



ACTUARIAL ASSOCIATION OF EUROPE

IFRS 17 Endorsement in Europe

Meeting with EFRAG Board 30 May 2018

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Executive summary

- The Actuarial Association of Europe represents c. 23,000 actuaries from 35 European countries. Actuaries play an important role in all aspects of insurance accounting.
- We have carried out an extensive survey of our member associations to assess views and experiences relating to IFRS 17.
- Key perceived advantages are greater consistency and comparability among preparers, the relevance of the standard in the context of modern accounting and potentially enhanced understanding of the industry.
- Challenges include inconsistency of treatment between direct business and reinsurance, reporting complexity and scope for different interpretation of principles.
- The standard is expected to be broadly positive for insurance markets if challenges are met.
- Costs will be significant and focus will be required to ensure the benefits are achieved in light of the challenges above.
- Actuaries are expected to play a leading role in the implementation of IFRS 17 and in the preparation of IFRS 17 accounts and professional bodies are committed to ensuring that actuaries are prepared for this.

Agenda

1. Introduction to AAE and description of approach
2. AAE's assessment of IFRS 17 in terms of Relevance, Reliability, Understandability and Comparability
3. Key challenges for IFRS17
4. Impact on competition and insurance markets
5. Costs and benefits
6. Role of actuaries in IFRS 17 and their education



Introduction to AAE and description of approach

Actuarial Association of Europe

- The Actuarial Association of Europe (AAE) was established in 1978, originally as the Groupe Consultatif Actuariel Européen, to represent actuarial associations in Europe. The AAE currently has 36 member associations in 35 European countries, and represents over 23,000 actuaries.
- A key strategic objective of the AAE is to provide high quality professional advice to the various organisations of the European Union, e.g. the Commission, the Council, the Parliament, EIOPA, other European stakeholders and industry and consumer protection bodies, to improve the soundness of decisions from an actuarial perspective.

Role of the actuary

- Actuaries are professionals who support life and non-life insurance undertakings in many technical and managerial areas and have specific capabilities in the area of providing a scientific view of future liabilities (and their relationship with assets) and risks.
- Under the Solvency II regulatory regime in Europe, the “actuarial function” is required to coordinate the calculation of technical provisions for insurance undertakings as well as having responsibilities in relation to reporting requirements, methods, assumptions and data and risk management.
- Actuaries are leaders for all aspects of cash flow projection and discounting in insurance companies, which are key elements of IFRS 17.
- As leaders, they provide advice to Boards and senior management to support decision making in key areas.

IFRS 17 will impact on key areas of actuarial leadership

- Cash flow modelling
- Creation and maintenance of valuation models
- Product pricing, strategy and implementation
- Establishment of methodologies and assumptions
- Comparison of assumptions and experience
- Asset liability modelling
- Data management
- Financial communication and reporting

Description of approach

- We have sought the views of our member associations based on their experiences to date with IFRS17. The work on the standard is at an early stage for many undertakings and these views may not be fully formed.
- The views represent a collation of opinions of actuarial professionals and their associations; they do not represent the views of particular undertakings, industries or individuals.
- Actuaries work within asset managers, auditors, consultants, insurance companies, reinsurers, brokers, supervisors, banks, risk management firms all across Europe. Our survey reflects this diversity.

Assessment of Relevance, Reliability, Understandability and Comparability associated with IFRS 17

Based on a survey of AAE member associations

Introduction

- Results of the survey are grouped under each of the four headings separately, i.e. Relevance, Reliability, Understanding and Comparability. We have included the key areas emerging from our member associations which are considered to potentially foster or hinder the attribute in question. There is some overlap between attributes.
- Following the consideration of each of the attributes, we have extracted some key advantages associated with the standard as well as potential challenges, with a view as to how these could be addressed.

Advantages

- Modern measurement of insurance assets and liabilities
 - Market consistent valuation
 - Current estimates
 - Risk-based approach
 - Explicit margins
- Fostering consistency and comparability, especially among jurisdictions, preparers and with Solvency II
- Split of insurance and finance results including investment components on the income statement
- Extended disclosures leading to greater understanding
- Some simplifications allowed, e.g. in relation to non-life

Challenges

- **Inconsistencies between direct and reinsurance**
 - **Hindering:** relevance, understandability, reliability, comparability.
 - **Issue, e.g.:** current standard creates a mismatch between a quota share reinsurance asset and liability on the primary insurers' balance sheets.
 - **Potential mitigation:** record reinsurance as hedging the covered liability. 🖐️
- **Reporting complexity**
 - **Hindering:** relevance, understandability, reliability.
 - **Issue:** current standard is unnecessarily complex in many areas of reporting segregation
 - **Potential mitigation:** simplify and clarify the reporting dimension. 🖐️
- **Too much room for different interpretation of principles**
 - **Hindering:** understandability, reliability, comparability.
 - **Issue:** principles' wordings leave unnecessary room for inconsistencies in many areas, e.g. concerning illiquidity premium, discount rates, contract boundaries, amortisation of CSM, PAA onerous contracts test, transition treatment, coverage units, risk adjustment, cost allocation and deferral, mutual business treatment, applicability of PAA, OCI approach.
 - **Potential mitigation:** narrow room for unwanted interpretation by less ambiguous wordings 🖐️

Note: We have addressed the potential mitigating actions but not the means for bringing these about which we consider to be for EFRAG to consider.



Impact on competition and insurance markets

Competition and Insurance Market Impacts

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- + Greater comparability and more transparency providing favourable backdrop for M&A activity and more effective capital access;
- + P&L better reflecting the business model even though non-GAAP measures will continue;
- + Greater alignment between Solvency II and IFRS;
- + More insights potentially available provided appropriate education is given;
- Inconsistency of understanding and implementation might inhibit competition;
- Difficult to create market statistics in countries where IFRS17 is not widely applied

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- + Greater alignment between accounting and other business views allowing more informed management
- + Expected better understanding of products and market environment
- + Expected better connection between pricing and reserving processes leading to improved collaboration across functions
- ? More complexity in budgeting process, steering more complex based on a new management reporting/KPIs with possible changes in remuneration and product design;
- ? Potential changes to business and portfolio structures;
- ? Position of the local supervisor with respect to the scope of the standard in local regulation
- High implementation costs and significant changes in current processes with possible market changes
- Potential competitive advantage for entities not applying IFRS 17 (no implementation cost, no detailed disclosures, some products less attractive under IFRS 17 may create opportunity for these entities)

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Uncertainties and challenges are mostly expected during the implementation and formative phases of the standard.



Costs and benefits of IFRS17

Costs and benefits relationship

Benefits:

- Increased comparability and improved transparency;
- One standard used across different countries;
- Approach similar to Solvency II and closer to market value balance sheet;
- More rational pricing and value creation.

Costs:

- High expenses and workload at implementation and on ongoing basis;
- Uncertainty in terms of interpretation, difficulty in implementation;
- More complexity in the standard;
- Disproportionate workload for small entities;
- Significant changes in current technical systems and new tools needed.

Conclusion:

- Implementation will be very costly; strong focus will be required during that process to enable delivery of targeted benefits;
- Less complexity could mitigate costs;
- An analysis of appropriate complexity reduction to mitigate undue costs should be performed.



Embracing the increasing role of actuaries in IFRS 17

The role of actuaries in the accounting process

- Today, actuaries have an enacted responsibility under Solvency II in setting technical provisions, including risk margin (and SCR);
- Today, actuaries are already involved in the closing of the accounts;
- IFRS 17 requires multidisciplinary knowledge and education (actuarial, accounting, modelling) in all of which actuaries have required skills;
- Ahead of the auditing review, which will require closer collaboration between the accounting and actuarial professions, actuaries will apply and demonstrate the consistent and reliable exercise of their judgment and expertise;
- We believe that actuaries will play a leading role in the implementation of IFRS 17 and the preparation of IFRS 17 accounts and that actuaries should have a more formal (enacted) responsibility for closing the accounts given this leading role.



Educating actuaries: leveraging skills and competencies

Education of actuaries on IFRS 17

Actuarial professional bodies and associations are committed to preparing their members to play a leading role in IFRS 17

International Actuarial Association :

- Development of a (model) International Standard of Actuarial Practice (ISAP 4) on IFRS 17, setting out high-level principles for practicing actuaries in their work with IFRS 17;
- Development of an International Actuarial Note (IAN) on application of IFRS 17 to advance the actuarial understanding of IFRS 17;

Actuarial Association of Europe:

- Development of various educational materials on IFRS 17 (e.g. webinars, presentations, slides, European comment on ISAPs and IANs);

Local actuarial associations:

- Potential adoption of selected parts or all of the IAA's model ISAPs or IANs for use of the relevant local actuarial association's members;
- Exploring best practice and discussion of implementation issues at local market level;

Thanks for your attention



Stay connected

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Appendices

Relevance

Fostering

- Risk based approach
- Fair/market value approach based on current assumptions
- Responsive to market changes
- Recognition of expected losses at day one
- Discounting of claims reserves
- Disaggregation into insurance service result, finance income and expenses
- Separation of onerous and profit-making contracts
- Providing economic view of release of profit margins
- Introduction of contractual service margin, incorporating unearned profits
- Comparability of financial statements

Hindering

- Greater volatility of results
- Complexity
- Possible inconsistencies between reinsurance and direct flows
- Extent of disclosure required
- Lack of proportionality
- Grouping of contracts leading to excessive complexity
- Presentation for non-life business
- Need for unbundling and different treatment of investment contracts

Reliability

Fostering	Hindering
<ul style="list-style-type: none">• Fair/market value approach based on current assumptions• Systematic release of contractual service margin• Testing of sufficiency of reserves• Transparency of composition of reserves• Consideration of all future cash flows• Inclusion of options and guarantees in measurement• Enhanced disclosure• Risk adjustment approach (and disclosure of confidence level)• Discounting of claims reserves	<ul style="list-style-type: none">• Complexity, leading to risk of error• Treatment of acquisition cash flows• Lack of clarity in aspects of standard leaves room for interpretation and provides scope for inconsistency• Possible inconsistencies between reinsurance and direct flows• Starting point – quality of transitional arrangements• Premium allocation approach comparability requirements• Use of Other Comprehensive Income may lead to valuation mismatches

Understandability

Fostering

- Cash flow based approach for long term business
- Premium allocation approach for short term
- Clearer presentation
- More extensive disclosures
- Separated financial & service disclosures
- Comparison of expected versus experience
- Contractual service margin
- Recognition of expected losses on day one
- Risk based approach
- Clear revenue concept, relating to provision of services
- Incorporating time value of money and current discount rates

Hindering

- Statement of profit and loss, due to complexity and differences of interpretation
- Transitional arrangements
- Greater volatility of results
- Possible inconsistencies between reinsurance and direct flows
- Grouping of contracts leading to excessive complexity
- Revenue presentation for non-life
- Accretion of interest rates for new groups over year
- Treatment of lock in of rates
- For risk adjustment, lack of definition of “confidence level technique”
- IFRS17 VS local GAAP in case of difference

Comparability

Fostering

- Global principles
- Consistency of reflection of risks
- Fair/market value approach based on current assumptions
- Accounting for investment contracts
- Non-life business, through Premium allocation approach
- Consideration of future cash flows for all entities
- Revenue relates to provision of services, not premium received
- Prescribed measurement models
- Recognition and treatment of onerous possibilities
- Enhanced disclosure giving information on areas of inconsistency

Hindering

- Lack of clarity in aspects of standard leaves room for interpretation and provides scope for inconsistency, e.g.
 - illiquidity premium
 - discount rates
 - contract boundaries
 - amortisation of Contractual service margin
 - Premium allocation approach onerous contracts test
 - transition treatment
 - coverage units
 - risk adjustment
 - cost allocation and deferral
 - mutual business treatment
 - applicability of Premium allocation approach
 - Other comprehensive income approach
- Possible inconsistencies between reinsurance and direct flows

Education of actuaries on IFRS 17 (detailed)

The actuarial community is developing various educational material on IFRS 17, with the aim of assisting the practicing actuary and other professions in their work around IFRS 17:

Organisation	Material
International Actuarial Association	<ul style="list-style-type: none"> • Development of a (model) International Standard of Actuarial Practice (ISAP 4) on IFRS 17, setting out high-level principles for practicing actuaries in their work with IFRS 17. This model standard document is not by itself binding on any actuaries, but needs endorsement by local associations. Its purpose are: <ul style="list-style-type: none"> — Facilitate convergence in standards of practice in connection with IFRS 17 within and across jurisdictions — Increase public confidence in actuarial services provided in connection with IFRS 17 — Demonstrate the IAA's commitment to support the work of the IASB in achieving high quality, transparent and comparable financial reporting internationally • Development of an International Actuarial Note (IAN) on Application of IFRS 17. This is a comprehensive educational document on actuarial subjects within IFRS 17, which has been prepared to: <ul style="list-style-type: none"> — Advance the understanding of the subject by readers, including actuaries and others, who use or rely on the work of actuaries, and — Serve as a model document for local associations that wish to publish educational notes on the same subject (see below).
Actuarial Association of Europe	<ul style="list-style-type: none"> • Development of various education materials on IFRS 17 (e.g. webinars, presentations, slides,, European comment of ISAP & IAN);
Local actuarial associations	<ul style="list-style-type: none"> • Adoption of selected or all of the IAA's model IASPs or IAN for use of the respective local actuarial association's members • IFRS 17 working groups have been established within different local actuarial associations, providing interpretation support and guidance on local matters to their members