UKEB UK Endorsement Board

Insurance Technical Advisory Group

Meeting Summary – 15 December 2020

Meeting held virtually

Attendees

Members

Jo Clube (Aviva plc)

Richard Crooks (Legal & General Group Plc)

Stuart Reilly (Direct Line Group Plc)

Danny Clark (KPMG)

Gail Tucker (PwC)

Kevin Griffith (EY)

Mark Spencer (BDO)

Dean Buckner (UK Shareholders' Association)

Tony Silverman (AM Best)

Sian Morgan (Columbia Threadneedle Investments)

Wijdan Yousuf (Aon)

Anju Bell (Willis Towers Watson)

Vasilka Bangeova (Guy Carpenter & Company Limited)

Andrew Spooner (Deloitte)

UK Endorsement Board

Seema Jamil O'Neill (Technical Director)	UK Endorsement Board secretariat (Chair)
Peter Drummond (Senior Project Director)	UK Endorsement Board secretariat
Justin Ryan (Project Director)	UK Endorsement Board secretariat
Caroline Federer (Project Manager)	UK Endorsement Board secretariat
Dean Battersby (Project Manager)	UK Endorsement Board secretariat

Observers

Andrew Murray (Bank of England)

1 Welcome and Introductions

- The Chair welcomed attendees to the meeting and introduced two new members of the UK Endorsement Board (UKEB) secretariat, who will be working on the impact assessment for IFRS 17 and supporting TAG meetings.
- The minutes of the previous meeting were approved by the TAG.
- An update was provided on the set up of the UKEB. The application period for Board members has now ended and candidates will be shortlisted for interviews. Announcement of the Board members and the delegation of functions from the Secretary of State to the UKEB is anticipated in Q1 2021.

2 Disaggregation of insurance finance income or expenses between profit or loss and other comprehensive income (OCI) (the "OCI Option")

- Key points in the paper were:
  - IFRS 17 permits entities to make an accounting policy choice to present insurance finance income or expenses (IFIE) either in profit or loss or disaggregated between profit or loss and OCI. The option is available on a portfolio by portfolio basis.
  - The OCI option under IFRS 17 permits entities to present the impact of changes in discount rates and other financial assumptions that relate to financial risks in OCI. This treatment may increase understandability because the impact of changes in discount rates and other financial assumptions are separately identifiable, increasing transparency. The requirement does not remove volatility arising from assumption changes, rather, under this option, it is presented in OCI.
  - The OCI option potentially provides meaningful additional information for users of financial statements in the following scenarios:
    - Contractual benefits are linked to realisation values and not interim interest rate volatility; and
    - Assets which back the insurance liabilities are classified as at fair value through other comprehensive income (FVOCI) under IFRS 9 and the entity engages in limited asset trading.
  - The disclosure requirements[1] will enhance understandability by enabling users to compare approaches between entities.
  - Disaggregating IFIE between profit or loss and OCI will provide more relevant information because it permits entities to reduce or eliminate accounting mismatches between insurance liabilities and supporting investment assets.
  - Disaggregation of IFIE can be complex and preparers must make a number of judgements in determining the methods to apply. This can introduce a risk to the reliability of financial statements because disaggregation is subjective and may be applied inconsistently among entities.

[1] Disclosure requirements include an explanation of the disaggregation methods used to determine the amount of IFIE presented in profit or loss and OCI

  - The OCI option will reduce comparability amongst insurers given not everyone will adopt it. Further, it will not lead to enhanced comparability of profit or loss between insurers and entities that do not issue insurance contracts as it is only available in IFRS 17. Similar accounting ratios calculated for different entities may disguise different underlying performance depending on whether the option is adopted.

- During the ensuing discussion, TAG members noted that:
  - IFRS 9 permits the classification of certain financial instruments as at FVOCI, therefore the use of OCI to report discount rate movements is familiar to users of financial statements. The OCI option in IFRS 17 should be considered alongside IFRS 9, setting out accounting requirements for financial assets, as it permits preparers to align asset and liability measurement and presentation.
  - Differences in investment strategy are more likely to result in a lack of comparability between insurers. The accounting treatment of investment assets, under IFRS 9, will determine whether or not the OCI option is beneficial to insurers. The option creates a lack of comparability between insurers' profit or loss performance because insurers who do not select the option will report duration mismatches in profit or loss.
  - Application of the OCI option is expected to be more widespread in continental Europe. In the UK, only some general insurers and some life insurers are expected to use the OCI option in respect of protection business.
  - The calculation of the amount to disaggregate and recognise in OCI is in many cases essentially mechanical. Judgement will then only be applied to determine whether to apply the OCI option, and potentially to determine amounts in OCI on transition.
  - Application of the OCI option may make it more difficult to assess performance because volatility due to mismatches is removed from profit or loss and included within OCI. Performance reported in profit or loss may therefore be incomplete and negatively impact understandability. Disclosures must be detailed and transparent to mitigate any loss of comparability.
  - Investors compare the performance of insurers with similar business models. The OCI option is expected to be applied for similar insurance products and therefore any impact to comparability is unlikely to be very significant. It is not expected to negatively influence the comparability of insurers with other entities, because investors do not generally seek to compare performance of these entities. The business models of such entities are dissimilar and do not provide meaningful comparisons.
  - The International Accounting Standards Board's (IASB) General Presentation and Disclosure exposure draft proposes to include insurance finance income and expenses within operating profit. Consequently, insurers that apply the OCI option will report a more stable operating profit than insurers who do not apply the option, because the latter's operating result will reflect volatility in IFIE.

3 Discount Rates

- Key points in the paper were:
    - IFRS 17 requires the discount rates applied to estimates of future cash flows to reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts.
    - The standard also requires the discount rates applied to be consistent with observable current market prices (if any) and to exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.
    - Discounting future cash flows provides relevant and understandable information. Recognising the time value of money is central to insurance business and well-understood by users of insurers' accounts. It is also consistent with the accounting for other items under IFRS such as pensions, provisions and financial assets.
    - IFRS 17 requires the discount rates applied to be based on the characteristics of the cash flows being discounted. This means that discount rates – and insurance finance expenses - reflect the nature of the insurance contract liabilities and thereby provide relevant information.
    - Including liquidity characteristics in the determination of the appropriate discount rate recognises the economic characteristics of insurance liabilities (for example their long term nature and the fact they may be predictable). This leads to a more faithful representation of liabilities and insurance finance expenses, enhancing reliability, and providing more relevant information.
    - IFRS 17 requires extensive and detailed disclosures in respect of discount rates, including explanations of recognised amounts, explanations of significant judgements and the nature and extent of risks arising from the use of discount rates. The disclosures enhance the relevance and understandability of the accounting impact of the discount rates applied.
    - The fact that IFRS 17 does not mandate any particular discount rate or, when the appropriate discount rates are not directly observable in the market, any particular estimation technique may be considered to impair reliability and/or comparability. In particular, the determination of the illiquidity premium when a "bottom-up" approach is applied is generally recognised to require considerable judgement.
    - Overall, the accounting requirements of IFRS 17 in respect of discount rates appeared on balance to meet the endorsement criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management. The principal challenges related to reliability and comparability.

- During the ensuing discussion, TAG members were supportive of the paper format, which might provide the basis for part of the text of a future draft Endorsement Criteria Assessment. They noted that the following points could further enhance the explanation:
    - The underlying principles in IFRS 17 were that the discount rate must reflect the time value of money, the characteristics of the cash flows and the liquidity

characteristics of the insurance contracts.

- The “top-down” approach in IFRS 17 does not require an entity to adjust the yield curve derived from a reference portfolio of assets for differences in liquidity characteristics between the insurance contracts and the reference portfolio. This simplification was permitted because the IASB envisaged that the reference portfolio of assets would have liquidity characteristics closer to those of the group of insurance contracts, rather than highly liquid, high-quality bonds.
- Judgement is needed to determine the credit risk adjustment and the reference portfolio in the top-down approach to setting discount rates.
- Illiquidity premia are already applied in other areas of UK financial and regulatory reporting, therefore the concept should not be contentious.
- Disclosures required by IFRS 17 go some way towards mitigating the risks to comparability. Disclosure of information about inputs, assumptions and estimation techniques can be used to highlight differences between entities, which will facilitate analysis of performance.
- The disclosure required by paragraph 110 of IFRS 17 would provide useful information to enable users of financial statements to evaluate the sources of insurance finance income or expenses recognised in profit or loss and other comprehensive income and, in particular, to understand the important relationship with the investment return on the assets.
- The IFRS 7 *Financial Instruments: Disclosures* requirement to disclose the sensitivity of discount rates adopted on profit or loss, would provide further information to users of accounts.
- The paper focused only on the core principles and did not address the standard’s particular requirements in respect of the determination of discount rates for specific cases or contract types (for example for cash flows that vary based on the returns on underlying items). Further analysis would be needed in respect of these other aspects.

- Although some members agreed with the conclusions in the paper one member expressed disagreement.

4 IFRS 17 preparer survey: key themes and Insights

- The UKEB secretariat presented some preliminary results from the IFRS 17 preparer outreach survey conducted during Q4 2020. These will be further analysed and put to the UKEB in due course.

5 Terms of Reference

- A revised draft of the Terms of Reference (ToR) was presented to the members for their comments and suggestions.

- The changes were made to acknowledge areas reflected in the TAG's discussions but not explicitly reflected in the ToR. These were:
  - To emphasise that the work of the TAG should have regard to the UK long term public good, and
  - To provide further information about the expectations of TAG members.
- One member questioned whether the TAG should also consider the UK short term public good. The Chair affirmed that the editorial change was to align the terms of reference of the TAG with the requirements of Statutory Instrument 2019/685.
- It was noted that the intention is to make the updated ToR publicly available.
- The TAG approved the revised draft of the ToR.

6 Forward Agenda

- The Chair asked TAG members to submit comments and questions on the forward agenda to the UKEB secretariat. The Chair reiterated that the agenda was a live document and would be reviewed on an ongoing basis.
- The UKEB secretariat noted that two guest presenters have agreed to present papers related to the accounting for with-profits contracts in the January meeting.
- TAG members commented that discussion of VFA eligibility should be brought forward on the agenda. The UKEB secretariat agreed to reconsider the forward agenda.

7 AOB

- No AOB were noted.

End of meeting