IFRS 17 for P&C: What's all the fuss?

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Content

This talk is about the impact of IFRS 17 on P&C insurers so far

What you should take away from this talk

- **Beware generalisations** when discussing the impact of IFRS 17 on specific firms
- **Who's affected**
- What's happening **when**
- A basic awareness of the **key changes required**
- An understanding of some the **issues** that it is throwing up and how those differ between insurers

Note: I have summarised the key requirements of IFRS 17 in this talk. To achieve compliance there is a lot more detail!

Background

Who's affected?

(Re)Insurers who are listed or have issued listed debt (and are not in the US)

Groups that have entities that write (re)insurance and are IFRS reporters locally

Companies who write insurance contracts and who report under IFRS

(Re)Insurers in countries where there is no local GAAP alternative

IFRS "non-insurers" who write insurance as defined under IFRS

IFRS 17 - Background

- IFRS17 is a mandatory new accounting standard for insurers coming into force on 1 January 2023
- 1st truly international accounting standard for insurance contracts
- Applies to IFRS reporters
- The key intended objectives are:
  - **Consistent** approach for all insurance contracts
  - Highly **transparent** model with greater **granularity**
  - **Alignment** of IFRS metrics with other industries
- IFRS17 represents a “once in a generation” overhaul of how insurers must report their financial performance & position
- IFRS17 is a principles-based standard leaving many areas open to interpretation and judgement.

IFS 17 Timing - The journey to 2023

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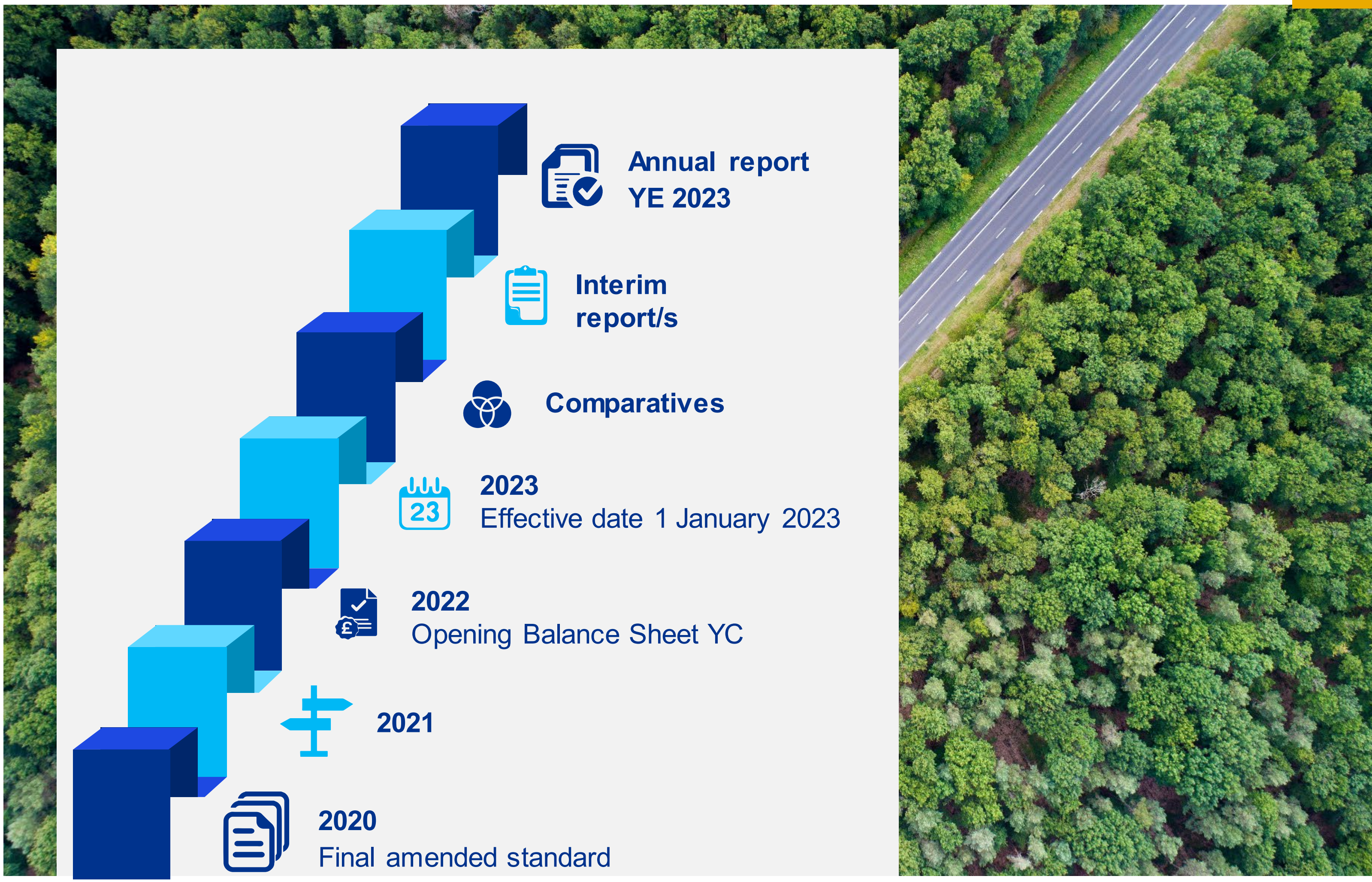
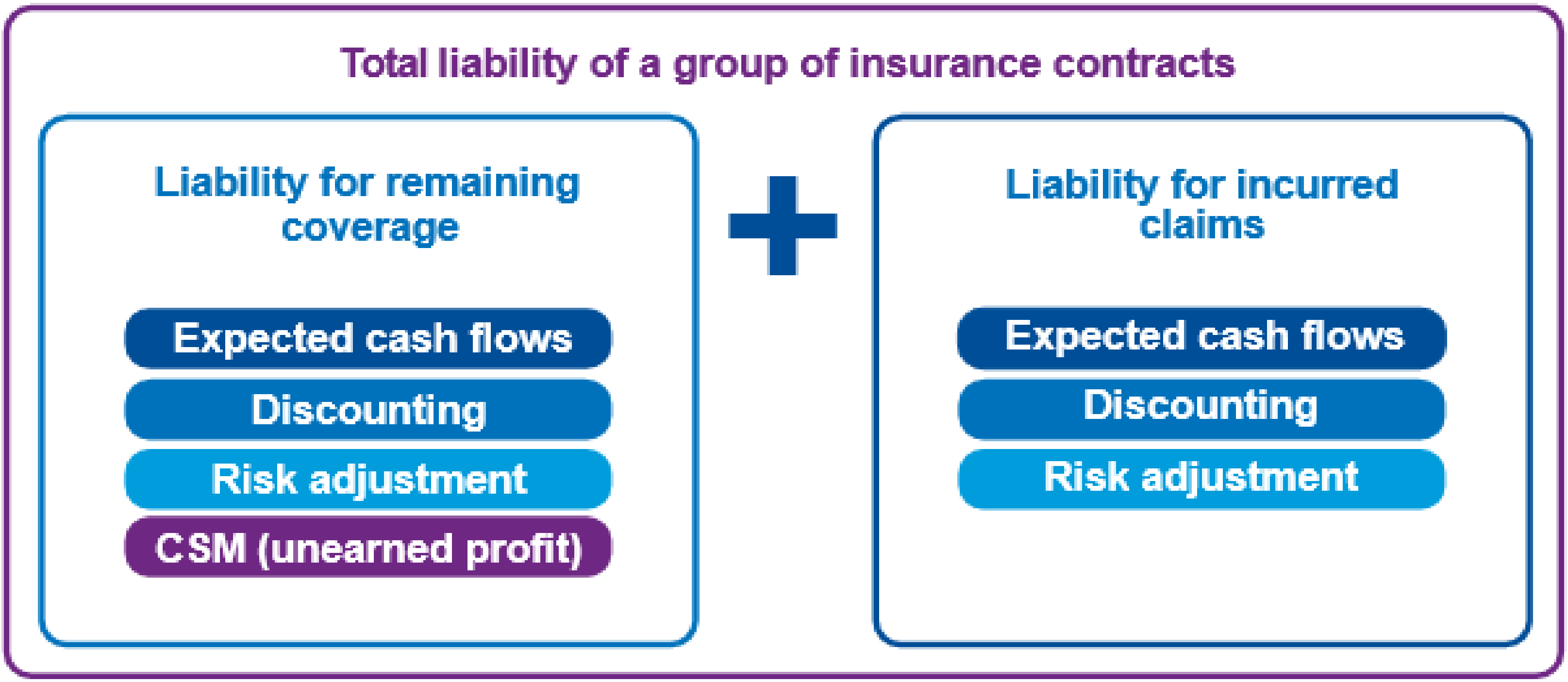


Measurement requirements

Measurement – the default model

General Measure Model



Measurement – the Premium Allocation Approach

Entities can elect to use a simplified approach, the PAA. Contracts are automatically eligible for the PAA if they have a coverage period of one year or less. **Most P&C insurers have opted to use the PAA where they can**

	GMM	PAA
Liability for remaining coverage	CSM	Simplified liability measurement (calculated as unearned premium received less acquisition costs)
	Risk adjustment	
	Discounting	
	Future cash flows	
Liability for incurred claims	Risk adjustment	Risk adjustment
	Discounting	Discounting
	Future cash flows	Future cash flows

Liability for Incurred Claims (LIC)

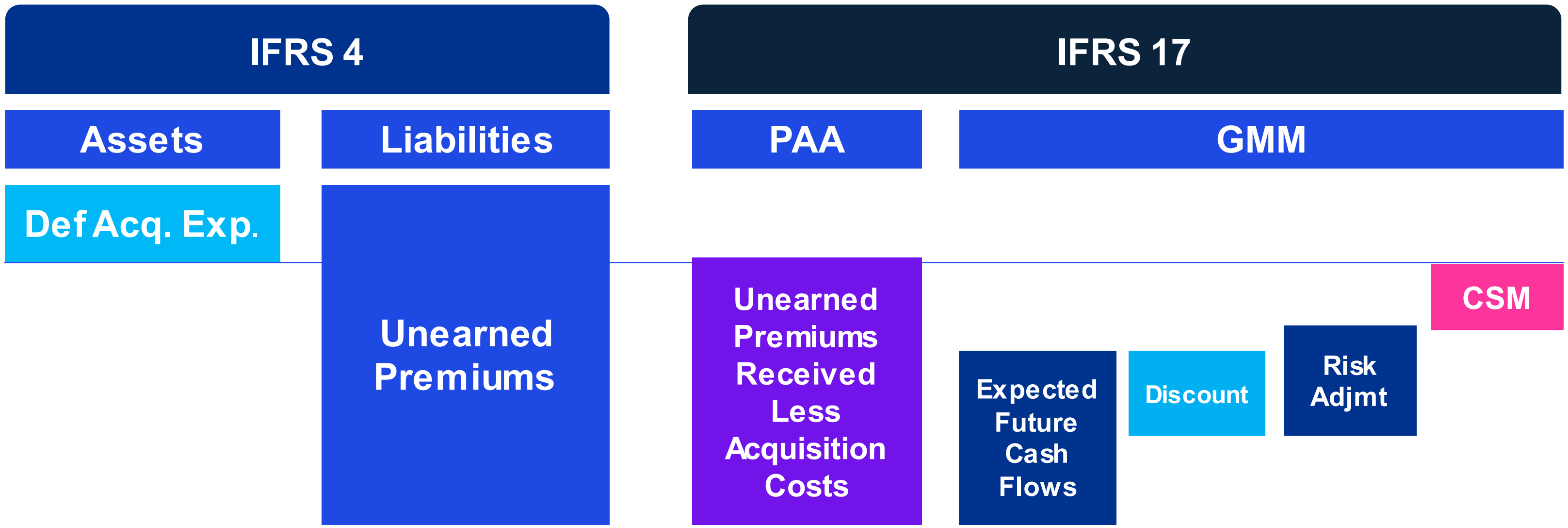
IFRS 4	IFRS 17
Expected unpaid claims	Expected future cash flows (Probability-weighted)
Discounting at actual portfolio yield rate (optional, and generally only for long tail libailities)	Discounting at adjusted market rate
Provision for adverse deviation (incl. interest rate risk)	Risk adjustment

Probability weighted expected cash flow → do not expect significant change
Discount rate → selection of rate will change and by portfolio (duration); no change in procedure (except if OCI option selected)
Risk adjustment → only covers insurance risk (no interest rate risk); confidence level will need to be disclosed (current approach will need to evolve)

Key message

For claim liabilities: it is on a true best estimate basis, discounted with a risk adjustment applied

Liability for Remaining Coverage (LRC)
Initial recognition



PAA: LRC = unearned (premium received less acquisition expenses); broadly equivalent to current IFRS 4

GMM: LRC = fulfilment cash flows (risk-adjusted present value) + CSM

CSM represents unearned profit results in no gain on initial recognition

If fulfilment cash flows result in no CSM, a **loss is recognized immediately**

Key message

At initial recognition, no profit is recognized under both models.

Level of aggregation

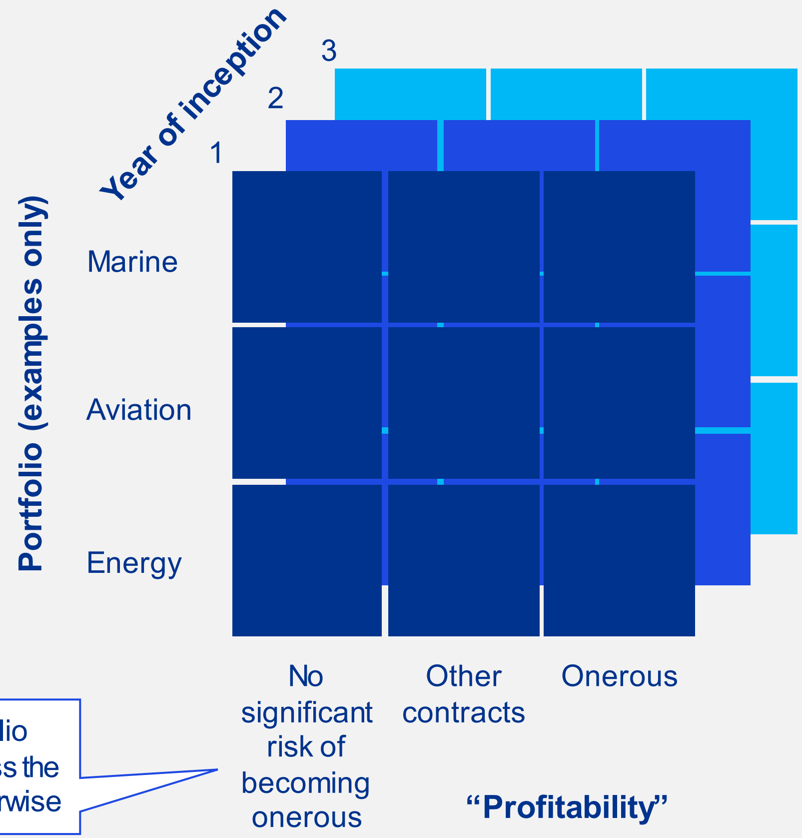
- At **initial recognition**, contracts should be divided into "groups" based on portfolio and "profitability". These groups will contain contracts written no more than 12 months apart from each other.

  This ensures that contracts that are onerous at inception are recognized immediately.

- **Subsequently**, Firms will account for each of the "groups" of contracts that were established at initial recognition, with losses recognised immediately for any group of contracts that subsequently becomes onerous. Year on year, the groupings may change

PAA: Assume no contracts in a portfolio are onerous at initial recognition unless the facts and circumstances indicate otherwise

IFRS 17 contract groupings



Key differences from today

Against IFRS 4/GAAP

- **Granularity and onerous contracts**
  - The requirement to recognize losses up front hasn't changed, but the granularity at which that testing takes place has
  - Specific disclosure for onerous contracts
- **Booking best estimate plus a <u>disclosed</u> risk adjustment and a confidence level**
- **Requirement to discount reserves**
- **Specific rules around reinsurance**
  - Some fundamental changes, especially for retrospective RI
- **Format of the FS has changed**

Against SII

- **PAA simplification** for unexpired risk
- **Requirement to recognise losses up front** does not exist for SII
- **Methodology for calculating the RA** is not prescribed
- **Discount rates** are not prescribed
- **Reinsurance** may be quite different

Financial statements and disclosures

Presentation – Income statement

Exclude investment components

Split between insurance service result and finance result

Exclude investment components

No more GWP or premiums due

In millions of euro	2021
Insurance revenue	54,269
Insurance service expenses	(43,104)
Net expenses from reinsurance contracts	(1,230)
Insurance service result	**9,935**
Interest revenue on financial assets not measured at FVTPL	8,398
Other investment revenue	21,095
Net impairment loss on financial assets	(324)
Investment return	**29,169**
Net finance expenses from insurance contracts	(22,855)
Net finance income from reinsurance contracts	396
Movement in investment contract liabilities	(1,311)
Movement in third party interests in consolidated funds	(62)
Net investment result	**5,337**
Revenue from investment management services	432
Other income	735
Other operating expenses	(6,318)
Other finance costs	(615)
Share of profit of equity-accounted investees, net of tax	233
Profit before tax	**9,739**
Income tax expense	(2,644)
Profit for the year	**7,095**

Explicit comparison between investment return and unwinding of discounting of liabilities

Source: Illustrative Disclosures for Insurers, page16

Statement of financial performance

The presentation of income statement is more **condensed** and more **aligned with non-financial companies**

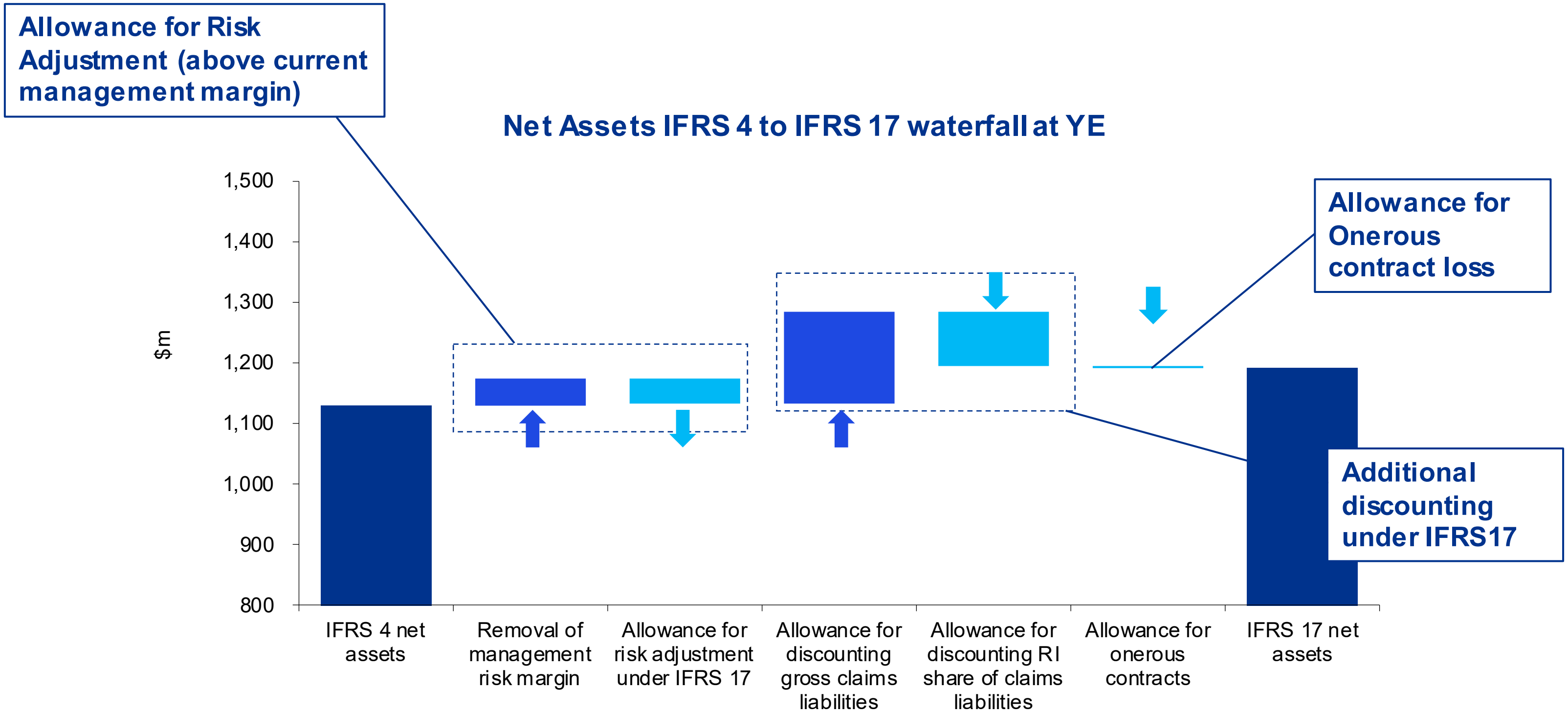
IFRS 4
Gross written premium
Written premiums, ceded
Net premiums written
Gross earned premiums
Earned premiums, ceded
Net premiums earned
Claims and claims adjustment expenses
Claims and claims adjustment expenses, ceded
Claims and claims adjustment expenses, net
Expenses for the acquisition of insurance
Net operating expenses

IFRS 17
Insurance revenue (IR)
Insurance service expense (ISE)
Net expenses from reinsurance contracts
Insurance service result
Insurance finance income/expense (IFIE)
Reinsurance finance income/expense (RFIE)
Net financial result
Other operating expenses

Balance Sheet Impact

The chart below demonstrates the impact of IFRS 17 on an illustrative balance sheet net assets. There are three main drivers of the balance sheet impact:

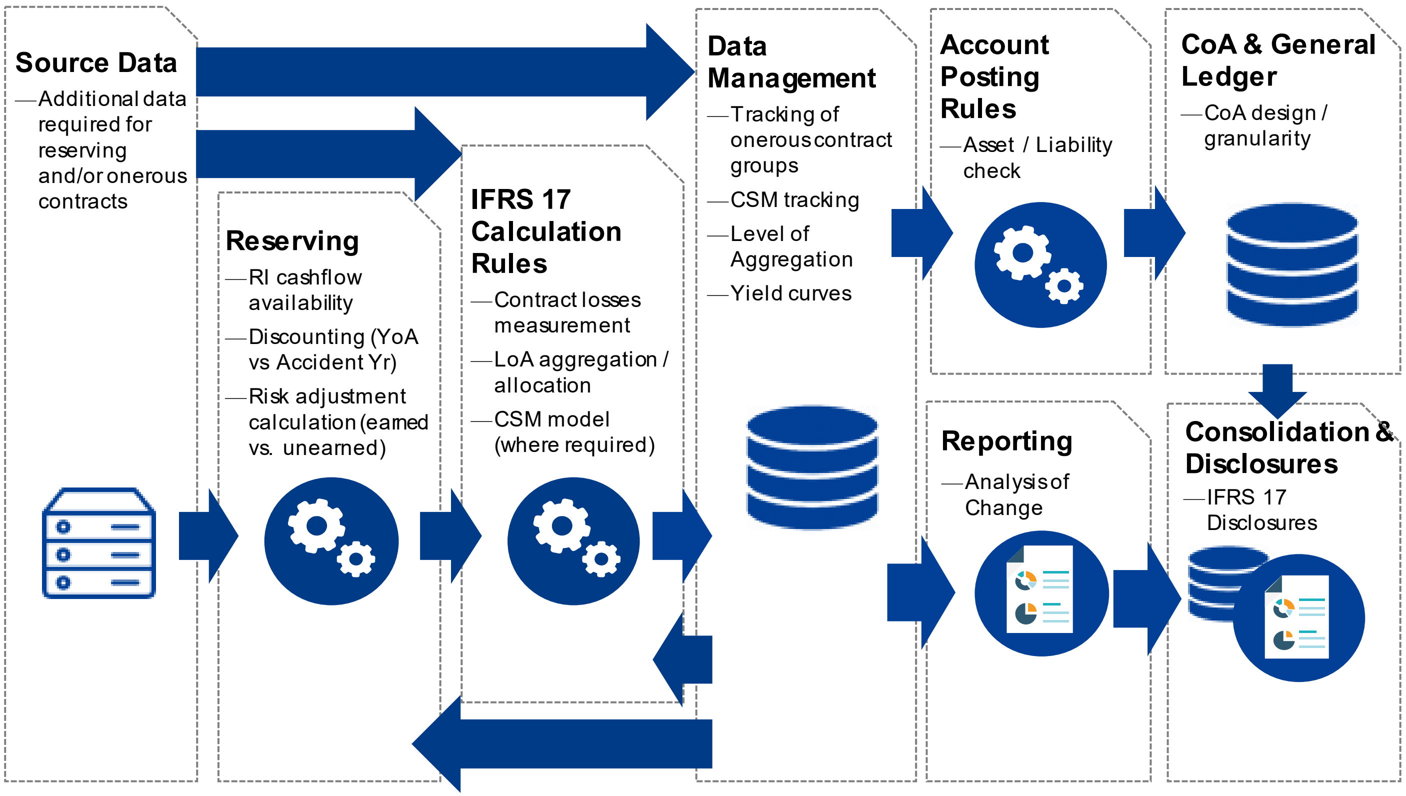
1) The impact of discounting claims liabilities and RI recoveries;
2) The risk adjustment held above best estimate liabilities and RI recoveries;
3) The loss component relating to onerous contracts.



Impact on GI Processes, Systems and Controls

Impact on GI Processes, Systems and Controls

End to End this has a big impact on firms and actuaries are a key part of that change. Finance and Actuarial working close is key to a successful implementation and Finance process



Key discussion points

- Have any significant data challenges been identified, e.g. new sources of data, significant underlying operational system change
- Requirements and optionality around CSM tool
- Where in the operating model new calculations will be performed
- Consistency of LoB/ LoA groupings across the business
- Reporting from the ledger vs. reporting from data stores
- Managing disclosures

Challenges for the interpretation of financial statements

Onerous contract recognition

Consistency in implementation

The Standard permits entities using the PAA to assume contracts are profitable unless “facts and circumstances” indicate otherwise. Some insurers may rely on this (and on summarised MI and arguably poor profitability monitoring) to avoid onerous contract recognition. Others are adopting a rigorous process for onerous contract identification.

Impact on the Financial Statements

Will vary with hard/soft markets, so from year to year profits and losses may be more volatile due to the need to release or build up a loss component.

May discriminate against smaller players, for whom MI is far more granular.

Very public for some entities where poor profitability has been masked historically by profits elsewhere within an entity or a group.

May give some interesting insight to the way some companies operate, for example, where add-ons (accounted for under IFRS 15) cross-subsidise loss making insurance. This will suddenly be visible.

Replacement of margin with Risk Adjustment and the Confidence level disclosure

- **Interpreted in different ways by different entities**
- **Key difference in approach:**
  - Floating RA
  - Floating confidence level
- **Lots of difference in methodology, including**
  - Cost of capital (….differences in selected cost and capital calculations)
  - Target confidence level driving RA
  - VaR
- **Loads of judgement involved – <u>Will the market appreciate this?</u>**
- **Inconsistency with US GAAP**
- **Tax implications**
- As far as confidence level is concerned, **still open as to where companies will land**

Discounting

Consistency in implementation

- Potential differences in discount rates, but unlikely to be significant while interest rates are low
- Very short tail policies may not be discounted at all, but discounting impact wouldn't be significant anyway
- Judgement involved in selection of payment patterns

Significance for opening BS (YE 21)

- Unlikely to be a large number where interest rates are low
- For very short tail insurers may never be very large

Close

Observations

Interpretation of financial statements will be challenging, for example, due to differences in the

- Accounting policy choices
- The business written
- Changes in the treatment of some contracts e.g. LPTs

There will be increased transparency over some things, potentially leading to questions about things not currently disclosed, such as

- Details of reinsurance
- Mix of insurance/non-insurance

…but the key point is **the impact will vary significantly**, both in implementation effort and the impact on FS, so beware generalisations

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