Market updates on the impact of IFRS 17

Observations from investor presentations by selected insurance groups

April 2023

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Building a better working world

Welcome

- Brian has been working on IFRS 17 for over 20 years, seeing it develop from the Draft Statement of Principles through IFRS 4 to finally see it being implemented as IFRS 17.
- He currently leads EY's approach to IFRS 17 across EMEIA and the actuarial approach globally.
- He's assisted multiple clients across EMEIA on the implementation and optimisation of financial reporting systems covering IFRS, US GAAP and Solvency II.

- Rachel is a director in EY's life actuarial team and has over 17 years' experience in the life insurance industry.
- She currently leads EY's UK Life Actuarial IFRS 17 team and works with insurers to help implement the required changes in an efficient way.
- In addition to her client work, Rachel runs monthly life insurance forums to debate IFRS 17 technical and implementation issues, she provides training, contributes to EY's thought leadership and speaks at industry events.

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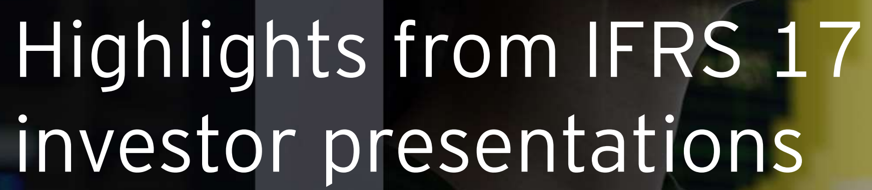
Highlights from IFRS 17 investor presentations



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Introduction

Observations were taken from IFRS 17 impact presentations published in 2022 by a panel of 20 global insurance groups:

Background:

- Insurers are implementing IFRS 17 *Insurance Contracts* (IFRS 17) since 1 January 2023 and most of them are also applying IFRS 9 *Financial Instruments* at the same date for the first time.
- In 2022, several insurance groups published information to the investor community on the expected impacts of implementing IFRS 17 on their financial position and performance.

Analysis performed:

- We have selected a panel of 20 listed insurance groups who have globally adopted IFRS as their accounting framework. For these companies, we have analyzed and summarized the publicly available information on the impacts of implementing IFRS 17 from investor presentations.
- Our analysis considers investor information published up to 31 December 2022. During 2023, insurers will provide, or have already provided, further updates and details on the impact of IFRS 17 through various sources. This information has not been considered in this analysis.
- We intend to update our analysis during Q2 2023 as more information on the expected impacts of IFRS 17 becomes available.

Insurers by geography:

Segment:

- **Life and Health:** 6 groups underwrite only life and health business, that includes short- and long-term savings, and retirement products.
- **Composite:** 12 groups are composite and underwrite both P&C business and life business (with two of them also having major reinsurance segments).
- **P&C:** 2 groups underwrite only non-life business, that includes property and casualty products.

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Executive summary: IFRS 17 has limited impact on overall financial strength and strategy, but impacts on equity and profit going forward could be significant

During their investor presentations, insurers focused on educating the analyst community on the direction of travel and the impact of IFRS 17 on day one equity and on future profitability/volatility:

Key highlights to investors:

- Most insurance groups expect minimal disruptions from IFRS 17. Strategy, cash flow, capital management and dividend capacity not expected to change.
- The CSM will become a key indicator of future profitability. Establishing the CSM and risk adjustment on transition has a downward impact on reported equity, but is a store of future earnings.
- Insurers highlighted the improvements in disclosures that IFRS 17 brings.
- KPIs are continuing the shift to cash flow-based metrics and are focusing on regulatory capital. New business measures and value added metrics may make use of the CSM going forward.
- Planned publication of IFRS 17 impacts in the year-end 2022 (YE22) financial results or annual report varies. Most do not plan to provide a detailed opening balance sheet and a restated 2022 P&L with their YE2022 results announcements.
- Publication of restated 2022 comparative numbers typically expected for 2Q 2023 (often alongside 1Q/1H 2023 presentations).

Key observations on IFRS 17 expected impacts:

- IFRS 17 could lift reported ROE, mostly because the transition shareholders' equity would be lower compared to IFRS 4:
  - Due to the transition and accounting for the CSM, shareholders' equity will reduce for many of the insurers reporting, particularly for Life business.
  - However, for the insurers presenting their ROE based on adjusted equity (excluding OCI and including CSM), this ratio should remain stable.
- A number of reporters noted that leverage ratios would reduce as a result of including the CSM as equity in the denominator of the leverage ratio.
- Life results expected to be more steady and predictable than today.
- On the P&C side, technical results would be improved due to the effect of discounting of claims. The combined ratio will change for many of the selected insurers by:
  - Reporting insurance revenue gross of reinsurance.
  - Reduction in insurance revenue and insurance service expenses for non-distinct investment components.

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Accounting policies and methodology: many insurers opted to leverage regulatory frameworks and manage the impact on transition to reduce profit volatility

Solvency II (SII) framework

European groups have indicated their intent to leverage the SII framework to determine the IFRS 17 liabilities, utilizing similar assumptions or calculation methods as much as possible.

Premium Allocation Approach (PAA)

For most of the players, the use of the PAA for a majority of their P&C business will reduce the impact of the transition to IFRS 17.

Bottom-up approach

Many of the insurers in the panel use the bottom-up approach to set the IFRS 17 discount curves, including an illiquidity premium. Annuity writers reported the use of the top-down approach. Disclosures of these curves will enable users of the financial statements to compare reported results.

OCI approach

Continental European insurers have generally opted for the OCI approach to account for the impact on insurance liabilities caused by changes in economic assumptions in order to reduce P&L volatility.

Others have selected the P&L approach with financial assets and even then also classified as FVPL under IFRS 9.

Retrospective approach

Many insurers reported using the retrospective approach to transition (either full or modified retrospective) for most of their business. The fair value approach has often been used for older or less significant groups of insurance contracts.

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Contractual service margin (CSM) will become a KPI, while the combined ratio will generally be based on gross earned premiums

IFRS 17 brings some changes to the design of KPIs:

Combined ratio

Mostly planned to be presented based on gross earned premiums. However, others will continue to use net-earned premiums. The combined ratio is likely to improve (decrease) due to the discounting of the liability for incurred claims.

Contractual Service Margin

This is expected to become a KPI. One insurer also noted that its new business metric will include the IFRS 17 CSM at inception. Another will use an IFRS 17 value added metric consisting of the IFRS 17 operating profit plus the change in the CSM for the year.

Some insurers plan to separately present the CSM on the face of the balance sheet.

New business (NB)

This will now include the CSM of the new business. Certain players are presenting a gross CSM, whereas others are presenting it net of taxes and of projected non-attributable costs. This would impact the comparability of the NB value across the market.

New business margin

Since single premiums are now released over the coverage period, the annual premium equivalent (APE) disclosed by some insurers as a new business volume metric will be replaced for certain companies by the present value of expected premiums measured on an IFRS 17 basis.

Return on Equity (ROE)

A number of insurers plan to exclude from equity the total of OCI in ROE calculations.

The use of OCI for the impact of changes in financial assumptions on insurance liabilities is envisaged to provide a better matching between the revaluation of investments and insurance liabilities.

Leverage ratio

CSM is added to the denominator of the leverage ratio. One insurer also plans to include the risk adjustment net of tax as part of the denominator.

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KPI impacts: for most (not all) insurers, operating profit should be similar or lower under IFRS 17 while the level of Shareholders' Equity (SHE) is generally expected to go down

Limited quantitative disclosure regarding the impact on KPIs has been provided. During their presentations, insurers focused on educating the analyst community on the direction of travel, and the impact of the standard on transition and future profitability or volatility:

Operating profit

Operating profit is generally expected to be similar or lower compared to IFRS 4.

The reported reduction varies from 5% to 25% compared to the IFRS 4 operating profit, mostly driven by the Life business.

However, more than 50% of insurers did not disclose an expected quantitative impact.

Level of Shareholders' Equity

This is expected to decrease at transition date for most life and composite insurers, with reported reduction varying from 5% to 50%.

Some insurers noted that excluding OCI from equity, or adding CSM to equity, would result in equity remaining more or less stable on transition.

Several insurers mention that the reduction of SHE is due to setting up a CSM.

Return on Equity

Depending on previous practices, the ROE targets will remain unchanged or will be improved. Indeed, in the past, some insurers were excluding OCI from the ROE calculation where others were not. Since part of the amounts previously in OCI are now included in the CSM, the ROE of the latters will be mechanically improved.

Contractual Service Margin

This is presented as gross, net of tax, or net of tax and projected non-attributable expenses. This latter view is perceived to provide a more direct view on the net-income impact of the release of CSM.

Risk adjustment

This could present varying levels of calibration depending on the risk appetite of the groups.

Some insurers plan to use the cost of capital approach, whereas others are using value at risk.

Insurers reported the expected percentile range of the risk adjustment to vary between 62.5% and 90%.

Release of Contractual Service Margin

The indication of pattern of release helps analysts to anticipate expected future profitability.

Insurers reported an expected release of CSM ratio (release divided by CSM before release) between 4% and 12% per annum depending on the type of business.

Analysts agree with insurers that there will be lower impacts on earnings, cash or solvency than previously anticipated

Observations	What analysts are saying
Most insurance groups are expecting limited disruptions from IFRS 17.	"We think UK annuity writers are set to see the greatest noise from IFRS 17 but valuations should not change for any insurers. Cash, dividends and solvency are unchanged. Fair IFRS PE ratios need to be adjusted to reflect the new paradigm. — **BofA**
CSM will be the biggest change, as it impacts reported book value negatively.	"The CSM is the biggest change. We view the treatment of new business gains, essentially "unearned profits" which are capitalized under IFRS 4 but will now be deferred and amortized under IFRS 17 through the CSM, as the biggest difference, which, from an accounting perspective, will lower reported book value upon transition and impact the timing of earnings. — **BMO**
Performance KPIs are shifting to cash flow-based metrics.	"Many life insurance-heavy names have switched their KPIs to non-earnings metrics, e.g., capital generation or cash, which are unaffected by IFRS 17. That said, we think IFRS 17 could introduce an element of 'presentational volatility' to earnings, which could conceivably increase the cost of equity in the space. — **Morgan Stanley**
IFRS 17 will lift reported RoE – this could flow through to higher valuations.	"We believe that the change to accounting linked to IFRS 17 is a positive — this is because it is reducing reported equity and, therefore, is lifting ROE (earnings are largely unchanged) ... Higher ROEs deserve a higher price-to-book ratio. This is because investing in a business with a high ROE produces a higher profit. – **Berenberg**

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2 Global benchmarking

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Core messages during the investor presentation

a.s.r

- No changes to underlying business fundamentals or cashflows
- No impact on existing share buyback commitment and progressive dividend policy
- Higher volatility expected in net result, mostly driven by operating result
- Change in timing of earnings recognition anticipated mostly impacting Life products

Admiral Group PLC

- No change in ultimate profitability of business written
- No impact on group strategy, solvency, dividend policy and cash generation
- No effect on investment and interest income on assets
- Equity to reduce
- Will maintain conservative reserving policy
- Enhanced disclosures in respect of claims reserves

Ageas

- No change to dividend strategy, economic leverage, capital and cash generation, and solvency position
- Limited impact on net-operating result and non-life liabilities
- Limited transition impact on shareholders' equity for consolidated entities while more stable equity development is expected over time

Allianz

- Limited economic impact (SII, cash flows, dividend)
- Strong fundamentals (operating profit slightly higher, net income similar level, equity less volatile and adjusted for OCI slightly lower, ROE slightly higher)
- Improved disclosures (transparency, comparability, simplicity, profitability)

Aviva Group

- No impact on cash remittances, capital generation, financial targets, dividend guidance
- £3b reduction in shareholders' equity although adjusted shareholders' equity (including CSM) higher by circa £2b and broadly equal to Solvency II net assets
- Operating profit to reduce by circa 15% per annum
- 60% of operating profit unaffected by IFRS 17

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Core messages during the investor presentation (cont'd)

AXA	CNP Assurances	Generali	Great-West Lifeco	HISCOX
► Group underlying earnings power to remain unaffected post-transition ► Shareholders' Equity (excl. OCI) expected to remain stable at transition ► Limited reporting impacts reflecting our profile focused on technical lines ► No change to capital management and strategy ► "Driving Progress 2023" key financial targets reaffirmed	► Company's underlying qualities unchanged ► Two new items on the liabilities side of the balance sheet: CSM for around €17b and RA for around €1.5b ► Equity slightly lower for around €1b (out of €21.1b) ► Earnings to be more volatile due to the market effects ► Financial reporting to be tailored due to adjustments to the formulas for calculating key indicators	► No impact on cash and capital generation, net holding cash flow, dividends and solvency ► SHE expected to be broadly stable at transition ► Improved visibility and predictability of profits anticipated from life business ► P&C to be more volatile but its business mix to reduce the sources of volatility ► Group operating result expected to be broadly stable	► No impact on business strategy ► SHE expected to decrease by 10%-15%, driven by the establishment of the new CSM ► Low-single-digit percentage decrease in base earnings expected ► Base EPS growth and dividend pay-out ratio to remain unchanged, base ROE objective expected to increase by 2% ► Positive impact to Life Insurance Adequacy Test (LICAT) expected	► No change in strategy and reserving philosophy, and no impact on regulatory capital, cash and dividends ► Reduced volatility expected in group's earnings ► Shareholders' equity to likely see a small net increase on transition, primarily due to discounting ► Greater transparency due to more granular disclosures

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Core messages during the investor presentation (cont'd)

Legal & General

- No impact on strategy, capital and cash generation, solvency or dividends
- Financial reporting of annuity/life insurance businesses (i.e., LGRI, retail), shareholders' equity (at transition) and composition of profit (on adoption) to be impacted
- More stable and predictable earnings from insurance product

M&G

- No change in strategy, solvency, capital management framework or dividend policy
- SHE expected to increase
- Leverage ratio expected to fall
- Volatility related to assumption changes (e.g., longevity) removed from annuities-adjusted operating profit result
- Profit signature of "with-profits" business (including PruFund) no longer back-end loaded

Manulife

- Core earnings expected to decline by ~10%, driven by the recognition of new business gains in the CSM and the timing of earnings from investment-related activities
- Decrease in equity of ~20% due to the establishment of CSM
- Capital position expected to remain strong
- ROE to increase, driven by changes to core earnings and equity

Munich Re

- No impact on business strategy, dividend and share buy-back policy, reserving strategy, capital strength
- More transparency in revenues and future profit margins from long-tail business
- Increase in total investments due to stronger reflection of fair values
- Overall earnings level to likely increase

NN Group

- No impact on strategy or targets (focus on SII and operating cash generation unchanged, no impact on dividend/capital return)
- Equity more stable and closer to SII, leverage ratio expected to be slightly higher, due to inclusion of CSM, operating profit expected to be slightly higher
- On track for implementation

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Core messages during the investor presentation (cont'd)

Sampo Group	Storebrand	Sun Life	Talanx	Zurich
▸ No effect on the business mix, balance sheet targets, solvency, capital management and financial targets ▸ No material change in net profit ▸ Limited positive effect expected on P&C KPIs, with combined ratio expected to decrease marginally due to the broadening of discounting	▸ No impact on cash generation, solvency margin and dividend ▸ Timing of profit recognition to be affected ▸ Higher and more volatile earnings expected on normalized basis ▸ Shareholders' equity to reduce ▸ Current reporting standards to continue while IFRS 17 (insurance contracts) supplements them	▸ No impact on business strategies ▸ Increase in underlying ROE expected ▸ Reduction in SHE by 15%-20% expected largely due to establishing the CSM ▸ Mid-single-digit reduction to underlying net income anticipated in 2022 comparative year ▸ Positive underlying net-income growth is expected from 2022 to 2023	▸ P/C equity expected to be more stable due to consistent discounting of assets and liabilities ▸ L&H business expected to see a significant initial drop in equity due to rise in liabilities and loss recognition results ▸ More earnings volatility expected due to stricter fair value approach adopted for investments ▸ Insurance revenues to be lower than gross written premiums ▸ KPIs like combined ratio to also change	▸ No major impact given the nature of business (75% unaffected or subject to PAA) ▸ Shareholders' equity impact driven by CSM and discounting of long-term liabilities ▸ Limited changes to P&C, and improved disclosures for Life ▸ Cash and capital generation remain strong

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3 Analysis of UK insurers

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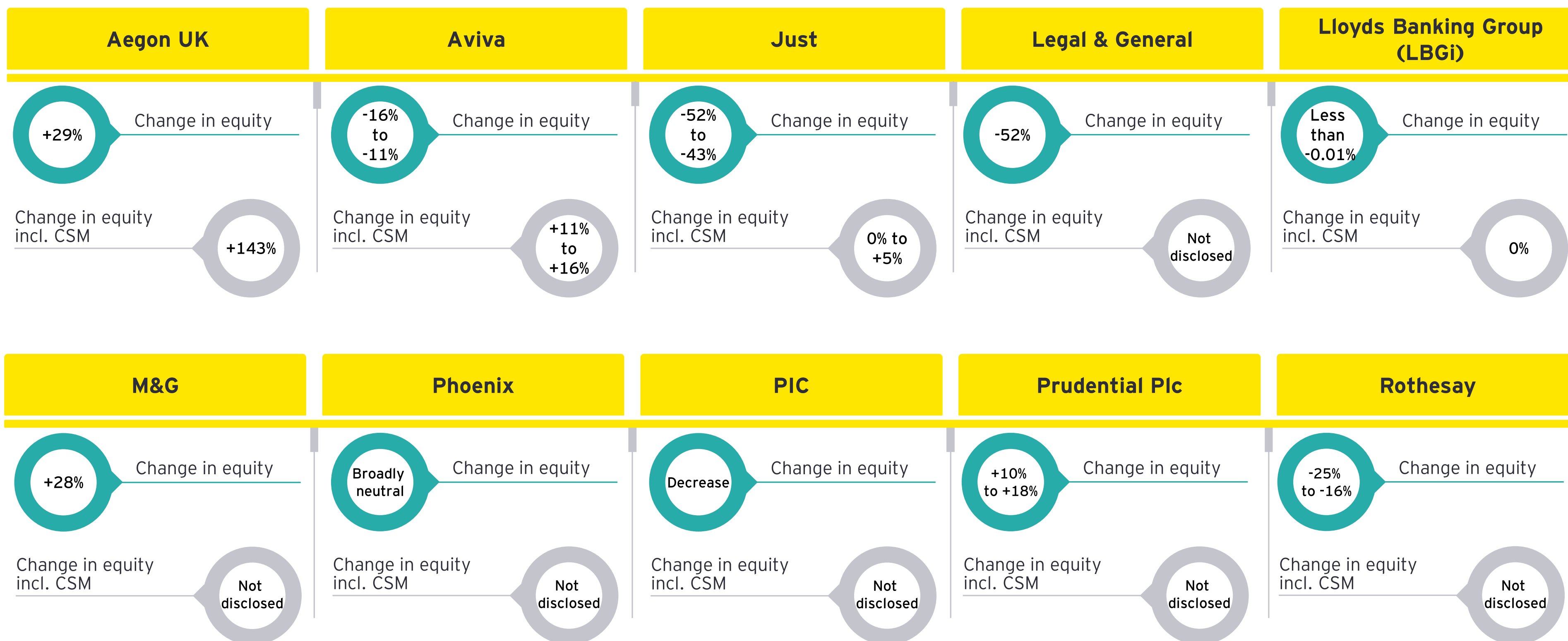
Equity impacts are not always negative



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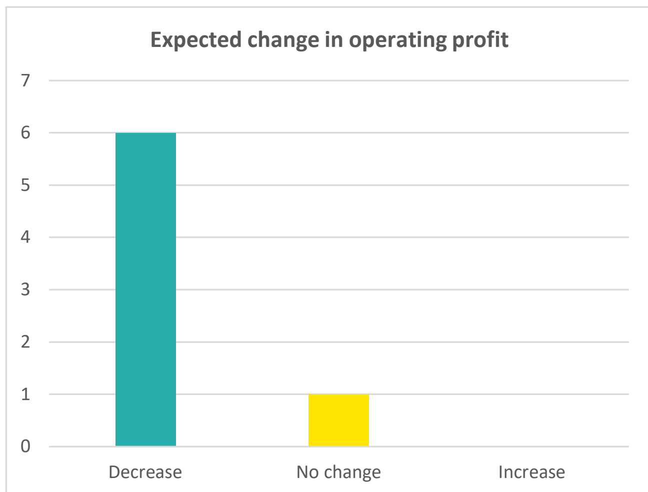
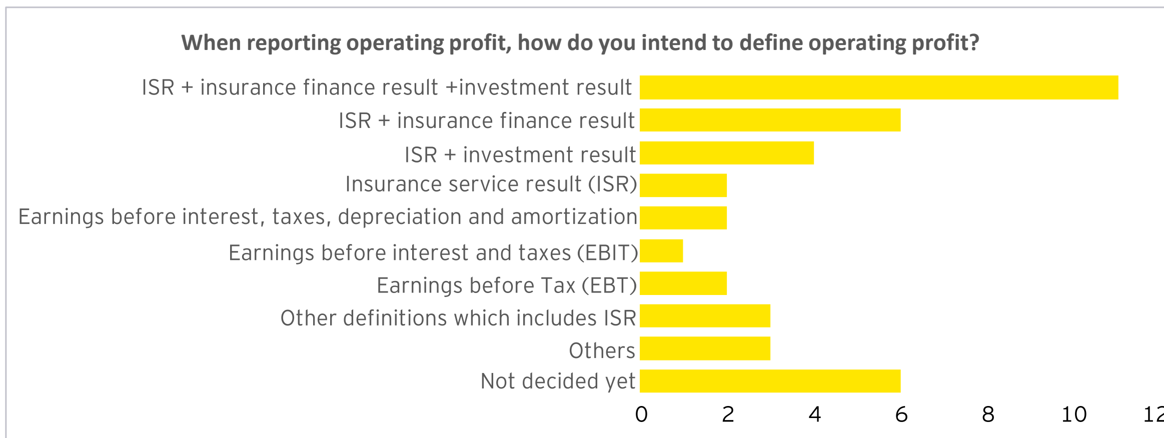
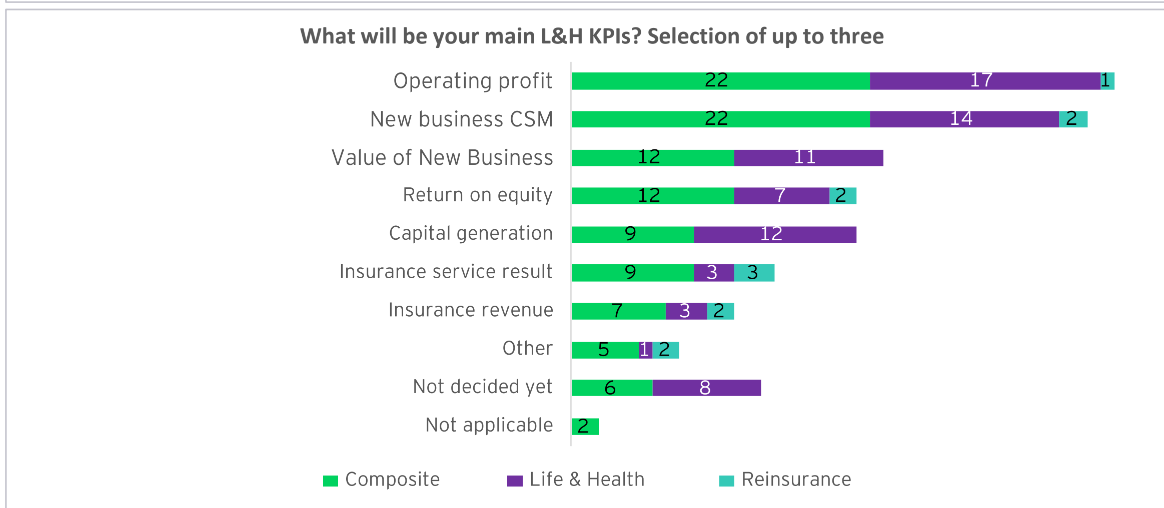
Operating profit is a key KPI, but there is no standard definition

Taken from EY's global IFRS 17 KPI survey (November 2022):



- Six of the insurers presentations stated that there was an expected decrease in profit
- Only Legal & General quantified the decrease as being between 20% and 25%
- Just Group expected the post IFRS 17 operating profit to be comparable to the IFRS 4 operating profit





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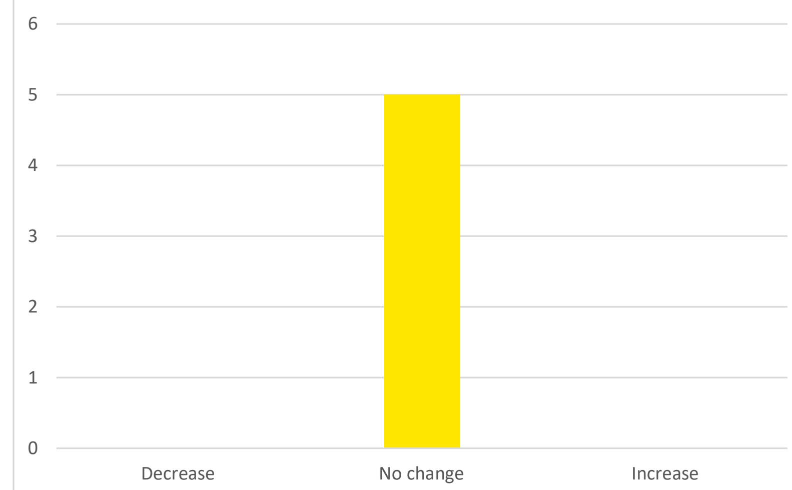
The level of CSM disclosure differs by insurer, other metrics remain unchanged

Disclosure of CSM and RA by company		
CSM only	Aviva	£4 - £5bn
	Phoenix	At least £2bn
CSM and RA separately	Aegon	CSM: £1.3bn RA: £0.43bn
	LBGi	CSM: £1.9bn RA: £1.5bn
Combined CSM and RA	Just	£1.3 - £1.5bn
	Legal and General	£13 - £14bn
	PIC	£2.6 - £2.8bn
	Rothesay	£5bn
No quantitative disclosure	M&G	
	Prudential plc	

- Insurers have disclosed differing levels of information
- Two insurers only disclosed the CSM
- Two insurers disclosed the CSM and the Risk Adjustment individually
- Four insurers gave a combined CSM and Risk Adjustment figure
- Two insurers gave no quantitative disclosure



- Aviva, Just Group, Legal and General and Rothesay Life all stated that they did not expect there to be any change in Earnings per Share or dividend payout ratio
- All other insurers review didn't comment

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Measurement model use is in line with expectations

Aegon UK
- GMM for protection and annuity business
- VFA for legacy unit-linked products

Aviva
- 40% GMM
- 15% VFA
- 35% PAA
- All other business out of scope

Just
- GMM for all business

Legal & General
- GMM for all business

Lloyds Banking Group (LBGi)
- GMM: annuities, WP with GAO and RI
- VFA: UL and WP without GAO

M&G
- GMM: annuities and other insurance contracts
- VFA: UL and WP

Phoenix
- Using both GMM and VFA

PIC
- GMM for all business

Prudential Plc
- VFA for WP, critical illness and UL, covering 2/3rds of CSM
- GMM for NP protection, UL with protection riders
- Very limited use of PAA

Rothesay
- GMM for all business

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Both top down and bottom up approaches are being used

Aegon UK

- Market observable risk-free rate + illiquidity premium (ILP) on a country unit basis
- ILP based on expected return on own assets, less adjustment for credit losses

Aviva

- Bottom-up approach other than for annuities which uses top-down approach

Just

- Top down discount rate, starting from an appropriate asset portfolio adjusted for credit default deductions

Legal & General

- Top-down approach starting from an appropriate asset portfolio with economic deductions

Lloyds Banking Group (LBGi)

- Risk free + ILP. ILP is applied to annuity contracts, certain RI contracts held, and WOL.
- ILP determined using bottom up approach for protection, and top down for annuities and RI contracts

M&G

- GMM: top down approach
- VFA: bottom up approach

Phoenix

- Annuity business: Top down approach using a reference portfolio of assets to determine an uplift to be applied to the risk-free discount rate curve.
- Unit-linked and with-profit business: Bottom-up approach, using a risk-free discount rate curve adjusted to reflect the characteristics of the liabilities such as illiquidity.

PIC

- Top-down method, based on a portfolio of assets that match the liabilities (excluding prudent margins)

Prudential Plc

- Bottom-up basis, starting with a liquid risk-free yield curve and adding an illiquidity premium to reflect the characteristics of the insurance contracts

Rothesay

- Insurance contracts: top-down approach
- Collateralised longevity only reinsurance contracts: reflect higher liquidity by using curve from assets that can be posted as collateral

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A mix of Value at Risk and confidence level methods are being used

Aegon UK	Aviva	Just	Legal & General	Lloyds Banking Group (LBGi)
► Risk Adjustment (RA) set at 80% of confidence interval, while allowing for group diversification benefit within RA	► Leverages Solvency II view of risk but allows for diversification and considers lifetime (vs. one year) view	► Allowance for non-financial risk determined using a Value at risk (VaR) method calibrated to the target confidence interval (1 year VaR is expected to be c.90%)	► Value at risk (VaR) method used to derive the overall non-financial risk	► Confidence level approach ► Explicit RA for non-financial risk, considering the same risks as under the Solvency II risk margin

M&G	Phoenix	PIC	Prudential Plc	Rothesay
► Confidence level approach	► Confidence level approach ► The Group will determine the risk adjustment using a one year time horizon	► Fixed basis points default allowance by asset, based on historic levels of default and downgrade with prudent margins.	► Confidence level approach	► Provision for adverse deviation approach (the PAD approach) - apply margins to the best estimates for demographic and expense risk

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The use of retrospective approaches varies significantly across the market

Aegon UK

- Where FRA cannot be applied use FVA based on market transactions.

Aviva

- FRA from 1 January 2016 (~35%)
- Extensive use of FVA for heritage, annuity and protection prior to 2016 (~55%),
- Limited use of MRA (~10%)

Just

- c. 80% of the CSM at the transition balance sheet date is calculated using the FVA, with the remainder using FRA

Legal & General

- ~55% of the CSM calculated using the MRA
- ~35% using FVA
- ~10% using FRA

Lloyds Banking Group (LBGi)

- FRA from 1 January 2016
- FVA prior to 2016

M&G

- FVA for traditional with-profits, annuities and unit linked
- MRA for PruFund and traditional with-profits
- Small proportion using FRA

Phoenix

- FRA for:
  - BPAs since 2018
  - ReAssure Annuity and conventional non-profit business
  - SunLife new business from 1 January 2018
  - All new business from 1 January 2021
- FVA for all other business

PIC

- FRA unless impracticable
- FVA prior to 2016

Prudential Plc

- All three approaches used

Rothesay

- FRA from 1 January 2016
- FVA prior to 2016

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Any questions?

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