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EIOPA's comments on EFRAG's draft endorsement advice on IFRS 17 Insurance Contracts

Dear Mr Gauzès,

Thank you for the opportunity to comment on EFRAG's draft endorsement advice and assessments of IFRS 17, as amended in June 2020. EIOPA supports EFRAG in its conclusion that – on balance – IFRS 17 meets the requirements for endorsement in line with the IAS Regulation. Regarding the issue on which EFRAG Board is split, i.e. IFRS 17's requirement to allocate profits of a portfolio of insurance contracts based on 'annual cohorts', EIOPA wants to provide its views to help the EFRAG Board in reaching consent on its endorsement advice for IFRS 17.

As you may be aware, EIOPA analysed[1] IFRS 17 from a European supervisory and regulatory perspective to foster a better understanding of the implications and potential impacts of the standard on European insurance and reinsurance undertakings, as well as to provide insights into the future interplay between insurers' financial and prudential reporting. Overall, EIOPA found that the expected increase in transparency and comparability of insurers' financial statements prepared under IFRS 17 would provide better insights into insurers' business models and have the potential to strengthen financial stability in the European Economic Area (EEA). Consequently, EIOPA regards the implementation of IFRS 17 as beneficial for the European public good: IFRS 17's current, market-consistent and risk-sensitive measurement of insurance obligations better reflects economic reality, which supports efficient risk management and allows stakeholders to gain important insights into the entity's business model, exposures and performance.

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

[1] EIOPA (2018): EIOPA's analysis of IFRS 17 Insurance Contracts, EIOPA-18-717, October 2018; https://eiopa.europa.eu/Publications/Reports/EIOPA-18-717_EIOPA_Analysis_IFRS_17_18%2010%202018.pdf.

consequently, may give rise to inconsistent implementation by insurance undertakings and hurdles to the comparability of the results. EIOPA emphasizes the high importance of monitoring the actual implementation of the requirements regarding the discount rate and the risk adjustment and suggests following up on these topics in a post-implementation review by the IASB. Similarly, EIOPA would have supported a more principle-based approach to determining the appropriate level of aggregation to measure the profitability of insurance contracts. EIOPA maintains its the views that the aggregation by annual cohorts is a key area to assess the efficiency of the standard in a post-implementation review by the IASB.

EIOPA observed that, contrary to stakeholders' strong pushback, the IASB - concluding on the amendments to IFRS 17 - decided that annual cohorts are necessary to provide useful information about an insurance company's financial performance, in particular about changes in profitability over time. In the IASB's view, any exemption from the requirement, even if aimed at a limited population of contracts, for which stakeholders challenge the cost-benefit assessment of the requirement, would risk losing important information. EIOPA understands that the IASB's decision was taken based on two key considerations that refer to the potential consequences of the deletion of - or partial exemption from - the annual cohort requirement:

- the risk of valuing together different groups of contracts with significantly different levels of profitability, so that actual pricing differences in different reporting periods could be obscured;
- the risk of delaying the recognition of onerous contracts, which could be mixed with profitable contracts for a number of years.

Further, EIOPA wants to mention that the IASB has specifically considered the issue of reporting the performance of 'mutualised contracts', which are at the core of the concerns of a few Member States considering their local life-insurance market. In the Application Guidance to IFRS 17 (paragraph B67) the IASB explicitly allows for the fulfilment cash flows to take into consideration the effects of 'mutualisation', i.e. where the cash flows of a contract are affected by other groups of contracts or other contracts within a portfolio. That means the cash flows allocated to a new group of contracts reflect the effects of the existing contracts and therewith determine the contractual service margin to be allocated to the new group of contracts. Subsequently, that contractual service margin has to be allocated in line with the pattern of service provision. The allocation of the actual performance and profits to a group of contracts is important to ensure transparency and relevance of the performance reporting. To minimise the use of judgement in the performance reporting, a standard approach, here the allocation to an annual cohort, has the benefit of ensuring consistent application. Leaving open the methodology for the necessary profit allocation to a group of contracts would impair the transparency on the profitability of the insurance or reinsurance undertaking.

EIOPA supports that EFRAG has paid particular attention to European stakeholders' concerns on the annual cohort requirement. However, EIOPA notes that even though a number of ideas to replace the annual cohort requirement were explored, as set out in Annex 1 of the draft endorsement advice, EFRAG did not identify a viable alternative to the annual cohort requirement. As EFRAG seems to consider advising on the endorsement of IFRS 17 potentially without the annual cohort requirement for 'intergenerationally-mutualised and cash-flow matched contracts', EIOPA wants to mention that - from EIOPA's perspective - an adapted EU-IFRS 17 may lead to undesired consequences:

- incomparability of EU IFRS-financial statements to financial statements in other jurisdictions, triggering reconciliation requirements for EU insurance undertakings listed in different jurisdictions and additional reporting costs; and
- necessity to fill the unregulated void when exempting all or specified contract types - with the necessity to clearly identify the exempted contract types -, which would contradict the spirit of the IAS Regulation[2].

The IAS Regulation, as the legal basis for the adoption and use of IFRSs in the EU and therewith the IFRSs' endorsement into EU law, was designed with a view to harmonising the financial information presented by the respective entities within the EU and globally, to ensure a high degree of transparency and comparability of financial statements and hence, an efficient functioning of the Community capital market and of the Internal Market. Any EU-specific adaptation to IFRSs would necessitate reconciliation efforts for undertakings listed at non-EEA stock exchanges and for international groups consolidating non-EEA subsidiaries – as well as communication efforts of the entities to provide sufficient information to financial analysts, enabling reasonable comparability with non-EEA insurance or reinsurance undertakings. For the reasons that led to the use of IFRSs in the EU, as set out by the IAS Regulation, to foster consistent and comparable financial statements, any modifications leading to EU IFRSs would impair the benefits of the use of IFRSs in the EU with regards to financial stability and the European public good.

Concluding, whilst EIOPA would have preferred a more principle-based approach to profit allocation in IFRS 17, in EIOPA's view, IFRS 17's annual cohort requirement should not distort the overall assessment of the standard or impede the endorsement of IFRS 17 in EU law.

Yours sincerely,

[2] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards; OJ L 243, 11.9.2002, p. 1–4.