This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in 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 Draft Final Endorsement Advice

Second decision- making session
Cover Note

Objective

1 The objective of the session is to approve the final endorsement advice ('FEA') for issue to the European Commission. In detail: to approve Appendix III, to discuss and approve Annex 1 and the Cover Letter.

Background

2 The FEA is composed of:

(a) the Cover Letter;

(b) Annex 1 (observations about the use of annual cohorts to intergenerationally mutualised and cash-flow matched contracts that are relevant for the FEA assessment of topics usually presented in Appendices II and III);

(c) Appendix I (description of the requirements in IFRS 17);

(d) Appendix II (FEA assessment and conclusion about the qualitative technical characteristics of all the other requirements in IFRS 17); and

(e) Appendix III (FEA assessment and conclusion about European Public Good about all the other requirements in IFRS 17).

3 At its meeting on 2 March 2021 the IAWG provided input to EFRAG Secretariat on the proposed changes to Appendices II and III. At its meeting on 3 March 2021 EFRAG TEG received a presentation of the comments received. At its meeting on 4 March 2021, EFRAG TEG approved and recommended to the EFRAG Board Appendices I, II and III of the IFRS 17 FEA, subject to wording changes.

4 The EFRAG Board approved Appendix I and II at its meeting on 15 March 2021, suggesting further wording changes for the latter. For Appendix III further changes were asked.

5 This session would focus on Appendix III, Annex 1 and the Cover Letter.

6 The Cover Letter provided for this session is unchanged from the DEA in its structure and conclusion (i.e., consensual support for all the requirements of IFRS 17 apart from the application of annual cohorts to intergenerationally-mutualised and cash-flow matched contracts and split views on annual cohorts). This is because, considering the comments received, the EFRAG Secretariat suggests to confirm to the structure and conclusion.

Changes to Appendix III as requested by EFRAG Board

7 At its meeting on 15 March 2021, EFRAG Board requested the following changes:

(a) Reinsurance: explain in more detail the nature of the mismatches (paragraphs 222 to 224 and footnote 14)

(b) Potential effect of IFRS 17 on small and medium sized entities: remove the phrase that Member States should consider proportionality measures in applying art 5 of the Regulation (former paragraph 378);

(c) IFRS 17 and dividend distribution: add the situation in Spain where the application of IFRS 17 may affect dividend distribution (paragraph 501); and

(d) Financial conglomerates: provide a more elaborate explanation of how the application of IFRS 17 and IFRS 9 will affect the regulatory capital of financial conglomerates (paragraphs 515 to 518).

EFRAG TEG discussion and approval

Changes to the cover letter

8 Two issues came out with more prominence from the comment letter analysis: the possible impact of accounting volatility on prudential ratios of conglomerates and the absence of recycling when entities elect to measure equity instruments at FVOCI. EFRAG Secretariat suggested to add these two points in the cover letter, including a reference to the relevant paragraphs of the appendices where to find the detailed illustration of the issue. In addition, considering that many constituents suggested items to be recommended to be considered for a post implementation review, EFRAG Secretariat suggested to add this point to the cover letter, with a footnote providing the list of such issues.

9 EFRAG TEG members discussed the cover letter on 23 March and agreed to include in the cover the issue of recycling of FVOCI. They didn't agree on the following additions suggested by the EFRAG Secretariat. EFRAG TEG also agreed to follow the recommendation of EFRAG IAWG and not include the topic of backloading of CSM amortisation in the FEA. These two points have been therefore not added in the cover letter prepared for this meeting:

- *As described in Appendix III paragraphs [513] to [515], EFRAG has been informed that in case of insurers that are part of a financial conglomerate, under the current prudential regulation, the IFRS book values of equity of the banking parent company are the basis for the prudential ratios. As a result, market volatility and unaddressed accounting mismatches from the application of IFRS 9 and IFRS 17 may affect other comprehensive income and, indirectly, the regulatory capital. This may create solvency ratio volatility.*
- *Finally, EFRAG note that in the consultation several constituents suggested to recommend considering some requirements for a post-implementation review. [IN A FOOTNOTE: These requirements are: annual cohorts (suggested by constituents that support the this requirement), the use of discount rates in general, the determination of the risk adjustment, CSM amortisation, scope of the VFA (amendment to paragraph B107), application of the contract boundary definition to reinsurance contracts held, treatment of reinsurance contracts, locked-in discount rates under the general model, disclosures of portfolios in an asset or liability position, equivalent confidence level disclosure for the risk adjustment, measurement of time value of options and guarantees, presentation of insurance premium receivables and claims payables, contracts acquired in their settlement period, separating components from an insurance contract, multi-component contracts, wider application issues relating to discount rates. Different constituents*

recommended different items.]

Requested advice from EFRAG TEG

10 An EFRAG Board member requested advice from EFRAG TEG whether the distinction or not the treatment of IGM and CFM contracts in the context of annual cohorts should be nuanced.

11 Six EFRAG TEG members that support the application of annual cohorts provided their view and considered that the arguments for an exemption for cash flow matched contracts with respect to annual cohorts are weaker than for those relating to intergenerationally-mutualised contracts. The other EFRAG TEG members did not provide a specific view.

EFRAG TEG views on the conclusions and final vote

12 Similarly to the approval of the IFRS 17 DEA, EFRAG TEG members have provided their position and advice in a Note from EFRAG TEG to EFRAG Board provided for this meeting as agenda paper 03-08.

13 EFRAG TEG members confirmed their initial position (with the exception of Sven Morich is not anymore TEG member so his view has not been considered in the Note).

14 In addition, three EFRAG TEG members that support the annual cohorts requirement asked the EFRAG Secretariat to suggest including in the arguments supporting the view of the EFRAG Board members that support the requirement to apply annual cohorts that:

(a) *the German application example as set out in paragraph 23 of Annex 1 shows that a workable approach exist to implement the requirements and*

(b) *international auditing firms and Accountancy Europe consider that the annual cohort requirement can be audited.*

Changes to Annex 1

15 When issuing the DEA, the EFRAG Board was unable to reach consensus on the annual cohort requirement and its application to specific contracts, namely intergenerationally-mutualised ('IGM') and cashflow-matched ('CFM') contracts. A

16 As previously discussed in the comment letter analysis, the feedback received broadly confirms the existence of a split in the respondents' views, similar to EFRAG Board's position, with some respondents supporting the annual cohorts to all contracts and some respondents considering there should be an exclusion for certain contracts. For further information, please refer to paragraphs 90 to 100 and 123 to 136 in paper 02-04 (the comment letter analysis).

17 Considering the above, EFRAG Secretariat suggested limited additions and editorial changes, confirming the overall approach taken in Annex 1.

Changes approved by EFRAG TEG

18 EFRAG TEG has approved the following changes to Annex 1:

(a) The additional information received on the prevalence of the relevant contracts and separating the information from German stakeholders from those from other countries (Appendix II: paragraphs 1 to 2 in Annex 1 and paragraphs 52-53 in Annex A);

(b) The description of a practical way to implement the annual cohort requirement as described in paragraph 71 of the comment letter analysis (paragraph 23 Appendix II in Annex 1);

(c) Concerns about the impact of allocation techniques when implementing the annual cohort requirement on comparability and reliability of information (Appendix II: paragraphs 18 and 20 in Annex 1);

(d) Specific reported arguments that annual cohorts would not cause procyclical effects (Appendix III: paragraph 20 in Annex 1);

(e) Enhancing the description of the operation of IGM and CFM contracts (paragraphs 55 to 57; 60; 64; 66 in Annex A); and

(f) Other changes to capture the following additional comments received that the annual cohort requirement:

   (i) Can be subjected to an audit (Appendix II, paragraph 24 in Annex 1);

   (ii) Supporters overemphasise the importance of guarantees in these contracts (Appendix II: paragraph 43 in Annex 1);

   (iii) Could further contribute to a move from annuities to unit-linked products (Appendix III: paragraph 10 in Annex 1);

   (iv) Could impact asset liability management activities (Appendix III: paragraph 11 in Annex 1); and

   (v) Has been acknowledged by the IASB to have significant costs that may exceed the benefits, however, this impacts a larger population than contemplated by the IASB. (Appendix III: paragraph 39 in Annex 1).

Questions for EFRAG Board

19 Does EFRAG Board have any comments on the update version of Appendix III 1 of the FEA?

20 Does EFRAG Board approve for issue the final version of Appendix III of the FEA?

21 Does EFRAG Board consider that a further distinction between intergenerationally-mutualised and cashflow-matched contracts in the cover letter is necessary?

22 Does EFRAG Board have any comments on Annex 1 of the FEA?

23 Does EFRAG Board approve for issue the final version of Annex 1 of the FEA?

24 Does EFRAG Board have any comments on the proposed changes to the cover letter of the FEA?

25 Does EFRAG Board approve for issue the final version of the cover letter of the FEA?

Agenda Papers

26 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 03-02 – IFRS 17 FEA – Annex 1 on Annual cohorts;

(b) Agenda paper 03-03 – IFRS 17 FEA – Annex 1 on Annual cohorts (tracked changes from DEA);

(c) Agenda paper 03-04 – IFRS 17 FEA – Cover letter;

(d) Agenda paper 03-05 – IFRS 17 FEA – Cover letter (tracked changes from DEA);

(e) Agenda paper 03-06 – IFRS 17 FEA – Appendix III;

(f) Agenda paper 03-07 – IFRS 17 DEA – Appendix III (tracked changes from DEA); and

(g) Agenda paper 03-08 – IFRS 17 FEA - Note from EFRAG TEG to EFRAG Board on the EFRAG TEG vote on IFRS FEA.

27 The following papers have been provided as background information:

(a) Agenda paper 03-09 – IFRS 17 FEA –Comment letter analysis;

(b) Agenda paper 03-10 – IFRS 17 FEA – Main feedback messages;

(c) Agenda paper 03-11 – IFRS 17 FEA – Appendix I of the FEA;

(d) Agenda paper 03-12 – IFRS 17 FEA – Appendix II of the FEA; and

(e) Agenda paper 03-13 – IFRS 17 FEA – Appendix II of the FEA (tracked changes from the DEA).

Appendix 1: Summary of changes to Appendix I, Appendix II and Appendix III of the FEA

28 There were no comments received on Appendix I to the FEA and therefore no changes have been made.

29 The package presented to the EFRAG Board in this session incorporates the following proposed main changes:

Appendix II

(a) In relation to the relevance criteria for reinsurance contracts held and issued, note the reported concern that the risk mitigation option cannot be applied retrospectively, leaving mismatches at transition unaddressed (paragraph 72).

(b) Correct the description of the risk mitigation approach under relevance (paragraph 139).

(c) Include feedback from EFRAG IAWG that information for the risk mitigation approach may not always be available on a granular level (paragraph 141).

(d) In relation to the relevance criteria for business combinations –include the reported concern that that the accounting treatment for contracts acquired in their settlement period lacks a sound conceptual basis and state that passing the cost-benefit assessment is doubtful. (paragraph 157).

(e) Include the concern that guidance for reinsurance contracts held are insufficiently clear and not well-adapted to the specifics of those contracts (paragraph 350).

Appendix III

(f) In relation to the interaction of IFRS 17 with IFRS 9 – the 'fair value through profit or loss'- note the reported concern that the measurement of puttable financial instruments under IFRS 9 may not reflect the way assets are managed in a long-term investment business model, which may limit the relevance of the information. (paragraphs 122-123);

(g) In relation to the key features of IFRS 17 – note the concern that the determination of contract boundaries to reinsurance contracts held will result in both accounting and economic mismatches due to: (i) applying different discount rates, measure differently the contract's CSM, (ii)determining different coverage periods, (iii) applying different risk adjustments and (iv) retaining different release patterns for that risk. The separate assessment of the contract boundaries for reinsurance contracts held will enable reflecting the expected gain or loss from the reinsurance of future underlying contracts not yet issued, but it involves extensive use of judgment and estimates, therefore questioning the cost-benefit (paragraphs 222 -225);

(h) In relation to reported concerns around prudential implications of volatility in OCI – note that EFRAG has been informed that the prudential capital of financial conglomerates will be affected by the application of IFRS 9 and IFRS 17 (paragraph 515);

(i) On IFRS 9 comparatives: acknowledge the operational burden of not being able to apply IFRS 9 retrospectively for items that are derecognised at date of initial application (paragraph 184);

(j) In relation to the potential effect of IFRS 17 on small and medium enterprises (SME's) – add that the threshold used in the assessment has been retained on a conventional basis, in the absence of more direct reference. (paragraph 371).

(k) In relation to the Covid-19 pandemic:

   (i) update of the section based on the latest developments around the impact on elevated macro risks, cost of capital and implementation of IFRS 17 (paragraphs 521 onwards);

   (ii) note the concern reported by one respondent that IFRS 17 if already applied, would have had a negative impact on supportive measures taken by insurers in the pandemic. (paragraph 528) EFRAG TEG suggested to obtain additional information to better illustrate this concern.

(l) On dividends/distributable reserves: inclusion of reference to Dutch and Spanish law where the interaction between IFRS and prudential regulation may affect dividend distribution (paragraph 500).

(m) Summaries and references to the comment letters of ESMA and EIOPA have also been included (paragraphs 581 to 591 and 596 to 608).

(n) An explanatory footnote has been added in Annex 6 – Insurance statistics based on present legislation (Annex 6).

(o) In the glossary, the term NSS was added.