

IFRS 17

- EFRAG published its Final Endorsement Advice (FEA) on IFRS 17 on 31 March 2021. In its advice, EFRAG conclude that, apart from the requirement to apply annual cohorts to intergenerationally-mutualised and cash-flow matched contracts, all the other requirements of IFRS 17 on balance meet the qualitative characteristics of relevance, reliability, comparability and understandability and are conducive to the European public good. With reference to **the requirement to apply annual cohorts to the intergenerationally-mutualised and cash-flow matched contracts**, EFRAG Board members are split: seven of the EFRAG Board members believe that the annual cohorts requirement meets the endorsement criteria, whereas **seven EFRAG Board members believe it does not** and two abstain.
- **The annual cohorts issue, specifically with reference to intergenerationally mutualised and cash-flow matched contracts, is one of the industry's key priority issues**, and Insurance Europe regrets that the International Accounting Standards Board (IASB) has decided not to address this specific concern. If not addressed, it will have a significant impact for many insurers in Europe.
- Therefore, **Insurance Europe supports a European carve-out based solution for annual cohorts. The solution should not impact the effective date of 1 January 2023.** The European solution should equally not prevent companies that want to apply the annual cohort requirement in line with IFRS 17, as issued by the IASB, to do so.
- A **carve-out with a limited scope is an option that should be explored as soon as possible** and Insurance Europe has worked with its members and with the CFO Forum to identify how a **suitable scope for a limited carve-out could be defined**. This incorporates existing terminology of IFRS and builds on the proposals from the CFO Forum, ICAC and the ANC, taking into account that we are now in a European context which opens up the potential simplifications of the text. Please see below a **potential definition of a principle-based limited scope exception**.

Potential solution to annual cohorts issue for European carve out

An entity is not required to apply paragraph 22 for contracts which, at initial recognition, fulfil either of the following criteria:

- Contracts described in IFRS 17 B67 and B68 that also meet the criteria of "contracts with direct participating features".

Or

- Contracts and related assets meet the conditions set out in Article 77b of the Solvency II - Directive 2009/138/EC

- We hope, at some point in the future, the IASB will allow the same outcome for annual cohorts that we achieve in the EU. Insurance Europe will continue to engage with the IASB to try to achieve this so that this European difference from IFRS 17 would be temporary.
- **Apart from an issue regarding annual cohorts, the industry agrees that other issues should not block the endorsement of IFRS 17** in the EU and can instead be addressed later as part of a post implementation review.
- The industry has expressed **a unified view on endorsement on the condition that there is a European solution to the annual cohort issue**, on an optional basis, and the **effective date remains 1/1/2023**.
- **The industry seeks a rapid political decision to support endorsement with the annual cohorts addressed** to remove as soon as possible the uncertainty over this project for companies in the process of their implementation projects.
- We therefore **urge ARC members to give the European Commission a mandate to work on a solution** to the annual cohort issue to ensure a smooth endorsement process in due time for the 2023 effective date.

Annex: Explanation of the annual cohort issue

The issue of level of aggregation has been of so great importance because it goes to the heart of the insurance business model. The insurance business model (and our ability to offer products to customers) is based around mutualisation and pooling of risks. This means aggregating individual contracts into portfolios and managing the aggregate risk. Unlike the selling of most other items (clothes, electronics, services) it is often impossible to determine if an individual insurance customer is profitable.

For example with car insurance there is either a claim, and then the insurer almost certainly pays back more than the premium to the customer or there is no claim in which case the insurer gets to keep the premium (less costs). The insurer pools the car insurance customers together and aims to charge each customer a premium so that in aggregate the total premiums exceed the total claims (and costs) and the insurer can earn a profit. The profit can only be measured at aggregate portfolio level. The same applies for most insurance products including savings products such as profit sharing where investment performance is pooled across customers and across time so the customer gets a smoothed return based on long-term performance rather than the everyday ups and downs of the markets.

IFRS standards generally require accounting for individual contracts. This makes no sense for insurers and after a long process a few years ago, the IASB finally accepted this was economic reality and necessary for the accounts to be meaningful. They made an exception to the general contract rules for IFRS 17 so that insurers can aggregate contracts into portfolios for the financial reporting purposes.

However, IFRS 17 still requires all portfolios to split into annual cohorts. This goes against the business model because insurance products are often a multi-year and are not measured or managed on an annual basis. The costs of the system changes and additional data gathering needed to allow the necessary data to be gathered and then the ongoing allocation of all data into such a grouping would be very high but more importantly the information is simply not useful or useful enough to justify it.

This is why, as well as the industry, the European Parliament in their Motion for Resolution raised the issue of aggregation, why it was one of the 6 key issues identified by EGRAG in their letter to the IASB and why EIOPA also in their analysis of IFRS 17 said they have "reservations on a few concepts that may affect comparability and relevance of IFRS 17 financial statements and should be duly addressed" and specifically noted that "Issues such as level of contracts' aggregation (...) may lead to further complexity of the financial statements".

Even the IASB recognised that for some contracts the value of information in annual cohorts may not justify the costs but they failed to find a way to identify such contracts.