UKEB

IFRS 17 – *Insurance Contracts*

User Roundtable Summary

22 June 2021

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

User representatives

Analysts attended the roundtable representing: KBW, Morgan Stanley, Barclays, HSBC, Columbia Threadneedle, Credit Suisse, Investec, Exane BNP Paribas and Autonomous

UK Endorsement Board representatives

UKEB Technical Director Seema Jamil O'Neill chaired the meeting which was also attended by members of the UKEB Secretariat IFRS 17 Project team.

1. Welcome and introductions

The meeting was held virtually and started at 10am. Following introductions, the Chair welcomed the attendees.

2. Update on the UK Endorsement Board IFRS 17 project

The Chair provided a summary of the IFRS 17 *Insurance Contracts* ("IFRS 17") endorsement project and the assessment of the standard for adoption in the UK.

The Chair highlighted the assessment criteria set out in Statutory Instrument 2019/685 and noted that IFRS 17 will be considered as a whole, including whether the standard represents an improvement in financial reporting.

As part of its assessment of the standard, the UKEB Secretariat was seeking the perspectives of users of insurance company financial statements. The content for the discussion was based on the preliminary findings from the Secretariat's IFRS 17 User Survey, issued in May 2021.

3. Proposed benefits

Overall, users were optimistic about the intended benefits of the standard. One of the most significant expected benefits was consistent revenue and profit recognition.

The following points were noted during the discussion:

a) A key advantage of IFRS 17 was the simplicity and clarity of the new statement of profit or loss and other comprehensive income. Users considered that this would provide better insight into the separate sources of income and expenses.

b) Users also considered the elements of profit in non-life insurance accounts would become easier to understand and explain to investors under IFRS 17. They noted that under IFRS 4, the nature of investment income (in life preparers) can be unclear. It was anticipated that the new presentation, coupled with new disclosures, would help clarify this for users.

c) Users noted that current profit recognition under IFRS 4 is not considered optimal. Under IFRS 17, profit recognition was anticipated to be easier to understand with the additional disclosures providing further insight. This was thought to be especially the case for UK annuities.

d) It was also noted that transparent and explicit reporting of management best estimates would provide greater insight on the level of prudence used by management.

e) It was considered that the Solvency II best estimate lacked consistency which IFRS 17 would seek to solve and make explicit e.g., through the differentiation between the risk adjustment for non-financial risk ("RA") and contractual service margin ("CSM") estimates.

The UKEB Secretariat enquired whether users were likely to make their own judgements about the nature of management's best estimates, for CSM and the RA. For example, in practice would users treat (part of) the RA and CSM as equivalent to equity?

The following points were noted during the discussion:

a) Users considered that the CSM and RA would act in a similar fashion in terms of profit recognition. The level of judgement used in quantifying the RA may mean that the CSM and RA are combined in analysis, especially for comparability purposes.

b) The crediting of CSM or RA to equity should not make a significant impact on user analysis. Generalist investors may place greater significance on reported equity in assessing and understanding return on equity. Specialist investors may have a deeper understanding and be able to make more informed decisions to understand the equity reported. Overall, it was considered that this would not affect user analysis.

c) Users considered the contractual service margin ("CSM") run-off disclosure as key to enhancing information on future profitability, especially as the different transition approaches permitted by the standard were likely to impact the CSM calculation.

4. Transition approaches

Users were divided on whether the different transition options would hinder the ability to compare insurance company financial statements.

The following points were noted in the transition approaches discussion:

a) Users observed that insurance companies were very hesitant to communicate which transition option they intended adopting. The general sense from users was that insurance companies wanted to keep the impact of transition to a minimum.

b) It was presumed that insurance companies were still assessing how the different transition approaches may impact their accounts. The cost and complexity of implementation appeared to be key considerations for them.

c) Users considered that insurance companies were most likely to adopt a transition approach which provided the best financial position and minimal impact on operating profit at adoption date. It was noted that this approach may impact their subsequent accounting treatment which some companies may not have fully appreciated.

d) While the impact of different transitional approaches was considered a concern for users, it was not considered a reason to further delay adoption of IFRS 17.

e) Even though IFRS 17 required the disclosure of CSM reconciliations for each transition approach, users considered that they would continue to rely on Solvency II metrics, at least until the accounts had stabilised post-transition.

5. Use of key performance measures

Capital generation and solvency metrics were found to be the most used metrics in the user survey. The UKEB Secretariat sought insight from users on the key performance measures currently used and how these may be affected by IFRS 17.

The following points were noted during the discussion:

a) While users intend to rely on capital and solvency metrics, the change in accounting is expected to result in improved disclosure and allow for a greater understanding of accounts-based metrics.

b) Some of the biggest changes will be to the statement of profit or loss and other comprehensive income and to profit recognition. Users noted that they expect that some preparers will provide 'pre-adoption' ratios to aid their analysis.

c) Users considered that the link between IFRS 9 *Financial Instruments* and IFRS 17 appeared to be weakest in non-life insurance. This may result in greater volatility in the statement of profit or loss and other comprehensive income which will necessitate a reassessment of the key performance measures.

d) If IFRS 17 ultimately provides a better representation of the underlying economics for insurance companies, then users anticipate increasing their reliance on and use of the accounts.

e) Users were also anticipating that the standard will make uneconomic products more transparent.

6. Implementation costs and Competition

Users recognised insurance companies' IFRS 17 implementations were complex and that they had incurred significant costs. However, they did not view these costs as material in the context of the scale of the industry.

The following points were noted during the discussion:

a) Implementation costs were significant for insurance companies. However, it was also noted that in comparison to market capitalisation it was not considered material enough to impact user valuations.

b) Users did not consider that the costs of implementation should deter adoption of IFRS 17. Some considered that, in some cases, the scale of the cost was due to a lack of preparation by insurance companies who had outdated systems in place.

In terms of competition, users found no significant disadvantages to UK insurance companies either domestically or internationally. The impact of a potential European 'carve out' on competition also was discussed.

The following points were noted during the discussion:

a) Users expressed a preference for all preparers to adopt IFRS 17 in its entirety to aid comparability and transparency.

b) Users noted that if a carve out were adopted by the EU then they would need to conduct additional analysis to enable an accurate comparison between UK and European insurance companies.

c) They also noted that insurance companies which chose to adopt a carve out would need to be prepared to justify their position.

d) It was noted that the introduction of Solvency II across the EU had enabled a clearer view of the economics of insurance business. Users considered that this would mitigate any potential disadvantages for UK preparers and/or users.

7. Impact of IFRS 17 on cost of capital and credit ratings

Results from the UKEB User Survey indicated that users felt there could be impacts to both cost of capital and ratings for insurance companies.

The following points were noted during the discussion:

a) Users considered that IFRS 17 would provide greater insight into the underlying economics and provide an additional lens through which to view insurance companies. New information may result in changes in cost of capital, although the direction of the change was uncertain.

b) It was anticipated that there may be a shift in the dynamics by insurance companies due to the requirement to provide more granular detail in the financial statements which would be subject to a greater level of scrutiny.

c) Users considered that the changes introduced by IFRS 17 would also enable them to obtain a better understanding of the underlying economics e.g., through the disclosures required by IFRS 17.

8. Attractiveness of the insurance sector

While users anticipate financial statements will be more comparable, they did not consider this would necessarily lead to increased engagement from ‘generalist’ investors.

The following points were noted during the discussion:

a) IFRS 17 created a “toolkit” which users could use to improve their analysis of insurance companies. However, generalist investors may still find insurance company financial statements inaccessible due to the inherent specialised nature of insurance business.

The Secretariat asked participants if they had any additional comments.

The following points were noted during the final discussion:

a) Educational material from insurance companies would be welcomed. Explanations as to the likely impacts of IFRS 17 would be a significant benefit to users. Participants advised that, currently, there is a lack of understanding of the scale of the coming change to insurance companies' accounts.

b) Users encourage the endorsement and adoption IFRS 17 as soon as possible to provide insurance companies with certainty about the direction of travel, and to allow them to commence engagement with users. It was noted that impacts on profit, equity and main product types are key areas users needed to understand.

c) Users' current expectation is that no detailed analysis will be provided by preparers until at least Q2 or Q3 2022. Users suggested that even high-level qualitative analysis would be beneficial at an earlier stage.

End of meeting 11:30am

This document 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.