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**Chairman**

**PDC N°**

Paris, May 15th, 2020

**Mr Jean-Paul GAUZES**

Chairman EFRAG Board
35 Square de Meeùs

B-1000 BRUXELLES

Dear Jean-Paul,

We refer to EFRAG's letter to the IASB dated March 24th. In this letter EFRAG mentioned that it would take the initiative, in order to support IASB's process, to gather proposals from constituents suggesting a possible technical solution to the annual cohort's requirement issue in the upcoming amended IFRS 17 that meets the requirements of stakeholders and the requirements of a high-quality standard.

In line with our previous letters[1], that already provided developments on the conceptual analysis, on illustrative examples, on comments of IASB amendments as well as on Board's decisions, we have prepared the accompanying suggestions for defining and scoping a principles based exception to the annual cohorts' requirement for contracts with intergenerational sharing of risks between policyholders.

Please do not hesitate to contact us to further discuss this suggestion,

Yours sincerely,

Patrick de Cambourg

Patrick de CAMBOURG

[1] ANC Comment letter on IFRS 17 amendments (2019-09-27) §21-72 ; ANC Comment Letter on IASB March 2019 meeting (2019-05-06); ANC IFRS17 Issues- Level of aggregation (2019-05-06)

**Suggestions for an exception to the annual cohorts' requirement for contracts with intergenerational sharing of risks between policyholders**

1 This note suggests a practical solution to define the scope of an exception to the annual cohorts' requirement that would address contracts with intergenerational sharing of risks between policyholders and discretionary participation features as recently addressed by IASB[2]. ANC believes that the scope of the proposed exception adequately captures the characteristics of contracts for which applying the annual cohort requirement would not provide relevant information to users of the financial statements.

## 1 Principles-based scope of a suggested exception to the annual cohort requirement

### *1.1 Criteria for defining the scope exception*

2 Supporting the objectives assigned to annual cohorts, ANC has previously highlighted that this requirement does not provide relevant information for contracts with discretionary cash flows where management exercises discretion as to the timing and the allocation of the policyholders' profit share to individual policyholders[3]. This is because the discretionary cash flows are fully fungible across generations of policyholders so that profitability is not determinable on a cohort by cohort basis.

3 Following the IASB re-deliberations on the 2019 Exposure Draft "Amendments to IFRS 17", ANC welcomes the acknowledgements and clarifications provided in the February 2020 IASB meeting about the annual cohort requirement. However, ANC disagrees that granting an exception would necessarily rely on arbitrary criteria and unduly increase the complexity of the standard.

4 ANC suggests introducing a principles-based exception to annual cohorts for intergenerational mutualised insurance contracts. Since it relies to a large extent on existing provisions of IFRS 17, it does not require bright lines. By and large our approach refers to a substantial "risk sharing" in order to connect with IFRS 17.BC138 acknowledging that situations exist where annual cohorts are not necessary.

5 An exception to IFRS 17.22 should be granted to a group of contracts that meet all of the following criteria:

- **Criterion 1)** The group of contract only includes contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts as outlined in IFRS 17.B67-B71 and;
- **Criterion 2)** contracts within the group jointly participate in a share of returns on a clearly identified common pool of underlying items. Contracts jointly participate when the entity exercises discretion as to the timing and the allocation of the total policyholders' profit-share to individual policyholders;
- **Criterion 3)** contracts in the group meet the definition of IFRS 17.B101 (the Variable Free Approach).

6 In addition we also recommend to separately provide for the proposed exception (i) the disclosure requirements in IFRS 17.98-105 and (ii) additional disclosure requirements.

[2] IASB 2020-02-AP 2B

[3] ANC Comment letter on IFRS 17 amendments (2019-09-27) §21-72 ; ANC Comment Letter on IASB March 2019 meeting (2019-05-06); ANC IFRS17 Issues- Level of aggregation (2019-05-06)

### *1.2 Exception to IFRS 17.22*

7 IFRS 17.22: 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. This provision does not apply to contracts in a group issued more than one year apart that (cumulatively):

- are referred to in IFRS 17.B67;
- jointly participate in a share of returns on a clearly identified common pool of underlying items. Contracts jointly participate when the entity exercises discretion as to the timing and the allocation of the total policyholders' profit-share to individual policyholders;
- are eligible to the VFA (IFRS 17.B101).

8 This could alternatively be shortly worded as:

9 IFRS 17.22: 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. This provision does not apply to contracts in a group issued more than one year apart that meet the criteria set in IFRS 17.B67 and IFRS 17.B101 and jointly participate in a share of returns on a clearly identified common pool of underlying items. Contracts jointly participate when the entity exercises discretion as to the timing and the allocation of the total policyholders' profit-share to individual policyholders.

## 2 Basis for conclusions commenting on criteria

### *2.1 1st Criterion: Contracts with cash-flows that affect or are affected by cash flows to policyholders of other contracts*

10 The first criterion preliminary requires that the group of insurance contracts only includes contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts as outlined in IFRS 17.B67-B71. Relying on existing provisions of IFRS 17, this criterion adequately addresses contracts with interdependencies across groups i.e. where policyholders share risks of changes in FCF.

### *2.2 2nd criterion: Joint participation in a share in the returns of a common pool of the underlying items*

11 The proposed second criterion further limits the scope of the exception to contracts where the contractual policyholders' share in the profits of a common pool of underlying items is determined jointly for the policyholders where management exercises discretion as to the timing and the allocation of the contractual profit share to individual policyholders.

12 When individual policyholders jointly share in the profits of a common pool of underlying items, this implies that no cohort within the groups is entitled to a separable profit share in a subset of the underlying single items before management exercises discretion.

13 In that regard, we welcome the acknowledgement by IASB[4] that "*the Board does not expect to track specific underlying items for each annual cohort if the contract requires the policyholder to share with policyholders of other annual cohorts the returns on the same specified pool of underlying items [as] that would not be practicable, nor would it*

[4] IASB 2020-02-AP 2B § 21(a)

*depict the nature of the sharing of the returns on the total pool of underlying items across the annual cohorts*".

14 When the proposed criterion is met, the sharing of returns is determined jointly for the policyholders and an allocation on a cohort by cohort basis is not objectively determinable as cash flows are fungible both within the group and across generations of policyholders, including future policyholders. Similarly, this means that the use of annual cohorts does not provide useful information about changes in the profitability of contracts over time because profitability is not measurable at contract or cohort level.

15 When the share in the returns is contractually determined jointly for all policyholders, the entity has no reason to monitor profitability and manage contracts at a lower level of aggregation. As a consequence the allocation to annual cohorts cannot "appropriately" reflect the legal and economic features of such contracts.

Discretion as to the timing of the allocation of the joint contractual profit share to individual policyholders

16 Unlike the IASB's example[5] of "*a 10% profit share of a 5% expected return is better than 10% of a 1% expected return*", the proposed criterion ensures that no single cohort "creates" any specific "expected return" that would be worth tracking over time. This is because the allocation of the overall profit share to individual contracts only occurs upon the exercise of discretion by the entity's management and not upon the change in the fair value of the underlying items.

17 Within the context of the simplified example considered by the Board in March 2019[6], ANC notes that the fact pattern considered the very specific case of a newly written portfolio in its build up phase. There was therefore no legacy and the insurer immediately invested the premiums paid by the policyholders at current market conditions. This has led IASB to conclude that each cohort would be entitled to the current market rate of returns at the date when the contracts are underwritten. This assumption however disregards the fact that, within the scope of the proposed exception, the contracts are only entitled to a joint profit share out of the overall returns from the portfolio. Within the context of a mature portfolio, the insurer might have used the premiums from the newly written contracts to pay the surrenders of previous generations of contracts. It would have then been apparent that newly written contracts benefit (or suffer) from the returns of investments made out of the premiums from previous generations of contracts.

18 Therefore, the criterion that management exercises discretion as to the timing of the allocation of the joint contractual profit share to individual policyholders ensures that the proposed exception would only apply to contracts where the profit share is mutualised across generations of policyholders. Actually, in such circumstances, the contractual profit share determined for the portfolio as a whole benefits to both :

- Existing contracts, to the extent that policyholders do not terminate their contracts before management exercises discretion;
- Future contracts to the extent that they are underwritten before management exercises discretion.

19 The proposed scope exception would therefore apply to contracts with intergenerational mutualisation, where the requirement in IFRS 17.24 otherwise arbitrarily requires allocating to existing policyholders future cash flows expected to be paid to future policyholders.

[5] IASB 2020-02-AP 2B §25
[6] IASB 2019-03 AP 2A §41

Discretion over how the entity shares the return between itself and the policyholders as a whole is an additional relevant feature but unnecessary to scope the exception

20 We agree with IASB[7] that "*the sharing of risks across generations of policyholders, particularly when the entity has discretion over how it shares the returns from underlying items between itself and the policyholders as a whole, makes the determination of the contractual service margin for new groups of contracts subjective*". We illustrated it in an example last year[8].

21 We further agree with IASB[9] that "*if the entity's share is discretionary the assumption that determines the initial amount of the contractual service margin for the new cohort becomes subjective, and the benefit of tracking these subjective amounts may be reduced*".

22 In that regard, we would like to highlight that in many European jurisdictions, insurers grant additional discretionary payments in excess of the minimum contractual joint profit share (in the returns from the underlying items) to their policyholders. In such situations, insurers exercise discretion as to their share in the returns from the underlying items. We therefore expect that the proposed exemption would adequately capture such contracts.

23 However, we think that discretion over how an entity shares the returns from underlying items between itself and the policyholders as a whole is not a required condition for an exception because the proposed scope exception is already limited to contracts where the annual cohort requirement does not provide relevant information because of intergenerational mutualisation.

### *2.3 3rd criterion: VFA as a practical expedient*

24 IASB[10] outlines that "*contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts*" include a combination of:

- Fixed cash flows[11] or "non-participation cash-flows" including some insurance claims and financial guarantees;
- Participation cash-flows that are payable to policyholders of contracts in all groups (including discretionary cash flows that are fungible across all contracts in the portfolio).

25 ANC believes that the proposed criteria should limit the scope of the proposed exception to contracts with intergenerational mutualisation that include a mix of "fixed" and fungible cash flows, therefore making the determination of the CSM arbitrary on a cohort-by-cohort basis. Arguably, the higher the proportion of fungible cash flows, the less relevant the annual cohort requirement becomes.

26 ANC agrees with IASB[12] that "*the effect of changes in 'fixed cash flows' on the CSM of certain groups is reduced to the extent that the changes affect the amount of the participation cash flows payable to policyholders of contracts in all groups*". IFRS 17.B67 (b) requires that policyholders "*bear a reduction in their share of the returns on the underlying items because of payments to policyholders of other contracts that share in the pool, including payments arising under guarantees made to policyholders of those other contracts*". Accordingly, contracts meeting the 1st criterion have fixed cash flows (including guarantees) that are shared across policyholders within the group (but

[7] IASB 2020-02-AP 2B §27(1)
[8] ANC Comment Letter on IASB March 2019 meeting (2019-05-06) § 20
[9] IASB 2020-02-AP 2B §25
[10] IASB 2020-02-AP 2B § 17(b)
[11] IASB 2020-02-AP 2B §23(a)
[12] IASB 2020-02-AP 2B § 18 (a)

might not have *all* fixed cash flows or *all* guarantees mutualised). Similarly, if guarantees are included in the underlying items, their related cash-flows are jointly shared according to criterion 2.

27 ANC acknowledges that some contracts may embed guarantees[13] specific to individual policyholders and not shared across contracts[14]. As a practical expedient, we believe that the criteria already set in IFRS 17.B101 would provide an adequate frame to scope an exception to the annual cohort requirement while relying on existing provisions of the standard and thus limiting disruption in its implementation. Indeed to qualify for the variable fee approach, the entity should "*expect a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items"*. This criterion therefore implies that the effect of changes in cash flows that do not vary based on the changes in the underlying items, (i.e. are not shared with other policyholders, the "fixed cash flows") should be small.

28 The combination of criteria 1, 2 and 3 in the proposed exception therefore ensures to only include contracts where fixed cash flows (including guarantees) are either shared (criterion 1 and 2) or small (criterion 3). In other words, in the scope of the defined exception, the effect of significant guarantees is shared with other policyholders.

29 ANC therefore agrees with IASB[15] that "*if the effects of financial guarantees over returns on underlying items in the contract is shared with other policyholders to a large extent/ across generations there is less likelihood that the group will become onerous since the CSM of the group is affected only by the entity's share of the effect of the financial guarantee.*"

30 Consequently, in the context of the exception, the entity is not exposed to financial guarantees granted to individual contracts unless their effects exceed the fungible discretionary cash flows available within the portfolio. Accordingly, financial risks are shared among the contracts of the group.

31 In other words, no single contract can become onerous if the amount of fungible discretionary cash flows included in the measurement of other contracts within the group of policyholders as a whole exceeds the difference between the premiums paid by the policyholders and the expected payments arising from the cost of the financial guarantees within the group. Therefore tracking losses at a lower level is unnecessary. The loss component in IFRS 17.49 should therefore be determined at the level of the group (of policyholders as a whole) in that case.

32 IASB[16] concluded on the example discussed at the September 2018 TRG meeting that "*the CSM is affected by the entity's share of the participation in the underlying items* where policyholders shared <u>equally</u> 90% of the overall returns on the portfolio of insurance contracts". Unlike this example, a joint participation between all policyholders and the insurer's discretion in allocating the profits to individual policyholders means that the entity is not affected by the (non-participation) cash flows arising from a specific subset of contracts unless the participation cash flows are exhausted.

33 Furthermore, the VFA criterion is consistent with the IASB's acknowledgement that applying the annual cohort requirement to contracts eligible to the variable fee approach requires a highly judgmental allocation of changes in the entity's share of the fair value of the underlying items thus impairing the relevance of the requirement.

34 Limiting the exception to contracts eligible to the VFA would also ensure that "hybrid contracts" are appropriately embedded in the exception. Such contracts (e.g. "multi-supports") combine two participating components, one with a discretionary participation

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[13] As referred to in IFRS 17.B113(b)

[14] Though not relevant within the context of French life insurance contracts,

[15] IASB 2020-02-AP 2B §27(3)

[16] IASB 2020-02-AP 2B §18(b)

(for instance, a "currency component"), and a unit-linked component, linked by the option to switch between the components. For such contracts, the profitability is measured at the level of the whole contract (which is the lowest unit of account under IFRS 17), and not by subcomponents. Therefore, it would be inconsistent to provide an exception for one subcomponent and not for the other.

35 ANC acknowledges that this criterion excludes from the scope of the exception indirect participating contracts for which the annual cohort requirement may not provide relevant information, especially when IFRS 17.B98 applies. Therefore referring to VFA is a practical solution that does not address all possible situations where an exception could be defined.

### *2.4 Additional disclosures*

36 We do concur with IASB that at inception, the impact of new contracts on the existing ones (IFRS 17.104 (a) (iii)) provides useful information. We further suggest that additional information be provided (i) on the actuarial technique applied for computing the CSM effect of new business on the groups eligible to the exception to the annual cohorts; and (ii) on the detailed features of such groups meeting the exception criteria.

37 ANC further acknowledges that the information that a group of contracts subject to the proposed exception becomes onerous would be valuable to users of the financial statements as it would concern a large set of contracts with intergenerational mutualisation. Accordingly, we suggest that the disclosure requirements in IFRS 17.101 and IFRS 17.104should be provided separately for groups of contracts subject to the proposed exception.

## 3 Main contractual features of European life insurance contracts

### *3.1 Intergenerational mutualisation is a key feature of life-saving business in many European jurisdictions*

38 The way insurers organise mutualised populations is a highly sensitive feature of insurance markets since it reflects and also shapes up a level of "social/societal" understanding of what is covered by insurance and what is left to the direct responsibility of the individual (natural or moral person). In this context the coherence and consistency of pricing and detailed coverage policies is a key element of stability and decision making for individuals and businesses in the development of their respective activities.

39 The perimeter of mutualised populations and the terms and conditions offered to them by insurers are the outcome of very long term evolutions and decisions reflecting fundamental choices made at the level of the society as a whole (explicitly via regulations, semi-explicitly when practices reflect or influence changes in behaviour). In many cases, the strategy of insurers is heavily influenced by a prevailing insurance environment (or culture) the evolution of which requires extensive debates.

40 Modifying the perimeter of mutualised populations for accounting purposes only may lead to unintended changes in the way insurers cover insurance risks. There is a significant difference between (i) reflecting, via accounting treatments, a slow and complex evolution of the insurance coverage system and (ii) introducing accounting treatments which may directly influence the way the insurance coverage system is organised and possibly reduce the current and accepted level of mutualisation.

### *3.2 French life insurance contracts with discretionary participation features*

41 French life insurance contracts with discretionary participation features meet the characteristics of IFRS 17.BC 167-168 whereby policyholders participate in the returns on specified underlying items. Under the contractual terms, the underlying items include (i) a portfolio of similar life insurance contracts and (ii) a contractually specified pool of assets (usually the general fund of the insurer).

42 The legal and contractual rights conferred to the policyholders usually include:

- A **guaranteed minimum interest rate**, which confers an individual right to the policyholders that accrues with the passage of time. Nowadays, given the low interest rate environment, newly written contracts only guarantee the premiums paid, i.e. a 0% guarantee;
- A **contractual joint profit sharing**: at the end of each accounting period, the policyholders' community is entitled to at least 90% of the positive technical returns arising from the portfolio of insurance contracts and 85% of the realised financial returns arising from the contractually specified pool of assets. Usually the contractual terms that determine policyholders' participation are based on the accounting result as determined under French GAAPs. The joint contractual profit-share for the year needs to be allocated to individual policyholders within a time limit (most of the time: 8 years). Management exercises discretion as to the timing and the amount of the allocation to individual policyholders. This implies that, within the portfolio (of similar life insurance contracts managed together):
    - o Individual policyholders have no enforceable rights over the contractual joint profit-share until management's decision to allocate policyholders' individual share;
    - o all policyholders are eligible to the contractual joint profit-share regardless of the date when their contracts were underwritten;
    - o no single contract has preferential rights on the contractual joint profit-share as compared to the others.

43 Finally, the insurer may allocate additional policyholders' share above the contractual minimum, reducing the entity's share accordingly.

44 For such contracts, the expected profit of the insurer stems from:

- The difference between the contractual management fee withheld for the policyholders' account balance and the actual expenses incurred to manage the contracts;
- The difference between the total returns from the contractually specified portfolio of assets and the total expected payments to the contracts that share into those returns.

45 Another key contractual feature of the French life insurance contracts is that the fair value returns from the underlying items benefit to both existing and future policyholders. In fact, since the contractual joint profit-share is calculated based on a different measurement than IFRS 17, the IFRS 17 policyholder's share in the returns that is not yet realised / allocated to the contractual joint profit-share might benefit to current as well as to future policyholders. The contractual joint profit sharing obligation stems from realised fair value gains, which implies that unrealised fair value gains do not create an immediate right for existing policyholders. The policyholders' joint right to the unrealised fair value gain is deferred until its realisation and ultimately benefits only to the contracts (existing and future) still in force at the time when the individual policyholder's share is attributed, which can occur as long as eight years after the realisation of the gain. This implies that:

- Existing policyholders at the time when the fair value gain on the underlying item occurs will benefit from a profit-share in the fair value gain only if their contracts do not lapse before the allocation to individual policyholder's share;

- Future policyholders will benefit from a profit share in the fair value gain if their contracts are underwritten (and do not lapse) before the allocation to individual policyholder's share;
- The insurer's share will vary depending on the exit of existing contracts, or entrance of new contracts within the same portfolio.

46 As at the end of 2018, the technical provisions arising from such contracts amounted to 76% of the total 1 975 billions of life insurance technical provisions according to the Solvency II prudential framework[17] .

47 Most French life insurance contracts with discretionary participation features are expected to qualify for the variable fee approach. Therefore, in practice, limiting the proposed scope exception to contracts that meet the criteria in IFRS 17.B101 would, in practice, not impact the scope.

### *3.3 Italian life insurance contracts with discretionary participation features*

48 Italian life insurance contracts with discretionary participation features (known as '*Gestioni Separate*') meet the characteristics of IFRS 17.B67-B68 whereby (a) the contracts share the return of the same specified pool of underlying item; and (b) their cash flows substantially affect or are affected by cash flows to policyholders of other contracts.

49 These contracts combine a guaranteed interest rate with participation benefits. The yield of these contracts payable to policyholders depends on the insurer's management of a pool of assets, known as '*Gestioni Separate'*, which is a fund that is managed separately from the insurer's general account.

50 The assets in the *Gestione Separata* are fully owned by the entity and the value of policyholders' benefits is not based on the fair value of the assets assigned to the segregated fund (ie the fund is not 'unitised'), rather all policyholders relying on the same fund, irrespective of their generation, are assigned the higher of either a pre-determined portion of the book return of the entire fund (the same rate applies to all policyholders irrespective of their generation) or the minimum guaranteed amount.

51 The yield of the assets assigned to the *Gestione Separata* fund is used as a parameter to re-valuate the PH's benefits and to re-determine the value of the technical reserves for the related insurance contracts; in addition, the rules to determine the yield are essentially based on the realized return of the underlying fund according to a specific set of regulatory requirements.

52 According to the IVASS Regulation, in the administration of the "*Gestione Separata*", the insurer by law ensures equal treatment for all insured persons, avoiding disparities that are not justified by the need to safeguard the interests of the all insured persons, and the balance and stability of the separately managed account. To this end, the undertaking pursues management and investment policies to ensure an equitable participation of policyholders in the financial results of the separately managed account.

53 Based on the wording of these articles, intergenerational mutualisation and management discretion appears as two closely related concepts: the discretion in Italian jurisdiction is referred to as the discretion in managing the underlying assets (eg continue to hold them or realize them) to provide the policyholders with the realized average return. All policyholders benefit from these management choices, as management decisions have an effect on all contracts without distinction. Each new policyholder enters into a community that is managed jointly.

[17] ACPR – Les chiffres du marché français de la banque et de l'assurance 2018 – Graphique 12

54 Similarly to other continental participating contracts the fair value returns from the underlying items belong to both existing and future policyholders. Since the contractual benefits/profit sharing is based on realised gains or losses, this implies that unrealised fair value gains or losses do not create an immediate right for existing policyholders. The policyholders' joint right to the unrealised fair value gain is deferred until its realisation is included in the regulatory segregated fund return only to the contracts (existing and future) still in force at that time.

55 The insurer's share will vary depending on the development of existing portfolio, or entrance of new contracts within the same portfolio.

56 Most Italian life insurance contracts with discretionary participation features are expected to qualify for the variable fee approach. Therefore, in practice, limiting the proposed scope exception to contracts that meet the criteria in IFRS 17.B101 would, in practice, not impact the scope.

### *3.4 German life insurance contracts with discretionary participation features*

57 Traditional German participating life insurance contracts have similarities with French life insurance contracts. They generally include a minimum interest rate guarantee as well as a profit share which depends on the returns of the insurance undertakings. However the yearly profit share is generally not immediately attributed to each individual policyholder. Instead a collective profit sharing mechanism is established before an attribution over time of the profit share to individual policyholders.

58 The determination of the policyholders collective profit share is based on German GAAPs but relies also on regulatory provisions.

59 German contracts must return to the policyholders at least 90% of the investment profits and the technical result calculated under German GAAP. However, the entity' may exercise discretion and return to policyholders additional amounts beyond the 90% threshold.

60 As a first step, the insurance undertaking computes the minimal regulatory profit share (*Mindestzuführungsverordnung*, MindZV).

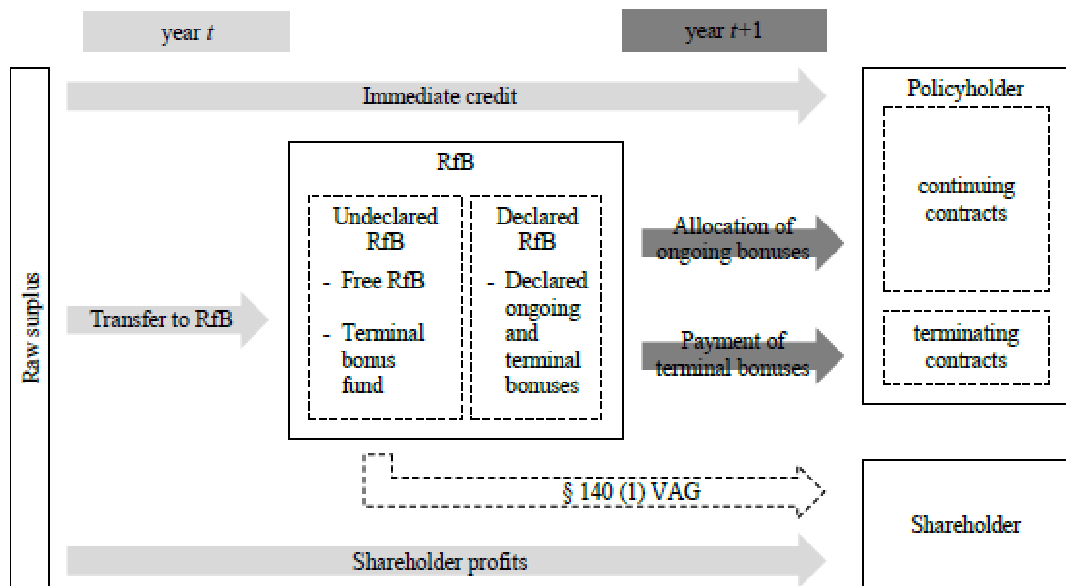
61 Then the surplus may be immediately credited to individual policyholders accounts or transferred to a collective profit share reserve called the RfB (*Rückstellung für Beitragsrückerstattung*), which is then attributed to individual policyholders in future periods either as:

- An increase of policyholders' individual accounts;
- Or as a terminal bonus upon the lapse of the contracts.

62 The amounts to be attributed to individual policyholders are determined in advance usually at the end of the accounting period preceding the accounting period of the payment.

63 The RfB is made up of three components:

- The Declared RfB: which includes amounts already allocated to individual policyholders as bonuses but not yet credited to individual policyholders accounts.
- The Terminal Bonus Fund TFB: which includes amounts accumulated to fund terminal bonuses in future years. Those amounts are already allocated to individual policyholders but the payment is not yet due. Individual policyholders do not have an enforceable right on those amounts.
- The Free RfB : which includes the collective profit share not yet allocated to individual contracts. Similarly to the TFB, policyholders do not have enforceable rights on the Free RfB.




### *3.5 Danish life insurance contracts with discretionary participation features*

64 Danish guaranteed life insurance contracts with discretionary participation features meet the characteristics of IFRS 17 67-68 whereby (a) the contracts share the return of the same specified pool of underlying item; and (b) their cash flows substantially affect or are affected by cash flows to policyholders of other contracts.

65 Danish guaranteed products are contractual based, i.e. specificities vary across companies. In general, all products have the following characteristics:

66 Under the contracts, customers obtain a right to receive contractually binding future pension benefits. Contributions are defined (they are effectively DC contracts), and the interdependence between contributions and benefits is calculated using extremely conservative assumptions regarding interest rates, longevity and administration costs. Currently the guaranteed interest rate may not exceed 0 pct.

67 Contracts are grouped so that the technical interest rate used for calculating benefits varies by no more than 1 pct.point across all contracts within the group. Any one group thus comprises contracts issued over several years, but which are homogenous with regards to the assumptions used for calculations.

68 Contracts in a group are contractually entitled to an equal share of the surplus of the group which arises when actual return on the groups' pool of underlying assets exceeds the guaranteed technical interest rate used for calculations. The surplus, which is referred to as the "collective bonuspotential", is released at the company's discretion. National rules ensure that the release of accrued bonuspotential in done in a timely manner so that all contracts receive a fair share.

69 The company's profit is determined as a risk margin (on technical provisions) which the company notifies to the supervisor at the beginning of the year. The risk margin may be deducted from the group investment return or from the already accrued bonuspotential before allocating interest to the contracts. Although national rules do not define a limit for the company's risk margin, the contracts share of accrued bonuspotentiel is very substantial, ranging in the 90-95 pct. area.

70 The setup ensures that the company's result relies on the group as a whole, and not on any single contract.

71 The company's result will only have to be affected in the event that the groups pool of underlying assets falls short of the required technical provisions for the group as a whole, ie. no bonuspotential remains.

72 Because of these characteristics Danish life insurers will anticipate the same result regardless of whether or not they divide their groups into annual cohorts. It is the group rather than the date of inception which determines results.

73 Danish life insurance contracts with discretionary participation features are expected to qualify for the variable fee approach. Therefore, in practice, limiting the proposed scope exception to contracts that meet the criteria in IFRS 17.B101 would, in practice, not impact the scope.

74 By end 2018 guaranteed products accounted for roughly 55 pct. of Danish life insurance technical provisions. These products are highly integrated in the general understanding of life insurance in Denmark, and although unit link style products have become more prevalent in recent years, many customers value the guaranteed products highly with no intentions to transfer out of these products.