ILAG The Practitioner Voice

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By email: ifrs17@endorsement-board.uk

02 February 2022

Dear Pauline,

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

The Investment & Life Assurance Group (ILAG) is a representative body, with membership from across the Life Assurance and Wealth Management Industries.

We openly share and develop practical experiences and expertise, applying this practitioner knowledge to the development of businesses, both individually and collectively, for the benefit of the membership and its customers.

ILAG is run by practitioners for practitioners, whether by engagement with industry associated bodies or through active consultation.

The ILAG membership list is at the end of this submission.

General Comments

We welcome the opportunity to comment on the UK Endorsement Board (UKEB) Draft Endorsement Criteria Assessment (DECA) for IFRS 17 ***Insurance Contracts***.

We have been involved in the development of IFRS 17 since the first Exposure Draft of the standard was released and have responded to all previous Exposure Drafts published by the International Accounting Standards Board (IASB) of IFRS 17.

Our members are supportive of endorsing IFRS 17 in the UK. When compared to IFRS 4, it represents an improvement to the consistency and comparability of the financial reporting of insurance contracts across the UK.

However, we believe there is one key issue for life insurers that remains unresolved and this may have an impact on the endorsement of IFRS 17 in the UK. This relates to the allocation of the contractual service margin for annuities (for example revenue recognition for annuity contracts). We understand that this is due to be first discussed by the IASB interpretations committee on 16 March 2022. We believe that until this discussion is complete it is not possible to say categorically whether this is a matter of interpretation or has potential implications for endorsement. We recommend that the UKEB considers the outcome from the IASB interpretations committee before it finalises its endorsement advice.

We appreciate that the IASB view is unlikely to be available within the current UKEB timeline for endorsement. We also note that UKEB has the power to make amendments to the Standard for adoption in the UK. We believe that both of these, the contractual service margin issue, and the IASB conclusions should all factor into the UKEB's decision.

In addition:

- Many ILAG members currently report under UK GAAP, and it is expected that this will still be the case post IFRS 17 adoption. If the FRC were to consider moving UK GAAP to something more aligned with IFRS 17 then this would require incredibly careful analysis as to whether the cost / benefit test would be met.
- The implementation of IFRS 17 in the UK is likely to increase the disconnect between accounting profit and equity and the basis on which cash and capital (linked to Solvency II) is reported. As a result of this we expect that insurers will continue to use alternative profit metrics, especially UK life insurers, to enable them to accurately reflect what has occurred within their business during the financial reporting period; and
- IFRS 17 continues to be operationally complex for insurers with a significant cost and resource impact to date. We expect this to continue throughout 2022 and 2023.

Our key comments on the DECA, cross-referenced with the appropriate sections of the DECA template, are set out in the following sections.

Contractual Service Margin (CSM) allocation for annuities

The method for amortising the CSM for annuity contracts has been subject to intense debate in the UK life industry. It is a significant point of interpretation given the size of the annuity market and the anticipated CSM, and the recognition of IFRS 17 profit arising from these contracts is material.

The difference in interpretation relates to varying views on the service (insurance coverage) that is provided, and this results in the disparity of approach to releasing the CSM and revenue recognition.

For an annuity-in-payment (with no guaranteed period), some consider the payments made to the policyholder, in each period, the relevant measure of insurance coverage under IFRS 17, while others believe that the coverage in each period also includes the promise to pay the policyholder a guaranteed income for the rest of their life. This is also relevant for deferred annuities both when vested and in deferral but the guidance in the Standard is unclear on this point. In its analysis of determining coverage units for annuities the TRG reported that the first approach was acceptable but did not explicitly consider and / or rule out the second.

We are supportive of the Institute of Chartered Accountants in England and Wales (ICAEW) seeking the views of the IASB in interpreting IFRS 17, on this important matter, as outlined in the ICAEW's detailed submission. We understand that the IASB Interpretation Committee (IFRIC) will consider the submission in March 2022.

Paragraphs 3.40 to 3.53 in the DECA set out the tentative assessment against the endorsement criteria in relation to CSM amortisation for annuities. Paragraph 3.50 states that it is 'likely that a consensus …will develop' and that the approach 'is essentially a matter of interpretation.'

We believe that until the IASB Interpretation Committee process is complete, it is not possible to conclude whether this is a matter of interpretation or has implications for endorsement of IFRS 17 in the UK. We recommend the UKEB considers the views from the IASB Interpretations Committee before its endorsement advice is confirmed. We appreciate that this is unlikely to be available in line with the current UKEB timeline for endorsement.

Grouping insurance contracts into profitability buckets and annual cohorts

As part of the European Union endorsement of IFRS 17 an optional 'carve-out' for the annual cohort requirement has been introduced ('EU-IFRS'). This applies for participating insurance and investment contracts that mutualise returns between policyholders, and contracts that fall within the Solvency II matching adjustment (MA) regulations. An implication of the carve-out (where taken up) is the need for dual accounting if an insurer is listed (or has certain other arrangements) in different jurisdictions, for example in the US, where full IFRS and EU-IFRS would need to be reported.

We do not believe such a carve out is necessary for the UK endorsement of the Standard as it would only be considered by a small number of with-profit funds. There are only a limited number of open with-profit funds in the UK currently reporting under IFRS, and for closed funds the transition rules permit a higher level of aggregation.

We understand that in the UK open with-profit funds are already managed at a lower level and it is unlikely that the option, if permitted, would be adopted given the complexity of removing the annual cohort requirement for specific lines of business, and not all portfolios of insurance contracts.

We are not supportive of the carve-out for cash flow matched contracts eligible for the MA, which we believe is contrary to the objectives of transparency and comparability.

We trust these comments are useful to the UKEB in formulating its final endorsement of IFRS 17 and welcome the opportunity to discuss any of the matters raised in this letter.

Yours sincerely,

Investment & Life Assurance Group

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