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FINANCIAL REPORTING

Need to raise standards

Insurers still have concerns about their two key International Financial Reporting Standards

As both preparers and users of financial reports, Europe's insurers understand the value and importance of meaningful, consistent and reliable financial reporting. And since the International Financial Reporting Standards (IFRS) drawn up by the International Accounting Standards Board (IASB) are used in the consolidated reporting of all the EU's listed (re)insurers and a large proportion of the unlisted ones, getting the IFRS right is crucial.

Two standards particularly affect insurers: IFRS 17, which applies to insurance liabilities; and IFRS 9, which applies to the assets that insurers hold to back those liabilities. The IASB — and hence Insurance Europe — have been active on both in the past year, as well as two other projects. These are the IASB's late-2019 proposed improvements to the way information is communicated in financial statements, through a consultation on general presentation and disclosure, and an early 2020 discussion paper on possible improvements to the information companies report on goodwill and impairment.

IFRS 17: last stages of a long journey

After a 20-year international debate around insurance contract measurement, IFRS 17 was published in May 2017, then re-opened following concerns raised by Insurance Europe and others, with the final version only published in June 2020.

While the industry broadly supports the goals of the IASB, the standard published in 2017 had not been good enough to achieve suitably high-quality global financial reporting and to avoid excessive implementation costs. The industry therefore welcomed the IASB decision to re-open the standard and provided significant input into the consultations and discussions that followed about potential improvements.

Six key concerns were highlighted in feedback to the IASB by the European Financial Reporting Advisory Group (EFRAG) — a private association, of which Insurance Europe is a member, which was established with encouragement from the European Commission to serve the public interest on financial reporting by providing independent advice to the EC and technical input to the IASB. The insurance industry also raised the points identified by EFRAG, as well as a number of others, as important issues that the IASB needed to address. Insurance Europe proposed solutions to all the issues the industry raised. Insurers also called for implementation of the standard to be postponed to January 2023 to allow time for the IASB to make the necessary improvements to it and to allow enough time for affected insurers to implement it.

Annual cohort concern

One of the issues that was of widespread concern was the requirement to split product portfolios into annual

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cohorts. This is because it significantly increases the cost and complexity of IFRS 17. In addition, it does not adequately reflect the true economic nature of insurance contracts, with their risk-sharing between customers and between different generations of customers over time (together often referred to as "mutualisation").

The industry appreciates that in the updated and final standard issued in June 2020 the IASB has made a number of important improvements and that it has postponed the standard's effective date to 2023. However, Insurance Europe was disappointed that the IASB left a number of important issues unaddressed. The lack of any changes to the annual cohort requirement is an area of particular frustration.

In Europe, the standard still requires endorsement. The first stage of this, expected by the start of 2021, is EFRAG's advice to the Commission on whether it should be endorsed. Following this, the Commission will form its view and then the European Parliament and Council will take the final decision. The issue of annual cohorts will be one of the main areas of discussion.

IFRS 9: a key issue remains

Insurance Europe welcomed the decision by the IASB to align the application date for IFRS 9 with the IFRS 17 application date of 1 January 2023. This alignment ensures more meaningful accounting information, avoids insurers having to explain two separate changes to users and reduces costs.

There remains, however, one area of ongoing discussion in Europe. This is known as the "recycling" issue. IFRS 9 provides a welcome mechanism to avoid temporary share-price volatility from distorting the profit and loss account. This is achieved through the use of a feature called FVOCI (fair value through other comprehensive income) and works by keeping that short-term volatility fully transparent, but held within the OCI part of the accounts.

Recycling is good

Using the FVOCI option is a very important mechanism but, currently, IFRS 9 will not allow insurers to recognise any of the actual realised gains from FVOCI equity investments in their profits.

Allowing realised capital gains to flow from OCI into profits and loss is allowed for bond investments and is called "recycling". Without it — given that capital gains typically represent 60% of overall equity returns — IFRS profits will not reflect the true financial performance or correctly represent insurers' long-term business model. As a result, an unnecessary disincentive for insurers to invest in equities is created.

Insurers have been calling for the reintroduction of recycling for FVOCI instruments under IFRS 9 for many years. Insurance Europe therefore welcomed the Commission's letter to the IASB in March 2020 calling for an expeditious review of the non-recycling requirement for equities measured at FVOCI.

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A non-financial reporting role for EFRAG

In January 2020, as part of the EC Action Plan on Financing Sustainable Growth, Executive Vice-President Valdis Dombrovskis announced proposals for two mandates that would significantly expand the role of EFRAG in developing non-financial reporting standards.

The Commission has since mandated EFRAG to start the technical preparatory work on EU non-financial reporting standards. Insurance Europe supports this mandate, since EFRAG's European Corporate Reporting Lab — which was started in 2018 with a remit to stimulate innovation in corporate reporting by identifying and sharing good practices — had already begun work in this area and there are clear benefits from having a link to financial reporting work.

By early 2021, the EC is expected to propose to mandate EFRAG to become Europe's standard-setter for non-financial reporting standards. Its proposals will need to also cover how EFRAG's governance and funding might need to change to accommodate such a role.

While global standards would be the ideal and ultimate goal, Insurance Europe would support this mandate, given the urgency arising from the need to tackle climate change, the need to comply with the EU's Taxonomy Regulation and its Sustainable Finance Disclosures Regulation, and the time it would take to reach international agreement on any global body and standards.

In developing environmental, social and governance (ESG) reporting standards for Europe, it will nevertheless be important to take into account international developments and in the longer term seek international alignment.