EFRAG
European Financial Reporting Advisory Group

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS ON IFRS 17 INSURANCE CONTRACTS AS AMENDED IN JUNE 2020

Once filled in, this form should be submitted by 29 January 2021 using the 'Comment publication link' available at the bottom of the respective news item. All open consultations can be found on EFRAG's web site: Open consultations: express your views.

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

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

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

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

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

Your details

1 Please provide the following details:

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

Actuarial Association of Europe

(b) Are you a:

☐ Preparer ☐ User X Other (please specify)

Actuarial Association of Europe

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

The Actuarial Association of Europe (AAE) was established in 1978 under the name Groupe Consultatif to represent actuarial associations in Europe. Its purpose is to provide advice and opinions to the various organisations of the European Union – the Commission, the Council of Ministers, the European Parliament, EIOPA and their various committees – on actuarial issues in European legislation. The AAE currently has 36 member associations in 35 European countries, representing over 26,000 actuaries. Advice and

comments provided by the AAE on behalf of the European actuarial profession are totally independent of industry interests.

The vision of the Actuarial Association of Europe (AAE) is for actuaries throughout Europe to be recognised as the leading quantitative professional advisers in financial services, risk management and social protection, contributing to the well-being of society, and for European institutions to recognise the valuable role that the AAE plays as a leading source of advice on actuarial and related issues.

The strategic objective no. one of the AAE is to:

Establish and maintain relationships with key European institutions, so that the AAE can effectively provide them with high quality professional advice to improve the soundness of decisions from an actuarial perspective.

- Play a prominent role in shaping the development of new European legislation, and in the review and refinement of existing legislation, affecting the work of actuaries in traditional areas and in wider fields as actuaries extend their areas of involvement;
- Reinforce existing relationships with the European Commission and EIOPA;
- Build and enhance relationships with the European Parliament and the Council of the EU; and
- Maintain contact with other European organisations such as industry and consumer protection bodies.

The AAE currently has 36 member associations in 35 European countries, representing over 26,000 actuaries. Advice and comments provided by the AAE on behalf of the European actuarial profession are totally independent of industry interests.

(d) Country where you are located:

Belgium

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

1 Place du Samedi, B-1000 Brussels, Belgium

secretariat@actuary.eu

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

Note to the respondents: *Appendix II presents EFRAG's reasoning with reference to all requirements in IFRS 17 apart from the application of the annual cohorts requirement to some contracts specified in paragraph 6 of Annex A within Annex 1 (those contracts are conventionally referred to in this questionnaire, in the Cover Letter, in its Appendices and Annex as 'contracts with intergenerationally mutualisation and cash-flow matched contracts'[1], or 'intergenerationally mutualised and cash flow matched contracts'. Annex 1*

[1] For a description of the affected contracts please refer to paragraphs 8 to 28 of Annex A to Annex 1 of the endorsement package relating to IFRS 17.

presents content of this requirement that contribute positively or negatively to the technical criteria on this matter.

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

- The EFRAG Board has concluded on a consensus basis that, apart from the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts, as explained in the attached Cover Letter, on balance, all the other requirements of IFRS 17 meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support 'economic decisions and the assessment of stewardship and raise no issues regarding prudent accounting. EFRAG has concluded that all the other requirements of IFRS 17 are not contrary to the true and fair view principle.
- EFRAG Board members were split into two groups about whether the requirement to apply annual cohorts to intergenerationally mutualised and cash-flow matched contracts meet the qualitative characteristics described above.
  - (i) 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.
  - (ii) 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 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.

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

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

X Yes ☐ No

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

(b) Having considered the technical arguments for those that support and those that oppose the application of annual cohorts to intergenerationally-mutualised contracts, as described in Annex 1, and having considered the two views from the EFRAG Board above does the requirement to apply annual cohorts to

intergenerationally-mutualised contracts (within the context of paragraphs B67-B71 of IFRS 17) meet the qualitative characteristics described above? Please explain your technical reasons for supporting your view.

☐ Yes X No

First, AAE would like to remind of its comments on EFRAG's draft comment letter on the IASB's ED/2019/4 amendments to IFRS17 released on September 2, 2019 (https://actuary.eu/memos/comments-on-eiopas-analysis-of-ifrs-17-insurance-contracts/ please see the annex at the end of this text) about the issue of annual cohorts. Basically, AAE stated that, in some several Continental European jurisdictions (notably France, Germany, Italy, Austria, Switzerland, Denmark and we can now add Norway), requiring annual cohorts for these mutualized contracts would not be effective if the fulfilment cash flows arising from the insurance contracts cannot be reliably allocated to each cohort using adequate metrics consistent with the economics and the characteristics of the cash flows.

Secondly and consistently with this view, AAE has asked its members to elaborate on how they were preparing themselves to implement IFRS 17. Countries for which mutualized contracts do not exist or are not material did not naturally flag any implementing issues about these contracts. However, we observe that among members in jurisdictions, where mutualized contracts are material, 2 sets of views exist:

1. One that is considering a pragmatical way to implement the annual cohorts in order not to postpone IFRS 17's implementation because the issue could jeopardize both the date of first-time application and the universality of the standard;
2. One that is consistent with a theoretical opposition to applying annual cohorts to mutualized contracts because any short-cut method to implement will be flawed by essence.

Thirdly, based on technical documentation[1], the AAE has reached the following technical conclusions:

i. Policyholders of mutualized contracts have no individual contractual right to any subset of the underlying items and the fair value returns from the latter are shared across all generations of policyholders through management's allocation of discretionary benefits;
ii. Splitting portfolios into annual cohorts requires allocation of change in fair value of underlying items to these subgroups;
iii. Different actuarial methods do exist and are conducive of significant different results when measuring the CSM of annual cohorts. The more granular the grouping, the more complex these allocations get and explicit modelling of cross-portfolio cash-flows may be is impossible for real-life portfolios with multiple groups;
iv. Some markets are considering methods such as an "MCEV marginal approach" to implement because it seems the most consistent with the objective of the standard:
    a. However, there are different views and sub-views about this approach: some measure the CSM of a new cohort on a marginal approach (i.e. measurement of the additional contribution of the new generations of contract to the portfolio) and subsequent measurements of the change of the CSM at

portfolio level are allocated to each group based on a systematic and rational driver. Those drivers comprise amount of CSM at the beginning of the period, discounted future loadings, value of in force, mathematical reserves etc. With this approach, the CSM of a group of contracts can be onerous even if the portfolio is profitable. A group of onerous contracts can become 'profitable' in subsequent measurements if the drivers enable an allocation of the change in the CSM to the onerous groups of contracts. Other insurers advocate that profit sharing contracts "fully share risks" and have therefore the same profitability. The absence of cohort would not change the pattern of profit recognition. The CSM of the new cohort is measured with a marginal approach in order to identify and isolate any onerous groups of contracts. Any new profitable cohort is added to the portfolio and the CSM is followed at portfolio level.

v. Even though these approaches are constructive and bring some information to insiders, these results may be providing misleading, not comparable and miss-understandable information for the users of the accounts. Reliability and relevance can also be questioned if these individually customized methods designed to fit a particular risk-profile and its management were to be standardized or uniformly implemented to each and every single company.

Finally, it is noteworthy to mention the following two facts about the thinking of the IASB about the matter:

i. In its agenda paper 2B of February 2020 and added basis for conclusions, notably BC139R-S, the staff and the IASB have considered that for some products that share common features, implementing the annual cohort requirement might result in costs outweighing the benefits of the resulting information see paragraph 27 of the mentioned paper). Our understanding of the recommendation not to allow for an exemption to annual cohorts to such contracts relied on the following notable points: the sole cost-benefit analysis (i.e. not the relevance of the requirement), the practical and arbitrarily difficulty to define a precise scope to the exemption and the resulting complexity that would disrupt implementation. It seems to us that supporting a requirement that is not reflecting the economic reality will leads to other arbitrariness and to information that is not comparable and understandable for a population of contracts which is material in several jurisdictions;

ii. As mentioned in IFRS17.BC261, when the Board rejected the mirroring approach to account for participating contracts, it gave credibility to the feedback that it would be difficult for entities to separate and measure separately the different components of the insurance contract. Some suggested that any decomposition of interrelated cash flows would be arbitrary, and that separate measurement would lead to different valuations of an insurance contract depending on arbitrary decisions. Our recollection is this arbitrariness was dealing much with the assessment of the cash-flows to be allocated to the policyholders and it had also been demonstrated

the instability of the method. It seems to us that annual cohorts lead to the same arbitrariness that once has been considered as a fatal flaw by the Board.

This leads the AAE to conclude that:

1. From a practical point of view, the requirement for annual cohorts is burdensome and operationally complex without producing any relevant information that could reflect an economic true view;
2. Attempting to attribute profitability to a lower level of granularity – this means to annual cohorts – does not reflect the management of the portfolio and would require numerous assumptions to allocate the overall profit to this lower level that does not exist economically;
3. The most commonly shared and relevant unit of account that would lead to comparable and understandable figures is the group of contracts without annual cohorts;
4. However, conscious of the implementation process and of the views of our members, we suggest to give an option to preparers to apply or not annual cohorts to the mutualized contracts as defined in Appendix 1 even though we would have preferred the solution we had suggested in September 2019.

[1] Notably i) the way the German market is currently considering implementation of annual cohorts, ii) an Austrian example and iii) the French example documented by the French National Standard Setter.

Annex 1:

AAE COMMENTS ON EFRAG'S DRAFT COMMENT LETTER ON THE IASB'S ED/2019/4 AMENDMENTS TO IFRS 17

September 2, 2019

Annual cohorts

We agree with EFRAG that it is worth reconsidering whether the annual cohort requirement is justified in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts, and that an exception for these contracts should be made.

We think that reaching the three qualitative objectives of the IASB (to appropriately depict trends in an entity's profit over time, to recognise profits of contracts over the duration of those contracts, and to recognise losses from onerous contracts on a timely basis) can be dealt by additional disclosures in the notes rather than through an overly complex, costly, judgmental and potentially arbitrary accounting process that may not give a true and fair view of the underlying profitability of these contracts.

In some large Continental European jurisdictions (notably France, Germany, Italy), requiring annual cohorts for some mutualized contracts would not be effective if the fulfilment cash flows arising from the insurance contracts cannot be reliably allocated to each cohort using adequate metrics consistent with the economics and the characteristics of the cash flows.

Indeed, some of these contracts clearly imply that no annual cohort of policyholders has a contractual right to any subset of the underlying items and that the fair value returns from the latter are shared across generations of

policyholders through management's allocation of discretionary benefits. In that context, annual cohorts create a costly and artificial allocation of future discretionary benefits between annual groups that does not reflect the contractual and economic features of contracts. This is because the initial allocation of benefits – if annual cohort was applied – would need to be reconsidered in every subsequent year in order to take into account the actual, new and subsequent allocations decided by the entity to all mutualized contracts, regardless of their underwriting year.

For the purpose of achieving comparability between preparers, it seems more reasonable that no accounting figures should be based on a method that cuts across actual management, pricing and risk-management decisions in this way. Therefore, we suggest additional disclosures in the notes for the contracts benefitting from this exception, e.g.

1. Qualitative disclosure about the portfolios of mutualized contracts, their grouping criteria and the underlying supporting items;
2. Reconciliations for the CSM from the opening to the closing balances;
3. Disclosure of profitability trends of the new business of these portfolios (past and expected recognition of future CSM);
4. Disclosure and explanation of the actuarial techniques for measuring the value of the new business and the allocation of underlying items between back-book and new business.

AAE would be glad to present a more thorough description of its view and of the underlying actuarial issues as this requires a lengthier and more detailed technical document to do so. Resolution of this issue is an urgent matter given the complexity of implementation of annual cohorts and the time available to implement the standard.

(c) Having considered the technical arguments for those that support and those that oppose the application of annual cohorts to cash-flow matched contracts, as described in Annex 1, and having considered the two views from the EFRAG Board above does the requirement to apply annual cohorts to cash-flow matched contracts meet the qualitative characteristics described above? Please explain your technical reasons for supporting your view.

☐ Yes ☐ No

The AAE did not collect sufficient information to express a qualified and strong opinion in relation to annual cohorts applied to cash-flow matched contracts.

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

Yes. The AAE identified three additional issues of importance:

1 In November 2020, the AAE published a discussion paper outlining a couple of proposals for a more formal role for actuaries in relation to IFRS 17. The AAE encourages EFRAG to take the proposals into consideration in its advice to the European Commission. We elaborate in our response to question 20, and

further information can be found here: https://actuary.eu/memos/roles-of-actuaries-in-relation-to-ifrs-17/

2 CSM Release – Systematic backloading of CSM release for VFA contracts. We elaborate in our response to question 20

Potential OCI mismatch for VFA business with modified retrospective approach for transition. We elaborate in our response to question 20.

Part II: The European public good

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

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

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

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

X Yes ☐ No

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

- EFRAG Board members were split between two groups, as described in the Cover Letter and above, with reference to the requirement to apply annual cohorts for contracts with intergenerational mutualisation and cash-flow matched contracts.

(b) Having considered the technical arguments for those that support and those that oppose the application of annual cohorts to intergenerationally-mutualised contracts, as described in Annex 1, and having considered the two views from the EFRAG Board above, is the requirement to apply annual cohorts to intergenerationally-mutualised contracts (within the context of paragraphs B67-B71 of IFRS 17) conducive to the European public good? Please explain your technical reasons for supporting your view.

☐ Yes X No

In addition to the comments mentioned under question 2B, the AAE is concerned with the cost and complexity in the reporting requirements as well

as the comparability and accounting volatility. The last point is exemplified in the example below:

Annual Cohorts for intergenerational mutualized business – Example

Complementary to AAEs COMMENT ON EFRAG'S ASSESSMENTS ON IFRS 17 INSURANCE CONTRACTS AS AMENDED IN JUNE 2020 the AAE wants to demonstrate, based on a simple example, that the requirement of annual cohorts for intergenerationally-mutualised contract leads to artificial accounting volatility.

For intergenerationally-mutualized contracts overall figures like Contractual Service Margin, Market Value Returns for Assets or Future Cash-Flows have to be derived on the level of the portfolio that is managed together respectively local laws like profit-sharing regulations that are in place.

In order to report on an annual cohort level a split to this lower level of granularity must be implemented. Attempting to attribute the Future Cash-Flows to annual cohort appropriate methods and numerous assumptions are required.

AAE demonstrates based on different methods that both seem to be appropriate to split overall figures like Contractual Service Margin, Market Value Returns for Assets or Future Cash-Flows to a lower aggregation level like annual cohorts. In practice there might be further methods in place.

Based on the results – as well in the CSM as in the P&L – it will be shown that these KPIs might differ significantly. These examples show that for intergenerationally-mutualized contracts the split to a lower level of granularity – annual cohorts – lead to artificial volatility that cannot reflect any economic truth.

The following examples show three different cohorts measured with three different methods/metrics in order to allocate the changes of CSM to annual cohort in a systematic and rational way.

Basis for the following two examples is focus only investment result, in a scenario with a 1 percentage point shift in the interest rate. The Market Value of Assets will increase by 400 while the Present Value of Future Profits will increase by 500. The GAP of 100 reflects a typical Asset-Liability-Mismatch for traditional business.
The Change in Present Value of Future Cash-Flows are calculated based on the reserve and duration. The impact of the P&L is based on a linear coverage period simplified for any cohort, i.e. P&L impact is reflected as 1/remaining duration. For simplification all examples assume no onerous cohorts when deriving the p&l impacts of the actual year.

Example 1a aggregates the Market Value Return from 400 based on the reserve to the cohorts. **Example 1b** aggregates the Market Value Return based on the Present Value of Futures profits. Both assumptions seem to be reasonable but lead to different results in CSM as well as in P&L.

Method 1a:	Market Value Return of Assets: split by reserve						
	reserve		duration	Market Value Return of Assets	Change in PVFCF	Change in CSM	impact in P&L
cohort1	5.000		1	182	50	132	132
cohort2	5.000		3	182	150	32	11
cohort3	1.000		30	36	300	-264	-9
	11.000			400	500	-100	134

Method 1b:	Market Value Return of Assets: split by PVFP						
	reserve		duration	Market Value Return of Assets	Change in PVFCF	Change in CSM	impact in P&L
cohort1	5.000		1	40	50	-10	-10
cohort2	5.000		3	120	150	-30	-10
cohort3	1.000		30	240	300	-60	-2
	11.000			400	500	-100	-22

These two examples show different results that result dependent which assumption was used for the aggregation to the annual cohorts.

Method 2 intends to take into account also technical (mortality, expense,…) profits and therefore defines a CSM ratio at initial recognition for each annual cohort. The change in CSM is aggregated based on this CSM ratio to annual cohorts.

Method 2:	CSM split by CSM at inception						
	reserve	CSM ratio at inception	duration	Market Value Return of Assets	Change in PVFCF	Change in CSM	impact in P&L
cohort1	5.000	5%	1	40	50	-5	-5
cohort2	5.000	35%	3	120	150	-35	-12
cohort3	1.000	60%	30	240	300	-60	-2
	11.000	100%		400	500	-100	-19

These methods are reliable methods based on appropriate assumptions but lead to different results. Inclusion of effects from onerous contracts might make the results even less comparable. The mutualized business is managed on a higher level and any cut down to a lower aggregation level can just be done on any rational approach but leads to results that are neither comparable nor meaningful as results on annual cohort level do not exist in a business that is managed together.

Furthermore, the introduction of any of these methods for aggregation results back to annual cohorts are complex and cost intensive and lead to arbitrary figures without any economic truth.

For the purpose of achieving comparability between preparers, it seems more reasonable that no accounting figures should be based on a method that cuts across actual management, pricing and risk-management decisions in this way.

By considering the inhomogeneity of the management of intergenerationally-mutualized contracts and the local profit-sharing regulations, the AAE advises an option to apply for the annual cohorts based on the general regulations in place.

(c) Having considered the technical arguments for those that support and those that oppose the application of annual cohorts to cash-flow matched contracts, as described in Annex 1, and having considered the two views from the EFRAG

Board above, is the requirement to apply annual cohorts to cash-flow matched contracts conducive to the European public good? Please explain your technical reasons for supporting your view.

☐ Yes ☐ No

The AAE did not collect sufficient information to express a qualified and strong opinion in relation to annual cohorts applied to cash-flow matched contracts.

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

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

The European Commission and the European Parliament asked EFRAG to provide its views on a number of specific matters, that are presented below.

Improvement in financial reporting

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

Do you agree with this assessment?

X Yes ☐ No

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

Costs and benefits

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

Do you agree with this assessment?

X Yes ☐ No

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

We believe that the benefits will outweigh the costs provided the principles contained in the Standard can be consistently interpreted by preparers, leading to consistency of valuation models, assumptions and methodologies with consequent positive impact on understandability, reliability and comparability. We propose one approach to enabling this consistency in our response to Q20 below.

Other factors

Potential effects on financial stability

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

Do you agree with this assessment?

X Yes ☐ No

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

Potential effects on competitiveness

(Appendix III paragraphs 227 to 286)

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

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

Do you agree with this assessment?

X Yes ☐ No

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

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

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

EFRAG commissioned a study from an economic consultancy. This study ('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[2] EIOPA quantitative thresholds).

(a) Do you agree with the assessment on pricing and product offerings?

X Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

(b) Do you agree with the assessment on asset allocation?

X Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

(c) Do you agree with the assessment on SMEs?

X Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

Presentation of general insurance contracts

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

Do you agree with this assessment?

X Yes ☐ No

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

[2] 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.

Interaction between IFRS 17 and Solvency II

10 EFRAG concludes that in implementing IFRS 17, there are possible synergies with Solvency II, but the extent of such synergies varies between insurers. In addition, no synergies are expected for building blocks that are specific to IFRS 17 such as the contractual service margin which is not 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. the 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 401 to 412).

Do you agree with this assessment?

X Yes ☐ No

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

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

11 On financial stability, refer to the conclusions in paragraph 6 of this Invitation to Comment.

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

On procyclicality and volatility, EFRAG believes that IFRS 17 has mixed effects on procyclicality. IFRS 17 may result in more volatile financial performance measures because of the use of a current measurement. However, from the evidence collected, it is not likely that this volatility 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 there is no linkage between the accounting equity (cumulative retaining earnings) and amounts available for distributions, which are defined within the requirements of Solvency II or within the requirements at national level, independently from the IFRS accounting. Finally, EFRAG notes that the transparent nature of the IFRS 17 information has the benefit for investors to be able to react timely to any changes at hand, thereby avoiding cliff-effects. (Appendix III paragraphs 483 to 507).

(a) Do you agree with the assessment on long-term investment?

X Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

(b) Do you agree with the assessment on procyclicality and volatility?

X Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

IFRS 17 and IFRS 9

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

In EFRAG's view, asset allocation decisions are driven by a variety of factors and disentangling the impact of accounting requirements from other factors is difficult. When defining the accounting for financial assets under IFRS 9, an insurer would not apply business models determined in isolation, but rather business models that are supportive of or complementary to their 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 has assessed the different tools that both standards offer to mitigate accounting mismatches. EFRAG assesses that:

(a) 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);

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

(a) Do you agree with the assessment on the application of hedge accounting?

X Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

(b) Do you agree with the assessment on the treatment of OCI-balances and risk mitigation?

X Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

Application of IFRS 15

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

Do you agree with this assessment?

X Yes ☐ No

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

Implications of transitional requirements

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

Do you agree with this assessment?

X Yes ☐ No

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

Please note our comment in relation to question 17.

Impact on reinsurance

15 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 criteria even though IFRS 17 states that they cannot be insurance contracts with direct participation features. However, EFRAG assesses that the risk mitigation option would largely address the accounting mismatches, thereby balancing relevant information. In addition, for reinsurance contracts held that are used to recover losses from the underlying contracts, EFRAG considers that the Amendments provide relevant information as they aim at reducing accounting mismatches which is present under the original version of the Standard (Appendix II paragraphs 63 to 74, 210 to 216, 274 to 275, 349 to 352, 395 to 397).

Do you agree with this assessment?

X Yes ☐ No

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

Implementation timeline

16 Feedback from the Limited Update to the Case Studies shows that the delay to the effective date of IFRS 17 to 1 January 2023 results in higher one-off implementation costs for preparers. However, the delay is also helping preparers to adjust their project approaches to the operational difficulties of the Covid-19 crisis. EFRAG understands from preparers that they may choose to avoid these costs by revisiting solution designs or may make more use of internal (cheaper) resources. Furthermore, according to the Limited Update to the Case Studies and other feedback from insurance associations, most of the participants did not intend to early apply IFRS 17, whereas a small minority wanted to have this possibility. EFRAG is not aware of any European insurer having taken a firm commitment to early apply the Standard. Finally, EFRAG notes that IFRS 17 requires a presentation of restated comparative information when applying the Standard for the first time. However, IFRS 9 does not have similar requirements for financial assets and liabilities (Appendix III paragraphs and 609 to 613).

(a) Do you agree with the assessment relating to delay of IFRS 17 implementation till 2023?

☐ Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

Not assessed by the AAE.

(b) Do you agree with the assessment relating to early application?

☐ Yes ☐ No

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

(ii) Do you have any other observations that you think is relevant for EFRAG's endorsement assessment on this topic? Please explain.

Not assessed by the AAE.

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

X Yes ☐ No

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

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

Notes to the respondents: *Respondents are reminded that responses to this Invitation to Comment will be made public on EFRAG's website. EFRAG is also inviting respondents to share quantitative data and to allow confidentiality of this information, constituents are kindly invited to submit these data separately from the Invitation to Comment. Such quantitative data can be sent to ifrs17secretariat@efrag.org. Only aggregated resulting data will be made public in the subsequent steps of the due process and will be presented in an anonymous way.*

The intergenerationally-mutualised and cash-flow matched contracts are specified in paragraph 6 of Annex A within Annex 1.

18 As stated in paragraphs 5 to 9 of Annex 1:

(a) What is the portion of intergenerationally-mutualised contracts and cash-flow matched contracts of all life insurance liabilities and all insurance liabilities? Please report the results for these two types of contracts separately where relevant.

Not assessed by the AAE.

(b) Please indicate the proportion of contracts with intergenerational mutualisation (within the context of paragraphs B67-B71 of IFRS 17) for which the requirement around annual cohorts is considered a significant issue. Please specify the share that would qualify for VFA.

Not assessed by the AAE.

(c) Please describe the approach you envisage to implement the annual cohorts requirement to contracts with intergenerationally-mutualised contracts (within the context of paragraphs B67-B71 of IFRS 17).

Not assessed by the AAE.

(d) Please indicate the proportion of cash-flow matching contracts for which the requirement around annual cohorts is considered a significant issue. Please specify how the features of the contracts compare with the description provided in Annex A of Annex 1.

Not assessed by the AAE.

(e) Please describe the approach you envisage to implement the annual cohorts requirement to cash-flow matched contracts.

Not assessed by the AAE.

Part V: Questions to Constituents raised in Appendix III

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

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

Not assessed by the AAE.

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

Not assessed by the AAE.

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

Not assessed by the AAE.

Part VI: EFRAG's overall advice to the European Commission

20 Do you have any other comment on, or suggestion for, the advice that EFRAG is proposing to give to the European Commission?

Issue 1: The role of actuaries

In November 2020, the AAE published a discussion paper outlining a couple of proposals for a more formal role for actuaries in relation to IFRS 17. The AAE encourages EFRAG to take the proposals into consideration in its advice to the European Commission.

A full copy of the paper can be found here:
https://actuary.eu/memos/roles-of-actuaries-in-relation-to-ifrs-17/

The abstract of the paper is repeated below:

The AAE welcomes many aspects of the improvements targeted by the IFRS 17 standard. However, the AAE recognises the complexities in the new regime and calls for a prominent role for qualified actuaries both in entities required to comply with IFRS 17 and in auditors in carrying out their assurance work relating to relevant insurance companies.

IFRS 17 as a principle based standard leaves considerable room for interpretation and inconsistency in assumptions and methodology between entities. The AAE observes that one way of dealing with the complexity associated with the principles, and securing a more harmonised approach, is to encourage the use of standardised methodologies and actuarial principles executed by professionals who are qualified through education and experience in assessing the value of insurance liabilities.

Consequently, the AAE believes that actuaries can and should be required to take statutory roles relating to the preparation by insurance companies and groups of IFRS 17 accounts, and that the involvement of actuaries in this way would add professionalism and consistency to the valuation of insurance liabilities under IFRS 17. The AAE believes that such roles should be defined as part of the accounting regulatory framework for insurance companies and groups reporting under IFRS 17.
In considering the audit of IFRS 17 accounts, the AAE recognises the auditors' statutory roles and responsibilities in relation to preparing and auditing financial statements, and the AAE proposes to cooperate with the audit profession to define the best possible statutory framework for actuaries and auditors to cooperate. This should in our opinion involve a requirement for auditors to engage with actuarial experts in auditing IFRS 17 insurance liabilities.

We expect that these proposals would contribute to a consistency in methodology and interpretation which would support some of the key aims of the IFRS 17 standard.

The AAE will be available to expand on these proposals, as well as to define further the framework which might apply for required roles of actuaries in preparers and auditors, and to consider additional education and standards which might be useful for its members to help them discharge their requirements.

Issue 2: CSM Release – Systematic backloading of CSM release for VFA contracts

For contracts accounted under the VFA (variable fee approach), the release pattern of the CSM is under continuous discussion in several countries. Auditors, actuarial associations and companies observed that so called "pure volume based" patterns, i.e. coverage units are defined on simple volume based values such as reserves for insurance services, give rise to a systematic distortion of the CSM release that can be observed by a backloaded quota of CSM release / coverage units in long term projections of IFRS 17 balance sheet and p&l.

The pure volume based pattern are generally thought to be generic when applying the IFRS 17 as outset e.g. by the IDW (German institute of auditors).

There are two main sources for the backloading of the CSM release pattern:

- Companies expect (for their strategic asset allocation) systematically higher investment income than reflected in the interest rate curve used for valuation of the LRC. As a consequence there is an expected systematic real world unlocking of the CSM that cannot systematically released according to services provided when using pure volume based coverage units.
- The reduction of uncertainty measured in the options and guarantees over time also results in a systematic CSM unlocking. Again, the use of pure volume based coverage units implies a backloaded CSM release. As a consequence the CSM release pattern (at least partly) refelects the release of uncertainty rather than the fulfilment of services.

Consequence: A pure volume based release pattern in general will

- not only backload the CSM release relative to service provided (and therefore be in conflict with IFRS 17 B.119)
- but also lead to a significantly overstated CSM after the first years of the implementation of IFRS 17 (in the years 2025 ff.) if companies continue to pay dividends according to the actuarial profit generation patterns – partly set out in the regulatory framework of the policyholder participation in gross profits e.g in Germany.

As a consequence the financial results are distorted and equity will be significantly understated in the IFRS 17 balance sheets of life insurance companies in markets where the VFA is applicable.

Approaches to avoid systematic backloading of the CSM release:

Several solutions have been and are still discussed in local actuarial and auditor associations. For example, the IDW (German institute of auditors) issued a paper on adjustments of the coverage units to avoid backloading of the CSM release for systematically expected investment returns higher than interest rates used for valuation of the LRC.

Nevertheless, a general solution to address this highly critical topic should be addressed by European associations or the IASB itself. Even if the examples of the issue and of the solution reflect the perspective of the German traditional market, the general issue of backloading of the CSM release are not specific to a local market. The sketched backloading of the CSM emerges in any traditional market.

References – IDW (German)

Issue 3: Potential OCI mismatch for VFA business with modified retrospective approach for transition

In contrast to IFRS 17, in IFRS 9 a comparative prior period is not required. So, for direct participating business the opening balance sheet for IFRS 17 at 1st January 2022 is derived from financial assets as underlying items accounted for under IAS 39. For the period 2023, this might lead to an accounting mismatch in OCI amounts between IFRS 17 liabilities and IFRS 9 financial assets. To remediate this potential mismatch an adjustment of the OCI amount of IFRS 17 liabilities on 1st January 2023 using the OCI amounts of underlying items under IFRS 9 would be helpful.