

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

IFRS 17 Insurance Contracts DEA

Issues paper on Release of CSM for insurance contracts with direct participation features

Introduction and Objective

- 1 The objective of this session is for EFRAG TEG to discuss a possible integration into the IFRS 17 draft endorsement advice ('DEA') in order to take into consideration the topic below which is included in the endorsement advice request from the European Commission ('EC').

European Commission endorsement advice request

- 2 The endorsement advice request from the European Commission states:
How does the pattern of release of the Contractual Service Margin ("CSM") for insurance contracts with direct participation features reflect the business models of the insurance sector?

Note from EFRAG Secretariat

- 3 The EFRAG Secretariat notes that the EC request was received before the IASB tentatively decided to change the CSM allocation for insurance contracts with direct participation features.
- 4 In December 2019, the IASB tentatively decided to finalise the CSM attributable to investment services - coverage units for insurance contracts with direct participation features, as proposed in the Exposure Draft. That is, an entity is required to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service.

Summary of May EFRAG IAWG meeting

- 5 One member suggested to indicate that the estimation of coverage units is judgemental rather than highly judgemental.
- 6 Another member, referring to paragraph 11 of the paper, indicated that there would be judgement in estimation of the coverage units and there would not be consistency in the way these coverage units are determined.
- 7 The below analysis in the DEA has been updated for EFRAG IAWG comments.

Current analysis in the IFRS 17 DEA

- 8 The DEA focusses on IFRS 17 as a whole and therefore does not make a distinction between before and after the IFRS 17 amendments.

9 The text below in italic reports the current DEA.

Appendix 2

Relevance

- 10 *For insurance contracts with direct participation features, the coverage units consider quantity of benefits and expected period of both insurance coverage and investment-related service (i.e. the management of underlying items on behalf of the policyholder). EFRAG considers that this represents the mixture of services provided under these contracts as these contracts are substantially investment-related service contracts and hence agrees that the allocation of the contractual service in accordance with the period of both the insurance coverage and investment-related services results in relevant information.*

Reliability

- 11 For insurance contracts with direct participation features, the coverage units consider quantity of benefits and expected period of both insurance coverage and investment-related service.

EFRAG considers that the estimation of coverage units is judgemental but entities would still be able to reliably measure them. This estimation is made easier because these contracts are substantially investment-related contracts, i.e. the investment-related service components clearly surpass any insurance service entailed. As a result, the weighting between insurance and investment would faithfully represent these types of contracts. Furthermore, the entity has to disclose the approach used in determining the weighting which would help users to assess the weighting.

Comparability

- 12 There is no specific mention of insurance contracts with direct participation features. There is, instead, a general assessment regarding identification of coverage units which covers all insurance contracts:

- 13 *The coverage units of the group are determined as the quantity of benefits provided by the contracts in the group and its expected coverage period. Judgement will be required for entities to determine the services provided, the related coverage units as well as the weighting of such coverage units to calculate the allocation of the contractual service margin and this may impact comparability between entities. However, EFRAG considers that this is balanced by the relevance of the resulting information as described in paragraphs xx to xx.*

Understandability

- 14 There is no specific mention of insurance contracts with direct participation features. There is instead a general assessment made:

- 15 *EFRAG acknowledges that the recognition of the contractual service margin as profit over the coverage period, rather than as a gain immediately on initial recognition of the group of insurance contracts (except for onerous groups of insurance contracts), may result in operational complexity for preparers, because they will need to track and allocate the contractual service margin. This method of recognising the contractual service margin also may add complexity for users of financial statements because of the need to understand the amounts recognised in the statement of financial position and in the statement of comprehensive income. However, EFRAG considered that recognition of the profit in the group of insurance contracts over the coverage period is necessary to represent faithfully an entity's financial performance over the coverage period and represents the entity's performance obligations satisfied over a period of time, which is consistent with IFRS 15.*

- 16 *Furthermore, EFRAG assesses that adjusting the contractual service margin for changes in future service provides relevant information about the unearned profit in the group of insurance contracts and is consistent with the approach in IFRS 15. In addition, the users will benefit from a better understanding of the present and future profitability.*

Appendix 3

- 17 There is no specific mention on whether the pattern of release of the CSM for insurance contracts with direct participation features reflect the business models of the insurance sector.

Question for EFRAG TEG

- 18 Does EFRAG TEG consider that the analysis currently in the DEA is sufficient to address the EC request or something is missing? Please explain.