRAG Secretariat is of the view this forms part of the cost-benefit analysis in Appendix III.

*Issue 36 – products where financial risk has a substantial effect on policyholder returns*

156 One participant noted that the disaggregation of finance income or expense for those cash flows where changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholder are systematically allocated to the income statement which give rise to accounting mismatches as the effective yield of the related assets are not fully matching the mechanics of IFRS 17.

157 Another participant noted that while electing for FVTPL, an accounting mismatch would arise resulting from the measurement differences between assets and liabilities due to differences between the asset yield (net of the cost of impairments) and the discount rate.

158 *EFRAG Secretariat analysis*: In accordance with IFRS 17 changes in the effect of financial risk that relate to the current or past affect profit or loss immediately. These may indeed differ from the effective yield the entity had initially in mind when buying the assets. However, these are real economic mismatches and not accounting mismatches. Hence, the EFRAG Secretariat proposes not to include this issue in the DEA.

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[2] Applying paragraph B5 in the IFRS 3 context means that the buyer is regarded as having provided the seller with adverse claims development for a deduction in price if the transfer did not include such contracts. After the acquisition, the seller no longer has any concerns about how the claims develop.

*Issue 37 – Complexity of the standard.*

159 Four participants noted that the standard has many complexities, e.g. four measurement models, numerous accounting policy choices, options and judgements.

160 *EFRAG Secretariat analysis*: This issue is already part of the DEA.

*Issue 38 – lack of comprehensive testing by IASB*

161 One participant noted that there is a lack of comprehensive testing by the IASB compared to Solvency II where there were six Quantitative Impact Studies.

162 *EFRAG Secretariat analysis*: In accordance with the IASB Effects analysis, the IASB did the following:

- 2007 Discussion Paper—Preliminary Views on Insurance Contracts.
- 2010 Exposure Draft—Insurance Contracts (the 2010 Exposure Draft).
- 2013 Exposure Draft—Insurance Contracts (the 2013 Exposure Draft).
- More than 600 comment letters received and analysed.
- Meetings with the Board's advisory bodies, including the Insurance Working Group.
- Over 900 meetings with individual and groups of investors, analysts, preparers, actuaries, regulators, standard-setters, accounting firms and others. The meetings with preparers included four rounds of fieldwork and testing meetings, as well as workshops discussing the costs and benefits of the proposals.
- Round-table meetings and discussion forums in 18 countries in 2010 and 2013.

163 *EFRAG Secretariat analysis*: Based on the above, the EFRAG Secretariat proposes not to add this issue to the DEA.

*Issue 39a – Differences in probability in default on both sides of balance sheet*

*Issue 39b – Application of the current period book yield*

164 One participant noted that (i) the Expected Credit Loss (ECL) accounted under IFRS 9 does not have the same PD compared to the one detected for the liabilities; therefore, accounting mismatch arises in P&L (ii) in the VFA it is still not clear if the Loss Component must be considered in the Mirroring Approach or not. With Mirroring Approach the participant refers to the IFRS17 OCI option under VFA accounting treatment for which the Income statement financial result is transferred to OCI in shareholder equity.

165 More specifically, in case of underlying financial instruments are recognized at fair value through other comprehensive income, IFRS 17 permits a policy choice of disaggregating insurance finance income or expenses for the period to include in profit or loss an amount that eliminates accounting mismatches with income or expenses included in profit or loss on the underlying items held: applying this choice an entity includes in profit or loss expenses or income that exactly match the income or expenses included in profit or loss for the underlying items, resulting in the net of the two separately presented items being nil, by using the current period book yield.

166 The standard does not distinguish between situations when CSM is positive and situations when there is a loss component; however applying par. 87, in case of loss component, insurance finance income or expenses does not comprise the change in the carrying amount of the group of insurance contracts arising from the effect of financial risk and changes in financial risk that would adjust the contractual service margin but do not do so when applying paragraphs 45(b)(ii), 45(b)(iii), 45(c)(ii) or

45(c)(iii). These are included in insurance service expenses and consequently it is not clear how to apply the disaggregation option.

167 *EFRAG Secretariat analysis:* it is normal that the probability of default of the assets (eg a corporate or government bond) is different than the probability of default of the liabilities. The issuing entities are different hence this is an economic mismatch.

168 On the issue of applying the current period book yield, the EFRAG Secretariat is of the view this is an implementation issue and hence proposes not to include it in the DEA.

*Issue 40 – Cost of PAA*

169 One participant noted the cost of PAA implementation remain considerable, (in particular for onerous contracts and the treatment of reinsurance).

170 *EFRAG Secretariat analysis*: this is part of the cost benefit analysis in Appendix III (the issue is related to issue 35).

*Issue 41 – Application of paragraph B107 and business combinations*

171 Two participants noted the application of the test in B107 to a contract level (when combined with the business combination rules) as a remaining issue.

172 *EFRAG Secretariat analysis*: This is a combination of issue 32 (proposal not to be added to the DEA) and issue 34 (proposal to be added to the DEA). The EFRAG Secretariat notes that this issue is closer to issue 32 and in accordance with the EFRAG TEG discussion of 26 March 2020 this is seen as an interpretation issue and thus not to be included in the DEA.

*Issue 42 – Disclosures costly to implement*

173 One participant noted that the disclosures are costly to implement: equivalent confidence level for the risk adjustment; the exclusion of investment component from revenue; and the separate disclosure of portfolios of contracts that are in an asset and a liability position compared to entity level.

174 *EFRAG Secretariat analysis*: although similar to issue 1, the scope of this issue is wider. The EFRAG Secretariat notes that is covered by the DEA in the cost-benefit section.

*Issue 43 – Costly implementation of the OCI approach for indirect par contracts*

175 One participant noted there are significant challenges to using an OCI approach for indirect par contracts. The finance income/expense must be determined using either a level effective yield or an effective yield reflecting the credited rate. The former results in a mismatch between the credited rate and discount rate while the latter is complex and costly to implement.

176 *EFRAG Secretariat analysis*: The EFRAG Secretariat notes that is covered by the DEA in the cost-benefit section.

*Issue 44 – VFA mechanics create volatility*

177 One participant noted that the current requirements do not reflect appropriately the economics and contractual terms of life and saving contracts eligible to the VFA - the performance of these contracts under IFRS 17 may differ significantly from the way it is currently represented. Because these contracts are long term products and managed as such, their performance is reflected overtime. Yet the requirement to reflect both in the Best Estimate and in the CSM the changes in the fair value of the underlying items create an unexpected volatility in the P&L, which differ significantly from the current representation of the performance.

178 *EFRAG Secretariat analysis*: The EFRAG Secretariat understands this as that the current measurement approach is not appreciated. This is similar to issue 28 and

as for that point, the EFRAG Secretariat refers to the current measurement analysis in Appendix II of the DEA.

*Issue 45 – Participating contracts with non-participating elements*

*Non-Profit Business in a With-Profit Fund*

179 In a UK-style with-profits fund, profits are distributed between with profit policyholders and shareholders, typically on a 90:10 basis.

180 Shareholders can only receive distributions from the with profit fund if profits are distributed to policyholders, in which circumstance shareholders receive their share.

181 Benefits paid to policyholders are generally calculated by reference to “asset shares” which broadly reflect the policyholders’ share of the with-profits fund assets attributable to their policies taking account of the investment performance of the fund.

182 With-profits funds typically include excess assets (“inherited estate”) which are available to support existing and future contracts. These excess assets will have arisen from a number of sources and either:

(a) the entity has undertaken a formal court approved attribution exercise in which case ownership of the estate (between shareholders and policyholders) is known and any distribution from the estate must be in accordance with a court approved scheme; or

(b) no attribution exercise has been undertaken in which case the estate is not owned either by the shareholders or policyholders in which case distributions to policyholder and shareholders can only be made as described above (e.g. on a 90:10 basis).

183 For UK-style with-profits business, there is full mutualisation between contracts, i.e. there is full sharing of all risks such that benefits of certain contracts can be reduced to meet claims payments in respect of other contracts. Such sharing of risks can be between generations of policyholder, i.e. across annual cohorts. The mutualisation can either occur directly between contracts or indirectly via the inherited estate.

184 It is common for non-profit business (e.g. annuities and unit linked business) to be written in a with profits fund. This business can either be:

(a) owned by with-profits contracts in the fund, in which case the profits on the non-profit business accrue to the asset shares of the with-profits contracts and are distributed between policyholders and shareholders in accordance with the profit sharing mechanism described above (e.g. on a 90:10 basis); or

(b) owned by the inherited estate, in which case the profits of the non-profit business accrue to the estate and can only be distributed in accordance with the rules for distributing the estate described above.

185 In summary, the shareholder is generally entitled to no more than 10% of the profits arising on all of the contracts in the fund (with-profits and non-profit). Shareholders are only required to inject assets into the fund in circumstances where guarantees are biting on all with-profits contracts and any inherited estate is exhausted – this is generally referred to as “burn-through”.

186 To provide an indication of the scale of such business, total existing liabilities for non-profit business written in the with profits funds of 3 major UK insurers are circa GBP 25 billion.

*IFRS 17 requirements*

187 The measurement of liabilities for non-profit business written in a with-profits fund comprises the:

(a) Best estimate liability - the estimated future cash flows adjusted to reflect the time value of money and any financial risks related to those cash flows.

(b) Risk adjustment - IFRS 17.37 states that this reflects the compensation that the entity requires for bearing the uncertainty about the amount and timing from non-financial risk..

(c) CSM – IFRS 17.38 states that this represents the unearned profit that the entity will recognise as it provides services in the future. The entity will only receive the shareholder's share of profits on the non-profit business in the with-profits fund. However, the IASB educational material entitled "Insurance contracts issued by mutual entities" dated July 2018, although not directly applicable to with-profits funds in proprietary companies, suggests that the CSM would reflect the total unearned profit on the non-profit contracts, i.e. both the shareholders' and policyholders' share.

188 IFRS 17 paragraphs B67-B71 describing the requirements for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts are not considered to be applicable as the with-profits contracts and the non-profit contracts do not share in the returns on the same specified pool of underlying items.

189 The measurement of the liabilities of the non-profit contracts is determined on a fulfilment basis in accordance with the requirements of IFRS 17. However, where these contracts form part of the underlying items of the with-profits contracts in the fund, in accord with IFRS 17 the measurement of the CSM of the with-profits contracts should reflect the fair value of the contracts determined in accordance with IFRS 13.

*Implications*

190 The IFRS 17 requirements described above result in the following outcome:

(a) In circumstances where the non-profit contracts are owned by with-profits contracts, the non-profit contracts form part of the underlying items. As described above, underlying items are measured at fair value (in accordance with IFRS 13) whereas non-profit insurance contract liabilities are measured at fulfilment value (in accordance with IFRS 17).

(b) This results in an accounting mismatch the movement on which is recognised in P&L and shareholder equity. This can result in significant volatility that cannot be mitigated by existing options in IFRS 17.

*Proposed solution by the preparer*

191 The following amendment to IFRS 17 would address the concern described above:

(a) Where the assets of with-profit contracts include profits from non-profit insurance contracts, those non-profit insurance contract assets should be measured at fulfilment value in accordance with IFRS 17.

192 *EFRAG Secretariat analysis*: This issue was discussed by the IASB in February 2020. The IASB decided not to change the standard for this because it would cause undue complexity and disrupt ongoing implementation[3].

193 The EFRAG Secretariat acknowledges the issue generates complexity because different elements are being mixed.

(a) There are two sorts of policyholders, the ones that only benefit from guaranteed benefits and the ones that benefit from guaranteed benefits and the participating elements.

[3] IASB Staff paper 2F February 2020, Appendix, topic 1.

(b) The VFA CSM is updated for the change in the fair value of the underlying items (thus including the non-participating insurance contracts);

(c) While the difference between fair value and fulfilment value of the insurance liability is limited, the biggest difference is due to valuing the CSM of the non-participating contracts at locked-in discount rate on the one hand and at fair value on the other hand;

(d) The application of the education material for mutual entities where the policyholders contractually share in the residual (i.e. equity) to a situation where the profits are shared between policyholders and shareholders on a 90-10 basis is unclear.

194 The use of fair value can be seen as an approximation when being applied to underlying items that are insurance contracts under the general model. As a result, the EFRAG Secretariat acknowledges that the accounting for this fact pattern is suboptimal but notes that this is balanced by the costs of disrupting the implementation of preparers. Hence it is proposed not to add this issue to the DEA.

*Issue 46a – appropriate level for onerous contracts*

*Issue 46b – more volatility due to financial markets*

195 One participant noted that an appropriate level of aggregation is needed for recognition of onerous business. Also, the combination of IFRS 9 and IFRS 17 for contracts without participation features is likely to increase P&L volatility due to financial markets (equity type instruments and structured bonds).

196 *EFRAG Secretariat analysis*: *Issue 46a:* this issue was one of the 6 EFRAG issues addressed to the IASB. It is currently included in the DEA.

197 *EFRAG Secretariat analysis*: *Issue 46b:* volatility that reflects economic changes in the market is good volatility and in the view of the EFRAG Secretariat should be shown in the statement of comprehensive income. This issue is addressed in Appendix III of the DEA.

*Issue 47 – applying IFRS and local gaap by a bancassurer*

198 One participant noted that where dual accounting will be kept (local GAAP and IFRS) there will be additional costs and burden. For bancassurers especially, the consolidation reporting process is expected to be more demanding given the additional effort required to aggregate and disclose the insurance results.

199 *EFRAG Secretariat analysis*: The EFRAG Secretariat considers this part of the cost benefit analysis in Appendix III.

*Issue 48 – cash-based measurement of insurance liabilities*

200 One participant noted raised a concern that measurement of insurance liabilities was cash-based and therefore includes all receivables and payables to counterparties and expenses modelled in the future cash flows, until they are actually paid, instead of accounting them separately on an accrual basis.

201 *EFRAG Secretariat analysis*: Cash-based accounting would mean that the accounting for transactions only happen when the premiums are received, or claims are paid. IFRS 17 includes all expected cash flows in the accounting models, not only those received or paid. However, unlike most local gaap, IFRS 17 does not distinguish between those cash flows already due under the contract and those that are not yet due but expected under the contract. This does not change the model to a cash-based model.

202 The EFRAG Secretariat understands that many actuarial systems today cannot distinguish between cash flows due but not yet paid as these normally form part of the accounting systems. The EFRAG Secretariat's analysis confirms the IASB's

concern that different interpretations of amounts due exist and attempting to harmonise these would result in some insurers having to change their systems whilst others would not. Therefore, the presentation of the liability reflects the IFRS 17 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.

203 Based on the above, the EFRAG Secretariat proposes not to include this issue in the DEA.

*Issue 49 – annual cohorts and procyclicality*

204 One participant noted that for mutualised contracts, the risk in a low interest rate environment is to favour pro-cyclical reporting effects linked to artificial and arbitrary allocations.

205 *EFRAG Secretariat analysis*: It is noted that procyclicality is addressed in Appendix III as a separate heading.