The UK Endorsement Board
8th Floor
125 London Wall
Barbican
London
EC2Y 5AS

3 February 2022

Dear UK Endorsement Board (UKEB),

UKEB IFRS 17 "INSURANCE CONTRACTS" DRAFT ENDORSEMENT CRITERIA ASSESSMENT (DECA)

The ABI

The Association of British Insurers (ABI) is the voice of the UK's world leading insurance and long-term savings industry. A productive, inclusive and thriving sector, we are an industry that provides peace of mind to households and businesses across the UK and powers the growth of local and regional economies by enabling trade, risk taking, investment and innovation. Founded in 1985, the ABI represents around 250 member companies, including most household names and specialist providers. The ABI's role is to:

- get the right people together to help inform public policy debates, engaging with politicians, policymakers and regulators at home and abroad;
- be the public voice of the sector, promoting the value of its products and highlighting its importance to the wider economy;
- help encourage consumer understanding of the sector's products and practices; and
- support a competitive insurance industry, in the UK and overseas.

We welcome the opportunity to respond to the UK Endorsement Board's (UKEB) IFRS 17 Insurance Contracts (Draft) Endorsement Criteria Assessment (DECA). The assessment is thorough and detailed, and we largely agree with conclusions reached. In our response we highlight areas where our views differ from those of the UKEB particularly as regards aspects of the technical analysis conducted in Section 3 and Appendix B.

As highlighted in Section 4 of the DECA "*Costs and benefits of applying IFRS 17*" Industry recognises the improvements to financial reporting IFRS 17 provides and how it offers a basis for greater global consistency in the accounting for and reporting of insurance contracts. In addition (and as highlighted in the DECA), to date £1.2bn has been spent on implementing IFRS 17. Industry also supports the concept of principle-based accounting standards such as IFRS 17 which are characterised and underpinned by the flexibility to apply professional judgement and interpretations in specific scenarios. For the afore mentioned reasons industry has no appetite to push for an outcome other than one in which IFRS 17 is fully endorsed for use in the UK. As a result, the ABI is supportive of adopting IFRS 17 in the UK based on the timely and successful resolution of outstanding UK specific issues most of which have been correctly highlighted in Section 3 and Appendix B of the DECA. We consider that the successful resolution of these issues would significantly improve the quality of financial reporting under IFRS 17. The UKEB's role here is critical in providing support towards the successful resolution of these issues and crucially in ensuring that the benefits of principles-based accounting standards are not eroded by the adoption of narrow single interpretations to the standard more akin to a rules-based approach. We would consider the latter as a step backward. Below, we outline our high priority outstanding issues which also serve as examples of where narrow interpretations of IFRS 17 provisions are a threat to its principles-based foundations:

- ➢ The ongoing issue relating to the amortisation of the contractual service margin (CSM) for annuities is a material one for industry and we provide some additional thoughts on this in our response to **question 5**. We await the outcome of deliberations at the IFRIC and are grateful for and would welcome UKEB's continued support in

achieving an interpretation that enables insurers to fairly present their results and reflect profit in line with the service that policyholders are prepared to pay for in the UK's active market. An appropriate outcome on this matter is key in ensuring IFRS 17 delivers reporting that is understandable, relevant, reliable and comparable, consistent with the technical criteria for endorsement. In addition, industry considers that the principles of IFRS 17 as currently drafted do permit a fair reflection of the CSM consistent with the service provided by the insurer. However, if deliberations at IFRIC do not support this as an acceptable interpretation of the standard, this in our view would constitute an issue with the standard itself as currently drafted and necessitate further engagement with the UKEB on the way forward.

- We note that the accounting treatment for Lloyds reinsurance to close (RITC) transactions was acknowledged and described in page 142 of the DECA. However, this analysis places equal weighting on characteristics of financial information which are considered enhancing in the IASB framework such as comparability and focusses much less on the more fundamental characteristics such as relevance and faithful representations. We consider the fundamental characteristics and an analysis against these more relevant in understanding the impact of IFRS 17 on RITC transactions. Furthermore, the accounting treatment should reflect the economic substance of the transaction which transfers substantially all risk and rewards of the RITC business. We acknowledge this matter only impacts a subset of preparers but notwithstanding could have wider and material implications to both the market efficiency of Lloyds of London, the UK based largest (re)insurance market in the world and the competitiveness of UK listed Lloyds insurers. We would urge the UKEB to ensure that this material, but isolated accounting issue is suitably resolved. We provide our views on this issue in detail in our response to **question 17** and our thoughts on the UKEB's approach to the technical analysis in our response to **question 1**.

- In our response, we highlight and describe an issue relating to the treatment of premium receivables under IFRS 17 which was not included in the DECA. This issue provides another example of where a narrow interpretation of the standard by certain stakeholders could have significant cost benefit implications for insurers. We provide added detail and give our view of what an optimal outcome would be in our response to **question 4**.

- We highlight in relevant sections of our response all other priority or significant issues where our views differ from those in the UKEB's analysis.

In conclusion the UKEB must now carefully assess the outstanding issues and be mindful of their respective impacts on the UK's long term public good and competitiveness. We have an opportunity now, in this endorsement period to address these issues and this should be our goal. We therefore look forward to ongoing collaboration with the UKEB and other relevant stakeholders to resolve them and ensure that IFRS 17 is fully endorsed for use in the UK. However, we are also mindful that the IFRS 17 post implementation review (PIR) affords us a secondary opportunity to raise and fully address any residual issues that may remain or new issues that may arise post endorsement. We will utilise this opportunity when required and where appropriate, but stress that focus should be on resolving outstanding issues now and pre-endorsement without waiting for the IFRS 17 PIR.

Yours Faithfully

The ABI

UKEB UK Endorsement Board

Invitation to Comment:

Call for comments on [Draft] Endorsement Criteria Assessment: IFRS 17 *Insurance Contracts*

Deadline for completion of this Invitation to Comment:

Close of business 3 February 2022

Please submit to: ifrs17@endorsement-board.uk

Part A: Introduction

The objective of this Invitation to Comment from the UK Endorsement Board (UKEB) is to obtain input from stakeholders on the UK endorsement and adoption of IFRS 17 *Insurance Contracts* issued by the International Accounting Standards Board (IASB) in May 2017 and subsequently amended in June 2020 [and December 2021[1]].

IFRS 17 is effective for annual periods beginning on or after 1 January 2023. Earlier application is permitted but only for entities that apply IFRS 9 *Financial Instruments* on or before the date of initial application of IFRS 17.

IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. It is intended to replace the current interim accounting standard on insurance contracts, IFRS 4 *Insurance Contracts*.

UK endorsement and adoption process

The requirements for UK endorsement and adoption are set out in the Statutory Instrument 2019/685[2].

1 In July 2021 the IASB published Exposure Draft ED/2021/8 *Initial application of IFRS 17 and IFRS 9 – Comparative Information (Proposed Amendment to IFRS 17)*. The IASB plans to complete any resulting amendment by the end of 2021.

2 The International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019: https://www.legislation.gov.uk/uksi/2019/685/made

The delegation of powers to adopt international accounting standards for use in the UK was made to the UKEB in May 2021[3].

The information collected from this Invitation to Comment is intended to help with the endorsement assessment. This will form part of the work necessary to assess IFRS 17 for potential UK endorsement and adoption.

Who should respond to this Invitation to Comment?

Stakeholders with an interest in the quality of accounts of UK entities that issue insurance contracts and that apply IFRS.

How to respond to this Invitation to Comment

Please download this document, answer any questions on which you would like to provide views, and then return it along with the document 'Invitation to Comment - Your Details' to **ifrs17@endorsement-board.uk** by close of business on **3 February 2022.**

Responses providing views on individual questions as well as comprehensive responses to all questions are welcome.

Privacy and other policies

The data collected through submitting this document will be stored and processed by the UKEB. By submitting this document, you consent to the UKEB processing your data for the purposes of influencing the development of and endorsing IFRS for use in the UK. For further information, please see our Privacy Statements and Notices and other Policies (e.g. Consultation Responses Policy and Data Protection Policy)[4].

The UKEB's policy is to publish on its website all responses to formal consultations issued by the UKEB unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. If you do not wish your signature to be published on our website, please provide UKEB with an unsigned version of your submission. The UKEB prefers to publish responses that do not include a personal signature. Other than the name of the organisation/individual responding, information contained in the "Your Details" document will not be published. The UKEB does not edit personal information (such as telephone numbers, postal or e-mail addresses) from any other document submitted; therefore, only information that you wish to be published should be submitted in such responses.

[3] The International Accounting Standards (Delegation of Functions) (EU Exit) Regulations 2021: https://www.legislation.gov.uk/uksi/2021/609/contents/made

[4] These policies can be accessed from the footer in the UKEB website here: **https://www.endorsement-board.uk**

Part B: Assessment against endorsement criteria

Section 1 – Legislative framework and our approach to the assessment

1. Do you have any comments on our approach to the assessment presented in Section 1 of our [Draft] Endorsement Criteria Assessment (ECA)?

Overall, we agree with the UKEB's approach to the DECA. We note that the analysis has been conducted consistent with the qualitative criteria of understandability, relevance, reliability and comparability as defined in the IASB's 2001 Framework for the Preparation a Presentation of Financial Statements (the Framework) which has now become part of the criteria for endorsement and adoption of IFRS for use in the UK via SI 2019/685.

However, UKEB's analysis does not distinguish between the fundamental characteristics of financial information (faithful representation and relevance) and the enhancing qualitative characteristics (comparability, verifiability, timeliness and understandability). It seems to place equal emphasis on all criteria considered and this limits its completeness particularly in the analysis of the issue relating to the Lloyds RITC transactions on page 142. Consequently, a useful additional perspective is missing from the DECA as it does not consider the fact that financial information that meets the enhancing characteristics is not rendered useful if that information does not meet the fundamental characteristics of relevance and faithful representation.

2. Do you agree that the finalisation of the amendment to IFRS 17 proposed in the IASB's Exposure Draft ED/2021/8 *Initial Application of IFRS 17 and IFRS 9 – Comparative Information (Proposed Amendment to IFRS 17)* is not likely to give rise to any issues that are significant for the purposes of our IFRS 17 ECA or adoption decision (paragraph 1.2 of [Draft] ECA)?

Yes	☒	No	☐

If not, please provide an explanation.

We agree. The ABI responded to the UKEB's consultation on its comment letter on the IASB's exposure draft (ED) "*Initial Application of IFRS 17 and IFRS 9 – Comparative Information (Proposed Amendment to IFRS 17)*". In our response we agreed with the UKEB's support for the proposals in the IASB's ED.

Section 2 – Description of IFRS 17

3. Do you have any comments on the summary of IFRS 17's requirements? Are there any other features of IFRS 17 that should be covered in this section?

We have no comments on this section. We consider that the summary covers the key features of IFRS 17.

Section 3 – Technical accounting criteria assessment

4. Do you agree that the assessment in Section 3, together with Appendix B, captures all the priority and significant technical accounting issues?

Yes	☒	No	☐

If not, please provide an explanation.

Given the criteria specified by the UKEB for the identification and classification of issues as either priority or significant, we agree that the assessment in Section 3 and Appendix B appropriately captures the prevailing technical accounting issues. We would like to raise an issue not considered in the DECA relating to the treatment under IFRS 17 of premium receivables from intermediaries. This issue arises when intermediaries acting on behalf of an insurer have received premiums from policyholders but have not yet remitted these to the insurer. By the UKEBs definitions in the DECA this would class as a significant issue as it has a potentially significant impact in the UK: that is, the issue is likely to be material to at least some companies and/or the efficient and effective functioning of UK capital markets. It is also an issue where there is a question over whether a specific interpretation of IFRS 17 requirements in this context meets all the technical accounting criteria. Considered against the UKEB's assessment of the long term public good which considers the costs and benefits of IFRS 17, this issue is also one where the costs of accounting for premium receivables in line with a specific narrow interpretation of the standard could drive material costs that far outweigh the benefits.

Differing views are emerging on accounting for premiums receivable from intermediaries in the context described above. Some stakeholders consider that an insurer applies IFRS 17 to amounts receivable from intermediaries (such as brokers), while others consider that IFRS 9 applies when the intermediaries are acting on behalf of the insurer and the intermediaries have received the premiums but have yet to remit it to the insurer. The application of either IFRS 17 Insurance Contracts or IFRS 9 Financial Instruments impacts data flows into the finance systems being built to produce IFRS 17 amounts for the financial statements; and could require significantly different types of information to be gathered. Therefore, this issue affects the way an insurer's accounting systems need to be designed in preparation for IFRS 17 adoption from 1 January 2023. As premiums and commissions are normally net settled between the intermediaries and the insurer, the same issues are also applicable to commissions payable. There could also be implications for claims payments to policyholders made via an intermediary, which might also be net settled between the intermediaries and the insurer.

This is a clear IFRS 17 interpretation/implementation issue on which industry would welcome dialogue with the UKEB and which in our view serves as an example of where a narrow interpretation of IFRS 17 provisions could threaten its fundamentally principles-based nature. An ideal outcome here would be to agree on acceptable interpretations of the standard in this respect. Industry stands ready to provide the UKEB with plausible interpretations to facilitate a timely resolution and some approaches currently considered include:

- Approach A – The application of IFRS 17 to premium receivables in all scenarios; and

- Approach B – The application of IFRS 9 to premium receivables when the intermediaries are acting on behalf of the insurer and the intermediaries have received the premiums but have yet to remit to the insurer only. IFRS 17 to apply to all other premium receivables.

Under both approaches, insurance contracts would be recognised initially based on IFRS 17.25 criteria and consequently once an insurer has an obligation to provide coverage, premiums from policyholders and held by intermediaries would be used in measuring that obligation. In the case of:

- Approach A, the obligation would be determined solely under IFRS 17, and premiums receivable would be netted off against any other fulfilment cash flows;

- Approach B, a gross up on the balance sheet occurs where the premium receivable considered under IFRS 9 is a) considered "received" and is not included in the fulfilment cashflows under IFRS 17 and b) a separate IFRS 9 receivable is recorded on the balance sheet (akin to current practice)

We are highlighting this issue to UKEB given its importance to some of our members. However, it is one where we consider that both approaches A and B as described above could be suitable interpretations of the standard and deemed valid depending on the facts and circumstances.

5. *CSM allocation for annuities*: do you agree with the [tentative] assessment against the endorsement criteria (paragraphs 3.40 – 3.53)?

Yes	☒	No	☐

If not, please provide an explanation.

In general, we agree with the UKEB's assessment of this issue. We do not consider that IFRS 17 should lead to any interpretation other than one which achieves the objective of reflecting the insurance service provided in each period. Therefore, the critical issues here are interpretation, the appropriate identification of the insurance service provided in each period and the consequent impact on the CSM. In line with the ICAEW letter on this issue (dated 18 November 2021) to the IASB and under consideration by IFRIC we consider the following interpretations appropriate and equally acceptable:

a) Approach A - The CSM allocation is determined based on the periodic benefit payable in each period that services are provided Under this method, the periodic benefit payable represents the quantity of benefits provided under the contract for each discrete insured event (policyholder's survival to the point of payment of a claim) and reflects both the maximum amount that a policyholder could validly claim in each period if an insured event occurs and the maximum contractual cover in each period; or

b) Approach B - The service in a period is based on the value to the policyholder of surviving to the end of the period which includes both the annuity payment in the period as well as the continued access to receive a continuous stream of future payments for as long as the policyholder survives aligned to the description within policyholder documentation (i.e., the peace of mind element). This reflects the insured risk under the contract (i.e., the risk of living longer than expected or

longer than the policyholder's savings lasts and the policyholder having insufficient funds to cover their living costs for the remainder of their life). The CSM allocation is determined based on a quantity of benefits that is represented by the present value of all future payments under the contract and is consistent with the method based on expected cash flows noted in the May 2018 TRG meeting.

We would like to highlight that users support industry's interpretations. We are also of the view that IFRIC agreeing both these interpretations as acceptable would drive a higher degree of consistency of application amongst preparers of financial statements helping users of accounts to assess specific approaches to CSM allocation applied and:

- would significantly mitigate concerns over diversity in application and enhance comparability; and

- enhance reliability and understandability when coupled with IFRS 17 requirements to disclose significant judgements (also noting the requirements of paragraph 94 of the standard for providing additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance).

Given the above, industry is grateful for and would welcome continued support from the UKEB to liaise with and influence the IASB to reach a consensus view and ultimately conclude on acceptable interpretations, which as currently drafted we believe the standard allows. However, if deliberations at IFRIC do not conclude on an acceptable interpretation of the standard in this respect, this in our view would constitute an issue with the standard itself as currently drafted and necessitate further engagement with the UKEB on the way forward.

When considered against the statutory criteria for assessing IFRS 17 in the UK long term public good we would like to highlight that a satisfactory resolution to this issue would ensure the standard fully meets the criteria because:

- Successful resolution will significantly improve the quality of financial reporting in the UK and deliver reporting that is understandable, relevant, reliable and comparable, consistent with the technical criteria for endorsement;

- The slower profit recognition driven by the CSM amortisation coupled with a narrow interpretation of the service provided by the insurer in each period would yield reported results that could discourage investment in the annuity and BPA markets. This would have a material and detrimental impact on the UK annuity market; and

- Any accounting outcome under IFRS 17 that negatively impacts UK annuity providers and the market, particularly in the case of BPA providers risks jeopardising the key service they provide not only in de-risking pensions liabilities enabling businesses to focus on growth but also by providing a key source of retirement income to policyholders in general. This would have material implications for UK economic growth.

6. *Discount rates:* do you agree with the [tentative] assessment against the endorsement criteria (paragraphs 3.72 – 3.90)?

Yes	☒	No	☐

If not, please provide an explanation.

We agree with the UKEB's assessment. We would add that any risks to reliability and comparability driven by the standard not mandating a particular discount rate is mitigated by disclosures required on significant judgements used. Specific to discount rates these include the yield curves, input assumptions and estimation techniques, the process for estimating inputs and the approach used to determine discount rates.

7. *Grouping insurance contracts – profitability buckets and annual cohorts*: do you agree with the [tentative] assessment against the endorsement criteria (paragraphs 3.101 – 3.116)?

Yes	☒	No	☐

If not, please provide an explanation.

In general, we agree with the UKEB's assessment. We note that the annual cohort requirement is not a priority for most UK insurers and agree with the rationale behind this position as outlined in the UKEB's 17 September 2021 paper titled *"IFRS 17 Insurance Contracts – Endorsement: Grouping Insurance Contracts: profitability buckets and annual cohorts"*

We do however note that the EU endorsed version of IFRS 17 does include an exemption from the annual cohort requirement for certain contracts most prevalent in Europe and we are mindful of the potential competitiveness and comparability issues this could pose for UK Insurers. However, at this stage we have no material concerns and as implementation of the standard progresses, we propose to raise any issues that may arise in the post implementation review period of IFRS 17 when launched.

8. *With-profits – inherited estates*: do you agree with the [tentative] assessment against the endorsement criteria (paragraphs 3.143 – 3.157)?

Yes	☒	No	☐

If not, please provide an explanation.

We agree with the assessment that the treatment of a with-profit fund under IFRS 17 will be dependent on the facts and circumstances of each fund. We also agree that treating the policyholders' share as part of fulfilment cash flows within insurance contract liabilities will result in relevant and understandable information.

We note that the treatment of the inherited estate under IFRS 17 results in different treatments for open and closed funds. On transition it is expected that an open fund will recognise the shareholders' share of the inherited estate in equity, whereas a closed fund will recognise an element in the contractual service margin (CSM). If an open fund closes after transition, the accounting for the now closed fund, will be inconsistent with a fund which was closed at the IFRS 17 transition date. This will make it more difficult for users of financial statements to compare and understand entities containing with-profit funds. However, we acknowledge that the accounting treatments applied to inherited estates may differ depending on the particular circumstances of the individual fund, terms and conditions and other agreements reached with policyholders.

For entities where an element of the inherited estate has been recognised as equity but where the related bonuses have not been declared, resulting in the shareholder not having access to this element of equity, additional disclosure will be required to allow the user of the financial statements to understand the restrictions on this element of equity and movements (profits or losses) arising in the reporting period related to it. As the movements may be both material to an entity and volatile, due to market movements on the assets backing the shareholders share of the inherited estate, this may be a key area where alternative performance metrics are necessary to explain the impact on the income statement to users of the financial statements.

9. Do you agree with our overall [tentative] conclusion that IFRS 17 meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management (paragraphs 3.158 – 3.161)?

Yes	☒	No	☐

If not, please provide an explanation.

In general, we agree with the UKEB's overall tentative conclusions, but would like to highlight the following:

- We note that there are outstanding issues where support is required including relating to the annuity CSM amortisation (please see our response to **question 5**), premium receivables (described in our response to **question 4**) and RITC highlighted by Lloyds market participants and described on page 142 of the DECA (please see our response to **question 17**). Whilst we do not envisage that these issues would preclude or cause us to disagree with the UKEB's assessment they need to be addressed and satisfactorily resolved to ensure that our support for the endorsement of the standard is unequivocal. For example, we are of the view that the accounting for the Lloyds RITC transactions under IFRS 17 does not reflect the economic substance of the transaction and does not increase the comparability of reported information among insurers.

- We acknowledge and appreciate that accounting mismatches, as noted in the assessment, are inevitable given the mixed measurement model that underpins IFRS. We also note that the DECA outlines the sources of accounting mismatches relating to with-profits funds including those arising from:

- the issue of eligibility of reinsurance for the variable fee approach, which could have a material impact on with-profits business where significant transfers of with-profit contracts are effected through reinsurance contracts such as was seen as part of Brexit;
- application of IFRS 17 to non-profit contracts written in a with-profit fund, both accruing to the policyholder and to the inherited estate; and
- treatment of the inherited estate and transactions with the inherited estate.

We would like to draw to the UKEB's attention to the fact that the application of IFRS 17 to with-profit business will result in a number of insurers who are impacted by more than one of the issues highlighted above having a significant challenge in explaining the impact of the standard on their financial statements and their results on an on-going basis. The complexity of the application to with-profit business will inevitably impact the understandability of the financial statements in this area where volatility arises from accounting mismatches and is not reflective of the economics of the business. To assist in explaining results it may be necessary to use alternative performance metrics, such as adjusted operating profit, resulting in significant adjustments to reported profits to better reflect the economics and performance of the business. The issues described and commented on here also relate to our response to the "Other VFA issues" outlined in **question 16** on the DECA.

Section 4 – UK long term public good assessment

10. *Improvements introduced by IFRS 17*: are there other aspects of the changes expected under IFRS 17 that need to be featured (paragraphs 4.30 – 4.59)?

Yes	☒	No	☐

If yes, please provide an explanation.

We agree with the UKEB's description of the improvements introduced by IFRS 17 and as highlighted earlier in this response welcome the global consistency for insurance contract reporting afforded by the standard.

When considered against the statutory criteria for assessing IFRS 17 in the UK long term public good we would like to highlight that a satisfactory resolution to this issue would ensure the standard fully meets the criteria because:

- Successful resolution will significantly improve the quality of financial reporting in the UK and deliver reporting that is understandable, relevant, reliable and comparable, consistent with the technical criteria for endorsement;
- The slower profit recognition driven by the CSM amortisation coupled with a narrow interpretation of the service provided by the insurer in each period would yield reported results that could

discourage investment in the annuity and BPA markets. This would have a material and detrimental impact on the UK annuity market; and

- Any accounting outcome under IFRS 17 that negatively impacts UK annuity providers and the market, particularly in the case of BPA providers risks jeopardising the key service they provide not only in de-risking pensions liabilities enabling businesses to focus on growth but also by providing a key source of retirement income to policyholders in general. This would have material implications for UK economic growth.

11. *Costs and benefits*: do you have any comments on the [tentative] assessment of the key costs and benefits for each of the main stakeholder groups (paragraphs 4.67 – 4.135), including the approach taken to sunk costs (paragraphs 4.91 – 4.99)?

We agree with the UKEB's cost benefit analysis including the stakeholders considered and the approach to the treatment of sunk costs in the context of an assessment of the long term public good. We note the following:

a) As highlighted in Section 4.95 of the DECA, UK insurers had incurred £1.2bn in IFRS 17 implementation costs to date. Given that if IFRS 17 is not endorsed these costs would not be reversed or recouped it is critical that outstanding issues highlighted in the DECA and described in this response are addressed to ensure that investments to date for IFRS 17 implementation are not wasted.

b) Whilst the Prudential Regulation Authority (PRA) may not rely on financial statements as a primary source of information for discharging its regulatory duties staff have indicated they would like to understand synergies between information reported under IFRS 17 and information they already collect via regulatory reporting and quantitative reporting templates (QRTs) under Solvency II. For the PRA, disclosures in accounts prepared on an IFRS 17 basis on significant judgements could provide added insight into an insurers processes and business models that could support effective supervision. As a result, we consider that it is likely regulators will request or want to see more information reported on an IFRS 17 basis regularly most likely via QRT reporting. This would also come at additional costs to insurers who are currently already overburdened with the significant amount of reporting required under Solvency II. There is a need to avoid duplication and to co-ordinate reporting requirements to ensure insurers do not face disproportionate and avoidable costs. For example:

    a. Where the PRA identifies information that would support its supervision it should seek this from the already detailed accounts provided by insurers and not also require them to duplicate this information in regulatory reporting templates; and

    b. Should the PRA's requirements go beyond what is required by IFRS 17 in a set of financial statements, both the UKEB and PRA should be mindful that this would come at an additional cost and time burden as insurers have largely developed systems and processes without prior knowledge or sight of these additional requirements.

c) The accounting for RITC under IFRS 17 is detrimental to both the market efficiency of the Lloyds of London, the iconic and largest (re)insurance market in the world based in the UK and to the competitiveness of Lloyd's insurers listed in the UK. It increases the complexity of the financial statements for Lloyd's Members that report under IFRS both ceding and receiving business through RITC and reduces comparability to the accounts of other Lloyd's Members that report under a different GAAP. This in turn leads to a higher cost of capital for Lloyd's insurers listed in the UK and could lead to arbitrage for other insurers including US listed insurers and acquirers as noted by some users of the financial statements. Operationally, the required accounting necessitates the implementation of additional systems and processes across the Lloyd's market. Furthermore, the data required to enable ceding members continue to account for the original insurance contract liabilities would not be available to members exiting the syndicate entirely given current Lloyd's systems and processes. This would significantly increase the costs of implementation and reduce the competitiveness of Lloyd's market. We expand on these points in our response to question 17.

12. *Effect on the economy*: does the [tentative] assessment fairly capture the principal expected impacts of the standard on the insurance industry and wider UK economy (paragraphs 4.136 – 4.275)?

Yes	☒	No	☐

If not, please provide an explanation.

We consider that the UKEB assessment here captures the principal expected impacts of the standard on the insurance industry and wider UK economy. From a tax perspective, we welcome the UK Government announcement that it would introduce regulations for insurers to spread the transitional impact of IFRS 17 for corporation tax purposes. We also welcome the current consultation "*Corporation Tax: Response to accounting changes for insurance contracts*" aimed at informing the design of the regulations. Both developments are important steps to ensure that the introduction of the new standard does not lead to inequitable tax outcomes or permanent tax disadvantages for insurers.

13. Do you agree with our [tentative] overall conclusion that IFRS 17 is likely to be conducive to the long term public good in the United Kingdom (paragraphs 4.276 – 4.299)?

Yes	☒	No	☐

If not, please provide an explanation.

We agree with UKEB's assessment aside from issues we raise in our response to:

- question 5 where we highlight the UK long term public good implications if the annuity CSM amortisation issue is not satisfactorily resolved; and
- question 17 on the technical analysis of RITC transactions used by Lloyds of London participants.

Section 5 – True and fair view assessment

14. Do you have any comments on our approach to the assessment against the true and fair view endorsement criterion?

We support the importance UKEB is placing on the consideration of the true and fair endorsement criteria and their holistic approach. In this context we consider resolution of the annuity CSM amortisation issue is important in achieving a true and fair view.

15. Do you agree with our [tentative] conclusion that IFRS 17 is not contrary to the true and fair principle set out in Regulation 7(1)(a) of SI 2019/685?

Yes	☒	No	☐

If not, please provide an explanation.

We consider that IFRS 17 is not contrary to the true and fair principle. In our introduction to this response (and at other relevant points including but not limited to our responses to questions 4, 5 and 17) we highlight outstanding issues that need to be resolved and our observations on these.

Appendix B – Assessment of remaining significant issues

16. Do you agree with the [tentative] assessment against the endorsement criteria for each of the remaining significant issues presented in Appendix B?

Yes	☐	No	☒

If not, please provide an explanation, identifying clearly to which significant technical issue your comments relate.

I. Risk Adjustment for non-financial risk
We agree with the UKEB's assessment. Whilst the risk adjustment (RA) is conceptually new under IFRS for insurers and reinsurers, consistent with our comments on the discount rate (please see our response to **question 6**) we consider that the disclosure requirements of the standard including the need to disclose significant judgements relating to the RA including inputs, estimation techniques used and the confidence level used to determine the RA all serve to enhance understandability and comparability across entities.

II. Interest Accretion at the locked-in rate for CSM under the GMM
We do not agree with UKEB's assessment here and consider that the analysis could be expanded in a number of ways as outlined below:

- **Relevance:** We acknowledge why a locked-in rate is used to determine CSM adjustments for changes in estimates of cash flows that relate to future services provided and for interest accretion on the CSM. However, we question the relevance of a historic rate to a user with a more future orientated view such as an analyst or investor who may be keen to understand the contribution an insurance contract makes to an insurer's current and future performance results. Such users will need to be given extra, more relevant information (perhaps through disclosures) to find such information useful for their objectives. Only a user interested in understanding how performance reflects contract pricing at the time an insurance contract (the contracts may have been written many years ago) was written would be interested in a locked-in rate for calculating interest on the CSM.

- **Understandability**: There is a benefit to the insurance service result being unaffected by changes in interest rates, but only to the extent that this relates to the expected cash flows and not to the CSM which is not measured in relation to expected cash flows.

- **Comparability:** IFRS 15 Revenue has a requirement to adjust the promised consideration to reflect the time value of money if the contract has a significant financing component. In an IFRS 15 context this is about future cash flows whereas the IFRS 17's CSM is not. Furthermore, IFRS 15 does not refer to or acknowledge the concept of a CSM and as such there is little basis for comparability between both standards.

- **Understandability:** In the description of the accounting impact of this topic on page 135 of the DECA it states on one hand "*we expect most UK insurers will account for their financial assets at fair value through profit or loss under IFRS 9 Financial Instruments and will therefore not use the OCI option available in IFRS 17 to disaggregate the presentation of insurance income or expenses*". On the other hand, and further in the analysis it states that "*however, some insurers could potentially mitigate this volatility in profit or loss by electing to disaggregate its insurance finance income or expense in profit or loss and other comprehensive income, effectively transferring such volatility to the other comprehensive income*". We agree with first of those two comments, as this reflects UK insurers' asset/liability matching strategies. Hence, we see the second comment as largely irrelevant, leaving understandability not compensated for but instead impaired. Furthermore, and in this context, we do not accept that disclosure can be relied on to mitigate concerns over understandability. UK insurers may in fact have to increase their use of Alternative Performance Measures compared with current practice, a result which is clearly in conflict with the IASB's overall aims for IFRS.

- **Consistency:** A locked-in discount rate for the CSM results in different parts of the insurance liability being measured at different discount rates, which cannot be helpful to the user.

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- **Cost/benefit:** In addition to the points above demonstrating the drawbacks of a locked-in discount rate requirement, we highlight that there will be significant extra costs to insurers in greatly increased data requirements and complex calculations.

III. <u>Recognition of income from reinsurance to match losses from onerous underlying contracts</u>
Overall, we agree with the UKEB's assessment. We would however like to highlight that the IASB's starting point in drafting IFRS 17 incorrectly treated a reinsurance contract only as legally independent of an insurance contract without recognising their inextricable economic dependence –one simply cannot operate without the other, unlike, for example, hedging relationships. This has led to many difficulties for which the IASB has addressed only some, piecemeal, which still leaves scope for unnecessary accounting mismatches with, therefore, impaired relevance and understandability.

IV. <u>Contract acquired in their settlement period</u>
We do not agree with UKEB's assessment here and consider that the analysis could be expanded in a number of ways as outlined below:

- **Relevance and comparability**: This results in an insurance revenue in profit or loss over the period that no insurance service is provided and as required by IFRS 17's general measurement model (GMM) for contracts incepted by the insurer. Were this otherwise, insurance revenue would be accounted for normally under the GMM over the periods both in which claims events can occur and in which claims are settled – which it is not.

- **Understandability and comparability:** Consistency with acquisition accounting under IFRS 3 will not enhance understandability and comparability with other IFRS reporters in relation to insurance transactions, because other IFRS reporters have no such business.

- **Understandability:** Recognition of insurance revenue will not be aligned only with users' current expectations but also their future ones, given that settlement of a claim is not recognised as a service to a policyholder by the initial issuer of an insurance contract. What is unclear is not what IFRS 17 insurance service is provided to the policyholder, but why insurance revenue is recognised by the acquirer.

- **Understandability:** It is not a virtue of a requirement that its effects are likely to decline over time, and in any case that may be true of a particular transaction but not of a series of transactions. Nor is it good to rely on disclosures to offset a poor classification/measurement/presentation requirement.

We comment on the application of IFRS 17 to RITC transactions in our response to **question 17**.

V. <u>Contracts that change nature over time</u>
We agree with the UKEB's assessment.

VI. Other comprehensive income option
We agree with the UKEB assessment. We note however that most UK insurers are likely to account for most of their financial assets at fair value through profit or loss, especially life insurers.

VII. Transition Requirements
We agree with the UKEB assessment

VIII. Other VFA Issues

a. Ineligibility of reinsurance contracts for VFA
We do not consider that it makes accounting sense to (as above) fail to recognise fully enough the inextricable economic dependence between an insurance contract and a related reinsurance contract. However, we agree that the risk mitigation option could be expected to eliminate most of the accounting mismatches that could arise from applying the VFA to the underlying insurance contracts and the GMM to the reinsurance contracts held, although as highlighted in the DECA by the UKEB it may not remove them entirely particularly in the case of some intra-group reinsurance arrangements and some disposals.

b. Prohibition of retrospective application of the risk mitigation option
We agree that the prohibition is likely to decrease understandability and relevance. However, we disagree that it would reduce reliability to the extent that does not occur in other areas also requiring the exercise of judgment – including the calculation of fair values at transition – and cannot be mitigated to a significant degree though good disclosure.

c. Eligibility for VFA when there are mutualised cash flows
We agree with the UKEB Assessment

d. Non-profit contracts written by a with-profit fund
We agree with the UKEB Assessment

17. Do you have any comments on the application of IFRS 17 to **Reinsurance-to-close** transactions (see comments towards the end of the assessment in respect of Contracts acquired in their settlement period – page 142)?

- The DECA highlights that in 2020 Lloyd's of London accounted for £35.5 billion in GWP. This equates to 13% of the total GWP for the UK Insurance and Long-term savings industry of £264 billion in the same period. Given the size and materiality of the Lloyds Market and its importance to the UK's Insurance and Long-term savings industry we would have expected this issue to perhaps feature more prominently in the DECA.

- The description of this issue focusses very narrowly on changes in the share of a corporate member through the reinsurance to close (RITC) process. It fails to identify, the perhaps larger issue caused by what we deem to be the incorrect treatment of the RITC as a reinsurance arrangement under IFRS 17. Such an accounting treatment would mean corporate members need to continue to report inwards (issued) and outwards (held) cashflows on contracts which may have been transferred via the RITC mechanism historically. This also poses practical and operational challenges because under current arrangements, where business transfers to a third party through an RITC (i.e., to a different corporate member) the initial corporate member/managing agent no longer manages or has sight of related data and subsequent transactions. Consequently, the initial corporate member would not be able to continue to report relevant issued or held cashflows making accounting practically challenging and potentially very costly to execute. All the above could ultimately impact the appeal of the Lloyd's market to investors and cannot be deemed to be in the longer-term public good.

- The UKEB endorsement includes an assessment of whether IFRS 17 is likely to be conducive to the UK long term public good. However, in respect of the above issue this assessment is missing, and we would have expected the description on page 142 of the DECA to have included this. We consider that the accounting treatment of the RITC under IFRS 17 cannot be deemed conducive to the long term public good because in treating it as reinsurance it:

  - Does not reflect the economic substance of the transaction which is more akin to a Part VII Portfolio transfer than it is a reinsurance contract and is a proven and efficient market mechanism to transfer substantially all risk and rewards in relation to RITC'd liabilities and corresponding assets. As such the current IFRS 17 treatment cannot be deemed to improve the quality of financial reporting. Furthermore, there is potential for inconsistency between IFRS 17 and current treatments under UK GAAP and IFRS 4 reporting bearing in mind that several Lloyds market participant and Lloyds itself continue to report on a UK GAAP basis.

  - Creates significant operational challenges (as described above) which would result in high implementation costs due to operational complexity.

  - Adversely impacts the functioning of the largest insurance and reinsurance market in the UK, putting the Lloyd's annual venture and market efficiency at risk. As such it is likely to adversely impact the UK economy given the materiality and importance of Lloyds to the UK Long-term saving and Insurance industry and ultimately the importance of the industry to the UK economy.

  - Furthermore, given that as described earlier some Lloyds participants and Lloyds itself continue to report on a UK GAAP basis, IFRS preparers in the Lloyds market are distinctly disadvantaged (competitive and otherwise) not only due to the sunk costs and ongoing costs of IFRS 17 implementation but also because other firms reporting under GAAP could account for an RITC transaction in a more favourable way that reflects its economic substance. This creates an uneven playing field within the Lloyds Market and increases the cost of capital of Lloyds insurers listed in the UK

- In terms of an analysis against the technical criteria:

  - The UKEB commentary places a disproportionate emphasis on the comparability and relevance with other IFRS 17 endorsed standards technical criteria despite suggesting that this issue only applies to a small number of firms in specific circumstances. This example supports the point raised in our response to question 1 where we suggested that the UKEB in its technical analysis should have distinguished between the fundamental qualitative characteristics of relevance and faithful representation and enhancing qualitative characteristics such as comparability, verifiability, timeliness and understandability. We are of the view that the resulting operational burden (as described above) coupled with our concerns about whether the standard as applies to this issue is conducive to the longer-term public good, the potential for market detriment and reporting complexity (understandability) are more relevant points to consider in a technical analysis given the number of firms this issue affects.

  - We disagree that in this context disclosures would aid understandability. Measurement will likely treat existing shares/business and portions acquired through RITC differently and the resulting disclosures will be complex. As noted by the UKEB, where different measurement models are used (for example, where all business would otherwise be entirely based on the premium allocation approach) this reduces understandability of the accounts compared to treating these changes in ownership as changes to fulfilment cashflows and continuing to use the existing measurement model.

For the reasons above and to ensure that the accounting treatment of RITC's reflect the economic substance of the transaction and is not detrimental to the functioning of the Lloyds Market we would welcome continued dialogue with the UKEB to satisfactorily resolve this matter and enable Lloyd's market participants to account for the RITC appropriately in their financial statements. To be clear we do not consider that this issue would preclude endorsement of the standard but re-iterate that it is a material one that needs to be fully addressed now in this endorsement period.

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Overall [Draft] ECA

18. Do you have any additional feedback that the UKEB should consider?

We appreciate the robust process UKEB has conducted in respect of IFRS 17 in the short period of time UKEB has been in existence. The UKEB discussions, including the points raised in this response, illustrate that whilst not possible when IFRS 17 was in development, the importance of UKEB taking a proactive role in the development of future standards to ensure that UK specific issues are fully considered and addressed.

[Tentative] Adoption decision

19. Do you agree with our [tentative] overall conclusion that IFRS 17 meets the statutory endorsement criteria and should be adopted for use in the UK (see Section 6)?

Yes	☒	No	☐

If not, please provide an explanation.

In general, we agree with the overall conclusions reached. However, we note the number of outstanding issues highlighted in the DECA and in this response that need to be fully addressed in this endorsement period in particular the annuity CSM amortisation issue. We therefore urge the UKEB to support satisfactory resolution of these outstanding matters whilst being mindful of their respective impacts on the UK's long term public good and competitiveness if they remain unresolved.

Thank you for completing this Invitation to Comment