ACTUARIAL ASSOCIATION OF EUROPE

Insurance Committee

Survey on IFRS17

Carried out by IFRS17 Working Group – March 2018

Survey contributors

- Austria
- Belgium
- Croatia
- Cyprus*
- Denmark
- Estonia
- Finland
- Hungary
- Ireland
- Italy
- Lithuania
- Netherlands
- Norway
- Portugal
- Spain
- Sweden
- Turkey

* Cyprus confirmed in their submission that they had not had a chance to review IFRS 17 related topics.

IFRS17 – key pros and cons emerging

PROS	CONS
• Fair value approach based on current assumptions • Recognition of expected losses at day 1 • Enhanced disclosure • Risk adjustment approach (and disclosure of confidence level) • Discounting of claims reserves • Disaggregation into insurance service result, finance income and expenses • Separation of onerous and profit-making contracts • Providing economic view of release of profit margins – timing in line with service provision • Introduction of CSM • Comparability of financial statements • VFA for policies with discretionary participating features	• Greater volatility of results • Complexity • Lack of clarity in aspects of standard leaves room for interpretation and provides scope for inconsistency • Possible inconsistencies between reinsurance and direct flows • Extent of disclosure required • Cost of implementation and ongoing preparation may outweigh benefit • Lack of proportionality • Grouping of contracts leading to excessive complexity

IFRS 17 – key pros and cons emerging

FUNDAMENTALS:

“Should lead to harmonised accounting system with increased transparency and accountability leading to greater understanding”

Portuguese response

Versus

“Room for interpretation and different methods makes it questionable that greater comparability will be achieved”

Spanish response

Features - relevance

Relevant	Not relevant
• Risk based approach • Consistency of reflection of risks • Fair/market value approach based on current assumptions • Consideration of future cash flows • VFA for policies with DPF • Responsive to market changes • Recognition of expected losses at day 1 • Risk adjustment approach (and disclosure of confidence level) • Discounting of claims reserves • Disaggregation into insurance service result, finance income and expenses • Separation of onerous and profit-making contracts • Providing economic view of release of profit margins – timing in line with service provision • Introduction of CSM, incorporating unearned profits • Comparability of financial statements	• Greater volatility of results • Complexity • Treatment of acquisition cash flows • Possible inconsistencies between reinsurance and direct flows • Extent of disclosure required • Lack of proportionality • Grouping of contracts leading to excessive complexity • Presentation for non-life business • Need for unbundling and different treatment of investment contracts

Features - reliability

Reliable	Not reliable
• Fair/market value approach based on current assumptions • Systematic release of CSM • Testing of sufficiency of reserves • Transparency of composition of reserves • Consideration of all future cash flows • Responsive to market changes • Inclusion of options and guarantees in measurement • Enhanced disclosure • Risk adjustment approach (and disclosure of confidence level) • Discounting of claims reserves	• Complexity, leading to risk of error • Treatment of acquisition cash flows • Lack of clarity in aspects of standard leaves room for interpretation and provides scope for inconsistency • Appropriateness of timing of release of profits • Possible inconsistencies between reinsurance and direct flows • Lack of proportionality • Presentation for non-life business • Starting point – quality of transitional arrangements • BBA/PAA comparability requirements • Application of contract boundaries could result in inappropriate onerous contracts • Use of OCI may lead to valuation mismatches • Moving from accruals to cash accounting • Delineation between VFA and GM not sharp and gives possibilities for judgement • Explanatory examples too simple!

Features - understandability

Understandable	Not understandable
• Cash flow based approach for long term business • PAA approach for short term • Global unification leading to comparability • Clearer presentation • More extensive disclosures • Separated financial, service disclosures • Comparison of expected v experience • CSM • Recognition of expected losses on day 1 • Risk based approach • Clear revenue concept - relates to provision of services, not premium received • Incorporating time value of money and current discount rates	• Statement of profit and loss due to complexity and differences of interpretation • Transitional arrangements • Greater volatility of results • Complexity leading to reduced understanding of insurance accounting • Lack of clarity and principles-based approach in aspects of standard leaves room for interpretation and provides scope for inconsistency • Possible inconsistencies between reinsurance and direct flows • Grouping of contracts leading to excessive complexity • Different rules for different types of contract leading to different CSM allocations and run off • Revenue presentation for non-life • Non-life – BBA for liabilities for remaining coverage • Lack of clarity on assumption setting • Accretion of interest rates for new groups over year • Treatment of lock in of rates • For risk adjustment, lack of definition of “confidence level technique” • IFRS17 v local GAAP where different

Features – comparability

Comparable	Not comparable
• Global principles • Consistency of reflection of risks • Fair/market value approach based on current assumptions • Valuation of employee benefits • Accounting for investment contracts • Non-life business, through PAA • Consideration of future cash flows for all entities • Revenue relates to provision of services, not premium received • Prescribed measurement models • Recognition and treatment of onerous possibilities • Enhanced disclosure giving information on areas of inconsistency	• Lack of clarity in aspects of standard leaves room for interpretation and provides scope for inconsistency, e.g. - illiquidity premium - discount rates - contract boundaries - amortisation of CSM - PAA onerous contracts test - transition treatment - coverage units - risk adjustment - cost allocation and deferral - mutual business treatment - applicability of PAA - OCI approach • Possible inconsistencies between reinsurance and direct flows

Other insights gained

Impact on competition

- Improved comparability/transparency will encourage competition
- Bigger burden for small companies making it harder to compete
- Greater transparency may lead to more rational pricing decisions
- Discretionary choices re accounting may distort market

Other insights gained

Effects on market

- Positive effect due to greater comparability and transparency, including potentially more effective access to capital
- Increased accounting costs
- Smoother P&L with greater alignment between Solvency II and IFRS
- Greater connection likely between pricing and reserving processes. May be less product cross subsidisation with more granularity on profit reporting by product line
- Companies may be less inclined to write products with up front profit emergence
- May lead to changes in sales channel remuneration
- New management reporting/KPIs required
- Board/regulator/analyst education – more difficult to understand insurance accounting but greater insights potentially available
- Different accounting and audit processes – greater role for actuaries
- Greater volatility in net assets for long term savings products may make these products less attractive
- CSM disclosure may influence customers to request lower premiums
- Should lead to greater collaboration across functions in companies
- Greater comparability may drive M&A activity

Thoughts on cost/benefit relationship

General view that costs may outweigh benefits

- Costs substantial (initial and ongoing) but benefits uncertain. Exercise of discretion reducing comparability and hence benefits. Disclosures may not give full picture and enable understanding
- Implementation will be difficult and issues still open
- Detailed level of aggregation and lock in of yield curves creates significant extra complexity which is hard to justify
- Biggest burden on small entities
- Less complexity could mitigate costs, e.g.
  - greater scope to apply fair value approach on transition
  - less granular level of aggregation
- IFRS17 and Solvency II should be more aligned

Thoughts on specific EFRAG questions

- Room for interpretation and different methods make it questionable that greater comparability will be achieved
- IFRS17 clearly takes into account specificities of the insurance sector
- A number of essential questions are still unresolved and under discussion
- The level of granularity is such that it will be more difficult to get an overall picture of results and detect main trends
- The CSM pattern of release may vary making results more difficult to interpret and compare

Next steps

- Present survey findings at Lisbon Insurance Committee meeting
- Identify key points from survey which should form the basis of AAE representations.
- Identify volunteers to urgently provide more detailed background and technical detail on these key points to facilitate supported representations.
- Working group to meet in April and May
- AAE proposing to meet with EFRAG Board in June
- Continue to support Alexander Dollhopf in his work with EFRAG
- Respond to consultation(s)

IFRS17 Working Group membership

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Alexander Dollhopf
Maria Dragomirescu
Philipp Keller
Aitor Milner
Tony O'Riordan
Pentti Soininen
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