

Background

The European industry went through a comprehensive testing exercise organized by EFRAG which has raised 11 significant areas of concern, which were supported by a detailed, fact-based analysis. The industry is committed to the successful global implementation of the standard for which changes are critical to deliver the quality, decision-useful information that investors analysts and other users are expecting.

In reaction to the significant concerns raised on both the need for more time and improvements to IFRS 17, from European and worldwide stakeholders, the IASB accepted in October 2018 to explore potential areas of improvement in the standard and tentatively decided on 14 November 2018 to postpone the effective date by one year (and extend also insurer's optional deferral of IFRS 9 -*Financial Instruments*). The IASB is currently considering potential amendments to the standard.

The issues analysed by the IASB include the ones raised by the European Parliament, EFRAG and the European insurance industry. We also note that the application of IFRS 17 for mutual entities is conceptually complex and has become an issue following the publication of an educational material by the IASB in July 2018.

The IASB has already gone through most of the issues at its December, January and February Board meetings, and is planning to finish in March 2019. After that they are expected to issue an Exposure Draft of the amendments to IFRS 17 around the end of the first half of 2019 and a new standard in the first half of 2020.

The table-below provides an overview of the degree to which the IASB is seeking to address the issues identified by the European insurance industry during the EFRAG field testing as needing improvement and which include those raised in the Motion for Resolution voted by the ECON Committee on 20 June 2018.

Part 1: Issues raised by the Industry and in the Motion for Resolution

Issue	Description of specific concerns	IASB Board decision
Presentation	The standard requires that groups of contracts be presented as asset or liability based on its entirety. In reality, different components, such as claims liabilities to be settled, unearned premiums, etc are managed separately and administered in different systems. Groups of contracts may frequently switch from an asset to liability position.	Partly addressed– limited changes proposed (December 2018).
	The standard requires premiums and claims to be included in the insurance provision on a cash paid/received basis. In reality, these are reflected on an accrual basis and payments/receipts are managed and administered separately.	Discussed and changes rejected (December 2018).
	The standard requires, for presentation of revenue only, segregation of non-distinct investment components, even for contract that do not have a specified account balance or component.	Not Considered by the IASB -
	When 'rolling forward' the CSM, paragraph B137 requires insurers to take the latest published CSM balance, for example the balance included in interim results, as the opening position.	Discussed and changes rejected (December 2018)
Level of aggregation	The prohibition to aggregate contracts that are issued more than one year apart is unduly complex. We believe that it should be replaced by a principle according to which the insurer determines based on its internal business and risk management the way it defines its portfolios. This determination should reflect mutualisation effects when they exist. In addition, the second profitability bucket (no significant possibility of becoming onerous) is highly subjective and adds to the complexity.	Not yet discussed at IASB (expect in March 2019)
Transition	The modified retrospective approach is very restrictive and will not provide the simplifications that make retrospective application possible in practice.	Discussed and changes –rejected (February 2019)
	The option to set OCI to nil under the fair value approach is not available to assets accounted at fair value through OCI, though a similar treatment is allowed on liabilities side	Discussed and changes rejected – (February 2019).
	The hedging adjustment (risk mitigation option) cannot be applied retrospectively on the date of initial application.	Discussed and changes rejected (February 2019).
Reinsurance	The approach to reinsurance gives rise to several accounting mismatches. Examples include; For an onerous contract a cedant has to recognise a loss component though P/L at inception whereas the relief from a corresponding reinsurance contract held has to be deferred over the coverage period.	Addressed for proportionate reinsurance, non-proportionate reinsurance not covered (January 2019).
	Reinsurance held cannot be accounted for under the VFA model, even if the VFA model is applied to the underlying insurance contracts.	Discussed and changes rejected (January 2019).
	Contract boundaries for reinsurance are inconsistent with those for the underlying insurance contracts, meaning that the reinsurance accounting requires the inclusion of an estimate of cash flows for underlying insurance business that is not yet written/ recognised.	Discussed and changes rejected (January 2019).

Implementation timeline concerns	IFRS 17 involves significant changes to systems and processes for insurance companies. The lack of resource and expertise to implement this comprehensive standard also make meeting the IASB application date extremely challenging, especially for smaller insurance companies. In addition, the requirement to restate comparatives really means companies will have to apply the standard by 1 January 2020.	Partially addressed by IASB (November 2018) – one-year delay rather than two, and no change to the mandatory restatement of comparatives.
IFRS 9 / IFRS 17 Link	IFRS 17 and IFRS 9 affect valuation both on the asset and liabilities side of insurers balance sheet. It is therefore important that those two standards' application dates be aligned for insurers and that consistency between the two standards is respected.	IASB delayed IFRS 9 as well as IFRS 17 (November 2018 decision) Industry remains committed to the reintroduction of equity recycling under IFRS 9.

Part 2: Additional issues raised by EFRAG, the Industry and referred to in Motion for resolution

Issue	Description of specific concerns	IASB Board decision
CSM amortization	The requirements on coverage units to be used for the CSM amortisation are not appropriate for all types of contracts. A key issue is that the CSM (of which the initial amount is impacted by investment spreads) cannot be amortised over the period in which the investment spread is earned and investment services/activity provided. This issue was mainly identified in the testing for GMM annuity contracts (particularly deferred annuities), savings and participating contracts.	Change for VFA contracts approved tentatively in June 2018.
	It is acknowledged that this is a topic under discussion by the IASB for contracts in scope of the VFA. However, the issue is equally relevant for the general measurement model.	A change for general model proposed (January 2019) but there are concerns that it only addresses partially the issue – currently under analysis by the IASB.
Acquisition Cost	Acquisition cash flows on new business that is expected to renew cannot be allocated to future periods. This is inconsistent with other industries which capitalise acquisition costs over multiple contracts. This was particularly evidenced in the testing of P&C contracts.	Addressed by IASB (January 2019)

Part 3: The remaining Industry priority issues identified during EFRAG's testing exercise

Issue	Description of specific concerns	IASB Board decision
Multi-component contracts	Certain contracts exposing the issuer to credit risk that are in substance loans (for example equity release mortgages in the UK) contain a small insurance element which causes the entire contract to be subject to Insurance accounting under IFRS 17.	Addressed by IASB (February 2019) – credit card issue remains to be solved (solution expected in March 2019)

Scope of hedging adjustment	<p>This was highlighted as part of the testing for a material book of business with guarantees that are hedged.</p> <p>Whilst IFRS 17 includes a specific hedging adjustment, its use is limited to specific circumstances: It is only available for contracts in scope of the VFA.</p>	<p>Discussed and changes rejected (December 2018).</p> <p>The Board requested the staff to work on the prospective application of the risk mitigation option starting at the transition date, instead of effective date (to be discussed in March 2019)</p>
	<p>Hedging adjustment can only be used when derivatives are used as hedging instrument.</p>	<p>Partly addressed—reinsurance added to scope of risk mitigation; other financial instruments not (January 2019)</p>
Scope of the VFA model vs General model vs PAA	<p>The testing has shown that the results are very different depending on the measurement model applied, whilst there is a continuum in the nature of insurance products. There are several elements in the VFA model that deal more appropriately with specific elements of insurance products but these are not available under the general model or premium allocation approach. These include the alignment of liability discount rates with (accounting for) asset returns and the transitional amounts in OCI.</p>	<p>Discussed and changes rejected (December 2018)</p>
Discount rates	<p>The use of a locked in discount rate for the CSM in the general model. The impact of assumption updates is absorbed in the CSM at the locked-in rate. The Best estimate liability (BEL) is measured at the current rate. The difference between the locked-in and the current rate is reflected in the P&L and will significantly distort the current period result. In the situation where the BEL component of the insurance liability is an asset and the CSM component is a liability, inconsistencies arise due to the different discount rates for BEL (current rate) and CSM (locked-in rate).</p>	<p>Discussed and changes rejected (December 2018).</p>
Business Combination	<p>There are several elements in accounting for insurance business combinations that add significantly to complexity, including: the requirement to assess classification at the acquisition date instead of the original inception date.</p>	<p>Discussed and changes rejected (December 2018).</p>
	<p>The treatment of claims in payment at the acquisition date.</p>	<p>Discussed and changes rejected (December 2018).</p> <p>Relief on transition for business combinations (February 2019)</p>