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25th Anniversary Conference

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IFRS17 in Action

Matching Standard Objectives with Business Realities

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Max Happacher
ERGO International AG

Tomas Milašius
Compensa Life VIG SE

Marika Guralnik
Compensa Life VIG SE

Luca Cavaliere
Milliman

Margus Liigand
Swedbank

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IFRS17: Benefit Harvesting?

Dr. Maximilian Happacher
Board of Directors of ERGO International AG

IFRS 17: What has happened so far…

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IFRS 17 is the first comprehensive international accounting standard for insurance contracts and applies to fiscal years starting from January 1, 2023.

- **1997** – IASB begins work on insurance contracts.
- **2001** – Included in the IASB's work program.
- **2004** – IFRS 4 Insurance Contracts published.
- **2005** – IFRS 4 effective from January 1, 2005.
- **2007** – Discussion Paper Preliminary Views on Insurance Contracts.
- **2010** – Exposure Draft ED/2010/8 Insurance Contracts.
- **2013** – Draft ED/2013/7 Insurance Contracts published.
- **2017** – May: IFRS 17 Standard published.
- **2020** – Amendments to IFRS 17: including the postponement of the effective date.
- **2021** – IASB publishes Initial Application of IFRS 17 and IFRS 9 — Comparative Information.
- **2023** – January 1: Implementation of IFRS 17.

IFRS17: A lost illusion and the Valley of Despair

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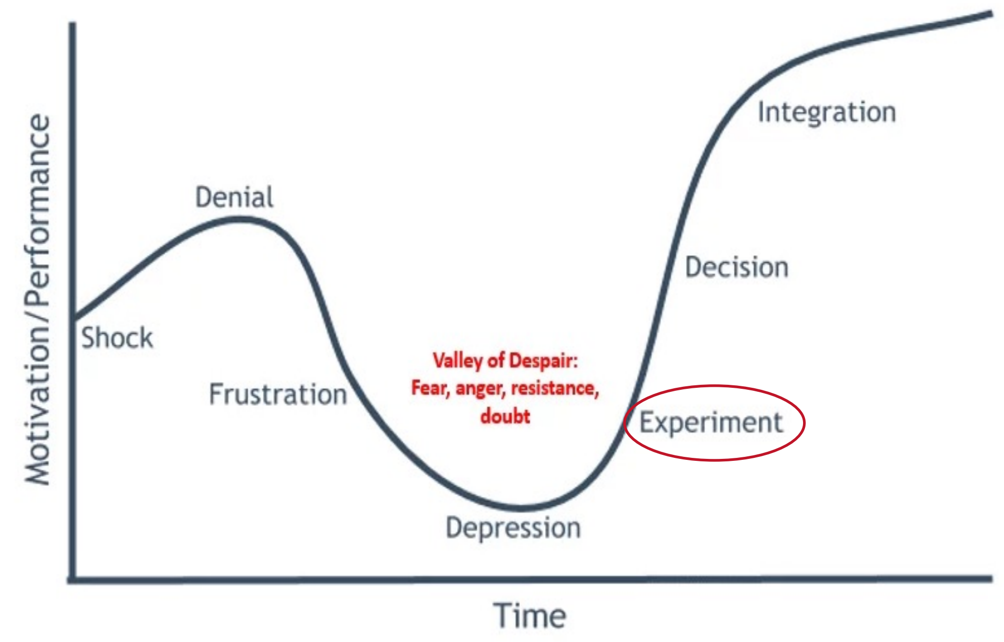

IFRS 17: Nothing changed?

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retrospective | prospective

	SII	IFRS17
Properties	▪ Forward- (SLT) and backward-looking (NSLT) ▪ Lines of Business (LoB)	▪ Forward- and backward- looking ▪ LoB / group of contracts
Purpose	▪ Capital requirement (financial stability) ▪ Regulatory reporting	▪ Consolidated (group) reporting (investor view)
Impact	▪ Capital management of the company	▪ IR[1]/ OCT[2] as an implicit "profitability measure" within IFRS17

Assumptions

Management Rules

Options & Guarantees

Risk Adjustment

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- **Reflects the compensation for uncertainty in future cash flows due to non-financial risks as insurance contracts are fulfilled**

Allianz

The risk adjustment for LRC for life/health corresponds to a confidence level of 72% to 77% and is calculated based on distribution assumptions consistent to Solvency II (where applicable). For life/health, an ultimate distribution is estimated based on the Solvency II one-year-view used in the Cost of Capital methodology for calculation of the risk adjustment for the LRC, projected to ultimate horizon per entity and aggregated to diversified group level. The confidence level is derived as the quantile of the Group net of reinsurance risk adjustment in the ultimate distribution of the Group.

Munich RE

More specifically, we apply a cost-of-capital rate of 6% to the amount of capital required as at each future reporting date on a going-concern basis, and we discount the result using the risk-free rates adjusted for illiquidity. The level of risk adjustment for non-financial risk used by Munich Re corresponds to a confidence level of 88% (87%) over a one-year period. Like the present value of the cash flows, the risk adjustment for non-financial risk is reviewed at each reporting date and updated to reflect the current conditions. IFRS 17 provides for the option of splitting the change in risk adjustment for non-financial risk into insurance service result and insurance finance income or expenses. We report the full change in risk adjustment for non-financial risk as part of the insurance service result unless it is due to changes in the time value of money.

Contractual Service Margin (CSM)

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Represents the unearned profits that the company expects to realize in the future.

Measured at the level of contract groups.

Derived at initial recognition based on the FCF.

CSM

Must be adjusted during subsequent measurement when changes in the FCF occur.

Initial recognition

Profitable (group of) contracts
- Unearned profits go to CSM; no profit at inception

Onerous contracts
- Immediate recognition of entire fulfillment loss in P&L

CSM - communicative challenges

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- ➢ What role do interest rates play?
- ➢ What are coverage units?
- ➢ What is the significance of recalibration?
- ➢ What does that have to do with ALM?
- ➢ What is the Bow-wave effect?

Combined Ratio- everything clear?

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- The CR is reported based on IFRS 17 figures: CR = ISE / IR
- Loss reserves under IFRS 17 are discounted
- Risk margins and acquisition costs tend to impact the Combined Ratio of growing portfolios
- Asymmetric treatment of profitable versus loss-making contracts over the coverage period distorts the CR over time
- Different definitions in practice:
  → Consideration of indirectly attributable costs
  → Treatment of ceded reinsurance

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Thank you for your attention!

Now it's your turn: Please ask your questions!

Pressure on the Technical Profitability?

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Discounting of Loss Reserves in IFRS 17 and the P&C Area

Interest rates ↑ → **Loss ratios** ↓

- **Compensated by less price discipline?**
- **Lower combined ratios in the long run?**

Pressure on the Technical Profitability?

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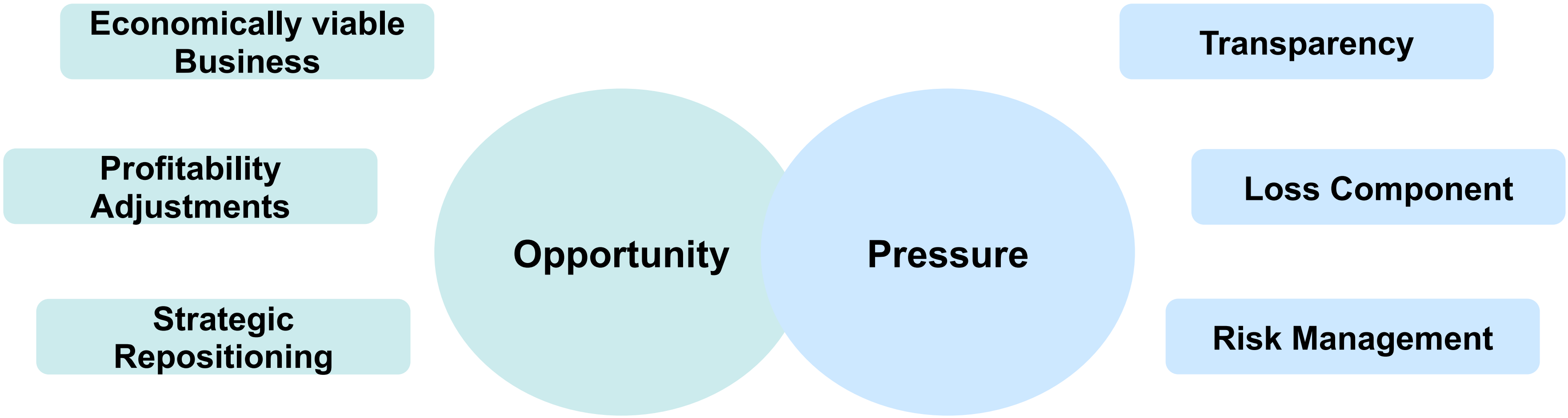
Onerous Contracts



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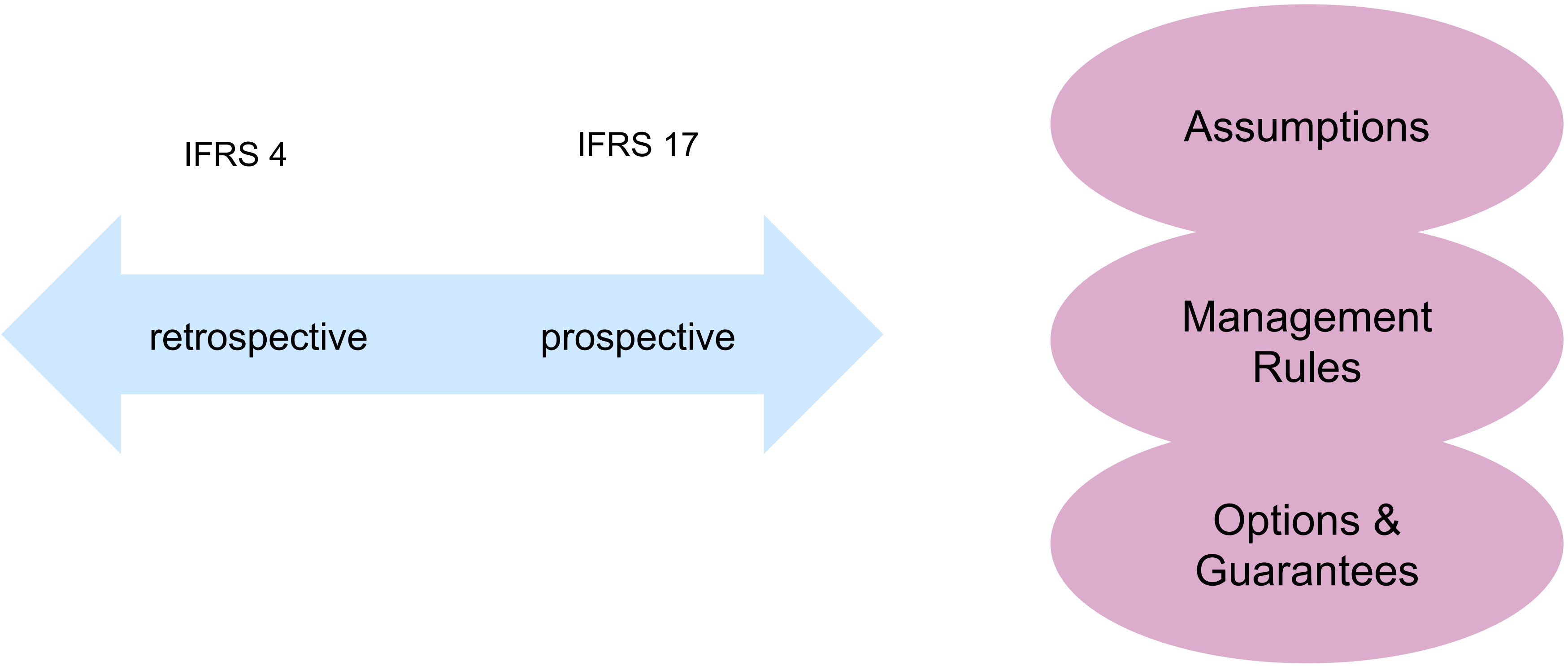
IFRS 17: Nothing changed?



Combined Ratio

Adjusted profitability:

- Discounting future claims and expenses to present value

Implications:

- More accurate profitability measurement
- Impact on financial ratios

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IFRS 17 disclosures in Europe

Luca Cavaliere
Consulting Actuary
Managing Director Italy & CEE

27th September 2024

Milliman

Introduction

Where we are with IFRS 17

- Key aims of IFRS 17 include the following:

  "*introducing… transparent and consistent financial information about insurance contracts.*" (1)

  Giving "*a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows*" (2)

- **Has the standard already achieved its aims of transparency, consistency and usefulness?**

(1) https://www.ifrs.org/content/dam/ifrs/project/insurance-contracts/ifrs-standard/ifrs-17-effects-analysis.pdf

(2) IFRS 17 Standard

IFRS 17 disclosures in Europe

Executive Summary (1/3)

For the first time, European listed insurance firms have published their annual reports for the 2023 fiscal year, incorporating comprehensive information under IFRS 17.

Methodology and assumptions

There are a range of methodology and assumption decisions which companies can take, which can have a significant impact on results. These include:

- Choice of transition methodology
- Level of discount rate and illiquidity premium used
- Approaches and confidence level of risk adjustment
- Definition of Non-Distinct Investment Component
- Expense Attributability
- Use of PAA (vs. GMM)

IFRS 17 disclosures in Europe

Executive Summary (2/3)

Alternative performance measures

- Many companies publish a range of Alternative Performance Measures, some of which are derived from IFRS 17, others not.
- This is because IFRS 17 alone does not provide sufficient information to understand the financial position and performance of insurers.
- Definitions are currently non-standard, and thus vary between companies, even where measures have the same, or similar names.

Management and strategy

- Many companies have publicly stated that IFRS 17 has little or no impact on aspects such as capital and cash generation, dividends, solvency and strategy.
- Therefore, they use other measures (such as those related to Solvency II) for this purpose.

IFRS 17 disclosures in Europe

Executive Summary (3/3)

In addition to the previous points, it should be noted that, in most major European markets, IFRS 17 is only currently compulsory for listed companies for their consolidated group financial statements. Also, many companies may have significant amounts of investment contracts measured under IFRS 9.

It appears that IFRS 17 has a long way to go to achieve its key aims of transparency, consistency and usefulness.

It will be interesting to see how IFRS 17 reporting develops over the next few years. To what extent will:

- Companies begin to consider it in their strategy and management
- Methodologies and assumptions converge (or not)
- Understanding by readers develop, so that companies can be more readily compared with one another
- Disclosures become sufficient to aid that understanding

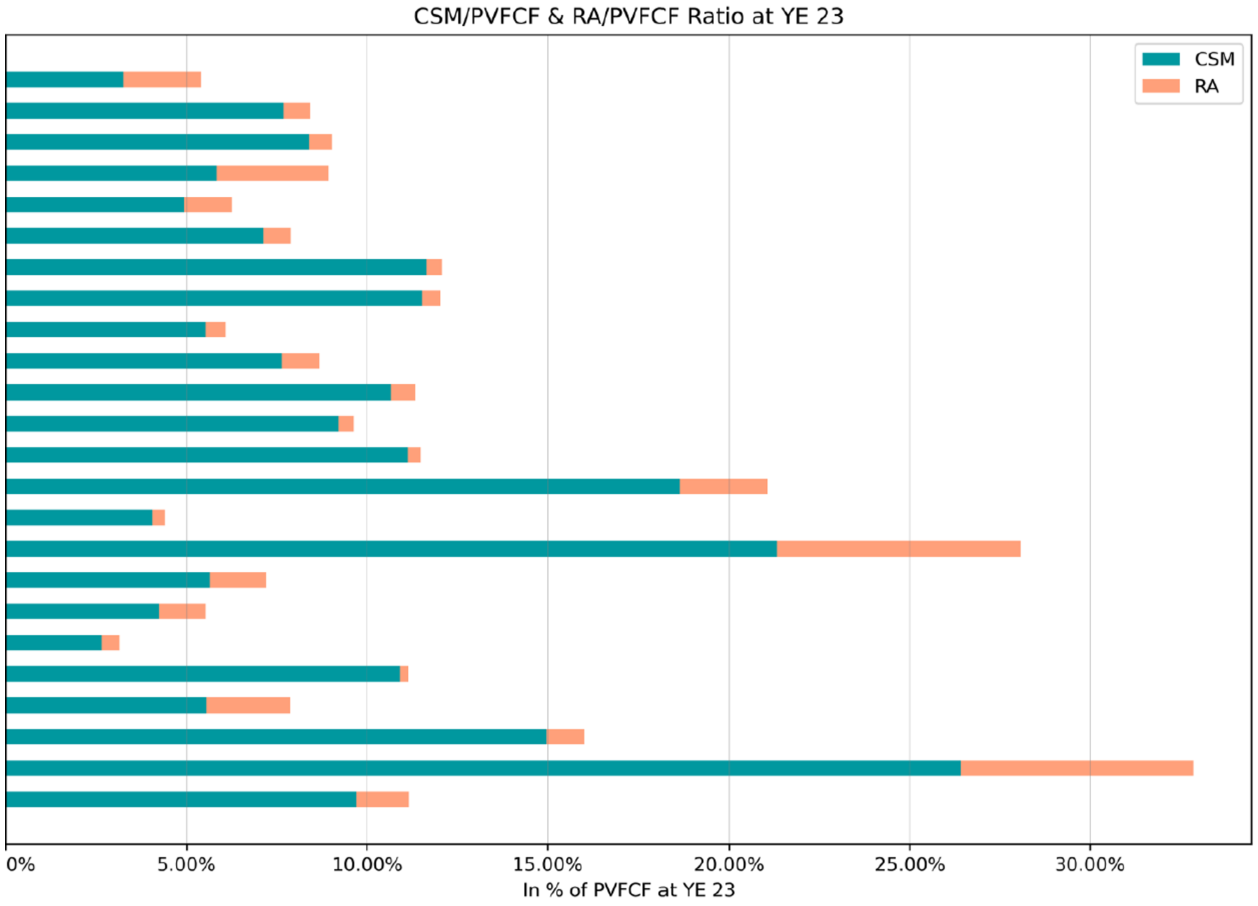
Performance and value creation

How to compare the financial results of different insurance companies

- The value of an insurance company is primarily based on its equity. It also encompasses elements from (re)insurance contracts expected to incrementally contribute to equity via the Profit & Loss (P&L) statement over time.
- The Contractual Service Margin (CSM) and Risk Adjustment (RA) are also two key components within the new IFRS balance sheet that will be recognized in the P&L.
- To assess and compare how the value of a company changes over a period, examining the relationship between CSM and RA, as well as the evolution of the CSM, is insightful.
- Underwriting profitable new business is crucial for insurance companies. The CSM generated from new business serves as a measure of whether this goal is achieved. A stable or increasing CSM level indicates the potential for future dividends from insurance operations, with normalized CSM growth being a metric for this assessment.
- The RA represents the compensation an entity demands for assuming the uncertainty of cash flows, which is also recognized in the P&L over time.
- Our analysis reveals that the initial levels of CSM, RA, and revaluations at the transition significantly influence the performance in the subsequent periods.

Profitability measure

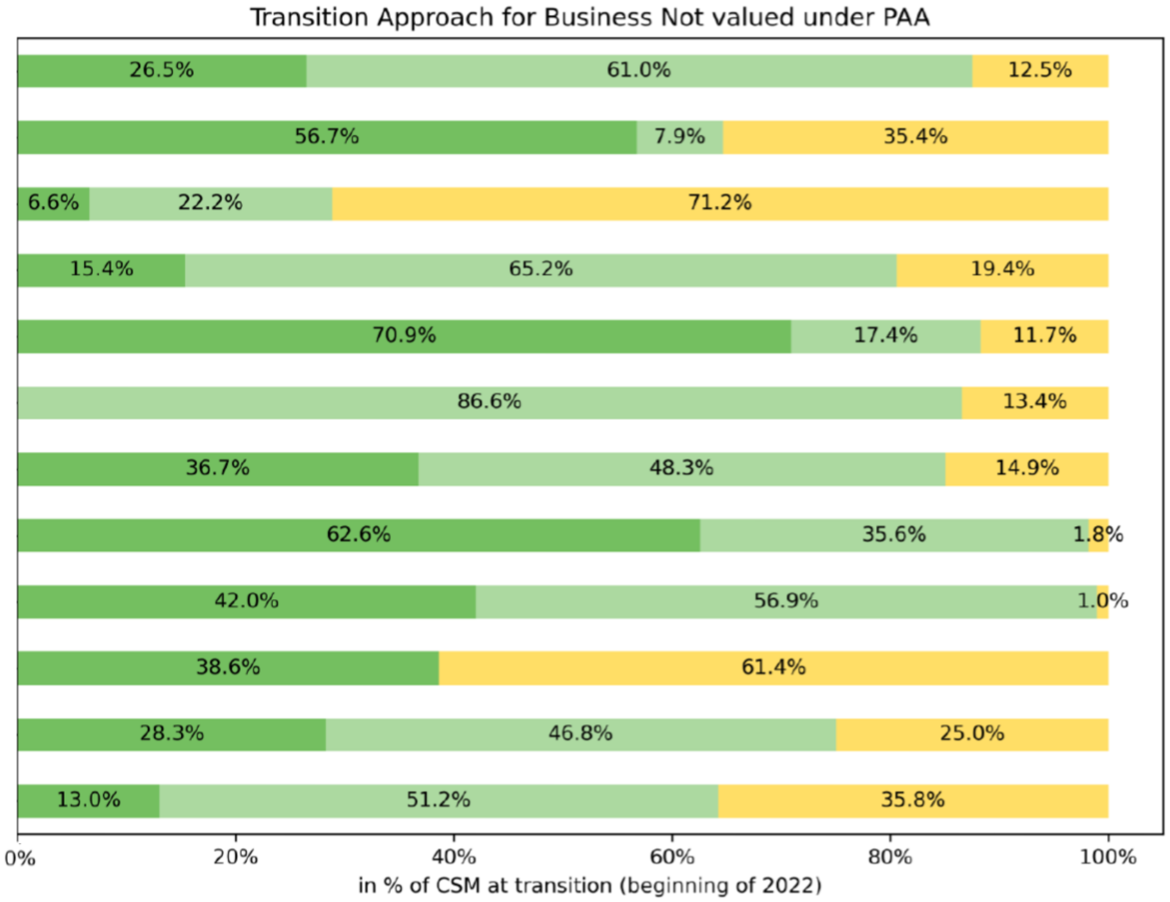
CSM and RA as a percentage of PVFC



- For new business and companies that applied the full or modified retrospective approach at transition, there is a direct connection between the CSM and the RA. A higher RA leads to a lower CSM.
- For companies that applied the fair value approach, the relationship between the two components is less direct.
- An advantage of the RA is its more stable release into P&L, but at the same time, the disadvantage is that it cannot absorb adverse deviations in the portfolio as well as the CSM can.

CSM by transition approach

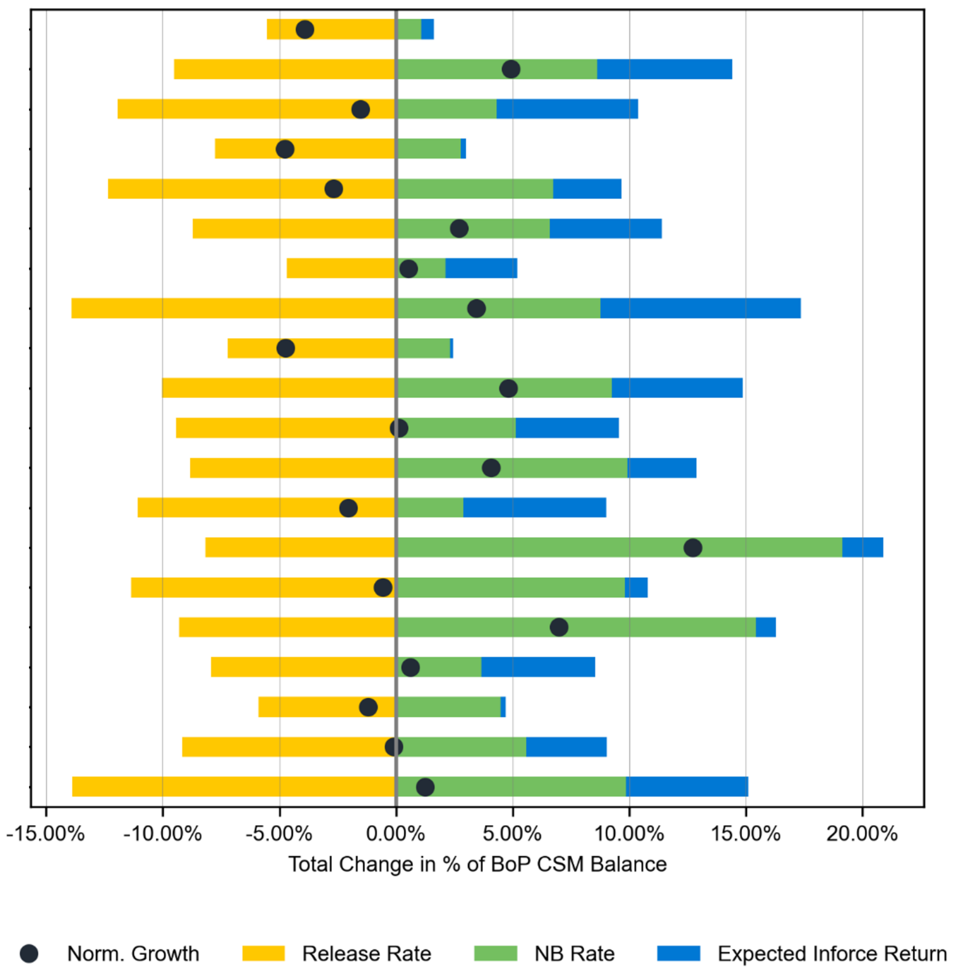
The CSM at transition calculated following different approaches



- The CSM at transition had an immediate impact on the equity per that date and future results. Most companies reported small changes compared to IFRS4/IAS39.
- The retrospective approaches (FRA and MRA) led to small or negative CSM in the case of historic strengthening of technical provisions. Portfolios with a small CSM or loss component under MRA can have a much higher CSM under the FVA.
- Companies that use the VFA or mutualization had a preference for the FVA.

Normalized CSM Growth

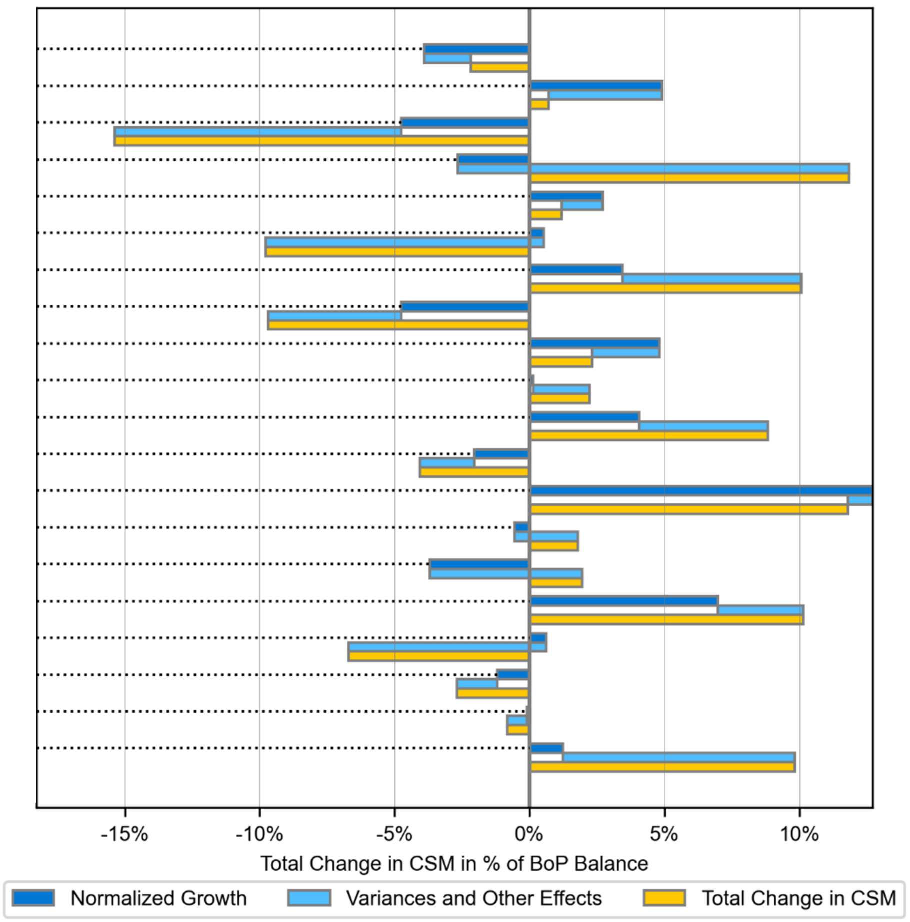
KPI aiming at removing one-off movements, can be an indicator of how stable a firm can grow



- Most companies demonstrated a positive growth rate. The amount released is replaced by new business and the expected return on the in-force.
- As of the transition date, the interest rates were relatively low. For companies applying GMM without the full retrospective approach, the expected in-force return is relatively low.
- For mature companies, it is challenging to generate the same amount of Contractual Service Margin (CSM) from new business as is released from the in-force book.

Normalized Growth vs. Total Change in CSM

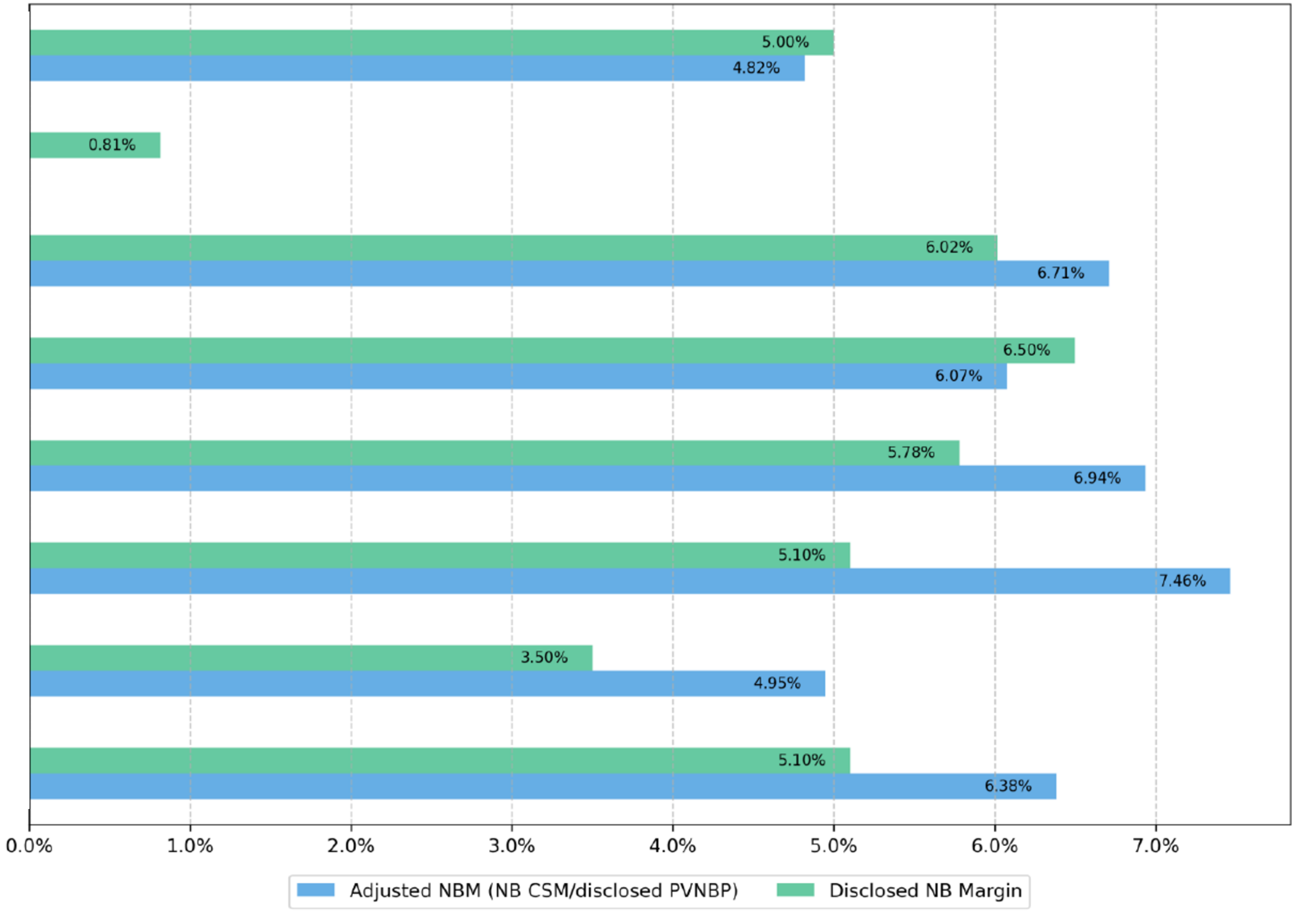
Magnitude and impact significantly differ among companies



- "Variances and Other Effects“ include effects of changes in assumptions and experience variances that impact future cash flows.
- This item encompasses factors that management can control, but they are also affected by policyholder actions and other factors management cannot control.
- Consideration should be given to businesses that use the Variable Fee Approach (VFA), as the actual return on underlying items can lead to additional effects on the Contractual Service Margin (CSM).

New Business Margin

The approach to determine the new business margin varies by company



- The CSM and RA, as of the start date, reveal the expected financial flow into the P&L throughout the duration of the new business.
- However, these figures alone do not provide a clear picture of the new business's profitability, as they lack comparison with the volume of new business. The New Business Margin serves as a measure of the profit margin per unit of premium.
- Variations in how different companies calculate these margins complicate the comparison of results across the industry.

New Business CSM vs. New Business Margin

Significant differences in methodology disclosed

Reflection of additional items compared to IFRS 17 NB CSM

General Approach to calculate NBM	Taxes deducted?	Non-attr. costs deducted?	Loss component deducted?	IFRS 9/15 contracts added?	Short term PAA contracts added?	Cost of reinsurance added?	Look through earnings (e.g., fees) added?
Adjusted NB CSM	✗	✓	✗	✓	✓	✓	✗
Adjusted NB CSM	✓	✗	✓	✓	✓	✓	✗
Adjusted NB CSM	✗	✗	✓	✓	✗	✗	✗
Adjusted NB CSM	✓	✗	✓	✓	✓	✗	✓
Adjusted NB CSM	✗	✓	✓	✓	✓	✓	✗
“MCEV like” measure	✓	✓	✓	n.a.	✓	✓	n.a.
Non-adjusted NB CSM	✗	✗	✗	✗	✗	✗	✗
Adjusted NB CSM	✓	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-adjusted NB CSM	✗	✗	✗	✗	✗	✗	✗

- Significant differences in methodology complicate the process of comparing companies using the disclosed New Business Value (or Margin).
- The NB CSM is a standard, audited KPI. On that basis, companies derive the NBM, adjusting various factors according to their specific business needs and the primary message they wish to convey.
- Tracking these metrics over time for each company can offer valuable insights into the evolution of new business activities.

Comparability

How to compare the financial results of different companies

- Investor presentations and press releases set out key measures considered by companies, together with commentary and some insights into how these relate to company management and strategy.
- Based on our analysis, IFRS 17 alone does not provide sufficient information to understand the financial position and performance of an insurer.
- Insurers continue to publish a range of non-standard measures, some based on IFRS, and some not, with different companies publishing and highlighting different measures. Definitions of such measures often vary between companies, even where they have the same or similar names.
- Therefore, comparability between companies on a like-for-like basis is very difficult, even aside from the various methodological and assumption choices which can significantly impact IFRS 17 results.
- In any case, for many markets in Europe only a small number of companies publish IFRS 17 at all.
- In addition, some companies continue to highlight that IFRS 17 has no impact on aspects such as capital and cash generation, dividends, solvency and strategy.
- It will be interesting to see how understanding, comparability and use by companies develops over the next few years.

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Thank you

Luca Cavaliere
luca.cavaliere@milliman.com

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