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# European Actuarial Note 4 (EAN 4)

# Application of IFRS 17 Insurance Contracts applying the 2021 EU endorsement

**Approved as educational material**

**by the General Assembly of the Actuarial**

**Association of Europe on 3 January 2023**

# Table of Contents

# 1. INTRODUCTION

## 1.1. Due process of this EAN

This European Actuarial Note (EAN) is an educational document for actuaries reporting under the IFRS 17 reporting standard as endorsed by the EU according to Commission Regulation (EU) no 2021/2036 of 19 November 2021 amending Regulation (EC) no 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) no 1606/2002 of the European Parliament and of the Council (hereinafter referred to as the Regulation). It has been adopted by the Actuarial Association of Europe (AAE) in order to advance the understanding of the subject by readers of the EAN, including actuaries and others, who use or rely upon the work of actuaries in relation to reporting under IFRS 17 as endorsed by the EU. It is not a European Standard of Actuarial Practice (ESAP) and is not intended to convey in any manner that it is authoritative.

Because an EAN is not intended to be authoritative, its language will be chosen carefully. It will not contain words such as “should”. Rather, its style will be descriptive or will convey meaning by the use of examples of actuarial practice, without suggesting that any of these examples are expected to be used or that they are comprehensive.

This EAN builds on the International Actuarial Note 100 Application of IFRS 17 Insurance Contracts (IAN 100) as issued by the International Actuarial Association (IAA) in August 2021. It supplements the IAN 100 only in those respects where the Regulation allows an exemption to IFRS 17 paragraph 22.

## 1.2. Executive Summary

IFRS 17 as approved by the EU according to Regulation (EC) no 1606/2002 of the European Parliament and of the Council contains a relaxation to the requirement that an entity shall not include contracts issued more than one year apart in the same group (IFRS 17 paragraph 22).

The Regulation gives rise to additional considerations for actuaries when reporting under IFRS 17 as endorsed by the EU, and this EAN supplements the IAN 100 by offering considerations in relation to this matter.

The EAN consists of three sections:

- General
- Level of aggregation
- Transition

The first section outlines the structure of the EAN and the relation to IAN 100 as issued by the IAA in August 2021. Further, the section repeats the Regulation and the related paragraphs of IFRS 17.

The second section relates to considerations when defining groups of insurance contract and the level of aggregation to be applied.

The third section relates to the transition rules in IFRS 17 and how the Regulation may give rise to additional considerations.

# 2. GENERAL

## 2.1. Structure

This EAN 4 builds on the International Actuarial Note 100 Application of IFRS 17 Insurance Contracts (IAN 100) as issued in August 2021 and supplements the IAN 100 only in those respects where the Regulation allows an exemption to IFRS 17 paragraph 22.

Each Article in the IAN 100 is phrased as a question, and an answer is provided to the reader. For each Article where the answer given in this EAN differs from or adds to that set out in the IAN 100, this document repeats the wording of IAN 100 followed by EAN 4 supplementary answer. If an Article from IAN 100 is not mentioned, it means that no further comments to IAN 100 are added in EAN 4.

## 2.2. Relevant Articles from the Regulation

*Article 2*

> *1. Each company shall apply the amendment referred to in Article 1 at the latest as from the commencement date of its first financial year starting on or after 1 January 2023.*
> *2. By way of derogation from paragraph 1, a company may choose not to apply the requirement laid down in paragraph 22 of the Annex to this Regulation to:*
> *(a) groups of insurance contracts with direct participation features and groups of investment contracts with discretionary participation features as defined in Appendix A to the Annex to this Regulation, and with cash flows that affect or are affected by cash flows to policyholders of other contracts as laid down in paragraphs B67 and B68 of Appendix B of that Annex;*
> *(b) groups of insurance contracts that are managed across generations of contracts and that meet the conditions laid down in Article 77b of Directive 2009/138/EC and have been approved by supervisory authorities for the application of the matching adjustment.*
> *When a company does not apply the requirement laid down in paragraph 22 of the Annex to this Regulation in accordance with paragraph 2 (a) or 2 (b) it shall disclose this, in accordance with International Accounting Standard 1 Presentation of Financial Statements, in the notes as a significant accounting policy and provide other explanatory information such as for which portfolios the company has applied this exemption.*

*Article 3*

> *The Commission shall review the optional exemption laid down in Article 2(2) by 31 December 2027 and, where appropriate, propose to amend or end that exemption.*

## 2.3. Paragraphs in IFRS 17 referred to in this document

*IFRS 17, paragraph 22*

> *An entity shall not include contracts issued more than one year apart in the same group. To achieve this the entity shall, if necessary, further divide the groups described in paragraphs 16–21.*

*IFRS 17, paragraph 114*

> *An entity shall provide disclosures that enable users of financial statements to identify the effect of groups of insurance contracts measured at the transition date applying the modified retrospective approach (see paragraphs C6–C19A) or the fair value approach (see paragraphs C20–C24B) on the*

*contractual service margin and insurance revenue in subsequent periods. Hence an entity shall disclose the reconciliation of the contractual service margin applying paragraph 101(c), and the amount of insurance revenue applying paragraph 103(a), separately for:*

*(a) insurance contracts that existed at the transition date to which the entity has applied the modified retrospective approach;*

*(b) insurance contracts that existed at the transition date to which the entity has applied the fair value approach; and*

*(c) all other insurance contracts.*

*IFRS 17, paragraph 115*

*For all periods in which disclosures are made applying paragraphs 114(a) or 114(b), to enable users of financial statements to understand the nature and significance of the methods used and judgements applied in determining the transition amounts, an entity shall explain how it determined the measurement of insurance contracts at the transition date.*

*IFRS 17, paragraph 116*

*An entity that chooses to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income applies paragraphs C18(b), C19(b), C24(b) and C24(c) to determine the cumulative difference between the insurance finance income or expenses that would have been recognised in profit or loss and the total insurance finance income or expenses at the transition date for the groups of insurance contracts to which the disaggregation applies. For all periods in which amounts determined applying these paragraphs exist, the entity shall disclose a reconciliation from the opening to the closing balance of the cumulative amounts included in other comprehensive income for financial assets measured at fair value through other comprehensive income related to the groups of insurance contracts. The reconciliation shall include, for example, gains or losses recognised in other comprehensive income in the period and gains or losses previously recognised in other comprehensive income in previous periods reclassified in the period to profit or loss.*

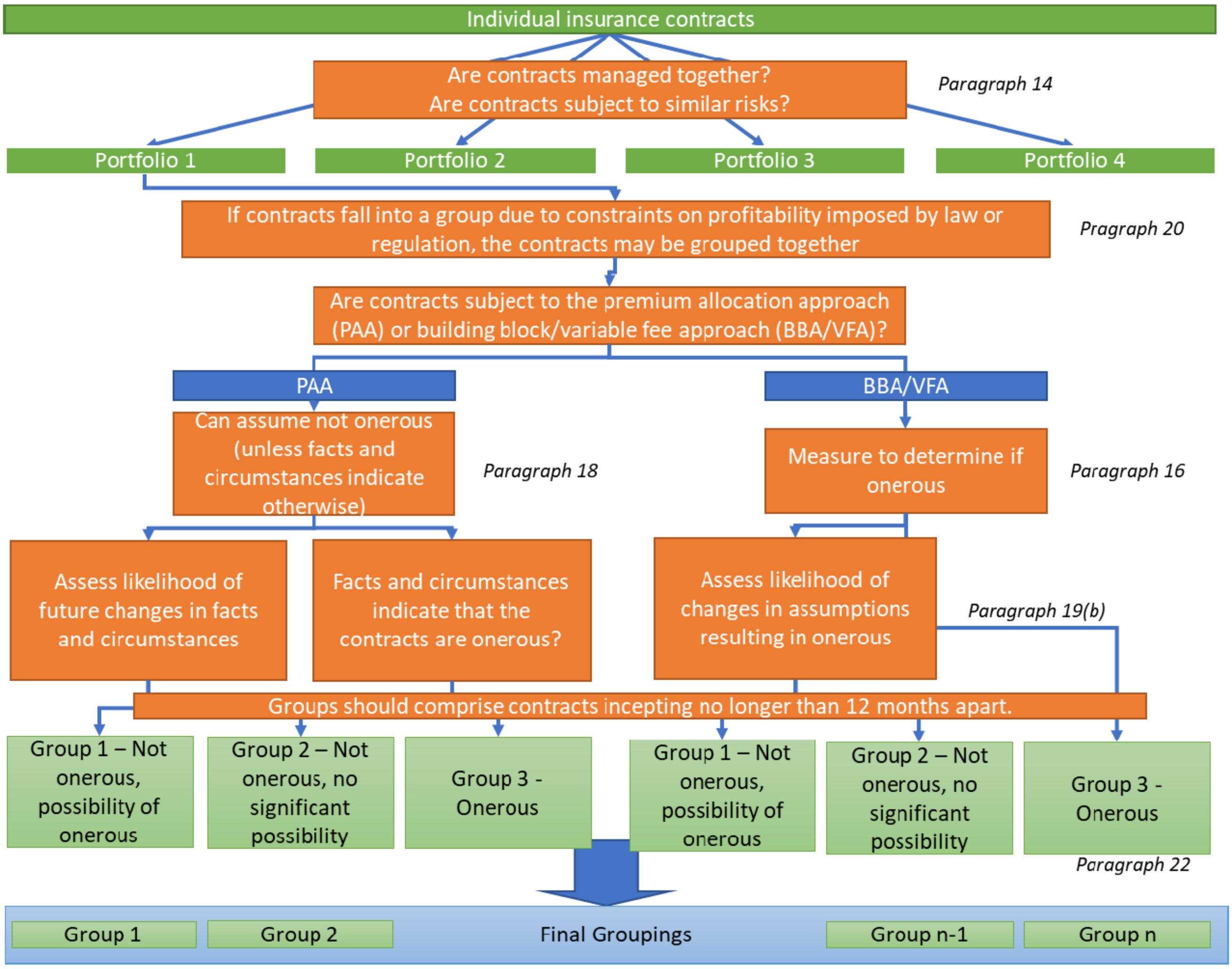
# 3. LEVEL OF AGGREGATION

## 3.1. What are levels of aggregation?

### 3.1.1. IAN 100 Chapter 5.2

*IAN 100 5.2 states: In determining the level of aggregation, an entity identifies portfolios. Each portfolio is divided into groups, which distinguish onerousness and profitability, and the entity aggregates individual contracts into these groupings. An entity cannot include contracts issued more than one year apart in the same group (paragraph 22).*
*The level of aggregation discussed in this chapter refers to aggregation for the purpose of measurement. Disclosures may require a different level of aggregation, and this is covered in Section E – Presentation, and Disclosure.*
*The group as defined by IFRS 17 is the minimum level of aggregation required. Lower levels of aggregation are permissible so long as the requirements of IFRS 17 are met.*
*A summary of the levels of aggregation follows in Figure 5.1.*

***Figure 5.1: Level of Aggregation***




### 3.1.2. EAN 4:

If the exemption option allowed by the Regulation in Article 2 paragraph 2. (hereinafter referred to as the exemption option) has been chosen by an entity then the actuary may want to interpret the answers to questions of IAN 100 where “one year apart” or “12 months apart” or “annual cohorts” are mentioned, by considering the objective of the Regulation. This relates to IAN 100 Chapters 1.17, 5.2, 5.12, 5.13, 5.14, 5.16, 5.22, 5.30, 5.31, 6.6, 6.35, 12.34, 12.35, 12.38 and 12.41.

*Optionality*

When applying Article 2 of the Regulation, the entity may consider the operational set-up in light of the fact that the Commission shall review the exemption option laid down in Article 2 paragraph 2. by 31 December 2027 and, where appropriate, propose to amend or end that exemption option, cf. Article 3.

Thus, the entity may still find it relevant to consider how to report without the exemption option after this date.

*Eligibility*

The eligibility of the exemption option is limited to contracts quoted in Article 2 paragraph 2. of the Regulation:

*(a)* *groups of insurance contracts with direct participation features and groups of investment contracts with discretionary participation features as defined in Appendix A to the Annex to this Regulation, and with cash flows that affect or are affected by cash flows to policyholders of other contracts as laid down in paragraphs B67 and B68 of Appendix B of that Annex;*

*(b)* *groups of insurance contracts that are managed across generations of contracts and that meet the conditions laid down in Article 77b of Directive 2009/138/EC and have been approved by supervisory authorities for the application of the matching adjustment.*

The Annex referred to in Article 2 of the Regulation is the IFRS 17 standard, and Article 77b of the Directive 2009/138/EC refers to contracts for which the entity applies the matching adjustment under Solvency II.

## 3.2. What is a group of insurance contracts?

### 3.2.1. IAN 100 Chapter 5.12.

*A group of insurance contracts is a further partition of a portfolio according to when the contract is written and the expected profitability (paragraph 16 and Appendix A). Hence, a group includes contracts that are issued no more than 12 months apart and have the property that contracts expected to be loss making are not in in the same group as contracts expected to be profitable. A group is a sub-set of a portfolio. Each group is sometimes referred to as a “unit of account”, although this term is not used in IFRS 17.*

### 3.2.2. EAN 4:

Portfolios of insurance contracts are defined in Appendix A of IFRS 17 as insurance contracts subject to similar risks and managed together. The portfolios shall be divided further on the basis of the profitability according to paragraphs 16-21 of IFRS 17.

According to paragraph 21 the entity can subdivide groups further for example into sets of contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts.

If these sets of insurance contracts fulfil the requirement laid out in Article 2 paragraph 2. of the Regulation and the exemption option has been chosen by the entity, they are groups of insurance contracts. The group can contain insurance contracts issued more than 12 months apart. If the exemption option is applied then, according to Article 2 paragraph 2. of the Regulation, the entity shall disclose this in the notes as a significant accounting policy and provide other explanatory information such as for which portfolios the company has applied this exemption.

## 3.3. How might groups be different for contracts with mutualisation features?

3.3.1. IAN 100 Chapter 5.16.

*When considering how to apply the grouping for contracts with mutualisation features, consideration might be given to how mutualisation and participation features might affect the allocation to groups. This is the case in respect of both considering whether contracts are subject to similar risks (portfolio allocation) and the split in respect of profitability.*

*IFRS 17 specifically addresses mutualisation in paragraphs B68-B71 and B103. The overarching principle of mutualisation is that the cash flow allocation to groups is based on all rights and obligations of the portfolio that may participate in a common pool of underlying items.*

*The fulfilment cash flows for a group:*
*(a) include payments arising from the terms of existing contracts to policyholders of contracts in other groups, regardless of whether those payments are expected to be made to current or future policyholders; and*
*(b) exclude payments to policyholders in the group that, applying (a), have been included in the fulfilment cash flows of another group.*

*Similarly, for this calculation, cash flows to policyholders implicitly transferred to other groups are excluded. Note this assumes that profit from the donor group has not already been released. For further detail on measurement of contracts with direct participation features, refer to Chapter 8 – Contracts with Participation Features and Other Variable Cashflows.*
*Because of the allowance for cash flows to policyholders to be transferred between groups, what would otherwise be an onerous group will potentially be profitable. Similarly, if a group is potentially about to become onerous, then a transfer from a profitable group is expected to prevent that.*

*One might argue that there is no point in sub-dividing groups by year of issue, because cash flows from a more profitable cohort could be transferred to a less profitable cohort. The ability to transfer between cohorts means that the profitability for business written in separate periods may be less differentiated. There may be particular operational challenges when determining the groups in respect of businesses where new policies share in profits generated by the existing book and vice versa.*

*However, the IASB has stipulated that groups be differentiated by not containing contracts issued more than one year apart. This is because the IASB expects that profitability would vary over time, and, at the extreme, one cohort might be onerous while another is profitable. The IASB did not want this information obscured by offsetting onerous contracts in one group with profitable contracts in another (see paragraph BC119 and the last two sentences of paragraph BC136).*

*Thus, the IASB still felt that subdivision by year of issue was appropriate even where there were transfers of cash flows between groups (see paragraph BC138). Notwithstanding this, the requirement in paragraph 22 is that an entity should not include contracts issued more than one year apart.*

*Paragraph BC138 notes that the amounts to be reported for each group are specified, but it is not necessary to calculate amounts at a group level. Thus, calculations could be undertaken at a higher (or lower) level, and the results then allocated to each group. This is important in the context of mutualisation, as IFRS 17 assumes that the amount of any transfers will be specifically known, whereas the actual quantification is likely to vary over time as facts and circumstances change. The September 2018 TRG paper AP10 contains some information on this topic.*

#### 3.3.2. EAN 4:

One might argue that there is no point in sub-dividing groups by year of issue, because cash flows from a more profitable cohort could be transferred to a less profitable cohort. The ability to transfer between cohorts means that the profitability for business written in separate periods may be less differentiated compared to the situation where no mutualization exists.

In such situations, the exemption option in Article 2 paragraph 2. of the Regulation may be applied by the entity to simplify measurement in situations where the aggregation provides relevant information that faithfully represents those groups of insurance contracts (IFRS 17, paragraph 1).

### 3.4. How might the pool of underlying items affect portfolios?

#### 3.4.1. IAN 100: 5.17.

*As explained in question 5.5, portfolios are defined as contracts subject to similar risks and managed together. The entity will determine how risks and the management thereof are affected by the pool of underlying items.*
*For example, it might be determined that contracts are subject to different risks and hence be in different portfolios, notwithstanding that they participate in the same pool of underlying items. Conversely, it may be that a single portfolio covers contracts that participate in multiple pools of underlying items.*

#### 3.4.2. EAN 4:

Under IFRS 17 paragraphs 14 and 16, a set of insurance contracts is defined as a subset of a portfolio of insurance contracts, i.e. a subset of insurance contracts subject to similar risks and managed together. Consequently, if a group of insurance contracts with direct participation features or groups of investment contracts with discretionary participation features fulfils the requirement laid out in Article 2 paragraph 2. (a) of the Regulation, with cash flows that affect or are affected by cash flows to policyholders of other contracts as laid down in paragraphs B67 and B68 of IFRS 17, all contracts of the group need to be in the same portfolio of insurance contracts.

In considering whether to apply the exemption option it may be considered to what extent insurance contracts that participate in multiple pools of underlying items can be grouped together in a single group, and under such circumstances, if all insurance contracts of the group fulfil the requirements of Article 2 paragraph 2. (a) of the Regulation, i.e. the actuary may consider whether the financial information becomes more relevant if grouping is based on a common underlying item as well as whether the grouping is regulatorily permitted or even required as a result of mutualisation."

### 3.5. How are contracts added to an existing group?

#### 3.5.1. IAN 100 Chapter 5.18.

*The establishment of a group can be a process that spans a period of up to one year. The original classification of the group determines the allocation of new contracts during that period. If the expected profitability of an open group changes during that period, it might be appropriate to close the open group and open a new one.*

#### 3.5.2. EAN 4:

How are contracts added to an existing group to which the exemption option laid down in Article 2 paragraph 2. of the Regulation has been applied?

The establishment of a group can then be a process that spans several reporting periods without predefined end.

The profitability classification at initial recognition determines the allocation of new contracts during each reporting period. If the expected profitability of new contracts changed during a subsequent reporting period, it seems to be the vision of at least the IASB that a “test for similar profitability” would be required (BC 137). When the profitability category of new contracts is different from previous contracts, they can then not be put together. Professional judgment is needed to either start a new group of contracts, or to add the new contracts to an older group that may already exist.

The interim or financial year end does not imply closing of the group as groups under Article 2 paragraph 2. of the Regulation can contain insurance contracts issued several years apart. (This is covered by Chapter 5.22.)

3.5.3. EAN 4:

For a group that is open for more than one year, the entity may want to apply the accounting policy choice described in IFRS 17, paragraph B137, *mutatis mutandis*, for any subsequent financial statements. If the entity applies the so called “year to date” option then it may need to revise previous financial statements in so far as they have an impact on the information in the current financial statement (including the comparative information).

# 4. TRANSITION

## 4.1. Are separate disclosures required for groups using different transition approaches?

### 4.1.1. IAN 100 Chapter 12.19.

*Yes. Paragraphs 114-116 describe the required disclosures.*

4.1.2. EAN 4:

When either the modified retrospective approach or the fair value approach is applied to a group of contracts and when an entity chooses the exemption option, the entity may need to consider how the disclosure requirements of IFRS 17 paragraph 114 can be fulfilled. In particular, the reconciliation of the Contractual Service Margin (CSM)(paragraph 101(c)) and the amount of insurance revenue (paragraph 103(a)) shall be disclosed for insurance contracts that existed at the transition date and disclosed separately when the modified retrospective approach or the fair value approach is applied for these contracts.

## 4.2. For measurement at a date subsequent to the transition date, can new contracts be added to the groups established at the transition date?

### 4.2.1. IAN 100 Chapter 12.20.

*For groups measured at transition using the full retrospective approach, new contracts can be added to the groups established at transition if consistent with paragraphs 14- 24D (e.g., if the group established at transition only covers 6 months of issues the group could continue until the full year maximum is reached).*

*For groups measured at transition using the modified retrospective approach or the fair value approach, the disclosure requirements of paragraphs 114-116 may prohibit new contracts being added to such groups.*

4.2.2. EAN 4:

For groups measured at transition using the modified retrospective approach or the fair value approach, the disclosure requirements of paragraphs 114-116 still need to be fulfilled. If the entity chooses to add new contracts to such a group, this group may include contracts issued several years before transition, and it may stay open for new contracts several years after transition.

If the entity has applied the full retrospective approach for the group at transition, the entity faces no additional disclosure requirements. However, if the entity has applied the modified retrospective approach or the fair value approach at transition, and if the entity chooses to add new contracts to the group, the entity will have to consider how the disclosure requirements laid out in paragraphs 114 – 116 can be met. For example, the requirements in paragraph 114 mean that the entity will have to disclose the reconciliation of the CSM and the insurance revenue separately for

a) Insurance contracts that existed at the transition date to which the entity has applied the modified retrospective approach;

b) Insurance contracts that existed at the transition date to which the entity has applied the fair value approach; and

c) All other insurance contracts.

The requirements in paragraph 114 do not mean that a separate CSM and insurance revenue would be recognized for the categories described in a) to c) above. One reason to use the exemption may be to combine contracts from before and after transition and to have one overall CSM measurement for all contracts. However, the entity may design the evolution of the CSM and insurance revenue in a rational and systematic manner so that they can be decomposed for disclosure purposes. For example, for the CSM this could be done by looking at the coverage units of contracts underwritten before and after the transition date. The entity may also consider whether such information provides relevant information as required by IFRS 17, paragraph 1. A more informative alternative may be to close the existing group at transition and open a new one for similar contracts issued after the transition date.