The Key Role of Actuaries in Steering IFRS 17 KPIs

Baptiste Brechot, Redouan Hmami

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About the speakers

Baptiste Brechot
• 10 years experience in IFRS4 phase 2 / IFRS17
• Member of the French Institute of Actuaries
• Partner at Deloitte Conseil - Actuarial

Redouan Hmami
• 10 years experience in IFRS4 phase 2 / IFRS17
• Member of the French Institute of Actuaries
• Director at Deloitte Conseil - Actuarial
Agenda

- Introduction to IFRS 17
- KPIs under IFRS 17
- Investors and analysts points of view
- Global Survey
- IFRS 17 levers
- Key learnings points
Introduction to IFRS 17

What is IFRS 17 Insurance Contracts?

**One**

IFRS 17 represents a **consistent accounting standard** for all insurance and reinsurance contracts across most jurisdictions around the world.

<table>
<thead>
<tr>
<th>Who is affected?</th>
<th>Why?</th>
<th>When?</th>
<th>IASB and FSB</th>
</tr>
</thead>
<tbody>
<tr>
<td>The new accounting standard has to be applied by all insurers using IFRS Standards</td>
<td>To improve uniformity of insurers' financial statements, to improve transparency</td>
<td>In March 2020, the IASB decided to differ the effective date to 2023</td>
<td>The International Accounting Standards Board (IASB) is the independent, accounting standard-setting body of the IFRS Foundation</td>
</tr>
<tr>
<td>Insurers in scope manage large amounts of assets</td>
<td>Better reflection of insurers and reinsurers profits</td>
<td>Still 2.5 years to go for companies to be compliant</td>
<td>The Financial Stability Board (FSB) is an international body that makes recommendations about the global financial system</td>
</tr>
</tbody>
</table>

The Key Role of Actuaries in Steering IFRS 17 KPIs
KPIs under IFRS 17 (1/2)

IFRS 17 will affect most **all the insurers KPIs**

**ISR**
- Insurance Service Revenue
- The ISR will be **new top line** of the P&L. It will reflect the insurance revenue and will replace the current premiums and other insurance income while **not being fully comparable**

**ISE**
- Insurance Service Expenses
- ISE represents incurred claims, attributable expenses to the insurance contracts and allocated acquisition expenses. It is **comparable** to the current operating expenses with possible differences in expense allocations

**Net Operating Income**
- The pattern of the recognition of profit or loss could change depending of the business and current accounting standards applied for the insurance contracts

**CSM**
- Contractual Service Margin
- The CSM represents the unearned margins on the in-force book of business. In addition IFRS 17 brings a new measure of Value of New Business: **new Business CSM**

**RA**
- Risk Adjustment
- It reflects **compensation for uncertainty**. It quantifies the uncertainty in future cash flows. The entity needs also to **disclose the quantile** corresponding to the Risk Adjustment uncertainty

The Key Role of Actuaries in Steering IFRS 17 KPIs

New KPI

Existing KPI impacted by IFRS 17
KPIs under IFRS 17 (2/2)

Return on Equity
Transition to IFRS 17 standard may impact the equity. In the same way, the new pattern of the revenue could be different.

Operating Free Cash Flows
Measured according to different approaches (e.g., operating income less the variation of required capital over the period), the operating free cash flows represents the cash available to invest or pay dividends.

Combined Ratio
The combined ratio is a KPI mainly used for P&C business. It could be impacted depending on how far combined ratio elements are revisited, e.g., changes in expense allocation, inclusion of risk adjustment, changes in contract boundaries, etc.

Cost Ratio
Overall costs will not change, the difference will be triggered by the allocation between attributable and non-attributable expenses as well as the amortization of attributable acquisition costs.

Solvency Ratio
Although harmonization with the international accounting developments is expected to increase. We expect differences to remain between the financial and prudential frameworks.

The Key Role of Actuaries in Steering IFRS 17 KPIs
Investors and analysts points of view

Example of investors and analysts’ expectations

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Expectations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volume of business</td>
<td>Information on sales volumes. Examples of alternative measures: annual premium equivalent (APE) and present value of new business premiums (PVNBP).</td>
</tr>
<tr>
<td>Return on Equity (RoE)</td>
<td>Information on the equity at transition.</td>
</tr>
<tr>
<td>Analysis of Changes in the CSM</td>
<td>Information on the changes of the CSM from one period to the next.</td>
</tr>
<tr>
<td>Differences with SII</td>
<td>Information on the differences between IFRS equity and Solvency II own funds</td>
</tr>
</tbody>
</table>

IFRS 17 could reduce the impression of current « black box »

A principle based approach could limit the comparability between insurers

Sensitivity analysis and a clear explanation of sources of profits between past and new business are key.
Global Survey

Overview

104 actuaries participated to this global survey

Respondents included actuaries involved in IFRS 17 projects, working in insurance companies, reinsurance companies as well as Deloitte, covering Life, Health and P&C activities across all of EMEA, APAC and Americas.

The answers collected were collected from 25/02 to 06/03/2020. They reflect views of respondents at the time of the survey and could change as IFRS17 projects are moving forward.
Global Survey
Approach

1. LIST OF TOPICS
   Where actuarial judgement could be involved

2. LEVEL OF ACTUARIAL JUDGEMENT
   QUESTION A
   For each topic, Level of actuarial expert judgment that could be applied, from Low to High

3. LEVEL OF DIVERENCE EXPECTED
   QUESTION B
   Expectation of divergence in practices between companies, from no divergence to high divergence

4. COMBINATION OF RESULTS AND RANKING
   We combined the results over the two questions to rank the topics into Low, Medium or High Actuarial Judgment Impact
Global Survey

Podium

1. Transition

2. Risk Adjustment

3. Analysis of Change of the CSM

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Global Survey
Results (overview)

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No divergence

High level of Actuarial Judgment

Risk Adjustment approach and implementation
Financial Communication
Groupings and Onerous Contract Test definition
Definition of coverage units for CSM amortization

High Divergence

Allocation of revenue between past / current and future service
Allocation of expenses, acquisition cost impairment test

Low level of Actuarial Judgment

Discount rates approach and calculation

Selection of approaches VFA, BBA, PAA
Handling IFRS 9 to IFRS17 mismatches and OCI measurement
Definition of contract boundaries
Reporting
Interim Reporting

Definition of underlying items for VFA contracts
Approach to modified BBA
Approach to ceded reinsurance

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Global Survey

Results (extract)

IFRS 17 topics

1. Selection of accounting approach: VFA, BBA or PAA

2. Groupings and Definition of the onerous contract test

3. Transition approach and implementation

4. Definition of contract boundaries

5. Approach and calculation of Risk Adjustment

6. Approach and calculation of discount rates

7. Definition of the analysis of change for CSM calculation

8. Definition of coverage units for CSM amortization

Assessment of the level of actuarial expert judgment that will be involved in each area

Assessment of how far it is expected practices will be different between stakeholders

Actuarial Judgment Impact

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IFRS 17 Levers

The graphic below presents different levers grouped in 4 categories:

- **Extreme / Crisis Levers**
  - Change in level of aggregation
  - Coverage Units
  - Discount Rates
  - Risk Adjustment
  - LIC or not LIC
  - OCI at transition
  - LIC management
  - Risk Adjustment release

- **Business Levers**
  - Management Actions
  - Higher of lower profit sharing
  - Change Assets mix (VFA)
  - Assets hedging strategies (VFA)
  - Change Business Mix

- **One-off / Strategic / Transition Levers**
  - Costs Allocation
  - Attributable Expenses
  - Assumption Changes

- **Tactical Levers**
  - Management Actions
  - Model changes
  - Reinsurance
  - Experience Variance
  - Change in level of aggregation

The Key Role of Actuaries in Steering IFRS 17 KPIs
**Key Learnings**

- IFRS 17 introduces new KPIs and has an impact on existing KPIs
- Analysts and investors have expectations that IFRS 17 will improve financial information
- IFRS 17 includes multiple areas of actuarial expert judgement
- Different types of levers exist to steer IFRS 17 and need to be identified and tested
Thank you for your attention

Contact details:

bbrechot@deloitte.fr
rhmami@deloitte.fr

https://www.actuarialcolloquium2020.com/
Appendix

Survey on IFRS17 & actuarial expert judgment
Global Survey
Detailed results (1/2)

### IFRS 17 topics

1. Selection of accounting approach: VFA, BBA or PAA
2. Groupings and Definition of the onerous contract test
3. Transition approach and implementation
4. Definition of contract boundaries
5. Approach and calculation of Risk Adjustment
6. Approach and calculation of discount rates
7. Definition of the analysis of change for CSM calculation
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Assessment of the level of actuarial expert judgment that will be involved in each area

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Assessment of how far it is expected practices will be different between stakeholders

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Actuarial Judgment Impact

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# Global Survey

**Detailed results (2/2)**

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<th>IFRS 17 topics</th>
<th>Assessment of the level of actuarial expert judgment that will be involved in each area</th>
<th>Assessment of how far it is expected practices will be different between stakeholders</th>
<th>Actuarial Judgment Impact</th>
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<tr>
<td>9. Allocation of revenue between past / current and future service</td>
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<td>10. Allocation of expenses between attributable and non-attributable expenses, acquisition cost impairment test</td>
<td><img src="chart3.png" alt="Chart" /></td>
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<td>11. Definition of underlying items for VFA contracts</td>
<td><img src="chart5.png" alt="Chart" /></td>
<td><img src="chart6.png" alt="Chart" /></td>
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<td>12. Handling IFRS 9 to IFRS17 mismatches and OCI measurement</td>
<td><img src="chart7.png" alt="Chart" /></td>
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<td>13. Approach to ceded reinsurance</td>
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<td>14. Approach to modified BBA</td>
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<td><img src="chart12.png" alt="Chart" /></td>
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<td>15. Interim reporting</td>
<td><img src="chart13.png" alt="Chart" /></td>
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<td>16. Reporting</td>
<td><img src="chart15.png" alt="Chart" /></td>
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<td>17. Financial communication</td>
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