To: IFRS 17 leading actuaries and AAE Insurance Committee

Copy to: Secretariats, AAE Board

In May 2017, the International Accounting Standards Board (IASB) issued IFRS 17 Insurance Contracts, which establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features.

When a new standard is issued by the IASB, the EU needs to endorse it before it comes into force. The endorsement process is under the responsibility of the European Commission. The commission has now asked the European Financial Reporting Advisory Group (EFRAG) for advice as to whether IFRS 17 meets the criteria for use in the preparation of financial statements in the EU, including whether the IFRS would be conducive to the European public good. EFRAG's assessment shall hence be based on the following endorsement criteria:

Technical qualitative criteria

- **Relevance (financial information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management);**
- **Reliability (financial information that is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost);**
- **Understandability (financial information is readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence);**
- **Comparability (like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently).**

True and fair principle (the financial information provides a true and fair view of the financial position and performance of an enterprise)

European good analysis

- **Potential effects on competition**

- **Potential impact on the insurance market**
- **Cost-benefit analysis.**

The AAE is preparing to provide feedback to EFRAG as part of its endorsement process. The Insurance Committee has established a working group, led by Jean-Michel Pinton and Alexander Dollhopf, to support this work. We would like now to receive input from member associations on issues which you have identified in your work to date on IFRS17. We therefore seek your advice on the questions contained in this survey. Where you have already supplied us with the name of the IFRS leader in your territory, we are also sending this survey to that person for their attention.

Please submit your response by 23 March 2018.

Thank you for your valuable contribution.

Jean-Michel Pinton

Chairperson AAE IFRS17 Working Group

1. Please submit:

Name of Member Association: Czech Society of Actuaries

Country to which response relates: Czech Republic

Name of person completing response to consultation: Petr Sotona

Email address of person completing response to consultation: petr.sotona@cz.ey.com

2. What characteristics or areas of IFRS 17 do you regard as relevant (in comparison to current accounting)?

- New presentation in the statement of financial position is more relevant;
- Unique measurement approaches across entities and comprehensive disclosures provide higher relevance.
- Better distribution of insurance profit during the lifetime of contracts is more relevant considering the characteristics of insurance contracts and provided insurance services;
- Annual cohorts better reflect changes in products offering and therefore it is more relevant compared with current accounting.
- Separate presentation of insurance and finance revenues / expenses and separate accounting of onerous contracts provides more relevant information.

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3. What characteristics or areas of IFRS 17 do you regard as <u>not relevant</u> (in comparison to current accounting)? *Please suggest how to deal with the particular issue.*

- Loss component for onerous contracts could be replaced by negative CSM.

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4. What characteristics or areas of IFRS 17 do you regard as <u>reliable</u> (in comparison to current accounting)?

- More measurement models for different insurance contracts increase reliability of results.
- Labilities reconciliations requirements increase reliability of results for financial users.

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5. What characteristics or areas of IFRS 17 do you regard as <u>not reliable</u> (in comparison to current accounting)? *Please suggest how to deal with the particular issue.*

- The model for long-term contracts (general model) is totally reliant on the entity expectations about the future development. Unluckily, there are situations when it is not possible to come up with reliable assumptions despite any effort of the company – the reliability of the IFRS 17 results might be even significantly worse in such situation. For example:
  - the company enters new segment of the market or significantly changes the sales-channels (and there is only insufficient history available as consequence);
  - the company operates on unstable or developing market;
  - there is a disruption of the market with unclear impact on future performance of the current policies.

- Necessity to split directly attributable acquisition costs over the contract duration is artificial and not reliable. There should be an option to recognize such costs faster or immediately (like for PAA).

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- Separation of insurance contracts into different insurance components (i.e. main tariff, additional coverage, UL component). Current principles are not clear enough to provide guidance that entities approach similar contracts in the same way. This will reduce reliability of results. In our market we have often so called hybrid products with complex terms and conditions and many various coverage risks. Solvency II forces to unbundle different components but IFRS 17 has very broad principles. Some entities may justify and follow the split like for Solvency II and other entities may keep overall contract as one policy.

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- Identification of directly attributable expenses will be significantly dependent on the internal capabilities and level of internal model which may reduce reliability of results. Smaller entities may not be able to identify accurately directly attributable costs which influences significantly results and its reliability.

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- Reported confidence level of risk adjustment is not reliable. If an entity considers all diversification benefits and various confidence levels for particular subportfolios then the overall confidence level is completely without reliable information (even when this value is appropriately derived).

6. What characteristics or areas of IFRS 17 do you regard as __understandable__ (in comparison to current accounting)?

- Risk adjustment is much better explicitly defined compared to current accounting. Nevertheless there are still many issues in real application (diversification, confidence level, and allowance for combination of financial and non-financial risks not considered).

- Strict split into four blocks (FCFs, RA, TVoM, CSM) and the distribution of Day 0 profit into future years is more understandable especially considering long duration of insurance liabilities in life insurance.

- Comprehensive disclosures with various reconciliations and tables help with the understandability of complex results arising from complex insurance liabilities.

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7. What characteristics or areas of IFRS 17 do you regard as __not understandable__ (in comparison to current accounting)? *Please suggest how to deal with the particular issue.*

- The model for long-term contracts (general model) is too complex to be truly understood by anyone who is not specialist in insurance accounting / actuarial science. It is necessary to educate much broader audience.

- Lack of guidance on key principles such as coverage units, eligibility for VFA and separation of non-distinct investment component reduces the understandability of new standard.

- Valuation of hybrid products (contracts containing UL funds, main coverage potentially with discretionary participation features and additional riders) and how to treat various proportion of these components and how to deal with possible changes in future that are not now monitored to derive proper assumptions to estimate these changes. Separation of the interrelated components in hybrid products (for each component different model should be used) is not possible. Another issue of these products is how to combine measurement when it contains UL funds to be measured through P&L and direct participation features where assets are to be measured through OCI.

Odstraněno: <#>Disclosed confidence level must be fixed over the time or is it possible to have volatile confidence level, e.g. by decision by the company or by the approach used (CoC approach will lead to different confidence level in each subsequent measurement period)¶

8. What characteristics or areas of IFRS 17 do you regard as __comparable__ (in comparison to current accounting)?

- Risk adjustment will be better comparable than in current accounting nevertheless there are still many practical issues that overall it will not be very much comparable.

- New business (as presented in liabilities reconciliations) will better present changes in new business structure and its profitability so it will be easier to compare it between companies applying IFRS 17.

- Comprehensive disclosures will increase comparability.

9. What characteristics or areas of IFRS 17 do you regard as not comparable (in comparison to current accounting)? *Please suggest how to deal with the particular issue.*

- In our experience, there is basically no comparability between local GAAP (e.g. Czech accounting standard) and IFRS 17 financial reports for the products which dominate CZ life insurance market nowadays. This would result into incomparability of the financial reports among competitors on CZ market (there are local entities that account for under local GAAP and entities that adopted IFRS).

- Accounting of reinsurance contracts is very specific for each reinsurance contract and therefore the accounting will significantly depend on understandability of all features of such contract and proper allowance for all IFRS 17 principles. Lack of guidance such as for allowance of "new business" in reinsurance contract accounting reduces comparability across market.

- Discounting and the curve used which should be based on the characteristic of the insurance liability may lead to lack of comparability if no standard discount curve methodology is used. Nevertheless, current accounting provides even lower comparability of discounting effect.

10. What thoughts or concerns do you have on potential effects on competition? *Please suggest how to deal with the particular issue.*

- There will be significant market disadvantage for the insurers reporting accordingly to IFRS17 (in comparison with the companies which will keep national accounting standards). Aside from the high costs for IFRS17 implementation, the competitors will have deep insight into the business model and future performance of the IFRS17 adopters (as consequence extensive and detailed disclosure prescribed by IFRS17). This will significantly tilt the playing field in favor of the companies which report only by the local GAAP standards.

- Regulation of the insurance sector might lead to higher prices.

- In non-life insurance companies applying IFRS 17 may stop selling some products which would force them to apply general model (instead of PAA) while another companies which do not apply IFRS 17 (and apply only local GAAP) may continue selling such products or even start selling such line of business.

11. What thoughts or concerns do you have on potential impact on the insurance market? *Please suggest how to deal with the particular issue.*

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- There won’t be consistent basis for aggregate market statistics and the comparison of the companies’ performance in case that there are both IFRS 17 and local GAAP users operating on the same market.

- Increased transparency or valuation complexity might lead to product or T&C changes such as the end of hybrid products, move to renewable contracts with annual contract boundary and less inherent options.

12. What thoughts or concerns do you have on the relationship between costs and benefits? *Please suggest how to deal with the particular issue.*

- It is important to implement IFRS17 in connection with management needs to be able to quickly respond to the results to get better market position, i.e. to get from the (high) implementation costs not only the fulfilment of the requirements, but the most for the agile business steering under new standard.

- Some reinsurance treaties may be changed or not accepted under IFRS 17 as the costs with the accounting of more complex reinsurance may be too high considering the exposed risk which is covered by such reinsurance treaty.

- Small insurance companies may have significant problems with IFRS 17 implementation due to very high implementation costs and also due to limitations of small insurance portfolio when calculating risk adjustment on certain confidence level.

13. In addition, the European Commission has specifically asked EFRAG to consider the following questions:

1. **What will be the benefits brought by this harmonisation compared to the existing situation?**
2. **Will IFRS 17 deliver consistent and understandable reporting of financial performance for insurance contracts within a group?**
3. **How does IFRS 17 take into account the specificities of the insurance sector?**
4. **Do the different accounting methods reflect properly the different business models and is the delineation between these different accounting methods such as the scope of the variable fee approach clear?**
5. **Is the level of aggregation striking the right balance between the usefulness of the information and the complexity and costs of its implementation?**
6. **How does the pattern of release of the Contractual Service Margin ("CSM") for insurance contracts with direct participating features reflect the business model?**

Do you have comments on any of the specific questions that the European Commission has asked EFRAG?

- Ad question 4 – For our hybrid products it is not clear enough to find a border between contracts to be accounted under general model and under VFA. From existing

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- Ad question 6 - The CSM release is based solely on the provision of the insurance service according to IFRS 17, ignoring the investment component and the corresponding services provided. This, of course, is not in line with the business model for any contract with significant investment component (i.e. the problem is not restricted to contracts with direct participating features).

14. Is there anything you wish to add?

- Disclosed confidence level must be fixed over the time (based on strategy of the company) or is it possible to have volatile confidence level? This may be a case when the company decides to use some approach such as CoC approach which will lead to different confidence level in each subsequent measurement period. This may be especially problem for composite insurance companies where risk adjustment on non-life portfolio may be derived based on quantile approach and on life portfolio using CoC approach. In practice it won't be possible to derive risk adjustment at certain confidence level and keep it consistent in time.

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