ACTUARIAL ASSOCIATION OF EUROPE

RMC - Topic 6.1: IFRS 17

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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 17[1]?

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 introduced[1]

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 reporting[1]

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 *(optional)*	(1,917)
Total other comprehensive income	**198**
Comprehensive income	**1,829**

Recognised when earned. Excludes deposits

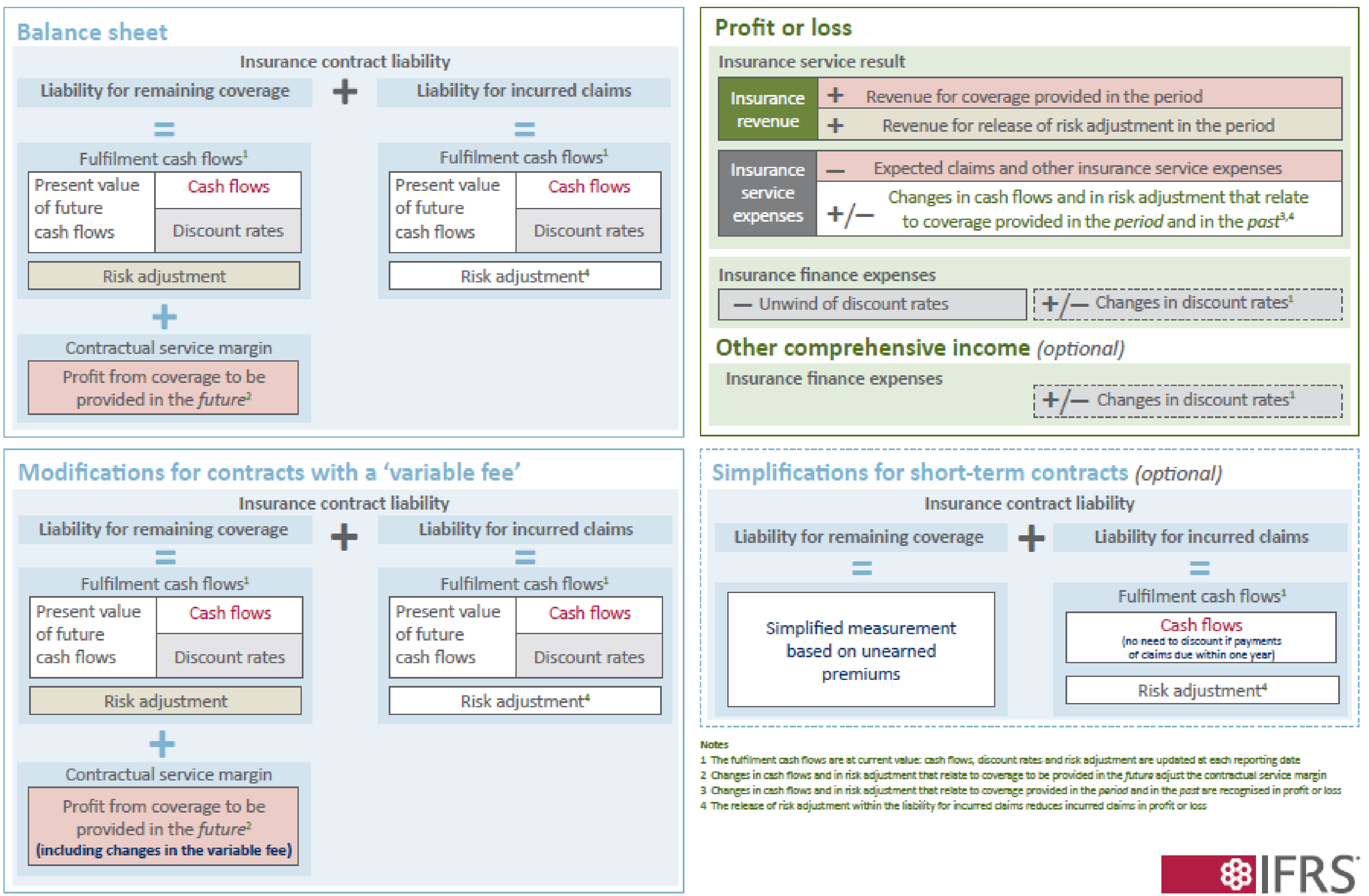
Two drivers of profits presented separately

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 page[1]



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 standard[1]

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

Contract Definition	An insurance contract is still defined as having significant insurance risk	Certain non-insurance components are to be separated from each contract	Similar policies will be grouped	
Different Calculation Approaches	Building Block Approach (BBA)	Premium Allocation Approach (PAA)	Variable Fee Approach (VFA)	Transition / Retrospective Calculations
New Figures	Contractual Service Margin (CSM)	Risk Adjustment	IFRS Future Cash Flows	
Overhaul of Reporting	New Balance Sheet	New Income Statement	Internal reporting and new KPIs	Additional Disclosures

1 – Source: Deloitte internal presentation, June 2017.

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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	• Relevant • Reliable • Understandable • Comparable
European good analysis	• Potential effects on competition • Potential impact on the insurance market • Cost-benefit analysis

- IFRS 17 case study[1]
- Surveys

1- Impact assessment on a sample of EU insurance groups. Testing results available on 25.07.2018..

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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1- Extract from the AAE Meeting with EFRAG Board on 30 May 2018.

Approach description

- We have sought the views of our member associations based on their experiences to date with IFRS 17. The work on the standard is at an early stage for many undertakings and these views may not be fully formed.

- The views represent a collation of opinions of actuarial professionals and their associations; they do not represent the views of particular undertakings, industries or individuals.

- Results of the survey are available under each of the four technical qualitative attributes (e.g. Relevance, Reliability, Understanding and Comparability).

- We observed some overlap in the answers across attributes. We have therefore extracted some key advantages associated with the standard as well as potential challenges, with a view as to how these could be addressed.

Advantages

- Modern measurement of insurance assets and liabilities
  - Market consistent valuation
  - Current estimates
  - Risk-based approach
  - Explicit margins
- Fostering consistency and comparability, especially among jurisdictions, preparers and with Solvency II
- Split of insurance result and financial result – including their components – with exclusion of investment components on the face of the income statement
- Extended disclosures leading to greater understanding
- Some simplifications allowed, for example in relation to non-life and other short-term business

Challenges

- Inconsistencies between direct and reinsurance
  - **Hindering:** relevance, understandability, reliability, comparability.
  - **Issue, for example:** Current standard creates a mismatch between a quota share reinsurance asset and liability on the primary insurers' balance sheets.
  - **Potential mitigation:** record reinsurance as hedging the covered liability.

- Reporting complexity
  - **Hindering:** relevance, understandability, reliability.
  - **Issue:** Current standard is unnecessarily complex in reporting segregation
  - **Potential mitigation:** simplify and clarify the reporting dimension.

- Too much room for different interpretation of principles
  - **Hindering:** understandability, reliability, comparability.
  - **Issue:** Principles' wordings leave unnecessary room for inconsistencies in many areas, for example concerning 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.
  - **Potential mitigation:** Narrow room for unwanted interpretation by less ambiguous wordings

Competition and Insurance Market Impacts

MARKET

- + Greater comparability and more transparency providing favourable backdrop for M&A activity and more effective capital access;
- + P&L better reflecting the business model;
- + Greater alignment between Solvency II and IFRS;
- + More insights potentially available provided appropriate education is given;
- – Inconsistency of understanding and implementation might inhibit competition;
- – Difficult to create market statistics in countries where IFRS 17 is not widely applied

ENTITY

- + Greater alignment between accounting and other business views allowing more informed management
- + Expected better understanding of products and market environment
- + Expected better connection between pricing and reserving processes leading to improved collaboration across functions
- ? More complexity in budgeting process, steering more complex based on a new management reporting/KPIs with possible changes in remuneration and product design;
- ? Potential changes to business and portfolio structures;
- ? Position of the local supervisor with respect to the scope of the standard in local regulation
- – High implementation costs and significant changes in current processes with possible market changes
- – Potential competitive advantage for entities not applying IFRS 17 (no implementation cost, no detailed disclosures, some products less attractive under IFRS 17 may create opportunity for these entities)

1 Uncertainties and challenges are mostly expected during the implementation and formative phases of the standard.

Costs and benefits relationship

Benefits

- Increased comparability and improved transparency;
- One standard used across different countries;
- Approach similar to Solvency II and closer to market value balance sheet;
- More rational pricing and value creation.

Costs

- High expenses and workload at implementation and on ongoing basis;
- Uncertainty in terms of interpretation, difficulty in implementation;
- More complexity in the standard;
- Disproportionate workload for small entities;
- Significant changes in current technical systems and new tools needed.

Conclusion

- Implementation will be very costly; strong focus will be required during that process to enable delivery of targeted benefits;
- Less complexity could mitigate costs;
- An analysis of appropriate complexity reduction to mitigate undue costs should be performed.

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Next steps

- Compare IFRS 17 and Solvency II
    - Similarities but also diverging treatment of several issues
    - EIOPA is working on a IFRS 17 – SII survey to identify efficiency gains, not everything being completely different depending on each framework objectives

➡ ***A draft on efficiency gains would be needed by end of September***

- Identify key points from the survey which could form the basis of AAE representations
- Respond to other consultation(s)
- Further interactions with EFRAG and EIOPA

AAE IFRS 17 working group[1]

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	• Assessment of significant investment related services and fees is based on insurance contract analysis

Level of aggregation	M	• EFRAG paper on the topic
		• Link with risk type/management and profitability variation
		• 3 levels:
		  • Portfolio: risk type and way of management
		  • Annual cohort: time of issuance (pricing stability)
		  • Group: onerous/no significant possibility of becoming onerous/others[1]

Estimates of future CF (incl. contract boundaries)	L/M	• Similar concepts to SII • IFRS17 allows for proxy methods for asymetric 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	• 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	• Extensively covered by IAA[1] • Link with risk appetite • Appropriate methodology selection • Challenges on granularity, aggregation/allocation, diversification and translation in confidence interval
Recognition of acquisition costs	L	• 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	• EFRAG paper on the topic • Linked to profitability recognition (CSM release) • Function of quantity of benefits and expected duration
Transition (modified retrospective/FV)	M	• 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	• 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	• Very interesting and EU specific • Should be the top priority given the current EIOPA study on SII – IFRS 17 efficiency gains