RÉPUBLIQUE FRANÇAISE

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AUTORITÉ DES NORMES COMPTABLES

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PDC n°2

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BELGIUM

EFRAG's Draft Endorsement Advice on IFRS 17 *Insurance Contracts*

Dear Jean-Paul,

I am writing to you on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned Draft Endorsement Advice (DEA).

This DEA is a major milestone in the development of an IFRS Standards for insurance contracts. It is the outcome of EFRAG's extensive work performed over many years. EFRAG analysed thoroughly and diligently the IASB's proposals and reached out to many stakeholders to both ensure that such proposals were operational and assess their expected effects at European level. This unprecedented work is reflective of EFRAG's mission—ie to serve the European public good. This mission does not only consist in providing an *independent* technical assessment of the IFRS Standards subject to the European endorsement process but also in *proactively* interacting with the IASB to help shape standard-setting in the interest of the European Union. ANC notes that EFRAG's role has been particularly instrumental in (i) helping stakeholders understand the overarching requirements in IFRS 17 and (ii) leading the IASB to amend IFRS 17 to respond to stakeholders' concerns and challenges in relation to the implementation of the new Standard. ANC commends EFRAG for its proactive role over the past years and thanks all stakeholders who provided input to EFRAG's work.

ANC has always been supportive of a robust IFRS Standard for insurance contracts. IFRS 4 *Insurance Contracts* is a 'temporary' Standard that has well-known limitations. Accordingly, we think IFRS 4 needs to be replaced. However, we think that the need for a new IFRS Standard is not, in and of itself, a sufficient reason to accept any new requirement without any further analysis or any critical mind. This is why we have participated in the assessment of the requirements in IFRS 17 and have provided both EFRAG and the IASB with extensive technical input—through technical contributions in particular—about the most essential aspects of the Standard. Some stakeholders might have interpreted ANC's contribution to the standard-setting and endorsement processes as a sign of our opposition to the development of a new IFRS Standard. This is untrue. This is just the indication that ANC supports the development of IFRS Standards that provide the most useful information and EFRAG's role in providing an independent assessment of the requirements in those Standards.

ANC has mixed views on IFRS 17. We acknowledge that the IASB kept ongoing dialogue with stakeholders after the issuance of IFRS 17 in May 2017 to improve this Standard. This resulted in the publication of the *Amendments to IFRS 17* in June 2020 which addressed many, *but not all*, concerns raised by European and French stakeholders. Accordingly, the revised version of IFRS 17 that is now subject to the endorsement process still includes requirements that, in our view, are unsatisfactory because they are based on debatable conceptual bases or do not reflect the way entities manage their insurance contracts. Those requirements may fail to result in information that is fully useful whilst entailing unnecessary implementation costs. In other words, we think there is still headroom for improvement in IFRS 17.

However, we think it is now time to move ahead with the implementation of the new Standard and entities must apply IFRS 17 no later than 1st January 2023. We note that the *Post Implementation Review of IFRS 17* is going to be an essential milestone in assessing the efficiency of this Standard—this will help take stock of the matters that, in ANC's view, IFRS 17 does not still adequately address. In contrast, we think there is one matter whose resolution cannot be deferred after the first time application of the Standard: the requirement in paragraph 22 of IFRS 17 to not include contracts issued more than one year apart in the same group of insurance contracts ('annual cohort requirement' throughout this letter). ANC, together with many French stakeholders, still think this requirement, when applied to insurance contracts of a certain type, is unable to provide information that is relevant, reliable and comparable. Such insurance contracts may be found in some European jurisdictions only but account for highly material amounts in the financial statements of the affected entities—in France, for example, the life insurance contracts to which this requirement would unduly apply accounted for 75 per cent of the total insurance liabilities recognised in the 2019 prudential balance sheets of insurance entities. We think this matter is sufficiently material to warrant close scrutiny at European level and thus, we appreciate EFRAG's extensive work undertaken in that respect.

- **Assessment of the requirements in IFRS 17—excluding the application of the annual cohort requirement to intergenerationally-mutualised contracts**

We still have significant reservations about the accounting in IFRS 17 for (i) reinsurance contracts (ii) contracts acquired during their settlement period when a business combination or a portfolio transfer occur and (iii) the presentation of an entity's financial statements. We think that EFRAG's tentative conclusions on those matters could have been more nuanced than currently stated in the DEA. Notwithstanding those reservations, we think those matters are not sufficiently material to affect EFRAG's endorsement advice. Accordingly, we agree with EFRAG that the requirements in IFRS 17, excluding the requirement to apply the annual cohorts to intergenerationally-mutualised contracts, meet, *on balance*, the technical criteria for endorsement as set out in the Regulation (EC) No 1606/2002 of the European Parliament and of the Council for the adoption of IFRS Standards.

Appendix A to this letter sets out our comments in relation to these requirements. In particular, this appendix sets our comments about the three above-mentioned matters, together with some other matters (such as the interaction between IFRS 9 *Financial Instruments* and IFRS 17) that, we think, the IASB could have better addressed. We think that most of those matters will deserve close attention no later than when the IASB performs its *Post Implementation Review of IFRS 17*—and when the IASB performs its *Post Implementation Review of IFRS 9* for some matters. We also think that the IASB should contemplate, on the short term, amending IFRS 9 to remove:

- the prohibition of applying this Standard to items that have been derecognised at the date of initial application of IFRS 9—this prohibition impairs comparability while resulting in excessive implementation costs. Such standard-setting would significantly facilitate the joint implementation of IFRS 17 and IFRS 9 without delaying their first time application.
- the prohibition of 'recycling' in profit or loss the changes in the fair value of equity instruments that an entity elects to present in other comprehensive income. This matter is subject to close scrutiny in Europe. We encourage EFRAG to carefully monitor any further development in this respect.

- **Application of the annual cohort requirement to intergenerationally-mutualised contracts**

ANC has consistently expressed strong reservations about applying the annual cohort requirement to some insurance contracts. We note this requirement has no strong conceptual basis and is a convention. We also note that the IASB introduced this requirement at a very late stage in the standard-setting process, more as an anti-abuse measure than anything conceptually based, having failed to develop a robust principle-based approach for the aggregation of insurance contracts. Had this requirement ever been exposed as such, we think the IASB would have gathered evidence that this requirement fails to provide useful information for some insurance contracts and thus, is not the appropriate way forward to defining the unit of account for such contracts.

The IASB has not changed its view on this requirement despite widespread calls in Europe to reconsider it. ANC still disagrees with the requirement to apply the annual cohort requirement to intergenerationally-mutualised contracts. Such contracts account for an important proportion of the life insurance contracts issued in several countries of the European Union, especially in France. We think this requirement fails, in those circumstances, to meet the technical criteria for endorsement—we think in particular it provides information that is not relevant, reliable and comparable. We also think it brings no benefits to financial reporting and thus, results in unnecessary high implementation costs. Consequently, we think this requirement is not conductive to the European public good.

Appendix B to this letter sets out our detailed technical analysis in relation to the annual cohort requirement—Appendices C and D supplement this appendix.

Some stakeholders acknowledge that the annual cohort requirement raises conceptual and practical challenges but say that there is no viable alternative option to this requirement. This justifies, in their view, a status quo. ANC thinks the view whereby there would be no alternative approach is untrue. Alternative approaches do exist. ANC, together with some other European stakeholders, have had a proactive approach to this matter by outlining the limitations of the annual cohort requirement and proposing technical solutions[1]. We regretfully note that the IASB rejected our proposals that would have resulted in narrow-scope amendments to IFRS 17. Some stakeholders also acknowledge the existence of alternative views but say that any exemption to the annual cohort requirement could undermine IFRS 17 or could result in an unacceptable loss of useful information. In contrast, we think that applying a requirement that results in no useful information and is not conducive to the European public good would be unacceptable. We also think that defining an exemption to a simplistic convention would be an acceptable approach.

- **EFRAG's advice to the European Commission**

Consistent with our explanations above, we think that EFRAG should conclude that all the requirements in IFRS 17 except for the requirement to apply the annual cohort to intergenerationally-mutualised contracts meet, *on balance*, the technical criteria for endorsement and are conducive to the European public good.

We appreciate EFRAG's efforts to provide an assessment of the annual cohort requirement, in particular by setting out in Annex 1 to its draft Cover Letter the views of those supporting, and those opposing, that requirement. Even though we disagree with some observations included in that document, we think such a thorough assessment is needed given the materiality of the underlying matter. However, we think the technical limitations of this requirement, together with its implications on the European public good, are of such an extent that EFRAG should make a recommendation in this respect—it should recommend this requirement be not endorsed for intergenerationally-mutualised contracts. We also strongly recommend to carefully assess whether this requirement meets the endorsement criteria for 'cash-flow matched' contracts that exist in some European jurisdictions and that establish mechanisms of in-substance mutualisation[2].

We note the views of those advocating for a swift application of IFRS 17 and thus, expressing concerns about the potential effects of EFRAG not recommending the endorsement of the annual cohort requirement for intergenerationally-mutualised contracts. ANC does support the application of IFRS 17 from 1 January 2023. However ANC does think the need for a new IFRS Standard for insurance contracts should not come at any cost and force EFRAG to skate over the major limitations of the annual cohort requirement. In addition, ANC notes that EFRAG's role is to provide a technical advice on the requirements in IFRS 17, not to dwell, or opine, on the possible endorsement due process implications of its recommendations—such considerations are beyond EFRAG's remits. We are confident that the European due process is sufficiently mature to (i) consider any matter that EFRAG would outline and (ii) develop, on a timely basis, any required remedial action.

In our view, EFRAG should recommend the endorsement of all the requirements in IFRS 17 except for the requirement to apply annual cohorts to intergenerationally-mutualised insurance contracts (and to cash-flow matched contracts if need be). Such a nuanced approach in a Final Endorsement Advice (FEA) would not be unprecedented—ANC reminds that EFRAG concluded on September 2015 in its FEA on IFRS 9 that this Standard was conductive to the European public good, *except for* the impact on the insurance industry. However, we acknowledge that EFRAG's decisions are made by consensus. We also acknowledge, on the basis of past discussions at EFRAG TEG and Board's levels, that views are tentatively mixed in relation to the annual cohort requirement. Accordingly, should no consensus be reached after having considered the feedback on this ITC, we think EFRAG's Final Endorsement Advice should not conclude on this matter. Consistent with the approach retained for the issuance of this DEA, the FEA should present an indicative vote of EFRAG's Board together with the views supporting the majority and minority views.

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[1] Our letter dated 15 May 2020 and Appendix B to this letter include a description of ANC's proposed exemption to the annual cohort requirement.

[2] Those contracts are not widespread in France but ANC understands that stakeholders in other jurisdictions have raised valid concerns about whether the annual cohort requirement meets the criteria for endorsement when applied to such insurance contracts.

Appendix E includes a letter from the *Compagnie Nationale des Commissaires aux Comptes* (the French auditors' institute) that supports the views expressed in our comment letter—in particular our view on applying the annual cohort requirement to intergenerationally-mutualised contracts.

Should you need any further information, please do not hesitate to contact me.

Yours sincerely,

Patrick de Cambourg

Appendix A—Comments on EFRAG draft Appendices II and III to the DEA (excluding comments on the annual cohort requirement)

- **Overall drafting policy for the appendices**

1. ANC notes that EFRAG has tentatively assessed in Appendix II to the DEA whether the requirements in IFRS 17 meet the technical criteria for endorsement as set out in Regulation N° 1606/2002 ('the qualitative characteristics' hereafter), having analysed twenty topics it deemed relevant in the context of the endorsement process. This analysis consisted in assessing each topic against the aforementioned technical criteria. Paragraph 1 of Appendix II to EFRAG's DEA sets out the criteria applied to select those topics. ANC notes it had the opportunity to comment on many of those topics in past comment letters to EFRAG and agrees with EFRAG's selection of topics.
2. For each topic, EFRAG provided a description of the applicable requirements in IFRS 17 and of the concerns that various stakeholders expressed on some of those requirements. EFRAG explained how those requirements could potentially fail to meet one, or several, qualitative characteristics while outlining the counterarguments that, in EFRAG's view, could mitigate that risk. This led EFRAG to tentatively conclude that some requirements met the qualitative characteristics and that some others did not fail to meet the qualitative characteristics. EFRAG tentatively concluded that, *on balance*, the requirements in IFRS 17 meet the applicable qualitative characteristics—the draft cover letter reflects this 'on balance' assessment.
3. ANC agrees with EFRAG's overall approach in that respect. ANC holds the view that EFRAG's role is to provide a balanced assessment of the requirements in IFRS Standards ie highlighting the merits but also the limitations of the requirements included in those Standards. This is part of EFRAG's public accountability.
4. IFRS 17 supersedes IFRS 4 *Insurance Contracts* that was published in 2004. IFRS 4 is a 'temporary' Standard which mainly consisted of 'grandfathering' existing accounting policies pending the completion of a comprehensive approach for the accounting of insurance contracts. Accordingly, all stakeholders are well-aware of the limitations of IFRS 4. Having said that, ANC thinks the objective of replacing IFRS 4 with IFRS 17 in due time should not lead to understate, or even ignore, the limitations that are part of that new IFRS Standard. ANC welcomes the improvements brought by IFRS 17 but still thinks that this IFRS Standard does not adequately address some aspects of the accounting for insurance contracts. **ANC thinks that EFRAG should clearly identify those limitations** even if they may not be of such an extent that they should thwart the endorsement of the new IFRS Standard. In this respect, ANC has reservations about the drafting policy that EFRAG applied throughout the DEA by systematically concluding positively (or not concluding negatively) on all aspects of IFRS 17, in some instances on rather unconvincing or shaky technical grounds.
5. ANC outlines below the topics that, in its view, warrant a more nuanced analysis than the analysis currently set out in the DEA :
    a. Reinsurance (paragraphs 7–36),
    b. Business combinations and portfolio transfers—Contracts acquired during their settlement period (paragraphs 37–57), and
    c. Presentation of an entity's financial statements (paragraphs 58–68).
6. ANC also provides feedback on some questions included in the ITC. This feedback notably includes a development on the interaction between IFRS 9 and IFRS 17 (paragraphs 70–81).

- **Reinsurance**

    - **Overall feedback**

7. Many stakeholders in our jurisdiction still fundamentally disagree with some significant aspects of the accounting for reinsurance contracts applying IFRS 17. There is a widespread perception in our jurisdiction that the IASB did not dedicate sufficient time and efforts to the specificities of the reinsurance contracts when compared to the work performed on direct insurance contracts. This results in an accounting model that, in our view, does not reflect correctly the economics of reinsurance contracts.
8. ANC acknowledges that the IASB made improvements to the accounting for reinsurance contracts held in the *Amendments to IFRS 17*. However those changes have not sufficiently modified the underlying approach for reinsurance contracts, the accounting of which is disconnected from the

accounting of the underlying insurance contracts—this is because the IASB holds the view that a reinsurance contract and the underlying insurance contract should be measured separately.

9. ANC has been made aware of many implementation difficulties in relation to the requirements for reinsurance contracts held. ANC thinks those difficulties arise from the limitations of the conceptual approach retained by the IASB in this respect and from unsatisfactory drafting of the applicable requirements. In particular, ANC has been made aware that the requirements in IFRS 17 (i) are insufficiently clear or precise to deal with the intricacies of the reinsurance contracts in relation with the direct insurance business or (ii) happen to result in questionable accounting outcomes.

10. ANC thinks that the challenges stakeholders are facing will require the implementation of realistic and sensible accounting solutions. Those challenges may also trigger requests put forward for the consideration of the IFRS Interpretations Committee in the near future. Given the lack of clear requirements for reinsurance contracts, there is a risk that agenda decisions might be used as a tool to 'fix' IFRS 17 in this respect. Accordingly, ANC thinks that the IASB should assess whether the requirements for reinsurance contracts are effective—and undertake standard-setting if need be—no later than the *Post Implementation Review* of IFRS 17.

11. ANC is unclear about EFRAG's assessment of the requirements for reinsurance contracts as set out in Question 15 of the ITC.

- **The model retained for reinsurance contracts held**

12. IFRS 17 requires a reinsurance contract held to be accounted for separately from the underlying insurance contracts to which it relates. In addition, an entity applies the same recognition and measurement principles as those applying to other insurance contracts, subject to the modifications set out in paragraphs 61–70 of the Standard. In paragraph BC298 of IFRS 17, the IASB explains this approach gives a faithful representation of an entity's rights and obligations and the related income and expenses from both the underlying and reinsurance contract, acknowledging though, this '*might create mismatches that some regard as purely accounting*'.

13. ANC is still unconvinced this approach is the appropriate way for an entity to account for insurance contracts held. From the perspective of the (ceding) primary insurer, reinsurance contracts held (ceded/purchased) are an efficient risk mitigating tool which does not serve any other purpose than the mitigation of risk as acknowledged in the definition of a reinsurance contract in Appendix A—this definition specifies that a reinsurance contract compensates an entity for claims arising from one or more underlying insurance contracts issued by another entity.

14. Accordingly, in ANC's view, the proper accounting for reinsurance held from the perspective of the primary insurer should, in principle:
    a. be driven by the economic link between the reinsured business and the reinsurance transaction rather than by the form of the reinsurance transaction, and
    b. present the risk mitigation effects of reinsurance held in symmetry with the accounting performance of the reinsured business.

15. ANC belongs to the stakeholders expressing the view described in paragraph 65 of Appendix II to the DEA and notes EFRAG's view set forth in this respect in paragraphs 66–68. However, ANC still thinks that taking the general measurement and recognition requirements in IFRS 17 and applying them separately, with the adjustments as set out in paragraphs 61–70 of the Standard, to the underlying insurance contracts and the corresponding reinsurance contracts held may arguably be an 'easy' approach to deal with reinsurance contracts. However, this is not the appropriate way forward because that does not reflect, in ANC's view, the economics of reinsurance.

16. ANC thinks the conceptual approach and drafting policy retained in IFRS 17 for reinsurance contracts held provide evidence that the IASB did not give sufficient consideration to the accounting for reinsurance contracts. This results in inconsistencies. In this respect, ANC notes that the requirements in paragraphs 40–43 of IFRS 17 on the subsequent measurement of insurance contracts refer to liabilities and unearned profits, and accordingly, cannot literally apply to reinsurance contracts held without any further adjustments.

- **Contract boundaries requirements to reinsurance contracts held**

17. IFRS 17 requires an entity to measure insurance contracts issued and reinsurance contracts held applying the same measurement principles. Measuring an insurance contract requires determining which cash flows are within the contract's boundary. To do so, an entity applies the contract boundary requirements in paragraph 34 of IFRS 17 to the insurance contracts it issues and the reinsurance contracts it holds. This paragraph specifies that cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums, or in which the entity has a substantive obligation to provide the policyholder with services.

18. Paragraph 34 of IFRS 17 does not include specific requirements for reinsurance contracts. At its February and May 2018 meetings, the Transition Resource Group for IFRS 17 (TRG) explained how, in its view, an entity applies that paragraph to reinsurance contracts by specifying that '*for reinsurance contracts held, cash flows are within the contract boundary if they arise from substantive rights and obligations that exist during the reporting period in which the entity is compelled to pay amounts to the reinsurer or in which the entity has a substantive right to receive services from the reinsurer*'.

19. The TRG also explained that '*a substantive right to receive services from the reinsurer ends when the reinsurer has the practical ability to reassess the risks transferred to the reinsurer and can set a price or level of benefits for the contract to fully reflect the reassessed risk or the reinsurer has a substantive right to terminate the coverage. Accordingly, the boundary of a reinsurance contract held could include cash flows from underlying contracts covered by the reinsurance contract that are expected to be issued in the future*'[3].

20. The requirements in IFRS 17 result in determining the boundaries of a reinsurance contract solely on the basis of the contractual rights and obligations of that contract. ANC disagrees with EFRAG's conclusion in paragraph 103 of Appendix II to the DEA whereby determining separately the contract boundary of insurance contracts issued and related reinsurance contracts held provides relevant information. This fails to (i) achieve consistency in the way of measuring the reinsurance and the underlying contracts and thus, results in mismatches, and (ii) reflect the way the ceding entity manages and mitigates its risks.

21. ANC thinks that the inconsistency in the way entities will measure reinsurance contracts held and the related underlying insurance contracts will result in accounting mismatches because entities will:

    a. apply different discount rates when measuring the contracts—accordingly, there will be accounting mismatches in entities' insurance finance result;

    b. measure differently the contracts' CSM and determine differing coverage periods and coverage units—accordingly, there will be accounting mismatches in entities' insurance result (notably because of the difference in timing on the assessment of future cash flows between the reinsurance contracts (at inception) and the underlying direct insurance contracts (when those contracts are eventually recognised), or changes in the key assumptions used for the estimation of cash flows);

    c. apply differing risk adjustments and retain different release patterns for that risk—here again, there will be accounting mismatches in entities' insurance finance result.

22. ANC understands that the requirement to assess separately the contract boundary for reinsurance contracts held would enable to reflect, in the CSM of the group of reinsurance contracts held, the expected gain or cost arising from the reinsurance of future underlying contracts not yet issued. This amount will however require entities to make assumptions about (i) the future subscriptions and (ii) policyholders' behaviour. In ANC's view, this will result in the extensive use of judgement and in estimates with significant measurement uncertainty. Furthermore, ANC notes this measurement uncertainty will only be reflected in the notes to the financial statements whereas the above-mentioned accounting mismatches will distort the relevance of information derived from the statement of profit or loss.

23. Lastly, ANC has no doubt about the increased operational complexity in which the requirements in IFRS 17 will result and accordingly, about the extent of the related implementation costs. Measuring future reinsured underlying contracts that are otherwise not yet recognised will be particularly costly for entities. Consequently, ANC questions whether the benefits of the requirements for contracts boundaries for reinsurance contracts held will outweigh their costs, for both users (mismatches distorting an entity's financial performance) and preparers (through operational complexities). In ANC's view, EFRAG should highlight this matter in its analysis in Appendix III to the DEA.

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[3] Summary of the TRG for IFRS 17 meeting held on 6 February 2018.

- **Prohibition of applying the VFA model to reinsurance contracts held or issued**

24. Paragraph B109 of IFRS 17 states that reinsurance contracts issued and reinsurance contracts held cannot be insurance contracts with direct participation features for the purpose of this Standard. In other words, such contracts are excluded from the scope of the variable fee approach (VFA) and are in the scope of the general model.
25. In the case of reinsurance contracts *held*, this is because, as explained in paragraph BC248 of IFRS 17, the entity holding the reinsurance contract and the reinsurer do not share in the returns on underlying items—ie the contracts do not meet the eligibility criterion to the VFA model as specified in paragraph B101(a) of IFRS 17. The IASB did not modify the scope of the VFA model to include reinsurance contracts held because, here again, this would have been inconsistent with its view that a reinsurance contract and the underlying contract should be accounted for separately.
26. However, the IASB acknowledged in paragraph BC249 of IFRS 17 that some types of reinsurance contracts *issued* might meet the criteria in paragraph B101 of IFRS 17 but confirmed the VFA model would not apply to such contracts—this is because reinsurance contracts provide, in the IASB's view, insurance coverage and do not provide substantially investment-related services.
27. The prohibition to apply the VFA model to reinsurance contracts—held or issued—when the VFA model applies to the underlying insurance contracts may result in accounting mismatches that do not reflect the economics of the reinsurance arrangements.
28. In paragraphs 69–72 of Appendix II to the DEA, EFRAG acknowledged there may be reinsurance contracts *issued* or *held* that meet the criteria in paragraph B101. However, EFRAG concluded that extending the risk mitigation option to reinsurance contracts would largely address the accounting mismatches issue. ANC welcomes this acknowledgement but thinks EFRAG should be more nuanced. We provide below our analysis distinguishing the case of reinsurance contracts held and reinsurance contracts issued.

- **Reinsurance *held***

29. ANC already had the opportunity to outline[4] that some reinsurance contracts held may meet the criteria in paragraph B101 and thus, could have been eligible for the VFA model had not there been the restriction set out in paragraph B109. In addition, the measurement inconsistency between (i) the underlying insurance contracts to which the VFA applies and (ii) the related reinsurance contracts held for which the use of VFA is prohibited, does not faithfully reflect the economics of such reinsurance operations and results in accounting mismatches—this is because an entity is prohibited from applying the VFA model to the reinsurance contracts held and thus, recognises any change in the financial risk immediately in profit or loss or in OCI. Conversely, any such change in the underlying contract—to which the VFA applies—is reflected in the CSM and spread over the coverage period. In those circumstances, the combination of a reinsurance and insurance contract may lead to accounting mismatches in profit or loss or in OCI.
30. ANC acknowledges that, as a response to the concerns expressed for reinsurance contracts held, the IASB amended the requirements on the risk mitigation option by extending the use of that option––this helped solved many issues, with one notable exception relating to the accounting mismatches that arise at the transition date (this is because an entity is not permitted to apply the risk mitigation option retrospectively).
31. ANC still thinks that permitting reinsurance contracts held to be accounted for under the VFA model when the underlying insurance contracts are measured under that same model would have been the appropriate solution—this is because it would have been the easiest approach to implement and it would faithfully reflect the economics of reinsurance operations.

- **Reinsurance contracts *issued***

32. Consistent with its view expressed in past technical notes[5], ANC thinks that reinsurance contracts issued that meet the VFA eligibility criteria (that is, for example, the case when the terms of the treaty specify that the return of underlying items is shared between the direct insurer and the reinsurer) should be required to use the VFA model. ANC is convinced that the prohibition to use the VFA for the reinsurance contracts issued is arbitrary and replaced by the requirement to assess their eligibility to the VFA model using the general criteria set in IFRS 17.

[4] See paragraphs 91–94 of ANC's technical note.
[5] See in particular paragraphs 88–90 of the same note.

- **Reinsurance contracts in a net cost position**

33. ANC welcomes the IASB's decision to reconsider the recognition of gains or losses when an entity first recognises a reinsurance contract held. The amendments to IFRS 17 in this respect will enable to reflect the fact that reinsurance held is a risk mitigation technique designed to absorb losses arising from underlying reinsured contracts.
34. However ANC thinks that the computation set out in paragraph B119D of IFRS 17 may not adequately reflect the economic loss-absorption capacity of reinsurance contracts held and thus, may lead to the recognition of a reinsurance gain even though a reinsurance contract held might represent a net cost for the cedant.
35. Applying paragraph B119D of IFRS 17, an entity will recognise a gain at initial recognition that equals the loss recognised on the underlying onerous insurance contracts multiplied by the percentage of claims that the entity expects to recover from the group of reinsurance contract held. However, this calculation disregards other relevant contractual features such as the reinsurance premium and fees. This ultimately means that such costs adjust the CSM and are spread over the lifetime of the contracts whereas the profit arising from the reinsurer's share of the claims is immediately recognised as a gain in profit or loss. In circumstances in which the reinsurance premium exceeds the expected reinsured claims—thus resulting in a net cost for the ceding company—paragraph B119D results in the recognition of a gain that does not appropriately reflect the economic effect of the reinsurance contract held.
36. ANC appreciates the IASB's efforts to reflect the risk mitigation purpose of reinsurance held in IFRS 17 without substantially changing the principles in the Standard, and ultimately to avoid disruption in the implementation of IFRS 17. However, ANC notes that circumstances in which the reinsurance premium exceeds the expected reinsured claims are expected to arise frequently in practice. Accordingly, ANC thinks this requirement will frequently convey information that may not meet the qualitative criteria of relevance, reliability and prudence.

- **Business Combinations and portfolio transfers—Contracts acquired during their settlement period[6]**

  - **The lack of conceptual basis for the requirements applying to contracts acquired in their settlement period**

37. IFRS 17 requires an entity to assess whether a contract meets the definition of an insurance contract based on facts and circumstances existing at (i) the inception of the contract if the entity issued the contract, or (ii) the date at which the contract is acquired if the entity acquired that contract in a transfer of contracts that do not form a business (such as a portfolio transfer) or in a business combination within the scope of IFRS 3 *Business Combinations*. IFRS 17 did not reinstate the exception in paragraph 17(b) of IFRS 3 whereby an entity was required to assess whether a contract meets the definition of an insurance contract (as defined in IFRS 4) on the basis of the contractual terms and other factors that existed *at the inception of the contract*.
38. Appendix A to IFRS 17 defines an insurance contract as a contract under which the entity accepts significant insurance risk from the policyholder by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely effects the policyholder. This appendix goes on and defines an insured event as an uncertain future event covered by an insurance contract that creates insurance risk.
39. IFRS 17 explains that the carrying amount of a group of insurance contracts at the end of each reporting period is the sum of the (i) liability for remaining coverage (LRC) and (ii) liability for incurred claims (LIC). Appendix A to IFRS 17 defines :
    a. LRC as an entity's obligation to investigate and pay valid claims under existing insurance contracts for insured events *that have not yet occurred* (ie the obligation that relates to the unexpired portion of the coverage period), and
    b. LIC as an entity's obligation to investigate and pay valid claim for insured events *that have already occurred*, including events that have occurred but for which claims have not been reported, and other incurred insurance expenses.
40. An entity may acquire contracts in a business combination. In the acquiree's financial statements, the insured event related to those contracts may have already occurred. In those circumstances, the

[6] The developments in this section equally apply to business combinations and portfolio transfers. For ease of reference, the section only refers to business combinations.

acquiree (i) has already recognised the contract's CSM in profit or loss and (ii) recognises a LIC as long as the claim amounts due to the policyholders are not determined and paid. Such contracts are referred to in a business combination as 'contracts acquired in their settlement period'.

41. IFRS 3 and IFRS 17 require the acquirer to reassess the classification of such contracts. ANC understands that, applying paragraph B5 of IFRS 17, the acquirer could conclude that those contracts meet the definition of insurance contracts at the acquisition date. This is because, when claim amounts are uncertain in timing or amount, the ultimate cost of those claims could be identified as the insured event—in those circumstances the insured event would not have occurred at the acquisition date. Should those contracts meet, once again, the definition of insurance contracts, the acquirer would have to apply the measurement requirements in IFRS 17 and thus, would (i) derecognise the LIC to recognise a LRC and then (ii) recognise a CSM, being the difference between the consideration received or paid and the contracts' fulfilment cash flows, until the date the ultimate cost of claims becomes known. In other words, this is equivalent to a situation in which the acquirer would have to 're-issue' the contract that the acquiree had already issued.

42. From a conceptual perspective, ANC does not understand how, absent any change in the contractual terms and other facts and circumstances, there could be differing assessments of whether an insured event has occurred or not, alternatively considering the acquirer's and acquiree's points of view—the acquirer's is indeed just 'stepping into the acquiree's shoes' without substantially changing the terms and economics of the contracts. In ANC's view, this demonstrates that either the requirements for contracts acquired in their settlement period or the definition of an 'insured event' should have warranted more consideration from the IASB.

43. ANC notes that the Basis for Conclusions on the Amendments to IFRS 17 are silent on the conceptual approach underpinning the accounting for contracts acquired in their settlement period—paragraphs BC327E–327G of IFRS 17 rather set out the IASB's interpretation of the requirements in paragraphs B3–B5 of that Standard than provide a conceptual discussion of the matter.

- **Those requirements may not provide relevant information**

44. ANC is unconvinced by EFRAG's analysis of the matter as set out in paragraphs 159–162 of Appendix II to the DEA. ANC identified in those paragraphs no compelling argument explaining why the insured event would have occurred from the acquiree's perspective but would not have occurred from the acquirer's point of view. In ANC's view, EFRAG should acknowledge that the IASB has not provided any conceptual analysis in relation to the accounting for contracts acquired in their settlement period. ANC considers this is sufficient to question whether those requirements provide relevant information.

45. Applying the requirements in IFRS 17, the acquirer should, at the acquisition date, (i) derecognise the LIC in the acquiree's financial statements and instead (ii) recognise a LRC, using the consideration received or paid for the contracts as a proxy for the premium received. Accordingly, the contracts acquired during their settlement period would result in the recognition of a CSM in the acquirer's statement of profit or loss.

46. Let's assume that an entity that issues one type of insurance contracts acquires another entity that issued the same type of contracts before the acquisition date, all of them being in their settlement period. The revenue the acquirer recognises in its consolidated financial statements after the acquisition date would include revenue from:

    a. the acquiree's contracts, ie the contracts in their settlement period. In those circumstances, revenue would be recognised because the acquirer would have to assess, at the acquisition date, that *the determination of the ultimate costs of claims* is the insured event and accordingly, that the insured event would not have occurred at this date; and

    b. the acquirer's and acquiree's existing or future contracts. In those circumstances, revenue would be recognised because the acquirer would have to assess, at the acquisition date, that *the occurrence of an adverse economic event* (loss) is the insured event and accordingly, that the insured event would not have occurred at that date.

47. In other words, the acquirer would recognise revenue for the same types of contracts but on very differing premises. In ANC's view, any such accounting is unlikely to provide relevant information.

48. Furthermore, the requirements for contracts acquired in their settlement phase would significantly impair the predictive value of insurance revenue. An entity would indeed comingle (i) revenue from its 'in-force portfolio' that reflects new subscriptions and, thus, business growth, with (ii) revenue from contracts that have been partially executed and for which the only uncertainty is the amount or timing of settlement. In other words, the changes in total insurance revenue are unlikely to reflect the real business trends. Should an acquisition be material, this would obfuscate the understanding of an

entity's financial performance.

49. ANC agrees with EFRAG's observation that an entity may wish, in those circumstances, to provide disaggregated information in its statement of profit or loss or specific disclosures in the notes to its financial statements. Nonetheless, this would inevitably add complexity to the understanding of the entity's financial performance and may encourage entities to develop alternative performance measures.

50. More broadly, the requirements applying to contracts acquired in their settlement phase seem to be predicated on the assumption that all entities enter business combinations for the purpose of making a profit from positive developments on the contracts acquired during in their settlement phase. ANC disagrees with this assumption—in practice, making a profit from such contracts is rarely a reason for an entity to undertake an acquisition. On the contrary, entities mostly make acquisitions as part of their external growth strategy. As such, the requirements for contracts acquired in their settlement phase ignore an entity's business model and, by doing so, are unlikely to provide relevant information.

51. In the light of the explanations set out above, ANC disagrees with EFRAG assessment in paragraph 163 of Appendix II to the DEA that the accounting treatment for contracts acquired in their settlement period results in relevant information. In ANC's view, EFRAG should acknowledge the limitations of IFRS 17 in this respect and conclude that this accounting does not provide useful information.

- **They may also not provide comparable information**

52. ANC observes that the requirements in IFRS 17 would result in recognising revenue twice for the same contracts absent any change in the contracts terms—one time in the acquiree's statement of profit or loss, another time in acquirer's statement of profit or loss. ANC also observes that two entities holding such contracts, one because it had issued the contract, the other one because it had acquired the contract in a business combination, would recognise revenue while each entity would be in completely different positions with regard to its obligations towards the policyholders—in the former case, the adverse economic event for the policyholder has not occurred, in the latter case that event has occurred and only the timing or the amount of the payment is unknown. Having in mind the IASB's observation in paragraph 2.27 of the 2018 *Conceptual Framework for Financial Reporting* whereby 'comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different' (emphasis added), ANC considers that the requirement for contracts acquired in their settlement phase do not result in comparable information.

53. ANC notes that EFRAG acknowledged the feedback of many stakeholders in this respect, in particular in paragraph 304 of Appendix II to the DEA. However, EFRAG explanations about why the requirements in IFRS 17 would not impair comparability are unclear and thus, unconvincing. Here again, ANC disagrees with EFRAG's assessment.

- **They unlikely pass the 'cost-benefit' assessment**

54. As explained above ANC sees little benefit, if any, to the accounting for contracts acquired in their settlement period.

55. In contrast, ANC clearly identifies the costs related to the requirements applying to those contracts. ANC notes the requirements in IFRS 17 introduce a significant change to the existing practices and will result in entities:

    a. reassessing the classification of all contracts acquired with the need to apply all the measurement requirements in IFRS 17 (in particular, the determination of a CSM and of a coverage period). This will significantly increase the time and resources dedicated to the allocation of an acquisition's purchase price considering the population of contracts to restate—having noted that the existing requirements in IFRS 3 already result, on a standalone basis, in extensive work. The incremental implementation costs that would arise thereof are going to be material for any significant business combination.

    b. preparing additional information in the notes or in their public communications to avoid confusion about changes in the business trends.

56. Those requirements may also increase the costs for users given the complexity they introduce for the understanding of an entity's financial statements.

57. ANC thinks that EFRAG could have assessed, in Appendix III to the DEA, whether the expected benefits of the requirements for contracts acquired during their settlement period exceed their expected costs.

- **Presentation of an entity's financial statements**

  - **Presentation of an entity's statement of financial position**

58. IFRS 17 requires an entity to measure a group of insurance contracts on the basis of all the cash flows expected to arise from fulfilling the contracts in the group, including premiums receivable and claims payable. Paragraph BC328 of IFRS 17 explains that, consistent with this measurement approach, the presentation in the statement of financial position reflects the combination of rights and obligations created by the contract as giving rise to a single insurance contract asset or liability.

59. ANC shares the concerns described in paragraph 122 of Appendix II to the DEA and thus, disagrees with the requirement to present a group of contracts as a single line item in the statement of financial position. In ANC's view, IFRS 17 should require further disaggregation. In particular, it should require the separate presentation of items conveying information that is essential for an understanding of an entity's activity and risks to which it is exposed. Those items are:

    a. the premium receivables corresponding to a coverage period that has already started but for which the entity has not yet received the full payment. Some legal or contractual requirements may force the entity to provide insurance coverage until the termination of the contract even though the policyholder has not yet paid all amounts owed.

    b. LRC and LIC. When an insured event occurs, there is a fundamental change in nature from LRC to LIC. The relevant factor for the LRC is the probability of occurrence of an insured event in the future whereas the relevant factor for the LIC is the quality of estimates.

60. ANC notes that entities commonly present separately the above-specified items when they apply IFRS 4. This is because the separate presentation of such items reflects the way entities manage their business and organise their information systems. ANC thinks that the requirements in IFRS 17 inevitably lead to commingle amounts due for payment and future expected cash flow in a same 'package' and as such, deprive users from information that is useful about cash collection. ANC also notes the mixed feedback on this matter from EFRAG's User Outreach indicating that the statement of financial position may lose part of its informational value.

61. ANC notes EFRAG's comment in paragraph 124 of Appendix II to the DEA observing that paragraph 55 of IAS 1 *Presentation of Financial Statements* requires the presentation of additional line items (including by disaggregation of required line items), headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of an entity's financial position. Applying that requirement, an entity might present a disaggregation showing the components of each of those line items—for example, to present the amounts of premiums receivable and claims payable included in the carrying amount of the insurance contract liability.

62. ANC observes that the requirements in IAS 1 would not permit the *separate presentation* of the components of an insurance asset or liability—it only requires further *disaggregation* of existing line items when this provides relevant information. In addition, ANC is unsure of whether such *disaggregation* would be deemed relevant and thus, appropriate. This is because in paragraph BC330D, the IASB states that '…*some stakeholders said they would like to continue further disaggregation because they view such disaggregated line items as providing meaningful information to users of financial statements. The [IASB] disagreed with suggestions to permit an entity to continue such disaggregation because it could result in the presentation of amounts that are not separable assets or liabilities. For example, premiums receivable for future insurance coverage is not a gross asset separable from the related liability for the future insurance coverage*'.

63. Overall, ANC thinks there is no effective remedial requirement or provision that would help entities make up for the loss of useful information in the statement of financial position.

  - **Restatement of comparative information when an entity initially applies IFRS 17 and IFRS 9 *Financial Instruments* at the same time**

64. Paragraph C3 of IFRS 17 requires an entity to apply IFRS 17 retrospectively unless impracticable, subject to some exceptions described in paragraphs C3(a) and C3(b) of IFRS17. IFRS 17 also requires an entity to present adjusted comparative information, applying the requirements of IFRS 17, for the period immediately before the date of initial application of IFRS 17. An entity may also present adjusted comparative information applying IFRS 17 for any earlier periods presented but is not required to do so.

65. Paragraph 7.2.1 of IFRS 9 requires an entity to apply IFRS 9 retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, subject to some exceptions listed in that paragraph. Paragraph 7.2.1 of IFRS 9 prohibits an entity from applying IFRS 9 to items that have already been derecognised at the date of initial application of IFRS 9. Paragraph 7.2.15 of

IFRS 9 permits, but does not require, an entity to restate prior periods. An entity may restate prior periods if, and only if, it is possible without the use of hindsight.

66. ANC notes that some entities that will initially apply IFRS 17 and IFRS 9 at the same time may wish to restate prior periods to reflect the requirements in IFRS 9. However, the requirement in paragraph 7.2.1 of IFRS 9 that prohibits entities from applying IFRS 9 to items that have already been derecognised practically deter those entities from restating prior periods—this is because this requirement is burdensome to apply and may result in non-comparable accounting treatments in the comparative period in areas where IFRS 9 and IAS 39 have dissimilar requirements, for example:

    a. capital gains arising from the disposal of equity instruments;

    b. expected credit losses model for financial assets measured at amortised cost and at fair value through other comprehensive income.

67. Given the interplay between the requirements in IFRS 9 and those in IFRS 17 for insurance contracts, ANC thinks that the discrepancy between the two Standards with regard to the restatement of comparative information is awkward. ANC thinks that entities should have been encouraged to restate comparative information to reflect the requirements in IFRS 9. ANC notes the IASB's observations in that respect in paragraph BC389 of IFRS 17 but still believes the IASB should propose narrow-scope amendments to IFRS 9 to helpfully permit entities to apply IFRS 9 to items that have already been derecognised at the date of initial application of IFRS 9.

68. ANC thinks that EFRAG's tentative explanation in paragraph 182 of Appendix III to the DEA for justifying this discrepancy is irrelevant.

• Other technical matters discussed in Appendix III to the DEA

69. In Appendix III to the DEA, EFRAG has included specific developments on some technical matters further to the European Commission and Parliament's requests. ANC comments on some of those matters below.

o Interplay between IFRS 17 and IFRS 9 (Question 12 of the ITC)

70. Applying the *Amendments to IFRS 4—Extension of the Temporary Exemption from Applying IFRS 9* Financial Instruments, many insurers will first apply IFRS 17 and IFRS 9 at the same time. ANC has still strong reservations about specific aspects of IFRS 9 that will significantly affect insurers and thinks EFRAG should outline those aspects in its cover letter.

- Changes in the fair value of investments in equity instruments

71. Applying IFRS 9, an entity measures investments in equity instruments at fair value. Paragraphs 4.1.4 and 5.7.5 of IFRS 9 specify that at initial recognition of an investment in an equity instrument that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination, an entity may make an irrevocable election to present in OCI subsequent changes in the fair value of that investment ('presentation election'). Paragraph B.5.7.9 of IFRS 9 states that amounts presented in OCI shall not be subsequently transferred to profit or loss ('recycling prohibition').

72. ANC has a long-standing view that amounts presented in OCI shall subsequently be transferred to profit or loss. ANC is unconvinced by the IASB's rationales supporting the recycling prohibition in IFRS 9.

73. Investing in equity instruments is a very substantial component of the insurance activity. Because insurers are in a 'long cash position', they invest in equity instruments with a long-term horizon. ANC thinks that presenting the changes in the fair value of insurers' investments in equity instruments in profit or loss, on a period-by-period basis, would not reflect the economic reality of their business because any gain or loss on investments is only realised at the expiry of their investment horizon. This would also introduce volatility in their financial performance that is 'long term' oriented. Accordingly, ANC agrees with the principle of presenting such changes in OCI. However, the prohibition of transferring in profit or loss the gains or losses when the entity disposes of the investments is a major financial reporting issue because part of the entity's financial performance—ie holding equity investments for capital appreciation in the long run—is not reflected in profit or loss. The requirements in IFRS 9 in this respect are clearly unsatisfactory.

74. This is no new issue. Many stakeholders have constantly expressed strong reservations about the

recycling prohibition. ANC notes that EFRAG's Endorsement Advice on IFRS 9 flagged this matter and stated that '*the default requirement to measure all equity investments at fair value through profit or loss may not reflect the business model of long-term investors, including entities undertaking insurance activities and entities in the energy and mining industries. EFRAG observes that IFRS 9 provides an option to measure some equity instruments at fair value through other comprehensive income. However, it is not likely to be attractive to long-term investors because the prohibition on recycling gains and losses may not properly reflect their performance*'[7].

75. ANC also notes that further to a request for technical advice on alternative accounting treatments for long-term equity investments, EFRAG advised[8] that '*the European Commission recommend to the IASB an expeditious review of the non-recycling treatment of equity instruments within IFRS 9 […], testing whether the revised Conceptual Framework for Financial Reporting […] would justify the transfer to profit or loss […] of fair value gains and losses accumulated in other comprehensive income on such instruments when realised. If recycling was to be reintroduced, the IASB should also consider the features of a robust impairment model, including the reversal of impairment losses*'. EFRAG's recommendation was indirectly supported by the Final Report of the High Level Forum on the Capital Markets Union published in June 2020 which notes that '*without [recycling], given that capital gains typically represent 60% of overall equity returns, IFRS profits will not reflect the true financial performance and can create disincentives for insurers to invest in equities. The final recommendation calls on the EU to continue to attempt to resolve this issue through engagement with the IASB. However, if the IASB does not adequately and expeditiously address this issue, then the EU must pursue its own solution to them*'[9]. This indicates that the recycling prohibition remains subject to close scrutiny from European stakeholders.

76. As a final note, ANC observes that the IASB decided in October 2020 to begin the PIR of the IFRS 9 classification and measurement requirements. ANC understands that the PIR is currently in the first phase which involves an initial identification and assessment of the matters to be examined. ANC expects the recycling prohibition to be part of those matters.

77. ANC notes that paragraphs 108–121 of Appendix III to the DEA discuss this matter. Surprisingly, the cover letter does not mention it.

- **The presentation of the changes in the fair value of puttable financial instruments**

78. Insurers hold financial instruments that impose on the entity that issued those instruments an obligation to deliver to the holder a pro rata share of the net assets of the entity only on liquidation ('puttable financial instruments'). Those instruments are financial liabilities but are classified as equity instruments by the issuer if it they have all the features and meet the conditions in paragraphs 16C and 16D of IAS 32 *Financial Instruments: Presentation*.

79. Such instruments do not meet the definition of an equity instrument in IAS 32 (they are no investment in equity instruments from the holder's perspective) and thus, are not eligible for the presentation election in paragraphs 4.1.4 and 5.7.5 of IFRS 9. Accordingly, those instruments are financial assets for the holder and are subject to the classification and measurement requirements applicable to such items. Because the contractual terms of those financial assets do not give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI), such assets are measured at fair value through profit or loss.

80. In many cases, those puttable instruments represent investments in funds that hold financial assets that are SPPI and are hold within a business model whose objective (i) is to hold those assets in order to collect contractual cash flows, or (ii) is achieved by both collecting contractual cash flows and selling those assets. Accordingly, the funds subsequently measure those assets at amortised cost or at fair value through OCI (FVOCI). If insurers were to hold those assets directly (ie not through a fund), they would subsequently measure them at amortised cost or at FVOCI.

81. Here again, considering the long-term holding of such instruments by insurers, ANC thinks that the presentation of changes in the fair value of puttable financial instruments in profit or loss is not relevant and introduces unnecessary volatility.

- **Application of IFRS 15 (Question 13 of the ITC)**

[7] Endorsement Advice on IFRS 9 *Financial Instruments* dated 15 September 2015.
[8] EFRAG's advice to the European Commission on the measurement of long-term investments in equity instruments dated 30 January 2020.
[9] Final Report of the High Level Forum on the Capital Markets Union, June 2020, page 44.

82. ANC agrees with EFRAG's assessment in this respect.

- **Implications of transitional requirements (Question 14 of the ITC)**

83. ANC already had the opportunity to provide its detailed views and analysis of those matters in a dedicated technical note. ANC overall agrees with EFRAG's assessment in this respect.

84. ANC agrees that the existence of several transition approaches enables entities to provide relevant information taking into account their practical constraints and considering the major changes introduced by IFRS 17. ANC acknowledges that the possible use of several transition methods may affect comparability at the transition date and, for long-term contracts, comparability over time. However, ANC notes that IFRS 17 requires an entity to disclose information that will help users understand the estimates an entity made and the judgments it applied, thereby balancing the concerns about a loss of comparability between entities.

85. However, ANC has still conceptual reservations about the use of the fair value approach as described in paragraphs C20–C24 of IFRS 17. This is because, in the insurance industry, transactions rarely occur on quoted markets. Accordingly, in the absence of observable transaction prices, the determination of fair value mostly relies on Level 3-inputs as defined in IFRS 13 *Fair Value Measurement*. In ANC's view, the fair value approach requires more judgment and estimates than applying the retrospective approach or the modified retrospective approach. ANC regrets that the requirements in IFRS 17 for the retrospective and modified retrospective approaches do not give sufficient flexibility to entities when applying those approaches and therefore could encourage the application of the fair value approach.

Appendix B—Comments on the requirement to apply the annual cohorts to intergenerationally-mutualised contracts

- **ANC's view on the annual cohort requirement and the way it has been developed**

86. Paragraphs 14–24 of IFRS 17 set out requirements for the level of aggregation at which insurance contracts are recognised and measured. Applying the requirements in paragraphs 14–21, an entity determines groups of insurance contracts by (i) identifying portfolios of insurance contracts, and (ii) dividing each portfolio into a minimum of three groups ('profitability buckets'). Paragraph 22 sets out an additional requirement in relation to the determination of groups of insurance contracts. This paragraph states: '*An entity shall not include contracts issued more than one year apart in the same group. To achieve this the entity shall, if necessary, further divide the groups described in paragraphs 16–21*'. In other words, an entity divides the aforementioned profitability buckets into groups of contracts not issued more than one year apart ('annual cohort requirement').

87. ANC notes that the annual cohort requirement is actually a convention. In ANC's view, this requirement is rather an anti-abuse measure than a conceptually based principle. The IASB introduced this requirement at a very late stage in the standard-setting process—ie a few months before publishing IFRS 17—after having failed to develop a robust principle-based approach for the aggregation of insurance contracts. This way of addressing an essential part of an IFRS Standard, ie the 'unit of account', has obvious limitations—in particular the inability to identify, in a timely manner, the contracts for which this unit of account is inappropriate.

88. ANC appreciates the underlying objectives of this requirement[10]. However, ANC thinks this requirement sets a simplistic convention, or a simplification, that does not work for all insurance contracts. ANC disagrees with applying this requirement to some insurance contracts because it fails to provide useful information for those contracts. Had this requirement ever been exposed as such[11], ANC thinks the IASB would have gathered evidence that it was not the appropriate way forward for all insurance contracts. ANC also notes that a genuine principle-based approach would have consisted in specifying the objectives pursued by the Board in the Standard itself—instead of specifying them in the Basis for Conclusions—rather than prescribing a methodology to meet those objectives.

89. ANC already had the opportunity to provide extensive input on this matter[12] and to explain why, in its view, the annual cohort requirement does not provide useful information for contracts with intergenerational mutualisation, in particular for some life insurance contracts that are issued by French insurance entities. ANC's extensive commitment reflects the prevalence of contracts in France to which this requirement would unduly apply and the concerns expressed among *all* categories of French stakeholders (preparers, auditors and regulators).

90. ANC also notes that similar concerns have been raised, formally or informally, in all the European jurisdictions where contracts with intergenerational mutualisation are prevalent. ANC also logically observes that no such concerns have been expressed in European jurisdictions where no such contracts exist (or marginally exist).

91. ANC also had the opportunity to suggest an alternative way forward by identifying possible criteria for an exemption to the annual cohort. ANC regretfully notes that the IASB rejected its proposals, together with the proposals coming from some other European stakeholders.

92. Consistent with its views on this matter and having acknowledged that the IASB retained, unchanged, the annual cohort requirement, ANC agrees with the EFRAG's Board members who think that the annual cohort requirement, when applied to intergenerationally mutualised contracts, does not meet all the qualitative characteristics for endorsement—in particular because the requirement results in information that is not relevant, not reliable and not comparable. Additionally, ANC thinks that the annual cohort requirement will result in (i) no useful information when applied to intergenerationally-mutualised contracts and (ii) significant implementation costs for insurance entities. Accordingly, ANC thinks the costs related to this requirement are going to exceed its benefits (if any) and thus, that this

[10] Paragraphs BC115–BC120 of IFRS 17 specify those objectives. Paragraph 17 of Agenda Paper 2A for the March 2019 IASB meeting clearly summarizes those objectives.

[11] ANC understands that this requirement was only subject to an external testing of the draft Standard in 2016. Stakeholders only had the opportunity to comment on this requirement when the Exposure Draft (ED) *Amendments to IFRS 17* was published in June 2019—noting though this ED did not ask any question in this respect. As noted in paragraph 9 of Agenda Paper 2B for the February 2020 IASB meeting, most of the respondents who commented on the annual cohort requirement were European stakeholders.

[12] See ANC's communications sent to EFRAG and the IASB (letters or technical analyses dated November 2018, February 2019, May 2019, May 2019, September 2019 and May 2020).

requirement is not conductive to the European public good.

93. In the paragraphs below, ANC:

    a. provides background information to help EFRAG (and other stakeholders) (i) identify the contracts issued by French insurance entities to which the annual cohort requirement would, in ANC's view, unduly apply, (ii) understand why the contractual and legal features of those insurance contracts create an intergenerational mutualisation, and (iii) assess the prevalence of such contracts in France (see paragraphs 94–107);

    b. discusses why, in its view, the annual cohort requirement does not provide relevant, reliable and comparable information in relation to those contracts (see paragraphs 108—156);

    c. provides its views on the costs of applying the annual cohort requirement to those contracts (see paragraphs 157–167), and

    d. reminds the exemption to the annual cohort requirement it proposed to the IASB in May 2020 to solve the matter (see paragraphs 168–192).

French life insurance contracts that have intergenerational mutualisation

Legal and contractual features

94. French insurance entities have been issuing life insurance contracts with intergenerational mutualisation over many decades.

95. Those contracts specify that the policyholders pay premiums and, in exchange, get the right to share in the returns on specified underlying items that include (i) a portfolio of similar life insurance contracts and (ii) a contractually specified pool of assets (usually the general fund of the insurer). The underlying items are contractually neither ring-fenced nor segregated at the level of individual contracts or group of contracts—in other words, no single contract or group of contracts has a right to some specific underlying items. All the contracts share in the same pool of underlying items irrespective of the date at which individual policyholders entered their contracts.

96. The returns from the underlying items are based on contractual and legal terms. Those terms set out a joint profit sharing (or policyholders' participation). The policyholders *as a whole*, not the individual policyholders, have an enforceable right to the joint profit sharing. **An essential feature is that the returns from the underlying items to which the policyholders as a whole are entitled only include *realised* *gains or losses*[13]—at any reporting date, the policyholders have *no* right to unrealised gains or losses on the change in the fair value of the underlying items**.

97. This joint profit sharing has the following features:

    a. it is a collective pecuniary right: at the end of each annual period, the policyholders as a whole are entitled to a minimum share in the realised returns arising from the portfolio of insurance contracts and from the contractually specified pool of underlying assets. The insurer might also decide to pay amounts above those required by the contractual terms.

    b. the amount allocated to each individual policyholder is at the entity's discretion: the entity allocates and pays the participation as described above to each individual policyholder and does so within a specified time frame—eight years most of the time starting from the date at which the realised returns occur. The entity's management exercises its discretion over the amount and timing (within the confines of the aforementioned time frame) of the payments to make to each individual policyholder. Each individual policyholder has an enforceable right to payment once the insurance entity makes a decision with regard to the allocation.

    c. the policyholders are entitled to at minimum (i) 90 per cent of the positive 'technical' returns arising from the portfolio of insurance contracts and (ii) 85% of the realised financial returns arising from the contractually specified pool of underlying assets. The terms usually specify that the policyholders' participation is determined on accounting figures prepared in accordance with French GAAPs. Consistent with the observation in paragraph 96, this implies that the policyholders' share in the returns of the underlying items is determined on *realised* gains only.

98. In addition, *each individual policyholder* may be entitled to a guaranteed minimum interest rate accruing with the passage of time. Given the existing low interest rate environment, newly written contracts are usually entitled to a zero per cent guarantee—ie the policyholder recovers at minimum the premiums paid less any management fees. If individual policyholders are entitled to a minimum

[13] For ease of reference, we only refer to 'gains' throughout this appendix.

interest rate, the related guaranteed payments are paid out of the amount of the joint profit sharing described in paragraphs 96 and 97 and therefore reduce the amount that is available for discretionary distribution to other policyholders without a guaranteed return.

99. Accordingly,

    a. the policyholders who are entitled to a minimum interest rate receive (i) the related guaranteed payment and (ii) a part of the joint profit sharing; and

    b. the policyholders who are not entitled to a guaranteed return only receive a discretionary share of the joint profit sharing to the extent that the latter exceeds the guaranteed interests paid to policyholders with a guaranteed minimum return.

- **Why the joint profit sharing features create an intergenerational mutualisation**

100. As explained in paragraph 95, the policyholders share in the return from a single contractually specified pool of underlying items. This implies that all generations of policyholders share in the returns from the pool and that no generation has a separable pecuniary right to any subset of that pool.

101. Furthermore, as explained in paragraph 96, the policyholders as a whole are ultimately entitled to a minimum share in the realised gains from the underlying items.

102. Accordingly, the fair value returns from the underlying items at a reporting date as specified in IFRS 17—ie both the unrealised and realised gains on fair value changes—benefit to both *existing* and *future* policyholders and do not create an immediate right for existing policyholders. The policyholders' joint right to the unrealised fair value gain (or loss) is deferred until the entity decides to recover the value of —ie disposes of—the underlying items. The fair value gain ultimately benefits only to the contracts that are still in force at the time when (i) the entity recovers the value of the underlying items and (ii) allocates the joint profit sharing to the individual policyholders—as explained above the allocation occurs, in general, no later than eight years after the realisation of the gain.

103. This implies that:

    a. the policyholders who are the parties to the contract at the time when the entity realises the value of an underlying item will benefit from part of the gain arising thereof only if their contracts do not lapse before the entity allocates the gain to individual policyholders;

    b. future policyholders will benefit from a profit share in the above-mentioned gain if their contracts are issued and do not lapse before the entity allocates this gain to individual policyholders; and

    c. the entity's share in the returns of the underlying items will vary depending on (i) the termination of existing contracts, (ii) the addition of new contracts within the same portfolio, (iii) the way the entity’s management exercises its discretion in relation to when it realises gains on the underlying items and (iv) the way the entity’s management exercises its discretion in relation to when and how it allocates the joint profit sharing to individual policyholders.

104. The way those contracts share in the returns of a single pool of underlying items together with the discretion that the entity has with regard to (i) *when* it recovers the value of the underlying items and (ii) the *amount* and *timing* of the allocation of the policyholders' participation to each individual policyholder create a legally/contractually-organised intergenerational mutualisation.

- **The prevalence of those contracts for French insurance entities**[14]

105. In France, insurance contracts with intergenerational mutualisation are an essential part of insurance entities’ business. Information provided by *Banque de France*—the French Central Bank—provides clear evidence that those contracts accounts for highly material amounts in the statement of financial position of French insurance entities. In 2019, those contracts accounted for (i) 75 per cent of the insurance liabilities (commonly referred to as 'technical provisions') recognised in French insurance entities' prudential balance sheet for life insurance contracts and (ii) more than a half of their total net assets and liabilities.

106. In the *Banque de France*’s reports, such contracts are referred to as ‘life with profit sharing’ contracts applying the European prudential classification of insurance contracts. This line item provides an

[14] This point specifically replies Questions 18(a) and (b) of the ITC.

adequate proxy because French life insurance contracts with discretionary participation features usually have the legal and contractual features outlined in paragraphs 95–97.

107. The tables below provide further quantitative information in this respect—based on prudential information:

Prudential balance sheet of French insurance entities		
in billions EUR	2018	2019
Investments - excluding unit-linked	2 177	2 335
Investments - unit-linked	349	402
Cash and deposits	65	68
Other assets	197	213
Total assets	**2 788**	**3 018**
Net assets	325	381
Insurance liabilities (w/o unit-linked)	1 844	1 950
Life with profit sharing †	*1 501*	*1 594*
Life without profit sharing	*134*	*142*
Non-life	*124*	*125*
Health	*84*	*89*
Insurance liabilities (including unit-linked) (Life)	340	389
Other liabilities	279	298
Total liabilities and net assets	**2 788**	**3 018**

† '*Assurance avec participation aux bénéfices*' -- 75 per cent of total life insurance liabilities (excl. health) in 2019

Adapted from the following publications:

Les chiffres du marché français de la banque et de l'assurance 2019, Banque de France, October 2020

Les chiffres du marché français de la banque et de l'assurance 2018, Banque de France, October 2019

Insurance liabilities for contracts with intergenerational mutualisation		
as % of French insurance entities'…	2018	2019
… life insurance liabilities (excl. unit-linked contracts)	92%	92%
… life insurance liabilities (incl. unit-linked contracts)	76%	75%
… total prudential balance sheet	54%	53%

- **For French life insurance contracts, the annual cohort requirement results in no relevant, reliable and comparable information**

  - **The annual cohort requirement results in no relevant information**

    - **The requirements specifying the allocation of FCF to the annual cohorts**

108. The fulfilment cash flows (FCF) that an entity estimates to measure insurance contracts—and thus, to determine the CSM—include the future cash flows the entity expects to pay to the policyholders[15]. For the insurance contracts as described in paragraphs 95–99 above, this estimate includes (i) the amounts of guaranteed payments to the individual policyholders (if applicable), (ii) the minimum policyholders' participation—ie the share in the returns of the underlying items to which the policyholders as a whole are contractually or legally entitled—and, if applicable, any additional expected discretionary payments above the contractual minimum.

109. Consistent with the legal and contractual terms, an entity estimates those FCF at the level of the *portfolio of insurance contracts*[16] as defined in IFRS 17. The portfolio usually reflects the whole population of contracts—irrespective of their issuance date—that have a right to the returns of the same specified pool of underlying assets.

110. Paragraphs 24 and 33 of IFRS 17 permit an entity to do so provided it is able to include the appropriate FCF in the measurement of the *group of insurance contracts* as defined in IFRS 17—ie to the sets of contracts resulting from the division of a portfolio of contracts applying the requirements in paragraphs 16–23 of IFRS 17 (including the annual cohort requirement). In other words, an entity may *estimate* the FCF at the level of the *portfolio* of contracts but it is ultimately required to *measure*

[15] They also include (i) a risk adjustment for non-financial risk and (ii) an adjustment to reflect the time value of money applying paragraph 32 of IFRS 17.

[16] Appendix A to IFRS 17 defines a portfolio of insurance contracts is insurance contracts subject to similar risks and managed together.

groups of contracts and thus, to allocate the estimated FCF to each group of contracts. Applying the annual cohort requirement, each annual cohort will account for a group of contracts—in this case, the entity allocates FCF to each annual cohort and thus, determines a CSM for each cohort.

111. When allocating FCF to each annual cohort, an entity will also consider the requirements in paragraphs B67–B71 of IFRS 17. In the light of the features set out in paragraphs 95–99 above, French contracts with intergenerational mutualisation are contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts. For such contracts, paragraph B68 of IFRS 17 requires the FCF of each group to reflect the extent to which the contracts in the group cause the entity to be affected by expected cash flows, whether to policyholders in that group or to policyholders in another group. Accordingly, paragraph B67(a) requires the FCF for a group of contracts to include payments arising from the terms of *existing contracts* to policyholders of contracts in other groups, regardless of whether those payments are expected to be made to *current* or *future* policyholders. As explained in paragraph BC172 of IFRS 17, this means, given the discretion the entity has, that some of the amounts based on the underlying items may be paid to policyholders of contracts that will be issued in the future, rather than to existing policyholders.

- **The annual cohort is not the level at which an entity is able to determine profitability**

112. ANC thinks that the requirements in paragraph B67–B71 of IFRS 17 are necessary to reflect the facts that (i) contracts with intergenerational mutualisation share the returns from a single pool of underlying items and (ii) the allocation to individual policyholders depends on the discretion of the entity's management's. Accordingly, ANC thinks the requirements in paragraph B67–B71 of IFRS 17 provide relevant information.

113. Furthermore, ANC agrees that, <u>at the initial recognition of newly-issued insurance contracts</u>, those paragraphs enable an entity to determine meaningful FCF and, thus a meaningful CSM for those newly-issued contracts. This is because, at the initial recognition of those contracts, the entity is able to make expectations about:

   a. the returns it will collect from investing the premiums received (based on current market risk premiums);

   b. the amount of future discretionary payments it expects to pay to the new group of contracts —by comparing the estimated future payments *before* and *after* issuing the new contracts.

114. However, <u>after the initial recognition of a new group of contracts</u>, an entity does not track separately the underlying items by generations of contracts. This is because the contractual terms state that all policyholders share in the returns from a single pool of underlying items and that the joint profit sharing is determined collectively for the policyholders as a whole. Consequently, the entity has no reason to determine separately the expected returns from the underlying items on an annual cohort basis.

115. Furthermore, because the entity's management exercises its discretion about (i) when it will realise the underlying items and (ii) how and when it will allocate the collective profit sharing to individual policyholders, it does not estimate the future discretionary payments for each annual cohort or for each policyholder.

116. In the light of the observations in paragraphs 114–115, '*the extent to which the contracts in the group cause the entity to be affected by expected cash flows*' is not determinable for an annual cohort. Because an entity cannot determine the FCF of an annual cohort, it is also unable to determine a CSM for that same cohort. In those conditions, the annual cohort requirement is unable to result in useful information. Profitability is instead determined at a higher level of aggregation than an annual cohort.

- **The annual cohort requirement leads to allocations that do not reflect the legal and contractual terms of the contracts**

117. The requirements in IFRS 17 will lead an entity to perform allocations of FCF to annual cohorts. Such allocations do not reflect the legal and contractual features of the contracts as described in paragraphs 95–99, and accordingly, cannot provide relevant information.

118. This is because, it will force, at each reporting date, the allocation of *unrealised* gains to annual cohorts that are actually entitled to *realised* gains, upon management's subsequent discretion over (i) the amount that will be paid to the policyholders of each cohort and (ii) the timing of payment to those policyholders—existing policyholders at a specific reporting date will not receive any gains if their contract terminates before management exercises its discretion whereas future policyholders may benefit from the realised gains.

- **Applying the annual cohort requirement to contracts for which the entity's management can contractually exercise its discretion will result, after their initial recognition, in a subjective determination of a cohort's CSM**

119. Paragraph 23 of Agenda Paper 2B for the February 2020 IASB meeting outlines—consistent with the observations in (i) paragraphs 113 and 138 of this letter and (ii) paragraph BC139L of IFRS 17—that an entity is required to identify the effect of new contracts it issues to first recognise them in the financial statements, irrespective of the application of the annual cohort requirement. This paragraph goes on and explains that '…*the question, therefore, is whether having identified the [CSM] for new contracts, there is sufficient benefit in tracking those amounts subsequently for each individual annual cohort to justify the cost of doing so*…'. Paragraph 23 identifies information about trends in profitability for the entity's share of the participation in the underlying items as one of the benefits of applying the annual cohort requirement.

120. In paragraph 25 of the aforementioned Agenda Paper, the staff go on and explain that they '…*observe that an entity's ability to change the way the returns on underlying items are shared between the entity and the policyholders as a whole affects the usefulness of [information about trends in profitability for the entity's share of the participation in the underlying items]… If the entity's share is discretionary […], the assumption that determines the initial amount of the [CSM] for the new cohort becomes subjective, and the benefit of tracking these subjective amounts may be reduced*'.

121. For contracts as described in paragraphs 95–99 of this letter, the policyholders' minimum share in the underlying items arises from the realised returns from the pool of underlying items. This implies that the policyholders' profit sharing, and therefore the entity's share, depend on how the entity's management exercises its discretion to realise the underlying items[17].

122. Accordingly, even though an entity is able to determine in a rational manner the CSM of a group of contracts at initial recognition, in subsequent periods, the CSM is affected by changes in how management expects to exercise its discretion. The CSM is therefore subjective and changes over time depending on management's decisions. Such decisions are not made at a cohort level—this is because an entity does not contractually determine the policyholders' profit sharing at that level. Accordingly, consistent with the observations in paragraph 120 above, ANC thinks there is no benefit in tracking a cohort's CSM after the initial recognition of that group of contracts.

123. In paragraph 63 of Annex 1 to the DEA, some supporting the application of the annual cohort to contracts with intergenerational mutualisation say that the possibility to share unrealised gains with current and future policyholders (if and when an entity issues new contracts) does not negate the existence of a CSM for the entity's shareholders. ANC disagrees with this view. In the absence of any contractual linkage between the returns of the underlying items and the annual cohorts, the fact that unrealised fair value gains may be discretionarily shared between existing and future policyholders implies that the entity's share in those gains cannot be determined for each cohort. Because that amount is not determinable, it is questionable that a CSM 'exists' at a cohort level.

124. Those supporting the application of the annual cohort requirement to contracts with intergenerational mutualisation also quote the IASB's observation in paragraph BC139J of IFRS 17 whereby '…*for example, a 20 per cent share in fair value returns created by an annual cohort for which the fair value returns during the coverage period are 5 per cent is more profitable for an entity than a 20 per cent share in fair value returns created by an annual cohort for which the fair value returns during the coverage period are 1 per cent*'. The IASB's observation is based on the assumption that the entity's share in the underlying items is fixed and thus, that the entity's profitability is derived by applying this fixed percentage to the changes in the fair value of the underlying items. That observation also assumes that an entity can relevantly allocate the returns from the underlying items to a specific cohort. This observation might be relevant for some insurance contracts but it does not apply to the French life insurance contracts as described in paragraphs in paragraphs 95–99 above—for those contracts, the entity's share in the underlying items is based on realised gains from those items and varies depending upon the entity's discretion about when it recovers the value of the underlying items. Accordingly, ANC thinks the IASB's observations in paragraph BC139J of IFRS 17 do not justify the application of the annual cohort requirement to French life insurance contracts.

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[17] ANC disagrees with the IASB's observation in paragraph BC139J of IFRS 17 whereby '…*the entity's share in the fair value returns depends on the contractual terms of each annual cohort and the economic conditions during the coverage period of each annual cohort*…'. The entity's share also depends on the entity's management's discretion for contract with intergenerational mutualisation.

- **The annual cohort requirement does not faithfully reflect the investment service to the policyholders**

125. An entity that is party to a contract with intergenerational mutualisation manages a single pool of underlying items, the returns of which (mostly) benefit to the policyholders as a whole. The service that the entity renders in those circumstances is to manage the underlying items on behalf of the policyholders as a whole—the entity does not, in substance, render a service to individual policyholders or to separate cohorts of policyholders.

126. Accordingly, the entity's management makes investment decision considering market conditions together with its expectations about policyholders' behaviour. The time horizon is therefore the expected lifetime of all contracts that share in the single pool of underlying items.

127. This also implies that (i) the entity's share in the underlying items is earned over the lifetime of all outstanding contracts and (ii) the entity's share in the underlying items is known only after all contracts have expired. For example, at the initial recognition of a new group of contracts, the entity may invest the related premiums in equity instruments and then hold those instruments over a period that is longer than the lifetime of the new group of contracts. In those circumstances and because the returns from the underlying items only consist of realised gains, (i) the policyholders in the new group of contracts will benefit from the returns accumulated in previous periods from other pre-existing underlying items whereas (ii) future policyholders will benefit from the fair value returns from the aforementioned equity instruments.

128. However, applying the annual cohort requirement results in (i) allocating (unrealised) fair value gains of a period to existing policyholders only, and (ii) the insurer not recognising any share in the underlying items after the last contract in the cohort of newly issued contracts has expired.

129. In other words, the annual cohort requirement leads to the situation in which the entity's share in the fair value of the underlying items—ie the CSM—is spread over a period shorter than the period during which the entity renders service to the policyholders as a whole. In ANC's view, this contradicts the overarching objective in IFRS 17 of aligning the CSM allocation with the service rendered.

- **The annual cohort requirement necessitates the use of judgement to such an extent that it results in information that is neither reliable nor comparable**

  - **The IASB acknowledged that the annual cohort requirement will require the use of judgement**

130. In paragraph BC139K of IFRS 17, the IASB explains it identified two aspects of applying the annual cohort requirement to contracts similar to those described in paragraphs 95–99 that could increase the costs of applying this requirement and reduce the benefits of the resulting information:

    a. distinguishing between the effect of risk sharing and the effect of discretion—the IASB developed further this aspect in paragraph BC139L of IFRS 17; and

    b. allocating changes in the amount of the entity's share of the fair value between annual cohorts that share in the same pool of underlying items—the IASB developed further this aspect in paragraph BC139M of IFRS 17.

131. The IASB acknowledged in paragraphs BC139L and BC139M that those two aspects would require the use of judgement.

132. ANC agrees with the identification of those two aspects it had raised in past letters or technical analyses.

133. The use of judgement is, itself, not a problem—ANC agrees that the use of judgement is an essential part of principle-based Standards. However, the use of judgement has inherent limitations: when there is no objective basis on which an entity is able to apply its judgement, the resulting accounting information is unlikely to be reliable, comparable, and more broadly-speaking, useful. ANC thinks that, in some circumstances, an entity is unable to apply its judgement in a rational manner in order to comply with the annual cohort requirement.

134. ANC disagrees with the IASB's view in paragraph BC139M of IFRS 17—view with which some stakeholders agree as described in paragraph 21 of Annex 1 to EFRAG's cover letter. The IASB explains that the judgements an entity makes '*will provide users of financial statements with useful information about how management expects the performance of insurance contracts to develop'*. In ANC's views, this statement does not hold true when the terms of the contracts specify that the policyholders' profit share is determined at a higher level of aggregation than the group of insurance

contracts. In this case, management has no reason to set expectations about how the business will unfold at the level of each cohort because this is not relevant when determining the policyholders' share in the underlying items—and thus, when determining the entity's share as well.

135. Paragraphs 137–147 below discuss further the extent to which an entity would apply its judgement when applying the annual cohort requirement.

136. ANC thinks helpful to remind that for both direct and indirect participating contracts that have intergenerational mutualisation, an entity's expected profit at the end of the reporting period is affected by:

    a. the expected profit from contracts issued during the period,

    b. the fair value returns from the underlying items; and

    c. the changes in assumptions that affect the estimate of the FCF for existing contracts.

    The annual cohort requirement introduces significant judgement by requiring to allocate items (b) and (c) to each annual cohort.

- **An entity is unable to perform a rational allocation of FCF—and thus, to determine a CSM at a cohort level—after the initial recognition of a group of contracts**

137. For ease of reference, ANC prepared, in Appendix C to this letter, an example outlining the practical challenges an entity issuing contracts as those described in paragraphs 95–99 would face if it were to apply the annual cohort requirement. Specifically, this example illustrates the circumstances in which an entity issues contracts that share the returns from a common pool of underlying items and has discretion about (i) when it realises the gains from the underlying items and (ii) the amount and timing of the allocation to the policyholders of such gains.

138. As explained in paragraph 235 of Appendix C and consistent with the observations in paragraphs 112–113, ANC agrees that the requirements in IFRS 17 for the allocation of FCF to annual cohorts enable an entity to apply its judgement in a rational manner **when it issues new contracts that share in the existing pool of underlying items**.

139. Accordingly, ANC agrees with the IASB's observation in paragraph BC139L of IFRS 17 whereby an entity is required to apply judgement to measure new contracts recognised in a period, irrespective of the existence of the annual cohort requirement[18]. In ANC's view, this is because the entity is able to compare the expected FCF of the portfolio of contracts *before* and *after* the issuance of the new contracts and thus, is able to derive the FCF related to the cohort including the newly-issued contracts.

140. Having said that, the IASB's observation holds true only when the entity issues new contracts. After the entity has issued those contracts, **the entity is unable to apply its judgement to perform a rational allocation of FCF to annual cohorts, in particular when the entity's management changes its expectations about how it will exercise its discretion**—see paragraphs 260–262 of Appendix C. Consistent with the observations in paragraphs 114–116, this is mainly because:

    a. no individual contract is entitled to a determinable share in returns from the underlying items. The policyholders as a whole are entitled to such returns. An allocation to each annual cohort is not objectively determinable—cash flows are fungible both within the group of contracts and across generations of policyholders, including future policyholders.

    b. the allocation of the returns from the underlying items to individual contracts occurs only when the entity's management exercises its discretion—there is no such allocation when a change in the fair value of the underlying items occurs.

    c. the underlying items are managed as a single pool and are not tracked by annual cohorts.

141. In paragraph 21 of Annex 1 to EFRAG's cover letter, those supporting the application of the annual cohort requirement to contracts with intergenerational mutualisation contend that this requirement does not add complexity as such—this is because an entity would be required to apply the same judgement to the same extent to measure new insurance contracts recognised during the reporting period even without applying the annual cohort requirement.

142. As explained in paragraph 236, ANC agrees that paragraph 104 of IFRS 17 would require an entity

[18] In paragraph BC139L of IFRS 17, the IASB explained that '…*an entity with such discretion is required to apply additional judgement compared to an entity without such discretion to allocate changes in FCF between groups in a way that appropriately reflects the effect of risk sharing and the effect of the discretion. However, that judgement is required to measure new contracts recognised in a period, so would be needed even without the annual cohort requirement'.*

to determine the CSM of newly issued contracts for disclosure purpose. This implies that, regardless of whether the annual cohort applies, an entity assesses the extent to which cash flows to newly written contracts may affect or be affected by existing contracts. However, the annual cohort requirement introduces undue complexity because it requires apportioning the entity's expected profit not only between newly-issued and existing contracts but also across generations of contracts.

143. In addition, as explained in paragraphs 112–113 and 138–139, an entity can develop meaningful expectations about the expected profitability of the new contracts it issues when the entity first recognises them—the entity does this by comparing its expected share in the underlying items before and after writing the contracts under current market conditions. However, after the initial recognition of the group, the entity is unable to apply this practical expedient because the underlying items are no longer at market conditions and are part of a single pool of underlying items that backs all generations of contracts.

- **An entity is unable to rationally allocate the changes in the amount of its share of the fair value of the underlying items between annual cohorts**

144. Applying paragraphs 45(b) or B98 of IFRS 17, the entity adjusts the carrying amount of the CSM of a group of contracts by its share of the change in the fair value of the underlying items.

145. As outlined in a past ANC's technical note on the level of aggregation, IFRS 17 does not specify how an entity allocates the changes in the amount of its share of the fair value of the underlying items across annual cohorts that share in the same pool of underlying items.

146. This was acknowledged:

    a. in paragraph 21(c) of Agenda Paper 2B for the February 2020 IASB meeting. In this paragraph, the IASB staff acknowledged that determining an allocation methodology that provides relevant information is challenging: '…*but with appropriate judgement, allocation approaches can be identified that do provide useful information, albeit that determining which method of allocation provides the most useful information can be a difficult judgement to make*'.

    b. in paragraph BC139M of IFRS 17. In this paragraph, the IASB acknowledged, without commenting further or providing helpful insight, that *'IFRS 17 does not include specific requirements for allocating those changes between annual cohorts that share in the same pool of underlying items*… [and] *that an entity needs to apply judgement to choose an allocation approach that provides useful information about the participation of each annual cohort in the underlying items*'.

147. For reasons similar to those described in paragraph 140 and as illustrated in paragraph 246, ANC observes that there is no rational basis on which an entity can allocate its share of the change in the fair value of the underlying items.

- **Implications of the inability of applying judgement in a rational manner**

148. In ANC's view, this will result in entities developing practical expedients to try reflecting the effects of mutualisation between groups of contracts. Entities will have to use allocation keys that relate neither to their business nor to the terms of the contracts. Accordingly, the annual cohort requirement will result in entities recognising in profit or loss a CSM having no economic meaning and thus, reflecting a performance that is not reliable. In contrast, determining the CSM at the level of the mutualised portfolio of contract would provide reliable information.

149. Entities in France express major concerns about the effects on their financial performance arising from the arbitrary allocations required by the annual cohort requirement.

150. Auditors in France also express similar concerns. They note that the annual cohort requirement is not consistent with (i) the way contracts are managed and (ii) the legal/contractual terms of these contracts. This will therefore require entities' extensive use of judgement to implement the annual cohort requirement.

151. The inability of applying judgement in a rational manner will also result in information that is not comparable (i) from period to period within a reporting entity and (ii) in a single period across reporting entities. The lack of comparable information is unlikely to provide useful information about (i) trends in the contracts' profitability and (ii) how an entity performs in comparison to its peers.

- **The annual cohort requirement has no added-value with regard to the contracts that include a financial guarantee which reduces the payments to policyholders in other groups of contracts**

152. Some stakeholders have relentlessly overemphasized the case of guarantees to justify the relevance of the annual cohort requirement. The IASB's observations in paragraphs BC139O and BC139P have fostered the interest in this requirement. In paragraph BC139P, the IASB '…*acknowledged that for some insurance contracts with substantial intergenerational sharing of risks, the effect of financial guarantees and other cash flows that do not vary with returns on underlying items would rarely cause an annual cohort to become onerous. However, the Board disagreed with stakeholders who said that the rarity of such an event makes less useful the information that results from applying the annual cohort requirement to such insurance contracts. The Board instead observed the rarity makes the information particularly useful to users of financial statements when such an event occurs. The Board identified such information about the effect of financial guarantees as being particularly important when interest rates are low*'.

153. As explained in paragraph 98, French life insurance contracts with intergenerational mutualisation may include a guaranteed minimum interest rate. However, those financial guarantees are paid out of the policyholders' profit sharing and thus, reduce the amount available for the discretionary allocation to policyholders in other groups. Accordingly, the 'cost' of those guarantees is born by the policyholders as a whole as long as the returns from the underlying items are sufficient to meet the guaranteed amounts. Consequently, the guaranteed payments are cash flows that affect the cash flows to policyholders of other contracts as defined by paragraphs B67–B71 of IFRS 17. They affect the entity's share in the underlying items only to the extent that the fair value returns from the underlying items are insufficient to pay off the cost of guarantees.

154. As explained in paragraphs 285–287, the annual cohort requirement does not, in those circumstances, result in more useful information than in a situation in which the entity would not apply that requirement.

155. Paragraph 36 of Annex 1 to EFRAG's cover letter relates the view of those supporting the application of the annual cohort requirement who say that it is important to acknowledge that whenever financial guarantees affect the CSM—either in full or partially when the risk is shared with policyholders—this may significantly affect the estimated profitability of a group of contracts and accordingly, the variable fee and the CSM. Annual cohorts would enable, in their view, to capture this without necessarily adding complexities relating to tracking of assets.

156. ANC observes that this view correctly outlines that financial guarantees may not affect the CSM ('either in full or partially') but forgets to highlight that the effect of financial guarantees may be fully absorbed by policyholders in other groups. This is especially the case within the context of contracts with cash flows that affect or are affected by cash flows to policyholders in other groups—French life insurance contracts have that feature. For such contracts, paragraph B69 of IFRS 17 indirectly illustrates that the CSM may not be affected by the guaranteed cash flows to the extent that such guaranteed payments decrease the profit sharing of policyholders in other groups. Furthermore, within this context, regardless of whether the absorption is integral or partial, the fact that some contracts may be entitled to a guaranteed return does not make the expected profitability determinable for each annual cohort. Paragraphs B67–B71 of IFRS 17 acknowledge the interdependencies across contracts in various groups and consequently, that the expected cash flows—ultimately the CSM because the CSM is a residual—cannot be adequately determined considering the group in isolation Accordingly, regardless of whether the contracts are entitled to guaranteed amounts, within the context of contracts with cash flows that affect or are affected by cash flows to policyholders in other groups, the annual cohort requirement does not provide relevant information about profitability.

- **Costs of applying the annual cohort requirement to contracts with intergenerational mutualisation**

  - **ANC's assessment of the costs of the annual cohort**

157. ANC agrees with the comments in paragraphs 32–35 of Annex I to EFRAG's cover letter.

158. However, those paragraphs do not, surprisingly, outline the fact that the IASB, itself, admitted there is a valid question about whether the benefits of the annual cohort requirement significantly exceed its costs.

159. Paragraphs BC139I–139S of the *Amendments to IFRS 17* include the IASB's observations about

applying the annual cohort requirement to insurance contracts with intergenerational sharing of risks between policyholders. In paragraph BC139Q, the IASB '*…concluded the costs of the annual cohort requirement might exceed the benefits of the resulting information for only a very limited population of contracts. The population is much smaller than some stakeholders had suggested*'. In paragraph BC139S, the Board went on and '*…concluded that for all but a very limited population of contracts there is no question that the benefits of the annual cohort requirement significantly outweigh the costs. For a very limited population of contracts the costs and benefits of the requirement are more finely balanced. However, it is not possible to define that population in a way that does not risk it becoming too broad. The Board therefore decided to retain the annual cohort requirement unchanged*'. In other words, the IASB admitted the annual cohort requirement may not meet the 'cost-benefits' criterion for *'a very limited population of contracts'*, although concluding that specifying an exemption from the annual cohort requirement would not be feasible.

160. ANC welcomes such an acknowledgement. However ANC disagrees with the fact that the affected population of contracts is 'very limited'—from a European perspective, this population is far from being 'very limited'. In particular, ANC understands that the IASB has restricted the population of contracts with substantial intergenerational sharing of risks to include contracts for which the entity has the discretion to allocate discretionary bonuses beyond the contractual minimum profit sharing[19]. However, as described in paragraphs 96–97, French life insurance with intergenerational mutualisation permits the entity to exercise its discretion as to when it realises the underlying items. In ANC's view, the population of contracts is significantly wider than the population identified by the IASB.

161. In addition, the observation that defining this population without creating the risk of capturing a wider population is predicated upon the assumption the population of contracts subject to any exemption should be limited. We question this assumption and think the objective should be to develop an exemption for the contracts to which the annual cohort requirement does not provide relevant information, irrespective to the size of the affected population of contracts—if this population is too wide, this might indicate the annual cohort was not the right way forward to address the unit of account of insurance contracts.

- **Paragraphs BC138 and BC139G of IFRS 17 do not provide an optional 'disapplication' of the annual cohort requirement for French life insurance contracts and as such do not provide any practical relief**

162. During its deliberation process, EFRAG has been made aware of differing views about the reading, and implications, of paragraphs BC138 and BC139G included in the Basis for Conclusions on IFRS 17.

163. Paragraph BC138 explains why the IASB decided not to provide an exception to the annual cohort requirement. It states (emphasis added) : '*…the Board acknowledged that, for contracts that fully share risks, the groups together will give the same results as a single combined risk-sharing portfolio, and therefore considered whether IFRS 17 should give an exception to the requirement to restrict groups to include only contracts issued within one year… IFRS 17 does not include such an exception. <u>Nonetheless, the Board noted that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts</u>. Therefore it may not be necessary for an entity to restrict groups in this way to achieve the same accounting outcome in some circumstances*'.

164. The IASB reiterated its view in paragraphs BC139G included in the Basis for Conclusions on the *Amendments to IFRS 17*. This paragraph states (emphasis added): *'Some stakeholders said that in some circumstances they could achieve at much less cost the same or a similar outcome without applying the annual cohort requirement as would be achieved applying that requirement. The Board concluded that it is unnecessary to amend IFRS 17 to reflect such circumstances. <u>The Board reaffirmed its view that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts (see paragraph BC138)</u>. An entity is required to apply judgement and to consider all possible scenarios for future changes in expectations to conclude whether it could achieve the same accounting outcome without applying the annual cohort requirement*'.

165. ANC also notes that the IASB published an educational material that added to the confusion about the reading of paragraphs BC138 and BC139G by providing a summary that does not entirely reflect the observations included in those paragraphs. That material states (emphasis added):'*…in some*

[19] ANC holds this view because paragraph BC139L that discusses the judgement required to distinguish the effect of risk sharing and the effect of discretion focuses on '*…the circumstances in which an entity has discretion over the portion of the fair value returns on underlying items that the entity pays and the portion that the entity retains. For example, an entity may be required under the terms of the insurance contracts to pay policyholders a minimum of 90 per cent of the total fair value returns on a specified pool of underlying items, but have discretion to pay more…*'

cases, applying the IFRS 17 requirements at a more aggregated level than envisaged by the annual cohort requirement may produce an outcome that is not materially different from the outcome applying the annual cohort requirement… Applying the annual cohort requirement may not always be necessary...'. In contrast, paragraphs BC138 and BC139G do not include any reference to the materiality concept.

166. ANC understands that some stakeholders read paragraphs BC138 and BC139G as permitting an entity to not apply the annual cohort requirement when contracts included in a group fully share risks, or share a high percentage of those risks. Accordingly, in those stakeholders' view, paragraphs BC138 and BC139G could ease the implementation of the annual cohort requirement.

167. ANC thinks that the Board's observations included in those paragraphs do not provide any practical relief for the life insurance contracts as described in paragraphs 95–99. This is because:

    a. the prohibition of grouping contracts if they are written more than 12 months apart is explicitly stated as part of the requirements in IFRS 17. Paragraphs BC138 and BC139G cannot override the requirements in this IFRS Standard.

    b. the IASB's observation in paragraph BC138 applies to groups including contracts that *fully* share risks—in those very specific circumstances, applying or not applying the requirement in paragraph 22 would lead to the same accounting outcome[20]. In ANC's view, if the contracts included in a group were to share a *high proportion* of risks, not applying the annual cohort requirement may produce an outcome that may not materially be different from the outcome of applying that requirement; however, this is not the fact pattern the IASB considered in paragraph BC138.

    c. If an entity were to be permitted not to apply the annual cohort requirement when the contracts share a high proportion of risks, it would have, from a practical perspective, to demonstrate that the outcome would not materially differ from the outcome that would derive if the annual cohort requirement applied. ANC notes such a demonstration would be burdensome and the IASB's observation would not result in any significant relief. This relief may not even exist at all—this is because, consistent with the Board's observation in paragraph BC139G, an entity would have to consider *all* possible scenarios for future changes in expectations to conclude whether it could achieve the same accounting outcome without applying the annual cohort requirement.

- **ANC's proposed exemption to the annual cohort requirement**

    - The proposed exemption

168. In a letter dated May 2020[21], ANC proposed to the IASB an exemption to the annual cohort requirement that would apply to contracts with intergenerational sharing of risks between policyholders. In ANC's view, the scope of the proposed exemption adequately captures the features of contracts for which the application of the annual cohort requirement does not provide relevant information.

169. ANC's proposal is an *exemption* to the annual cohort requirement—ie an entity can opt-out from the requirement in paragraph 22 of IFRS 17 when it issues contracts that meet the criteria in paragraph 170 below but would nonetheless apply the aggregation requirements specified in paragraphs 14–21 of the Standard. Given the mixed views existing among European stakeholders about the annual cohort requirement, ANC thinks preferable to define an *exemption* rather than an *exception*—an exception would *require* an entity not to apply paragraph 22 of IFRS 17 to some contracts.

170. Applying ANC's suggested exemption, an entity could elect to *not* apply the annual cohort requirement to a groups of contracts that meets the three following criteria:

    a. the group of contracts only includes contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts as described in paragraphs B67–B71 of IFRS 17;

    b. the contracts in the group jointly participate in a share of returns on a clearly identified

[20] ANC thinks that paragraph 20 of Agenda Paper 2C for the March 2019 IASB meeting confirms this reading.
[21] This letter can be found on the following link:
http://www.anc.gouv.fr/files/live/sites/anc/files/contributed/ANC/2.%20Normes%20internationales/NI2020/ANC_Suggestion_for_scoping_an_exception_to_annual_cohorts.pdf

common pool of underlying items. Contracts jointly participate when the entity exercises discretion in relation to the timing and allocation of the total policyholders' profit share to individual policyholders; and

c. the contracts in the group are insurance contracts with direct participation features as specified in paragraph B101 of IFRS 17—accordingly, the VFA model applies to those contracts.

171. The entity would also:

  a. disclose the information required in paragraphs 101 and 104 separately to each group of contracts to which the exemption would apply;

  b. provide information about (i) the actuarial technique applied for determining the CSM effect of new business on the groups of contracts to which the exemption would apply and (ii) the detailed features of such groups.

172. Paragraphs 10–35 of ANC's letter published in May 2020 explain the rationales supporting this exemption. For ease of reference, ANC summarises below the key considerations it considered when developing this exemption.

173. The first criterion of ANC's proposed exemption enables to target groups of contracts with interdependencies ie contracts for which policyholders share risks of the changes in FCF.

174. The second criterion enables to target groups of contracts :

  a. in which no contract is entitled to a separable profit share in a subset of the underlying single items before the entity's management exercises its discretion. Because cash flows are fungible both within the group and across generations of policyholders, including future policyholders, an entity cannot objectively allocate the returns from the underlying items to each annual cohort. Accordingly, for such groups of contracts, the entity cannot determine a CSM for each cohort—the entity has besides no reason to monitor the profitability of such contracts at an annual cohort level.

  b. for which the profit share is mutualised across generations of policyholders.

175. The third criterion limits the scope of the proposed exemption to contracts with intergenerational mutualisation that *predominantly* include fungible cash flows across generations of policyholders. The higher the proportion of fungible cash flows, the less relevant the annual cohort requirement is. French insurance contracts include financial guarantees that are mutualised between generations of policyholders. ANC acknowledges this criterion also captures contracts that include financial guarantees that are not shared across generations of policyholders—French life insurance contracts do not usually include such types of financial guarantees but entities in other jurisdictions happen to issue contracts that have financial guarantees specific to individual policyholders are thus, are not mutualised across generations of policyholders. Having said that, ANC observes that to apply the VFA model, paragraph B101(c) requires an '*entity* [to] *expect a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items*'. This implies, in ANC's view, that the effect of changes in cash flows that do not vary based on the changes in the underlying items, (ie are not shared with other policyholders, the 'fixed cash flows') should be small.

176. The combination of the criteria above ensures that the exemption captures only contracts whose fixed cash flows (including guarantees) are either shared (criteria (a) and (b)) or small (criterion(b))—in other words, the effect of significant guarantees is shared between policyholders.

177. ANC also notes that other stakeholders proposed exemptions that are similar to, or supplement, its exemption. ANC thinks those exemptions are worth being considered.

178. ANC reproduced in Appendix D to this letter (i) the reply it received on 5 June 2020 from the IASB in relation to ANC's proposed exemption and (i) the answer ANC sent to EFRAG on 19 June 2020 further to the IASB's response. ANC thinks the IASB has not provided compelling technical evidence to reject ANC's proposed exemption.

- The operability of an exemption to the annual cohort requirement

179. ANC thinks that the criteria set out in paragraph 170 are sufficiently clear to ensure that the exemption can be easily implemented. ANC has not identified any significant 'side-effects' of such an exemption on the application of the other requirements in IFRS 17—in other words, this exemption would not undermine the application of the Standard. Accordingly, ANC disagrees with those saying that there is no alternative to the annual cohort requirement.

180. ANC is also unconvinced by the IASB's observations in paragraph BC139R that set out the IASB's rationales for not developing an exemption to the annual cohort requirement. In particular, in paragraph BC139R(a), the IASB observed that '… *any focused exemption would be complex because of the interaction between contract features that increase the costs and reduce the benefits. An exemption would therefore result in difficulties for entities and auditors in identifying which contracts would be exempted*...'. French entities and French auditors do disagree with that statement because the application of the annual cohorts results in undue operational costs for no informational benefits—they prefer applying an exemption that captures a clearly-defined population of contracts and that results in useful information. Should its proposed exemption creates complexity, ANC thinks this complexity is not commensurate to the complexity that the annual cohort entails.

181. As explained in paragraph 63 of Annex 1 to EFRAG's cover letter, some say that developing an exception to the annual cohort would necessarily rely on arbitrary criteria and would unduly increase the complexity of FRS 17—that argument is similar to the IASB's observation in paragraph BC139R of IFRS 17 whereby '…*there is no way to specify the scope of the exemption other than by using arbitrary thresholds*…'. ANC disagrees with this view. A clearly-defined and targeted exemption to the annual cohort requirement, such as ANC's proposed exemption, would limit the scope of that exemption to contracts for which the annual cohort requirement does not provide relevant information. This would not necessarily increase the complexity of the Standard's implementation. In ANC's view, simplicity should not be achieved at the expense of relevant information. IFRS 17 is already a very complex Standard. ANC prefers a Standard providing relevant information with little incremental complexity to a Standard that fails to deliver relevant information for a wide population of contracts. ANC also notes that the complexity resulting from identifying the contracts in the scope of an exemption would be largely offset by the benefits of that exemption—that is providing relevant information and providing relief from the costs of implementing the annual cohort requirement.

182. ANC does not either agree with the view described in paragraph 65 of Annex 1 to EFRAG's cover letter whereby some say that the stakeholders who proposed exemptions had not demonstrated that those exemptions would result in better information than the annual cohort requirement. In ANC's view, the objective of an exemption is to relieve preparers from the operational complexity of applying a requirement that, for a specific population of contracts, does not provide relevant information at all. The point is not to provide better information, it is simply to provide relevant information.

183. ANC appreciates the concerns described in paragraph 41 of Annex 1 to EFRAG's cover letter whereby an exemption may result in the loss of useful information in relation to contracts that include fixed cash flows and whose risks are not fully mutualised. Having said that, those expressing such concerns cannot refer to any exemption whatever its boundaries might be. The loss of useful information depends on the proposed exemption's scope. In that respect, ANC notes that its proposed scope for an exemption includes robust criteria ensuring that there would be no significant loss of useful information—applying this exemption, the fixed cash flows in the contracts should be small.

184. Accordingly, ANC disagrees with those who say there is no viable alternative to the annual cohort requirement. ANC thinks there are viable options on the table. Pointing out a lack of viable solution to justify the assessment of the annual cohort's effectiveness when the IASB performs its *Post Implementation Review of IFRS 17* is not, in ANC's view, a valid argument to support the endorsement of the annual cohort requirement.

- Applying IFRS 17 without the annual cohort requirement

185. Some stakeholders have arguably asked how an entity would apply the requirements in IFRS 17 if it were to apply ANC's proposed exemption.

186. As mentioned in paragraph 179, not applying the annual cohort requirement does not prevent an entity from applying the other requirements in IFRS 17. In those circumstances, an entity would still apply the requirements in paragraphs 14–21 of IFRS 17 to identify groups of contracts. Those groups would just not be disaggregated into annual cohorts. The entity would determine the FCF of such groups and would determine their CSM applying the measurement requirements in IFRS 17. The entity would not be forced to perform arbitrary allocations (see paragraphs 140 and 147) that do not reflect the contractual terms.

187. Paragraphs 264–275 illustrate how an entity would prepare its financial statements in those circumstances.

188. In Annex I to EFRAG's draft cover letter, those supporting the application of the annual cohorts to intergenerationally-mutualised contracts have outlined limitations that would arise from not applying the annual cohort requirement. In ANC's view, those comments might show there are significant misunderstandings about the accounting that an entity would apply in those circumstances and, to some extent, some overstatement of the annual cohort requirement's informational value.

189. In paragraph 29 of Annex 1 to EFRAG's cover letter, some say the annual cohorts would avoid indefinite re-averaging of a group's CSM. In paragraph 31 of this same annex, those stakeholders go on and say that, without the annual cohort, some of the profits reported will be at the expense of future profits or even create losses in the future, in particular in the prolonged nil interest environment—which represents a loss to shareholders. ANC thinks quite challenging to explain that not applying the annual cohort would simultaneously lead to 'indefinite re-averaging' (paragraph 29) and recognising profit upfront (paragraph 31)—there is some contradiction in those observations. ANC notes that without the annual cohort requirement, the entity would still apply the requirements in paragraph B119 of IFRS 17—ie would identify coverage units for the group of contracts and allocate the CSM to such units—and would thus, take into account future services to all generations of policyholders. This would only result in spreading the recognition of expected profit over the lifetime of the group of contract (a 'profitability bucket' in this case) instead of a cohort' lifetime.

190. In paragraph 32 of Annex 1 to EFRAG's cover letter, those stakeholders say '*not applying annual cohorts would give management the discretion when profit arise to a certain extent which could leave room for a judgmental or even opportunistic allocation of profit or loss at the expense of future periods. They believe that this would enable entities to potentially defer the recognition of losses that are in onerous portfolios*'. Paragraph 39 of that annex reports similar views. ANC thinks those observations are undemonstrated statements. Here again, an entity that does not apply the annual cohort requirement would apply paragraph B119 of IFRS 17 and determine the coverage unit at a higher level of aggregation than an annual cohort. It's unclear why determining the coverage unit at this higher level would lead to management's bias. In contrast, ANC thinks that determining the coverage unit at that level would result in more reliable information than doing so at the annual cohort's level––applying the law of large number, taking into account a broader set of contracts would make the estimate more reliable. Furthermore, with regard to the recognition of losses, within the context of contracts with cash flows that affect or are affected by cash flows to policyholders in other groups, paragraphs B67–B71 of IFRS 17 require an entity to consider the extent to which policyholders of other groups bear expected losses—paragraphs B67–B71 of IFRS 17 therefore imply that the interdependencies between contracts may not enable an entity to measure the CSM of a cohort on a stand-alone basis.

191. Some stakeholders supporting the application of annual cohorts also explain in paragraph 60 of Annex 1 to EFRAG's cover letter that '*the possibility to share unrealised gains with current and future policyholders (if an when insurers enter new contracts) does not negate the existence of a CSM for the shareholders. […] Factors that impact the variable fee earned by the shareholders such as guarantees or fair value returns on assets (for contracts under the VFA) or other financial factors should be reflected in the period they occur even though it may be indirectly through the CSM'*. ANC observes that life insurance contracts with intergenerational mutualisation issued in France are contracts for which the policyholders' profit share is contractually determined based on *realised* gains on the underlying items—*not* on *unrealised* gains. As explained in paragraph 123, ANC thinks it is questionable that a CSM 'exists' at a cohort level for such contracts. In addition, for contracts to which the VFA model applies, paragraph B113(b) of IFRS 17 specifies that the effect of financial guarantees relates to future services and thus, adjusts the CSM—unless the risk mitigation option applies. This applies regardless of whether the annual cohort requirement applies.

192. Those stakeholders go on in paragraph 61 and say that '*without the annual cohorts, in good periods, the reporting would penalize existing shareholders to the benefit of future shareholders, as the entity's reported profitability of a given year would not reflect the positive investment performance in that year, resulting in a distortion of future profitability and an increased risk profile for the current shareholder*'. ANC observes this comment relates to the relevance of the annual cohort requirement mainly when an entity applies the VFA model to its contracts. Without the annual cohort requirement, an entity that applies the VFA model would still adjust the CSM by the changes in its share in the fair value returns from the underlying items—though at a higher level of aggregation than the annual cohorts. Existing shareholders would therefore be in a position to assess the increase or decrease in the entity's expected profitability.

Appendix C—Illustrative Example

- **Background information**

193. ANC prepared an illustrative example explaining why the application of the annual cohort requirement to the contracts described in paragraphs 94–99, and more broadly to the contracts that are in the scope of ANC's proposed exemption to the annual cohort requirement (see paragraphs 168–178 of this letter), results in an entity being unable to apply its judgment on a rational basis to allocate the fulfilment cash flows (FCF) to each cohort, and accordingly that this requirement is unable to provide useful information about the profitability of those contracts. This happens whenever an entity is required to allocate changes in FCF that are not related to the issuance of new insurance contracts. This is because the entity's management exercises its discretion with regard to:

    a. the realisation of gains and losses from the underlying items and can therefore discretionarily change its share in the returns from the underlying items; and

    b. the timing of the payment to the policyholders of the returns from the underlying items.

194. Changes in the FCF cannot be univocally allocated to the annual cohorts. ANC thinks that the use of judgment required will be of such an extent that the annual cohort requirement will result in information that is not relevant, reliable and comparable.

- **Fact patterns**

    - General assumptions

195. ANC considered the case of a mature portfolio of life insurance contracts with discretionary participation features (ie the VFA model applies to those contracts), in which new generations of policyholders share in the returns from a common pool of underlying items.

196. The entity first applies IFRS 17 on 1st January Y. At the transition date, the entity has 1,000-investment contracts outstanding with discretionary participation features (legacy contracts) that all meet the eligibility criteria for the ANC proposed exemption to the annual cohort requirement. At this date, all policyholders' account balances amount to €1,000 (the amount of accumulated savings and bonuses). Throughout the examples below, the contracts terminate linearly over 5 years—ie 200 contracts terminate each year.

197. The policyholders as a whole are contractually entitled to 80 per cent of the realised gains (or losses) from the pool of underlying items (policyholders' profit share) at minimum. The entity can exercise its discretion with regard to the timing of the payment of the policyholders' profit share within a 8-year time span. In the examples, the entity pays the minimum contractual profit sharing to the policyholders as a whole. However, as highlighted in ANC's letter dated May 2019, European life insurers frequently exercise their discretion to pay amounts to policyholders beyond the minimum contractual policyholders' profit sharing.

198. The individual policyholders who are parties to the insurance contracts outstanding at the transition date are not entitled to any minimum guaranteed interest rate.

199. At the transition date, the entity applies the fair value approach as described in paragraphs C20–C24 of IFRS 17 to measure the insurance contracts outstanding. Furthermore, in accordance with paragraph C23 of IFRS 17, the entity is not in a position to apply retrospectively the annual cohort requirement.

200. At the transition date, the pool of underlying items includes:

    a. 800 bonds with (i) a nominal value of €1,000, (ii) a maturity date of 5 years and (iii) a 3 per cent fixed interest rate—the market interest rate at the transition date is 2 per cent; and

    b. 200 listed equity instruments with (i) an acquisition cost of €200,000 and (ii) a fair value of €250,000. The entity does not receive any dividend from those instruments.

201. Applying the requirements in IFRS 9, the entity measures the equity instruments at fair value.

202. To avoid mismatches and for simplification purpose, the entity applies the fair value option specified in paragraph 4.1.5 of IFRS 9 to measure the bonds and accordingly, measures them at fair value through profit or loss.

203. On 1st December Y, the entity issues 200 new contracts in exchange of €200,000 insurance premiums with a fixed 5-year maturity. Given the market interest rate, the entity decides to use the new premiums to pay the terminal payments to older generations of policyholders. For the purpose of

simplicity, the examples do not consider the recognition of contracts written afterwards but assume that the entity would keep underwriting new contracts.

204. In the light of the features described above, the entity exercises its discretion as to:

    a. when to realise the fair value gains or losses on the equity instruments—throughout the examples, the entity will change its decisions in this respect;

    b. whether to pay to policyholders an amount that is higher than the minimum contractual profit share—throughout the examples, the entity decides to pay only the minimum contractual profit share; and

    c. when to pay the returns of the pool of underlying items to individual policyholders (with the 8-year time constraint though)—throughout the examples, the entity will change its decisions in this respect.

- Simplifications

205. For the sake of clarity, the features of the contracts have been simplified. The fact patterns disregard the contractual options available to policyholders.

206. All payments to the policyholders occur at the year-end.

207. Additionally, the measurement of the insurance contracts is simplified. The simplifications mostly relate to:

    a. the estimation of the FCF:

        i. notwithstanding the requirements in paragraph B37 of IFRS 17, the examples consider only one economic scenario whereby the fair value of the equity instruments held by the entity is unchanged all over the lifetime of the contracts—applying paragraph B37 of IFRS 17, the entity would have to consider other possible outcomes to estimate the FCF. However, the conclusion about the discretion that management exercises as to the realisation of the fair value gains would still hold true in all scenarios in which there is an unrealised fair value gain arising from the equity instruments.

        ii. the examples also disregard liquidity issues and assume that the entity can fund any cash shortage through bank overdrafts. This simplification reduces the number of economic constraints considered when projecting the expected FCF to be paid to policyholders. The entity's management would in reality consider those constraints when applying judgment about how it expects to exercise its contractual discretion to realise gains and losses from the underlying items.

        iii. the risk adjustment for non-financial risk is ignored. Additionally, there is no future cash inflows arising when the entity fulfils the contract. Thus, the fulfilment cash flows are equal to the present value of the future cash outflows (expected payments to policyholders throughout those examples).

    b. the discount rate: notwithstanding the requirements in paragraph B74 of IFRS 17, the discount rate is assumed to equal the flat market interest rate. The market interest rate is assumed unchanged throughout the examples to 2 per cent.

    c. coverage units: the examples use the number of contracts in force as the coverage unit for the allocation of the contractual service margin (CSM) in profit and loss.

- Entity's statement of financial position at the transition date (1st January Y)

208. To prepare its statement of financial position, the entity determines the liability for remaining coverage (LRC) and the CSM arising from the legacy contracts.

209. The policyholders' profit share includes:

    a. 80% of the bonds' interest income;

    b. 80% of the realised fair value gains (or losses).

210. To compute the expected payments to the policyholders of the legacy contracts at the transition date, the entity applies the steps below.

- ***Step 1: Determining the expected returns from the underlying items***

211. The entity assesses the future discretionary benefits it expects to pay to the policyholders as a whole based on the expected returns from the pool of underlying items. This is because the policyholders' minimum profit sharing is determined on the basis of the realised returns from the pool of underlying items. Those returns include:

    a. the interest revenue from the bonds;

    b. the net proceeds from the disposal of the equity instruments—no dividend is paid in the examples.

- ***Step 2: Determining how the entity's management expects to exercise discretion as to the realisation of fair value gains and losses***

212. The entity's management exercises discretion as to the realisation of the fair value gains arising from the equity instruments. There is therefore a need to define how the entity's management expects to exercise this discretion.

213. At the transition date, the examples assume that the entity's management expects to realise a fair value gain of €50,000 at the end of year Y+4.

- ***Step 3: Determining the policyholders' profit share***

214. The policyholders' contractual minimum profit share is 80 per cent of the realised gains and the examples assume that the entity's management does not expect to allocate additional payments beyond this minimum.

- ***Step 4: Determining how the entity's management expects to exercise discretion as to the timing of the payment of the policyholders' contractual profit sharing to individual policyholders***

215. The entity's management contractually exercises its discretion as to the timing of the allocation to individual policyholders. The example initially assumes that the entity expects to pay the policyholders profit sharing during the year in which it realises the gain from the underlying items.

216. Having applied the steps above, the expected returns from the underlying items and the policyholders' profit sharing are as follows:

Expected future payments upon transition						
	Y	Y+1	Y+2	Y+3	Y+4	Total
Interests on bonds	24,000	24,000	24,000	24,000	24,000	120,000
Gain/ loss on equity instruments	-	-	-	-	50,000	50,000
Realized gains	**24,000**	**24,000**	**24,000**	**24,000**	**74,000**	**170,000**
Policyholders' share	19,200	19,200	19,200	19,200	59,200	136,000
Expected payment of policyholders' profit share	**19,200**	**19,200**	**19,200**	**19,200**	**59,200**	**136,000**
Minimum guaranteed payments	-	-	-	-	-	-
Discretionary policyholders' profit share	19,200	19,200	19,200	19,200	59,200	136,000
Outstanding profit share payable to policyholders	-	-	-	-	-	
Terminal payments (one fifth per year)	200,000	200,000	200,000	200,000	200,000	1,000,000
Expected payments to policyholders	**219,200**	**219,200**	**219,200**	**219,200**	**259,200**	**1,136,000**
Discounted expected payments (2%)	214,902	210,688	206,557	202,507	234,765	1,069,420

217. The expected future discretionary payments benefit to both (i) legacy contracts and (ii) contracts to be written in future periods. This is because the policyholders' contractual profit sharing is determined collectively and the entity exercises discretion as to the allocation to individual policyholders. Accordingly, the expected policyholders' profit sharing from year Y to Y+4 is expected to benefit to:

    a. the legacy contracts not terminated at the date when the entity exercises its discretion to allocate the discretionary returns;

    b. the new contracts written before the entity exercises discretion.

218. However, paragraphs 24 and 25 of IFRS 17 require the allocation of the future discretionary benefits to existing groups of insurance contracts—paragraph BC265 of IFRS 17 outlines that '*when applying IFRS 17, payments to policyholders form part of the fulfilment cash flows regardless of whether those payments are expected to be made to current or future policyholders*'. Accordingly, the future benefits are entirely allocated to the cohort made of legacy contracts.

219. By simplification, the entity considers that the fair value of the contracts at the transition date is equal to the discounted value of future payments at current rate. There is no CSM at that date.

220. The fair value of the bonds upon transition is €837,708[22].

221. Consequently, the entity's statement of financial position at the transition date is as follows:

Balance sheet	1st January Y
Bonds	837,708
Equities	250,000
Liability for remaining coverage	(1,069,420)
Contractual service margin	-
Retained earnings	(18,288)

- **First example: the entity issues contracts in December Y that do <u>not</u> include any guaranteed interest rate**

222. The individual policyholders who are parties to the contracts issued in December Y are not entitled to any minimum guaranteed interest rate—ie same situation as for the policyholders of the legacy contracts.

223. On 1st December Y, the entity receives premiums of €200,000 from the issuance of 200 new insurance contracts (€1,000 balance per contract). New contracts have a five-year fixed maturity.

224. Having considered the market interest rate, the entity decides (i) to hold the existing bonds and equity instruments and (ii) to use the premiums received to make the terminal payments to the legacy contracts. Those terminal payments are assumed to occur on 31 December Y and will relate to 200 legacy contracts.

225. Furthermore, to ensure that new policyholders will benefit from a bonus in year Y+5, the entity decides to dispose of the equity instruments in Y+5 rather than in Y+4. Other assumptions are unchanged.

- <u>Initial recognition of the newly-issued contracts</u>

  - ***Determination of the expected payments to the policyholders after the initial recognition of the new contracts***

226. The expected payments to the policyholders are as follows:

Expected future payments as at 1 December Y after recognition of the new group							
	Y	Y+1	Y+2	Y+3	Y+4	Y+5	Total
Interests on bonds	24,000	24,000	24,000	24,000	24,000	-	120,000
Gain/ loss on equity instruments	-	-	-	-	-	50,000	50,000
Realized gains	**24,000**	**24,000**	**24,000**	**24,000**	**24,000**	**50,000**	**170,000**
Policyholders' contractual minimum share (80%)	19,200	19,200	19,200	19,200	19,200	40,000	136,000
Expected payment of policyholders' profit share	**19,200**	**19,200**	**19,200**	**19,200**	**19,200**	**40,000**	**136,000**
Minimum guaranteed payments	-	-	-	-	-	-	-
Discretionary policyholders' profit share	19,200	19,200	19,200	19,200	19,200	40,000	136,000
Outstanding profit share payable to policyholders	-	-	-	-	-	-	
Terminal payments (one fifth per year)	200,000	200,000	200,000	200,000	200,000	200,000	1,200,000
Expected payments to policyholders	**219,200**	**219,200**	**219,200**	**219,200**	**219,200**	**240,000**	**1,336,000**
Discounted expected payments (2%)	**218,839**	**214,548**	**210,341**	**206,216**	**202,173**	**217,017**	**1,269,133**

[22] 24,000 x (1 – 1.02 ^ (-5)) / 0.02 + 800,000 x 1.02 ^ (-5) = 837,708

➢ ***Comparison between the expected payments determined on 1st January Y and those determined on 1st December Y***

227. If the entity had not issued the new contracts and not revised its expectations, the expected discounted future payments would have been as follows as at 1 December Y:

Expected future payments as at 1 December Y without issuing the new group	Y	Y+1	Y+2	Y+3	Y+4	Y+5	Total
Interests on bonds	24,000	24,000	24,000	24,000	24,000		120,000
Gain/ loss on equity instruments	-	-	-	-	50,000		50,000
Realized gains	**24,000**	**24,000**	**24,000**	**24,000**	**74,000**	**-**	**170,000**
Policyholders' contractual minimum share (80%)	19,200	19,200	19,200	19,200	59,200	-	136,000
Expected payment of policyholders' profit share	**19,200**	**19,200**	**19,200**	**19,200**	**59,200**	**-**	**136,000**
Minimum guaranteed payments	-	-	-	-	-	-	-
Discretionary policyholders' profit share	19,200	19,200	19,200	19,200	59,200		136,000
Outstanding profit share payable to policyholders	-	-	-	-	-		-
Terminal payments (one fifth per year)	200,000	200,000	200,000	200,000	200,000		1,000,000
Expected payments to policyholders	**219,200**	**219,200**	**219,200**	**219,200**	**259,200**	**-**	**1,136,000**
Discounted expected payments (2%)	**218,839**	**214,548**	**210,341**	**206,216**	**239,066**	**-**	**1,089,009**

228. The entity compares the expected cash flows before and after issuing the new of contracts. The entity observes the following differences:

Differences in expected payments before and after issuing the new group	Y	Y+1	Y+2	Y+3	Y+4	Y+5	Total
Interests on bonds	-	-	-	-	-	-	-
Gain/ loss on equity instruments	-	-	-	-	(50,000)	50,000	-
Realized gains	**-**	**-**	**-**	**-**	**(50,000)**	**50,000**	**-**
Policyholders' contractual minimum share (80%)	-	-	-	-	(40,000)	40,000	-
Expected payment of policyholders' profit share	**-**	**-**	**-**	**-**	**(40,000)**	**40,000**	**-**
Minimum guaranteed payments	-	-	-	-	-	-	-
Discretionary policyholders' profit share	-	-	-	-	**(40,000)**	**40,000**	-
Outstanding profit share payable to policyholders	-	-	-	-	-	-	
Terminal payments (one fifth per year)	-	-	-	-	-	200,000	200,000
Expected payments to policyholders	**-**	**-**	**-**	**-**	**(40,000)**	**240,000**	**200,000**
Discounted expected payments (2%)	**-**	**-**	**-**	**-**	**(36,893)**	**217,017**	**180,124**

229. The differences in the expected payments—ie €180,124—can be analysed as follows:

   a. change in the timing of realisation of the equity instruments. The discretionary future payments arising from the realised gain on the equity instruments is postponed to year Y+5. This decreases the discounted expected cash flows by -€723[23];

   b. issuance of new contracts. The newly written contracts generate a cash inflow of €200,000 in year Y and a cash outflow of €200,000 in Y+5. The underlying items are otherwise unaffected and the entity's contractual profit sharing obligation is therefore unchanged. The discounted value of the future payments is €180,847[24].

➢ ***Allocation of the portfolio's expected payments and CSM to the annual cohorts***

230. The discounted value of future payments after issuing the new cohort of contracts increased by €180,124[25], whereas the entity collected €200,000 in premiums—so the CSM increases by €19,876[26].

231. IFRS 17 requires the allocation of the FCF to the annual cohorts. Applying paragraph B68 of IFRS 17, that allocation results in the FCF of each group reflecting the extent to which the contracts in the group (ie an annual cohort) cause the entity to be affected by expected cash flows, whether to policyholders in that group or to policyholders in another group.

[23] 50,000 x 1.02 ^ (-49/12) – 50,000 x 1.02 ^ (-61/12) = 723
[24] 200,000 x 1.02 ^ (-61/12) = 180,847
[25] 180,847 – 723 = 180,124
[26] 200,000 – 180,124 = 19,876

232. Within the context of discretionary cash flows, the application of paragraph B68 requires the use of judgment to identify changes in FCF arising from:

   a. the issuance of the contracts; and

   b. how the entity expects to exercise its contractual discretion over the payments.

233. In the example, the entity applies its judgment to allocate the -€723 amount arising from the change in the timing of the discretionary payments to the policyholders—policyholders who are parties to both the legacy contracts and the newly issued contracts.

234. In this very specific case, ANC acknowledges that the marginal cash outflows arising from the newly written contracts primarily includes the €200,000 terminal payment in year Y+5. Consequently, the allocation of FCF can be performed in a relatively straightforward manner. The bulk of the increase in the expected payments and CSM can therefore be allocated to the newly written contracts—thus, reflecting the fact that the entity receives 'cash for free' although the market interest rate is 2%. Accordingly, the entity decides to allocate the whole of the CSM increase of the new contracts.

235. ANC concurs that in those circumstances (ie when the entity issues new contracts), an entity can apply its judgement in a rational manner to allocate the FCF to the annual cohorts and that the requirements in IFRS 17 provide relevant information.

236. However, ANC thinks that such information does not stem from the annual cohort requirement itself but from the requirement to disclose separately the contribution of newly written contracts to the contractual service margin applying paragraph 104 (a) (iii) of IFRS 17. The annual cohort requirement is therefore unnecessary to provide useful information about the expected profitability of newly written contracts.

237. Having applied the steps described above result, the entity records the following journal entries:

– *Initial recognition of the new contracts* –

(Dt) Cash	200,000	
(Ct) FCF		180,124
(Ct) CSM—'new contracts' cohort		19,876

- <u>Financial position and performance at 31 December Y</u>

238. At the end of year Y, the entity:

   a. pays the €200,000 expected terminal payment to one fifth of the legacy contracts;

   b. pays the €19,200 policyholders profit sharing;

   c. receives the €24,000 interest income from the bonds; and

   d. does not revise any of the expectations set earlier.

239. The entity records the following journal entries to reflect those transactions:

– *Payments to the policyholders* –

(Dt) FCF	219,200[27]	
(Ct) Cash		219,200

– *Interest income from the bonds* –

(Dt) Cash	24,000	
(Ct) Financial income		24,000

➢ ***Determination of the fair value of the bonds***

240. The fair value of the bonds is € 830,462[28]. Accordingly, the change in the fair value of the bonds is - €7,246[29].

[27] 200,000 + 19,200 = 219,200
[28] 24,000 x (1 – 1.02 ^ (-4)) / 0.02 + 800,000 x 1.02 ^ (-4) = 830,462
[29] 24,000 x (1 – 1.02 ^ (-5)) / 0.02 + 800,000 x 1.02 ^ (-5) – 830,462 = - 7,246

241. The entity records the following journal entry to reflect the remeasurement of the bonds:

– Change in the FV of the bonds –

(Dt) Financial expenses 7,246

(Ct) Financial assets (bonds) 7,246

➢ ***Determination of the expected future payments***

242. The expected future payments at the closing date are follows:

Expected future payments as at the end of year Y						
	Y+1	Y+2	Y+3	Y+4	Y+5	Total
Interests on bonds	24,000	24,000	24,000	24,000		96,000
Gain/ loss on equity instruments	-	-	-	-	50,000	50,000
Realized gains	**24,000**	**24,000**	**24,000**	**24,000**	**50,000**	**146,000**
Policyholders' contractual minimum share (80%)	19,200	19,200	19,200	19,200	40,000	116,800
Expected payment of policyholders' profit share	**19,200**	**19,200**	**19,200**	**19,200**	**40,000**	**116,800**
Minimum guaranteed payments	-	-	-	-	-	-
Discretionary policyholders' profit share	19,200	19,200	19,200	19,200	40,000	116,800
Outstanding profit share payable to policyholders	-	-	-	-	-	
Terminal payments (one fifth per year)	200,000	200,000	200,000	200,000	200,000	1,000,000
Expected payments to policyholders	**219,200**	**219,200**	**219,200**	**219,200**	**240,000**	**1,116,800**
Discounted expected payments (2%)	**214,902**	**210,688**	**206,557**	**202,507**	**217,375**	**1,052,030**

➢ ***Allocation of the expected future payments to the annual cohorts***

243. The entity allocates the expected future payments to the cohorts—the cohort of legacy contracts and the cohort of the newly-issued contracts. Consistent with its assumptions at the initial recognition of the newly written contracts, the entity allocates to those contracts the marginal expected cash flows arising from the portfolio of insurance contracts.

244. The breakdown of the FCF is therefore as follows:

Allocation of cash-flows to the cohorts						
	Y+1	Y+2	Y+3	Y+4	Y+5	Total
Total expected undiscounted cash-flows	**219,200**	**219,200**	**219,200**	**219,200**	**240,000**	**1,116,800**
Legacy contracts	219,200	219,200	219,200	259,200		916,800
Newly written contracts	-	-	-	(40,000)	240,000	200,000
Total discounted cash-flows	**214,902**	**210,688**	**206,557**	**202,507**	**217,375**	**1,052,030**
Legacy contracts	214,902	210,688	206,557	239,461	-	871,608
Newly written contracts	-	-	-	(36,954)	217,375	180,422

➢ ***Determination of the CSM***

245. The VFA model applies to the contracts. Thus, the entity unlocks the CSM to recognise its share in the changes in the fair value of the underlying items:

a. the changes in the liability for remaining coverage (excluding the CSM and thus, including the FCF only) are as follows:

Change in the liability for remaining coverage			
	Legacy	New	Total
Opening balance	**1,069,420**	-	**1,069,420**
Unwind of the discount rate	21,388	297	21,686
Newly written contracts	-	180,124	180,124
Payments to policyholders	(219,200)	-	(219,200)
Closing balance	**871,608**	**180,422**	**1,052,030**

b. the changes in the fair value of the underlying items are as follows:

Fair value of the underlying items			
	Opening	Change in FV	Closing
Bonds	837,708	(7,246)	830,462
Equity instruments	250,000	-	250,000
Total	**1,087,708**	**(7,246)**	**1,080,462**

c. consequently, the change in the entity's share in the underlying items that adjusts the CSM is - €4,932[30].

246. Because all cohorts share in the same pool of underlying items, there is, in ANC's view, **no objective basis to perform the allocation**. For the sake of simplicity the adjustment of the CSM is fully allocated to the CSM of the newly written contracts.

247. This leads the entity to record the following journal entries:

– CSM adjustment for entity's share of the change in the FV of the underlying items –

(Dt) CSM—new contracts cohort 4,932

(Ct) Financial income 4,932

– Unwinding effect –

(Dt) Financial expenses 21,686

(Ct) FCF 21,686

248. The newly written contracts have a 5-year maturity. As a simplification, the example uses the number of contracts in force as coverage units. The amount allocated to the period is therefore one month out of a total duration of 60 months. Accordingly the entity recognises € 249[31] as CSM in profit or loss for the year.

249. The entity records the following journal entry:

(Dt) CSM—new contracts cohort 249

(Ct) Insurance revenue 249

250. The changes in the CSM of the new contracts cohorts are as follows:

Roll-forward of the CSM	
	Year Y
Opening balance	-
Newly written contracts	19,876
Change in the entity's share in the value of the underlying items	(4,932)
Allocation to profit and loss	(,249)
Closing balance	**14,695**

251. The entity's statements of financial position and performance are as follows:

Statement of financial position	End of year Y
Cash	4 800
Bonds	830,462
Equities	250,000
Liability for remaing coverage	(1,052,030)
Net income	(,249)
Contractual service margin	(14,695)
Retained earnings	(18,288)

Profit and loss statement	End of year Y
Insurance revenue	249
Financial income	16,754
Financial expenses	(16,754)
Net income	249

o Year Y+1

252. In year Y+1, the example assumes that the entity prepares interim financial statements as at June 30.

253. The entity issues no new contract.

[30] +24,000 – 7,246 – 21,686 = -4,932

[31] (19,876 – 4,932) x 1 / (5 x 12) = 249. One month elapsed over the 60 months during which the new contracts will be outstanding.

254. However, the entity's management changes its expectations with regard to how it will exercise its discretion. It now expects to realise a €40,000 fair value gain on the equity instruments in year Y+5 instead of €50,000. Furthermore, the entity's management decides to postpone all payments by one year as permitted by the contractual terms.

➢ ***Determination of the expected future payments***

255. As at June 30, the expected future payments are as follows:

Expected future payments as at June 30 Y+1							
	Y+1	Y+2	Y+3	Y+4	Y+5	Y+6	Total
Interests on bonds	24,000	24,000	24,000	24,000		-	96,000
Gain/ loss on equity instruments					40,000	-	40,000
Realized gains	**24,000**	**24,000**	**24,000**	**24,000**	**40,000**	**-**	**136,000**
Policyholders' contractual minimum share (80%)	19,200	19,200	19,200	19,200	32,000	-	108,800
Expected payment of policyholders' profit share	**-**	**19,200**	**19,200**	**19,200**	**19,200**	**32,000**	**108,800**
Minimum guaranteed payments	-	-	-	-	-	-	-
Discretionary policyholders' profit share	-	19,200	19,200	19,200	19,200	32,000	108,800
Outstanding profit share payable to policyholders	19,200	19,200	19,200	19,200	32,000	-	
Terminal payments (one fifth per year)	200,000	200,000	200,000	200,000	200,000	-	1,000,000
Expected payments to policyholders	**200,000**	**219,200**	**219,200**	**219,200**	**219,200**	**32,000**	**1,108,800**
Discounted expected payments (2%)	**198,030**	**212,785**	**208,612**	**204,522**	**200,512**	**28,698**	**1,053,158**

➢ ***Analysis of the changes in the expected future payments and conclusions about the relevance of the annual cohorts requirement***

256. Had the entity's management not changed its expectations about how it exercises its discretion, the FCF would have been the same as expected at the end of year Y.

257. The changes arising from the management's revised expectations are as follows:

Changes in the expected future cash flows							
	Y+1	Y+2	Y+3	Y+4	Y+5	Y+6	Total
Interests on bonds	-	-	-	-	-	-	-
Gain/ loss on equity instruments	-	-	-	-	(10,000)	-	(10,000)
Realized gains	**-**	**-**	**-**	**-**	**(10,000)**	**-**	**(10,000)**
Policyholders' contractual minimum share (80%)	-	-	-	-	(8,000)	-	(8,000)
Expected payment of policyholders' profit share	**(19,200)**	**-**	**-**	**-**	**(20,800)**	**32,000**	**(8,000)**
Minimum guaranteed payments	-	-	-	-	-	-	-
Discretionary policyholders' profit share	(19,200)	-	-	-	(20,800)	32,000	(8,000)
Outstanding profit share payable to policyholders	19,200	19,200	19,200	19,200	32,000	-	108,800
Terminal payments (one fifth per year)	-	-	-	-	-	-	-
Expected payments to policyholders	**(19,200)**	**-**	**-**	**-**	**(20,800)**	**32,000**	**(8,000)**
Discounted expected payments (2%)	**(19,011)**	**-**	**-**	**-**	**(19,027)**	**28,698**	**(9,340)**

258. The decrease in the discounted expected payments of -€9,340 can be analysed as:

a. the change in the realisation amount of the equity instruments ie -€7,318[32] (discretion not to realise the €10,000 fair value gain on the equity instruments);

b. the deferral of the payments to be made to the policyholders ie -€2,022[33] (discretion to postpone the payment of the policyholders' contractual profit sharing by one year).

259. Similar to the allocation of the changes in the fair value of the underlying items, such changes about how the entity's management expects to exercise its discretion cannot be allocated in a rational manner to the annual cohorts. This is because:

a. the contractual profit sharing is collective so that no individual contract is entitled to a determinable share in the underlying items;

b. the underlying items are managed as a single pool and are not tracked by annual cohorts.

260. As outlined in the ANC's suggestions for an exemption to the annual cohort requirement for contracts with intergenerational sharing of risks between policyholders, within the context of the ANC's proposed exemption, an allocation on a cohort-by-cohort basis is not objectively determinable because cash flows are fungible across generations of policyholders, including future policyholders. When individual policyholders jointly share in the profits of a common

[32] 8,000 x 1.02 ^ (- 9 / 2) = - 7,318
[33] 32,000 x 1.02 ^ (- 11 / 2) - 32,000 x 1.02 ^ (- 9 / 2) + 19,200 x 1.02 ^ (- 9 / 2) - 19,200 x 1.02 ^ (1 / 2) = -2,022

pool of underlying items, this implies that no cohort within the groups is entitled to a separable profit share in a subset of the underlying items.

261. Furthermore, this example shows that changes about how the entity's management expects to exercise its discretion can significantly affect the contractual service margin after the initial recognition of a group of contracts without a straightforward allocation to the annual cohorts.

262. Consequently, whenever the entity's management changes its expectations, the entity is unable to allocate in a rational manner the changes in the FCF to determine the CSM of each annual cohort. Accordingly, the annual cohort requirement:

a. does not result in useful information, and

b. is likely to lead to inconsistent implementation of IFRS 17 among entities.

263. In this context, there is no benefits in tracking profitability by annual cohorts. The averaging of profitability as new contracts join the mutualised pool of underlying items adequately reflects the economic interdependencies across generations.

264. The example goes on without applying the annual cohort requirement.

265. As at 30 June Y+1, the entity recognises €12,000 as accrued interest income related to the bonds. Accordingly, the entity recognises the following journal entry:

– Interest income from the bonds –

	Dt	Ct
(Dt) Accrued interest	12,000	
(Ct) Financial income		12,000

266. As at June 30 Y+1, the fair value of the bonds is €826,844. Accordingly, the changes in the fair value of the underlying items are as follows:

Fair value of the underlying items			
	Opening	Change in FV	Closing
Bonds	830,462	(3,618)	826,844
Equity instruments	250,000	-	250,000
Total	**1,080,462**	**(3,618)**	**1,076,844**

267. Consequently, the entity records the following journal entry to reflect the remeasurement of the bonds:

– Change in the FV of the bonds –

	Dt	Ct
(Dt) Financial expenses	3,618	
(Ct) Financial assets (bonds)		3,618

268. The changes in the LRC (excluding the CSM) are as follows:

Change in the liability for remaining coverage	
	30/06/Y+1
Opening balance	**1,052,030**
Unwind of the discount rate	10,468
Changes in discretionary expectations	(9,340)
Payments to policyholders	-
Closing balance	**1,053,158**

269. The entity records the following journal entry to reflect the changes in the LRC:

– Revision of discretion –

	Dt	Ct
(Dt) FCF	9,340	
(Ct) CSM—portfolio		9,340

– Unwinding effect –

	Dt	Ct
(Dt) Financial expenses	10,468	
(Ct) FCF		10,468

270. The adjustment to the CSM to reflect the change in the entity's share in the underlying items amounts to €2,086[34]. The following journal entry reflects this adjustment:

– CSM adjustment for entity's share of the change in the FV of the underlying items –

(Dt) CSM—portfolio	2,086	
(Ct) Financial income		2,086

271. The coverage units are determined on the basis of the number of contracts in force computed at the portfolio level.

Number of contracts at the beginning of the accounting period and coverage units							
	01/01/N+1	01/07/N+1	31/12/N+1	31/12/N+2	31/12/N+3	31/12/N+4	01/12/N+5
Legacy contracts	800	800	600	400	200	0	
Newly written contracts	200	200	200	200	200	200	0
Prorata temporis	0,50	0,50	1,00	1,00	1,00	1,00	0,92
Number of coverage units	500	500	1 000	800	600	400	183
Cumulated number of coverage units	3 983	3 483	2 983	1 983	1 183	583	183

272. Considering the duration of the group of contracts as the coverage units, the entity recognises €2,767[35] in profit or loss as CSM for the reporting period.

273. The entity records the following journal entry:

(Dt) CSM—portfolio	2,767	
(Ct) Insurance revenue		2,767

274. The changes in the LRC (without the CSM) and CSM of the portfolio is as follows:

Roll-forward of LRC and CSM		
	LRC (w/o CSM)	CSM
Opening 1 January Y+1	**1,052,030**	**14,695**
Unwinding	10,468	-
Change in FCF due to discretion	(9,430)	9,430
Change in the entity's share in underlying items	-	(2,086)
Allocation to profit or loss	-	(2,767)
Closing 30 June Y+1	**1,053,068**	**19,272**

275. The statements of financial position and performance at 30 June Y+1 are as follows:

Statement of financial position	30 June Y+1
Cash	4,800
Bonds	826,844
Accrued interests	12,000
Equity instruments	250,000
LRC	(1,053,068)
CSM	(19,272)
Net income	(2,767)
Retained earnings	(18,537)

Statement of profit or loss	H1 Y+1
Insurance revenue	2,767
Finance income	14,086
Finance expenses	(14,086)
Net income	2,767

- **Second example : the entity issues contracts in December Y that include a guaranteed interest rate**

276. This fact pattern is similar to the first one except that the newly written contracts in December Y are entitled to an annual 3% guaranteed rate. The other contractual features are unchanged.

277. The newly written contracts are entitled to guaranteed payments amounting to €6,000 each year. The entity's management exercises its discretion as to the amount of the payment to individual policyholders and therefore decides that the €6,000 guaranteed payments will reduce the discretionary payments to other contracts without any guaranteed interest rate.

278. Similar to the first fact pattern, the entity decides to (i) hold the existing bonds and equity instruments and (ii) use the premiums received to pay the terminal payments to the legacy contracts. Furthermore,

[34] 12,000 – 3,618 – 10,468 = 2,086
[35] (14,695 + 9,430 – 2,086) x 500 / 3,983 = 2,767

it decides to realise the fair value gain on the equity instruments in year Y+5 instead of Y+4.

279. Given the assumptions described above, the future expected payments as at December 1st Y are unchanged as compared to the first fact pattern—except for the breakdown between discretionary and guaranteed payments). Those payments are as follows:

Expected future payments as at 1 December Y after writing the new group							
	Y	Y+1	Y+2	Y+3	Y+4	Y+5	Total
Interests on bonds	24,000	24,000	24,000	24,000	24,000		120,000
Gain/ loss on equity instruments						50,000	50,000
Realized gains	**24,000**	**24,000**	**24,000**	**24,000**	**24,000**	**50,000**	**170,000**
Policyholders' contractual minimum share (80%)	19,200	19,200	19,200	19,200	19,200	40,000	136,000
Expected payment of policyholders' profit share	**19,200**	**19,200**	**19,200**	**19,200**	**19,200**	**40,000**	**136,000**
Minimum guaranteed payments		6,000	6,000	6,000	6,000	6,000	30,000
Discretionary policyholders' profit share	19,200	13,200	13,200	13,200	13,200	34,000	106,000
Outstanding profit share payable to policyholders	-	-	-	-	-	-	
Terminal payments (one fifth per year)	200,000	200,000	200,000	200,000	200,000	200,000	1,200,000
Expected payments to policyholders	**219,200**	**219,200**	**219,200**	**219,200**	**219,200**	**240,000**	**1,336,000**
Discounted expected payments (2%)	218,839	214,548	210,341	206,216	202,173	217,017	1,269,133

280. Drawing a comparison between the expected cash flows before and after issuing the new generation of contracts, the following differences arise—no change as compared to the first example except for the split between guaranteed and discretionary cash flows:

Differences in expected payments before and after writing the new group (fact pattern 2)							
	Y	Y+1	Y+2	Y+3	Y+4	Y+5	Total
Interests on bonds	-	-	-	-	-	-	-
Gain/ loss on equity instruments	-	-	-	-	(50,000)	50,000	-
Realized gains	**-**	**-**	**-**	**-**	**(50,000)**	**50,000**	**-**
Policyholders' profit share	-	-	-	-	(40,000)	40,000	-
Expected payment of policyholders' profit share	**-**	**-**	**-**	**-**	**(40,000)**	**40,000**	**-**
Minimum guaranteed payments	-	6,000	6,000	6,000	6,000	6,000	30,000
Discretionary policyholders' profit share	-	(6,000)	(6,000)	(6,000)	(46,000)	34,000	(30,000)
Oustanding profit share payable to policyholders	-	-	-	-	-	-	-
Surrenders	-	-	-	-	-	200,000	200,000
Expected payments to policyholders	**-**	**-**	**-**	**-**	**(40,000)**	**240,000**	**200,000**
Discounted future payments to policyholders	-	-	-	-	(36,893)	217,017	180,124

281. Similar to the first fact example, the newly written contracts generate (i) an incremental cash inflow of €200,000 in year Y and (ii) an incremental cash outflow of €200,000 in year Y+5. The guaranteed payments to the new policyholders are 'absorbed' by the reduction in the discretionary payments made to the policyholders of the legacy contracts.

282. The discounted value of future payments after issuing the new contracts increases by €180,124, whereas the entity has collected €200,000 in premiums. Consequently, the CSM increases by €19,876.

283. Applying paragraph B68(b) of IFRS 17, the entity excludes the guaranteed payments from the FCF allocated to the new contracts because such payments have already been included in the FCF of the legacy contracts.

284. Therefore, the existence of a guaranteed rate does not affect the CSM of the newly issued contracts and results in no difference on the expected profitability from that group of contracts.

285. Considering the scope of ANC's proposed exemption to the annual cohort whereby (i) the profit sharing obligation is collective and (ii) the entity's management exercises discretion in relation to the allocation to individual policyholders, the newly issued contracts would affect the entity's share in the underlying items only in circumstances in which:

   a. the entity's management would decide not to exercise its discretion to reduce payments to other policyholders or;

   b. the guaranteed payments would exceed the discretionary payments included in the measurement of the legacy contracts. This would arise only in the circumstances in which the returns from the overall pool of underlying items were to be insufficient to cover the guaranteed payments to all contracts that share in its returns.

286. In both circumstances, the whole portfolio of insurance contracts (legacy and new contracts) would become onerous and therefore reporting the loss for the whole portfolio would provide exactly the same information as the annual cohorts would do—but without requiring an unnecessary judgmental allocation to the groups.

287. Therefore, within the boundaries of ANC's proposed exemption to the annual cohort requirement and taking into account the specificities of determining the FCF for group of contracts that affect or are affected by cash flows to policyholders of other groups of contracts, ANC sees no informational benefit arising from the annual cohort requirement in relation to financial guarantees.

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Chairman

PDC N° 19

Paris, 23 June 2020

Mr Jean-Paul Gauzes
EFRAG Board President
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IFRS 17—Annual cohorts

Dear Jean-Paul,

We refer to our letter dated 15 May 2020. In this letter, we informed you of our proposal for an exception to the annual cohort requirement as currently set out in IFRS 17 *Insurance Contracts*. This exception would apply to contracts with intergenerational sharing of risks between policyholders.

We shared our proposal with the International Accounting Standards Board (IASB). The Chairman of the IASB responded to our proposal in a letter dated 5 June 2020. We attach this reply in Appendix I to this letter.

The IASB staff (staff) reject our proposed exception to the annual cohort requirement because such an exception would include contracts for which the IASB concluded that not applying the aforementioned requirement would result in an 'unacceptable loss of useful information'. This is because, in the staff view, the profitability of contracts for which an entity has discretion over the timing of allocation of the policyholders' share of fair value returns on underlying items would be objectively determinable on a cohort-by-cohort basis.

We acknowledge that the staff rationale might be relevant in certain specific circumstances, for example when the underlying assets are segregated and ring-fenced at the level of an annual cohort or lower (e.g. contract's level). In this situation, an entity could indeed determine profitability for each cohort.

However, our suggested exception captures contracts that have different terms. Our proposal targets contracts in which (i) underlying assets are all pooled together, irrespective of their date of purchase, and (ii) policyholders share the returns from that single common pool of underlying items whatever the contracts' issuance year might be. Such contracts represent a very significant part of insurance portfolios in a number of European jurisdictions.

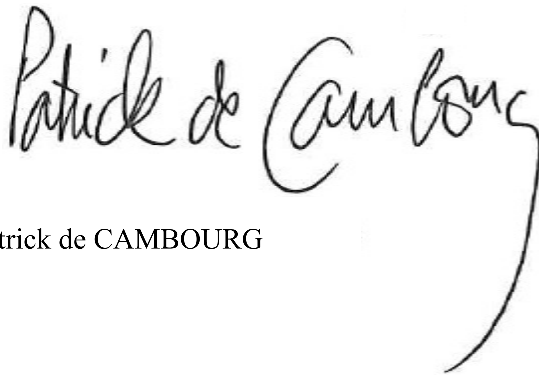
Specifically, the staff analysis overlooks the implications of the second criterion set out for our proposed exception. Applying this criterion, an entity would not apply the annual cohort requirement to contracts that *jointly* participate in a share in the returns of a clearly identified common pool of underlying assets. According to this criterion, policyholders' profit share would be determined collectively for the community of policyholders, without any individual contract having a right to the joint profit share until management exercises its discretion to allocate the returns. We note that the entity's profit share for those contracts is determined at a higher level of aggregation than the annual cohort. In those circumstances, allocating the entity's contractual profit share to annual cohorts would (i) be unnecessary and irrelevant to monitor profitability, and (ii) would require an arbitrary allocation *before* management exercises discretion as to the timing and amount of the allocation to individual policyholders. Accordingly, we think the annual cohort requirement does not provide useful information about those contracts.

As explained in Appendix II to this letter, the staff developed other arguments that rely on the same erroneous assumption.

We disagree with the staff rationale for rejecting our proposal because it assumes that the profitability of the underlying assets is objectively contractually allocable to each annual cohort, as if those assets were segregated and ring-fenced at the level of an annual cohort or lower (e.g. contract's level). Such an additional assumption is *not* applicable to the contracts scoped in our proposed exception, especially with regard to the second criterion. This assumption is contrary to the legal and contractual discretion of the insurer when individually allocating over a set period of time returns jointly benefiting to the policyholders as a whole.

Please do not hesitate to contact us to further discuss this letter.

Yours sincerely,



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5 June 2020

Patrick de CAMBOURG

Chairman

Autorité des Normes Comptables

Via email

Dear Patrick

Thank you for your letter of 25 May 2020 sharing with us the proposals you developed for EFRAG regarding the annual cohort requirement.

Attached is my response to the President of the EFRAG Board, who also wrote to me about your proposals, including an analysis by my staff of your proposals and of other proposals developed by other European constituents of EFRAG.

Thank you for taking the time to write to us. We look forward to continuing dialogue with you towards the successful implementation of IFRS 17.

Yours sincerely

Hans Hoogervorst

Chairman, International Accounting Standards Board

Attachments: Letter to Jean-Paul Gauzès, President of the EFRAG Board, dated 5 June 2020
Analysis of proposals for exceptions to the annual cohort requirement

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Analysis of proposals for exceptions to the annual cohort requirement

1. In May 2020, the ANC, the ICAC and CFO Forum each shared with EFRAG and with the IASB their proposals for exceptions to the annual cohort requirement in IFRS 17.
2. This document sets out an analysis by the staff of the IFRS Foundation of the three sets of proposals.

ANC proposals

The proposal and rationale given

3. The scope of the ANC's exception from the annual cohort requirement is groups of contracts that:
   a. include only contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts as described in paragraphs B67-B71 of IFRS 17;
   b. jointly participate in a share of returns on a clearly identified common pool of underlying items. Contracts jointly participate when the entity exercises discretion as to the timing and the allocation of the total policyholders' profit-share to individual policyholders; and
   c. meet the definition in paragraph B101 of IFRS 17 of variable fee approach contracts.
4. Consistent with previous papers from the ANC, the rationale for proposing the exception is that annual cohorts do not provide useful information because profitability is not determinable on a cohort by cohort basis. In the ANC's view, profitability is not determinable on a cohort by cohort basis because the entity can choose how much of the return on underlying items to distribute to each policyholder (ie different policyholders can receive different rates of return even though they all share in the same return on underlying items).

Staff analysis

5. The scope of the ANC proposed exception can be enforced using existing requirements in IFRS 17 (the criteria in paragraphs B67 and B101 of IFRS 17), so it minimises the added complexity that an exception always entails.
6. However, the ANC's scope would include contracts for which the Board concluded an exemption from the annual cohort requirement would result in an unacceptable loss of useful information.
7. Specifically:
   a. for a contract to be in the scope of the ANC exception, contracts have to share the effect of risks with other contracts, but the exception does not require all

risks to be shared nor does it specify the extent to which the risks have to be shared. Agenda Paper 2B of the February 2020 Board meeting (AP2B)[1]) concluded that unless: (i) the effect of *any* financial guarantees on returns in underlying items is shared with other policyholders, and (ii) any other fixed cash flows that were not shared is 'small', the removal of the annual cohort requirement would lead to an unacceptable loss of useful information.[2] The ANC argues that, as a practical expedient, the requirement to meet the VFA scope is a sufficient restriction on the extent of unshared risks. However, as acknowledged by the ANC, the VFA scope could include contracts with financial guarantees the effect of which is borne solely by the entity or contracts that include more than 'small' amounts of other fixed cash flows that are not shared with other policyholders. Timely information about losses caused by those financial guarantees or other fixed cash flows would be lost—this is particularly important in the current low interest rate environment.

b. for a contract to be in the scope of the ANC proposed exception, the entity must have discretion over the way that the total policyholders' share of the fair value (FV) returns on underlying items is distributed to individual policyholders. However, it is *not* necessary for the entity to have discretion over the share of the FV returns that is distributed to the policyholders as a whole and the share that is retained by the entity. As explained in AP2B, it is the latter discretion that causes subjectivity in the determination of the contractual service margin (CSM) and potentially reduces the usefulness of the annual cohort information. Without that latter discretion, the determination of the CSM for annual cohorts, while complex, is objective. In these circumstances, AP2B concluded that there was no justification for the loss of information about trends in profitability that would result from an exception to the requirement for annual cohorts.

8. In terms of the rationale set out in the ANC proposals, there are two key arguments we disagree with:

   a. ANC argument 1: if an entity has **discretion** over the timing of an allocation of the policyholders' share of FV returns on underlying items, profitability is not determinable on a cohort by cohort basis; and

   b. ANC argument 2: if changes in the effect of a **financial guarantee** are shared with policyholders of other contracts in a portfolio, an annual cohort can only be onerous if whole portfolio is onerous.

9. In relation to discretion (paragraph 8.a of this paper), AP2B demonstrated:

   a. if the split between the entity and the policyholders as a whole is specified, it does not matter how the entity determines the subsidisation between policyholders, the entity's share is still objectively determinable;

[1] The Board discussion of AP2B resulted in the Board agreeing with the staff recommendations in the paper based on the analysis set out in the paper.

[2] It is important to remember that even for contracts with these features, AP2B did *not* conclude that the cost of the annual cohort requirement exceeded the benefits of the resulting information. AP2B acknowledged only that features of such contracts increase the costs of applying the annual cohort requirement compared to other contracts and/or reduce the usefulness of the resulting information.

b. IFRS 17 requires an entity to allocate its share of the FV returns in any period across the CSMs of the annual cohorts that exist in the period in which the FV returns occur. The entity's share in returns therefore depends on the contractual terms of each annual cohort and the economic conditions during the coverage period of each annual cohort. For example, a 20 per cent share in returns created by an annual cohort for which returns during the coverage period are 5 per cent is more profitable for an entity than is a 20 per cent share in returns created by an annual cohort for which returns during the coverage period are 1 per cent. Hence the annual cohort CSMs provide useful information about trends in profitability. Removing the annual cohort requirement would average higher or lower profits from each generation of contracts, resulting in a loss of information about changes in profitability over time. In particular, annual cohorts prevent the entity's share of FV gains or losses on underlying items being recognised *after* the annual cohort of contracts that existed when those FV gains or losses arose has ceased to exist. The fact that the entity expects to spread the *policyholders' share* of the FV returns to policyholders over a longer period, ie the duration of the entire portfolio, does not mean it should not recognise *its share* over the life of the annual cohort of contracts to which the FV returns relate.

c. if the split between the entity and the policyholders as a whole can be varied at the discretion of the entity, the determination of the CSM of annual cohorts becomes subjective. But the ANC scope includes contracts that do not include that discretion. Furthermore, even in those cases where the contracts do include such discretion, an entity has to make a judgement about the expected split in order to recognise new business, irrespective of the annual cohort requirement. Thereafter, it is possible to track the CSM for each annual cohort assuming that each CSM grows at the same rate of return. The Board concluded that it is possible to apply the annual cohorts even to contracts that include that discretion and that, although based on subjective judgement, the resulting information would be useful to users of financial statements.

10. In relation to the effect of a financial guarantee (paragraph 8.b of this paper), AP2B demonstrated that even if the changes in the effect of a financial guarantee are shared with other policyholders in a portfolio, the entity still retains its share of the change.. The share that the entity retains affects the CSM of the annual cohort in which the financial guarantee belongs, and could make that annual cohort onerous without the portfolio being onerous. Without annual cohorts, the effect of the financial guarantee borne by the entity would not be apparent—it could be obfuscated by profits from other contracts in the portfolio.

ICAC proposals

The proposal and rationale given

11. The scope of the ICAC's exception is contracts that are managed under cash flow matching techniques, potentially linked to Solvency II regulatory requirements. This scope is broad. In particular, it would include contracts that:

a. are general model contracts;

b. do not fall in the scope of paragraphs B67-B71 of IFRS 17 (the requirements relating to contracts that share risks across policyholders in different groups); and

c. include long-term fixed guarantees on interest rates payable to policyholders.

12. The contracts discussed are mostly immediate and deferred annuities and life endowments with guaranteed interest rates. Entities are required by regulation to invest in assets that match the cash flows, applying cash flow matching techniques. The ICAC proposals state that entities therefore essentially only bear default risk (which is said to be low because of the types of asset that the local regulator allows the entity to invest in) and reinvestment risk caused by deviations from the expected duration of the contracts (because of early or late deaths). The proposals do not discuss reinvestment risk that would arise if the entity could not find assets with a duration as long as the insurance contracts. The proposals also state that, by applying cash flow matching techniques to the assets and liabilities at a portfolio level, there is intergenerational sharing of risk, even though the contracts do not have the features described in paragraph B67 of IFRS 17 (ie the cash flows of one contract do not affect the cash flows of another contracts).

13. The rationale for the proposed exception is that insurance contracts issued more than one year apart are backed by a single portfolio of assets. Spanish regulation requires the assets and insurance contracts to be managed together using cash flow matching techniques. Managing the assets and insurance contracts at a portfolio level allows the entity to minimise the reinvestment risk caused by deviations from the expected duration of the contracts (because of early or late deaths).

14. The ICAC proposals state that annual cohorts would not provide relevant information and would lead to financial reporting not reflecting faithfully the economic nature of the contracts. The ICAC explains that a reduced number of contracts in a group would generate more variability in the adjustments to the CSM, resulting in a greater possibility of onerous contracts and 'artificial' variability in performance. The argument seems to rely on there being a greater chance of deviating from the expected longevity in a small group such as an annual cohort, than in a large group, such as a portfolio.

Staff analysis

15. The scope of the ICAC exception is broad and, in our view, extremely difficult to enforce. The ICAC proposals link the scope to specific regulatory requirements in Spain. But it is extremely unlikely, if not impossible, that 'cash flow matching techniques' could be defined in a way that could be applied consistently internationally. It is likely that almost all insurers could use that phrase to describe their asset/liability management activities.

16. Further, the scope of the ICAC exception is unrelated to the features that AP2B identified as increasing the costs of annual cohorts or reducing the usefulness of the resulting information. It seems there is nothing about the contracts in the ICAC proposed scope that makes the annual cohort requirement harder to apply or the resulting information less useful compared to any other type of insurance contracts. Agenda Paper 2A of the March 2019 Board meeting explained why determining the

level of aggregation using asset and liability management techniques or risk management techniques would lead to an unacceptable loss of useful information.

17. Hence, if the annual cohort requirement did not apply, users of financial statements would lose critical information about:

    a. **trends in profitability** of contracts issued in different years; and

    b. **losses** on onerous contracts.

18. In relation to the **trend in profitability** (paragraph 17.a of this paper), the ICAC proposals state that most Spanish insurers earn an expected constant financial margin in these contracts, and that the contracts are priced consistently to achieve a stable margin. But we cannot assume that will always be the case—amounts invested from premiums at different dates (and reinvested when assets are sold at different dates) will generate different returns reflecting the different economic conditions at those dates. Annual cohorts give transparency about the resulting different margins over time.

19. In relation to **losses** on onerous contracts (paragraph 17.b of this paper), most of the risk associated with the contracts described in the ICAC proposals is financial risk. Applying the general model in IFRS 17, changes in the effects of financial risk are recognised in profit or loss or OCI when the changes occur. This means that the guaranteed interest rates in the contracts might make contracts onerous on initial recognition (which would be captured in the information in paragraph 17.a of this paper), but changes in the effect of the guarantees will not make initially profitable groups of contracts onerous—any loss arising from the guarantee will be recognised as insurance finance income or expenses. Changes that could make the contracts onerous are limited to changes in underwriting risks. But this is true for all general model contracts, and we think information about such changes is critically useful—the annual cohort requirement is essential in capturing this information.

CFO Forum proposals

The proposal and rationale given

20. The proposals from the CFO Forum are for two exceptions from the annual cohort requirement:

    a. an exception very similar to that proposed by the ANC; and

    b. an exception very similar to that proposed by the ICAC.

21. The rationale given for the exceptions is also very similar to that given by the ANC and the ICAC.

22. **Differences with ANC**—The key difference between the CFO Forum proposals and the ANC proposals is that the contracts captured by the exception must have cash flows that *substantially* affect or are affected by cash flows to policyholders of other contracts—but the CFO Forum proposals includes no guidance on what 'substantially' in this context means. The CFO Forum proposals also differ from the ANC proposals in having no requirement for the entity to have discretion over how it distributes FV

returns across policyholders, although their explanation of why the exception is needed refers to such discretion.

23. **Differences with ICAC**—The key difference between the CFO Forum proposals and the ICAC proposals is that the CFO Forum proposals include some requirements on what 'cash flow matching techniques' involve. However, in our opinion, assessing whether those requirements are met would involve complex and subjective judgements that would be extremely difficult to audit.

Staff analysis

24. The CFO Forum has proposed two different exceptions. Their rationale for proposing the exceptions is that the annual cohort requirement for any contracts is not aligned to the fundamentals of insurance business, but the issue is specifically relevant to the types of contract covered by the two proposed exceptions. Our analysis of each proposed exception is the same as our analysis of the ANC and ICAC proposals. Both the differences described in paragraphs 22–23 of this paper in principle would limit the scope of each exception, but both would add subjectivity and complexity to their application.

Appendix II—Additional comments on the IASB staff analysis of the proposed exception

1 The reasoning detailed in the cover letter similarly applies to the other arguments expressed in the IASB letter.

2 **According to § 7b,** “*if an entity has discretion over the way that the total policyholders' share of the fair value (FV) returns on underlying items is distributed to individual policyholders, the determination of the CSM for annual cohorts, while complex, is objective*”.

3 As mentioned above, such an allocation would take place before management exercises discretion as to the timing and amount of the allocation to individual policyholders and consequently could not “objectively" reflect the legal and economic features of such contracts.

4 **According to § 9a,** “*AP2B demonstrated that if the split between the entity and the policyholders as a whole is specified, it does not matter how the entity determines the subsidisation between policyholders, the entity's share is still objectively determinable*”.

5 Paper AP2B of February 2020 does not provide such a demonstration. It refers back to AP2A of March 2019 in which the Board examined one example of annual cohort for contracts with intergenerational sharing of risks. This conclusion however relies on a simplified assumption within the context of a portfolio in its build-up phase whereby the insurance entity would invest all the premiums from newly written contracts at current market conditions. This led to considering that “*the entity's share of the fair value gain is created by each group*” (AP2A March 2019) and that each annual cohort generates specific returns that “belong” to the cohort. This assumption may be relevant where, for instance, the underlying assets are ring-fenced at the level of an annual cohort or lower (e.g. contract's level). Otherwise, this assumption generally does not reflect the economic reality considering, for instance, a mature portfolio where premiums from newly written contracts may be used instead to hold the entity's existing financial instruments over a longer period. We therefore fundamentally disagree with the conclusion that paper AP2B of February 2020 demonstrates that an objective allocation to the annual cohort is practicable under all circumstances.

6 This assumption is **replicated in § 9b** stating that the “*entity's share in returns therefore depends on the contractual terms of each annual cohort and the economic conditions during the coverage period of each annual cohort. For example, a 20 per cent share in returns created by an annual cohort for which returns during the coverage period are 5 per cent is more profitable for an entity than is a 20 per cent share in returns created by an annual cohort for which returns during the coverage period are 1 per cent. Hence the annual cohort CSMs provide useful information about trends in profitability*”.

7 This is inconsistent with the second criterion of the ANC proposed exception whereby policyholders share the returns from a single common pool of underlying items and the profit share is determined collectively for the policyholders as a whole. In a previous letter dated 6 May 2019, ANC already opposed this assumption. Based on the contractual features in the proposed exception, the entity's contractual profit share stems from a single pool of underlying items and the policyholders' profit share is collective so that the underlying items belong to the community of policyholders without any group having individual rights on any subset of the overall portfolio. This is also illustrated by the fact that an insurer may decide to use the premiums received from the new business to indemnify the lapse of policyholders instead of selling assets. Considering that a change in the fair value of the assets acquired with the premium paid by a group solely belongs

to this group would be equivalent to considering that the underlying items are ring-fenced on a cohort by cohort basis.

8 The criteria of the proposed exception therefore secure that the split between the entity and the policyholder as a whole is not objectively determinable on a cohort-by-cohort basis.

9 **According to § 9c,** "*the ANC scope includes contracts that do not include the discretion of an entity over the split between the entity and the policyholders as a whole*".

10 Criterion 2 of the proposed exception provides that the entity exercises discretion as to the amount of profit share allocated to individual policyholders. This indeed includes, without requiring it, the discretion over how an entity shares the returns from underlying items between itself and the policyholders as a whole. Such discretion is an additional reason for an exception. However, as mentioned above, the discretion as to the timing of the allocation of the joint contractual profit share to individual policyholders is already sufficient to justify the exception.

11 **According to § 10**, AP2B demonstrated that even if the changes in the effect of a financial guarantee are shared with other policyholders in a portfolio, the entity still retains its share of the change. The share that the entity retains affects the CSM of the annual cohort in which the financial guarantee belongs and could make that annual cohort onerous without the portfolio being onerous.

12 Paper AP2B disregards the fact that, within the context of the proposed exception, the policyholders' contractual profit share is determined collectively for the community of policyholders as a whole. As highlighted previously, the entity's share in the returns from the underlying items can only be determined at the level of the overall portfolio of contracts that share in the returns from the common pool of underlying items.

13 The entity therefore does not retain a profit-share out of a single annual cohort. It retains a profit share out of the overall returns from the pool of underlying items that includes:

- The total expected returns from the pool of underlying items
- Minus the guaranteed benefits
- Minus the expected discretionary benefits. The discretion is usually constrained by a minimum contractual profit share. However, whenever management expects to pay additional amounts beyond the contractual minimum, the split between the entity and the policyholders as a whole can be varied at the discretion of the entity.

Le Président

Mr Patrick de Cambourg
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Paris, 29 January 2021

Référence : YOL.CED.CBA.20210044

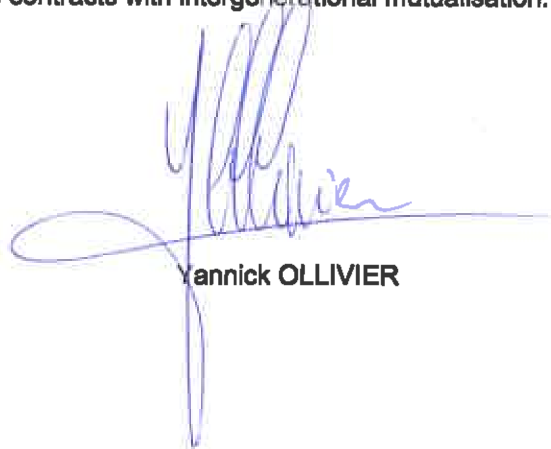
Objet : EFRAG's Draft Endorsement Advice (DEA) on IFRS 17 Insurance Contracts

Dear Patrick,

I am writing to you in connection to EFRAG's Draft Endorsement Advice (DEA) on IFRS 17 *Insurance Contracts*.

ANC has prepared a letter to comment on EFRAG's DEA. This letter reflects the views of many stakeholders in France, including those of auditors. We confirm to you that CNCC is supportive of ANC's comment letter and shares the views expressed in this letter in relation to the application of the annual cohort requirement to insurance contracts with intergenerational mutualisation.

Yours sincerely,



Yannick OLLIVIER

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