CONGRESSO NAZIONALE degli ATTUARI

IFRS 17 : An actuarial challenge

New standard and new challenges

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IFRS 17

Il nuovo paradiso attuariale ?

o

Il peggior incubo dell’assicurazione ?

IFRS 17

Uno standard contabile basato su modelli e logica molto attuariali

e

Uno standard contabile più difficile da decifrare, spiegare e confrontare

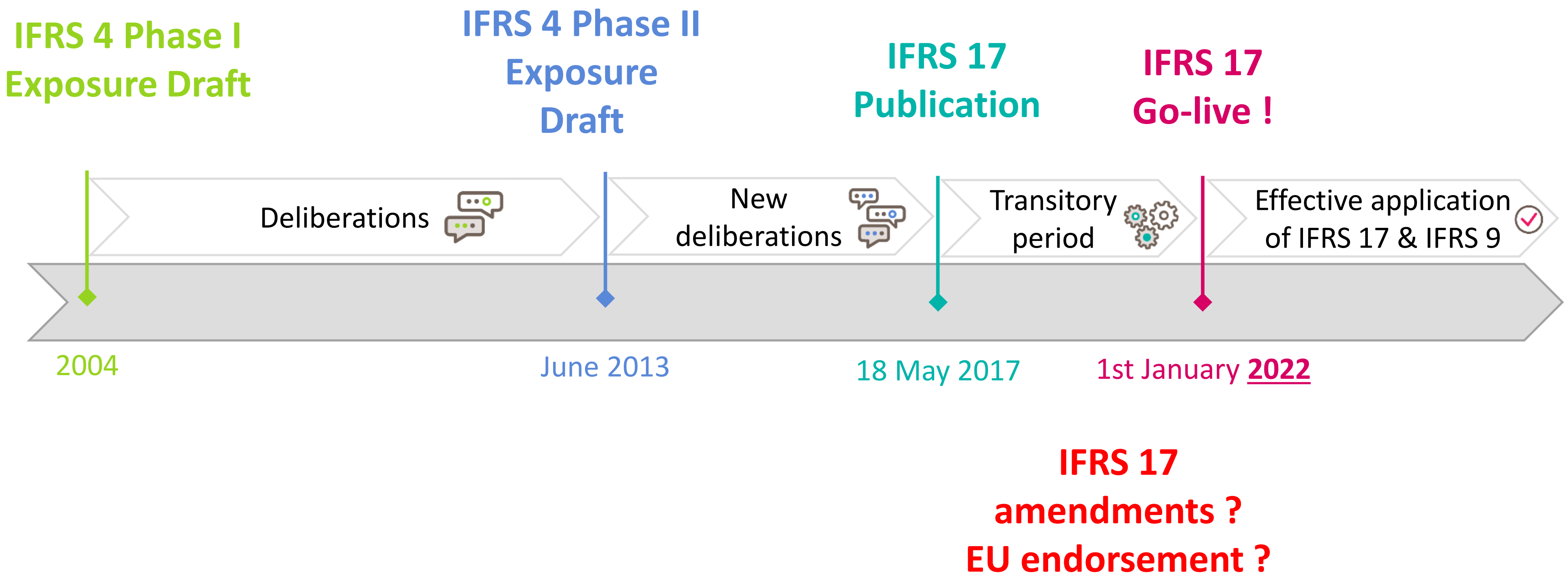
IFRS 17

- IFRS 17 basics
- The role of the actuary facing IFSR 17
- IFRS 17 topics under review

IFRS 17 basics

IFRS 17 is the new **accounting standard for Insurance Contracts** published 18 May 2017

- Replace the interim standard IFRS 4 (not standardized across jurisdictions)
- EU endorsement still under process
- Go-live 1^{st} January 2022



IFRS 17 basics

IFRS 17 align as much as possible insurance accounting with the general IFRS accounting of other industries

- Introduce **three accounting models** for all types of insurance contract
- Provide useful information about **profitability of insurance contracts**
- **Reflect economics and risks** in a timely manner
- Increase the **comparability** of financial statements of insurance undertakings
- Consistent with **IFRS 9**

One of the most substantial change to insurance accounting requirements in over 20 years !

Fundamentally **change financial reporting for insurers**.

IFRS 17 basics

IFRS Balance sheet

ASSETS
classified and valuated
in accordance with IFRS 9

SHAREHOLDERS' EQUITY
- Financial capital
- Other Comprehensive Income
- Cumulative Results

INSURANCE & INVESTMENT CONTRACTS LIABILITIES
- Contractual Service Margin
- Fulfillment Cash Flows
  - Future Cash Flows
  - Time Value
  - Risk Adjustment

IFRS 17 basics

IFRS Profit or Loss

CSM amortization
Risk adjustment release
Experience variance
Expected claims and benefits
(-)Claims and benefits paid
Onerous contracts
INSURANCE SERVICE RESULT
Investment income
Insurance finance expenses
NET FINANCIAL RESULT
OPERATING PROFIT
Finance costs
Income tax expense
PROFIT FOR THE PERIOD

IFRS 17 basics

Actuaries will be responsible for **IFRS 17 Insurance Liabilities valuations** :

=

CSM

Contractual Service Margin : profit that the business expects to make after paying out all claims and expenses and providing for the risk adjustment.

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RA

Risk Adjustment for Non-Financial Risks:

- reflects uncertain premiums & claims at best estimate
- is a buffer in case experience changes for the worst

→ Release of the risk adjustment is a profit.

\+

BEL

Present value of expected cash flows : all expected **premiums** from the policy (in contract boundaries), **claims & expenses** to be paid out, valued at today's terms.

→ Valuation **similar to Solvency 2** Best Estimate Liabilities.

IFRS 17 basics

Contracts eligible to IFRS17

Contracts with direct participation features

- substantially investment-related service contracts
- under which the entity promises an investment (substantial share)
- return based on a clearly identified pool of underlying items.

Indirect participating contracts

- contracts whose cash-flows vary with the underlying items but not eligible for VFA
- reinsurance

Non participating contracts

- contracts whose cash-flows don't vary with the underlying items

VFA – Variable Fee Approach

CSM absorbs the effect of the change in financial **and** technical assumptions
Current interest rate curve
(Ex : Savings contracts)

BBA – Building Block Approch
General Model

CSM absorbs the effect of the change in technical assumptions
At initial recongnition interest rate curve
(Ex : Credit insurance contracts)

PAA – Premium allocation Approach
Simplified Approach

Produce **non-materially different results** from the use of the general model **and** **Coverage period** of each contract is less than 1 year (Ex : P&C contracts)

IFRS 17 basics

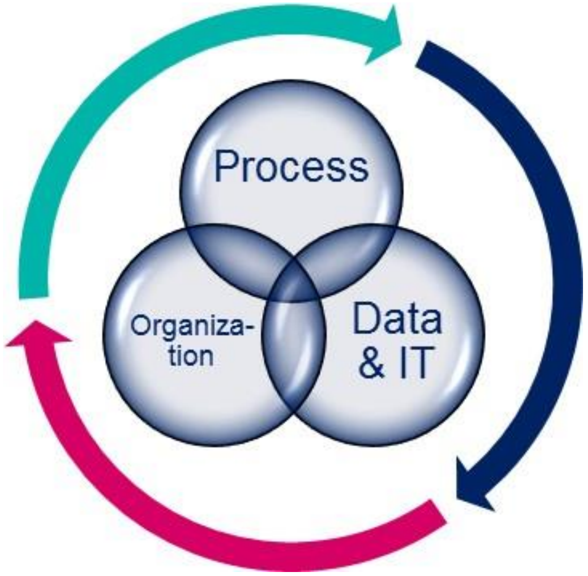
Differences between Solvency 2 and IFRS 17

Solvency 2		IFRS 17
Solvency 2 Value of In-Force in own funds	**CSM**	CSM absorbs shocks and decreases at each period
Entity x LoB	**Granularity**	Portfolio x Group of contracts
Cost of capital	**Risk Margin**	Method to be defined by the entity
Swaps yield curve + Volatility adjustment	**Discount rates**	Top down or bottom up approach
Cash-flows consistent with Solvency 2	**Best Estimate**	Cash-flows consistent with IFRS 17
✕	**P&L**	P&L IFRS 17
QRT, RSR & SFCR	**Disclosing**	Financial statements (including annexes)
Quarterly	**Reporting period**	Monthly to Annually (regulation & entity)

The role of Actuary facing IFRS 17

New actuarial solutions

- Calculation on a prospective basis
- New granularity in actuarial tools
- New metrics : CSM and RA
- Storage of results : yield curves, CSM analysis of variations *etc.*
- Complexity to estimate future profits
- Impacts on accounting and steering tools
- Transition



New accounting standards

- New financial statements and new chart of account
- Coexistence of 3 accounting models
- Articulation IFRS17 / IFRS9
- Analysis and justification of differences between standards : local GAAP / IFRS17 / SII
- Reduction of time delays

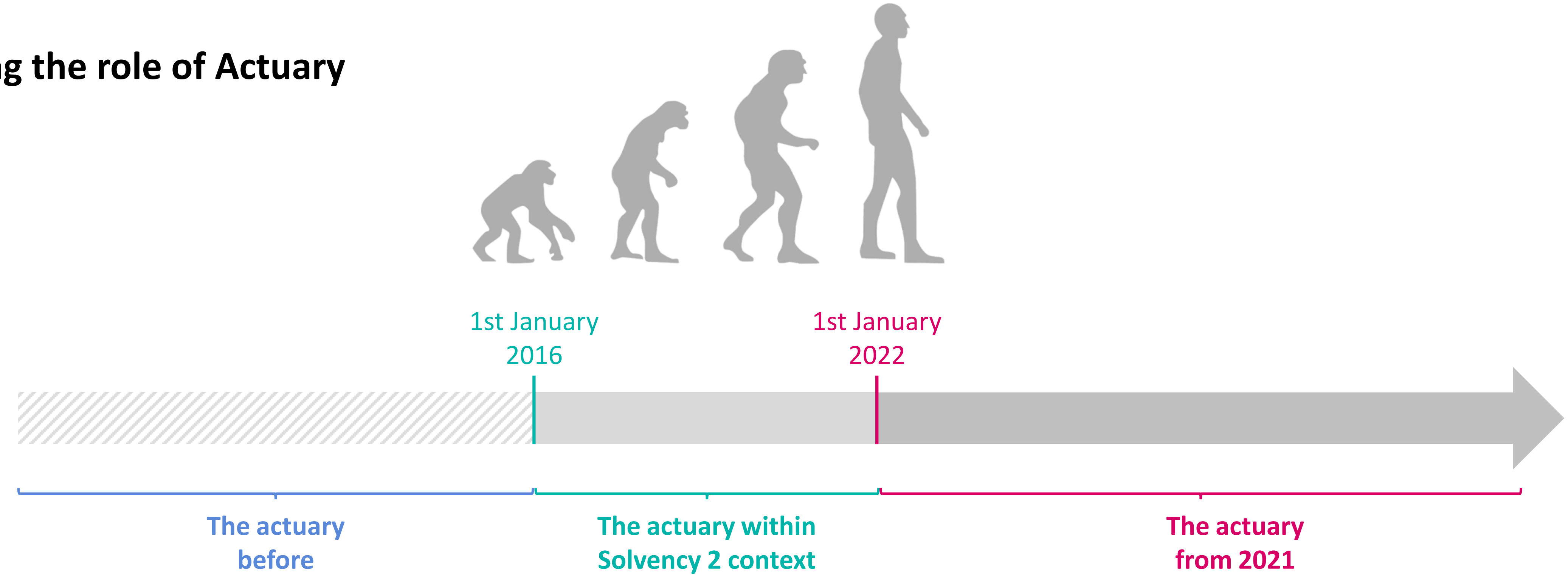
New financial communication & strategic impacts

- New reading of profits recognition and new indicators
- Potential impacts on production conception and on pricing activities

- Transformation of processes and internal organization
- Substantial changes on actuarial and accounting tools
- Revision of business management and anticipation of future financial communication

The role of Actuary in Europe facing IFRS 17

Moving the role of Actuary



Actuaries domain of intervention will soon

► go **upon the estimation of insurance liabilities**

► cover the establishment of future **group financial statements**

Actuaries constraints regarding **communication** and **popularization of actuarial technics** will be largely strengthened.

The role of Actuary in Europe facing IFRS 17

The actuary before

- **Limited contribution** of actuarial models to **Group financial statements**
- **Relative flexibility** in actuarial methodologies for modelling purposes
- Justification of technical choices given to **internal management**, **MCEV reviewers** and **local supervision authorities**

The role of Actuary in Europe facing IFRS 17

The actuary within Solvency 2 context

- Creation of the **Actuarial Function**
  - Control role at a second level
  - Duty to report to AMSB
- **Broader use of actuarial methologies** in financial communication : necessity to **communicate and formalize**
- Actuaries dealing with **two main environments** : local/IFRS 4 GAAP and Solvency 2 / MCEV
- Business steered through **risk management**
- More significant contribution to **IT projects** (**data quality**, controls, complex actuarial tools etc.)

The role of Actuary in Europe facing IFRS 17

The actuary from 2021

- **Strong contribution** of actuarial models to **Group financial statements**
- Actuaries dealing with **three main environments** : local GAAP, IFRS GAAP and Solvency 2 / MCEV
- Justification of technical choices given to **internal management**, **auditors** and **local supervision authorities**
- **New KPI to build and monitor**
- Strong **interdependency between actuarial, accounting and management control** teams
- New role under legal audit ?

IFRS 17 subjects on the agenda

Voted on 14.11.2018

- According to **Paper of the IASB** November 2018, **effective date of IFRS 17** and **temporary exemption to IFRS 9 in IFRS 4**
  - will be **deferred by one year**
  - entities will be required to apply IFRS 17 & IFRS 9 for annual periods beginning on or after **1st January 2022**
- Next **Transition Resource Group** for IFRS 17 *Insurance Contracts* meeting
  - on **4 April 2019**
  - instead of 4 December 2018 (because of limited number of submissions received since last TRG meeting)
- **Fine-tuning of IFRS 17 standard**: according to IASB meeting, the Board:
  - unanimously agreed **criteria for evaluating any future potential amendments to IFRS 17**
    - no deterioration of the information provided
    - no additional cost of implementation
  - no new arguments on the substance appear in CFO Forum communications
  - implementation costs have been clarified and the standard could be refined only for the purpose of reducing them
  - these refinements will however be minor and will not bring substantial modifications to the standard

IFRS 17 subjects on the agenda

IFRS 17 **principles based** approach
leads many questions:

▶ **Normative interpretations**

and/or

▶ **Market disagreements**

Separating components	In order to determine to which standard the component is subject to, separation of the components of an insurance contract between: ▪ Insurance ▪ Investment ▪ Goods and non-insurance services → A long and tedious mapping of the products…
Building **groups of contracts**	Contracts should be separated in groups of contracts following 3 criteria : Portfolio / Profitability / Cohort → A lot of interpretations to do! And how to understand notion of “Sets of contracts” ?
Contract boundaries	How and how long future premiums have to be projected for Savings and Pension business?
Accounting model	Difficulty to justify the use of alternative approach instead of general model: ▪ BBA – Building Block Approach = “general model” ▪ VFA – Variable Fee Approach ▪ PAA – Premium Allocation Approach
Discount rates	Complexity for building discount rate with top-down or bottom-up approach.

IFRS 17 subjects on the agenda

IFRS 17 **principles based** approach
leads many questions:

▶ **Normative interpretations**

and/or

▶ **Market disagreements**

Attributable **acquisition costs**	Which costs are attributable ? Which are not ? → Impact on the level of the CSM
CSM amortization	CSM recognized in P&L in each period to reflect the services (coverage units). How to define “service” in insurance? Which driver for CSM amortization?
Reinsurance	Inconsistency between Assets and Liabilities for Savings and Pensions business because reinsurance must be valuated with BBA.
Transition	3 possible approaches for calculating the CSM at transition : ▪ Full retrospective approach ▪ Modified retrospective approach ▪ Fair value approach They each have their advantages and drawbacks and the entity could not be able to put into practice the most accurate (lack of data).
Financial disclosure	New financial disclosure to implement: need to identify the bottom end of the balance sheet to be integrated in BEL and define issues related to the presentation of the groups of contracts in active or passive position

IFRS 17 subjects on the agenda

The **Actuarial Association of Europe (AAE)**

welcomes many aspects of the new standards:

- **market consistency**
- greater **anticipated consistency and comparability** across the accounts of different insurers and reinsurers
- **allowance for risk**
- **release of profits** in line with the underlying earnings profile

recognizes many complexities. Concerns relate to:

- inconsistent treatment of **direct insurance and reinsurance** in the accounts of reinsurers
- **complexity** of the regime
- level of **interpretations required** to be made across many different elements of the standard which could put the aims of consistency and comparability at risk

- calls for a **prominent role for qualified actuaries** in undertakings required to comply with IFRS 17 and underlines the **importance of actuarial involvement in implementation and ongoing preparation of IFRS17** accounts

  → possibility of a regulatory requirement for actuarial involvement in closing the accounts ?
- considers that **reconciliation between Solvency II and IFRS 17 balance sheets** will be an important exercise for insurers and for regulators.

IFRS 17 subjects on the agenda

The **International Actuarial Association (IAA)** published

► **ISAP 4**

(International Standard of Actuarial Practice 4)

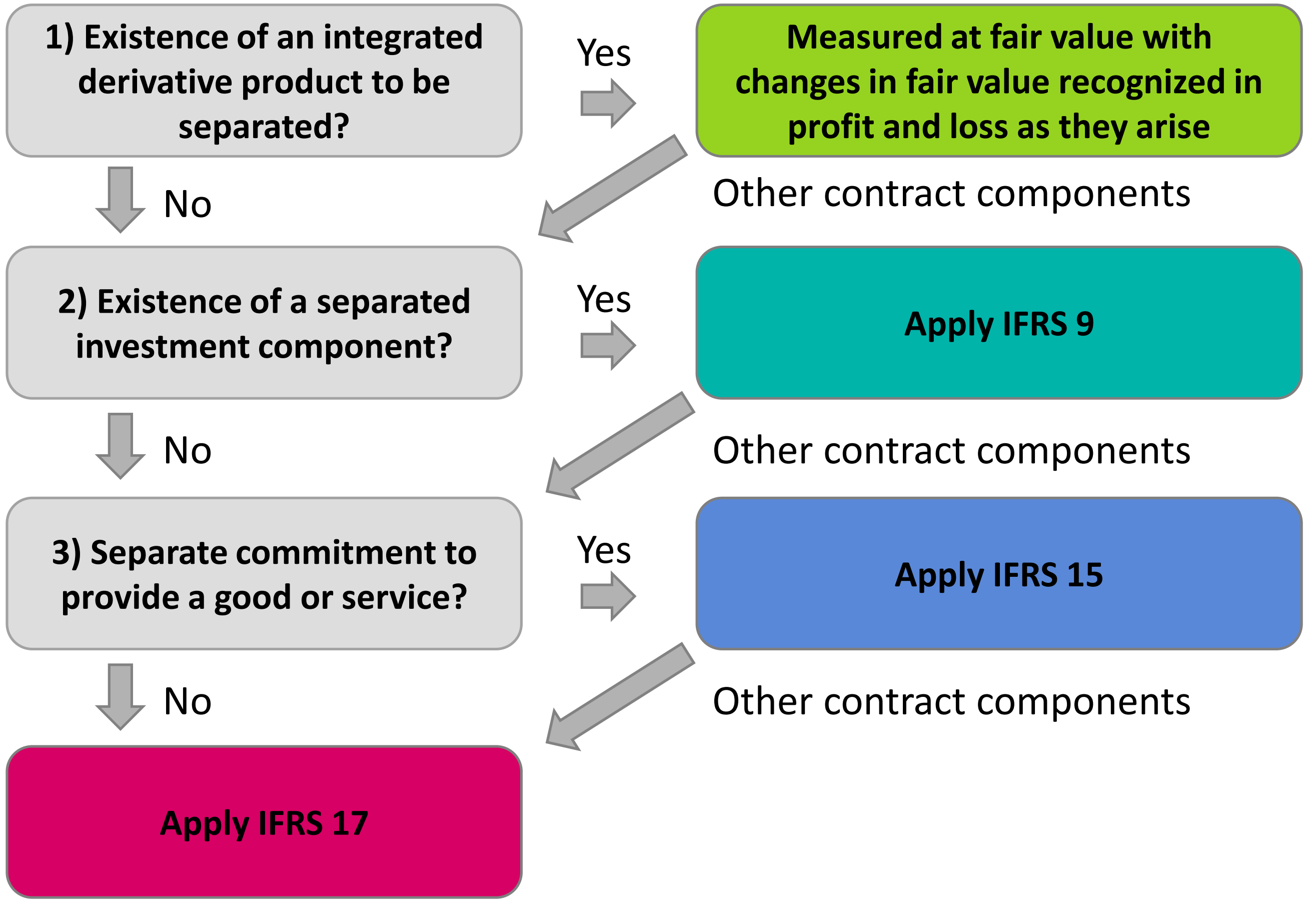
- provides guidance to actuaries when performing actuarial services
- increase intended users' confidence that:
  - actuarial services are **carried out professionally** and with due care
  - **results are relevant** to their needs, are **presented clearly and understandably**, and are **complete**
  - assumptions and methodology (including models and modelling techniques) used are **disclosed appropriately**

► **IAN 100**

- is an **educational document** on an actuarial subject to assist actuaries in producing actuarial work-products by offering **practical examples** of ways in which actuaries might **implement ISAP 4 and IFRS17**
- deals with all the **main topics describes previously** : Classification of Contracts, Model Introduction, Estimates of Future Cash Flows, Discount Rates, Risk Adjustments for Non-Financial Risks, CSM, Contracts with Participation Features and Other Variable Cash Flows, PAA, Reinsurance, Presentation, Contract Modifications and Derecognition, Business Combinations and Portfolio Transfers, Embedded Derivatives, Value, Transition

Annex - Separating components from an insurance contract

IFRS 17 provides for the separation of the components of an insurance contract, such as derivatives, investment components or the supply of goods or services

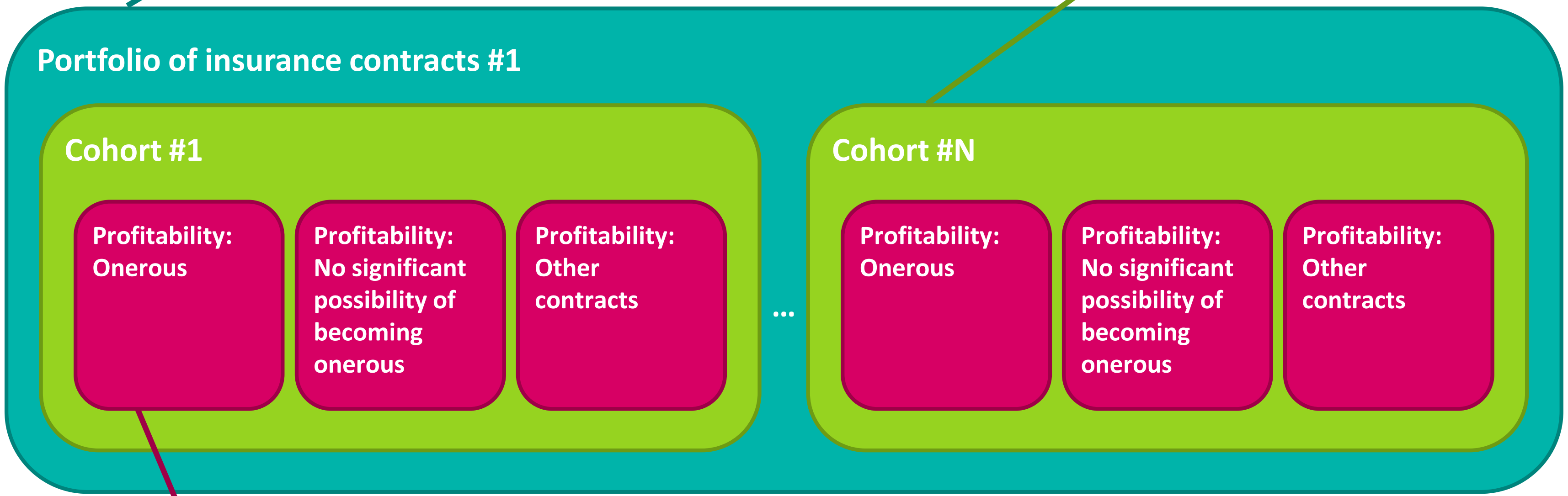


Annex - Granularity

3 levels of aggregation of insurance contracts in order to define groups of contracts (level required for CSM calculation) :

A portfolio is a group of insurance contracts **subject to similar risks** and **managed together**

A group of contracts **shall not include contracts issued more than one year**



An entity shall divide a portfolio of insurance contracts issued into at least the 3 following groups :

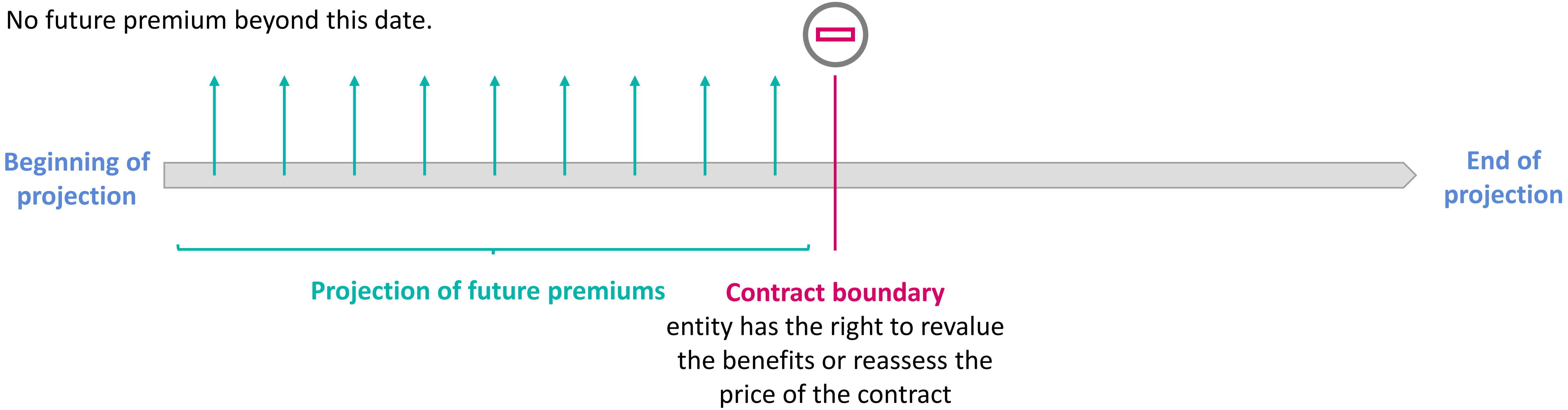
- contracts **onerous at initial recognition**
- contracts **have no significant possibility of becoming onerous subsequently**
- **remaining contracts** in the portfolio

Annex - Contract boundaries

Future premiums are projected when they give rise to a significant obligation for the insured or the insurer (respectively for the payment of premiums and for the supply of a service).

Commitment deemed to be due when the insurer has the right to revise the price or collateral to reflect the risk at the policy or portfolio level.

No future premium beyond this date.

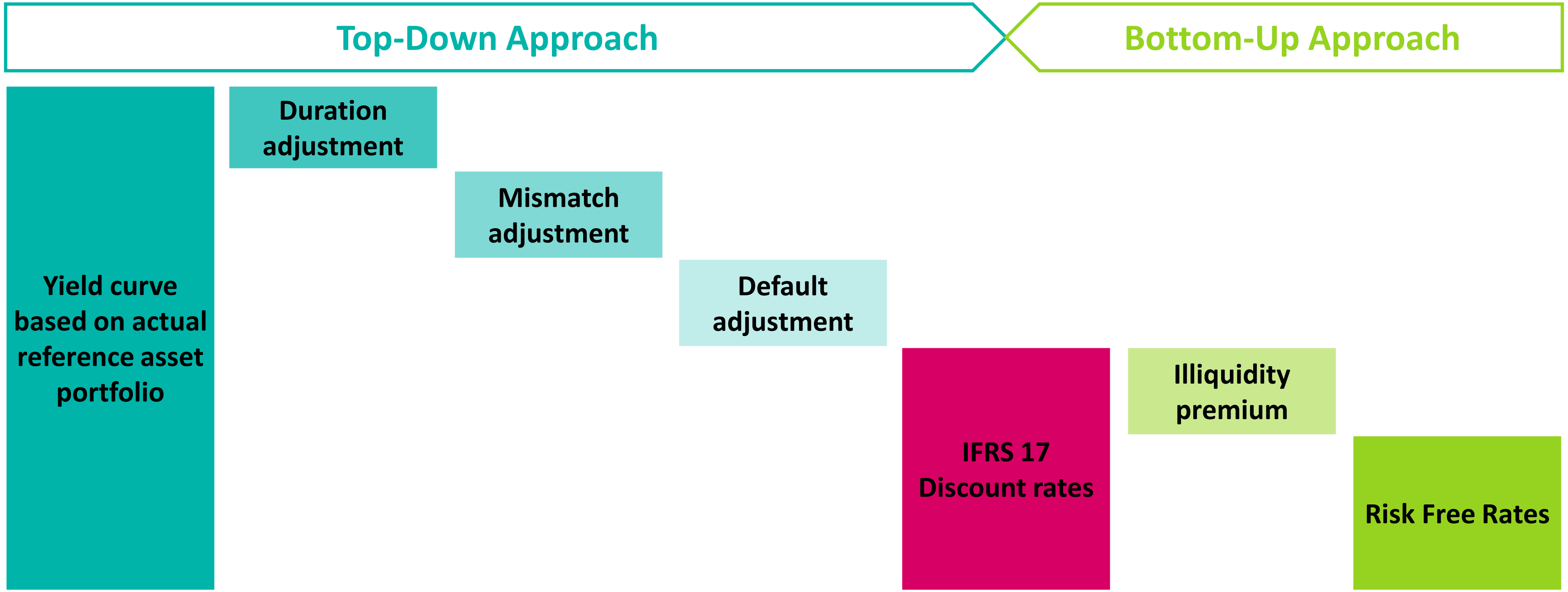


As in Solvency 2, the question of the projection of future premiums arises for savings guarantees in General Fund.

IFRS 17 and Solvency II contract boundaries are not necessarily the same one.

Annex - Discount rates

3 possible approaches for building interest rate curve:



No interest rate to the ultimate is imposed by the texts.

The implementation of these principles is likely to differ widely from one actor to another.

Annex - Transition

3 possible approaches for calculating the CSM at transition:

Full retrospective approach → **Method deemed "unrealistic"** → **Modified retrospective approach** / **Fair value approach**

Approach	Principe		
Full retrospective approach	Revaluation of contracts according to the new standard as soon as they are subscribed, **as if the standard had always existed**	▪ Default method required ▪ Most accurate assessment of balance sheet accounts at transition	▪ Operationally very constraining ▪ Requires to build complete historical data (cash-flows and discount rate)
Modified retrospective approach	**Simplification** of the full retrospective approach	▪ Application to sets of contracts ▪ Based on the value of the asset at transition	▪ Requires significant retrospective data
Fair value approach	Valuation of a **transfer value** of the portfolio	▪ Need less data ▪ Potentially easier to implement	▪ Method unknown at this stage ▪ Don't take into account entity's specificities