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IFRS 17 Draft Final Endorsement Advice

First decision- making session

Cover Note

Objective

- 1 The objectives of the session are to:
 - (a) consider the comments received in response to EFRAG's Invitation to Comment on its draft endorsement advice ('DEA') on IFRS 17 Insurance Contracts as amended in June 2020; and
 - (b) discuss and approve Appendices I, II and III of the final endorsement advice as recommended by EFRAG TEG ('FEA').

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 The scope of this session on IFRS 17 excludes the assessment on the Cover Letter and Annex I of EFRAG's endorsement advice. The updates to the Cover Letter and Annex 1 will be discussed at the meeting on 29 March 2021.
- 4 At its meeting on 2 March 2021 the IAWG provided input to EFRAG Secretariat on the proposed changes to Appendices II and III.
- 5 At its meeting on 3 March 2021 EFRAG TEG received a presentation of the comments received.
- 6 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. The papers for this session include the recommendations by EFRAG TEG for further changes.

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

- 7 There were no comments received on Appendix I to the FEA and therefore no changes have been made.

- 8 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. Note however, that the cost-benefit assessment for endorsement is not performed per requirement (paragraphs 157 and 159).
- (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 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 proportionality measures should be considered in requesting insurance companies to apply IFRS 17, in particular through the application of art. 5 of the IAS Regulation (paragraph 379).
- (k) In relation to the Covid-19 pandemic:
 - (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 523 to 529 and 536 to 540);

- (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 529) EFRAG TEG suggested to obtain additional information to better illustrate this concern.
- (l) On dividends/distributable reserves: inclusion of reference to Dutch law where the interaction between IFRS and prudential regulation may affect dividend distribution (paragraphs 501-505 and 518).
- (m) Summaries and references to the comment letters of ESMA and EIOPA have also been included (paragraphs 585 to 592 and 604 to 609).
- (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.

EFRAG TEG proposed changes in the comment letter

- 9 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.
- 10 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.

Questions for EFRAG Board

- 11 Does EFRAG Board have any comments on the Comment Letter Analysis?
- 12 Does EFRAG Board have any comments on Appendix I of the FEA?
- 13 Does EFRAG Board have any comments on Appendix II of the FEA?
- 14 Does EFRAG Board have any comments on Appendix III of the FEA?
- 15 Does EFRAG Board approve the final version of Appendix I of the FEA?
- 16 Does EFRAG Board approve the changes to and the final version of Appendix II of the FEA?
- 17 Does EFRAG Board approve the changes to and the final version of Appendix III of the FEA?

Agenda Papers

- 18 In addition to this cover note, agenda papers for this session are:
 - (a) Agenda paper 04-02 – IFRS 17 FEA – Issues paper summarising comment letters received;
 - (b) Agenda paper 04-02A – IFRS 17 FEA – Slide pack summarising the comment letter analysis;
 - (c) Agenda paper 04-03 – IFRS 17 FEA – Appendix I of the FEA;
 - (d) Agenda paper 04-04 – IFRS 17 FEA – Appendix II of the FEA;
 - (e) Agenda paper 04-05 – IFRS 17 FEA – Appendix II of the FEA (tracked changes);

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- (f) Agenda paper 04-06 – IFRS 17 FEA – Appendix III of the FEA;
- (g) Agenda paper 04-07 – IFRS 17 FEA – Appendix III of the FEA (tracked changes); and
- (h) Agenda paper 04-08 – IFRS 17 FEA – Issues paper discussing the concerns for a PIR.