Institute and Faculty of Actuaries

3 February 2022

UK Endorsement Board - [Draft] Endorsement Criteria Assessment: IFRS 17 Insurance Contracts

IFoA Response

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

Key points

The IFoA supports the endorsement of IFRS 17 in the UK. It represents an improvement compared to current IFRS 4 and while there are certain aspects of IFRS 17 that could be improved, we do not consider this warrants non-endorsement of IFRS 17.

A key issue that has been discussed in the UK is the allocation of the contractual service margin (CSM) for annuities, and the rate at which the CSM is recognised as revenue. It is a significant point of interpretation, given both the size of the annuity market and the likely CSM on these contracts. We understand that this will be considered by the IASB Interpretation Committee in the coming months. In our view, until this process is complete, it is too early to conclude whether this is a matter of interpretation or has potential implications for endorsement. We recommend that the UKEB considers the views from the IASB Interpretations Committee before endorsing IFRS 17.

Reinsurance-to-close (RITC) is unique to the Lloyd's market, based in the UK. We understand that the current interpretation of RITC is that it is a reinsurance transaction under IFRS 17 rather than a derecognition as adopted for UK tax and regulatory requirements. Our view is that this could increase the complexity of the financial statements for relevant Lloyd's Members and would require the implementation of additional systems and processes. While we recognise the complexity and cost challenges arising, we believe this to be a matter of interpretation and should not prevent the UKEB finalising the endorsement of IFRS 17.

The application of IFRS 17 to UK with-profits contracts is particularly complex and we draw the UKEB's attention to a number of specific matters, including:

- treatment of equity in with-profit funds – The existence of equity that is restricted and unavailable to shareholders will be a new concept for UK with-profit funds and may increase the need for alternative disclosures;
- application to non-profit contracts written in with-profits funds – There is the potential for an accounting mismatch, and the resulting profit and loss and shareholder equity amounts could be significant.

We support the IFRS 17 discount rate requirements. The inclusion of an illiquidity premium in the discount rate is important for UK insurers, particularly those writing annuity business.

We acknowledge that the UKEB is not responsible for UK GAAP, however, the endorsement of IFRS 17 in the UK may influence considerations about the potential changes to UK GAAP. We view that, if and when the requirements of UK GAAP are reviewed in future, it will be important that the experience of IFRS reporters in implementing IFRS 17 and in publishing the resulting accounts is assessed several years after initial publications as part of a full cost benefit analysis of UK GAAP reporters.

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1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to comment on the UK Endorsement Board (UKEB) Draft Endorsement Criteria Assessment (DECA) for IFRS 17 Insurance Contracts. We have been actively engaged in the development of IFRS 17 for a number of years including responding to each Exposure Draft published by the International Accounting Standards Board (IASB) and through supporting the global IFRS 17 work of the International Actuarial Association (IAA).

2. It is important to note that, as for any IFoA response, we have considered the IFRS 17 DECA from an independent, public interest perspective.

3. The IFoA supports the endorsement of IFRS 17 in the UK. It represents an improvement compared to current IFRS 4 and while there are certain aspects of IFRS 17 that could be improved, we do not consider this warrants non-endorsement of IFRS 17.

4. A key issue that has been discussed in the UK is the allocation of the contractual service margin (CSM) for annuities, and the rate at which the CSM is recognised as revenue. We understand that this will be considered by the IASB Interpretation Committee in the coming months. In our view, until this process is complete, it is too early to conclude whether this is a matter of interpretation or has potential implications for endorsement. We recommend that the UKEB considers the views from the IASB Interpretations Committee before endorsing IFRS 17. This may not be possible on the current UKEB timeline with endorsement expected in March 2022.

5. We also note that:

    - we have now entered the comparative year for IFRS 17 with a balance sheet as at 1 January 2022 required. The implementation of IFRS 17 continues to be operationally complex for many insurers, with significant effort and resources deployed to date and expected to continue to be throughout 2022 and 2023. The certainty provided by endorsement of IFRS 17 in the UK will be an important milestone for insurers. We are not advocating the UKEB adjusts IFRS 17 for UK purposes, however, if this conclusion were reached by the UKEB then we would recommend that any changes are optional, as some insurers may not have time to implement them;
    - the implementation of IFRS 17 in the UK is likely to increase the disconnect for insurers between accounting profit and equity, and the basis on which cash and capital (linked to Solvency II) is reported. The existence of a disconnect between accounting profit and cash generation is not different to some other (non-insurance) sectors. We expect that insurers, especially UK life insurers, will continue to use alternative profit metrics, to enable them to tell their financial story more clearly to the market;
    - the endorsement of IFRS 17 in the UK may influence considerations about potential changes to UK GAAP affecting more than 150 entities across the UK.

6. In the remaining sections of this letter we set out our significant comments on the DECA and these are cross-referenced in the required UKEB comment template, which we are also submitting with this covering letter.

Contractual Service Margin (CSM) allocation for annuities

7. Within the UK insurance market, annuity contracts, and specifically the bulk purchase annuity market, are a major growth area for life insurance business within the scope of IFRS 17.

8. The method for amortising the CSM for annuity contracts has been debated in the UK for a number of years. It is a significant point of interpretation, given both the size of the annuity market and the likely CSM, and so impacts the pace of emergence of IFRS 17 profit arising from these contracts.

9. The difference in interpretation relates to differing views on the service (insurance coverage) that is provided, and this in turn results in a difference in the approach to releasing the CSM and revenue recognition. For an annuity-in-payment (with no guaranteed period), some practitioners in the UK market consider the payments made to the policyholder in each period to be the relevant measure of insurance coverage under IFRS 17. There are others who consider that the coverage in each period 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 whether there is insurance coverage in the deferred period.

10. We strongly support the direction taken in the 18 November 2021 detailed submission by the Institute of Chartered Accountants in England and Wales (ICAEW, the UK accounting profession) seeking the views of the IASB in interpreting IFRS 17 on this important matter: https://www.icaew.com/-/media/corporate/files/technical/financial-services/ifrs17-and-iasb/ifrs-17-letter-to-the-iasb.ashx). We understand that the IASB Interpretation Committee will consider the submission during Q1 2022.

11. Paragraphs 3.40 to 3.53 in the DECA set out the tentative assessment against the endorsement criteria in relation to this matter. In particular paragraph 3.50 noted that it is 'likely that a consensus … will develop' and that the approach 'is essentially a matter of interpretation.' In our view, until the IASB Interpretation Committee process is complete, it is too early to conclude whether this is a matter of interpretation or has potential implications for endorsement of IFRS 17 in the UK. We therefore recommend that the UKEB considers the views from the IASB Interpretations Committee before its endorsement advice is confirmed, including noting that this is unlikely to be available relative to the current UKEB timeline to March 2022.

Application of IFRS 17 to Reinsurance-to-Close (RITC) in Lloyd's of London

12. Reinsurance-to-close (RITC) is unique to the Lloyd's market, based in the UK. It provides liquidity and finality for capital providers (members) for potentially long-term insurance liabilities and, along with the Lloyd's chain of security, helps to ensure the appeal, flexibility, financial strength and underwriting competition of the Lloyd's market, and thus is in the wider public interest. The RITC process achieves this through, in substance, being a full transfer of both rights and liabilities under the subject business whilst legally taking the form of reinsurance.

13. We understand that the current interpretation of RITC is that it is a reinsurance transaction under IFRS 17 rather than a derecognition as adopted for UK tax and regulatory requirements. From an accounting perspective, our view is that this could increase the complexity of the financial statements for Lloyd's Members (and IFRS reporting groups containing Lloyd's Members), both ceding and receiving business through RITC.

14. Operationally, adopting reinsurance accounting will require the implementation of additional systems and processes across the Lloyd's market as RITCs, once transacted, are not currently tracked by the ceding business. These new systems and processes would be required prospectively but also in respect of historic RITCs (at transition), particularly where liabilities that were previously treated as finalised would now require further ongoing reporting by the ceding members. The complexities would likely compound over time when a single policy underwritten at Lloyd's undergoes multiple RITCs prior to settlement of the underlying liabilities. The proposed treatment may also risk reducing the attractiveness of the Lloyd's market for certain potential capital providers.

15. While we recognise the operational and reporting complexities and cost challenges that exist for RITC under IFRS 17, we believe this to be a matter of interpretation and should not prevent the UKEB finalising the endorsement of IFRS 17. We expect the industry to consider and assess alternative interpretations which reflect the substance of the RITC transaction and avoid, as set out above, the potentially significant operational changes to the Lloyd's market.

Application of IFRS 17 to with-profits contracts

16. The application of IFRS 17 to UK with-profits contracts is particularly complex and we would like to draw the UKEB's attention to a number of specific matters set out below. The driver of many of these points is that there is no concept of the with-profits fund being separate from the reporting entity under IFRS 17.

(i) Eligibility of reinsurance for the variable fee approach (VFA)

17. We support the use of reinsurance contracts held as a risk mitigation technique in paragraphs B115 to B118 of IFRS 17. However, this solution does not address one scenario that we believe is important. Some reinsurance contracts transfer both non-financial and financial risk to the reinsurers, on underlying contracts that are eligible for the VFA. The prohibition in IFRS 17 on applying the VFA approach to reinsurance will give rise to accounting mismatches in this scenario as paragraph B115 to B118 do not apply. In particular, paragraph B115 applies only to financial risk and reinsurance contracts held, but not those issued. An example of this is where large-scale transfers of with-profits and unit-linked insurance contracts are implemented through reinsurance contracts that can last for several years. This can, for example, have occurred where business has been moved to a European subsidiary as part of Brexit, but been reinsured back to the original entity's with-profits fund.

(ii) Application to non-profit contracts written in with-profits funds

18. In circumstances where non-profit contracts are written in a with-profits fund, the non-profit contracts can form part of the underlying items of the with-profit contracts. The underlying items are measured at fair value (in accordance with IFRS 13 Fair Value Measurement). This contrasts with the non-profit contract liabilities which are measured at fulfilment value (in accordance with IFRS 17). There could be a number of reasons why these values may differ since the IFRS 17 measurement model is not fair value.

19. As set out in the April and May 2021 UKEB Technical Advisory Group papers (and our responses to the IASB 2019 Exposure Draft[1]), this results in an accounting mismatch, and we note the profit and loss and shareholder equity amounts arising can be significant. This will raise investor communication challenges for UK insurers. The position and the extent of the accounting mismatch can also be more complex where profits on non-profit contracts accrue in the first instance to an inherited estate in the with-profits fund rather than to current with-profits policyholders.

20. In practice, the profits on the non-profit contracts belong in the first instance to the with-profits fund and are earned through shareholder transfers linked to the bonus declaration. Currently, under IFRS 4, profits on these contracts are not separately recognised, as the accounting profit is linked to the bonus declaration for the with-profits fund as a whole. Under IFRS 17 the contracts are not eligible for the VFA and will generate a CSM despite only a portion being attributable to shareholders. This will raise further communication challenges as the profits released by this business will be owned by the entity rather than shareholders.

[1] http://eifrs.ifrs.org/eifrs/comment_letters/544/544_26038_StevenGrahamInstituteandFacultyofActuariesIFoA_0_0925IFRs17ED4_v6.pdf

21. A similar issue may arise with other cash flows met by the inherited estate rather than current with-profit policyholders, for example costs that are not directly attributable to the fulfilment of the insurance contracts.

(iii) Treatment of equity in with-profits funds

22. We agree with the UKEB assessment that the treatment of equity will depend on the facts and circumstances of each with-profits fund (for example, certain closed funds may be treated differently to certain open funds). We highlight that this will be a key point of difference in the treatment of with-profits funds which will make comparability between insurers harder. If an open fund is closed, or even if there is just a partial distribution of the estate, the accounting results under IFRS 17 may be counterintuitive, thereby reducing the understandability of the financial statements.

23. In IFRS 17, profit on with-profits contracts will emerge gradually over time as the insurance coverage and investment service is provided. However, this is likely to be in advance and without a direct link to the bonuses declared to policyholders or shareholder (cash) transfers. This acceleration of accounting profit, relative to the cash bonus basis (particularly where profits are distributed using significant terminal bonuses), could introduce elements of profit in the period and equity that is restricted and unavailable to the shareholder. There is required disclosure of such restrictions under IFRS 12 *Disclosure of Interests in Other Entities*, however, it will be a new concept for UK with-profits funds. The restricted equity will remain until cash/ bonus emergence. We observe that this may increase the need for alternative profit metrics (and additional explanatory equity disclosures), for with-profits insurers to tell their financial story to the market.

(iv) Other with-profits related matters

24. We are aware that there are different interpretations amongst practitioners in the application of IFRS 17 to both ‘hybrid contracts’ (i.e., contracts that combine unitised with-profits and unit-linked investment options) and with-profits contracts that include guaranteed annuitisation options. This could result in a divergence in approach when IFRS 17 is first adopted in the UK.

Discount rates

25. We support the requirement of IFRS 17 that estimates of future cash flows should be discounted to reflect the time value of money, using a discount rate that is current and that reflects the characteristics of the insurance contracts. This results in information that is relevant for users. Consistency between the discount rate and observable market data enhances the reliability of the financial results. We recognise that IFRS 17 does not prescribe the approach to setting the discount rate and includes a degree of optionality (e.g. the choice between a top-down and bottom-up rate). Although this could potentially lead to a lack of comparability between companies reporting under IFRS 17, this is mitigated by requirements for the discount rate to be consistent with observable market data and for the disclosure of both the discount rate and any material judgements used.

26. IFRS 17 recognises that insurance contracts can be illiquid and that the liability discount rate should be adjusted to reflect this illiquidity. The inclusion of an illiquidity premium in the discount rate is important for UK insurance companies, particularly those writing annuity business. Without reflecting the significant illiquidity of such business, liabilities at initial recognition would be higher than the premiums charged to customers, resulting in losses being incurred. Such an outcome would not reflect the underlying economics of annuities which are priced allowing for an illiquidity premium. Removing the illiquidity premium from a discount rate that otherwise reflects pricing could also potentially lead to insurers raising prices for consumers to mitigate accounting losses. As a result, we support the inclusion of an illiquidity premium where appropriate, an approach which is in line with other IFRS standards, Solvency II and pension accounting reporting.

Grouping insurance contracts into profitability buckets and annual cohorts

27. As part of the European Union endorsement of IFRS 17, an optional 'carve-out' in relation to the annual cohorts requirements has been introduced ('EU-IFRS'). This applies for contracts that are eligible for the variable fee approach, that are investment contracts with discretionary participating features, or fall within the Solvency II matching adjustment 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.

28. In the UK a carve-out equivalent to EU-IFRS would likely apply to most with-profits, unit-linked and annuity contracts in the scope of IFRS 17. If such a carve-out were widely taken up then it would represent a significant portion of the UK life insurance market. For UK with-profits contracts, the concepts of asset shares, bonus series, the application of the principles of 'Treating Customers Fairly' and the use of fair value accounting for assets typically results in a more granular management of these contracts compared to equivalent continental European participating contracts. In addition, the requirement for annual cohorts is expected to impact only a limited number of with-profits funds, as most such funds in the UK are closed; these closed funds are likely to apply the fair value approach on transition to IFRS 17 where this is an exemption from the requirement. In this context, we can understand the conclusion reached by the UKEB in paragraphs 3.101 to 3.116 of the DECA that grouping of insurance contracts meets the requirements for endorsement.

UK GAAP reporters and the implications of IFRS 17

29. Paragraph 4.187 of the DECA indicates that there are more than 150 insurers currently using UK GAAP, representing around 40% of gross written premiums in the UK, who will not be required to adopt IFRS 17. Such business include mutual insurers, friendly societies, and Lloyd's of London, including syndicates. We acknowledge that the UKEB is not responsible for UK GAAP, however, the endorsement of IFRS 17 in the UK may influence considerations about the potential changes to UK GAAP.

30. In paragraph 57 of FRS 103 Insurance Contracts, it is noted that: *'The FRC will review the requirements of FRS 103 in light of this new IFRS* [IFRS 17]*, however the timing of this review is yet to be determined.'* This was further expanded in the FRC Panel Discussion *Benefits and barriers to implementation of IFRS 17 Insurance Contracts (24 April 2018)* where the minutes note: *'… FRC will review implementation experience of listed insurers before considering the case for changing FRS 103 – any changes would be subject to public consultation.'*[2] We consider that, when the requirements of FRS 103 are reviewed, it will be important that the experience of IFRS reporters in implementing IFRS 17 and in publishing the resulting accounts is assessed several years after initial publication, as part of a full cost benefit analysis of UK GAAP reporters. This experience will take a number of years to be fully understood and we do not view that any consideration of changes to UK GAAP for insurers in the next few years is required.

[2] https://www.frc.org.uk/getattachment/102ec5eb-5524-486e-8700-105ae6a85f1e/ARPT-event-summary.pdf

We trust that these comments will be useful to the UKEB in assessing IFRS 17 for endorsement in the UK. We reiterate the strong commitment of the IFoA to assist the UKEB in this process. In particular, we would welcome the opportunity to discuss our comments with the UKEB.

Should you want to discuss any of the points raised please contact me, Technical Policy Manager (steven.graham@actuaries.org.uk) in the first instance.

Yours Sincerely,

Steven Graham
On behalf of Institute and Faculty of Actuaries

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.

[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.

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].

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].

[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

[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**

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.

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)?

No comments.

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.

N/a

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?

No comments.

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.

N/a

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.

Within the UK insurance market, annuity contracts, and specifically the bulk purchase annuity market, are a major growth area for life insurance business within the scope of IFRS 17.

The method for amortising the CSM for annuity contracts has been debated in the UK for a number of years. It is a significant point of interpretation, given both the size of the annuity market and the likely CSM, and so impacts the pace of emergence of IFRS 17 profit arising from these contracts.

The difference in interpretation relates to differing views on the service (insurance coverage) that is provided, and this in turn results in a difference in the approach to releasing the CSM and revenue recognition. For an annuity-in-payment (with no guaranteed period), some practitioners in the UK market consider the payments made to the policyholder in each period to be the relevant measure of insurance coverage under IFRS 17. There are others who consider that the coverage in each period 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 whether there is insurance coverage in the deferred period.

We strongly support the direction taken in the 18 November 2021 detailed submission by the Institute of Chartered Accountants in England and Wales (ICAEW, the UK accounting profession) seeking the views of the IASB in interpreting IFRS 17 on this important matter: https://www.icaew.com/-/media/corporate/files/technical/financial-services/ifrs17-and-iasb/ifrs-17-letter-to-the-iasb.ashx). We understand that the IASB Interpretation Committee will consider the submission during Q1 2022.

Paragraphs 3.40 to 3.53 in the DECA set out the tentative assessment against the endorsement criteria in relation to this matter. In particular paragraph 3.50 noted that it is 'likely that a consensus … will develop' and that the approach 'is essentially a matter of interpretation.' In our view, until the IASB Interpretation Committee process is complete, it is too early to conclude whether this is a matter of interpretation or has potential implications for endorsement of IFRS 17 in the UK. We therefore recommend that the UKEB considers the views from the IASB

Interpretations Committee before its endorsement advice is confirmed, including noting that this is unlikely to be available relative to the current UKEB timeline to March 2022.

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 support the requirement of IFRS 17 that estimates of future cash flows should be discounted to reflect the time value of money, using a discount rate that is current and that reflects the characteristics of the insurance contracts. This results in information that is relevant for users. Consistency between the discount rate and observable market data enhances the reliability of the financial results. We recognise that IFRS 17 does not prescribe the approach to setting the discount rate and includes a degree of optionality (e.g. the choice between a top-down and bottom-up rate). Although this could potentially lead to a lack of comparability between companies reporting under IFRS 17, this is mitigated by requirements for the discount rate to be consistent with observable market data and for the disclosure of both the discount rate and any material judgements used. IFRS 17 recognises that insurance contracts can be illiquid and that the liability discount rate should be adjusted to reflect this illiquidity. The inclusion of an illiquidity premium in the discount rate is important for UK insurance companies, particularly those writing annuity business. Without reflecting the significant illiquidity of such business, liabilities at initial recognition would be higher than the premiums charged to customers, resulting in losses being incurred. Such an outcome would not reflect the underlying economics of annuities which are priced allowing for an illiquidity premium. Removing the illiquidity premium from a discount rate that otherwise reflects pricing could also potentially lead to insurers raising prices for consumers to mitigate accounting losses. As a result, we support the inclusion of an illiquidity premium where appropriate, an approach which is in line with other IFRS standards, Solvency II and pension accounting reporting.

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.

As part of the European Union endorsement of IFRS 17, an optional 'carve-out' in relation to the annual cohorts requirements has been introduced ('EU-IFRS'). This applies for contracts

that are eligible for the variable fee approach, that are investment contracts with discretionary participating features, or fall within the Solvency II matching adjustment 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.

In the UK a carve-out equivalent to EU-IFRS would likely apply to most with-profits, unit-linked and annuity contracts in the scope of IFRS 17. If such a carve-out were widely taken up then it would represent a significant portion of the UK life insurance market. For UK with-profits contracts, the concepts of asset shares, bonus series, the application of the principles of 'Treating Customers Fairly' and the use of fair value accounting for assets typically results in a more granular management of these contracts compared to equivalent continental European participating contracts. In addition, the requirement for annual cohorts is expected to impact only a limited number of with-profits funds, as most such funds in the UK are closed; these closed funds are likely to apply the fair value approach on transition to IFRS 17 where this is an exemption from the requirement. In this context, we can understand the conclusion reached by the UKEB in paragraphs 3.101 to 3.116 of the DECA that grouping of insurance contracts meets the requirements for endorsement.

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.

The application of IFRS 17 to UK with-profits contracts is particularly complex. In circumstances where non-profit contracts are written in a with-profits fund, the non-profit contracts can form part of the underlying items of the with-profit contracts. The underlying items are measured at fair value (in accordance with IFRS 13 Fair Value Measurement). This contrasts with the non-profit contract liabilities which are measured at fulfilment value (in accordance with IFRS 17). There could be a number of reasons why these values may differ since the IFRS 17 measurement model is not fair value.

As set out in the April and May 2021 UKEB Technical Advisory Group papers (and our responses to the IASB 2019 Exposure Draft), this results in an accounting mismatch, and we note the profit and loss and shareholder equity amounts arising can be significant. This will raise investor communication challenges for UK insurers. The position and the extent of the accounting mismatch can also be more complex where profits on non-profit contracts accrue in the first instance to an inherited estate in the with-profits fund rather than to current with-profits policyholders.

In practice, the profits on the non-profit contracts belong in the first instance to the with-profits fund and are earned through shareholder transfers linked to the bonus declaration. Currently,

under IFRS 4, profits on these contracts are not separately recognised, as the accounting profit is linked to the bonus declaration for the with-profits fund as a whole. Under IFRS 17 the contracts are not eligible for the VFA and will generate a CSM despite only a portion being attributable to shareholders. This will raise further communication challenges as the profits released by this business will be owned by the entity rather than shareholders. A similar issue may arise with other cash flows met by the inherited estate rather than current with-profit policyholders, for example costs that are not directly attributable to the fulfilment of the insurance contracts.

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.

See cover letter for our full comments.

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.

N/a

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)?

See cover letter for our full comments.

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.

N/a

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.

See cover letter for our full comments.

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?

See cover letter for our full comments.

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.

N/a

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.

See cover letter for our full comments.

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)?

Yes:

Reinsurance-to-close (RITC) is unique to the Lloyd's market, based in the UK. It provides liquidity and finality for capital providers (members) for potentially long-term insurance liabilities and, along with the Lloyd's chain of security, helps to ensure the appeal, flexibility, financial strength and underwriting competition of the Lloyd's market, and thus is in the wider public interest. The RITC process achieves this through, in substance, being a full transfer of both rights and liabilities under the subject business whilst legally taking the form of reinsurance.

We understand that the current interpretation of RITC is that it is a reinsurance transaction under IFRS 17 rather than a derecognition as adopted for UK tax and regulatory requirements. From an accounting perspective, our view is that this could increase the complexity of the financial statements for Lloyd's Members (and IFRS reporting groups containing Lloyd's Members), both ceding and receiving business through RITC.

Operationally, adopting reinsurance accounting will require the implementation of additional systems and processes across the Lloyd's market as RITCs, once transacted, are not currently tracked by the ceding business. These new systems and processes would be required prospectively but also in respect of historic RITCs (at transition), particularly where liabilities that were previously treated as finalised would now require further ongoing reporting by the ceding members. The complexities would likely compound over time when a single policy underwritten at Lloyd's undergoes multiple RITCs prior to settlement of the underlying liabilities. The proposed treatment may also risk reducing the attractiveness of the Lloyd's market for certain potential capital providers.

While we recognise the operational and reporting complexities and cost challenges that exist for RITC under IFRS 17, we believe this to be a matter of interpretation and should not prevent the UKEB finalising the endorsement of IFRS 17. We expect the industry to consider and assess alternative interpretations which reflect the substance of the RITC transaction and avoid, as set out above, the potentially significant operational changes to the Lloyd's market.

Overall [Draft] ECA

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

No

[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.

See cover letter for our full comments.

Thank you for completing this Invitation to Comment