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.

# EFRAG's Final Letter to the European Commission Regarding Endorsement of IFRS 17 *Insurance Contracts* as amended in June 2020

John Berrigan
Director General, Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels

xx March 2021

Dear Mr Berrigan,

**Endorsement of IFRS 17 Insurance Contracts as amended in June 2020**

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on IFRS 17 *Insurance Contracts*, issued by the IASB on 18 May 2017 and amended by the IASB on 25 June 2020 ('IFRS 17' or 'the Standard'). EFRAG provided its comment letter on the Exposure Draft (Amendments to IFRS 17) on 24 September 2019.

IFRS 17 is the result of a technical debate that lasted for more than 15 years. EFRAG has previously commented on a Discussion Paper *Preliminary Views on Insurance Contracts* published on 3 May 2007; the Exposure Draft (ED/2010/8 *Insurance Contracts*) published on 29 July 2010 and the revised Exposure Draft of 2013 (Revision of ED/2010/8 *Insurance Contracts*) published on 20 June 2013. All these documents are available on EFRAG's website.

IFRS 17 replaces IFRS 4 *Insurance Contracts.* IFRS 17 is designed to ensure that an entity provides relevant information that faithfully represents insurance contracts. This information would give a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows.

IFRS 17 shall be applied retrospectively, with certain exceptions, for annual periods beginning on or after 1 January 2023, with earlier application permitted. If entities apply IFRS 17 earlier, they shall disclose that fact. Early application is permitted for entities that apply IFRS 9 *Financial Instruments* on or before the date of initial application of IFRS 17. A description of the Standard is included in Appendix I to this letter.

In order to provide its endorsement advice as you have requested, EFRAG has first assessed whether IFRS 17 would meet the technical criteria for endorsement, in other words, whether IFRS 17 would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, lead to prudent accounting and would not be contrary to the true and fair view principle. EFRAG has then assessed whether IFRS 17 would be conducive to the European public

good. EFRAG has also analysed specific matters that you have asked for in your request for advice and from the European Parliament resolution of 3 October 2018.

To provide additional input to its assessment, in 2018, EFRAG conducted an extensive case study and a simplified case study with preparers on the expected impact of IFRS 17. Furthermore, as there were amendments being made to IFRS 17, EFRAG conducted, in 2020, a Limited Update to the 2018 Case Studies, in order to assess the effects of the Amendments.

Furthermore, EFRAG conducted two User Outreaches, one in 2018 related to current accounting and IFRS 17 and another one in 2019 which specifically related to the proposed amendments to IFRS 17. Also, in 2020, EFRAG discussed with auditors and preparers to assess considerations around hedge accounting under IFRS 9 and IAS 39 in conjunction with insurance liabilities. In addition, in 2020, Accountancy Europe provided their feedback on the auditability of IFRS 17.

EFRAG also commissioned a study from an economic consultancy ('the Economic Study'). The purpose of the Economic Study, which provided input into EFRAG's analysis, was to provide several analyses on the ex-ante impact assessment of IFRS 17 as issued in May 2017, the June 2019 proposed amendments to IFRS 17 and the subsequent changes arising from the deliberations process until March 2020. In particular, the study provided inputs relating to the competitiveness landscape, observable trends in the business model(s) of European insurers and investor perception of the insurance sector.

Annex 8 lists the outreach activities conducted by EFRAG since the Standard was issued in May 2017.

EFRAG also considered the input provided by European Insurance and Occupational Pensions Authority (EIOPA) on their areas of expertise, *EIOPA's analysis of IFRS 17 Insurance Contracts*, including concerns on IFRS 17's requirements on determining the applicable discount rate and risk adjustment. In addition, EFRAG has considered, in its analysis, the results of a recent investigation carried out by the European Supervisory Authorities performed to collect evidence and stakeholders' views on undue short-term pressure from financial markets on corporations.

A summary of the results of EFRAG's assessments is provided below.

**Does IFRS 17 meet the IAS Regulation technical endorsement criteria?**

**Note to EFRAG TEG**

This cover letter will be discussed by EFRAG Board in the meeting on 29 March, when the EFRAG Board members will be asked to approve the final endorsement advice for issuance. As such, the following text, in particular, is subject to changes to reflect the final position of the EFRAG Board members, should they consider to change their preliminary position. Consequential changes may also be needed in the text highlighted in grey in the rest of this cover letter.

*EFRAG has analysed the technical criteria taking into consideration, in the endorsement advice, the concerns and arguments raised by some stakeholders.*

- *The EFRAG Board has concluded on a consensus basis that, apart from the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts as explained below, 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 also assessed that all the other requirements of IFRS 17 do not create any distortion in their interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, 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, as described below, with reference to the requirement to apply annual cohorts for some contracts, described in Annex A of Annex 1[1], which are conventionally referred to, in this document, as 'contracts with intergenerational mutualisation and cash-flow matched contracts' or 'intergenerationally-mutualised and cash-flow matched contracts'.*
- *Content relating to the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts is in Annex 1 to this letter and EFRAG's reasoning on all the other requirements of IFRS 17 is explained in Appendix III to this letter.*

**Is IFRS 17 conducive to the European public good?**

- *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, on balance, are conducive to the European public good.*
- *EFRAG Board members were split between two groups, as described below, with reference to the requirement to apply annual cohorts for contracts with intergenerational mutualisation and cash-flow matched contracts.*

**IFRS 17 Requirement to apply annual cohorts for contracts with intergenerational mutualisation and cash-flow matched contracts**

- *A description of contracts with intergenerational mutualisation and cash-flow matched contracts is provided in Annex 1. Contracts with intergenerational mutualisation and cash-flow matched contracts are different in nature and Annex 1 reports separately content relating to the requirement to apply annual cohorts respectively for these two families of contracts. EFRAG understands that these contracts account for a significant share of the overall European insurance market. EFRAG Board members were split between two groups, respectively holding the views described below.*
- *Nine EFRAG Board members consider that overcoming in a timely manner the issues of IFRS 4 brings sufficient benefits despite the concerns on annual cohorts. They believe that, in the absence of an alternative principles-based approach to grouping of contracts, on balance the annual cohorts requirement provides an acceptable conventional approach that enables to meet the reporting objectives of the level of aggregation of IFRS 17.*
- *Seven EFRAG Board members consider that in many cases in Europe the requirement to apply annual cohorts for insurance contracts with intergenerational mutualisation and cash-flow matched contracts will result in information that is neither relevant nor reliable. This is because the requirement does not depict an entity's rights and obligations and results in information that represents neither the economic characteristics of these contracts nor the entity's underlying business model. These EFRAG Board members also consider that this requirement is not conducive to the European public good*

[1] Content relating to the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts is in Annex 1 to the Cover Letter. Annex A of Annex 1 describes the issue and its pervasiveness.

> *because it (i) adds complexity and cost and does not bring benefits in terms of the resulting information, (ii) may lead to unintended incentives to change the way insurers cover insurance risks and (iii) may produce pro-cyclical reporting effects.*

A detailed illustration of how this specific requirement may positively or negatively affect each of the technical endorsement criteria and the assessment of European Public Good is reported in Annex 1.

***The assessment reported below relate to all the other requirements in IFRS 17***

*Improvement to financial reporting*

IFRS 17 is a comprehensive standard providing a full set of recognition, measurement, presentation and disclosures requirements. EFRAG has assessed whether IFRS 17 would contribute to improving financial reporting over that required by IFRS 4 on the areas of changes it considers most significant.

EFRAG notes that, while providing flexibility and being non-costly to preparers, the requirements in IFRS 4 were designed to be an intermediary step towards a more comprehensive solution to insurance contract accounting and fail to provide comparable and transparent information to users. As a result, EFRAG is of the view that the efficiency of current IFRS 4 requirements is suboptimal.

EFRAG believes that the following main aspects improve insurance contracts accounting under IFRS 17 compared to IFRS 4:

- IFRS 17 increases comparability and transparency;
- IFRS 17 uses current estimates and updated assumptions for the measurement of insurance contracts that are in many cases long-term, thus helping to better portray the changes in market conditions and consequential effects to which an entity is exposed;
- IFRS 17 reflects the economics of the insurance business; and
- IFRS 17 measures insurance contracts in a way that reflects the fact that entities generally fulfil insurance contracts over time by providing insurance contract services to policyholders (see Appendix III, paragraphs 15 to 67).

That is why EFRAG considers that IFRS 17 provides better financial information than IFRS 4.

**Other matters in your request for advice**

***The assessment reported below relate to all the other requirements in IFRS 17***

You asked EFRAG to provide its views on certain specific matters referred to in Annex 2 of your request for endorsement advice. EFRAG summarises its response below.

*General*

EFRAG has assessed some general issues requested by you relating to specific content of IFRS 17. EFRAG's response to each specific question is below.

On benefits compared to the existing situation, EFRAG refers to its explanations set out above regarding improvement in financial reporting. In addition to this, most specialist and generalist users, as confirmed by EFRAG's User Outreach, are expecting an improvement in comparability between insurance entities. Also, most of the specialist and generalist users from EFRAG's User Outreach did not consider added volatility in reported financial performance as a problem if it reflects the economic substance and the underlying causes were communicated clearly. EFRAG also refers to the cost-benefit analysis below.

In Appendix II, EFRAG has concluded positively on the following technical aspects as requested in the Commission's request for the endorsement advice:

- *delivering consistent and understandable reporting of financial performance relating to understandability and comparability* (paragraphs 250 to 338 and 339 to 386);
- *whether the delineation between different accounting methods, such as the scope of the variable fee approach, is clear relating to understandability* (paragraphs 343 to 349);
- *pattern of release of the contractual service margin ('CSM') for insurance contracts with direct participation features relating to relevance* (paragraphs 91 to 96).

*On how IFRS 17 caters for specificities of the insurance sector,* the requirements of IFRS 17 take into account the broad categories of products offered by European insurers. They include relevant modifications to the general accounting model to capture the specificities of some insurance products (Appendix III paragraphs 331 to 368).

*Potential effects on financial stability*

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 433 to 487).

*Potential effects on competitiveness*

(Appendix III paragraphs 232 to 291)

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. The reasoning leading to this conclusion is reported below.

*Current competitive landscape*

Looking at today's European insurance financial reporting landscape, EFRAG concludes that no 'level playing field' exists today, but rather a variety of applicable GAAPs. Insurers' IFRS consolidated financial statements are based on several different local practices. As a consequence, financial information is not comparable, sometimes, within an entity's own consolidated financial statements nor comparable across countries. EFRAG is not aware of any evidence that these differences have created significant competitive (dis)advantages for the insurers involved.

Based on the results of the Economic Study, EFRAG notes that the degree of competition between European-based insurers and third country-based insurers is relatively low.

*Impact of current measurement in IFRS 17*

Compared with present financial reporting of the insurance industry, reporting under IFRS 17 may entail more volatility in profit or loss and OCI. According to some preparers, increased volatility in profit or loss may represent a competitive disadvantage for insurers relating to their cost of capital; for some stakeholders, also the added volatility in other comprehensive income[2] is a source of concern. This is because they consider that the market perceives as more risky entities when reported performances are more volatile. However, EFRAG observes that no causal effect has been demonstrated between the

[2] Refer to paragraph 32 in Appendix II and paragraph 503 in Appendix III.

use of current measurement methods or the recognition of revenue over time and the cost of capital.

EFRAG concludes that no evidence exists at this stage of a direct competitive (dis)advantage due to the current measurement approach introduced by IFRS 17.

*Impact of IFRS 17 implementation costs*

EFRAG concludes that the implementation cost of IFRS 17 does not generally have a causal effect on competition for particular products or markets.

*Competition issues between US GAAP and IFRS 17*

In assessing the competition issues between applying US GAAP and IFRS 17, EFRAG concludes that the transition to IFRS 17 will remove material limitations of the existing Standard and reporting practices that are currently used in Europe, bringing more transparency and comparability. This may result, indirectly, in improving the competitive position compared to other jurisdictions where entities use a different GAAP, including the US.

*Potential impact on the insurance market*

(Appendix III paragraphs 292 to 330)

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 proposed[3] EIOPA quantitative[4] thresholds).

*Cost-benefit analysis*

(Appendix III paragraphs 555 to 581)

EFRAG has assessed the one-off costs of implementing the Standard, the ongoing costs of applying it and the possible cost savings. EFRAG has also assessed the benefits of the IFRS 17.

Views from users, regulators and auditors show a strong expectation that the implementation of the Standard will result in improving financial reporting for insurance contracts. It is expected that IFRS 17 will increase transparency, in particular, as it will increase comparability. It will further introduce current value fulfilment measurement on a consistent basis and increase visibility of risk exposures of insurers through significant additional disclosures.

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[3] Reference is made to EIOPA's publicly consulted Consultation Paper on the Opinion on the 2020 review of Solvency II to amend the thresholds for applying Solvency II.

[4] Reference is made in the Appendices to EIOPA quantitative data and statistics; EFRAG acknowledges that those data and statistics are based on supervisory and not accounting data.

EFRAG has collected the views of the insurers that participated in the case studies on whether the expected benefits of IFRS 17 would exceed its implementation costs. 46%[5] of the participants from Europe (excluding participants in the UK), that provided a specific answer to this question, reported a positive overall cost/benefit appreciation in the long term. This share would increase to 59% if the Standard had a solution for annual cohorts for intergenerationally-mutualised and cash-flow matched contracts.

The feedback from the preparers' case studies (updated in 2019) shows that the budgets for implementation projects consider significant one-off expenses (average one-off cost per insurer[6] reported was €155 million for participants[7] from the EEA excluding the UK). The expectations around the cost of implementing the annual cohorts requirement varies significantly (reported to be between 2% and 20% with a mean of around 9%), depending on the product composition and on how the actuarial modelling and financial reporting systems have been built up to today.

Taking into account the evidence obtained from the various categories of stakeholders, EFRAG assesses that the benefits of all the other requirements in IFRS 17 exceeds the related costs.

In addition, EFRAG concludes that, if IFRS 17 is applicable to small insurers, in particular to life insurers, the costs of implementing IFRS 17 can be characterised as very significant.

**Other matters based on the European Parliament resolution of 3 October 2018**

EFRAG was also asked to provide its views on certain specific matters referred to in the European Parliament resolution of 3 October 2018. EFRAG summarises its response below.

***Views from Regulators***

*Preliminary views of EBA*

The below refers to EBA's concerns on IFRS 17 permitting an insurance entity to determine a discount rate using either a top-down or a bottom-up approach.

The EBA indicated that it did not evaluate the Standard as a whole, as its review was carried out purely from a banking supervisory perspective and, as such, focussed on issues that could affect bancassurers[8], i.e. different accounting treatment between the insurer and bancassurer for similar transactions and high level of judgement around the determination of interest rates (Appendix III paragraphs 593 to 596). EFRAG's assessment of the requirements of IFRS 17, apart from the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts, as illustrated in Appendix II, confirms that they meet the endorsement criteria.

EBA did not comment to the EFRAG's draft endorsement advice.

*Views of EIOPA*

In its comment letter on EFRAG's draft endorsement advice on IFRS 17 EIOPA noted IFRS 17 would provide better insights into insurers' business models and have the potential to strengthen financial stability in the European Economic Area (EEA).

[5] 38% of the participants from Europe (excluding participants in the UK) that provided a specific answer to this question reported a positive overall cost/benefit appreciation other than in the long-term.

[6] This was based on responses from 15 EU participants excluding UK.

[7] To put these figures into context, EFRAG notes that on average the dividends distributed every year by the listed entities in this group have been in excess of € 1 billion (excluding share buy-backs) for the last five financial years.

[8] i.e. groups that provide both banking and insurance services.

Consequently, EIOPA regards the implementation of IFRS 17 as beneficial for the European public good. (Appendix III, paragraphs 597 to 609)

EIOPA maintains its reservations regarding IFRS 17's principles on determining the applicable discount rate and risk adjustment, which may have exceeded the appropriate level of allowing for entity-specific inputs.

EIOPA wants to mention that an adapted EU-IFRS 17 may lead to undesired consequences. Whilst EIOPA would have preferred a more principle-based approach to profit allocation in IFRS 17, in EIOPA's view, IFRS 17's annual cohort requirement should not distort the overall assessment of the standard or impede the endorsement of IFRS 17 in EU law.

*Views of ESMA*

In its comment letter on EFRAG's draft endorsement advice on IFRS 17 ESMA noted to support the endorsement of IFRS 17 which [in their view] will provide a consistent system of requirements to account for insurance and reinsurance contracts, thus achieving the much-needed replacement of the current IFRS 4 Insurance Contracts which does not provide for the necessary level of transparency and comparability to promote investor protection and financial stability.(Appendix III, paragraphs 582 to 592)

ESMA also noted that on balance IFRS 17 will be conducive to the European public good and, in particular, have a positive impact on investor protection and financial stability. ESMA also emphasises the importance of the swift adoption of IFRS 17 in order to ensure the application by insurance undertakings of IFRS 9 Financial Instruments which has for long been delayed to the detriment of investor protection.

***The assessment reported below relate to all the other requirements in IFRS 17***

*Presentation of general insurance contracts*

The presentation requirement for contracts in an asset or liability position were at group level per the original Standard (May 2017). This was changed by the Amendments (June 2020) and the disclosure is now required at portfolio level. Other concerns raised on presentation requirements related to receivables and payables, separation of the non-distinct investment component of revenue and insurance funds withheld. EFRAG is of the view the presentation requirements of IFRS 17 would provide relevant information (Appendix II paragraphs 118 to 125).

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, as contracts in an asset or liability position are affected by the timing of cash flows received and paid for insurance contracts. If, for example, an entity pays expenses sooner than it receives premiums, the insurance contracts may be in an asset position. (Appendix II paragraphs 118 to 120, 362 to 364).

*No distortion of social guarantees offered*

This aspect has been covered as part of the potential impact on the insurance market.

*Interaction between IFRS 17 and Solvency II*

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 an element of the measurement approach for insurance liabilities under Solvency II. Synergy potential is available in areas that have a high degree of commonality under the two frameworks, i.e. building blocks for the measurement of the insurance liability 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. (Appendix III paragraphs 406 to 417).

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

- On financial stability, refer to the conclusions above;
- 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 124);
- 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 has the potential to 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 in general there is no linkage between the accounting equity (cumulative retaining earnings) and amounts available for distributions, which are mainly 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 be able to react timely to any changes at hand, thereby avoiding cliff-effects. (Appendix III paragraphs 488 to 519).
- 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, as under the current prudential regulation the IFRS book values of equity of the banking parent company are the basis for the prudential ratios, market volatility and any accounting mismatches not addressed under IFRS 17 and IFRS 9 may affect other comprehensive income and, indirectly, the basis of calculating regulatory capital requirements. This may create solvency ratio volatility.

*IFRS 17 and IFRS 9*

(Appendix III paragraphs 135 to 191)

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 business model for managing insurance contracts. 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 financial statements and this may differ largely from one insurer to another.

EFRAG wishes to recall its view that the lack of recycling of gains or losses of equity instruments classified at FVOCI in accordance with IFRS 9 is not representative for demonstrating the performance of a long-term business model.

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 5);
- the treatment of OCI balances and risk mitigation at transition will not, on balance, negatively impact the usefulness of the resulting information.

*Application of IFRS 15*

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).

*Implications of transitional requirements*

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, 229 to 238, 301 to 304, 374 to 376, 400 to 402).

*Benefits to all stakeholders* – refer to cost-benefit analysis above.

*Impact on reinsurance*

EFRAG concludes that the separate treatment under IFRS 17 of reinsurance contracts held and underlying direct contracts 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 approach 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 was present under the original version of the Standard (Appendix II paragraphs 63 to 74, 211 to 217, 275 to 276, 350 to 354, 397 to 399).

*Implementation timeline*

Feedback from the Limited Update to the 2018 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 2018 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 629 to 633).

Finally, EFRAG has been made aware that several requirements are to be considered in the post-implementation review of the standard. [9]

***Requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts***

Content relating to the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts is reported under the section Appendix III within Annex 1 to assess specific requests in the motion of the European Parliament, i.e. for the following points:

- *Concerns relating to the level of aggregation including how business is run; Concerns relating to level of aggregation and effect of disaggregation of portfolio on profitability criteria and annual cohorts; Diversity in business models vis-à-vis their major competitors outside Europe; specificities of the insurance sector*; *different accounting methods reflecting properly the different business models* (paragraphs 1 to 12)*;*
- *Impact on the range of insurance products, the design and pricing, the demand for various products, economic aspects and where relevant environmental and social aspects. To check that all core features does not distort the social guarantees offered (paragraphs 24 to 34);*
- *Does not endanger financial stability; impact of new standards on financial stability and long-term investment in the EU; pro-cyclical effects and/or higher volatility* (paragraphs 13 to 23);
- *Whether the complexity of the Standard is justified in terms of costs of application, in particular as regards to the subdivision of products into subgroups (onerous, non-onerous and the remaining contracts) and annual cohorts; Level of aggregation striking the right balance between usefulness and the complexity and costs* (paragraphs 35 to 44).

**Our advice to the European Commission**

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.

[9] These requirements are: annual cohorts, 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.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Jean-Paul Gauzès
**President of the EFRAG Board**