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Non-current Liabilities with Covenants, Proposed amendments to IAS 1 – EFRAG’s Draft Comment Letter on the IASB’s Exposure Draft (November 2021)

Dear Mr Gauzès

On behalf of the German Insurance Association (GDV) we welcome the opportunity to provide our comments on the EFRAG’s Draft Comment Letter (‘the DCL’) in response to the IASB’s Exposure Draft ‘Non-current Liabilities with Covenants, Proposed amendments to IAS 1’ (‘the ED’), published by EFRAG on 21 January 2022 for comments.

Like EFRAG, we support the IASB’s efforts to address the stakeholders’ concerns related to potential consequences of the amendment to IAS 1 *Presentation of Financial Statements* issued by the IASB in January 2020, and as clarified in the related tentative agenda decision of the IFRS Interpretations Committee in December 2020. In general, we agree with the IASB’s proposal to amend IAS 1 to achieve that those specific conditions with which an entity must comply within twelve months *after* the reporting period have no effect on whether the entity has, *at* the end of the reporting period, a right to defer the settlement of a liability for at least twelve months after the reporting period. We are fully supportive of the IASB’s intention that such conditions should have no effect on the classification of a liability as current or non-current.

While we back the proposed requirement in the ED to disclose those respective liabilities classified as non-current but subject to such conditions in the notes (and subject to general entity-specific materiality considerations), like EFRAG, we don’t support the proposed requirement in the ED to separately present these liabilities in the statement of financial position for the reasons provided in paragraphs 34 till 37 of the DCL (Question 2).

Considering the proposed new paragraph 72C for IAS 1 in the ED the German insurance industry is very much concerned about the envisaged outcome of its adoption. We understand that the proposal is intended to

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apply also to all (re)insurance liabilities in scope of IFRS 17 *Insurance Contracts* and (re)insurance liabilities are on purpose explicitly mentioned in the ED. The rationale for the concerns raised is as follows:

- The ED proposes to clarify when a company does not have a right to defer settlement of a liability for at least twelve months. It should be the case if an uncertain future event or outcome might or might not occur and its occurrence or non-occurrence is unaffected by the entity's future actions. As an example, "insurance contract liability" is explicitly mentioned in the proposed new paragraph 72C (b) in the ED.
- The proposed amendment indicates that the IASB's intention is to clarify that **(re)insurance contract liabilities** are always, in all circumstances, to be classified as **current**. As a matter of principle, we generally disagree with this absolute outcome.
- While the (re)insurers used to apply the presentation by order of liquidity (paragraphs 60 and 64 of IAS 1), the envisaged general classification of (re)insurance contract liabilities as current liabilities does not seem to be appropriate and might lead to problematic consequences, specifically in the context of the digital reporting.
- The intended approach is **inappropriate** as it would not faithfully reflect the economics of the financial position of (re)insurers. It is also problematic because for example the tagging required for IFRS financial statements might provide misleading information/inputs to investors and other users of digitalised financial statements when they proceed with the data not properly reflecting the (re)insurers' financial position (e.g., when building ratios for investment decisions).

If this essential issue remains not addressed, insurers are concerned that they would be obliged to provide disclosures about the (re)insurance contract liabilities as current, though their nature is indeed a different one. Starting from 1 January 2023, (re)insurance contract liabilities will continue to be presented on a portfolio basis as required by paragraph 78 of IFRS 17. And this presentation reflects properly the underlying business model which is based on risk sharing and on the law of large numbers. Moreover, as a matter of fact, the **payments** at the level of a portfolio of (re)insurance contracts are to a very large extent **predictable** across the coverage periods of insurance contracts aggregated in the portfolio. We like to note that this predictability also allows for a reliable measurement of (re)insurance contracts. As only a respective partial amount of settlement payments is expected to be due within the subsequent twelve months after the reporting period, it would be counterintuitive and economically false to classify all (re)insurance contract liabilities as current liabilities, i.e., assuming that all the payments for contracts in the portfolio could be due within the next twelve months. The position is rather mixed in nature; it does not consist solely of current positions, but it includes both current and non-current portions. Therefore, we are fully supportive of EFRAG's reservations regarding

the proposed classification in the ED (Question 1, paragraph 16 of the DCL). And we would like to note that paragraph 132 (b) of IFRS 17 provides specific minimum disclosure requirements regarding separate maturity analyses for portfolios of (re)insurance contracts. The proposed general classification of insurance contracts as current in the ED doesn't seem to be aligned with these specific requirements in IFRS 17.

Hence, while we support the suggested clarification in paragraph 18 of the DCL, we recommend EFRAG also to explicitly put in question the IASB's intention concerning the **classification of insurance liabilities** at large. In this context, we are not fully supportive of the clarification as suggested by EFRAG in paragraph 15 in the DCL. While this paragraph does not mention the "insurance contract liability" in an explicit manner, it still builds on the content and on the direction of the IASB's proposal in paragraph 72C (b) of the ED where such an explicit reference is made. Hence, we are concerned that the clarification indented in the DCL might lead to an adverse outcome as intended from the perspective of the insurance industry, specifically if the IASB decides to keep both examples (a financial guarantee or insurance contract liability) as included in the ED when proceeding further. Therefore, we would kindly recommend to explicitly address in the EFRAG's final comment letter to the IASB the issue of classification of insurance liabilities as an issue to be explicitly revised when finalising the amendments to IAS 1.

In addition, we recommend EFRAG to suggest to the IASB to clarify that no additional new line items need to be **presented** in the statement of financial position when entities apply the alternative presentation using the order of liquidity (paragraph 37 of the DCL). Furthermore, **no additional granularity** should be required for (re)insurance contracts presentation beyond what is already specified in paragraph 78 of IFRS 17, since it had already been subject to considerable deliberations in the past because of the insurers' valid concerns regarding practicability from the operational perspective.

Regarding the paragraph 27 in the DCL we would suggest recommending the IASB to clarify that entities applying the presentation by order of liquidity would not be required to provide any additional **disclosures** because of the envisaged amendments to IAS 1 as proposed in the ED. Currently the paragraph 27 suggest clarifying only whether disclosure would be required in such a situation. We like to note that the ED refers in paragraph 76ZA only to liabilities subject to conditions described in paragraph 72B(b), hence from our perspective no additional disclosures are proposed/required in other circumstances. Furthermore, it should be noted that for (re)insurance contracts paragraph 132 of IFRS 17 provides already specific disclosure requirements regarding liquidity risks. These specific disclosure requirements must not be undermined or overloaded by any additional future amendments to IAS 1, even though being generally applicable to all liabilities.

Overall, we kindly ask EFRAG to suggest to the IASB to approach the general concern of the insurance industry described above when finalising the

amendment to IAS 1. We believe that IAS 1 should be generally capable of providing faithful presentation of the underlying business model of (re)insurers. Therefore, any contradictions or potential conflicts with specific presentation or disclosure requirements in IFRS 17 should be prevented and clarified in advance. Finally, any unintended consequences for digital consumption of information provided in IFRS financial statements should be avoided as well.

We would greatly appreciate if the comments of the German insurance industry could be considered when finalising the comment letter of EFRAG. If you would like to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,

German Insurance Association (GDV)