

ACTUARIAL ASSOCIATION OF EUROPE

RMC - Topic 5.5: IFRS 17

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4 May 2018, Warsaw

Agenda

Introduction to IFRS 17

AAE IFRS 17 working group

- Context
- Survey results
- Next steps

Possible interactions with RMC

Introduction to IFRS 17

What is IFRS 17¹?



One

accounting model for all
insurance contracts in all IFRS
jurisdictions—replaces IFRS 4



Who is affected?



450
listed insurers
using IFRS
Standards



\$13 trillion
total assets of
those listed
insurers

When?



2021
mandatory
effective date of
IFRS 17

What changes?



More
useful and
transparent
information



Better
information
about profitability

1 – Source: “IFRS17 Insurance contracts – How IFRS17 works and what it means”, Darell Scott (IASB Member), IFRS17 seminar organised by IA, Paris 19.10.2017.

Introduction to IFRS 17

Main improvements introduced¹

More useful and transparent information

- Current assumptions regularly updated
- Options and guarantees fully reflected
- Discount rates reflect characteristics of the insurance liability

Consistent recognition of revenue and profits for insurance services

- Revenue recognition more consistent with other IFRS Standards
- Profits recognised as the insurance coverage is provided
- Additional metrics to evaluate performance

1 – Source: “IFRS17 Insurance contracts – How IFRS17 works and what it means”, Darell Scott (IASB Member), IFRS17 seminar organised by IA, Paris 19.10.2017.

Introduction to IFRS 17

Improved performance reporting¹

IFRS 4*
Premiums
Investment income
Incurred claims and expenses
Change in insurance contract liabilities
Profit or loss

➔ Cash based and includes collection of deposits. Inconsistent with other industries

➔ Confusing adjustment that incorporates multiple factors

IFRS 17	
Insurance revenue	9,856
Incurred claims and expenses	(8,621)
Insurance service result	1,235
Investment income	7,787
Insurance finance expenses	(7,391)
Net financial result	396
Profit or loss	1,631
Other comprehensive income	
Investment income	2,115
Insurance finance expenses <i>(optional)</i>	(1,917)
Total other comprehensive income	198
Comprehensive income	1,829

➔ Recognised when earned. Excludes deposits

➔ Two drivers of profits presented separately

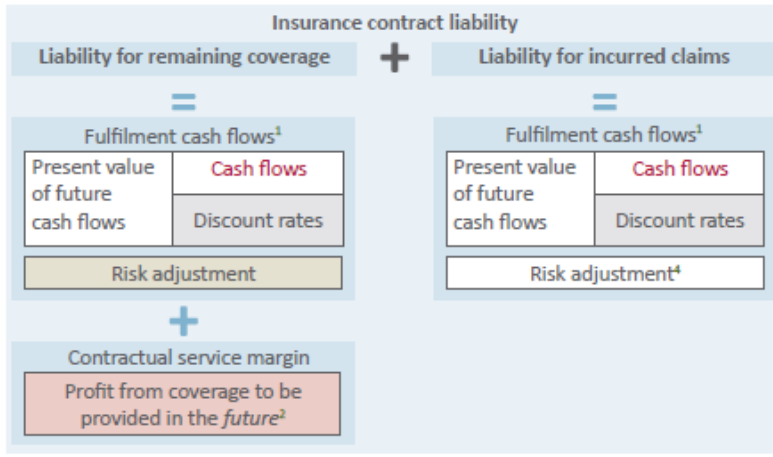
Changes in financial assumptions do not affect insurance service result

¹ – Source: “IFRS17 Insurance contracts – How IFRS17 works and what it means”, Darell Scott (IASB Member), IFRS17 seminar organised by IA, Paris 19.10.2017.

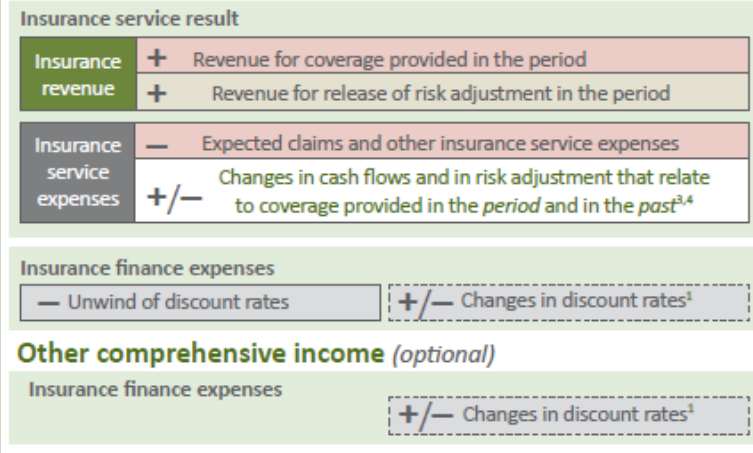
Introduction to IFRS 17

The accounting model in one page¹

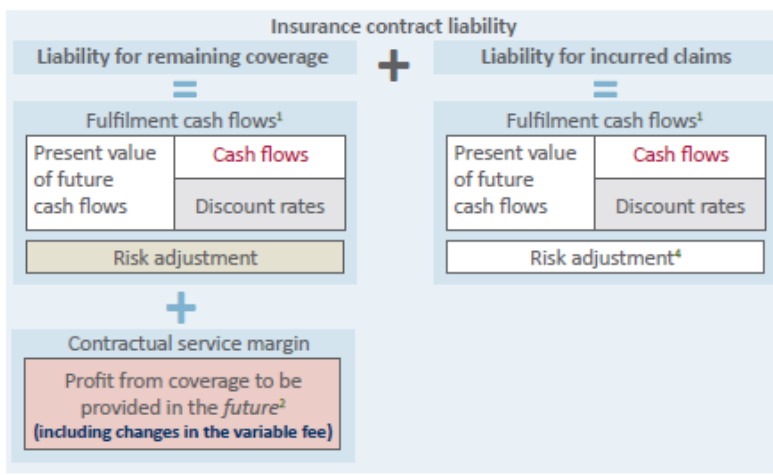
Balance sheet



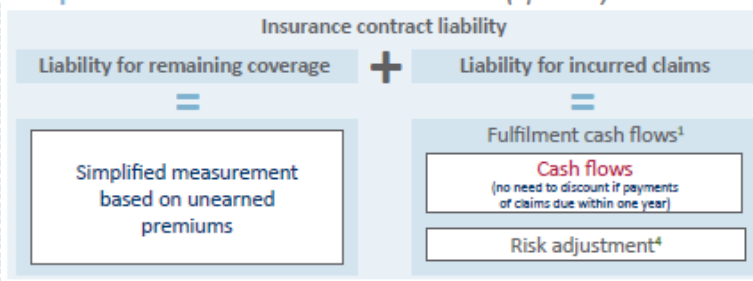
Profit or loss



Modifications for contracts with a 'variable fee'



Simplifications for short-term contracts (optional)



Notes

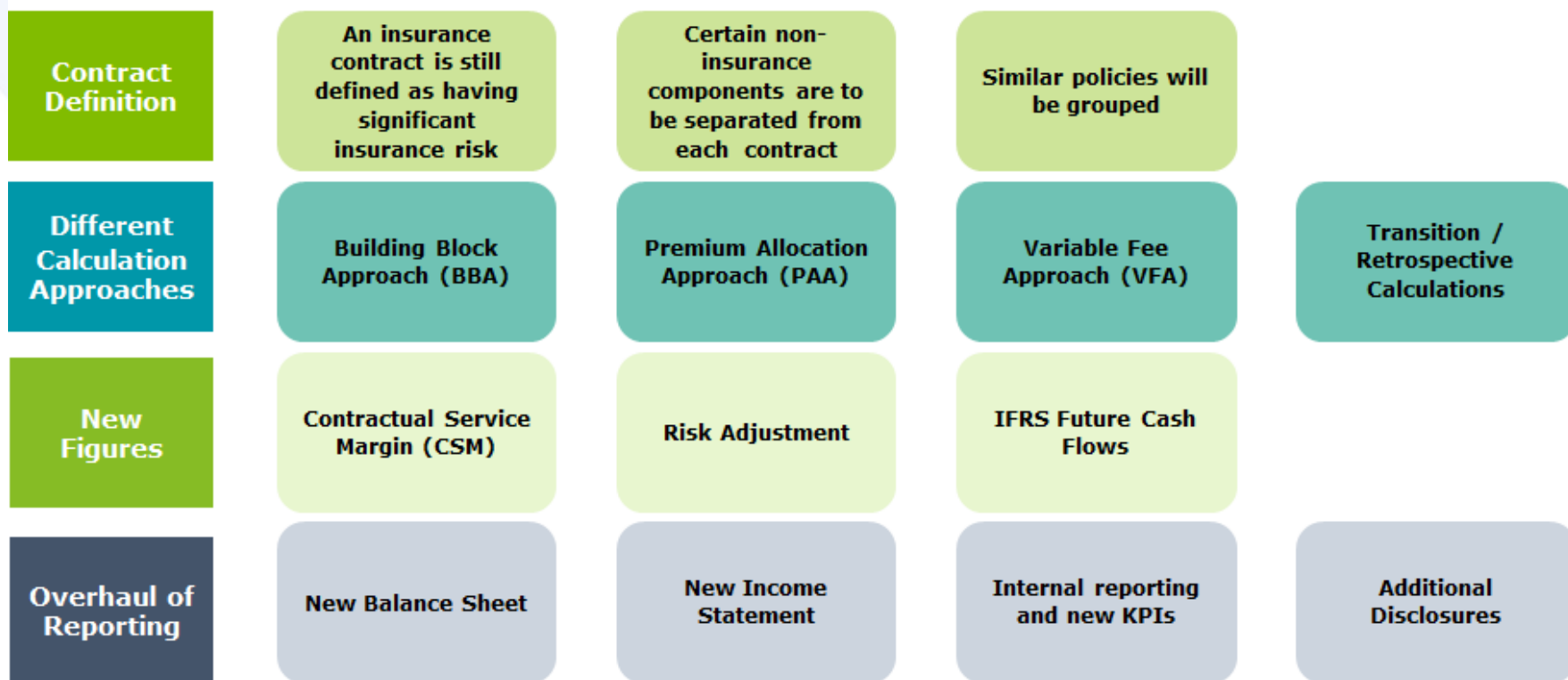
- 1 The fulfilment cash flows are at current value: cash flows, discount rates and risk adjustment are updated at each reporting date
- 2 Changes in cash flows and in risk adjustment that relate to coverage to be provided in the future adjust the contractual service margin
- 3 Changes in cash flows and in risk adjustment that relate to coverage provided in the period and in the past are recognised in profit or loss
- 4 The release of risk adjustment within the liability for incurred claims reduces incurred claims in profit or loss

1- Source: <http://www.ifrs.org/news-and-events/2018/01/the-ifrs-17-accounting-model-in-one-page/>

Introduction to IFRS 17

Key changes under the new standard¹

The requirements under IFRS 17 will change the way insurers and reinsurers operate, calculate and report on their business



¹ – Source: Deloitte internal presentation, June 2017.

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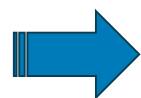
Possible interactions with RMC

AAE IFRS 17 working group

Background

- IFRS 17 needs to be endorsed by the EC before coming into force in the EU and EEA
- At the request of the EC, the European and Financial Reporting Advisory Group (EFRAG) shall assess whether IFRS 17 meets the criteria for endorsement:

Criteria	Description
Not contrary to the true and fair principle	
Technical qualitative criteria analysis	<ul style="list-style-type: none"> • Relevant • Reliable • Understandable • Comparable
European good analysis	<ul style="list-style-type: none"> • Potential effects on competition • Potential impact on the insurance market • Cost-benefit analysis



- IFRS 17 case study¹
- Surveys

1- Impact assessment on a sample of EU insurance groups.

AAE IFRS 17 working group

Terms of Reference

Objectives

- Assisting A. Dollhoft in his EFRAG participation with sound actuarial opinions
- Analysing any need of aligning EU actuarial practices on IFRS 17

Governance

- Report to the Insurance Committee
- J-M Pinton (chairman) and A. Dollhoft (vice-chairman)
- Membership open to representatives of AAE member associations
- Duration until EFRAG provides their final advice to the EC (expected by EOY18), with possible extension if aligning actuarial practices is required

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IFRS 17 survey results¹

Key pros and cons emerging (1/2)

PROS	CONS
<ul style="list-style-type: none"> • 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 	<ul style="list-style-type: none"> • 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

1- Source: "Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018", AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

Key pros and cons emerging (2/2)

FUNDAMENTALS:

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

Response A

Versus

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

Response B

1- Source: “Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018”, AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

Features - relevance

Relevant	Not relevant
<ul style="list-style-type: none"> • 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 	<ul style="list-style-type: none"> • 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

1- Source: "Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018", AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

Features - reliability

Reliable	Not reliable
<ul style="list-style-type: none"> 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 	<ul style="list-style-type: none"> 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!

1- Source: “Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018”, AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

Features - understandability

Understandable	Not understandable
<ul style="list-style-type: none"> • 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 	<ul style="list-style-type: none"> • 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

1- Source: “Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018”, AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

Features - comparability

Comparable	Not comparable
<ul style="list-style-type: none"> • 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 	<ul style="list-style-type: none"> • Lack of clarity in aspects of standard leaves room for interpretation and provides scope for inconsistency, e.g. <ul style="list-style-type: none"> - 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

1- Source: "Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018", AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

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

1- Source: “Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018”, AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

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

1- Source: “Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018”, AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

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

1- Source: "Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018", AAE Insurance Committee, Lisbon 12.04.2018.

IFRS 17 survey results¹

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

1- Source: "Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018", AAE Insurance Committee, Lisbon 12.04.2018.

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AAE IFRS 17 working group¹

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)

1- Source: "Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018", AAE Insurance Committee, Lisbon 12.04.2018.

AAE IFRS 17 working group¹

Current membership

Jean-Michel Pinton (Chair)

Daphné de Leval

Alexander Dollhopf

Maria Dragomirescu

Philipp Keller

Aitor Milner

Tony O’Riordan

Pentti Soininen

Petr Sotona

Lutz Wilhelmy

1- Source: “Survey on IFRS 17 carried out by IFRS 17 Working Group – March 2018”, AAE Insurance Committee, Lisbon 12.04.2018.

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Draft assessment – for discussion purposes only (1/3)

IFRS 17 actuarial topic	Level of connexion with RM (H/M/L)	Justification
Scope VFA	L	<ul style="list-style-type: none"> Assessment of significant investment related services and fees is based on insurance contract analysis
Level of aggregation	M	<ul style="list-style-type: none"> EFRAG paper on the topic Link with risk type/management and profitability variation 3 levels: <ul style="list-style-type: none"> Portfolio: risk type and way of management Annual cohort: time of issuance (pricing stability) Group: onerous/no significant possibility of becoming onerous/others¹
Estimates of future CF (incl. contract boundaries)	L/M	<ul style="list-style-type: none"> Similar concepts to SII IFRS17 allows for proxy methods for asymmetric CF if appropriate Contract boundaries definition combines both a contractual analysis and the link between pricing and covered risks, which has a duration impact

1- Contracts with a low profitability at inception or with highly variable profitability.

Possible interactions with RMC

Draft assessment – for discussion purposes only (2/3)

IFRS 17 actuarial topic	Level of connexion with RM (H/M/L)	Justification
Discount rates (DR)	H	<ul style="list-style-type: none"> Defining the approach: bottom-up or top-down Defining the rates above LLP Accounting policy choice at portfolio level to recognize change in interest rates in P&L or OCI
Risk Adjustment (RA)	H	<ul style="list-style-type: none"> Extensively covered by IAA¹ Link with risk appetite Appropriate methodology selection Challenges on granularity, aggregation/allocation, diversification and translation in confidence interval
Recognition of acquisition costs	L	<ul style="list-style-type: none"> Mostly linked to valuation and profitability purposes Distinction between attributable and non-attributable acquisition costs (P&L), amount to be included in the measurement of a group of contracts

1- Monograph expected by Q2_2018.

Possible interactions with RMC

Draft assessment – for discussion purposes only (3/3)

IFRS17 actuarial topic	Level of connexion with RM (H/M/L)	Justification
Coverage units	L	<ul style="list-style-type: none"> • EFRAG paper on the topic • Linked to profitability recognition (CSM release) • Function of quantity of benefits and expected duration
Transition (modified retrospective/FV)	M	<ul style="list-style-type: none"> • EFRAG paper on the topic • FV: differences in DR (own credit risk) and RA (market's perspective) • Modified retrospective: proxy DR at initial recognition date and proxy RA release at transition dates
Risk mitigation techniques	M	<ul style="list-style-type: none"> • Reinsurance mitigation: consistent assumptions with underlying insurance contracts, adjustment for non-performance, contract boundaries • Financial mitigation: IFRS 17 allows some modifications for the VFA, link with IFRS 9
Interaction with SII	H	<ul style="list-style-type: none"> • Very interesting and EU specific • Could be postponed until we are further in the IFRS 17 implementation process and result in an AAE paper