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**

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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)?

In our view the approach adopted in assessing IFRS 17 for endorsement in the UK has considered carefully the three criteria set out in the legislation. In particular

- We support the decision to form a technical advisory group, this was imperitative given the specialist nature and complexity of the standard.
- We would support this approach going forward to deal with endorsement of any major new standards as the opportunity to debate issues facilitated direct feedback from preparers, users and auditors in a timely and efficient way.
- We note that IFRS 17 was never fully field tested by the IASB prior to its publication. In our view this has resulted in undue complexity in some areas (e.g. with profits contracts generally and in particular those including guaranteed annuity options). We acknowledge that the UKEB did not exist until after IFRS 17 had been published, however going forward we would stress the importance of the UKEB's influencing activities to ensure that the impact of new standards on UK entities is fully considered by the IASB during the development stage. We commend UKEB for their efforts in establishing an effective endorsement process so quickly and in liaising and working with EFRAG, who did some partial testing. We believe it is important to maintain close links going forward with European and other international bodies.

The explanation of the technical criterion required to be assessed in reaching an endorsement decision is clear and we support the use of an exceptions based approached in assessing UK specific concerns around understandability, relevance, reliability and comparability. Our responses to Questions 5 to 8 set out the specific concerns we have with respect to the technical criterion. We support the emphasis on 'true and fair' considerations.

We note the requirement to assess the impact of IFRS 17 on the long term public good in the UK, particularly with regard to costs and benefits. In reality given the timing of the UK endorsement process much of the significant initial implementation costs of IFRS 17 had already been incurred by the time of the assessment. We support the approach to assess the initial costs of implementation and expected ongoing costs against the long term benefits, however we are not convinced that sufficient consideration was given to the potential impact on the UK economy and UK customers of IFRS 17's impact on certain UK products, which are the most relevant to its application. In particular requirements in respect of annuity contracts arising from the sale of defined benefit pension schemes (usually referred to as Bulk Purchase Annuities (BPAs)) and the impact on UK style With Profits business is much more significant than elsewhere in the world. We do not believe the cost benefit test has been met with respect to these products and as a result we believe there is a risk of increased costs and less choice for future customers. This is not sufficient to recommend non-endorsement overall given the stage in implementation we

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have reached and the importance of international comparability, however it remains a significant challenge for the UK industry to navigate. This should be picked up with the IASB in IFRS 17's post implementation review and for future standards this is an area where the UKEB should seek to influence directly to ensure UK specific concerns are raised and resolved in the development stage of any new standard. We note the criterion to assess whether the standard is contrary to a true and fair view for individual and consolidated financial statements is necessarily a high hurdle and we support the holistic approach taken which considers the impact of the standard as a whole. We would note however the importance of balancing the need for comparability with the fact that life insurance products around the world are often closely linked with country specific regulations. Therefore giving due consideration to economic substance of how the contracts operate in practice is important in achieving balance with the criterion of understandability, relevance, reliability and comparability. This is linked to our assessment of the technical criterion and we would note that IFRS 17 principles do not operate well in accounting for UK Style With profits business generally and in particular With Profit contracts with guaranteed annuity options. Our overall assessment of the true and fair criterion is also linked to the outcome of IFRIC's interpretation of IFRS 17 principles on amortisation of CSM as applied to UK Annuity contracts. We are concerned that if this does not deliver an appropriate outcome, such that we are able to recognise CSM revenue associated with the protection component of an annuity contract guaranteeing the policyholder will receive an income for life, there are further challenges around assessing whether IFRS 17 meets this criterion. This is a consequence of the significance of this product in the UK market.

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 consider this amemdment is helpful as it enables insurers to present their opening balance sheet on a basis that reflects both IFRS 9 and IFRS 17 restated balances. Without this amendment we would have been obliged to retain IAS 39 measurement of assets and liabilities sold in the comparative period. Hence this amendment improves consistency and understandability of opening balance sheet disclosures.

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?

Section 2 provides a good overview of the key features of IFRS 17. One point we believe should be added is a summary of how the measurement approach has been designed to reflect the strong links between insurance liabilities and the assets held to support these liabilities. In particular explaining that the VFA was developed to deal with the interaction between the liabilities and a specified pool of underlying assets and for GMM the top-down approach to setting the discount rate was developed to accommodate the strong linkage between insurance liabilities and associated assets. There are some further more detailed points which we feel would be helpful to clarify as follows: • Paragraph 2.26 comments on volatility and notes that IFRS 17 provides an option for volatility arising from changes in discount rates to be reported in OCI. Given the majority of UK Life insurers are expected to continue to use Fair Value through P&L (FVPL) it would be helpful to explain that an alternative approach to explaining this volatility is through additional disclosure of a non-GAAP operating profit metric which shows operating profit using expected discount rates and expected returns and shows separately the volatility arising from changes in discount rates and short term market flucations form the expected rate. This approach, which is expected to be applied across UK Life Insurance entities, enhances understandability and enables the interaction between asset and liability movements to be better understood. • Paragraph 2.44 (c) it would be helpful to include duration as an example of factors that influence observable market prices but do no affect the future cash flows of the insurance contracts. • Paragraph 2.73 (c) could be clarified to note that while IFRS 17 permits acquisition costs to be expensed immediately, this is an accounting policy choice and an equally valid alternative is to capitalise and allocate to the measurement cash flows when the associated group of insurance contracts are recognised.

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.

Yes we agree

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.

We only agree with the tentative assessment against the endorsement criteria to the extent that there is a satisfactory outcome to the interterpretation of CSM allocation for UK annuity contracts. We agree that CSM allocation for annuities is a priority technical accounting issue. We also agree that IFRS 17 is principles based and that there is a clear principle that CSM should be recognised as revenue in line with service provided, using coverage units as the mechanism to allocate the service. We therefore believe under the standard it is fully appropriate to allocate CSM in line with the the service provided to customers in a manner that reflects the prices customers pay for the service as observed in the UK's active market for annuities, (where knowledgeable willing parties pay a fee to purchase insurance coverage that ensures they continue to receive a guaranteed payment each period for the rest of their life). We can demonstrate the differential in pricing compared to a contract that delivers payments for a fixed period only. Hence we believe it is in line with the principles of the standard to allocate insurance revenue in line with the price a rational market participant is prepared to pay. To the extent the interpretation of the standard as written is not considered to permit this, which some supporters of paragraph 3.22 believe to be the case, then we consider there is a fundamental flaw in the standard. Our view is that IFRS 17 is sufficiently clear on the principle that CSM should be recognised in line with service such that this principle can be applied to align with observable market pricing of this service. We agree with paragraph 3.49 that the level of judgement required to support this is in line with similar levels of judgement required by other standards (including IFRS 15 revenue recognition).

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.

Yes we agree with the tentative assessment against the endorsement criteria IFRS 17 does not mandate or prescribe the discount rates for use in the measurement of fulfilment cash flows. Instead, the standard provides a framework for setting the discount rates, based on the characteristics of the liabilities and making maximum use of market observables, together with extensive disclosure requirements. We consider that this approach is appropriate and agree with the (tentative) assessment that it meets the endorsement criteria. We do not consider it possible to prescribe appropriate discount rates that insurers should use for all the various types of liabilities across different jurisdictions. We consider that use of

either a top-down or bottom-up approach to setting the discount rate may be appropriate, depending on the characteristics of the liabilities. For UK insurers, a combination of top-down and bottom-up approaches are likely to be used. For annuity liabilities that are illiquid in nature, sensitive to interest rates and generally closely matched by a portfolio of fixed-interest assets, a top-down discount rate approach is likely to be appropriate with the discount rate curve derived from the yield on the own assets held. For more liquid and less interest-sensitive liabilities, such as term assurance, a bottom-up approach is likely to be appropriate and practical to apply. These approaches build on long-standing well-established actuarial practice in the UK. We do not believe that the lack of prescription in the standard will impair reliability or comparability.

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.

Yes we support the assessment against the endorsement criteria in respect of the IFRS 17 annual cohorts and profitability grouping requirements. We believe that the standard's requirements result in relevant information being provided to users by requiring immediate recognition of losses on contracts which are onerous at inception (with an offset where the contracts are reinsured) and by enabling the identification of profitability trends through time via the use of annual cohorts. We note that the granularity required as a result of the profitability grouping and annual cohort requirements is significantly greater than that required under IFRS 4 and SII giving rise to one-off implementation and on-going costs. However, we do not believe these costs are disproportionate in the context of the relevance of information enabled by the granularity. We have recently disposed of our continental European operations and are therefore not exposed to the particular risk sharing products which have given rise to the concerns about the annual cohort requirement that is addressed by the EU carve out.

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.

Yes we agree with the tentative assessment against the endorsement criteria

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.

Overall we consider that IFRS 17 meets the endorsement criteria of understandability, relevance, reliability and comparability. However this view is subject to satisfactorily resolving the approach to revenue recognition for UK annuities. We believe the principles of the standard permit an interpretation that fairly reflects the service we provide and associated revenue recognition, however if this is deemed not to be the case we believe changes will be necessary to the standard in order to meet this endorsement criteria. This is due to the fact that in the UK annuities are the largest product type that is in scope of IFRS 17 measurement and the most significant product where growth is expected over the foreseeable future (at least the next 10 years).

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.

No we do not believe other aspects of IFRS 17 need to be featured

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)?

While we note that there are significant benefits arising on a global basis from the implementation of IFRS 17, this comes at a considerable cost. In our view the majority of benefits could have been achieved at a significantly lower cost if the proposals of the standard had been properly field tested. We would encourage the UKEB to invest in influencing activities to ensure that future standards consider UK issues appropriately and consideration is given to a more comprehensive cost benefit analysis.

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.

Yes

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.

Overall we are supportive of endorsement however we feel strongly that the CSM allocation for UK annuities needs to be resolved to support the long term public good of IFRS 17 in the UK

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 holistic approach taken which considered the impact of the standard as a whole

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.

Yes

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	☐

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

Yes

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)?

We do not believe that IFRS 17 changes the criteria for recognition or de-recognition of reinsurance-to-close. In our view the accounting that is presented today represents a judgement and IFRS 17 does not alter managements ability to make such judgements. So if there is to be a change in approach management and their auditors would need to explain the reason for the change and whether this represents a change in estimate or a prior year error.

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Overall [Draft] ECA

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

Overall we commend the UKEB for the robust process they have undertaken in the limited time available to assess IFRS 17 against the Endorsement criteria. We note that IFRS 17 is a principles based standard and would recommend that UKEB continue to support a principles based approach and use their influencing skills to support interpretation that aligns to the principles in the standard and a holistic assessment of true and fair.

[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.

Overall we are keen to see IFRS 17 endorsed, however we would note our comments above in respect of CSM allocation for annuities. Therefore to ensure a meaningful application of the standard in a UK context we would encourage UKEB to support the validity of an interpretation of CSM allocation for annuities that enables recognition of CSM in line with the service provided and that can be demonstrated in the UK's large and active market for annuities.

Thank you for completing this Invitation to Comment