IFRS 17 Insurance Contracts Preparer Survey Summary

UKEB

September 2020

The views expressed in this presentation not necessarily those of the Endorsement Board, nor are they necessarily reflective of any official policy or position.

Contents

I. Overview

16 Respondents*

12 Groups

4 Individual Entities

10 Listed Companies

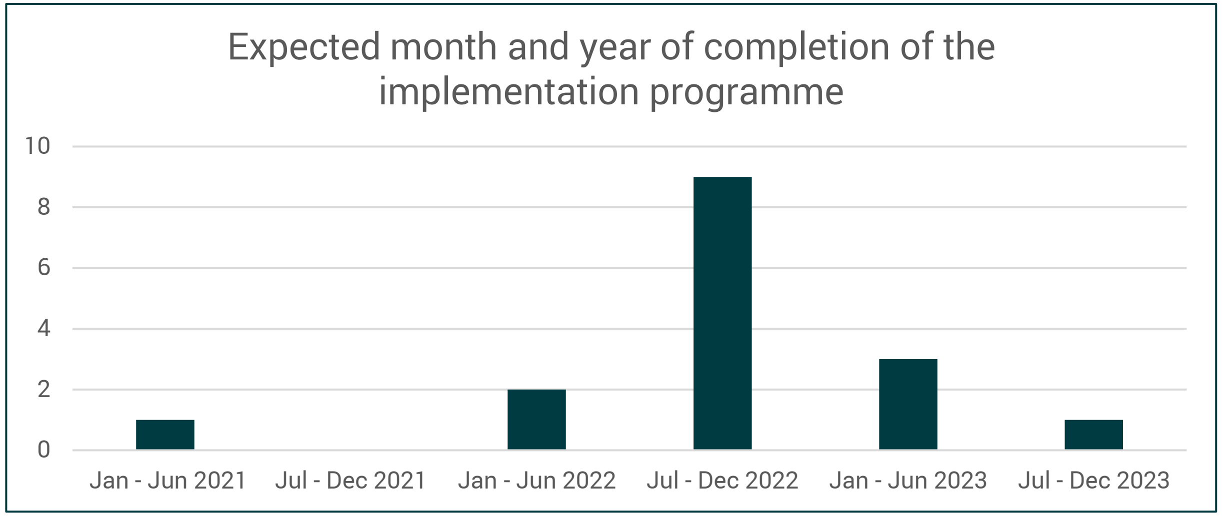
9 Life Insurers

6 General Insurers

1 Composite Insurer

<u>Implementation challenges:</u>

- Interpretation uncertainty
- Data readiness
- Operational complexity
- Resource availability
- Endorsement uncertainty

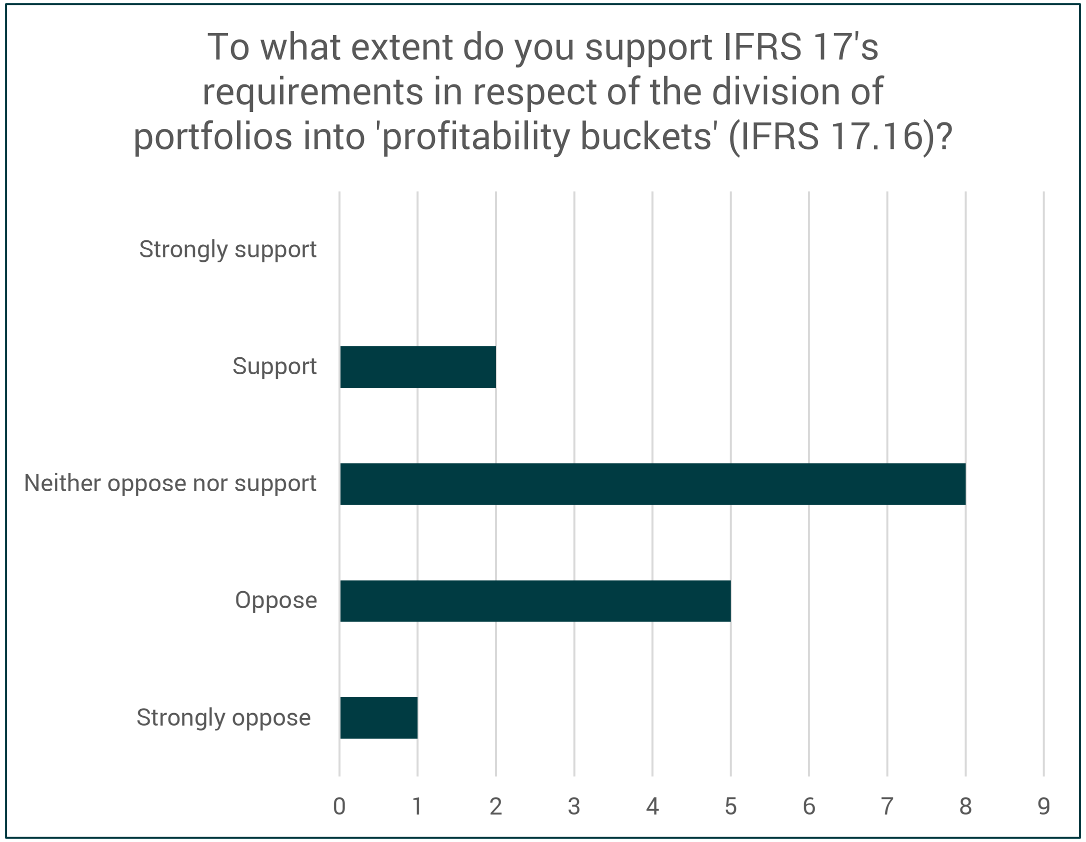


Majority of respondents are building and testing systems, with only one respondent at the parallel run stage.

** Representing approximately 67% of the total gross written premiums of IFRS reporters in the UK based on their latest set of accounts.*

2. Level of Aggregation

81% of respondents will recognise significantly more groups of insurance contracts under IFRS 17 than under current GAAP



Favorable comments:

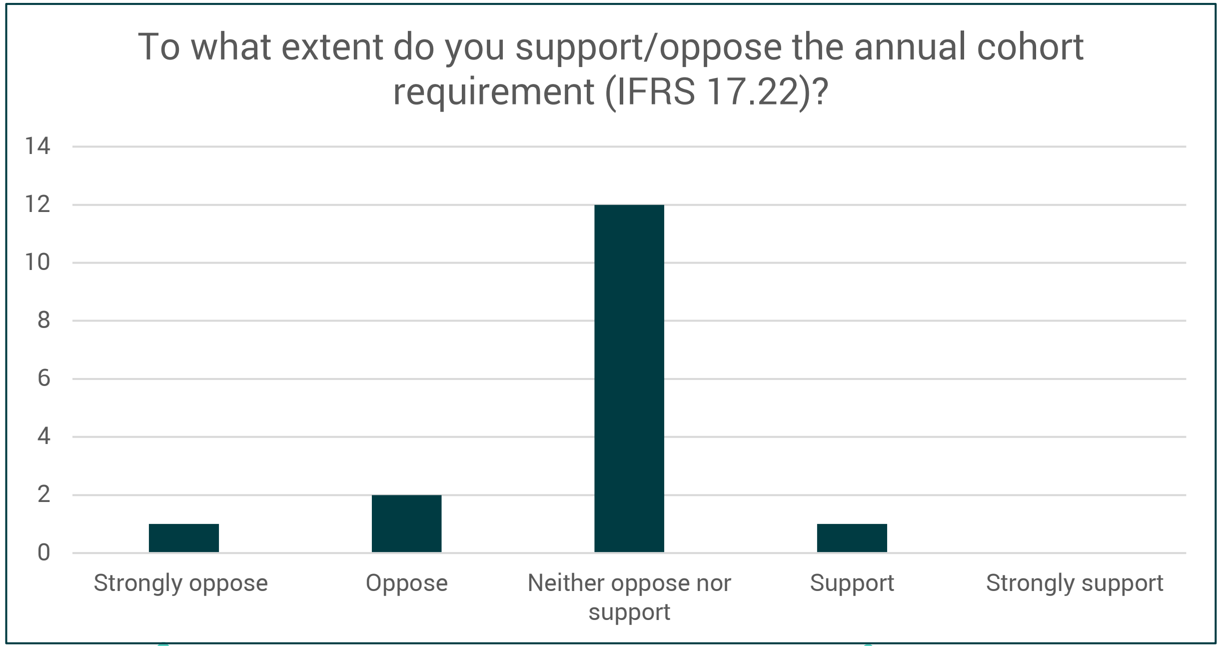
- Supportive of objective to avoid offsetting profitable and onerous contracts
- Promotes a greater understanding of unearned profit upon recognising contracts

Unfavorable comments:

- The nature of the insurance business is the aggregation and sharing of risk so profitability expectations should be set at the portfolio level
- The requirement to divide a portfolio into the profitability buckets does not meet the cost benefit analysis
- Introduces significant cost and complexity

3. Annual Cohorts

"Insurance contracts are fundamentally managed together as a portfolio, as are the assets backing those liabilities. The annual cohort requirement undermines the fundamental business model of insurance."



"Enhancing disclosure around profitability of each underwriting cohort enhances transparency"

"The requirement aligns with the underwriting year view of planning and is consistent with the insurance cycle."

Life Insurers

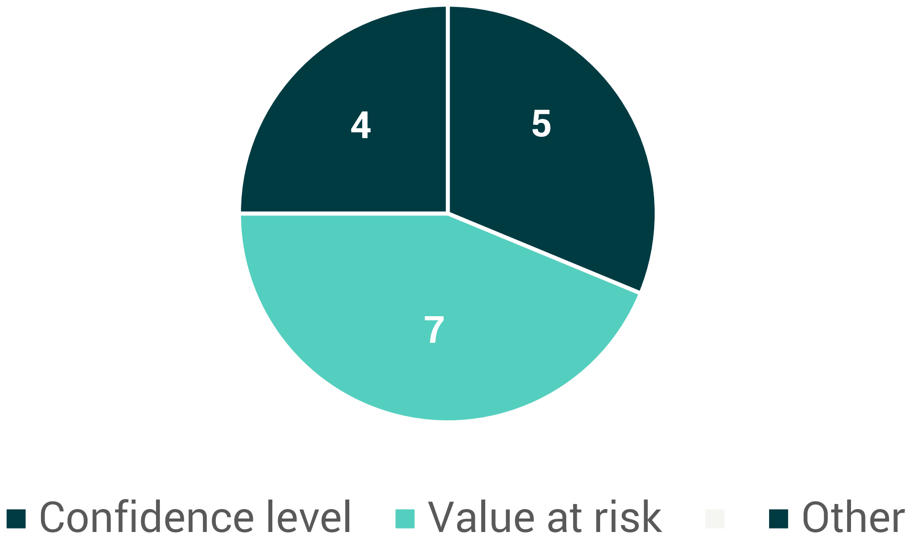
General Insurer

Only 3 of the 9 Life insurers oppose the requirement.

"The need for annual cohorts is understood, but at the same time results in additional calculation complexity"

4. Risk Adjustment

What estimation technique does the entity expect to use when determining the risk adjustment for non-financial risk (IFRS 17.B91-92)?



The estimation technique is not expected to differ by portfolio

Does the entity plan to present separately the effect of discounting the risk adjustment or to include it all as part of insurance service result (IFRS 17.81)?

31%
Include it all in insurance service result

69%
Disaggregate and include part in insurance finance income or expenses

5. Discount Rates

Preferred approaches by product

Bottom up	Top down
Protection Business	Annuities
With-Profit	
General/P&C	
Health	Health

Policy objectives driving the choice of approach:

- Regulatory alignment
- Consistency with current practice
- Operational simplicity
- To minimise accounting volatility that doesn't reflect economics
- To aid explanation of performance

6. Presentation

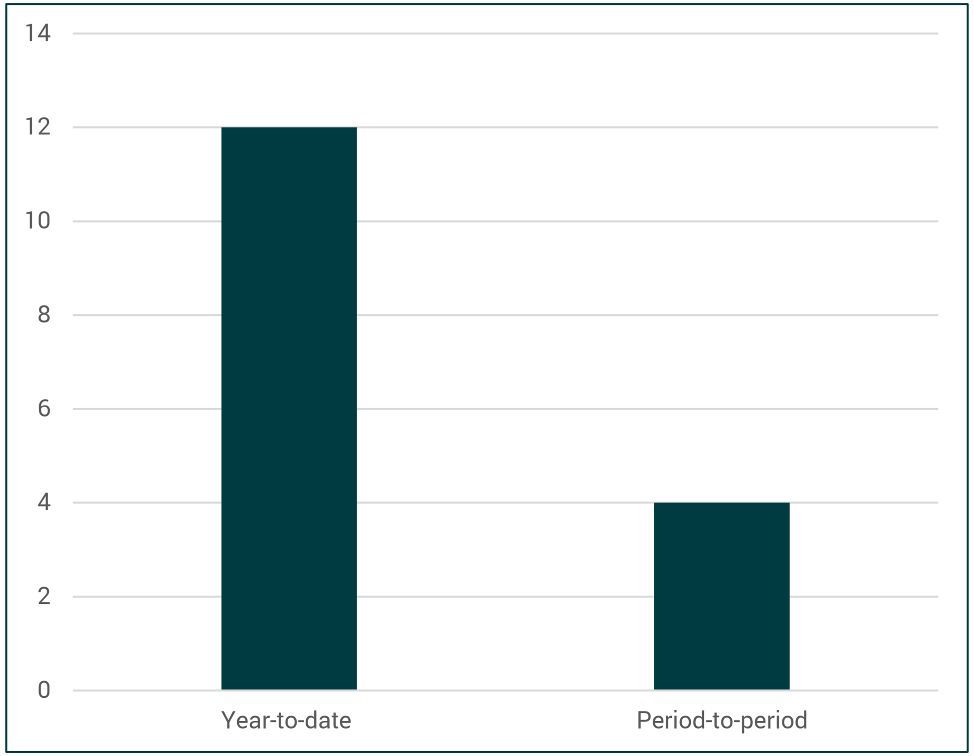
19% of respondents plan to apply the OCI option.

Rationale:

- it aligns with their IFRS 9 policy (FVOCI) and enables asset and liability matching
- it will reduce volatility

Treatment of accounting estimates in interim financial statements

75% of respondents will take advantage of the amendment and apply a year-to-date approach in respect of accounting estimates made in previous interim financial statements (IFRS 17:B137)



(Restatement of interim estimates) (No restatement of interim estimates)

7. Transition

Average application of transition approaches across respondents		
	General	**Life**
Fully retrospective approach	98%	54%
Modified retrospective approach	2%	3%
Fair value approach	-	43%

Drivers behind policy choice:

- Availability of data and ease of calculation
- Operational complexity
- Alignment of business models within the group

8. Reinsurance

12 out of 16 Respondents were supportive of the requirements to recognise income in P&L on certain RI contracts to cover losses on onerous underlying insurance contracts.

Only one entity anticipates a critical impact on their financial statements from measuring RI contracts under the GMM, but related underlying contracts under PAA.

81% of respondents note that the accounting for intra-group reinsurance arrangements will be more complex or significantly more complex.

Accounting mismatches will arise on consolidation because the contract will be accounted for differently by the issued entity and held entity

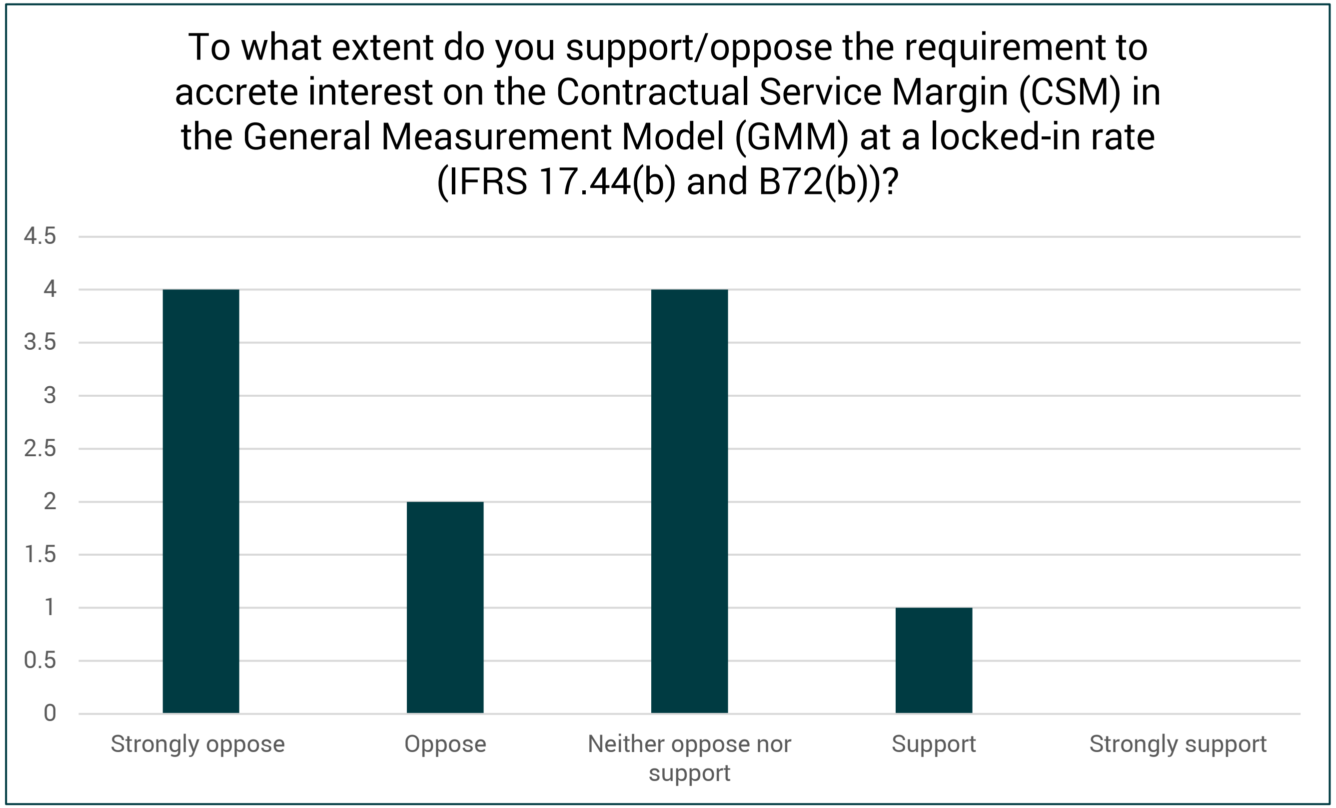
VFA ineligibility creates accounting mismatches that are difficult to explain in the entity accounts

Complexity is further increased because internal reinsurance relates to with-profits business

Reinsurance of unit linked investment contracts is more challenging when accounted for under IFRS 9/IFRS 17 compared to IAS 39/IFRS 4

9. Interest accretion on CSM at locked in rate

83% of respondents agree or strongly agree that accreting interest on the CSM at the current rate would significantly reduce the operational burden.



Points noted in favor:

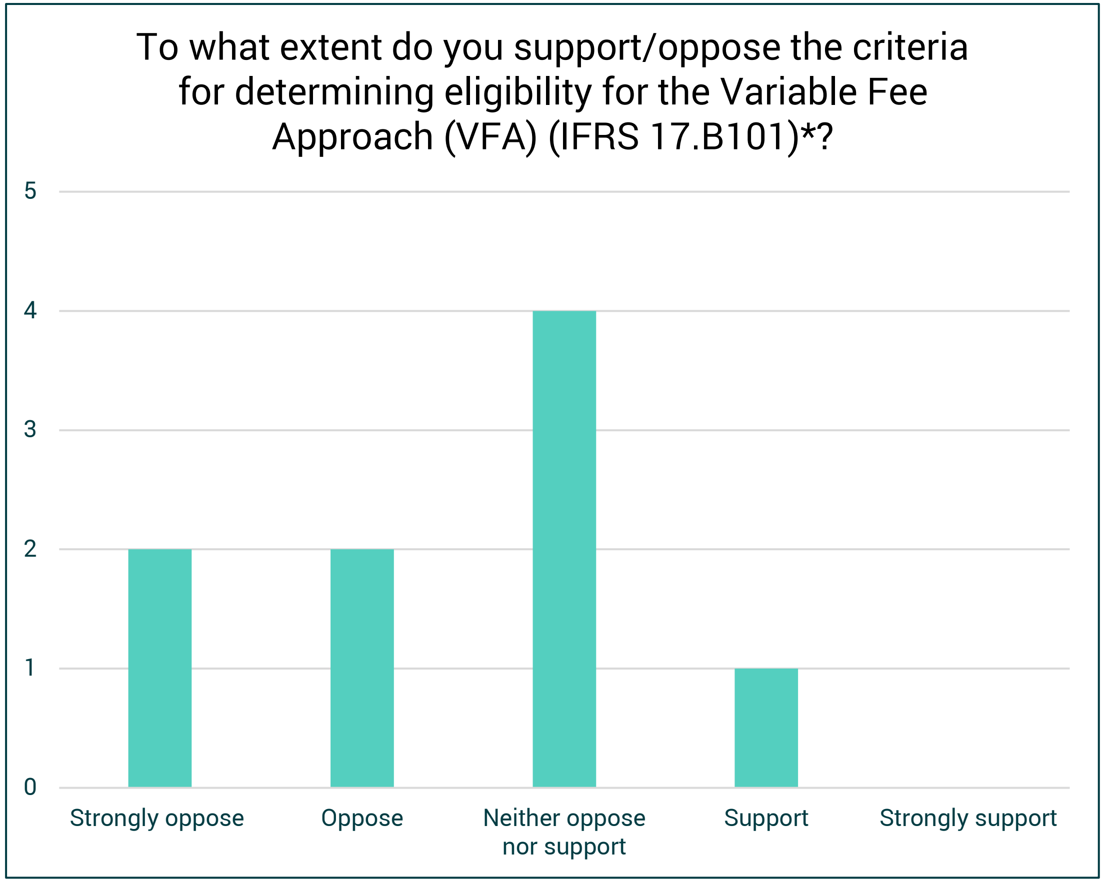
- Principles are clear
- Consistency across methodology
- CSM does not reflect a future cash flow

Points noted against:

- Creates an accounting mismatch (other components of the balance sheet are measured at current rates)
- Operationally complex to track and manage historic discount rates
- Undesirable volatility in financial statements

58% of respondents note that the difference from applying a locked-in vs current discount rate to the CSM is expected to be material.

10. Variable fee approach



* Of the 9 respondents who provided a response to this question

At what level does the entity expect to determine eligibility for the VFA?
Individual contract/group of contracts/other

40% respondents

Individual contract level

60% respondents

Other

- Operationally impractical to determine at an individual contract level

- Propose to determine eligibility for one representative contract in a group of homogenous contracts

11. With-Profits

The main themes from the responses:

- Accounting treatment will lead to accounting mismatches and unnecessary volatility in results.
  - valuation of policies with guaranteed annuity options
  - non-profit contracts in a with-profit fund
- Accounting treatment is not consistent with the economics of the businesses or funds:
  - Inherited estates – allocation between policyholders and shareholders
- Significant additional disclosure will be needed to explain these products to investors

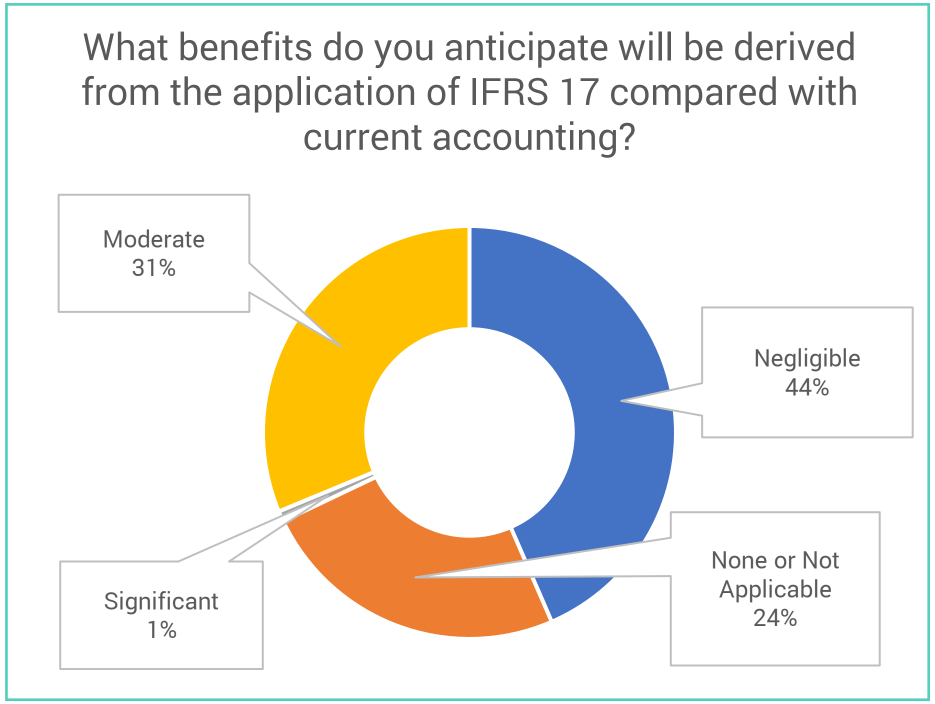
12. Significance of benefits from IFRS 17

Approximately a third of respondents anticipated some moderate benefits but most stated either negligible or no benefit. Common benefits were noted as consistency of accounting treatment, greater comparability and a better understanding of data.

'The increased disclosure requirements … should also aid comparability and external confidence in strength of insurer's Balance Sheets.'

'… uniformity of reporting for long-term business contracts across products & territories, and the resulting scope for operational simplification.'

'improving the understanding of the business and industry in anticipation that it will make the industry and company more attractive to investors.'



'We are struggling to envisage any benefits from the standard, which is frustrating as it is a lot of effort and cost to implement'

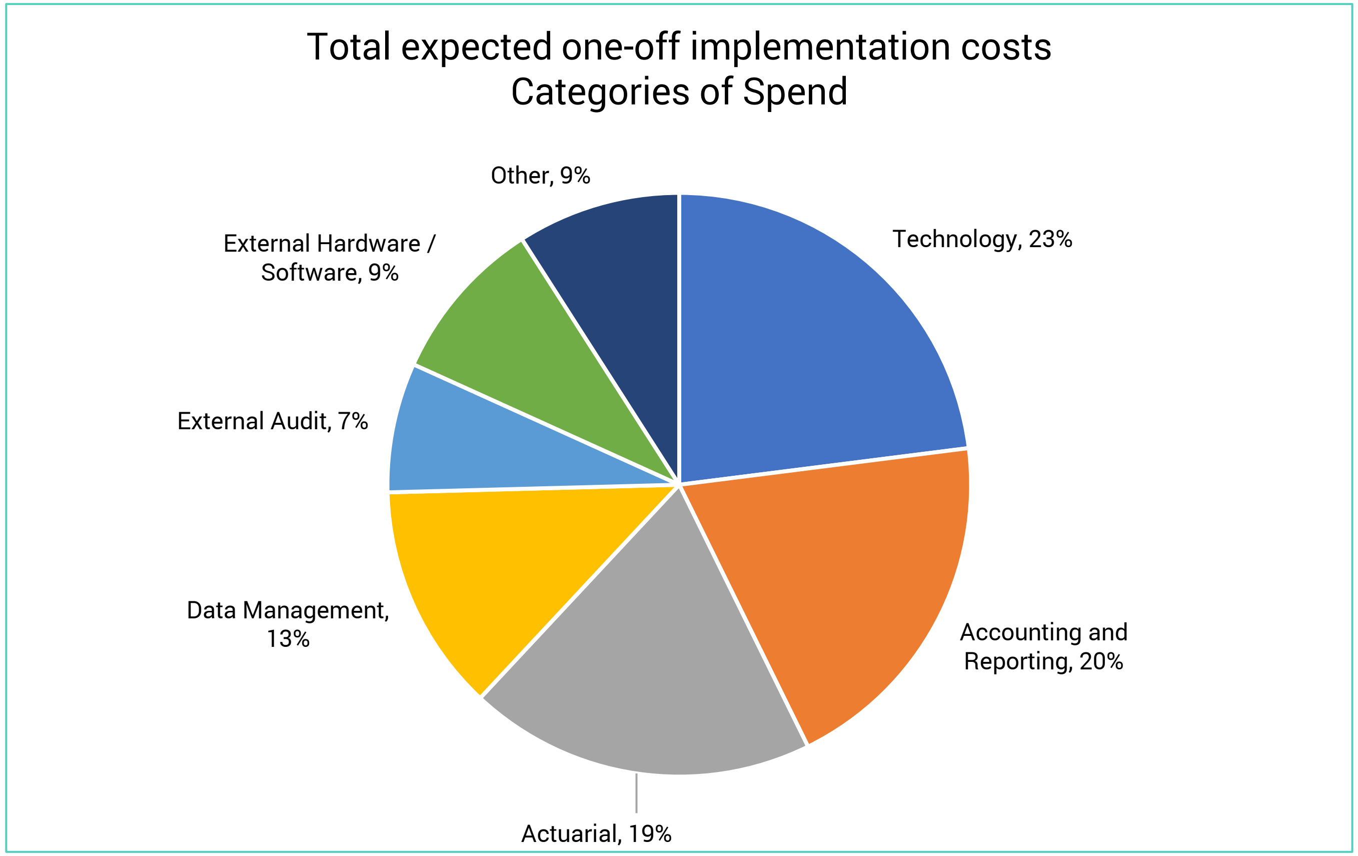
'Greater consistency of accounting treatment across the Group resulting in streamlining of processes and use of Group tools'

'Greater comparability with other insurers, better understanding of data and internal Management Information'

'Greater insight into financial performance through increased granularity of profitability information'

13. One-off IFRS 17 implementation costs

Aggregate implementation costs were £783m[1] ranging from £3.5m to £191m[2]. All but one insurer advised that implementation costs were 1% (or less) of Gross Written Premium *(as the average calculated over the last 5 years).*



Significant investment has been made in systems development, actuarial and reporting processes and the management of data.

1. *One survey participant chose not to disclose their implementation costs. There cost was estimated by using a regression model based on their Gross Written Premium to determine an estimated implementation cost.*
2. *Some survey participants submitted their costs inclusive of wider finance transformation costs i.e. in addition to directly attributable IFRS 17 implementation costs. Therefore, the total cost may be overstated to an extent.*

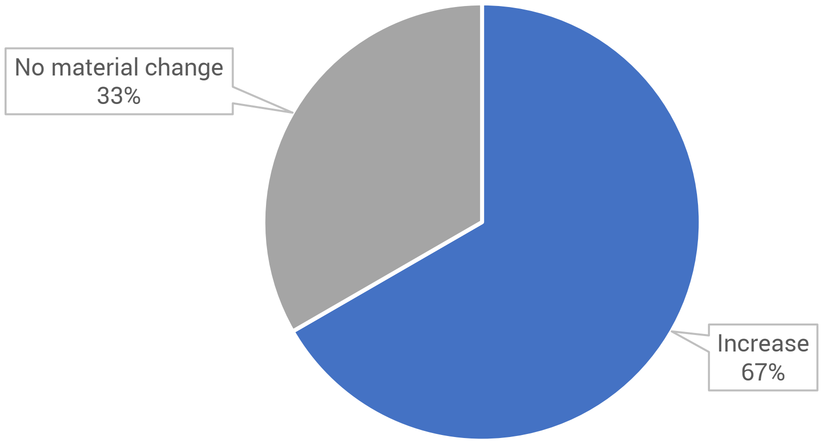
14. Impact on baseline reporting costs

Most insurers have yet to quantify the impact on 'business as usual'. However, 64% anticipated that costs will increase while 36% saw no material change. This appeared to be due to the associated cost reductions from improvements to systems, process and data quality.

'In the absence of transformation we would expect run-rate costs to increase marginally as a result of increased requirements mostly notably in the actuarial function.'

'although we anticipate no material change, this is in the context of multiple other changes of a transformation nature impacting financial reporting processes in parallel.'

Does the entity expect total annual financial reporting costs to increase or decrease as a consequence of adopting IFRS 17, taking 2019 as a baseline?



'additional operational complexity of the standard will undoubtedly increase internal and external (e.g. audit) costs.'

15. Requirements causing ongoing cost increases

	Requirement	Rationale
1	Disclosures and granularity of reporting	Increased ongoing financial reporting costs from both an internal and external (e.g. audit) perspective.
2	Data, systems and processes	To achieve the working day timetable, the IFRS 17 solution requires additional data warehousing, processes changes and visualisation tools. In addition to third party licence fees the new process will require more scrutiny and validation of the results.
3	Eligibility testing	The requirement to assess eligibility for VFA at individual contract level is expected to be significant.
4	Actuarial models	Discounting and Risk Adjustment require additional actuarial models which need to be maintained going forward.
5	Locked-in discount rate	The requirement to use a locked-in discount rate for accreting interest and adjusting the CSM under the General Model will result in significant ongoing annual cost and complexity.

Of those responding on behalf of a group, 45% expect subsidiaries to have to prepare individual entity accounts using policies other than IFRS 17. Of these, all expected that this would lead to both greater differences in accounting between subsidiary and group and increased annual financial reporting costs.

16. Anticipated significance of commercial impacts

Approximately three quarters of respondents believe commercial impacts will be either negligible or have not yet fully assessed them.

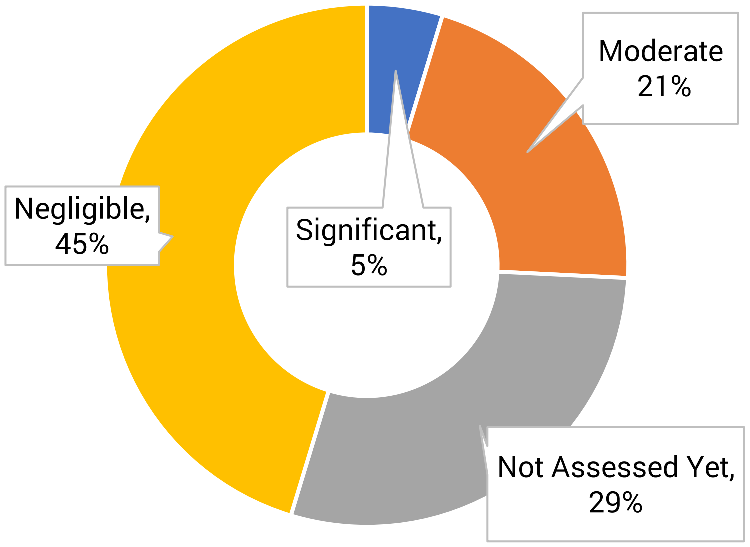
Moderate commercial Impacts

Reinsurance strategy
'Impact on IFRS metrics may influence level of reinsurance sought on some products. However, reinsurance strategy will be mostly influenced by regulatory capital impacts …'

Rating agencies
'It is possible that rating agency models will change, e.g. to reflect changes in leverage arising from IFRS 17 and if they are going to benchmark insurers.'

Hedging strategy
'P&L volatility under IFRS 17 may require additional hedging to be put into place to mitigate the impact of mismatches, taking into account the impact on regulatory capital within the Group'

Commercial impacts anticipated compared with current accounting?



Significant commercial impacts

Mergers and acquisitions
'IFRS 17 will encourage diversified product portfolios and be a potential barrier to entry. This may impact mergers and acquisitions in the insurance industry.'

Product range and design
'As some products will be less attractive as a result, there will be changes to product range and design'

Buy in and Buy outs
'Deferred DB schemes will be less attractive as a product'

17. Competitive impacts (outside UK)

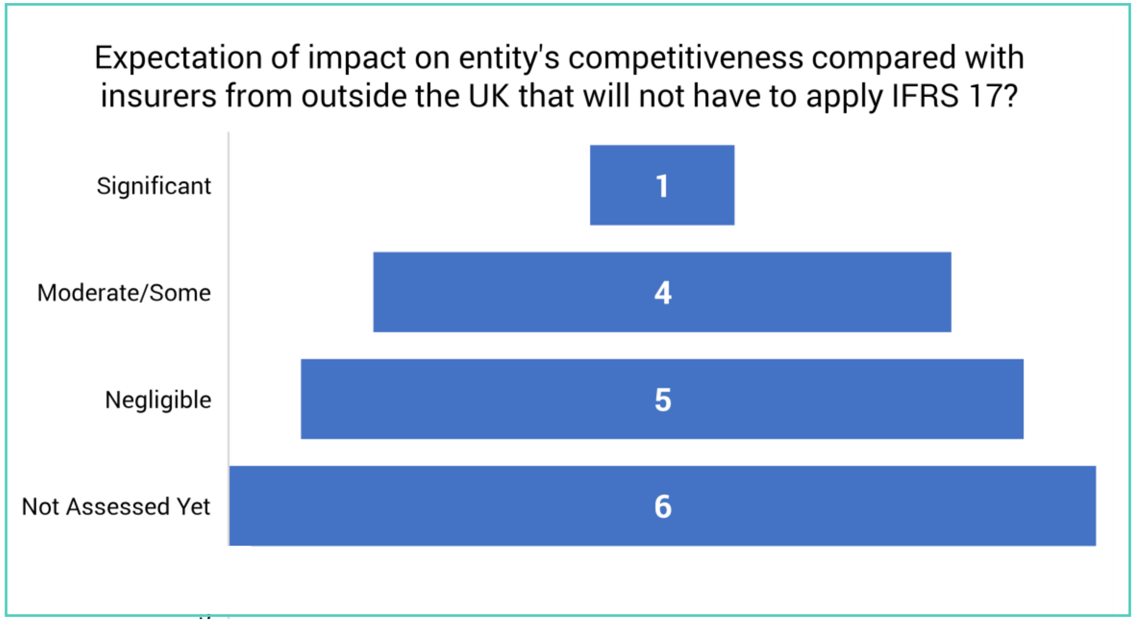
Most respondents perceive this as either negligible or have yet to fully assess the impact on their competitiveness. One participant noted a significant impact (but did not provide rationale) and four a 'moderate' impact - of these three viewed it as a disadvantage.

Moderate Impacts

'expect that more consistent global accounting policies would improve competitiveness. However, we note that IFRS 17 is not required in the US, Switzerland and Japan and it is uncertain how fully China will adopt'

'the standard will have little benefit on the comparability of insurers from outside IFRS reporting areas'

'Due to additional costs (resource, software license fees, and audit) from having to account under two fundamentally different GAAPs.'



Negligible Impacts

'We do not expect any impact on our competitiveness.'

'Competitiveness is likely to be dominated by regulatory constraints.'

'Greater transparency across other insurers based in other countries... Other insurers might not have applied IFRS 17, but there are similar measures out there e.g. US GAAP.'

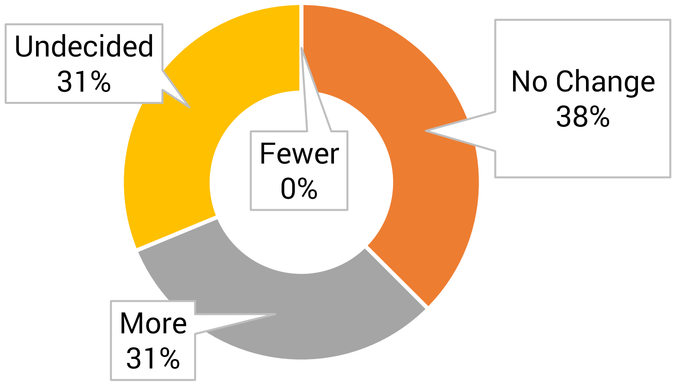
18. Non-GAAP MPMs and post transition presentation

A third of responders anticipated more MPMs while another third anticipated no change. No responders anticipated fewer MPMs while a third remain undecided on the extent of the change.

MPMs under consideration

- Underlying IFRS operating profit - to explain the impact of accounting mismatches and short term fluctuations.
- Adjusted operating profit metric – may include a reconciliation to existing economic new business metrics.
- Present Value of New Business Premiums
- European Embedded Value (EEV) results
- Additional disclosures to explain sales volumes and to reconcile IFRS 17 measures to other information provided.
- Cost : Income Ratio
- Free surplus generation
- Net client flows
- Assets under Management and or Administration
- Measures on Solvency Position such as Solvency II coverage ratio, capital generation etc.

Does the entity expect to present fewer or more non-GAAP Management Performance Measures (MPMs) under IFRS 17 than it does under current accounting?



Post Transition Presentation

'…we anticipate a greater focus on the value of new business value being generated in any year…'

'deferral of income and costs through the CSM will inevitably impact the cost : income ratio therefore an adjusted metric may be required.'

'anticipate having to remove additional accounting mismatches from the result to reflect the economics of the business.'

'We may change our emphasis towards regulatory metrics as they will more clearly reflect dividend capacity although this will depend on final interpretations.'

Most responders anticipate providing additional voluntary disclosure in the notes to enable reconciliation between financial statements and MPMs.

UKEB UK Endorsement Board

The views expressed in this pack are not necessarily those of the UK Endorsement Board, nor are they necessarily reflective of any official policy or position.
This publication forms part of the UK Endorsement Board's outreach activities in relation to the endorsement of IFRS 17 *Insurance Contracts.*

Should you be interested in being involved further with the endorsement process, please contact us at: IFRS17@endorsement-board.uk

April 2021