This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Level of aggregation – Grouping contracts on maturity date
Issues Paper

Objective

1 The objective of this paper is to discuss the suggestion of grouping insurance liability contracts based on maturity date instead of inception date.

2 The EFRAG Secretariat will provide an oral update on the inputs received from EFRAG IAWG on the topic.

Grouping contracts based on maturity date

Description of the approach

3 Some have argued that insurance liability contracts could be grouped based on maturity date instead of inception date. The paragraphs below describe how this approach is applied by one particular insurance entity.

4 Scope: grouping by maturity date is applied to profit-sharing contracts with a combination of early guaranteed return and profit sharing in which 90% of the unrealised changes in the fair value of the portfolio assets held for each portfolio is allocated to the policyholder. Unbundling is used for separating the insurance risk from the savings component of the insurance contracts.

5 Contractual maturity date: all contracts in this category have a stated maturity date.

6 Underlying asset buffers: No collective (underlying asset) buffers are used. The entity relies on dedicated asset buffers that are kept separately for each contract. The guarantee is yearly as well as the profit-sharing, so assets need to be added to the portfolio if the return on the assets is insufficient to pay the guaranteed amount.

7 Number of groups used: The entity does not focus on the number of groups to be created, rather the aim is to reflect asset management by maximising returns given the entity's risk appetite.

8 That focus on the asset-liability management implies that the risk profile in the portfolio is reduced the closer that portfolio value is to the accrued minimum guaranteed amount and the closer to the start of paying out the value of the insurance policy.

9 The asset management is similar to that for "generation funds". These funds have a high-risk profile when there is a long time before they start to pay out, while the risk profile is much lower when it is close to payment. Therefore, there is no need to have an exact maturity profile matching. For example: all contracts with more than 20 years to maturity is held in one portfolio, 20 to 15 years are in another portfolio etc. So, when the liabilities fulfil the criteria to be moved to another portfolio, the

liability as well as the corresponding assets values are transferred to the other portfolio.

10 How is profit determined? A distinction is made between the savings component, the insurance risk component and the administrative component.

(a) *Savings component*: the calculation is made for each separate insurance contract, as a result the entity has an exact proportion of each separate portfolio that "belongs" to the savings component of the insurance liability.

(b) *Insurance risk component*: Unbundling is used. The total pure insurance risk is calculated, regardless of maturity and compared with the initial balance of the insurance risk. Premiums received are allocated during the life of the insurance contracts. The net of the insurance premium income and the change in the insurance liability are recognised in profit or loss as risk result.

(c) *Administrative component*: the premiums for administrative services are recognised during the life of the insurance contracts and presented together with the cost of the management of the contracts.

11 Application of mutualisation: No mutualisation is applied for the savings component.

EFRAG Secretariat analysis

12 The EFRAG Secretariat notes that this approach as applied by the entity:

(a) Relates to particular insurance contracts only, not to all types of insurance contracts;

(b) Requires a follow up of the savings component at individual contract level, which may not be applied by the majority of European insurance companies; and

(c) Makes use of dedicated underlying asset funds. While this approach is more common, some European insurance entities rely rather on general asset funds to support (all or part of) their insurance liabilities.

13 In the EFRAG's Secretariat's view the approach to group contracts by maturity date is likely to lead to the creation of more groups compared to IFRS 17. This is because, when writing life policies, for contracts written during 2017, groups could range from ending immediately (people dying immediately after subscribing an insurance) until for example 2087 (consider a 20-year old that subscribes a policy and is expected to live until 90 years old).

14 The EFRAG Secretariat understands that the creation of an excessive number of groups is avoided by combining groups into maturity bands spanning several years, even decades. This approach reduces the reliability of the assumptions to be used for calculating the insurance liability. For example, when using a discount rate for the 15-20-year time band, which discount rate is to be used? The one at year 15, year 20, an average of the data points on the discount yield curve spanning from year 15 till 20?

15 In addition, this approach does not clarify how changes in the yield curve across time bands is addressed in the measurement of the insurance liability. For example, a yield curve may go down in years 13 and 14, but move upwards in years 15 and 16 or vice versa.

16 Considering the above, the EFRAG Secretariat is of the view that the approach to group insurance contracts based on maturity dates:

(a) Has a limited scope where supporting assets relate directly to the insurance liabilities;

(b) May require a follow up of insurance contracts on an individual basis;

(c) If shortcuts by using maturity bands are not used, requires the continual creation of new groups of existing contracts, with consequent difficulties in allocating any unearned profits to groups on a consistent basis;

(d) If shortcuts by using maturity bands are not used, increases the number of groups to be created; and

(e) In using shortcuts by using maturity bands for constructing groups, reduces the reliability of the resulting measurement.

Question for EFRAG TEG

17 Do EFRAG TEG members think that aggregation based on remaining duration of contracts will achieve the objectives set by the IASB in developing the level of aggregation requirements?