Webcast IFRS 17 simplified case study

Insurance Europe - 23 April 2018

Agenda

1. Introduction
2. IFRS 17 in short
3. Overview of the endorsement process
4. IFRS 17 – EFRAG simplified case study
5. IFRS 17 case study – current snapshot of emerging key issues
6. Q&A
7. Closing remarks / Contact details

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1	Introduction
2	IFRS 17 in short
3	Overview of the endorsement process
4	IFRS 17 – EFRAG simplified case study
5	IFRS 17 case study – current snapshot of emerging key issues
6	Q&A
7	Closing remarks / Contact details

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6. Questions and Answers

- Questions will be answered as the final part of this Webcast
- But they can be submitted at anytime to the **Host** "Insurance Europe" via WebEx Instant Messaging feature

1. Introduction

Who are we?

Olav Jones – Insurance Europe
Deputy director general/Director, economics & finance

Harm van de Meerendonk – NN Group
Head of Financial Accounting and Reporting

Massimo Tosoni – Generali
Head of Group Accounting Policy & Reporting and Group Own Funds

Jo Clube – AVIVA
Group Technical Accounting Director

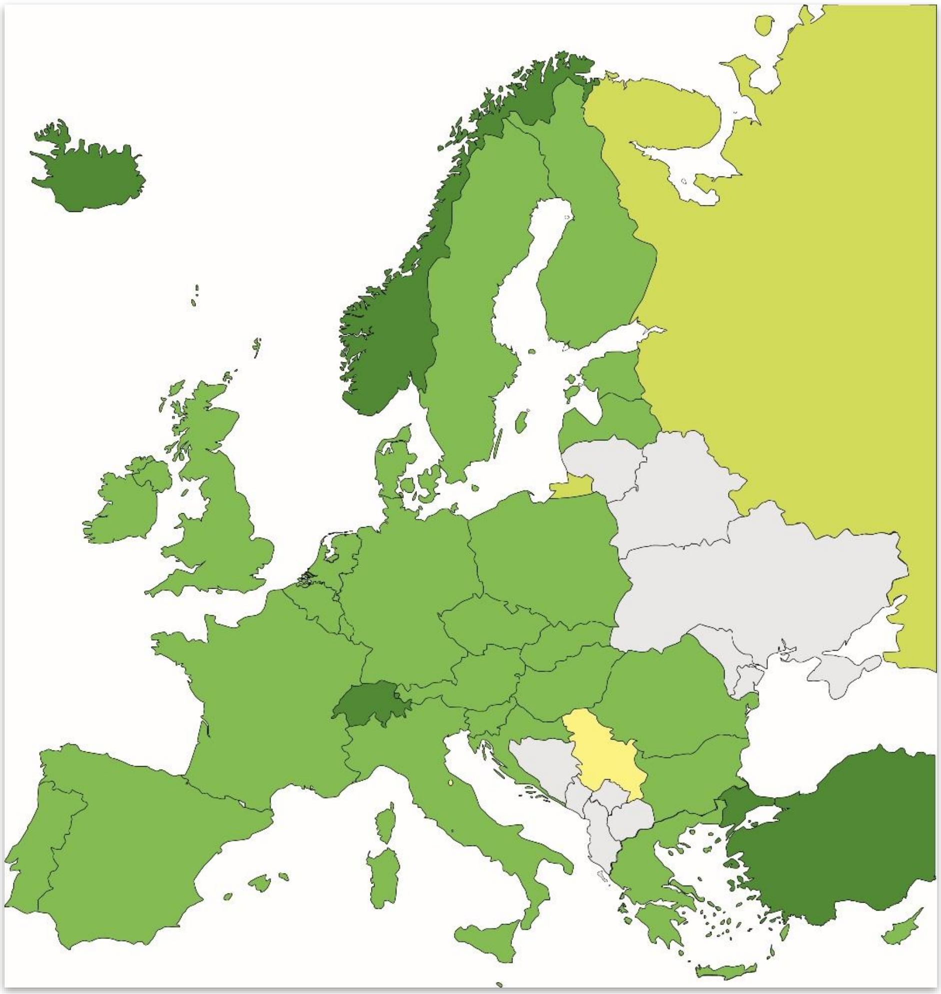
Dr. Patrick Bosch – Allianz
Accounting Policy Specialist

1. Introduction

Who is Insurance Europe ?

Who?	▪ European insurance and reinsurance federation, founded in 1953
What?	▪ Represents around 95% of European insurance market by premium income ▪ Covering all forms of insurance: life, non-life, re-insurance and mutuals
Why?	▪ Committed to achieving an efficient and effective regulatory and supervisory framework for insurers at European and international level

1. Introduction



35 national associations

27 EU member states

5 non-EU markets

Switzerland, Iceland, Norway, Turkey, Liechtenstein

2 associate members

Serbia, San Marino

1 partner

Russia

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1. Introduction

Contribution to the economy*

Insurance Europe represents around 3 500 European (re)insurers, which:

- generate premium income of €1,200bn
- directly employ 940,000 people
- invest nearly €10,100bn in the economy

*Source: European Insurance in Figures (2016 Data), published by Insurance Europe, February 2018

1. Introduction

Objectives for IFRS 17

- More transparent information on the performance of insurers.
- One common measurement model for all types of insurance contracts. Increased comparability between insurers.
- Consistency with other standards in the IFRS framework.
- Focus on the reporting of risks and uncertainties.
- Focus on the reporting of performance drivers.

1. Introduction

IFRS use key figures

Listed insurance companies only: Reporting framework	Number of companies	Total assets[28] (US$ trillions)
IFRS Standards	449	13.3
US GAAP	128	4.7
Japanese GAAP	11	4.0
Other national GAAP	38	0.1
Total	626	22.1

Note: this table excludes insurance brokers.

Source: IASB

Analysis of the accounting standards used by these listed insurance companies

Overview by geographical region of the listed companies operating in the insurance sector

Listed insurance companies only: Geographical region	Number of companies	Total assets[28] (US$ trillions)
Europe	95	8.6
Asia Pacific	191	7.2
North America	110	5.8
Africa and Middle East	184	0.3
Latin America	46	0.2
Total	626	22.1

Note: this table excludes insurance brokers.

Source: IASB

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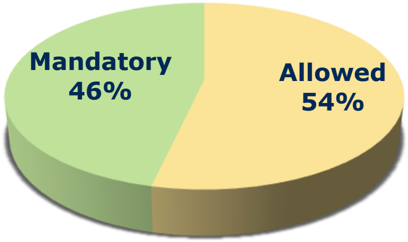
1. Introduction

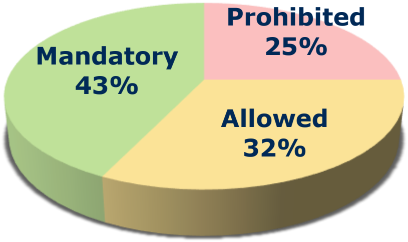
IFRS use across the 28 EU members

IFRS application for Listed companies Consolidated Reporting

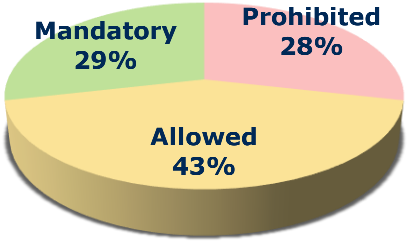
IFRS application for Unlisted companies Consolidated Reporting



IFRS application for Listed companies Statutory reporting



IFRS application for Unlisted companies Statutory Reporting



Sources:
- "*Overview of the use of options provided in the IAS Regulation (1606/2002) in the EU*" – Accounting Regulatory Committee (December 2013)
- Insurance Europe "Use of IFRS in the EU" survey (November 2017)

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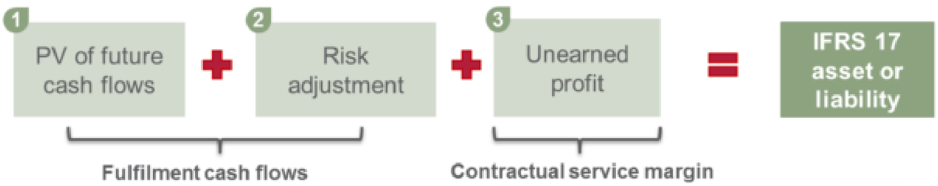
2. IFRS 17 in short … Key Changes

Profit Recognition – Contractual Service Margin



Source: IASB

Key implementation challenge

- **CSM amortization on the basis of "coverage units"**
    - **Define coverage units ?**
    - **CSM amortization ?**
- **Methodologies**
    - **Discount rate**
    - **Valuation of options**
    - **Risk Margin**

Presentation P&L

Current presentation

Premium received less premium ceded
Investment income
Other Income
Total Income
Benefits and claims
Change in insurance contract liabilities
Expenses
Profit/Loss before tax
OCI – (but discount rate changes)
Total comprehensive income

IFRS 17 presentation

Insurance contract revenue
Incurred claims and fulfilment expenses
Insurance service result
Investment income
Insurance finance expense
Net financial result
Profit/Loss before tax
Discount rate changes on insurance liability (optional) - OCI
Total comprehensive income

Key implementation challenge

- **Accounts mapping**

2. IFRS 17 in short … Key Changes

Insurance Contract Measurement Methods

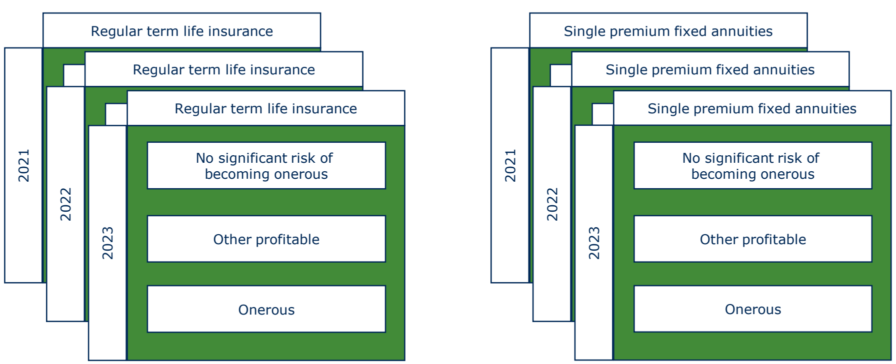
	General Model Building Block Approach (BBA) Mandatory	Premium Allocation Approach (PAA) Optional	Variable Fee Approach (VFA) Mandatory
Use ?	Default Model for all insurance contracts	Simplified measurement for short term contracts with little pre-claim variability	Model for direct participating business
Typical contract	Life insurance Some healthcare	Car insurance Fire insurance	With profit contracts

Source: inform.pwc.com

Key implementation challenge

- **Contracts eligible for the PAA ?**
- **Scope of VFA ?**

Level of Aggregation



Key implementation challenge

- **Classify contracts by types of risk and managed together**
- **Annual Cohorts**

2. IFRS 17 in short... IFRS 17 vs Solvency II

Conceptual similarities but not the same

Selection of the differences between IFRS 17 & SII

Topic	IFRS 17	Solvency II
Recognition	Earliest of start of coverage and premium receipt (plus onerous contract test	Date party to contract
Measurement model	Building Block Approach (BBA), or Premium Allocation Approach (PPA), or Variable Fee Approach (VFA) for eligible contracts	No choice, cashflow approach more closely aligned to BBA under IFRS 17
Discount rate	Company specific, principle based	Prescribed
Contractual Service Margin	Eliminates day-one gain (measure of unearned profit)	No similar concept, day-one taken immediately into own funds
Risk allowance	Risk adjustment – no prescribed method	Risk margin – prescribed cost of capital method and calibration
Other comprehensive income (optional)	Isolates the impact of discount rate changes from the rest of the P&L	No similar concept

Source: actuary.com

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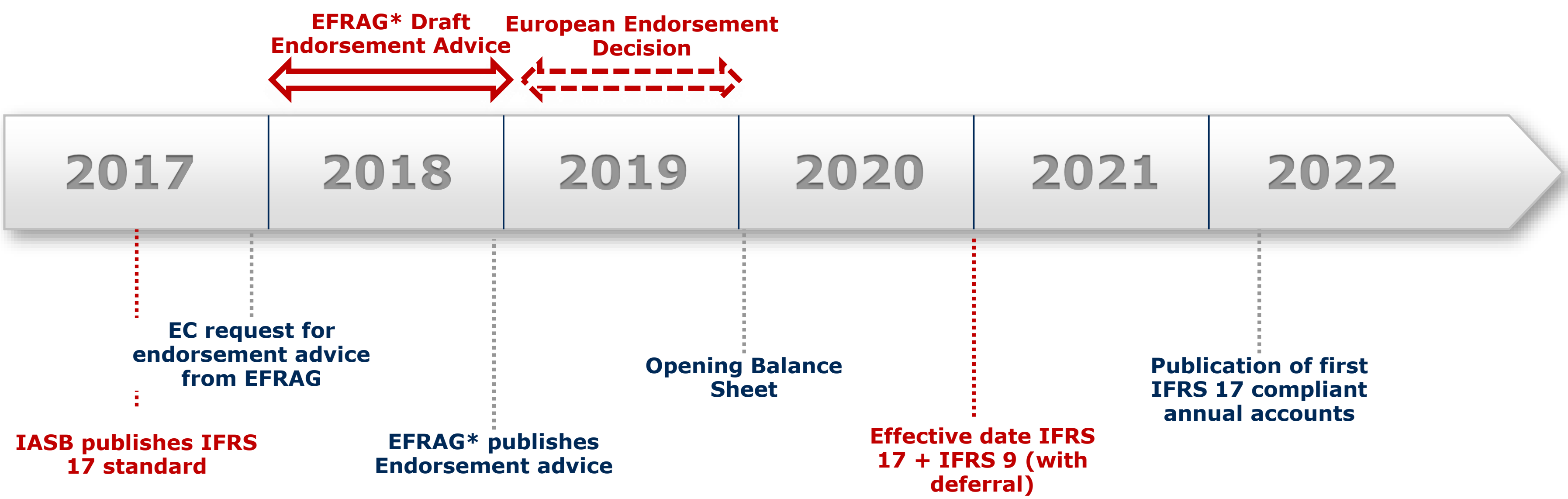
2. IFRS 17 simplified time-line

Timeline



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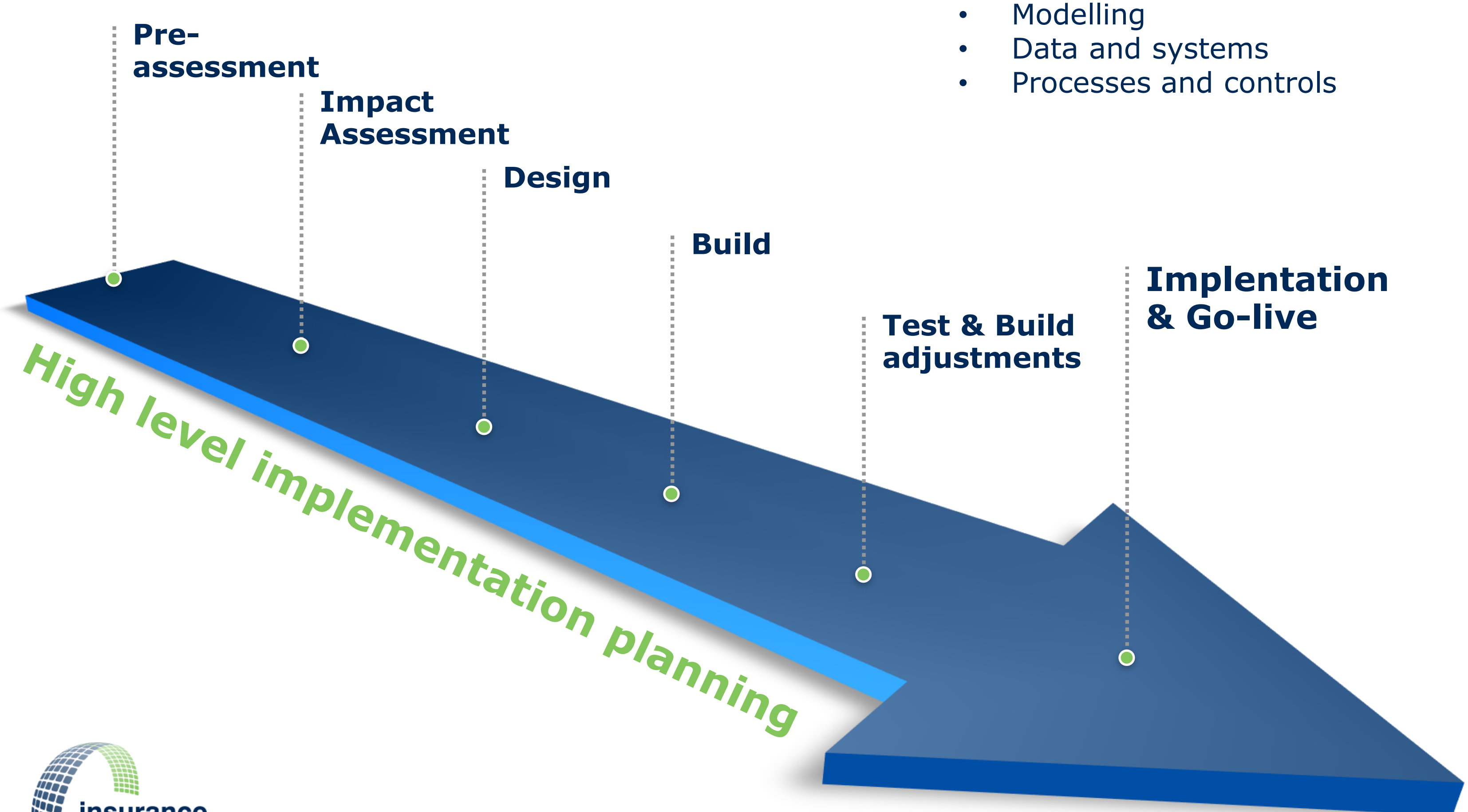
***EFRAG**: European Financial Reporting Advisory Group

2. IFRS 17 simplified time-line

Very significant implementation project with significant impact on:

- Accounting & reporting
- Modelling
- Data and systems
- Processes and controls



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3. European Endorsement process

EU Endorsement of IASB issued standards

IFRS standard issued → EFRAG advice → Commission proposal → ARC vote → Council and Parliament scrutiny → endorsement decision

Source: European Commission

EFRAG advises the EC on whether the adopted IFRS Standards **meet the criteria for use** in Europe

If the **Accounting and Regulatory Committee's (ARC)** opinion is positive, the draft is submitted to the **EU institutions**:

- **European Parliament**
- **Council**

If, after a 3-month scrutiny period, **there are no objections** from the European Parliament and the Council, the EC **adopts IFRS 17**

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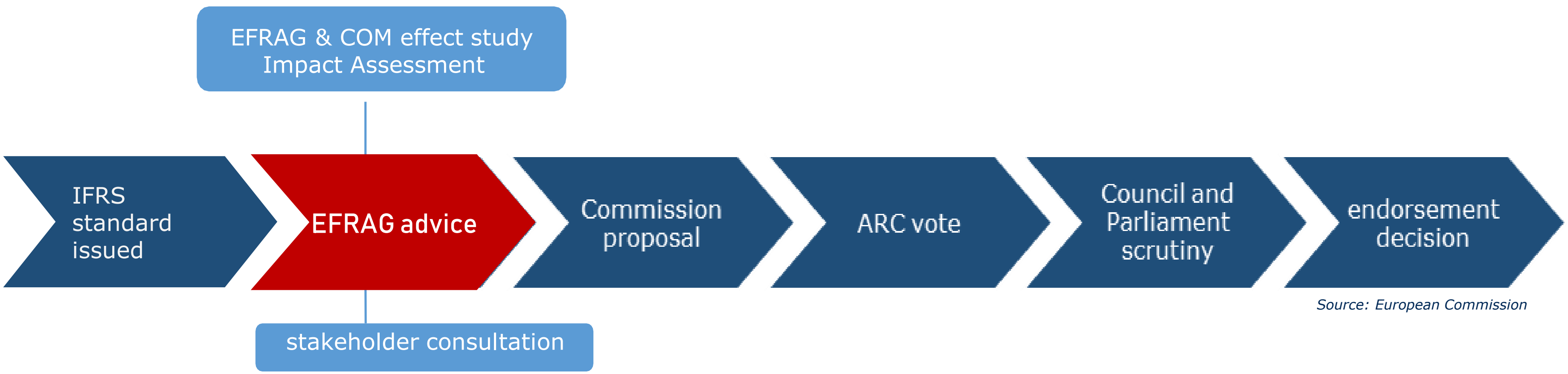
***ARC**: Accounting Regulatory Committee

3. European Endorsement process

EU Endorsement of IASB issued standards



Source: European Commission

European Commission request

- **Delivery of consistent and understandable reporting**
- **Comparability**
- **Representation of business model**
- **Impact on Competitiveness**
- **Impact on design and pricing of products**
- **Comparison of SII / IFRS 17**
- **Attractiveness of sector**
- **Effect on Cost of Capital**
- **…**

Work carried out by EFRAG on IFRS 17

- **Full Case Study**
- **Simplified Case Study**
- **Economic Studies**
- **User Outreach**
- **IFRS 17 / Solvency II comparison**

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4. IFRS 17 -EFRAG simplified case study

- Purpose: Gather information from insurers that apply IFRS Standards not taking part in the full case study to be used as input in the Draft Endorsement Advice (DEA).
- Data will be treated confidentially
- Partial submission accepted (to increase number and range of contributors)
- Deadline: 31 May 2018
- All input received will be aggregated with input from other responses and sources
- Simplified case study can be found on EFRAG's website here

Insurance Europe and its member associations are encouraging insurers to take part in the simplified case study to ensure EFRAG has input from a wide range of companies and is aware of all key issues and concerns

4. IFRS 17 -EFRAG simplified case study

Part A: Qualitative

Part A – General Information (Qualitative)

- Product trends
- Pricing impact
- Estimates of costs
  - Implementation
  - Ongoing
  - Impact of Solvency II costs
- Performance indicators
- Asset – Liability Management
- Benefits of IFRS 17
  - Availability of options
  - Uniform Chart of Accounts
  - Level of aggregation
  - Resolving accounting mismatches
  - Reflecting economics of business
  - Sharing of risk
  - …

Points to note

- Partial answers accepted
- "Benefits of IFRS 17": 1-5 scale & comment section to raise issues with standard
- Can be answered independently from Part B

4. IFRS 17 -EFRAG simplified case study

Part B - Quantitative

Part B – Quantitative Information

- Step 1: Selection of portfolio
- Step 2: Application of current GAAP
- Step 3: Application of IFRS 17 and IFRS 9
- Step 4: Comparison with current accounting and explanation of the differences

- Transition
- Overall measurement
- Scope of VFA
- Level of aggregation
- Economic mismatches
- Accounting mismatches
- CSM allocation patterns
- Insurance finance income/expenses
- Direct insurance combined with reinsurance
- Sharing of risks
- Discretionary cash flows
- Overall impact
- Overall comment

Points to note

- Partial answers accepted
- Select one insurance portfolio and apply the standard

Emerging issues - First speaker

Harm van de Meerendonk – NN Group
Head of Financial Accounting and Reporting

NN

Topics covered

- General presentation
- Hedging

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CFO FORUM

Summary of most significant ‘key-issues’ in IFRS 17

April 2018

5. IFRS 17 case study – emerging key issues

Snapshot of emerging key issues from CFO Forum companies

- The European Insurance CFO Forum ("CFO Forum") is a body representing the views of 21 of Europe's largest insurance companies
- These companies are working in IFRS 17 in several ways:
  - Individual implementation projects
  - EFRAG testing exercises
  - CFO Forum Working Groups
  - IASB Transition Resource Group
- Several issues have been identified in IFRS 17; the current snapshot of the most significant key issues are summarised in the following slides
- These are not all issues for all members, but the most significant common issues identified so far
- The issues are not prioritised as different issues are of different importance to different members

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5. IFRS 17 case study – key issues (1/4)

Topic	Issue noted	Implications
Level of aggregation	The annual cohort requirement leads to significant operational burden, whereas it will not provide more relevant information, particularly where mutualisation exists. Separation of contracts into individual risk components should be permitted to allow grouping by risk.	• The annual cohort requirement will add significant operational complexity and may lead to greater income statement volatility • Restrictions on permitting separation of contracts could mean results do not clearly reflect the economics of the business
CSM Amortisation	CSM amortisation on the basis of 'coverage units' is seen as a very complex area and is not clear how this applies to certain contracts, especially those in the scope of the VFA and those that provide both insurance and investment benefits	• CSM amortisation is a fundamental driver of profit • A narrow/restrictive interpretation may result in profit profiles that do not represent the economics • Practical expedients may be needed operationally

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5. IFRS 17 case study – key issues (2/4)

Topic	Issue noted	Implications
Reinsurance	The treatment of reinsurance will lead to volatility for several reasons: • The asymmetry with respect to onerous underlying contracts (negative CSM on underlying contracts recognised immediately, positive CSM on reinsurance recognised over time) • Reinsurance cannot be accounted for using the VFA model, even if the underlying insurance contracts are under the VFA; • Contract boundary of proportional reinsurance contracts held includes (an estimate of) the total amount of underlying contracts that will be written, but are not yet recognized	• The reinsurance model potentially results in significant mismatches between gross and reinsurance results, which will create significant income statement volatility • It also adds undue operational complexity
Transition	It is believed that the implementation efforts can be reduced significantly by easing the transition. The modified retrospective approach may not result in much less efforts than fully retrospective and the possibility to apply fair value transitioning may be too limited.	• Without simplification the transitional requirements could result in significant implementation effort and cost

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5. IFRS 17 case study – key issues (3/4)

Topic	Issue noted	Implications
Presentation issues	These presentational issues are seen as very costly and difficult to implement but provide little benefit in terms of the understandability and usefulness of the financial statements: • the requirement to present insurance contract assets and liabilities separately (including accounts payable and receivable in the fulfilment cash flows is also not seen as accurately representing the economics of the transactions); • the requirement to separate non-distinct investment components from revenue; • it is not clear whether accounts payable / receivable, including funds withheld and deposit back assets should be included in the fulfilment cash flows; and • the requirement to present revenue under the PAA model based on premiums received	• These presentational issues will result in significant operational complexity and cost, without adding real benefits.
Scope of VFA	The scope insurance contracts qualifying for the Variable Fee Approach is considered too narrow, mainly because: • The detailed requirements include a quantitative assessment, which may result in contracts meeting the principles still not qualifying • Insurance contracts with constructive obligations from discretionary participation may not qualify	• A narrower scope has the potential to lead to greater income statement volatility • Cliff effect where similar products could have very different accounting • A requirement to perform a quantitative assessment of eligibility would be operationally difficult and restrict the use of VFA

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5. IFRS 17 case study – key issues (4/4)

Topic	Issue noted	Implications
Acquisition cash flows	Prohibiting acquisition cash flows on new business that is expected to renew from being allocated to future annual cohorts is not considered to reflect the economic substance	• This issue results in more onerous contracts, that in reality are profitable
Hedging	IFRS 17 only accommodates hedging for products accounted for under the VFA model and then only where derivatives are used to hedge options and guarantees. It also cannot be applied retrospectively on transition.	• The narrow scope will lead to greater income statement volatility which does not represent economic reality

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Emerging issues - Second speaker

Massimo Tosoni – Generali
Head of Group Accounting Policy & Reporting and Group Own Funds

Topics covered

- Level of aggregation : Annual Cohorts requirement
- Contractual Service Margin release

Annual cohort requirement

Annual cohort requirement

- The **annual cohort requirement** leads to **significant operational burden**, whereas it will not provide more relevant information
- This requirement **is not consistent with the management of an open insurance portfolio** and do not provide additional useful information because **it does not reflect the intergenerational mutualization of participating policies** and leads to **artificial and costly reallocation of mutualized business** into annual groups.

Suggestion for improvements are**:**

- **Remove the annual cohorts** requirement and **allow a grouping that reflects how the business is managed** in practice (i.e. allowing for intergenerational grouping) :
  - This is **not in contrast with the recognition of losses in case of onerous contracts written**;
  - For participating business, this will **be aligned with the ALM strategy of the underlying items** (investments) that is not based on annual cohorts, rather than to ensure that the overall fund is able to pay policyholders obligations

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CSM amortization

CSM amortization

- CSM amortization on the basis of **“coverage units”** is seen as a **very complex area** and is not clear how this applies to certain contracts, **especially those in the scope of the VFA** and those that provide **both insurance and investment benefits**
- The application of coverage units for certain saving participating contracts (e.g. business under VFA) may lead to a linear profit recognition not consistent with the underlying investment services provided.

Suggestion for improvements are**:**

- drivers shall take into account of all the services provided under a contract (not only insurance);
- Amortization drivers reflecting expected cash flows or equivalent proxies shall be used if that best reflect the services provided (e.g. investment management services)

Emerging issues - Third speaker

Jo Clube – AVIVA
Group Technical Accounting Director

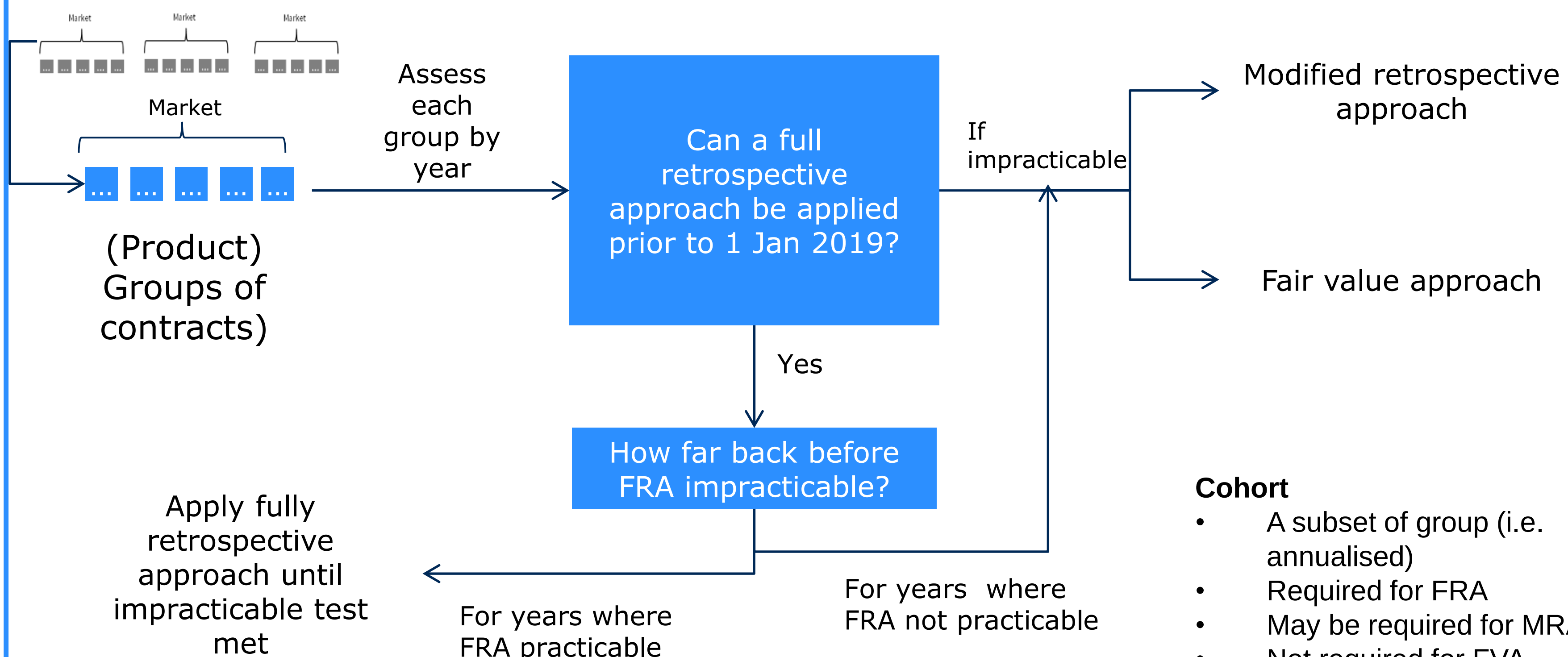
Topics covered

- Reinsurance
- Transition requirements

IFRS 17 – Transition

- IFRS 17 needs to be applied retrospectively from the transition date (1 January 2020).
- Where it is practicable to do so, then a full retrospective approach (FRA) must be used.
- Where not practicable, there is a free choice of applying a modified retrospective approach (MRA) or a fair value approach (FVA).

Decide transition method for each block of business



Cohort

- A subset of group (i.e. annualised)
- Required for FRA
- May be required for MRA
- Not required for FVA

IFRS 17 – Transition

Transition Approach and Financial / Operational Implication

Transition Approach	Financial/ Commercial Impact	Operational Impact
Full Retrospective Approach (default choice unless able to justify otherwise)	H	H
Modified Retrospective Approach	H	H
Fair Value Approach	H	M/L

The inability to carry out a **full retrospective approach will need to be evidenced.**

The choice between MRA and FVA will have both a financial impact and operational impact.

All 3 approaches could be used depending on the product and year of inception.

IFRS 17 – Reinsurance

- Inability to apply a 'look through' approach for proportional reinsurance.
  - Results in mismatches
  - differing models between direct and outwards contracts (PAA vs. BBA)

- No day 1 gain to offset day 1 loss on reinsured onerous contracts

- Different contract boundary and coverage period

- VFA for reinsurance not permitted

- Unit of account different
  - Differences in value of reinsurance asset vs underlying (reinsured) liabilities

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Emerging issues - Fourth speaker

Dr. Patrick Bosch – Allianz
Accounting Policy Specialist

Allianz

Topics covered

- Presentation
- VFA Scope
- Acquisition costs

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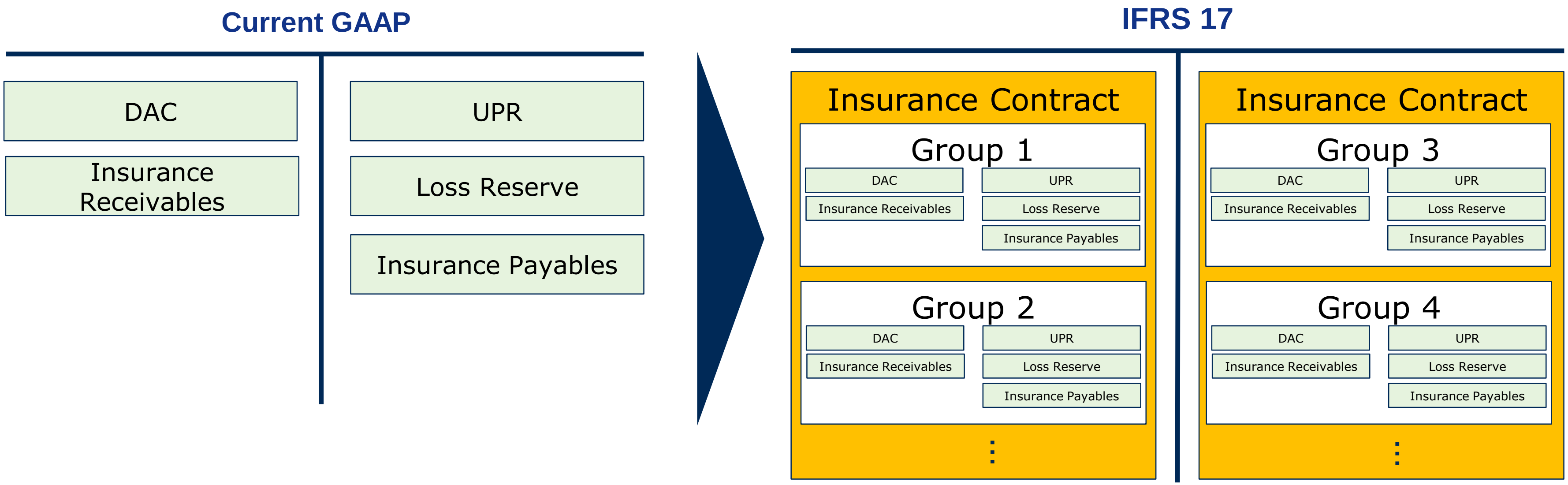
Presentation



Issues:

- Allocating cash flow components to the group of contracts
- Premium received concept
- Identification of non-distinct investment component

! **Presentational issues are very costly and difficult to implement but provide little benefit in terms of the understandability and usefulness of the financial statements**

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Scope of VFA

	Standard requirement	Issue
	Insurance contracts with direct participation features are insurance contracts that are substantially investment-related service contracts under which an entity promises an investment return based on underlying items. Hence, they are defined as insurance contracts for which:	
B101(a)	the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items	Enforceability – Grey area cases ➢ Using "constructive obligation"
B101(b)	the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items	Qualitative vs. Quantitative assessment
B101(c)	the entity expects 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	

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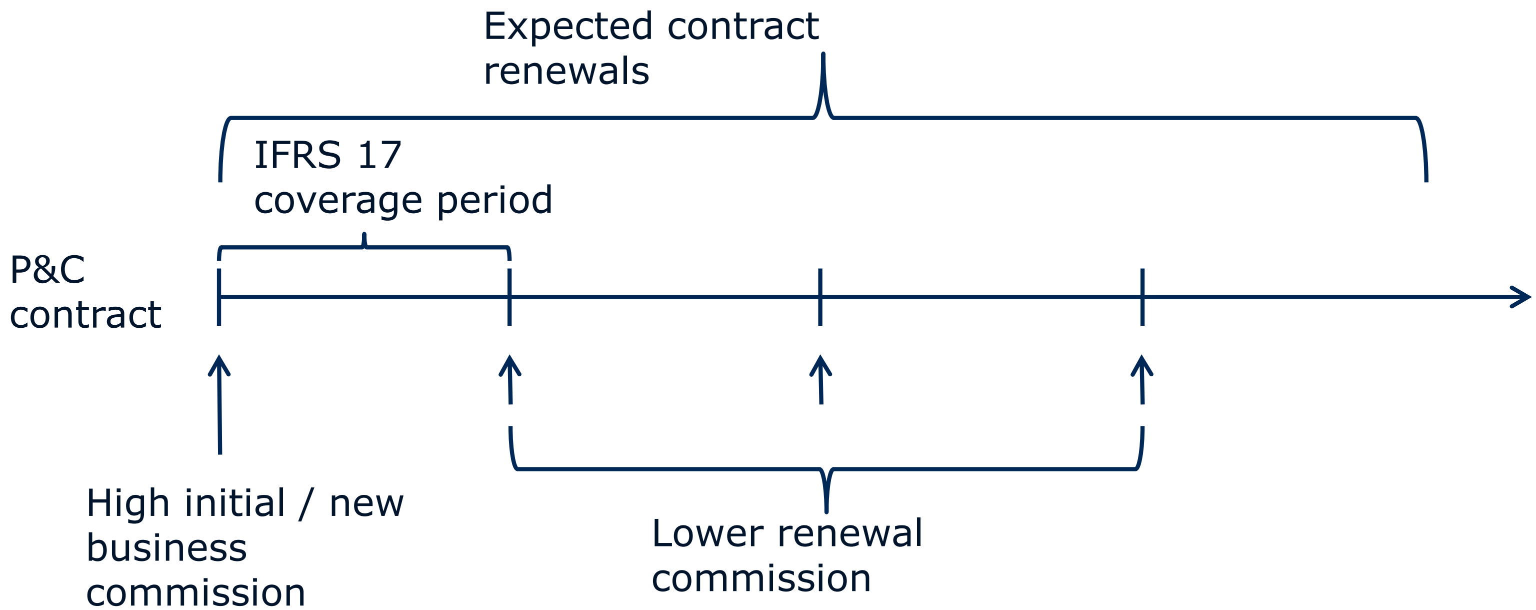
Insurance acquisition cash flows



- Pricing reflects expected renewals
- Conflict with IFRS 17 contract boundaries
- February TRG meeting requires to allocate unconditional commissions only to initially written contracts

! **Can lead to onerous new business and is inconsistent with IFRS 15 treatment**

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6. Questions and Answers

- Questions can be submitted at anytime to the Host "Insurance Europe" via WebEx Instant Messaging feature

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7. Closing remarks / contact details

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Thank you

For more information

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