This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, 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
Issues paper – Issues for discussion

Introduction and Objective

1 The EFRAG Secretariat updated both (i) Appendix 2 of the IFRS 17 draft endorsement advice and (ii) the paper on the interaction between IFRS 17 and IFRS 9 based on EFRAG TEG comments that were sent in writing. However, some of the changes suggested in written may have a more substantial nature (i.e. not merely wording) and would modify the current analysis shared by TEG in previous meetings.

2 This paper summarises these suggested changes.

Appendix 2 of the IFRS 17 draft endorsement advice

Topic 1: Comparability section – Risk mitigation

Analysis currently in the draft endorsement advice

3 For contracts under the general model, the risk management of the interest rate risk may find an accounting solution under hedge accounting, in order to ensure that risk management practices are treated equally across industries.

Disagreement of current analysis by one EFRAG TEG member

4 Hedge accounting does not help in addressing the CSM impact mentioned previously (and for which risk mitigation provisions have been introduced in IFRS 17).

Question for EFRAG TEG

5 Does EFRAG TEG agree with the current analysis in the DEA or should it be changed to reflect the disagreement? Please explain.

Interaction between IFRS 17 and IFRS 9

Topic 2: Credit spreads

Analysis currently in the draft endorsement advice

6 For 13 portfolios credit spread risk mismatches were reported, and for only three of these, quantitative information was provided.

7 As an illustration of the potential effect of credit spread risk mismatches, consider the following market interest rates:

Euro Member State	Interest on 30-year government bonds[1]
France	1.63%
Germany	1.10%
Italy	3.52%
Spain	2.58%

8 Many of these credit spread risk mismatches were significant reflecting the credit spreads of each Eurozone Member State. In particular, respondents used qualifications such as “most”, “majority” or “mainly” to indicate whether their assets were held in the same jurisdiction as the corresponding liabilities.

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9 Although the VFA could be applied in cases where entities do not hold the underlying assets, EFRAG is of the view that in such cases another economic mismatch arises, as changes in assumptions of the IFRS 17 liability will be recognised in profit or loss over time without the recognition of similar changes in assets.

Disagreement of current analysis by one EFRAG TEG member

10 What does economic mismatches / credit spread risk mismatch mean? Obviously, since insurers invests in financial instruments, they always bear the related credit risk. It’s unclear how credit risk could be matched between financial instruments and insurance liabilities and why it matters.

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11 It is unclear why the accounting treatment under the VFA approach matters when discussing an economic mismatch supposedly uncorrelated with accounting

Question for EFRAG TEG

12 Does EFRAG TEG agree with the current analysis in the DEA or should it be changed to reflect the disagreement? Please explain.

Topic 3: The main reason why IFRS 9-17 causes volatility

Analysis currently in the draft endorsement advice

13 …, it is noted by insurers that the application of IFRS 17 and IFRS 9 together will increase the volatility in profit or loss. Why is that?

14 The main reason for this is that IFRS 17 measures the insurance liability independently from the assets on the balance sheet (i.e. there is no accounting mirroring). That principle is upheld even for contracts with direct participation features, where the discount rate reflects the variability of the financial underlying items. Notwithstanding this variability adjustment economically linked to the assets, the discount rate still needs to reflect the other characteristics of the liabilities, as a main principle.

[1] As at 11 September 2018.

Disagreement of current analysis by one EFRAG TEG member

15 This is exactly the same under all GAAP. It's therefore unclear why this is relevant for the analysis.

Question for EFRAG TEG

16 Does EFRAG TEG agree with the current analysis in the DEA or should it be changed to reflect the disagreement? Please explain.

Topic 4: Extract of the EFRAG Board decision on equity instruments (in bold)

Analysis currently in the draft endorsement advice

17 As a result, when economic mismatches exist between the asset and the liability side, the accounting will have to reflect this with resulting volatility in the profit or loss statement. In addition, the application of IFRS 17 and IFRS 9 also creates some accounting mismatches. However, as mentioned in the chapter relating to the long-term business model, **asset allocation decisions are driven by a plurality of factors and disentangling the impact of accounting requirements from other factors such as expectation of future returns or assets, regulations, taxes and prudential requirements is difficult.**

Disagreement of current analysis by one EFRAG TEG member

18 If there are accounting mismatches, then the information delivered is not relevant. The fact that investment decisions are driven by various factors does not mean that accounting does not matter for investors. The sentence suggests that whatever the quality of the information, accounting is only a second order factor. Then why bother producing financial statements?

Question for EFRAG TEG

19 Does EFRAG TEG agree with the current analysis in the DEA or should it be changed to reflect the disagreement? Please explain.