

To: Mr Alain Deckers
Head of Unit, Accounting and Financial Reporting
DG Financial Stability, Financial Services and Capital Union
European Commission
Rue de Spa 2 – 1000 Brussels

From: Insurance Europe

Date: 24 March 2017

Reference: ECO-FRG-17-025

Subject: Final stage of the insurance contracts project (IFRS 17)

Dear Mr Deckers,

We thank you for meeting us on 7 March 2017 and for the helpful discussion of the insurance industry's concerns regarding the IASB's completion of the insurance contracts Standard. We set out here a summary of three of those key concerns that our members believe can and should be resolved before the Standard is published. **These are not the only outstanding issues of key concern¹, but we have selected a very limited number, in line with your request**, and focused on those which can lead to significant unnecessary complexity and operational costs if not resolved. We have in each case provided simple proposals as to how the concern can be addressed.

Please note that we firmly support a successful finalisation of the project. However, a holistic assessment and an ultimate list of industry concerns will only be possible after the publication of the future IFRS 17 because:

- none of our members have seen the whole draft IFRS, including the wording of certain key requirements that the IASB has said that it is still working on, nor any of the Basis for Conclusions which may be very significant in interpreting how the requirements are to be applied;
- most of our members have not seen the whole of the draft text for the IFRS's requirements, as the IASB has severely restricted the circulation of the fatal flaw review draft of the Standard;
- only a very few companies amongst our members have been given even the opportunity, through the IASB's field-testing last summer, to test at the operational level some of the draft IFRS's specific requirements, and particular very significant ones developed since the revised Exposure Draft in June 2013; and
- there has been no testing or evaluation by our members or their companies of the cost/benefit balance of the draft IFRS as a whole, and we believe that this is also true of investors and other users as well. It therefore remains far from clear that the IFRS will deliver meaningful reporting of financial performance which appropriately reflects insurers' business models, and does so at a proportionate cost.

Initial onerous contract assessment

Despite the IASB staff efforts on this issue, we still have major concerns regarding identifying the group of contracts that are onerous at inception. We understand that the Board's intention is to allow a "top-down" approach for assessing contracts that are onerous at inception, and we very much welcome this because it recognises that, in contrast with many other businesses, insurers manage risk, pricing and performance at portfolio level and not individual contracts. In fact, when a policy is sold, the cost of a claim at contract level is not known in advance. The cost of claim, when the contract is written can meaningfully be estimated only if based on a pool (i.e. portfolio) of contracts.

¹ For example: the hedging solution being not applicable to the indirect participating contracts, uncertainty about the scope of the variable fee approach or the rule-based pattern for the CSM release. See our letter on 16 February for further information.

Profitability assessment and therefore also the identification of whether a group of contracts is onerous at inception requires a “top-down” approach. However, the revised paragraph 18 of the IFRS 17 extract on level of aggregation requires companies to “determine that the contracts in the sets are either **all onerous or all not onerous**”. This “all or nothing” approach brings us back to requiring “bottom-up” calculations at individual contract level and negates the top-down approach needed.

Insurance Europe suggestion:

We have noted that the IASB has granted, in the new paragraph 20 of the IFRS 17 extract on level of aggregation (presented in Appendix B to the Agenda Paper 2C of the IASB February 2017 meeting), a conditional presumption that no contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise. However, it applies only to contracts to which the premium allocation approach is applied.

We recommend this conditional presumption should be permitted to be applicable to all insurance contracts. This can be achieved by deleting in full paragraph 18 and 19 of the IFRS 17 extract on level of aggregation and by deleting the passage in paragraph 20 of the IFRS 17 extract on level of aggregation that constraints the presumption to contracts under the scope of the PAA only.

While we prefer the suggested change, alternatively, the IASB could, as a minimum, delete the problematic wording in paragraph 18 (a) and to amend it as follows: “(a) any sets of contracts, if using reasonable and supportable information the entity can determine that the ~~contracts in the~~ particular sets ~~are~~ is either ~~all~~ onerous or ~~all~~ not onerous;”. We believe that these changes would eliminate the problematic “all nor nothing approach” likewise.

Annual cohorts requirement

We continue to have serious concerns about the new requirement for annual cohorts. When annual cohorts requirement was introduced for the first time in November 2016, the IASB staff argued that it was necessary to have the one year grouping to avoid a never ending CSM on the balance sheet.

However, the IASB states in paragraphs 67 and B107 of the July 2016 testing draft IFRS 17 that the requirement to allocate the contractual service margin using coverage units, which reflect the expected duration and size of the contracts in the group, ensures that the CSM is fully amortised when the related contracts expire or lapse. Likewise, paragraph 67 deals with derecognition (i.e. the elimination of liabilities, including CSM, when a contracts terminates). Therefore, there is no justifiable need for the annual cohorts requirement which will bring operational complexity and require insurers to incur significant costs in developing IT systems that will group and track annual cohorts.

Insurance Europe suggestion:

We urge the IASB to abandon this requirement by simply deleting paragraph 23 of the IFRS 17 extract on level of aggregation (presented in Appendix B to the Agenda Paper 2C of the IASB February 2017 meeting).

Mandatory restatement of comparatives at initial application

IFRS 9 does not require the restatement of comparative information on transition, in fact it prohibits the restatement of comparatives if it cannot be done without the use of hindsight. The mandatory restatement of the 2020 comparative information for IFRS 17 creates a misalignment of assets and liabilities in the comparative information and effectively reduces significantly the length of the transition period from three and a half to two and half years.

Insurance Europe suggestion:

We urge the IASB to align IFRS 17 to IFRS 9 by making the restatement of the IFRS 17-based 2020 comparative information optional.



More detailed explanation of our rationale is provided in the annex to this letter. We would be grateful if you could support our views.

Should you have any comments or questions, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in blue ink, appearing to be "O. J. ...", is written over a horizontal line.