Building a better
working world

Ernst & Young Global Limited
6 More London Place
London
SE1 2DA

Tel: +44 20 7980 0000
Fax: +44 20 7951 1345
ey.com

Mr. Jean-Paul Gauzès
President of the EFRAG Board
EFRAG
Square de Meeûs 35
B-1000 Brussels
Belgium

29 January 2021

Dear Mr. Gauzès

EFRAG Invitation to comment – draft letter to the European Commission regarding endorsement of IFRS 17

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on EFRAG's draft letter to the European Commission regarding endorsement of IFRS 17 ('draft letter').

In May 2017, the International Accounting Standards Board (IASB) issued IFRS 17 Insurance Contracts (IFRS 17) and, in June 2020, it issued amendments to that standard. IFRS 17 will have a profound impact on the accounting for insurance contracts and is also expected to have a significant operational impact on the insurance industry globally.

Given the importance of IFRS 17, which will greatly affect users and other stakeholders including market regulators, some supervisors and auditors in the European market, we appreciate the extensive efforts EFRAG has undertaken in preparing its draft letter.

In the draft letter, the EFRAG Board concludes on a consensus basis that, apart from the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts, on balance, all the other requirements of IFRS 17: (i) meet the IAS Regulation technical endorsement criteria; and (ii) are conducive to the European public good. Regarding intergenerationally-mutualised and cash-flow matched contracts, the EFRAG Board is split on whether applying the annual cohorts requirement for such insurance contracts would result in relevant and reliable information and would be conducive to the European public good.

We acknowledge that practical issues will arise for insurers seeking to apply the annual cohort requirement, particularly within the context of intergenerationally-mutualised contracts. We understand the key concerns that stakeholders have raised in this area. We noted this in our comment letter in response to the June 2019 Exposure Draft (ED), recommending that the IASB carefully consider these concerns and evaluate whether any solutions merit further analysis when re-deliberating the comments on the ED. We have included the relevant observations on this matter from our comment letter in the appendix attached to this letter.

In the light of these concerns, we understand why the draft letter extensively analyses and flags the concerns arising from the application of annual cohorts to intergenerationally-mutualised and cash-flow matched contracts. At the same time, we also note that the IASB re-deliberated the annual cohort issue in its February 2020 meeting and identified several challenges and complexities that would arise in attempting to resolve the issue. One of these challenges is the difficulty of determining the scope of contracts that might qualify for exception to the annual cohort requirement. As a result, the IASB decided not to make any changes to the annual cohort requirements and retained the existing requirements as issued in 2017.

On balance, and acknowledging the legitimate concerns that have been raised, we believe that the advantages to all stakeholders, including insurance companies and users of financial statements, of having a globally consistent accounting standard for insurance contracts outweigh the costs of applying the annual cohort requirements for this business. Contracts with intergenerationally-mutualised and cash-flow matched features also exist in other jurisdictions and any differences in how such contracts are accounted for across jurisdictions could impair transparency and comparability across the insurance industry globally. Ultimately, we believe that all stakeholders, from both within and outside the EU, would benefit from a globally consistent principles-based IFRS standard for insurance contracts, which would call for the EU to endorse IFRS 17 as issued by the IASB without introducing any changes as part of its endorsement process. It would then be the responsibility of the various stakeholders, such as preparers, regulators and auditors, to find practical ways to apply the annual cohorts in a suitable manner considering the available guidance and the specific circumstances of a jurisdiction.

As we have already commented on the technical aspects of IFRS 17 extensively in our comment letters to the IASB throughout the various due process stages of its insurance contracts project, we have not provided any further responses to the questions included in EFRAG's invitation to comment and refer to our comment letters to the IASB.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas, EY Global IFRS Leader at the above address or on +31 (0)8840 75035, or Kevin Griffith, EY's Global Insurance IFRS 17 Leader on +44 (0)20 7951 0905.

Yours sincerely,

Ernst + Young Global Limited

Appendix: Observations regarding contracts subject to mutualisation
(as included in Appendix 2 of EY Comment Letter, dated 25 September 2019, to the IASB's June 2019 Exposure Draft Amendments to IFRS 17)

Considering the requirement in paragraph 22 of IFRS 17 that an entity may not include contracts issued more than one year apart in the same group (annual cohorts' requirement), EY supports the objective of the Board to:

- Recognise profits from contracts as services are provided,
- Account for losses from onerous contracts in a timely manner, and
- Report timely information about changes in the expected profitability from insurance contracts (paragraph BC165 of the ED).

These objectives should in our view apply to all types of products covered by IFRS 17.

In some jurisdictions, products are issued that are designed in such a way that policyholders collectively share in some (or all) of the risks of a group of contracts, and the shareholder (insurer) is only affected to the extent that policyholders collectively no longer absorb losses. This type of business is often referred to as 'mutualised business'. We observe that, in a number of jurisdictions where such products are issued, concern has been expressed by stakeholders that the application of the annual cohort requirement to these types of products would cause complexities that, in their view, would be unwarranted. For example, contractual terms and discretionary features require the application of mechanisms for determining the sharing of benefits among generations of policyholders (sometimes referred to as 'intertemporal mutualisation'). Against the backdrop of such mechanisms, allocating IFRS 17 fulfilment cash flows to individual underlying annual cohorts may, according to these stakeholders, not be achieved without a high degree of arbitrariness and undue complexity. In that context, annual cohorts are seen by them as a costly and artificial allocation of benefits between annual groups that does not reflect the contractual and economic features of the contracts. These stakeholders believe that the objective of appropriately depicting trends in an entity's profit over time may be achievable through means other than a strict application of the annual cohorts requirement.

We note that different solutions have been suggested by stakeholders, from further clarifying paragraph BC138 of the standard and/or elevating it into the standard itself, to removing the annual cohort requirement for mutualised business but requiring additional disclosures about profitability over time. We recommend that the Board carefully considers these proposals on their merits, to explore whether a pragmatic balance can be found between achieving the aforementioned objectives of the Board for mutualised products, and a pragmatic approach that will result in consistency among preparers for the same types of contracts and maintain auditability by the audit profession.