

Regulation and Supervision at a glance
Nº 16 / July 2019

IFRS 17 Insurance Contracts: The final countdown reloaded

In **May 2017** the International Accounting Standards Board (IASB) published the new financial reporting standard **IFRS 17 Insurance Contracts**. Subsequently, the IASB started its activities to monitor and support the implementation efforts of insurers to be ready to (re)act if necessary. As part of its supporting efforts the IASB established a Transition Resource Group (TRG). In parallel, the European Financial Reporting Advisory Group (EFRAG) initiated its activities to holistically evaluate the standard and, as a final objective, to deliver an endorsement advice on it as requested by the European Commission (EC) in October 2017. In these overlapping work streams at the IASB, TRG and EFRAG it became clear that some targeted **amendments to IFRS 17** would be adequate to better achieve the intended objectives and to fine-tune the balance between the implementation costs and benefits of the standard. And what are the **German insurers' views** in the current debate on IFRS 17 amendments and with regard to its endorsement?

- German insurers generally **support** the standard issued by the IASB.
- German insurers generally **support** the amendments to IFRS 17 as proposed by the IASB in its Exposure Draft (ED) published in June 2019.
- German insurers **are keen to adopt the amended IFRS 17 in due time**.

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Key positions of the German insurance industry

- The German insurers consider **IFRS 17** Insurance Contracts as the necessary global financial reporting standard, share its objectives and support its global adoption.
- The German insurers **support** the IASB's proposal to delay the mandatory adoption of the standard **by one year only**, i.e. till the 1 January 2022. Any further delay beyond would be disruptive for their ongoing and well-advanced implementation projects. And it would significantly increase the costs of implementation projects. Nevertheless, the IFRS 17's requirement to provide fully restated **comparative information** at transition to IFRS 17 is still an issue of concern and should be suspended.
- The German insurers support the **EU endorsement of IFRS 17 in due time**. The EU endorsement of the amended standard in due time is **indispensable**; otherwise no level playing field would be ensured for German insurers active on a global basis.
- The German insurers support the **focused and disciplined proceeding** by the IASB during its work on the necessary amendments to IFRS 17; only a limited number of targeted amendments can be accomplished within the additional timeframe given.
- The IASB's proposed amendments in the **ED** go in the right direction. The **outstanding issues** will be brought to the attention of the Board throughout the consultation process following the ED publication.
- The German insurers are committed to the **global nature** of the IFRS-Standards. Generally, local carve-ins/outs are not supported. IFRSs are rightly subject to the strict endorsement regime in the EU. In case of a positive endorsement advice provided by EFRAG on a particular IFRS, it should be endorsed in the EU as issued by the IASB.

I. IFRS 17 Insurance Contracts: an Overview

IFRS 17 replaces the existing IFRS 4 Insurance Contracts which effectively grandfathered the accounting policies applied before 1 January 2005, supplementing them with some additional disclosures. IFRS 17 introduces for the first time a global basis for insurance contracts accounting leading to a level of **comparability across markets and insurers across the globe** which did not exist before. The local Generally Accepted Accounting Principles like the German Code of Commerce are also ensuring a proper accounting. However, they are based on different concepts designed to reflect specific characteristics of insurance products offered in particular jurisdictions (subject to local regulatory regimes for example regarding the policyholders' participation). The principle-based IFRS 17 aims to overcome these differences and to ensure that the financial statements of globally active insurers are better comparable.

The complexity of the comprehensive IFRS 17's approach is a result of the IASB's efforts to achieve a balance between the needs of different markets and products and the need to ensure a sufficient level of common accounting principles for insurance contracts on a global basis. In principle, IFRS 17 offers three measurement approaches:

- The **building block approach (BBA)** is the main measurement approach in IFRS 17. It's based on the current estimate of the fulfilment cash flows, which are discounted (to reflect the time value of money) and risk-adjusted (to reflect the uncertainty of the cash flows). To avoid a day-one gain a **contractual service margin (CSM)** is recognised on profitable contracts as **part of the liability**. Subsequent changes in non-financial assumptions are offset against the CSM to the extent it remains positive. Initial losses on onerous contracts are recognised immediately in profit or loss.
- The **variable fee approach (VFA)** is a modification of BBA to address the specific characteristics of insurance contracts with direct participation features (e.g. life insurance in Germany). The main difference is how the CSM is determined when being subsequently measured. In the VFA it absorbs also the changes in financial assumptions and ensures a **proper treatment of long-term guarantees** promised to policyholders. More generally, the VFA ensures that the linkage between insurance liabilities and underlying items (e.g. financial assets like debt or equity instruments) is properly reflected for eligible contracts with direct participation features.
- The **premium allocation approach (PAA)** is a simplification of the BBA for short-term insurance contracts (typically property and casualty business). The

IASB acknowledged that the complex BBA is not necessary to be used if the same proper accounting outcome can be achieved in a less costly way. PAA applies to the measurement of the **liability for remaining coverage (LRC)**. The **liability for incurred claims (LIC)** continues to be measured on the current basis using the current cash flow model of the BBA. The main advantage is that using PAA it is not necessary to determine and track the development of the CSM.

II. Proposed amendments to IFRS 17

In October 2018 the IASB decided to approach 25 issues identified as a concern by various stakeholders (e.g. preparers, users, authorities) after the release of IFRS 17 in May 2017. Although the standard was published after twenty years of controversial discussions, some concerns referred again to the flexibility provided to insurers by the principle-based standard. Other concerns referred however to issues included into the standard only in the very final stage of the process (e.g. the requirement to subdivide portfolios by **annual cohorts**) or were the result of an IASB's differing assessment regarding the relevance of the issue (e.g. initial measurement of **reinsurance contracts held** in case of proportionate reinsurance).

In subsequent meetings the IASB assessed the merits of these 25 issues of concern and evaluated them once on an **isolated basis** (December 2018 to March 2019) and also at large **as a package** (April 2019) against the criteria set up in October 2018, which were: (a) avoid significant losses of useful information for investors; (b) not unduly disrupt implementation processes under way; and (c) not risk undue delays in the effective date of IFRS 17.

Based on a disciplined and focused work the IASB decided finally to issue an ED with **12 proposed targeted amendments**. However, the Board decided not to follow all the requests of other stakeholders to introduce further constraints or rules to the standard. The **principle-based nature** of IFRS 17 regarding determination of discount rate or risk adjustment creates an opportunity to take advantage of **solutions** applied for Solvency II. And the accounting policy choices like for example the OCI (other comprehensive income) presentation option allow for a proper reflection of the underlying economic performance of insurance business without artificial market driven volatility ('market noise') in profit or loss statement.

The IASB released the ED **on 26 June 2019** for public consultation (with 90 days comment period).

a) Timing dimension: IFRS 17 to go live in 2022

German insurers generally supported IFRS 17 as issued by the IASB already in May 2017. The IASB's proposal to delay the mandatory adoption of the standard by one year only, i.e. till 1 January 2022, is supported. Any further delay is not seen as necessary or helpful. However, the obligation to provide a restatement of comparative information at transition to IFRS 17 is still an issue of concern and should be suspended.

In addition, the IASB decided to propose that the existing **alignment of effective dates** between **IFRS 17** and **IFRS 9** Financial Instruments should remain. There is a risk that any further delay of IFRS 17 might create the situation that insurers would be obliged to adopt IFRS 9 on an isolated basis. It would cause accounting mismatches and artificial volatility in profit or loss (as experienced currently by those German insurers who were effectively forced to apply IFRS 9 starting on 1 January 2018, ahead of the IFRS 17's adoption).

b) Content dimension: some fixes still necessary

The amendments proposed by the IASB in the ED are intended to address the concerns brought forward by various stakeholders. German insurers will contribute their views on the need to address outstanding concerns on IFRS 17's requirements as some issues are still indeed problematic:

- **Annual cohorts:** the main cost driver for implementation and not in line with the insurance business;
- **Balance sheet presentation:** the IFRS 17's requirements will require costly IT system changes while reducing the value of information provided in the balance sheet; for example introducing cash basis instead of existing accrual basis for premiums receivable/claims payable;
- **Reinsurance contracts held:** the interaction between proportionate reinsurance contracts held and onerous underlying insurance contracts is approached in the ED; however the scope of the amendment needs to be further fine-tuned. In addition, the requirement to estimate underlying insurance business not yet written is still a concern;
- **Restatement of comparatives:** see below.

German insurers believe that the IASB should approach these issues as it would significantly **improve the cost/benefit balance** of the ongoing use of the standard. Finally, it is of utmost importance that insurers are in a position to **properly determine the CSM on business in force** at transition.

c) Inherent linkage between IFRS 17 and IFRS 9

German insurers have the view that it is essential to appropriately consider the inherent linkage between IFRS 17 and IFRS 9. This request refers to both dimensions: (a) the alignment of the effective dates, incl. requirements on comparatives; and (b) the need to ensure that material accounting requirements interact in a proper way.

- The **recycling ban** in IFRS 9 for equity instruments accounted for at fair value through other comprehensive income (FVOCI) is a critical issue. It still needs to be addressed by the IASB. Specifically for the property and casualty business and for reinsurance undertakings it is essential that gains and losses at disposal can be reflected in the profit or loss statement. It creates an **accounting disadvantage** for such equity instruments if realized gains or losses cannot be properly portrayed as part of the entity's performance. The recycling ban is also not aligned with IFRS 17. Should the IASB decide not to approach this issue for FVOCI equities there is a real risk that insurers will reconsider their investments in long-term equity instruments or as private equity.
- The **requirement to restate comparative information** at transition to IFRS 17 is an issue of concern. Effectively, it reduces the transition period by one year and undermines the deferral decision with regard to adoption of IFRS 9 by insurers. To achieve a meaningful performance reporting insurers would be forced to

provide restated comparatives for both insurance contracts (IFRS 17) and financial instruments (IFRS 9); and to run in parallel two systems for this purpose would be extremely costly. Not to forget that the IFRS 9 comparatives are not really meaningful as they result from a mixture of old IAS 39's and new IFRS 9's rules. Consequently, German insurers urge the IASB to make the **presentation of comparative information** under IFRS 17 in the first published financial statement **optional** the same way IFRS 9 does in this regard.

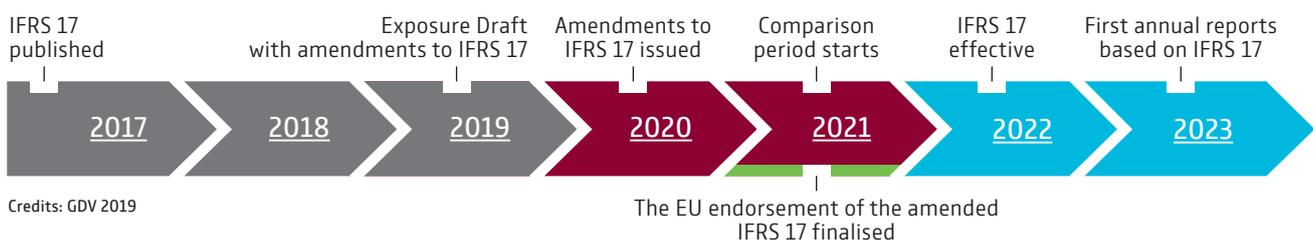
III. Positions of the German insurance industry

While being generally supportive of the standard as issued in May 2017, the German insurers also appreciate the amendments proposed by the IASB in June 2019. The intention of the IASB to publish the **final amendments to IFRS 17 in the first half of 2020 is a desirable objective**. It would contribute to the EU endorsement process being finalized within the IFRS 17's revised timeline.

Finally, the German insurers have set up their projects on a timely basis and have budgeted significant financial and staff resources for IFRS 17 adoption. They are keen to go live with the new standard in due time. Hence, they request legal certainty and clarity which have to be provided also with regard to the **EU endorsement of amended IFRS 17** without any further undue delay, **ahead of 1 January 2022**.

IFRS 17 has to be endorsed in the EU in due time, i.e. ahead of 1 January 2022

Chart 1 · Timeline for the finale debate on amendments to IFRS 17 and its endorsement in the EU



Credits: GDV 2019

Imprint

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Editorial deadline

25 July 2019

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Cover photo credits

Adobe Stock

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at GDV.DE