# Insurance Technical Advisory Group

## Meeting Summary – 20 October 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*

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

*Observers*

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| Andrew Murray (Bank of England) | |
| Justin Ryan (Project Director) | UK Endorsement Board secretariat |

## 1 Welcome and Introductions

- The Chair welcomed attendees to the meeting.
- The Chair asked TAG members whether they had any further comments on the minutes of the September meeting. One member agreed to send comments to the UK Endorsement Board secretariat (UK EB) shortly after the meeting.
- On the condition that there were no material changes, the minutes of the previous meeting were approved by the TAG.

## 2 The use of locked-in interest rates for the contractual service margin (CSM) under the general measurement model (GMM)

- Key points in the paper were:
  - IFRS 17 requires entities to measure fulfilment cash flows and the CSM at two different sets of discount rates under the GMM:
    - Fulfilment cash flows must be measured based on current rates.
    - The CSM must be measured based on “locked-in” discount rates. Specifically, this means that the locked-in discount rates will be used to:
      - accrete interest on the CSM; and
      - measure changes to the CSM – for example due to changes in operating assumptions (i.e. changes in fulfilment cash flows relating to future service).
  - This use of two different sets of rates will lead to volatility in the insurance finance result as market interest rates change and may hinder users’ understanding of financial performance.
  - By contrast, using a current interest rate to accrete interest on the CSM would mean the insurance service result would reflect changes in discount rates. Consequently, the insurance service result and the insurance finance result would no longer be as clearly separable, and performance would be more difficult to understand.
  - Applying a locked-in rate to the CSM may result in insurance finance income or expenses being misrepresented in periods when there are operating assumption changes. This is because the insurance finance result will include an element that relates to a ‘catch-up’ adjustment - reversing amounts recognised in profit or loss in earlier periods.
  - Accreting interest on the CSM at the locked-in interest rate leads to relevant information that is consistent with the determination of the CSM at initial recognition and its subsequent measurement.
  - The requirements of IFRS 17 to use a locked-in interest rate will create costs for entities because they must track and store locked-in interest rates for each group of insurance contracts. This may be operationally burdensome, in particular for long duration contracts, and is likely to require investment in new systems and processes.

  - On balance, the rationale behind the locked-in requirement had a strong conceptual basis, which outweighed any disadvantages.
- During the ensuing discussion, TAG members noted that:
  - The International Accounting Standards Board's (IASB) decision to lock in discount rates for the CSM was marginal. One TAG member's view was that locking in the discount rate for the CSM but measuring the rest of the insurance liabilities at current discount rates, was a conceptual flaw in the standard which did not aid understandability or relevance.
  - This topic was a particular concern for UK insurers because the UK holds more of its business under the general measurement model than its continental European peers.
  - The financial impact of applying a historic locked-in rate rather than a current rate is yet to be quantified but preliminary examples indicate that it may be material.
  - Measuring the CSM with a locked-in discount rate is consistent with other fundamental principles in the standard, such as not reassessing the composition of groups of contracts after initial recognition. The requirement reflected the standard's overall model which involves a balance sheet at current value and an insurance service result that spreads forward the profit determined at initial recognition of the contract.
  - Using a locked-in rate means performance reflects contract pricing at the time the contract was written. The CSM is not a future cash flow, but the unearned profit at inception, adjusted only for specified amounts, therefore it is consistent to accrete interest on the CSM at the rate determined at initial recognition. Furthermore, the IFRS 17 requirements are consistent with the treatment of deferred revenue under IFRS 15 *Revenue from Contracts with Customers*.
  - The OCI option in IFRS 17 can be used to minimise volatility in profit or loss. However, this option may not be appropriate for some insurers given the financial assets they hold.
  - Monitoring and tracking the locked-in discount rates will be operationally complex and increase costs. It may also reduce understandability by making results more difficult to explain, requiring entities to incur additional costs to explain performance to users.
  - The standard does not require an entity to disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and the insurance finance income or expenses. This optionality seems inconsistent with the treatment required for changes in the CSM.
  - Further work to determine the materiality of the issue in the UK was required. TAG members agreed to assist the secretariat in carrying out this work.
  - Work would be carried out to compare the accounting for long term contracts under other standards against the requirements of IFRS 17.

## 3 [DRAFT] Endorsement Criteria Assessment: Amendments to IFRS 4 – Extension of the Temporary Exemption from Applying IFRS 9

- The TAG considered a Draft Endorsement Criteria Assessment (DECA) in respect of the *Amendments to IFRS 4 Insurance Contracts* extending the temporary exemption from IFRS 9 *Financial Instruments* for eligible insurers (the Amendments).
- The Amendments extend the temporary exemption from applying IFRS 9 for two years, until annual periods commencing on or after 1 January 2023.
- It is possible that the Amendments to IFRS 4 will be endorsed for use in the European Union before the end of the UK's Transition Period. If so, the Amendments will form part of the body of EU-adopted IFRS brought into UK law at the end of the Transition Period. However, in view of uncertainty regarding the EU adoption of the Amendments, the UKEB secretariat has commenced the work needed to ensure the UK stands ready to adopt the Amendments if necessary.
- Key points in the paper were:
    - The Amendments may result in less relevant information for users because they will delay the provision of improved information about financial instruments which may affect decision making. However, this loss of information is mitigated by the additional disclosures required by IFRS 4.
    - Extending the temporary exemption from applying IFRS 9 by two years extends any impaired comparability with non-insurers and ineligible insurers, who have already applied IFRS 9.
    - The Amendments will prevent the adverse effects of implementing two major accounting standard changes in quick succession. They will avoid a negative impact on trend information, thereby enhancing investors' ability to understand and analyse the performance of insurers.
    - If IFRS 9 is applied before IFRS 17 it may result in accounting mismatches, and hence volatility in profit or loss that does not reflect economic substance. This would reduce understandability and can be avoided if both standards are implemented at the same time.
    - Overall, the Amendments are not contrary to the principle that an entity's accounts/consolidated accounts must give a true and fair view. The Amendments will improve the quality of financial reporting and the Amendments are not likely to have an adverse effect on the economy of the UK, including on economic growth.
- During the ensuing discussion, it was noted that:
    - TAG members approved of the structure and format of the DECA for a limited amendment. Questions were raised about the appropriateness of the DECA for a more significant standard such as IFRS 17. The UK EB commented that the IFRS 17 DECA was expected to be more extensive.
    - Stakeholder feedback indicates that insurers are aligning their IFRS 9 and IFRS 17 implementation plans, and it would be beneficial for the two standards to be implemented at the same time.

- The DECA should highlight that no significant change in the classification and measurement of financial assets held by insurers is expected as a result of adoption of IFRS 9.
- If IFRS 9 were to be implemented in January 2021, there could be a greater risk of error due to the short time to implement the standard; in addition this would likely detract from IFRS 17 implementation.
- Maintaining comparability with internationally adopted standards was an important consideration.

## 4 Review of operation of TAG to date

- The Chair discussed some administrative and operational issues regarding the TAG meetings, including the challenges arising from a new group commencing, and continuing, operations in a virtual environment.
- The November meeting has been cancelled to provide time to reconsider the forward agenda, and to incorporate the views of the newly appointed UK Endorsement Board Chair. The group will reconvene in December.
- The Chair stated that the Insurance TAG would continue to focus discussions on the endorsement criteria. Topics that raise primarily implementation and interpretation concerns are outside of the remit of this group, but the UK EB would seek to refer them to the IASB through other channels for resolution where appropriate.

## 5 Forward Agenda

## 6 Items not selected for discussion by the TAG

- Items 5 and 6 were discussed together.
- The Chair asked TAG members to submit comments and questions on the forward agenda to the UK EB secretariat. The Chair reiterated that the agenda was a live document and would be reviewed on an ongoing basis.
- The UK EB secretariat commented that the forward agenda is projected to continue into 2021, ensuring complex endorsement concerns can be discussed fully. TAG members were not aware of any companies intending to early adopt IFRS 17 and did not have any reservations about the timetable.
- The TAG members were invited to an education session on the variable fee approach (VFA) in January before the TAG considers issues related to VFA.
- TAG members suggested that With-Profits matters should be included on the forward agenda. With-Profits contracts are an important product in the UK and the requirements of IFRS 17 in respect of With-Profits contracts may create endorsement concerns that should be discussed. The UK EB secretariat agreed to include this topic on the forward agenda.
- The Chair clarified that it would be permissible to invite non-members of the TAG to present a topic, but subject to agreement from the TAG members.

- Members suggested that further consideration should be given to certain items currently not selected for discussion, including reinsurance followed by Part VII transfers, pension scheme buy-ins/buy-outs, acquisition costs allocated to renewals and interim reporting. Topics could be added to the forward agenda as appropriate.

## 7 AOB

- No AOB were noted.

## End of meeting