



MINISTERIO  
DE ASUNTOS ECONÓMICOS  
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Mr Jean-Paul Gauzès  
European Financial Reporting Advisory Group  
35 Square de Meeûs  
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Madrid, 25th of June 2020

**IFRS 17 Insurance Contracts: an exception to the annual cohorts' requirement.**

Dear Jean-Paul,

We refer to our letter from the 15th of May 2020 in which we shared with you and with the International Accounting Standards Board (IASB) ICAC's proposal of an exception to the annual cohorts' requirement. The Chairman of the IASB responded to our proposal the 5th June 2020.

We regret that the IASB has finally decided not to address the concerns raised on the annual cohorts issue after providing detailed explanations of why IFRS 17 will not adequately reflect the economic nature of certain insurance contracts that, in the case of Spain, are cash flow-matched over different generations of policyholders. We believe that not addressing this issue will significantly increase the cost of financial reporting and the resulting financial information will not be as useful as it would be desirable by different interest parties and stakeholders.

ICAC has provided EFRAG with potential solutions to address the issue described above and we believe that they could be used as a basis to identify the contracts to which the annual cohort requirement should not be required.

We urge EFRAG to consider our suggested potential solutions and depict in the Draft Endorsement Advice a description of the issue raised by ICAC together with an assessment of the consequences in terms of the technical advice to be provided to European Commission

Please do not hesitate to contact us to further discuss this letter.

Yours sincerely,

Santiago Durán Domínguez

President of ICAC

Cc: Hans Hoogervorst (IASB Chair)  
Alain Deckers (European Commission - DG Financial Stability, Financial Services and Capital Markets Union)

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**Appendix 1:  
ICAC's view on the IASB staff analysis on the suggestions for an exception to the annual cohorts' requirement for regulated insurance contracts with intergenerational risk sharing**

IASB Staff analysis	ICAC's view
<p><b>P.15:</b> <u>The scope of the ICAC exception is broad and, in our view, extremely difficult to enforce.</u> The ICAC proposals link the scope to specific regulatory requirements in Spain. But it is extremely unlikely, if not impossible, that 'cash flow matching techniques' could be defined in a way that could be applied consistently internationally. It is likely that almost all insurers could use that phrase to describe their asset/liability management activities.</p>	<p>The scope of this exception is not intended to be broad (i.e. it is not applicable to all portfolios measured under the GMM) and is limited to regulated portfolios either under the Solvency II regime (Matching Adjustments portfolios which require local regulatory approval ) or under local GAAP (specific regulatory requirements to ensure that asset and liability matching techniques are covering insurance and financial risks as intended)</p>
<p><b>P.16:</b> Further, the scope of the ICAC exception <u>is unrelated to the features that AP2B identified as increasing the costs of annual cohorts or reducing the usefulness of the resulting information.</u> It seems there is nothing about the contracts in the ICAC proposed scope that makes the annual cohort requirement harder to apply or the resulting information less useful compared <u>to any other type of insurance contracts.</u></p> <p>Agenda Paper 2A of the March 2019 Board meeting explained why determining the Page 5 of 6 level of aggregation using asset and liability management techniques or risk management techniques would lead to an unacceptable <u>loss of useful information.</u></p>	<p>In our view, ICACs exception is related to the features included in Paper AP2B (IASB Board march 2019). As it was noted in paragraph 23 of this document, contracts measured individually would not provide useful information about insurance activities, which often rely on an entity issuing a number of similar contracts to reduce risk. The Board concluded, therefore, that the contractual service margin should be measured at a group level.</p> <p>Using the same argument made by the IASB, in contracts managed under cash flow matching techniques annual cohorts would not provide useful information because the pricing, the business and risk management techniques applied to these portfolios are done at portfolio level and not on an annual cohort basis.</p> <p>Therefore we believe that in the case described by ICAC the result would be less useful information compared to other types of contracts.</p>
<p><b>P.17:</b> Hence, if the annual cohort requirement did not apply, users of financial statements would <u>lose critical information</u> about:</p> <ul style="list-style-type: none"> <li>a. trends in <u>profitability</u> of contracts issued in different years; and</li> <li>b. losses on <u>onerous</u> contracts.</li> </ul>	<p>We believe that stating that users of financial statements would lose critical information it is not entirely accurate. It is true that as the data in the agenda paper 2A show, grouping contracts loses information, but it is not due to the non-application of annual cohorts, but due to not performing the contract-by-contract measurement. During the development of the standard the IASB concluded that it was necessary to strike a balance between the loss of information and the need for useful information about insurance activity, and for that reason they concluded that the contractual service margin should be measured at a group level. We believe that once this loss of information is assumed in order to correctly reflect the insurance activity, our proposal is fully aligned with the IASB main objectives of having critical information.</p> <p>As we have explained in paragraph 16, profitability and also losses in onerous contracts, would be distorted by the fact that these contracts are managed at the portfolio level and not on an annual cohort level.</p>





<p><b>P.18:</b>In relation to the trend in <u>profitability</u> (paragraph 17.a of this paper), the ICAC proposals state that most Spanish insurers earn an expected constant financial margin in these contracts, and that the contracts are priced consistently to achieve a stable margin. But we cannot assume that will always be the case—amounts invested from premiums at different dates (and reinvested when assets are sold at different dates) will generate different returns reflecting the different economic conditions at those dates. Annual cohorts give transparency about the resulting different margins over time.</p>	
<p><b>P.19:</b> In relation to losses on <u>onerous</u> contracts (paragraph 17.b of this paper), most of the risk associated with the contracts described in the ICAC proposals is financial risk. Applying the general model in IFRS 17, changes in the effects of financial risk are recognised in profit or loss or OCI when the changes occur. This means that the guaranteed interest rates in the contracts might make contracts onerous on initial recognition (which would be captured in the information in paragraph 17.a of this paper), but changes in the effect of the guarantees will not make initially profitable groups of contracts onerous—any loss arising from the guarantee will be recognised as insurance finance income or expenses. Changes that could make the contracts onerous are limited to changes in underwriting risks. But this is true for all general model contracts, and we think information about such changes is critically useful—the annual cohort requirement is essential in capturing this information.</p>	





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