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IFRS 17 Draft Final Endorsement Advice

Second decision- making session

Cover Note

Objective

- 1 The objective of the session is to discuss and approve Annex 1 and the cover letter of the final endorsement advice ('FEA') for recommendation to the EFRAG Board and to discuss and approve the note from EFRAG TEG to EFRAG Board on the vote on the endorsement advice.

Background

- 2 The FEA is composed of:
 - (a) the Cover Letter;
 - (b) Annex 1 (observations about the use of annual cohorts to intergenerationally mutualised and cash-flow matched contracts that are relevant for the FEA assessment of topics usually presented in Appendices II and III);
 - (c) Appendix I (description of the requirements in IFRS 17);
 - (d) Appendix II (FEA assessment and conclusion about the qualitative technical characteristics of all the other requirements in IFRS 17); and
 - (e) Appendix III (FEA assessment and conclusion about European Public Good about all the other requirements in IFRS 17).
- 3 At its meeting on 2 March 2021 the IAWG provided input to EFRAG Secretariat on the proposed changes to Appendices II and III. At its meeting on 3 March 2021 EFRAG TEG received a presentation of the comments received. At its meeting on 4 March 2021, EFRAG TEG approved and recommended to the EFRAG Board Appendices I, II and III of the IFRS 17 FEA, subject to wording changes. The EFRAG Board approved Appendix I and II at its meeting on 15 March 2021, suggesting further wording changes for the latter. For Appendix III further changes were asked.
- 4 The scope of this session on IFRS 17 excludes the Appendices approved by the EFRAG Board although these have been provided as background information. The session will focus on the updates to the Cover Letter and Annex 1 and once recommended by EFRAG TEG will be discussed by the EFRAG Board at its meeting on 29 March 2021. EFRAG TEG will also discuss and approve a revised Note from EFRAG TEG to EFRAG Board on the vote on the endorsement advice.
- 5 The Cover Letter provided for this session is unchanged from the DEA in its structure and conclusion (i.e. consensual support for all the requirements of IFRS 17 apart from the application of annual cohorts to intergenerationally-mutualised and cash-flow matched contracts and split views on annual cohorts). This is because, considering the comments received, the EFRAG Secretariat does not

anticipate changes to the structure and conclusion. The EFRAG Board will discuss and approve the Cover Letter of the FEA on 29 March 2021. EFRAG TEG members, similarly to what was done for the approval of the DEA, will provide to the EFRAG Board their position, in a Note from EFRAG TEG to EFRAG Board. For this purpose, we provide as a basis for discussion in this session the *Note from EFRAG TEG to EFRAG Board on the EFRAG TEG vote*, as approved in the EFRAG TEG on 3 September when approving the DEA.

Proposed changes to the cover letter

- 6 At its meeting on 4 March 2021, EFRAG TEG agreed to briefly include the interaction of regulatory requirements and IFRS 17 for conglomerates and recycling of equity instruments in the cover letter, with detail in Appendix III.
- 7 EFRAG TEG decided to include references to the reported concern about the interaction of regulatory requirements and IFRS 17 for conglomerates and recycling of equity instruments in the cover letter of the IFRS 17 FEA. EFRAG TEG decided to report in the cover letter that several of the issues assessed in Appendices II and III should be considered in the post-implementation review of the standard, without including a separate list of issues. EFRAG TEG also agreed to follow the recommendation of EFRAG IAWG and not include the topic of backloading of CSM amortisation in the FEA.
- 8 At its meeting on 15 March 2021, the EFRAG Board approved the updated Appendix I and II of the IFRS 17 FEA, however, given the changes to Appendix III, this will be considered at its next meeting on 29 March 2021.

Proposed changes to Annex 1

Background

- 9 As previously discussed and described in paper 02-04 (the comment letter analysis), the EFRAG Board was unable to reach consensus on the annual cohort requirement and its application to specific contracts, namely intergenerationally-mutualised ('IGM') and cashflow-matched ('CFM') contracts. The feedback received broadly confirms the existence of a split in the respondents' views, similar to EFRAG Board's position, with some respondents supporting the annual cohorts to all contracts and some respondents considering there should be an exclusion for certain contracts. For further information, please refer to paragraphs 90 to 100 and 123 to 136 in paper 02-04 (the comment letter analysis).
- 10 In the context that many of the comments received confirmed the position set out in Annex 1, the EFRAG Secretariat is proposing modest changes, not impacting the structure nor a wholesale re-write of the document.

EFRAG Secretariat proposals for change

- 11 The EFRAG Secretariat have updated Annex 1 for the following topics:
 - (a) The additional information received on the prevalence of the relevant contracts and separating the information from German stakeholders from those from other countries (Appendix II: paragraphs 1 to 2 in Annex 1 and paragraphs 52-53 in Annex A);
 - (b) The description of a practical way to implement the annual cohort requirement as described in paragraph 71 of the comment letter analysis (paragraph 23 Appendix II in Annex 1);
 - (c) Concerns about the impact of allocation techniques when implementing the annual cohort requirement on comparability and reliability of information (Appendix II: paragraphs 18 and 20 in Annex 1);

- (d) Specific reported arguments that annual cohorts would not cause procyclical effects (Appendix III: paragraph 20 in Annex 1);
- (e) Enhancing the description of the operation of IGM and CFM contracts (paragraphs 54 to 56; 59; 63; 65 in Annex A); and
- (f) Other changes to capture the following additional comments received that the annual cohort requirement:
 - (i) Does not faithfully reflect the investment service to policyholders (Appendix II: paragraph 37 in Annex 1);
 - (ii) Supporters overstate the importance of guarantees in these contracts (Appendix II: paragraph 42 in Annex 1);
 - (iii) Could support a move from annuities to unit-linked products (Appendix III: paragraph 10 in Annex 1);
 - (iv) Could impact asset liability management activities (Appendix III: paragraph 11 in Annex 1); and
 - (v) Has been acknowledged by the IASB to have significant costs that may exceed the benefits (Appendix III: paragraph 39 in Annex 1).

Requested advice from EFRAG TEG

- 12 At its previous meeting on 19 February 2021, an EFRAG Board member requested advice from EFRAG TEG whether the distinction or not the treatment of IGM and CFM contracts in the context of annual cohorts should be nuanced. The EFRAG Secretariat has not made specific changes in respect of this request.

Questions for EFRAG TEG

- 13 Does EFRAG TEG consider that a further distinction between intergenerationally-mutualised and cashflow-matched contracts in Annex 1 or the cover letter is necessary?
- 14 Does EFRAG TEG have any comments on Annex 1 of the FEA?
- 15 Does EFRAG TEG approve and recommend to the EFRAG Board the final version of Annex 1 of the FEA?
- 16 Does EFRAG TEG have any comments on the proposed changes to the cover letter of the FEA?
- 17 EFRAG TEG members will be asked to approve and recommend to the EFRAG Board the updated cover letter of the FEA. EFRAG TEG recommendations on the conclusion will be reported to the EFRAG Board in updating the Note from EFRAG TEG to EFRAG Board (Agenda Paper 02-03B): which changes do EFRAG members want to suggest to this Note? Does EFRAG TEG approve the Note from EFRAG TEG to EFRAG Board, subject to the changes agreed in this session?

Agenda Papers

- 18 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 02-02 – IFRS 17 FEA – Annex 1 on Annual cohorts;
 - (b) Agenda paper 02-02A – IFRS 17 FEA – Annex 1 on Annual cohorts (tracked changes);
 - (c) Agenda paper 02-03 – IFRS 17 FEA – Cover letter; and
 - (d) Agenda paper 02-03A – IFRS 17 FEA – Cover letter (tracked changes);
 - (e) Agenda paper 02-03B – IFRS 17 DEA - Note from EFRAG TEG to EFRAG Board on the EFRAG TEG vote

- 19 The following papers have been provided as background information:
- (a) Agenda paper 02-04 – IFRS 17 FEA –Comment letter analysis;
 - (b) Agenda paper 02-04A – IFRS 17 FEA –Main feedback messages;
 - (c) Agenda paper 02-05 – IFRS 17 FEA – Appendix I of the FEA;
 - (d) Agenda paper 02-06 – IFRS 17 FEA – Appendix II of the FEA;
 - (e) Agenda paper 02-07 – IFRS 17 FEA – Appendix II of the FEA (tracked changes);
 - (f) Agenda paper 02-08 – IFRS 17 FEA – Appendix III of the FEA; and
 - (g) Agenda paper 02-09 – IFRS 17 FEA – Appendix III of the FEA (tracked changes),

Appendix 1: Summary of changes to Appendix I, Appendix II and Appendix III of the FEA

- 20 There were no comments received on Appendix I to the FEA and therefore no changes have been made.
- 21 The package presented to the EFRAG Board in this session incorporates the following proposed main changes:

Appendix II

- (a) In relation to the relevance criteria for reinsurance contracts held and issued, note the reported concern that the risk mitigation option cannot be applied retrospectively, leaving mismatches at transition unaddressed (paragraph 72).
- (b) Correct the description of the risk mitigation approach under relevance (paragraph 139).
- (c) Include feedback from EFRAG IAWG that information for the risk mitigation approach may not always be available on a granular level (paragraph 141).
- (d) In relation to the relevance criteria for business combinations –include the reported concern that that the accounting treatment for contracts acquired in their settlement period lacks a sound conceptual basis and state that passing the cost-benefit assessment is doubtful. (paragraph 157).
- (e) Include the concern that guidance for reinsurance contracts held are insufficiently clear and not well-adapted to the specifics of those contracts (paragraph 350).

Appendix III

- (f) In relation to the interaction of IFRS 17 with IFRS 9 – the ‘fair value through profit or loss’- note the reported concern that the measurement of puttable financial instruments under IFRS 9 may not reflect the way assets are managed in a long-term investment business model, which may limit the relevance of the information. (paragraphs 122-123);
- (g) In relation to the key features of IFRS 17 – note the concern that the determination of contract boundaries to reinsurance contracts held will result in both accounting and economic mismatches due to: (i) applying different discount rates, measure differently the contract’s CSM, (ii) determining different coverage periods, (iii) applying different risk adjustments and (iv) retaining different release patterns for that risk. The separate assessment of the contract boundaries for reinsurance contracts held will enable reflecting the expected gain or loss from the reinsurance of future underlying contracts not yet issued, but it involves extensive use of judgment and estimates, therefore questioning the cost-benefit (paragraphs 222 -225);
- (h) In relation to reported concerns around prudential implications of volatility in OCI – note that EFRAG has been informed that the prudential capital of financial conglomerates will be affected by the application of IFRS 9 and IFRS 17 (paragraph 515);
- (i) On IFRS 9 comparatives: acknowledge the operational burden of not being able to apply IFRS 9 retrospectively for items that are derecognised at date of initial application (paragraph 184);
- (j) In relation to the potential effect of IFRS 17 on small and medium enterprises (SME’s) – add that the threshold used in the assessment has been retained on a conventional basis, in the absence of more direct reference. (paragraph 371).
- (k) In relation to the Covid-19 pandemic:

IFRS 17 FEA – Cover Note

- (i) update of the section based on the latest developments around the impact on elevated macro risks, cost of capital and implementation of IFRS 17 (paragraphs 521 onwards);
 - (ii) note the concern reported by one respondent that IFRS 17 if already applied, would have had a negative impact on supportive measures taken by insurers in the pandemic. (paragraph 528) EFRAG TEG suggested to obtain additional information to better illustrate this concern.
- (l) On dividends/distributable reserves: inclusion of reference to Dutch and Spanish law where the interaction between IFRS and prudential regulation may affect dividend distribution (paragraph 500).
 - (m) Summaries and references to the comment letters of ESMA and EIOPA have also been included (paragraphs 581 to 591 and 596 to 608).
 - (n) An explanatory footnote has been added in Annex 6 – Insurance statistics based on present legislation (Annex 6).
 - (o) In the glossary, the term NSS was added.