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IFRS 17 – Insurance Contracts – Input received from September EFRAG IAWG meeting

Objective

- 1 The objective of this paper is to provide a summary of the September EFRAG IAWG's discussions to EFRAG TEG. This summary was considered when updating Appendix I and II of the draft endorsement advice for IFRS 17 *Insurance Contracts*.

Specific issues for understanding and clarification

Insurance business model of the law of large numbers

- 2 EFRAG IAWG members clarified a comment made in an earlier meeting about the inability of applying the law of large numbers. In order to implement the grouping of IFRS 17, some preparers see it as a requirement to break down the parameters (for example age, geography, etc.) used in pricing the insurance contracts.
- 3 Currently, the pricing of insurance contracts is done based upon a large number of parameters resulting in a lower standard deviation of the pricing and consequently a lower possibility of the contract becoming onerous. Some read the requirements of IFRS 17 as testing the onerousness of contracts based on each single parameter (for example only age), leading to a higher standard deviation of the pricing and consequently a higher possibility of becoming onerous. If this practice is required, it could potentially affect the pricing policy of insurers.
- 4 In addition, pricing is currently done on portfolio level, taking cross-subsidisation between contracts into account at that level.
- 5 The debate is therefore about how many parameters can/should be taken into account in identifying the statistical tipping point as from when a contract is considered to be onerous for financial reporting purposes. The debate is not specifically with the law of large numbers.
- 6 It is therefore an implementation question whether (i) current pricing methodologies can be maintained when implementing IFRS 17 with allocation of subsidising cash flows to the IFRS 17 groups or (ii) if pricing methodologies need to be changed in order to be able to fulfil the IFRS 17 groups.

Purpose(s) for which aggregation is used within insurance entities

- 7 EFRAG IAWG members noted that insurers aggregate insurance contracts for different purposes. The level of aggregation is driven by the availability of information needed to result in statistical relevant outcomes. Although no general rule was identified, aggregation can happen, amongst others, at portfolio level, entity level or the level of the technical reserves.

Start date versus maturity date for cohorts

- 8 EFRAG IAWG members noted that the argument to organise insurance contracts based on their maturity date was used as a counterargument for the IFRS 17

requirement to use annual cohorts in Appendix II. The argument is no longer supported.

Allocation of the contractual service margin ('CSM') to profit or loss)

- 9 EFRAG IAWG members note that the allocation of CSM to profit or loss as required by IFRS 17 does not allow them to reflect the performance of their business. This is because some auditors and preparers read paragraph BC279 of IFRS 17 as a linear allocation of the CSM to profit or loss over the duration of the group of insurance contracts. EFRAG IAWG members noted that this issue was related to both the General Model and the Variable Fee Approach.
- 10 Paragraph BC279 of IFRS 17 states that '*Insurance coverage is the defining service provided by insurance contracts. The Board noted that an entity provides this service over the whole of the coverage period, and not just when it incurs a claim. Consequently, IFRS 17 requires the contractual service margin to be recognised over the coverage period in a pattern that reflects the provision of coverage as required by the contract. To achieve this, the contractual service margin for a group of insurance contracts remaining (before any allocation) at the end of the reporting period is allocated over the coverage provided in the current period and expected remaining future coverage, on the basis of coverage units, reflecting the expected duration and quantity of benefits provided by contracts in the group.*'
- 11 In addition, EFRAG IAWG members noted that some insurance products do not have face amounts that could assist in the determination of the quantity of the benefits provided under a contract in order to determine the coverage units. Therefore, the way the standard is written, a linear allocation could seem to be the only way of allocating the CSM, even if the expected pay-out declines over the coverage period. Also, the question was raised what the quantity of benefits represents.

Reinsurance contracts held - accounting mismatches

Introduction

- 12 EFRAG IAWG members identified several topics in relation to reinsurance contracts held. However, they have not fully documented these topics in time for their inclusion in this paper. These issues will be brought to EFRAG TEG when additional information has been provided by EFRAG IAWG members.

Proportional reinsurance held – accounting mismatches

- 13 In case of proportional reinsurance contracts held, EFRAG IAWG members note that, with the exception of the non-performance risk for the reinsurance contract held, an accounting mismatch exists between the proportional reinsurance contract being held and the underlying primary insurance contract. EFRAG IAWG members are of the view that this accounting mismatch makes it difficult for users of financial statements to identify the extent to which the primary insurance contracts benefit from reinsurance coverage.

Scope of Variable Fee Approach

- 14 EFRAG IAWG members were of the view that contracts with constructive obligations should be considered within the scope of the Variable Fee Approach.

Concerns with IFRS 17 and interpretation issues

- 15 EFRAG IAWG members discussed the presentation of a number of concerns with IFRS 17 and whether these will be submitted to the IASB's Transition Resource Group. The presentation of these concerns will be submitted to EFRAG TEG in October 2017.

- 16 EFRAG IAWG members discussed a number of interpretation issues with IFRS 17 and whether these will be submitted to the IASB's Transition Resource Group. The overview of these will be submitted to EFRAG TEG in October 2017.

Main comments received on Appendix I and II

- 17 The EFRAG IAWG members provided the following feedback in addition to the topics discussed above which they considered to be relevant for Appendix II.

Appendix I

- 18 The wording was to be adapted in order to avoid appearing judgemental in an appendix that is intended to be descriptive.
- 19 One EFRAG IAWG member noted that there were still a lot of differences between the financial statements of an insurer and a bank, also because banks have important off-balance sheet activities.

Appendix II

- 20 Appendix II should reflect a structure discussing the main elements of IFRS 17.
- 21 The different insurance accounting models should be discussed under relevance.
- 22 The assessment of the level of aggregation should:
- (a) include a discussion on how insurers assess profitability;
 - (b) discuss the impact of mutualisation; and
 - (c) include the uncertainty on how to apply the concept of coverage units.
- 23 The relevance of the release pattern of the CSM to profit or loss is to be reassessed.
- 24 The use of discount rates and also accounting mismatches are to be assessed under reliability.
- 25 Presentation in the statement of financial position and reinsurance contracts held relating to the existence of accounting mismatches are to be assessed against understandability.