EFRAG
European Financial Reporting Advisory Group

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS ON IFRS 17 INSURANCE CONTRACTS AS RESULTING FROM THE AMENDMENTS (JUNE 2020)

Once filled in, this form should be submitted by [date] using the 'Comment publication link' available at the bottom of the respective news item. All open consultations can be found on EFRAG's web site: Open consultations: express your views.

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IFRS 17 *Insurance Contracts* as resulting from the June 2020 Amendments ('IFRS 17' or 'the Standard'). In order to do so, EFRAG has been carrying out an assessment of IFRS 17 against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of IFRS 17 is set out in Appendix I.

Before finalising its assessment, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interests of transparency, EFRAG will wish to discuss the responses it receives in a public meeting, so it is preferable that all responses can be published.

In order to facilitate the EFRAG process, it is strongly recommended to use the structure below in your responses.

EFRAG's initial assessments, summarised in this questionnaire, will be updated for comments received from constituents when EFRAG is in the process of finalising its *Letter to the European Commission* regarding endorsement IFRS 17.

Your details

1 Please provide the following details:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

(b) Are you a:

☐ Preparer ☐ User ☐ Other (please specify)

(c) Please provide a short description of your activity:

(d) Country where you are located:

(e) Contact details, including e-mail address:

Part I: EFRAG's initial assessment with respect to the technical criteria for endorsement

Note to the respondents: EFRAG reasoning with reference to all the other requirements of IFRS 17 is presented in Appendix II, apart for the observations on the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts, which are presented in Annex 1 (refer to the section titled Appendix II in Annex 1).

2 EFRAG's initial assessment of IFRS 17 is that:

- The EFRAG Board has concluded on a consensus basis that, apart from the requirement to apply annual cohorts to some contracts, described in Annex A of Annex 1 (which are conventionally referred to in the Cover Letter, in its Appendices and Annex as 'contracts with intergenerational mutualisation and cash-flow matched contracts' or 'intergenerationally mutualised and cash-flow matched contracts'), as explained in the attached Cover Letter, on balance, all the other requirements of IFRS 17 meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support 'economic decisions and the assessment of stewardship and raise no issues regarding prudent accounting. EFRAG has concluded that all the other requirements of IFRS 17 are not contrary to the true and fair view principle.
- EFRAG Board members were split between two groups, with reference to the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts.

EFRAG's reasoning and observations are set out in Appendix II, Annex 1 and the Cover Letter regarding endorsement of IFRS 17.

(a) Do you agree with this assessment for all the other requirements of IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts?

☐ Yes ☐ No

If you do not agree, please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.

(b) What are your views about the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts? Please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.

(c) Are there any issues that are not mentioned in Appendix II, Annex 1 and the Cover Letter regarding endorsement of IFRS 17 that you believe EFRAG should take into account in its technical evaluation of IFRS 17? If there are, what are those issues and why do you believe they are relevant to the evaluation?

Part II: The European public good

Note to the respondents: *EFRAG's reasoning with reference to all the other requirements of IFRS 17 is presented in Appendix III, apart for the observations on the requirement to apply annual cohorts to intergenerationally mutualised and cash flow matched contracts, which are presented in Annex 1 (refer to the section titled Appendix III in Annex 1).*

3 In its assessment of the impact of IFRS 17 on the European public good, EFRAG has considered a number of issues that are addressed in Appendix III and Annex 1 regarding the endorsement of IFRS 17.

- The EFRAG Board has on a consensus basis assessed that, apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts, all the other requirements of IFRS 17 would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified any other requirements of IFRS 17 that could have major adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that all the other requirements in IFRS 17 are, on balance, conducive to the European public good.
- EFRAG Board members were split between two groups, as described in the Cover Letter, with reference to the requirement to apply annual cohorts for contracts with intergenerational mutualisation and cash-flow matched contracts.

(a) Do you agree with this assessment for all the other requirements apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts?

☐ Yes ☐ No

If you do not agree, please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.

(b) What are your views about the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts regarding the European public good? Please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.

Part III: The questions in Part III relate to all the other requirements in IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts

Note to the respondents: *In this Part, "IFRS 17" or "requirements in IFRS 17" or "the Standard" is intended to be referred to all the other requirements in IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts (your views on the latter requirement are to be covered in Part IV).*

Improvement in financial reporting

4 EFRAG has identified that, in assessing whether the endorsement of IFRS 17 is conducive to the European public good, it should consider whether the Standard is an improvement over current requirements across the areas which have been subject to changes (see paragraphs 15 to 27 of Appendix III). To summarise, for all the other requirements in IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts, EFRAG considers that they provide better financial information than IFRS 4.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Costs and benefits

5 EFRAG's initial assessment is that taking into account the evidence obtained from the various categories of stakeholders, the benefits of all the other IFRS 17 requirements in IFRS 17 exceeds the related costs..

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Other factors

Potential effects on financial stability

6 EFRAG has assessed the potential effects on financial stability based on the ten criteria set out in the framework developed by the European Central Bank "*Assessment of accounting standards from a financial stability perspective*" in December 2006. Based on this assessment, EFRAG is of the view that, on balance, IFRS 17 does not negatively affect financial stability (Appendix III paragraphs 428 to 482).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Potential effects on competitiveness

(Appendix III paragraphs 227 to 286)

7 EFRAG has assessed how IFRS 17 could affect the competitiveness of European insurers taking into account the diversity in their business models vis-à-vis their major competitors outside Europe.

EFRAG concludes that the underlying economics and profitability will always be more decisive in taking up a business in a particular region or a particular insurance product than changes to the accounting that is used to report on it.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Potential impact on the insurance market (including impact on social guarantees)

8 EFRAG has assessed the potential impact on the insurance market in Appendix III paragraphs 287 to 325.

The Economic Study stated that entities may re-consider both their pricing methodologies and product offers when applying IFRS 17 for the first time. The effect on pricing may be more significant than the effect on product offers. However, EFRAG does not have any quantification of the extent of changes in pricing or product design that would result from it.

As per the Economic Study, a majority of stakeholders interviewed (i.e. supervisory authorities, insurers and external investors) agreed that IFRS 17 alone would not impact the asset allocation of insurance undertakings, because this activity is more driven by risk management and/or asset/liability management.

Furthermore, EFRAG has considered how IFRS 17 could affect small and medium-sized entities (SMEs). EFRAG concludes that the number of small insurers that would be affected by IFRS 17 in producing their individual financial statements is very limited (between 27 and 35 depending on the option chosen based on the increased EIOPA quantitative thresholds).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Presentation of general insurance contracts

9 EFRAG is of the view the presentation requirements of IFRS 17 would provide relevant information. EFRAG also concludes that providing separate information for contracts that are in an asset, from those in a liability, position would provide useful information to users. (Appendix II paragraphs 118 to 125, 360 to 362).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Interaction between IFRS 17 and Solvency II

10 EFRAG concludes that in implementing IFRS 17, there are possible synergies with Solvency II, but the extent of such synergies varies between insurers. In addition, no synergies are expected for building blocks that are specific to IFRS 17 such as the contractual service margin which is not a concept under Solvency II. Synergy potential is available in areas that have a high degree of commonality under the two frameworks, i.e. the elementary contract data needed to establish the cash flow projections, and actuarial systems to measure insurance liabilities. The potential depends, to an extent, on the differences in the starting position of insurers and the investments already made in the implementation of Solvency II. It also depends on the amount of effort to adapt existing actuarial systems, that were developed for the Solvency II environment, to the IFRS 17 reporting requirements. In conclusion, EFRAG assesses that the benefits in terms of quality of the resulting financial information expected from these specific building blocks in IFRS 17 justify the limits to potential synergies (Appendix III paragraphs 401 to 412).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Impact of the new Standard on financial stability, long-term investment in the EU, procyclicality and volatility

11 On financial stability, refer to the conclusions in paragraph 8 of this Invitation to Comment;

On long-term investment in the EU, EFRAG's view is that asset allocation decisions are driven by a variety of factors, among which external financial reporting requirements might play some part but do not appear to be a key driver. There is no indication that IFRS 17 in isolation would lead to any significant changes in European insurers' decisions on asset allocation or holding periods (Appendix III paragraphs 96 to 123).

On procyclicality and volatility, EFRAG believes that IFRS 17 has mixed effects on procyclicality. IFRS 17 may result in more volatile financial performance measures because of the use of a current measurement. However, from the evidence collected, it is not likely that this volatility is related to economic cycles and, as such, does not play a specific role in producing pro-cyclical or anti-cyclical effects. EFRAG also assesses that IFRS 17 does not have the potential to reinforce economic cycles, such as overstating profits and thus allowing dividends and bonus distributions in good times, as there is no linkage between the accounting equity (cumulative retaining earnings) and amounts available for distributions, which are defined within the requirements of Solvency II or within the requirements at national level, independently from the IFRS accounting. Finally, EFRAG notes that the transparent nature of the IFRS 17 information has the benefit for investors to react timely to any changes at hand, thereby avoiding cliff-effects. (Appendix III paragraphs 483 to 507).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

IFRS 17 and IFRS 9

12 EFRAG is of the view that mismatches reported by preparers that contributed to EFRAG's assessment do not arise solely from the application of IFRS 17 and IFRS 9 but are mostly economic in nature. EFRAG considers that reporting the extent of the economic mismatches in profit or loss provides useful information.

In EFRAG's view, asset allocation decisions are driven by a variety of factors and disentangling the impact of accounting requirements from other factors is difficult. When defining the accounting for financial assets under IFRS 9, an insurer would not apply business models determined in isolation, but rather business models that are supportive of or complementary to their insurance liability business. EFRAG notes that the interaction between each of an entity's internal policy decisions will determine the importance of any accounting mismatches remaining in the statement of financial position and this may differ largely from one insurer to another.

EFRAG has assessed the different tools that both standards offer to mitigate accounting mismatches. EFRAG assesses that:

- there is no conceptual barrier against the application of hedge accounting in the context of IFRS 17. However, given the lack of experience and systems by the industry, it would require significant investment both in time and systems development to achieve hedge accounting in this context (Appendix III, annex 4);
- the treatment of OCI balances and risk mitigation at transition will not, on balance, negatively impact the usefulness of the resulting information.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Application of IFRS 15

13 In some instances, an entity (including insurers) may choose to apply IFRS 15 instead of IFRS 17 to contracts that meet the definition of an insurance contract but that have as their primary purpose the provision of services for a fixed fee. EFRAG concludes that this option would probably be made by those entities that do not operate in the insurance business. EFRAG concludes that for these entities accounting for these contracts in the same way as for other contracts would provide useful information and that applying IFRS 17 to these contracts would impose costs for no significant benefit (Appendix III paragraphs 68 to 76).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Implications of transitional requirements

14 Considering the extent of the information available for each particular group of insurance contracts at transition, EFRAG assesses that the existence of three transition approaches does not result in a lack of relevant information. The alleviations granted under the modified retrospective approach are still leading to relevant information as they enable achieving the closest outcome to a full retrospective application without undue cost or effort. In addition, EFRAG acknowledges that the possible use of three different transition methods may affect comparability among entities and, for long-term contracts, over time. However, the practical benefits of the modified retrospective and fair value approach, which were introduced by the IASB to respond to operational concerns of the preparers, may justify the reduced comparability (Appendix II paragraphs 129 to 155, 228 to 237, 300 to 303, 372 to 374, 398 to 400).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Impact on reinsurance

15 EFRAG concludes that the separate treatment under IFRS 17 of reinsurance assets and insurance liabilities reflects the rights and obligations of different and separate contractual positions. Furthermore, EFRAG acknowledges that reinsurance contracts issued or held may meet the variable fee criteria even though IFRS 17 states that they cannot be insurance contracts with direct participation features. However, EFRAG assesses that the risk mitigation option would largely address the accounting mismatches, thereby balancing relevant information. In addition, for reinsurance contracts held that are used to recover losses from the underlying contracts, EFRAG considers that the Amendments provide relevant information as they aim at reducing accounting mismatches which is present under the original version of the Standard (Appendix II paragraphs 63 to 74, 210 to 216, 274 to 275, 349 to 352, 395 to 397).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Implementation timeline

16 Feedback from the Limited Update to the Case Studies shows that the delay to the effective date of IFRS 17 to 1 January 2023 results in higher one-off implementation costs for preparers. However, the delay is also helping preparers to adjust their

project approaches to the operational difficulties of the Covid-19 crisis. EFRAG understands from preparers that they may choose to avoid these costs by revisiting solution designs or may make more use of internal (cheaper) resources. Furthermore, according to the Limited Update to the Case Studies and other feedback from insurance associations, most of the participants did not intend to early apply IFRS 17, whereas a small minority wanted to have this possibility. EFRAG is not aware of any European insurer having taken a firm commitment to early apply the Standard. Finally, EFRAG notes that IFRS 17 requires a presentation of restated comparative information when applying the Standard for the first time. However, IFRS 9 does not have similar requirements for financial assets and liabilities (Appendix III paragraphs and 609 to 613).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

17 Do you agree that there are no other factors to consider in assessing whether the endorsement of the Standard is conducive to the European public good?

☐ Yes ☐ No

If you do not agree, please identify the factors, provide your views on these factors and indicate how this could affect EFRAG's endorsement advice.

Part IV: The questions in Part IV aim at collecting constituents' inputs (Questions to constituents in Annex 1) and views relating to the requirement in IFRS 17 to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts

18 As stated in paragraphs 5 to 7 of Annex 1:

(a) EFRAG is seeking quantitative data that would help to quantify the materiality of the contracts under assessment in European jurisdictions. What is the portion of intergenerational mutualised contracts and cash flow matched contracts of all life insurance liabilities and all insurance liabilities?

(b) Please indicate the proportion of contracts with intergenerational mutualisation or cash flow matching for which the requirement around annual cohorts is considered a significant issue.

(c) If this requirement is not considered a significant issue for contracts with intergenerational mutualised contracts and cash flow matching, please explain the approach taken to implement annual cohorts?

Part V: Questions to Constituents raised in Appendix III

19 As stated in paragraphs 532 to 534 of Appendix III:

(a) In your view, how will the Covid-19 pandemic affect the impacts of IFRS 17 on the insurance market (see a description of some expected impacts in paragraphs 518 to 527 in Appendix III) and indirectly, on the European economy as a whole?

(b) Is the Covid-19 pandemic affecting your implementation process for IFRS 17 and IFRS 9? Please explain in detail the impacts such as project ambitions, budget for implementation and ongoing costs, resources, speed of implementation. Please also explain whether this relates to the IT systems implementation, or rather the actuarial or accounting aspects of implementation.

(c) Are there other aspects around the implications of Covid-19, not yet addressed in the DEA that you want to expand on?

Part VI: Overall assessment with respect to the European public good

20 The EFRAG Board, as explained above has concluded on a consensus basis, apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts, that:

- all the other requirements of IFRS 17, on balance (i) meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, raise no issues regarding prudent accounting, and that they are not contrary to the true and fair view principle; and (ii) are conducive to the European public good;
- solely with reference to the requirement to apply annual cohorts to the intergenerationally mutualised and cash-flow matched contracts, EFRAG Board members do not have a consensus. Nine EFRAG Board members believe that the annual cohorts requirement meets the above endorsement criteria, whereas seven EFRAG Board members believe it does not.

(a) Do you agree with the assessment with regard to all the other requirements of IFRS 17 apart from the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts?

☐ Yes ☐ No

(b) If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

(c) What are your views with regard to the use of annual cohorts to the intergenerationally mutualised and cash-flow matched contracts? Please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.