September 2, 2019

Jean-Paul Gauzes
European Financial Reporting Advisory Group
35 Square de Meeûs
1000 Brussels
Belgium

Re: EFRAG's draft comment letter on the IASB ED/2019/4 Amendments to IFRS 17

Dear Mr. Gauzes,

The Hub Global Insurance Group appreciates the opportunity to provide input to your comment letter on the IASB's Exposure Draft ED/2019/4 Amendments to IFRS 17.

The Hub Global Insurance Group (Hub Group) was founded in 2011 by Asian, European and North & South American insurance companies and trade associations with the objective to support the development of high-quality and robust accounting standards for the insurance industry. In recent years, the Hub Group has closely followed the Insurance Contracts standard project with great interest and has sought to contribute to the IASB's efforts to prepare a high quality standard.

Against this background, the Hub Group is also following the discussions taking place within the EU including EFRAG's endorsement activities relating to IFRS 17. We would like to thank EFRAG for its continuous efforts to consider significant concerns raised by the insurance industry. On 15 July 2019, the EFRAG Board has published a draft comment letter on the IASB's ED/2019/4 Amendments to IFRS 17.

The Hub Group has reviewed all of the proposed amendments to IFRS 17 in the exposure draft as well as all of the comments referenced in the EFRAG's draft comment letter. Overall, we believe that the proposed amendments provide a significant improvement to the Standard.

We support the deferral of the effective date of IFRS 17 (and IFRS 9). Our members have been investing significant efforts in implementing IFRS 17 targeting at the currently proposed effective date, i.e. 1 January 2022. However, we are concerned on the IFRS 17 timeline in combination with the endorsement process in Europe as well as the different adoption approaches around the world, which might result in different effective dates in different jurisdictions. We would like to note the importance of a global effective date of the Standard as well as the aligned application of IFRS 17 and IFRS 9. A timely finalization of the discussions and publication of the revised IFRS is of high importance to provide clarity for the ongoing implementation projects.

Furthermore, we note that there are some remaining important concerns that are worthy of further consideration. In September 2018, the Hub Group sent a letter to the IASB confirming the high relevance of the topics which were referenced in the EFRAG letter dated 3 September 2018 and in the CFO Forum's presentation. Some of the raised topics are fully addressed by the proposed changes. For others, the Exposure Draft provides partial or no solutions.

From the perspective of the Hub Group we highlight the following technical points that are of high relevance for Hub Group members:

- Proportionate reinsurance contracts – while we support the objective of the proposed changes for proportionate reinsurance contracts held, the proposed wording in the ED would limit application and provide little relief in practice. The accounting mismatch the IASB Board intended to fix is not resolved for many prevailing types of proportionate reinsurance contracts.

- CSM erosion under the variable fee approach – in the course of the implementation we have identified a significant issue which relates to the accounting for the contracts with direct participation features containing non-participating features. These contracts are very common in practice in certain jurisdictions. Applying the current requirements would result in significant accounting mismatches in profit or loss. This issue has not been picked up through the EFRAG field testing. Given the significance of the issue, we strongly believe there needs to be a solution. Further details including examples are summarized in Appendix 3.
- Level of Aggregation – we believe that for contracts that are significantly mutualized, the annual cohort requirement does not reflect the way in which the entity manages its business or generate useful information and therefore we would recommend to remove the annual cohort requirement for such contracts. Further, we would recommend to remove the annual cohort requirement for all contracts at transition. We believe this will significantly reduce operational complexities without significantly affecting the outcome.
- Transition – we believe that due to the very restrictive limitations in the modified retrospective approach, the ability to apply this method is unduly limited in practice, forcing the entity to apply the fair value approach. We recommend that the criteria should be more principle-based and that the risk mitigation approach to be applied retrospectively as part of the transition relief. In addition, we recommend that the relief regarding business combinations should be permitted regardless of transition approach and whether the acquisition is made before or after the transition date.
- Interim reporting – Under the current IFRS 17 requirements, measurement differences between group and solo reporting may arise solely due to differences in reporting frequency.

We recognize and appreciate EFRAG's significant efforts in developing and promoting European views in the accounting for insurance contracts as well as ensuring these views are considered appropriately in the standard setting process of the IASB. We believe that resolving these issues will increase the quality and operational practicability of the new insurance contracts standard substantially.

The documents enclosed comprise our comments on EFRAG's draft comment letter to the IASB as well as the questions to its constituents raised by EFRAG.

If you have questions or would like to discuss our comments in more detail, please do not hesitate to contact us.

Sincerely,

The supporting Hub members

Supporting Hub members:
Aegon
Allianz SE
American Council of Life Insurers (ACLI)
Assicurazioni Generali
AXA
Dai-ichi Life Holdings, Inc.
Manulife Financial Corporation
Meiji Yasuda Life Insurance Company
Nippon Life Insurance Company
Sumitomo Life Insurance Company

HUB Group's response to the EFRAG draft comment letter on IASB's Exposure Draft ED/2019/4

Appendix 1

Overview

Areas where questions have been raised to Constituents in addition to the IASB's questions *It would be most helpful if you answer only those questions that are relevant to you.* 1 Scope exclusions (paragraph 10, Appendix 1). 2 Expected recovery of insurance acquisition cash flows (paragraph 18, Appendix 1) 3 Contractual service margin attributable to investment-return service and investment-related service and disclosures about the profit recognition patterns (paragraphs 35 and 36, Appendix 1). 4 Reinsurance contracts held – recovery of losses on underlying insurance contracts (paragraphs 45 to 47, Appendix 1). 5 Presentation in the statement of financial position (paragraph 54, Appendix 1). 6 Applicability of the risk mitigation option (paragraphs 64 - 65, Appendix 1). 7 Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs 73 to 75, Appendix 1). 8 Transition modifications and reliefs (paragraphs 94 to 95, Appendix 1). 9 Minor amendments (paragraphs 99 to 105, Appendix 1) 10 Terminology (paragraph 110, Appendix 1). 11 Annual cohorts (paragraphs 140 to 143, Appendix 2). 12 Transition: Modified retrospective approach and fair value approach (paragraph 155, Appendix 2). 13 Balance sheet presentation: Non-separation of receivables and payables (paragraph 161, Appendix 2). 14 Reinsurance contracts: contract boundary (paragraphs 172 to 174, Appendix 2).

Question 1 - Scope exclusions

Question 1—Scope exclusions—credit card contracts and loan contracts that meet the definition of an insurance contract (paragraphs 7(h), 8A, Appendix D and BC9–BC30)
(a) Paragraph 7(h) proposes that an entity would be required to exclude from the scope of IFRS 17 credit card contracts that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer. Do you agree with the proposed amendment? Why or why not? (b) If not excluded from the scope of IFRS 17 by paragraphs 7(a)–(h), paragraph 8A proposes that an entity would choose to apply IFRS 17 or IFRS 9 to contracts that meet the definition of an insurance contract but limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract (for example, loans with death waivers). The entity would be required to make that choice for each portfolio of insurance contracts, and the choice for each portfolio would be irrevocable. Do you agree with the proposed amendment? Why or why not?

EFRAG's response

Loans that transfer significant insurance risk:

EFRAG supports the proposal to permit entities, on portfolio level, to either apply IFRS 17 or IFRS 9 to insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract.

Credit cards that provide insurance coverage:

EFRAG agrees with the exclusion of certain credit cards that provide insurance coverage from the scope of IFRS 17. This is because the exclusion reduces the implementation costs and operational burden for entities that issue credit card contracts for which the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer. Furthermore, the exclusion is not expected to lead to a significant loss of useful information.

However, EFRAG is concerned that the term 'credit card' excludes payment cards which have similar clauses as the credit cards in the scope exclusion.

EFRAG Question to Constituents

10 Paragraph B.4.1.9.E of IFRS 9 allows a regulated interest rate as a proxy for the time value of the money in applying the SPPI test, under certain conditions. EFRAG understands that in some countries the insurance element is not required by the regulation and, as a consequence, the financial instrument could fail the SPPI test and would have to be measured at fair value through profit or loss. How prevalent are these concerns within your jurisdiction?

General response:

We support the proposed amendments. We believe the additional scope exclusion will reduce the implementation costs for the entities that otherwise would not have to apply IFRS 17. At the same time, in our view, the accounting for such contracts under either IFRS 9 or IFRS 17 will give a faithful presentation of the economics. Therefore, the exclusion will not lead to a significant loss of useful information.

Additional response to EFRAG:

We support the comments made by EFRAG. We have no specific comments on the scope of these amendments regarding the payment cards and/or the impact on the SPPI test, as it is not of significant relevance for our members.

Question 2 - Expected recovery of insurance acquisition cash flows

Question 2 - Expected recovery of insurance acquisition cash flows (paragraphs 28A–28D, 105A–105C, B35A–B35C and BC31–BC49)
Paragraphs 28A–28D and B35A–B35C propose that an entity: (a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to any groups that include contracts that are expected to arise from renewals of the contracts in that group; (b) recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and (c) assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired. Paragraphs 105A–105C propose disclosures about such assets. Do you agree with the proposed amendments? Why or why not?

EFRAG's response

EFRAG supports the IASB's proposals with regards to the treatment of acquisition cash flows as the resulting financial information will better reflect the economic substance of these transactions.

EFRAG supports the allocation of the acquisition cash flows to the contracts to be a mandatory requirement. EFRAG agrees with the proposed recoverability assessment approach.

<u>EFRAG Question to Constituents</u>

18 Insurance contract renewals are not a defined term which may lead to diversity in practice when allocating insurance acquisition cash flows. Do you consider that insurance contract renewals should be defined in order to achieve comparability and, if so, how would you define them?

<u>General response:</u>

We generally support the spirit of the proposed amendments. We believe that taking the expected renewals into account of the allocation of the insurance acquisition costs will better reflect the economic substance of these contracts.

However, discussions within the industry indicate that the amendment is unclear and may lead to various outcomes depending on how the reader interprets it. Paragraph B35A (in conjunction with paragraph 28A) can be misinterpreted to limit entities to only allocate to future groups of contracts, acquisition cash flows that are directly attributable at a group level. This interpretation is not the intent of the Standard as Appendix A defines insurance acquisition cash flows as those that are directly attributable at a portfolio level to be allocated to groups of contracts including those that contain contracts that have yet to be issued. To clarify, insurance acquisition cash flows that are directly attributable at a portfolio level includes those that are not directly attributable at a group or contract level. We suggest IASB to revise B35A to reflect the intent of the Standard.

Paragraph 28D introduces the requirement for testing recoverability of each group's DAC, and refers to paragraph B35B for application guidance. Paragraph B35B(a) says to recognize an impairment loss if the group's DAC exceeds the expected net cash inflow for the related group. This would appear to suffice, however, paragraph B35B(b) requires an additional impairment test for the subset of the group's DAC that arose from expenses allocated to it from paragraph 35A and the subset of expected net cash inflow for the related group that arises from expected renewals of contracts related to B35A expenses. This additional impairment test adds significant complexity to implementation by adding an aspect of measurement within group – i.e., within the unit of account of measurement. Furthermore, in our view, this additional impairment test is unnecessary, as there is no reason to differentiate between recoverability of the portion of the DAC that arose from paragraph 35A cash flows and the portion that arose from other cash flows.

Additional response to EFRAG:

Regarding the question on insurance contract renewals, we believe that the requirements in IFRS 17 should be principle-based to avoid any unintended consequences due to too prescriptive requirements. Therefore, we consider that a definition of "renewal" is not necessary. In addition, we are not aware of significant diversity in practice regarding the interpretation of the insurance contract renewals.

Question 3 - Contractual service margin attributable to investment-return service and investment-related service

Question 3 - Contractual service margin attributable to investment-return service and investment-related service (paragraphs 44–45, 109 and 117(c)(v), Appendix A, paragraphs B119–B119B and BC50–BC66)
(a) Paragraphs 44, B119–B119A and the definitions in Appendix A propose that an entity identify coverage units for insurance contracts without direct participation features considering the quantity of benefits and expected period of investment-return service, if any, in addition to insurance coverage. Paragraph B119B specifies criteria for when contracts may provide an investment-return service. Do you agree with the proposed amendment? Why or why not? (b) Paragraphs 45, B119–B119A and the definitions in Appendix A clarify that an entity is required to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service. Do you agree with the proposed amendment? Why or why not? (c) Paragraph 109 proposes that an entity disclose quantitative information about when the entity expects to recognise in profit or loss the contractual service margin remaining at the end of a reporting period. Paragraph 117(c)(v) proposes an entity disclose the approach used to determine the relative weighting of the benefits provided by insurance coverage and investment-return service or investment-related service. Do you agree with the proposed disclosure requirements? Why or why not?

EFRAG's response

EFRAG supports the IASB's proposals regarding contracts under the general model. Some contracts under the general model include investment activities and the proposal will ensure that the contractual service margin (CSM) that will be allocated to profit or loss will reflect both insurance and investment return services provided to the policyholder.

EFRAG also supports the IASB's proposals regarding contracts under the variable fee approach because these contracts are substantially investment-related contracts.

EFRAG considers that the disclosure proposals related to CSM amortisation will provide useful information to users of financial statements.

EFRAG Question to Constituents

35 EFRAG has been informed of possible fact patterns of deferred annuities for which there is no investment component as defined by the ED, nor a right to withdrawal; however, the insurance entity performs asset management activities, revenues of which would not be captured in the CSM release. For example, for particular Deferred Annuities, there is an accumulation phase followed by the annuity phase. The policyholder's beneficiaries receive no return if the

policyholder dies during the accumulation phase. During the annuity phase, a surviving policyholder receives a fixed annuity amount based on premiums/technical provisions. In these deferred annuities the policyholder does not have a right to withdraw during either the accumulation phase or the annuity phase. Do you have additional examples of investment activities that are not captured by the proposals in the ED?

36 Entities have to provide quantitative disclosures on the expected recognition in profit or loss of the contractual service margin remaining at the end of the reporting period, in appropriate time bands. Do user constituents agree with this disclosure requirement? Do preparer constituents consider that this information is commercially sensitive? Please explain.

General response:

Question 3a): We support the proposed amendments to take into account the investment-return for the amortization of the CSM of the contracts without direct participation features. We believe that it is a significant step forward having the right objective.

However, we are aware of certain contracts with investment activities but which do not fulfil the definition of the investment-return service as currently proposed in the ED, because the contract cannot be transferred externally or surrendered. We consider that the contracts with or without the possibility to transfer or surrender are economically very similar. Therefore, we believe that the definition of the investment-return service shall be amended in a way so that such contracts could also fulfil the criteria of the investment-return service.

Question 3b): We support the proposed amendment to require to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service, as the proposed amendment would provide a more appropriate profit pattern than without considering the investment-related service.

Question 3c): We do not disagree with the proposed disclosure requirements.

Question 4 - Reinsurance contracts held—recovery of losses on underlying insurance contracts

Question 4 - Reinsurance contracts held—recovery of losses on underlying insurance contracts (paragraphs 62, 66A–66B, B119C–B119F and BC67–BC90)
Paragraph 66A proposes that an entity adjust the contractual service margin of a group of reinsurance contracts held that provides proportionate coverage, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. The amount of the adjustment and resulting income is determined by multiplying: (a) the loss recognised on the group of underlying insurance contracts; and (b) the fixed percentage of claims on the group of underlying contracts the entity has a right to recover from the group of reinsurance contracts held. Do you agree with the proposed amendment? Why or why not?

EFRAG's response

EFRAG welcomes the proposals of the IASB aiming to reduce the accounting mismatches for reinsurance contracts held.

<u>EFRAG Question to Constituents</u>

45 For proportionate reinsurance contracts, please provide fact patterns that are not captured by the amendment but for which the solution proposed by the IASB would be relevant.

46 The IASB has not addressed non-proportionate reinsurance contracts. A peculiarity of such contracts is that there is no one-to-one relationship between the direct underlying contract and the reinsurance contract held, for example because there are many underlying contracts that are covered by a single excess loss reinsurance contract held. Addressing non-proportionate reinsurance may therefore require the need to identify a "link" between the reinsured risk and the underlying contracts. EFRAG understands that any accounting mismatch for non-proportionate contracts may, in practice, be reduced due to the impact on the risk adjustment rather than on the CSM.

47 In your view:
(a) Should non-proportionate reinsurance contracts be treated similarly to proportionate reinsurance contracts, i.e. gains in profit or loss when a loss is recognised on underlying contracts? If yes, please provide information about (i) the prevalence of such contracts, including volumes and jurisdictions where the issue arises and (ii) the cash flow pattern of these non-proportionate reinsurance contracts.
(b) How would an accounting solution for non-proportionate reinsurance work?

<u>General response:</u>

We support the objective of the proposed amendment, which is based on the principle that a gain on proportionate reinsurance should be recorded in profit or loss to the extent that it offsets a loss on onerous underlying insurance contracts. We appreciate the straightforward approach to treat proportionate reinsurance contracts as an economically natural hedge.

While we recognize and appreciate the Board's proposed change to recognize the recovery of losses on underlying insurance contracts when the entity enters into a reinsurance contract that provides such relief, the change appears to be limiting to a certain set of proportionate reinsurance contracts. There are other types of reinsurance that provide similar relief, which we believe should be reflected in the Insurance Standard-IFRS 17.

The new definition of "proportionate" (see page 29 of Exposure Draft – ED/2019/4 Amendments to IFRS 17) is different from the description in BC304 of IFRS 17. The exposure draft states:

> "A reinsurance contract held that provides an entity with the right to recover from the issuer a percentage of all claims incurred on groups of underlying insurance contracts. The percentage the entity has a right to recover is fixed for all contracts in a single group of underlying insurance contracts, but can vary between groups of underlying insurance contracts."

Whereas, BC304 states:

> "Many reinsurance arrangements are designed to cover claims incurred under underlying insurance contracts written during a specified period. In some cases, the reinsurance contract held covers the losses of separate contracts on a proportionate basis. In other cases, the reinsurance contract held covers aggregate losses from a group of underlying contracts that exceed a specified amount."

It is our understanding of BC304 that proportionate reinsurance treaties are covering losses of individual underlying policies where the cover relates to the collective loss of a portfolio/group of underlying policies. Thus, proportionate reinsurance includes all quota share and surplus reinsurance. As such they provide a natural and effective hedge for the loss component of each reinsured policy. Under current market practice retentions and limits are frequently used when entering into proportionate reinsurance arrangements.

The ED definition would limit application to only certain quota share reinsurance that would pass as proportionate reinsurance. As soon as limits are introduced, the percentage how individual claims are shared is not identical for all underlying policies under such a reinsurance arrangement. Therefore, they would not fall under the new definition, although each claim is shared proportionally on a defined percentage for each underlying policy.

The integration of the new "proportionate" definition into IFRS 17 would likely result in a huge step back especially for primary insurers that have already begun implementation based on the original version of IFRS 17 and the intent of the Board as described in BC304. A reassessment of the impact of the proposed ED guidance for proportionate reinsurance, if passed as proposed, would likely result in increased cost and effort. We believe that most constituents have been setting up the recognition processes for reinsurance contracts held in accordance with the described market view of proportionate prior to the ED.

The intention of a change to IFRS17 that loss components of onerous contracts should be compensated to the extent they are naturally and effectively hedged by reinsurance is in practice not met following the proposed definition. The accounting mismatch the IASB Board intended to fix is not resolved for the prevailing types of proportionate reinsurance contracts.

Consequently, we recommend the following changes be made.

- Modify paragraph 66A as follows: An entity shall adjust the contractual service margin of a group of reinsurance contracts held that provides coverage, and as a result recognise income to the extent the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. The amount of the adjustment and resulting income is determined applying paragraph B119D.

- Modify the definition on page 29 as follows: A reinsurance contract held that provides an entity with the right to recover from the issuer a contractually defined percentage of each claim ~~all claims~~ incurred on ~~groups of~~ individual underlying insurance contracts within a group of contracts. ~~The percentage the entity has a right to recover is fixed for all contracts in a single group of underlying insurance contracts, but can vary between groups of underlying insurance contracts.~~"

- Modify paragraph B119C as follows: Paragraph 66A applies to reinsurance contracts held that provide proportionate coverage. Such reinsurance contracts provide the entity with the right to recover from the issuer a ~~fixed~~ contractually defined percentage of ~~all~~ each claim ~~claims~~ incurred on – an individual ~~group of~~ underlying insurance contract within a group of contracts. Such reinsurance contracts can also include cash flows, other than claims, that are not proportionate to cash flows of the underlying groups of insurance contracts issued. For example, in such reinsurance contracts, the premiums due to the reinsurer might not be proportionate to premiums due from the policyholders of the groups of underlying insurance contracts.

Modify paragraph B119D as follows: An entity shall determine the adjustment to the contractual service margin and the resulting income recognised applying paragraph 66A as the portion of claims on the group of underlying insurance contracts that the entity has a right to recover from the group of reinsurance contracts held.

- The new footnote on page 56 (ED/2019/4) to BC304 should be removed.

Question 5 - Presentation in the statement of financial position

Question 5 - Presentation in the statement of financial position (paragraphs 78–79, 99, 132 and BC91–BC100)
The proposed amendment to paragraph 78 would require an entity to present separately in the statement of financial position the carrying amount of portfolios of insurance contracts issued that are assets and those that are liabilities. Applying the existing requirements, an entity would present the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities. The amendment would also apply to portfolios of reinsurance contracts held that are assets and those that are liabilities. Do you agree with the proposed amendment? Why or why not?

EFRAG's response

EFRAG agrees with the proposed amendments, as they would simplify processes for preparers, decreasing the costs of implementation, without significantly reducing the information available to users.

<u>EFRAG Question to Constituents</u>

54 Do Constituents that are Users agree that separate balance sheet presentation (of insurance contracts that are in an asset position from those that are in a liability position) on a portfolio level rather than at group level will not significantly reduce the information available? Please explain.

<u>General response:</u>

We support the proposed amendment to require to present separately the carrying amount of portfolios of insurance contracts, rather than groups of contracts, that are assets and those that are liabilities. The proposed amendments would be an operational relief and therefore reduce the implementation costs significantly without impairing the usefulness and relevance of the information available to users.

<u>Other issues related to presentation</u>

We recognize that applying paragraph B137 of IFRS 17 the CSM must be "locked-in" at interim reporting which may give rise to different CSM measurement at different levels of consolidations due to differences in external reporting frequency between group and subsidiary entities. This increases significantly the operational complexity in the production of financial statements in a group, with hardly additional benefits.

<u>Additional response to EFRAG:</u>

We support the comments made by EFRAG. As insurance contracts are typically managed at the portfolio level, presentation in the balance sheet at portfolio level is better aligned with how the business is managed and, therefore will not significantly reduce the information usefulness.

Question 6 - Applicability of the risk mitigation option

Question 6 - Applicability of the risk mitigation option (paragraphs B116 and BC101–BC109)
The proposed amendment to paragraph B116 would extend the risk mitigation option available when an entity uses derivatives to mitigate financial risk arising from insurance contracts with direct participation features. That option would apply in circumstances when an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts with direct participation features. Do you agree with the proposed amendment? Why or why not?

EFRAG's response

EFRAG supports the IASB proposals because it addresses an accounting mismatch that arises from using reinsurance held to mitigate financial risks.

EFRAG Question to Constituents

64 EFRAG has heard that the extension of the risk mitigation option should be widened, for example, to include non-derivative instruments such as when hedging of interest rate risk is carried out using a combination of swaps, swaptions and fixed interest securities.

65 Please explain the prevalence including volumes and jurisdictions involved, of the risk mitigation strategies identified in paragraph 64 above.

General response:

We support the proposed amendment to extend the risk mitigation option that is currently available only when an entity uses derivatives to mitigate financial risk to circumstances when an entity uses reinsurance contracts held to mitigate financial risk. Additional changes are needed, however.

First, the risk mitigation option should be further extended to circumstances when an entity uses non-derivative financial instruments to mitigate financial risk. For various reasons, insurance company hedging strategies generally employ a combination of fixed income securities, mortgage loans, equity investments and (interest rate or equity) derivatives. The current constraints on the risk mitigation solution within IFRS 17 could have the effects of constraining effective risk management or burdening insurers with additional cost and complexity within their hedging strategies.

Second, additional consideration should be given to products that have both "participating" and "non-participating" components but which meet the criteria for the Variable Fee Approach. Such products are common in Asia and North America and include variable annuities, which frequently have a non-trivial "fixed" component. For the "non-participating" component of such contracts, the asset investment result (i.e. interest accretion and change in value) impacts the statement of financial performance while the corresponding IFRS 17 liability effect is offset by the contractual service margin. This results in accounting volatility and can create an earnings pattern that is inappropriately front-ended.

Note that any potential solutions for either of these two aforementioned recommendations should be reviewed in light of paragraphs 88 and 89 of IFRS 17 as written to ensure an adequate OCI solution is available to avoid further accounting mismatches.

Finally, the risk mitigation option should be available to all insurance contracts, rather than being limited to contracts accounted for under the variable fee approach. The inability to use the risk mitigation adjustment outside the variable fee approach results in accounting mismatches, as the effects of changes on hedging instruments are not recognised in the same location as the changes on the hedged items (either in CSM or P&L/OCI). This significantly distorts the net result and creates misalignments between accounting results and risk management. For various reasons, IFRS 9 hedge accounting is not well suited for the more macro approach that is common within the insurance industry, and the IASB's dynamic risk management project will not be in a position to address the concerns in the medium term, and it is unclear if it will address them at all. Therefore a solution is needed within IFRS 17.

Question 7 - Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4

Question 7 - Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs C1, [Draft] Amendments to IFRS 4 and BC110–BC118)
IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. The amendments proposed in this Exposure Draft are such that they should not unduly disrupt implementation already under way or risk undue delays in the effective date. (a) The proposed amendment to paragraph C1 would defer the effective date of IFRS 17 by one year from annual reporting periods beginning on or after 1 January 2021 to annual reporting periods beginning on or after 1 January 2022. Do you agree with the proposed amendment? Why or why not? (b) The proposed amendment to paragraph 20A of IFRS 4 would extend the temporary exemption from IFRS 9 by one year so that an entity applying the exemption would be required to apply IFRS 9 for annual reporting periods beginning on or after 1 January 2022. Do you agree with the proposed amendment? Why or why not?

EFRAG's response

EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17, but it does not have a view at this stage on the appropriate extension of the effective date of IFRS 17.
EFRAG agrees with the IASB that the effective date for IFRS 9 should continue to be aligned with the effective date of IFRS 17.
EFRAG considers that the necessary amendments to IFRS 4 Insurance Contracts extending the optional deferral of IFRS 9 need to be published as early as possible and, at the latest, before the end of June 2020 so as to enable timely endorsement within Europe before the current expiry date of 1 January 2021.

<u>EFRAG Question to Constituents</u>

73 Do you consider that the proposed deferral of the effective date to 1 January 2022 is sufficient or would you support an additional year (i.e. 1 January 2023)?

74 Arguments in favour of accepting the proposed effective date of 1 January 2022 include:
(a) Further delaying the application of IFRS 17 beyond 2022 will be disruptive, as will increase the costs of their implementation processes; and
(b) A delay beyond 2022 may encourage entities to defer their implementation efforts rather than using the extended period to better implement the Standard.

75 Arguments in favour of further delaying the effective date to 1 January 2023 include:
(a) Some entities, mainly small and medium sized ones, often rely on third IT systems providers and so far there are no IT solutions for IFRS 17 available on the market, thereby making it difficult to meet the proposed 2022 effective date;
(b) The IASB expects to finalise the amendments by mid-2020. As a result, there will only be six months before the comparative period for IFRS 17 starts and this may be challenging for some entities; and
(c) Entities that would like to apply IFRS 17 earlier would be able to do so.

General response:
We support the deferral of the effective date of IFRS 17 (and IFRS 9). Our members have been investing significant efforts in implementing IFRS 17 targeting at the currently proposed effective date, i.e. 1 January 2022. However, we are concerned on the IFRS 17 timeline in combination with the endorsement process in Europe as well as the different adoption approaches around the world, which might result in different effective dates in different jurisdictions. We would like to note the importance of a global effective date of the Standard as well as the aligned application of IFRS 17 and IFRS 9. A timely finalization of the discussions and publication of the revised IFRS is of high importance to provide clarity for the ongoing implementation projects.

System implementation is a significant component of adoption effort and operationalization of IFRS 17 has been challenging for many preparers as there is yet to be a complete commercially viable IFRS 17 system solution. Some companies have already seen significant delays from vendors in meeting key development milestones. Once available, significant efforts are required from insurers to integrate the solution into their financial reporting environment, perform impact studies, and educate and socialize the potential impacts to stakeholders. In addition, regulatory reporting, capital and taxation requirements are all based on the IFRS reporting in certain jurisdictions and it will take time to align all of these areas with IFRS 17.

Question 8 - Transition modifications and reliefs

Question 8 - Transition modifications and reliefs (paragraphs C3(b), C5A, C9A, C22A and BC119–BC146)
(a) Paragraph C9A proposes an additional modification in the modified retrospective approach. The modification would require an entity, to the extent permitted by paragraph C8, to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired. Paragraph C22A proposes that an entity applying the fair value approach could choose to classify such a liability as a liability for incurred claims. Do you agree with the proposed amendments? Why or why not? (b) The proposed amendment to paragraph C3(b) would permit an entity to apply the option in paragraph B115 prospectively from the transition date, rather than the date of initial application. The amendment proposes that to apply the option in paragraph B115 prospectively on or after the transition date, an entity would be required to designate risk mitigation relationships at or before the date it applies the option. Do you agree with the proposed amendment? Why or why not? (c) Paragraph C5A proposes that an entity that can apply IFRS 17 retrospectively to a group of insurance contracts be permitted to instead apply the fair value approach to that group if it meets specified criteria relating to risk mitigation. Do you agree with the proposed amendment? Why or why not?

EFRAG's response

<u>Transition relief for business combinations:</u>

EFRAG supports the IASB's proposals on transition relief for business combinations for both the modified retrospective approach and the fair value approach for practical reasons.

<u>Transition relief for risk mitigation – transition date:</u>

EFRAG assesses that the amendment to IFRS 17 to extend the option in paragraphs B115 to B116 of IFRS 17 is a step in the right direction.

However, EFRAG considers that retrospective application of the risk mitigation relief for contracts accounted for under the variable fee approach would provide more relevant information if entities are able to prove, using reasonable and supportable information, that a risk mitigation strategy was in place at the inception of the risk mitigation activity.

EFRAG considers that the wording in the ED is unclear as to whether retrospective application of the risk mitigation according to paragraph B115 is allowed when using reinsurance for risk mitigation purposes.

<u>Fair value approach:</u>

EFRAG considers that the possibility to apply the risk mitigation option of paragraph B115 from the transition date and the option to apply the fair value approach when the entity meets the conditions for risk mitigation in paragraph C5A of the ED are a step in the right direction. However, if the IASB accepts EFRAG's suggestion to allow retrospective application of the risk mitigation in paragraph B115, these two options are no longer necessary.

EFRAG Question to Constituents

94 Do Constituents agree with the approach suggested by EFRAG, i.e. to prefer retrospective application of paragraph B115 instead of supporting the two consequential amendments? Please explain why.

95 If you expect to apply the risk mitigation retrospectively under the approach proposed by EFRAG, how would you find the required evidence in practice? What would be the starting point for collecting the evidence and what process would you use?

General response:

Question 8a:

We support the proposed amendments as the proposed transition relief for the business combination reduces the operational complexity and the resulting financial information will be conceptually more meaningful. However, we believe that the proposed transition relief shall be also allowed for full retrospective approach and independent whether the acquisition is made before or after the transition date.

Treating incurred claims as a liability for remaining coverage after the acquisition date would confuse users, impair comparability with other portfolios existing pre-acquisition as well as comparability with peers and distort well-established Key Performance Indicators (KPIs) that users ask for (e.g., combined ratio). Given the frequently significant settlement time of insurance claims, the impact on the financial statements would maintain over many years.

From an economic perspective, there is no real "contract" behind the insurance coverage for adverse development. It is questionable who is receiving this insurance coverage. From the perspective of the original policyholder, the underlying insured event does not change. To treat liability for incurred claims as liability for remaining coverage after the business combination will impair the information relevance, as insurance revenue would be generated without transferring insurance coverage to the original policyholder. Therefore, we believe that the character of the claims in payment at the acquisition date should stay as it is before the acquisition, i.e. they should be treated as liability for incurred claims (LIC) instead of liability for remaining coverage (LRC).

From an operational perspective, a CSM and revenue would need to be determined for loss reserves, which is not foreseen in current systems/processes. This would introduce significant complexity. For some companies, it may require the capability to measure insurance contracts using the general model only if a future business combination takes place. Further, there were some business combinations among P&C insurance companies in recent years, which have solely short-duration contracts that are eligible for the premium allocation approach. At transition, the acquiring group can generally apply the full retrospective approach. As the proposed transition relief is not applicable for the full retrospective approach, the acquiring group would have to treat the claims incurred before the business combination date as a liability for remaining coverage, failing to apply the premium approach and therefore would need to set up the system capable for the general model. This increases significantly the operational complexity and the implementation costs.

Therefore, a further amendment to treat the incurred claims as liability for incurred claims for the business combinations going forward as well as for the business combinations for full retrospective approach would be needed. Such amendments in IFRS 17 would increase comparability and the relevance of the financial information.

Question 8b and 8c:

We welcome the proposed amendments with a prospective application of the risk mitigation from the transition date and allowing the fair value transition approach. However, while these amendments resolves some of our concerns, they do not resolve completely the issue for some blocks of business. We recommend that the risk mitigation option should be applied retrospectively on transition, provided that a proper documentation exists for the risk management prior to the date of initial application of IFRS 17. To allow a retrospective application of the risk mitigation option will better reflect the existing hedging arrangements and provide a more adequate opening CSM balance. In addition, reflecting risk mitigation retrospectively provides better information to the analysts and is fairer reflection of entity's risk mitigation activity that existed prior to transition date.

We note that if the risk mitigation were to be applied retrospectively, the proposed amendments in Question 8b and 8c would no longer be needed.

Question 9 – Minor amendments

Question 9 - Minor amendments (BC147–BC163)
This Exposure Draft also proposes minor amendments (see paragraphs BC147–BC163 of the Basis for Conclusions). Do you agree with the Board's proposals for each of the minor amendments described in this Exposure Draft? Why or why not?

EFRAG's response

EFRAG supports the IASB's proposal.

<u>EFRAG Question to Constituents</u>

99 Do Constituents consider that there are any unintended consequences arising from the minor amendments? Please explain.

100 EFRAG has heard two concerns which are described in the following paragraphs.

B128 of the amended IFRS 17

101 Paragraph B128 of the amendments to IFRS 17 clarifies that changes in the measurement of a group of insurance contracts caused by changes in the fair value of underlying items should be treated as changes in investments and hence as changes in the time value of money and financial risk. The concern is that there would be a misclassification between insurance service result and finance result requiring the presentation of non-financial items in the financial result.

Paragraph 28 of the amendments to IFRS 17 and paragraph 22 of IFRS 17

102 Paragraph 28 of the amendments to IFRS 17 indicate that in recognising a group of insurance contracts in a reporting period an entity shall include only contracts that individually meet one of the criteria set out in paragraph 25 of the amendments to IFRS 17. That is, based on:

(a) the beginning of the coverage period of the group of contracts;
(b) the date when the first payment from a policyholder in the group becomes due; and
(c) for a group of onerous contracts, when the group becomes onerous.

103 However, in paragraph 22 of IFRS 17, an entity shall not include contracts issued more than one year apart in the same group.

104 Using the issue date in paragraph 25 of the amendments to IFRS 17 instead of the recognition date for the grouping would have implications on, for example, for the discount rate and could create difficulties in terms of data availability causing operational issues and undue costs.

105 If you agree with either of the above two issues, please explain why this is an issue for you and the prevalence of the issue, including volumes and jurisdictions where the issue arises?

<u>General response:</u>

We support the proposed amendments set out in paragraphs BC147-BC163, except for the following points:

<u>Recognition of contracts within a group (paragraph 28 of IFRS 17, BC150)</u>

We support the minor amendment to paragraph 28. However, we strongly disagree with the clarification in BC150, which states that "*the intention of paragraph 22 of IFRS 17 is to refer to the time at which insurance contracts are issued, rather than recognized. Therefore, the Board is not proposing to amend paragraph 22 of IFRS 17".*

In our view, the objectives of the annual cohorts requirements, i.e. to appropriately depict trends in an entity's profit over time; to recognize profits of contracts over the duration of those contracts, and timely recognition of losses from onerous contracts, are met for both concepts (i.e. issue date or recognition date). However, to build up a group of contracts and therefore track them based on the issue date would require a data base which is not available in systems so far. An implementation of the "issued" approach would require significant change to the current systems and unduly disrupt the implementation projects.

We believe that conceptually it is more appropriate to align the date for the grouping with the recognition date than with the issue date. Grouping a contract that is not yet recognized into an established annual cohort would rather be confusing. To keep the date for the grouping consistent with the recognition date fits better to the way of how the entity manage its business. For example, for motor insurance, the tariff 2019 would be completely in one annual cohort, not divided in different groups because of different issue dates.

Overall, we believe that the requirement to use the issue date for the annual cohorts requirements would require substantial additional implementation costs which outweigh significantly the additional benefits it might have.

Therefore, we propose to remove the last sentence in BC150. If a clarification were deemed necessary, in our view, using the recognition date instead of the issue date for the annual cohort would better reflect the way how the insurance companies manage their business and therefore we would propose to amend IFRS 17.22 as follows:

> IFRS 17.22 "An entity shall not include contracts initially recognized, i.e. that meet one of the criteria set out in paragraph 25, ~~issued~~ more than one year apart in the same group."

<u>Excluding changes relating to the time value of money and assumptions that relate to financial risk from changes in the carrying amount of the contractual service margin (paragraph B96(c) of IFRS 17, BC157)</u>

The proposed amendment to paragraph B96(c) of IFRS 17 to not adjust the contractual service margin for any differences between investment components expected to become payable in the current period and the actual investment component, if those differences arise from changes in fulfilment cash flows due to the effect of the time value of money and changes in the time value of money and the effect of financial risk and changes in financial risk.

From a conceptual perspective, we generally support the minor amendment. However, the amendment implies a segregation of any unexpected investment component payments into a part which is due to a change in financial variables, and a part which is due to a change in non-financial variables. We believe, from an operational perspective, the determination of the actual investment component is already very complex and the segregation of the two effects will further increase the operational complexity.

We would rarely expect any material effects in practice, as for products that do not qualify for the VFA, significant changes in the surrender value/investment component due to changes in financial assumptions during the year are generally unlikely to occur.

The unexpected repayment of investment component which is due to a change in financial variables is not adjusting the CSM, but remains in the statement of financial performance. However, the amendment does not explicitly state whether to present it in the insurance service result or insurance finance result. We propose to clarify that it should be presented as part of the insurance finance result (as it is triggered by a change in fulfilment cash flows due to a change in financial variables). This will avoid mismatches in the presentation of the profit sources in the income statement.

<u>Treatment of changes in underlying items (paragraph B128 of IFRS 17, BC161)</u>

We understand that this amendment was introduced to solve the accounting mismatch for the contracts that are accounted for under the general measurement model but have participation features in non-financial items. We do see a need to resolve the issue. However, this should be done in a more targeted, less far-reaching way.

The current proposed amendment to paragraph B128(c) creates new issues for some contracts under the variable fee approach. A change in cash flows from participation in non-financial items, e.g. mortality or morbidity risk, would have to be presented in insurance finance result although it does not relate to financial results. Showing all changes in underlying items in financial result, as proposed in B128(c) would result in mispresentation in both insurance service results and insurance finance results. Note that any potential solutions should be reviewed in light of paragraphs 88 and 89 of IFRS 17 to ensure an adequate OCI solution is available to avoid further accounting mismatches.

<u>Level of aggregation for the variable fee approach eligibility criteria (paragraph B107b(ii))</u>

The proposed amendment to paragraph B107 b (ii) has changed the wording from “over the duration of the group of insurance contracts” to “over the duration of the insurance contract”. Neither the revised Basis for Conclusions, nor any other document explains why this change has been made.

We are concerned that this proposed amendment could be interpreted as to assess the eligibility for the variable fee approach on individual contract level, which is inconsistent with other principles of the standard: The unit of account for the CSM is the group of contracts and it is thus not possible to have a general model and variable fee approach in parallel within one group of contracts. However, the contract grouping has to be conducted before the assessment of the measurement model. As a consequence, the assessment has to be conducted for the entire group of contracts.

We currently assume that the eligibility test for the variable fee approach can be performed at the level of the group of contracts based on paragraph 24 of IFRS 17, which states that recognition and measurement should be performed at this level. If the proposed amendment to B107 b(ii) were meant to require the VFA test to be carried out at the contract level rather than the group of contracts, this would be a major change to our interpretation of the standard and would unduly disrupt the implementation projects. Such requirement would need to allocate all of the cash flows to individual contracts before the test can be performed. Mutualisation effects would also need to be allocated to contract level in all scenarios. Such a change would require significant additional effort and additional cost for all entities and would be inconsistent with the principles of IFRS 17.

Amendment to IFRS 3 Business Combinations (Appendix D of the Exposure Draft, BC162)

In addition to the treatment of the incurred claims in business combinations as noted in Question 8, we do not concur with the requirement to re-assess the classification of acquired contracts on the business combination date, rather than retaining the classification made at inception. Because it represents a further operational challenge. Especially if the new subsidiary includes contracts that change in nature during their life, applying current requirements will result in significantly different accounting treatments between the group and subsidiary financial statements. This increases significantly unnecessary complexity and costs. Therefore, we propose to not require the acquiring group to reassess the classification of acquired contracts in the course of the business combinations, but can retain the classification at contract inception.

Question 10 – Terminology

Question 10 - Terminology
This Exposure Draft proposes to add to Appendix A of IFRS 17 the definition 'insurance contract services' to be consistent with other proposed amendments in this Exposure Draft. In the light of the proposed amendments in this Exposure Draft, the Board is considering whether to make a consequential change in terminology by amending the terms in IFRS 17 to replace 'coverage' with 'service' in the terms 'coverage units', 'coverage period' and 'liability for remaining coverage'. If that change is made, those terms would become 'service units', 'service period' and 'liability for remaining service', respectively, throughout IFRS 17. Would you find this change in terminology helpful? Why or why not?

EFRAG's response

EFRAG agrees with the IASB making consequential changes in terminology as the CSM allocation now reflects services provided rather than being limited to insurance coverage.

EFRAG Question to Constituents

110 Do Constituents consider that there may be any unintended consequences arising from the proposed change in terminology? Please explain.

General response:

Although we understand the rationale for such changes, we are concerned that the changes would be widespread throughout the standard which might be rather disruptive at this late stage of the implementation projects, as the educational material and any further documents would need to be adjusted. Further, the proposed change in terminology might cause unintended consequences.

As noted in the response to Question 3, we support the proposed amendments to recognize the provision of investment-return and investment-related services in the amortization of CSM. However, the application of the new term "insurance contract services" (which comprises the services recognized in the amortization of CSM) has created confusion and unintended consequences. For example,

- Paragraph 34 – The definition of contract boundary has been changed by the restriction to "insurance contract services". This change would be significant (as well as disruptive); however, it appears to be unintended.
- Paragraphs 41(a), 83 – The amendments to these paragraphs conflict with the supporting paragraph B120 and therefore cause confusion.
- Appendix A (LRC) – Restricting the LRC to "insurance contract services" would be a significant and disruptive change; however, it appears to be unintended.

We respectfully suggest that the amendments related to the new term "insurance contract services" should be reversed from paragraphs 12, 34, 41(a), 83, 103, 104, Appendix A (LIC,LRC) and B65. Also, the amended definition of "coverage period" should not be used in paragraph 25 (recognition) or paragraphs 53-59 (PAA). Finally, though we could support a change from the term “coverage units” to “service units”, we likely would not support the other suggested changes as they potentially create further confusion.

Appendix 2 – Other comments arising from topics in EFRAG's September 2018 letter to the IASB that have not been addressed by the ED

Topic 1 – Annual cohorts

EFRAG's view

EFRAG agrees with the IASB's reporting objectives of the level of aggregation requirements in IFRS 17: depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses from onerous contracts.

EFRAG acknowledges that the annual cohort requirement is a trade-off between tracking individual contracts and ensuring the recognition of onerous contracts even where there are contracts with similar risks but different levels of profitability. Nonetheless, EFRAG considers that the requirement leads to unnecessary cost in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts.

EFRAG therefore believes that it is worth re-considering whether in certain cases the annual cohorts requirement is justified for such contracts. EFRAG recommends that the IASB consider developing an exception for such contracts, starting from paragraph BC138; the exception should be reflective of the reporting objectives of the level of aggregation requirements in IFRS 17.

<u>EFRAG Question to Constituents</u>

140 For contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts:

(a) EFRAG is suggesting to the IASB to provide an exception to the requirement to restrict the grouping of contracts using the annual cohorts. Would Constituents agree with this proposal? Please explain why or why not.

(b) Please provide fact patterns - and their prevalence - for which the application of the annual cohorts requirement results in added complexity that is not justified and, as a consequence, should be captured in such an exception. For example:

- (i) Contracts to which the VFA applies compared to other contracts;
- (ii) Contracts with full sharing of risks compared to other contracts that only share a substantial or significant part of the risks;
- (iii) Contracts that share all risks or only particular risk types; and
- (iv) Contracts with sharing of asset returns of underlying pools compared to other contracts.

141 As reported in paragraph 129, the exception should meet the reporting objectives of IFRS 17 (i.e. depicting profit trends over time, recognising profits of contracts over the duration of those contracts and timely recognising losses onerous contracts).

With reference to the pattern of recognition of the CSM, EFRAG in its case study received mixed results as to whether the resulting information would be impacted by the removal of the annual cohorts.

In your opinion, how would you ensure that the CSM release pattern would be in line with the IFRS 17 stated objectives? Do you envisage any loss of information as contemplated by the IASB in paragraph BC177 of the ED? If so, how would you address that loss of information?

142 Are there other types of contracts in the life insurance business, other than the contracts with cash flows that affect or are affected by cash flows to policyholders, that create similar complexity?

143 Some have observed that when a grouping approach broader than annual cohorts is applied, there is a benefit in providing additional information about trends in profitability. Such disclosure could include:
(a) Reconciliations for the CSM of those groups from the opening to the closing balances (according to paragraph 101 of IFRS 17)
(b) Disclosure on profitability trends by presenting the CSM effect of new business joining the groups, extracted from (a), as a series of historical data (for example, the last 3 years);
(c) Disclosure of the actuarial techniques applied for computing the CSM effect of new business joining the group as well as disclosure about the method used for assessing the profitability referred in (b).
Would Constituents consider it appropriate to include these additional disclosures?

General response:

We support EFRAG's suggestion to the IASB to provide an exception to the requirements of to restrict the grouping of contracts using annual cohorts. Many insurers issuing long term insurance contracts do not manage their business on an annual cohort basis. Measuring insurance contracts using groups that are inconsistent with the way the contracts are managed and regulated will not generate useful information.

As set out in the CFO Forum "IFRS 17 Priorities" document, which was has been discussed with EFRAG and the IASB, we believe that as a minimum IFRS 17 should include an exception to the requirement to restrict the grouping of contracts using annual cohorts for mutualised portfolios measured using the variable fee approach.

In addition, we believe that relief from the use of annual cohorts is needed for in-force business in transition, under all transition approaches. This proposed amendment would result in a significant reduction in the cost and effort of completing IFRS 17 transition using a retrospective approach.

Using annual cohorts for contracts with significant intergenerational risk sharing is not useful and requires implementing accounting processes which are not aligned with the economics of the business. Just after having been issued, a new contract (to the extent that it is not onerous) is part of the mutualisation and the initial information provided by the individual CSM becomes non-pertinent: there is only a mutualised CSM for the total portfolio including the newly added products. Once a policyholder has joined a mutualised population, the margin contributed by this contract is linked to the mutualised portfolio and not to the sole contract. When policyholders accept to share significant risks, a contract does not become onerous (for the insurer) unless the mutualisation among policyholders is not sufficient to cover the risks. There is no onerous contract in a mutualised population except if the whole population becomes onerous. In most cases in many jurisdictions these contracts are eligible to apply the VFA.

In an intergenerational mutualised portfolio, the mandatory allocation of the CSM to annual cohorts under IFRS 17 requires discretion from the insurer and consequently does not necessarily better reflect the performance or the profitability of each cohort. In practice, profitability would be assessed at a mutualised level and then allocated to cohorts so that providing information at cohort level is purely artificial. We therefore do not concur with a view that removing such information would lead to a loss of useful information.

With regard to the need for transparency about trends in profitability, we note that such information is already provided by the combination of the existing requirements to disclose the amount of CSM contributed by new business and to disclose movements in the CSM balance for in-force portfolios.

Topic 2 – Transition: Modified retrospective approach and fair value approach

EFRAG's view

EFRAG is aware that the modified retrospective approach and the fair value approach are two different measurement bases resulting in different outcomes that are not comparable, with the modified retrospective being the approach that aims to approximate the full retrospective approach which applies the most useful information.

EFRAG acknowledges the IASB decision not to allow further modifications to the modified retrospective approach, as this would further reduce comparability. However, in order to address the implementation challenges and prevent that a strict interpretation unduly restricts the use of retrospective approaches, EFRAG recommends that the IASB acknowledges in the main text of the final standard that the use of estimates is allowed, including those needed to approximate the missing information.

EFRAG also suggests that the IASB clarify that the 'reasonable and supportable information' criterion is not intended to change the judgement ordinarily required in IAS 8 to make estimates.

EFRAG Question to Constituents

155 Please provide specific prevalent fact patterns where the application of the modified retrospective approach is proving particularly challenging in practice. This would assist EFRAG in understanding better the interpretation difficulties arising in obtaining reasonable and supportable information and in estimating missing information that is required to apply the modified retrospective approach.

General response:

We support the comments made by EFRAG.

We believe that the modifications currently permitted under the modified retrospective approach, as set out in paragraphs C9 to C19 of IFRS 17, are too restrictive and a strict interpretation would unduly restrict the use of modified retrospective approach in practice. If the modified retrospective approach is not improved, insurers will be forced to use the fair value approach, even where reasonable approximations other than the modifications permitted in the standard would be possible for many portfolios. Whilst the fair value approach is a helpful practical expedient in some cases, it may not provide an appropriate profit recognition pattern in all cases, depending on the final interpretation of the fair value.

We believe the modified retrospective approach should be more principle-based. The prescribed modifications shall be considered as non-exhaustive examples with a more general principle to allow reasonable approximations to be made. This change would retain the objective of the modified retrospective approach but allow greater flexibility for insurers to apply it based on the extent of retrospective data that are available. This would allow entities to make more use of the retrospective transition approaches which may rather improve the comparability amongst insurers than the current default to the fair value approach.

Topic 3 – Balance sheet presentation: Non-separation of receivables

EFRAG's view

EFRAG agrees with the decision of the IASB to retain the requirements in IFRS 17 on balance sheet presentation, without a mandatory separate presentation of premiums receivable.

EFRAG Question to Constituents

161 Do Constituents support the presentation of separate information about premiums receivable? If so, should information about premiums receivable:

(a) be mandatory?

(b) be based on a predefined definition of "premium receivables" and , in this case, how should premiums receivable be defined?

(c) be provided on the face of the balance sheet or in the notes?

(d) be separated by insurance portfolio?

Response to EFRAG:

We support the comments made by EFRAG.

We don't believe information about premiums receivable is mandatory. It should be each company's choice whether to disclose that information separately or not.

Appendix 3 – Further topics that arise after the IASB re-deliberations and had not been considered in the past

VFA mechanic issue – Unlocking of CSM for the changes in non-underlying cash flows

Fact pattern

In the course of the implementation, there is one issue identified, which may neither have been considered as the standard was developed nor picked up through the EFRAG field testing last year. However, as the implementation project proceeded, we realized that the respective contracts seem wide-spread around the world in sizeable volumes.

The topic relates to the accounting for the contracts under the variable fee approach (VFA), as they fulfil the criteria in IFRS 17.B101, but which also contain certain non-participating features. For the cash flows arising from these features are not covered by underlying items.

We are aware of the following examples, for which the concerned issue appears relevant:

- Variable annuities with a participating accumulation phase covered by underlying items and a non-participating annuity phase not covered by underlying items.
- Variable annuities with GMxB or guarantees that are **not covered by underlying items**.
- Certain unit-linked contracts with non-participating risk riders, for which the unbundling of the components are not permitted.

Accounting consequences

These products qualifies for the VFA based on an assessment against the criteria in IFRS 17.B101 at inception, even though there is a non-trivial part of future cash flows which may not vary based on changes in the underlying item. For example, at the time of eligibility assessment the non-variable annuity pay-out phase of the variable annuity may have had less weight compared to the variable cash flows in the participating accumulation phase.

Applying the current requirements to these contracts containing cash flows not arising from underlying items would result in significant accounting mismatches in profit or loss. Because according to IFRS 17.B113(b), the changes in the time value of money (TVoM) and financial risk not arising from underlying items shall adjust the CSM, while the investment result from the general account investments backing the non-participating future cash flows is directly recognized in profit or loss in the current period. Consequently, the CSM might be eaten up rapidly, giving rise to a loss component, although economically the contract is not onerous.

We understand and acknowledge that any solution to this issue might be difficult to develop. However, we consider a solution to this issue an absolute necessity in order to obtain a consistent, reasonable accounting framework for such insurance contracts that have been described in the fact pattern. Otherwise, applying the current requirements to these contracts containing cash flows not arising from underlying items would result in significant accounting mismatches in profit and loss.

The accounting issue presented above is not just a theoretical issue, but it is a "real-world" problem affecting a multitude of common insurance contracts in different jurisdictions.

Illustrative example

- Contracts with three-year participating accumulation phase (assets in separate account) and subsequent life-contingent non-participating annuity payout phase (assets on general account)
- $10,000 up-front premium, 5% expected return (= risk free rate), 2% variable fee
- Direct par contract determined at inception of contract (hence VFA accounting model)
- Life-contingent annuitization of accumulated amount (paid out equally over ten year assumed life expectancy). Annuity phase within contract boundary
- The policyholder does not participate in any investment result during annuity phase
- Mortality assumed only during annuity phase
- No minimum annuity, just pay-out of the accumulated amount
- Investment during pay-out phase: cash flow matching of expected annuitization pay-outs invested in bonds (earning 5% coupon payments)

Our understanding of the Standard:

- CSM is unlocked for changes in TVoM not arising from underlying items (B113(b))
- IFRS 9 investment result on non-underlying bonds is recognized directly in P/L and does not unlock the CSM

As shown in the table and graph below, the lack of underlying items in the annuitization phase results in a frontloaded & distorted P&L

1. Overstated total profit in year 4 (first year of annuitization), because TVoM adjusts CSM (balance sheet) rather than being presented as insurance finance expense (P&L).
2. Understated total profits in years 6-13, because there is no CSM to release (due to past erosion), while service is still being provided to the policyholder.
3. Spread appears between Line 4 (asset income) & Line 2 (losses on onerous), not within total Finance Result, because TVoM is presented in insurance service result (loss on onerous) rather than in insurance finance expense.

Statement of Financial Results	0	1	2	3	4	5	6	7	8	9	10	11	12	13
Line 1 - CSM release		141	144	147	43	-	-	-	-	-	-	-	-	-
Line 2 - Loss on Onerous		-	-	-	-	(297)	(430)	(385)	(337)	(288)	(236)	(181)	(124)	(63)
Insurance Service Results		141	144	147	43	(297)	(430)	(385)	(337)	(288)	(236)	(181)	(124)	(63)
Line 4 - Investment result		465	477	489	539	496	451	404	354	302	248	190	130	67
Line 5 - Insurance finance result		465	477	489	-	-	-	-	-	-	-	-	-	-
Finance Result		-	-	-	539	496	451	404	354	302	248	190	130	67
Total Profit/Loss		141	144	147	582	199	22	19	17	15	12	9	6	3
Balances														
FV Underlying	10,000	10,465	10,942	11,431	-	-	-	-	-	-	-	-	-	-
BEL	8,967	9,380	9,813	10,267	9,451	8,594	7,694	6,749	5,757	4,715	3,621	2,472	1,266	-
CSM (Loss Component)	1,033	943	843	731	175	(297)	(696)	(995)	(1,186)	(1,259)	(1,203)	(1,002)	(637)	(63)