# IFRS 17: How May Future Key Performance Indicators (KPIs) Look Like?

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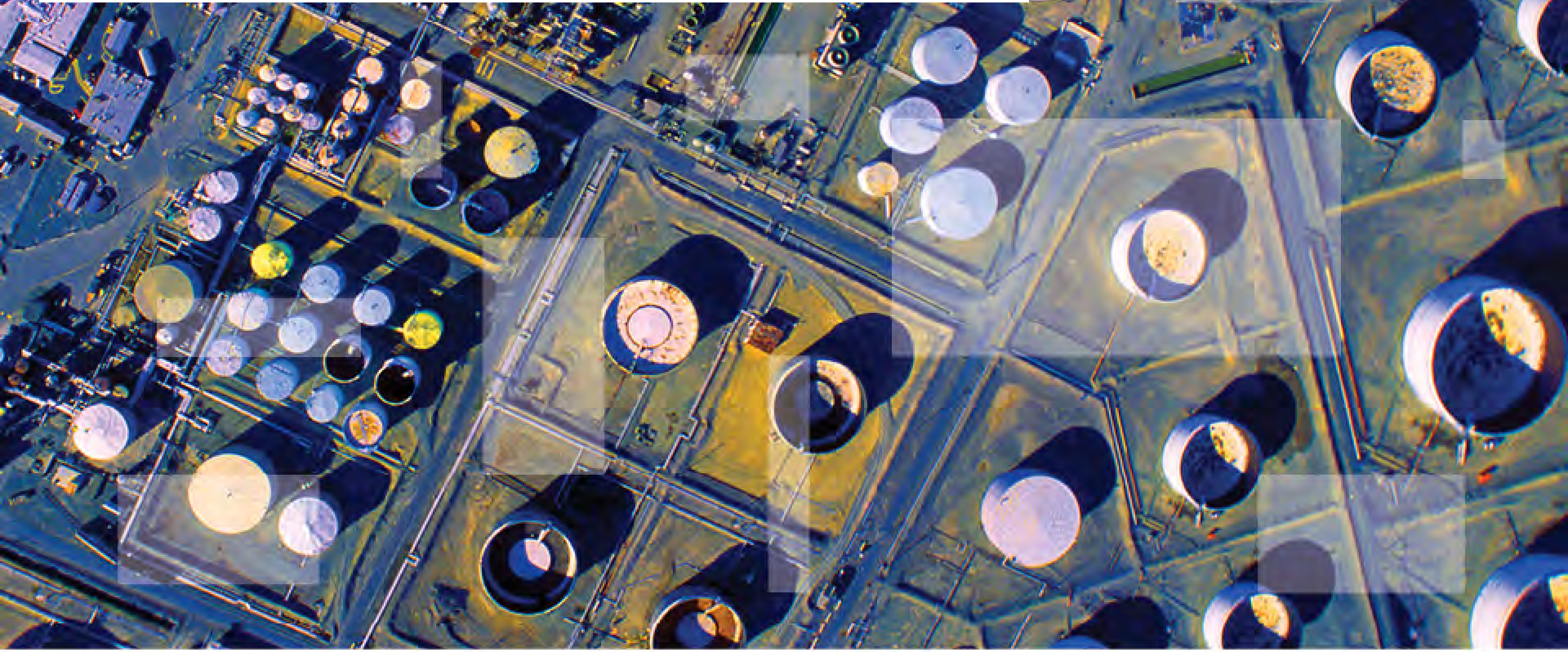

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# Moderator and Presenters

| Moderator / Presenters | | Background |
|---|---|---|
|  | **Ralph Ovsec**<br>**FSA, FCIA, MAAA**<br><br>**Senior Director**<br>**Willis Towers Watson**<br>Ralph.Ovsec@willistowerswatson.com | ■ Ralph is a Senior Director with the Insurance Consulting & Technology business of Willis Towers Watson in Toronto, Canada. Ralph’s expertise include financial and regulatory reporting, financial modeling, reinsurance, mergers and acquisitions, embedded value calculations and life insurance securitization, Canadian GAAP actuarial valuation, asset liability management, earnings analysis and public disclosures, experience analysis, capital requirements and product pricing.<br>■ Ralph is the Willis Towers Watson global lead on the IFRS 17 on responding to internal queries on IFRS 17 interpretations and developing responses to specific client-related questions. Ralph also leads our external communication on IASB updates and developments. |
|  | **Dr. Thorsten Wagner**<br><br>**Senior Director**<br>**Willis Towers Watson**<br>Thorsten.Wagner@willistowerswatson.com | ■ Thorsten is a Senior Director with the Insurance Consulting & Technology business of Willis Towers Watson in Cologne, Germany. Thorsten is and has been involved in several IFRS 17 projects with focus on the methodology as well as on the financial impact assessment.<br>■ Thorsten has extensive experience in financial reporting (IFRS, US-GAAP as applied in the German market and German local GAAP) and risk management (Solvency II). Within the risk management, a most recent topic is the use of reinsurance solutions to stabilize the Solvency II figures and decrease volatility implied by the (increased) volatility of capital markets |
|  | **Dan Kim**<br>**FSA, CERA, MAAA**<br><br>**Director**<br>**Willis Towers Watson**<br>Dan.Kim@willistowerswatson.com | ■ Dan is a Director with the Insurance Consulting & Technology business of Willis Towers Watson in Atlanta, U.S. Dan has extensive experience in financial reporting and risk management with expertise in IFRS 17, embedded value and economic capital. Dan currently supports the IFRS 17 Initiative in Willis Towers Watson.<br>■ Dan’s IFRS 17 related experience includes financial reporting framework development, IFRS 17 calculation engine implementation, developing and reviewing guidance notes/technical papers, and financial impact analysis using IFRS 17 calculation engine. |

# Agenda:
# How may future KPIs look like?



# Current industry view

## What will be the role of IFRS 17 for your business? (check all that apply)

Question 1 (out of 2)

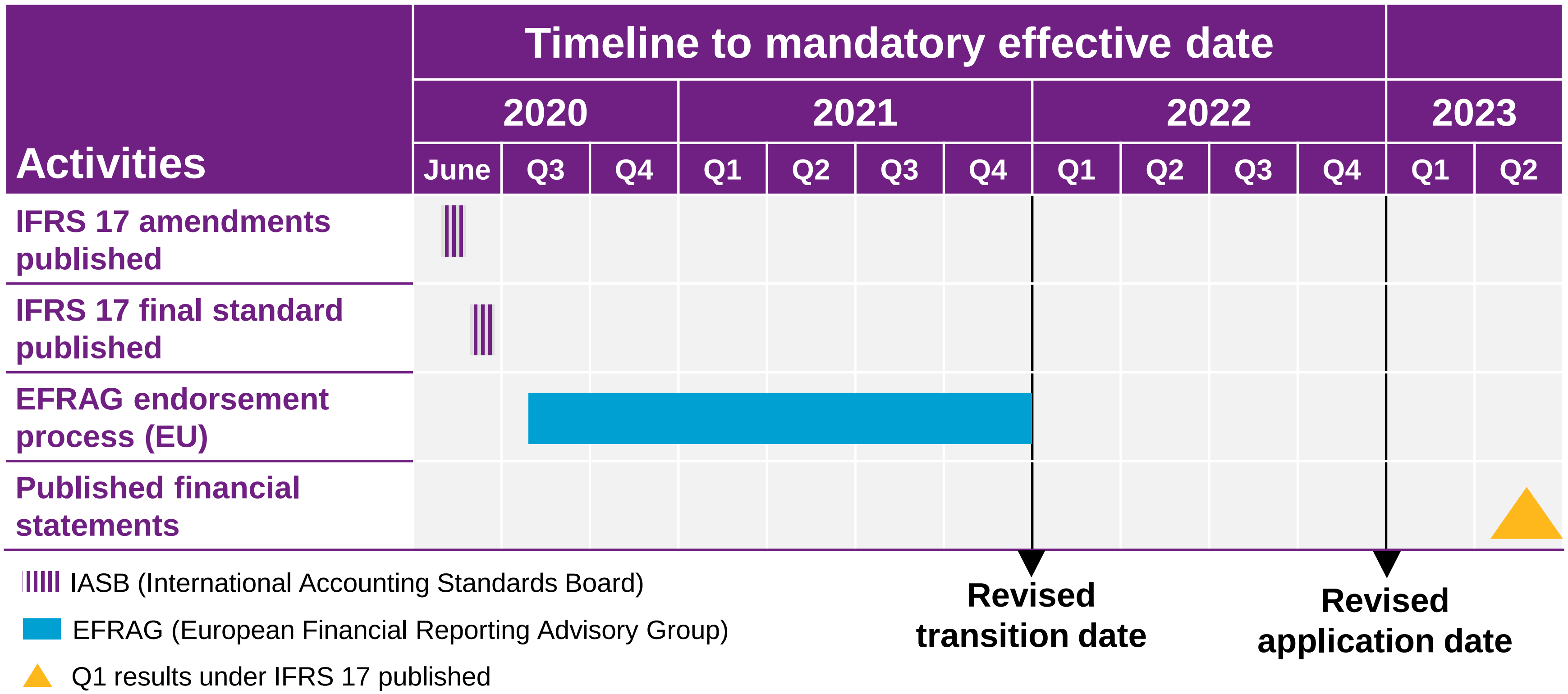
1. Statutory reserve requirement
2. GAAP reporting that differs from statutory requirement
3. Group consolidation reporting
4. Internal management financial reporting
5. Not relevant

**What is your expectation of IFRS 17 impact on business decisions? (check all that apply)**

# Question 2 (out of 2)

1. Business planning / Pricing
2. Performance analysis / management
3. Capital management
4. Too early to tell
5. Not relevant

# IFRS 17 background and Timescales




The IASB released the final insurance contracts standard IFRS 17 on Thursday June 25th. This is the culmination of almost 23 years of discussion, with IFRS 17 scheduled to take effect with annual reporting cycles beginning on or after January 1, 2023

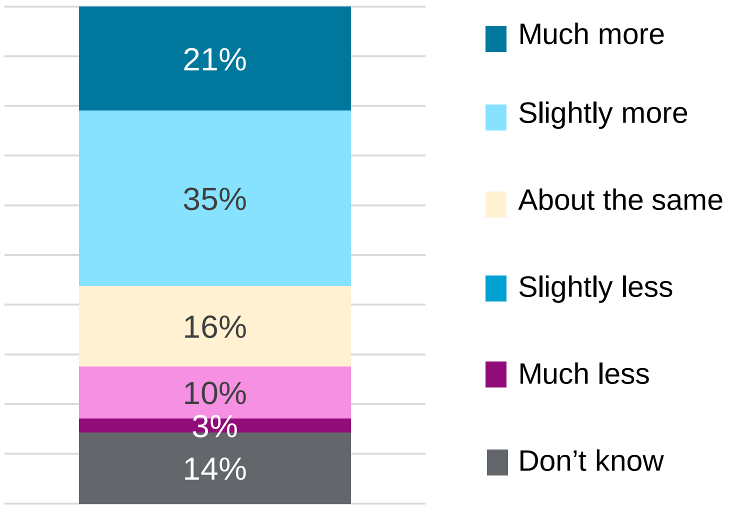
# Where are we now?

## Willis Towers Watson global IFRS 17 survey, June/July 2020

| | |
|---|---|
| Implementation Progress | • **53%** indicated **less than halfway through** implementation vs **32% more than halfway through**<br>• **More than half** stared **business process automation exercises**<br>• **72%** feel they are **at least half way through** impact analysis |
| Forecasting Budgeting | • **44%** made **no progress** in business planning and forecasting<br>• **31%** made **some (or less than half) progress** |
| Driving Decisions | • **52%** expressed **some internal views on business implications** **37%** responded they have **made a start**<br>• Most view the IFRS 17 will affect **business planning** and **ALM/Capital modeling** more than other areas (pricing, reinsurance, M&A, product design, executive compensation) |

Based on 105 Life and Health insurers' responses

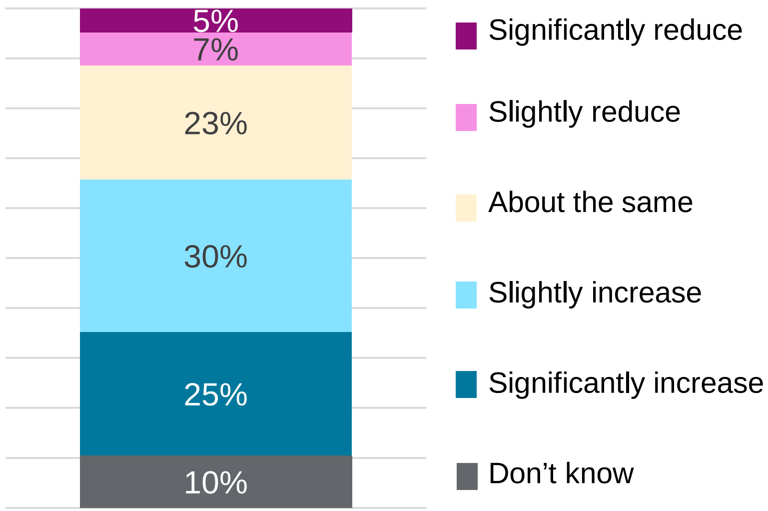
# Do you believe that Future IFRS earnings / equity will be more helpful as metrics to manage your business than Current GAAP earnings / equity?




- About 56% believe that IFRS 17 is likely to be more or much more helpful than current GAAP earnings / equity
- In general, Groups expect a higher degree of usefulness than Subsidiaries

Willis Towers Watson global IFRS 17 survey, June/July 2020
Based on 105 Life and Health insurers’ responses

# Do you think the need for non-GAAP measures / supplementary reporting will increase or reduce as a result of IFRS 17?




- A majority of 55% expects an increase in supplementary reporting, whereas a minority of 12% expects such need to reduce
- Respondents who found IFRS more helpful tended to respond less need for supplementary reporting

Willis Towers Watson global IFRS 17 survey, June/July 2020
Based on 105 Life and Health insurers’ responses

# Profits

# Results: Earnings before interest and taxes (EBIT), ROE etc.

## Our view

- Existing measures will remain
- However, the amounts will and also the volatility might change
- Therefore, it will need some time to interpret old KPIs measuring profits based on the new IFRS 17 regime

## Interpretation of existing KPI measures

- Profit measurement and also shareholder equity will change significantly by introducing IFRS 17
- In consequence, analysts as well as preparers might need a kind of adaption phase

## Additional KPIs might arise

- Additional KPIs might arise because of one of the following two reasons:
  - Establishing a kind of “economic view” out of IFRS figures – see the “Total Comprehensive Return on Equity” described on the next slide
  - IFRS 17 provides additional and new data (balance sheet, P&L as well as in the disclosures) which might be used to focus on aspects currently not analysed – see the “Combined Ratio” on the next slide as example

# Results: EBIT / ROE etc.

| | |
|---|---|
| **EBIT Margin** | IFRS 17 would change the denominator “net revenue”. While former IFRS 4 revenue was mainly determined by “premiums” it may now change to the “insurance revenue” defining “revenue” as a benefit magnitude.<br>Attention: High dependency on interpretation of “investment component”! |
| **RoE: Return on Equity** | No change of definition, but changes in amounts: “return” as well as “equity” |
| **TCRoE:<br>Total Comprehensive Return on Equity**<br><br>**(Reveal something that the industry has fought for not to show transparently in the P&L, however …)** | One possible definition of this adjusted RoE KPI:<br>$$TCRoE := \frac{(Net\ Income + change\ in\ OCI + change\ in\ CSM)}{(Equity\ incl.OCI + CSM)}$$<br>▪ Denominator is based on figures averaged over the considered period<br>▪ Other Comprehensive Income (OCI) and Contractual Service Margin (CSM) figures should be transformed to be after tax and minorities<br>▪ Expansion possible to be consistent with amounts effecting the net income:<br>  ▪ Risk Adjustment as expected future shareholder gain in denominator and its change in the nominator<br>  ▪ Accordingly, present value of Non-attributable Expenses as deduction |
| **Combined Ratio (Life)** | Possible definition:<br>$$Combined\ Ratio\ (Life) := 1 - \frac{(Net\ Insurance\ Service\ Result)}{(Gross\ Insurance\ Revenue)}$$<br>▪ Concerns:<br>  ▪ KPI is exposed to volatility of benefit cash flows → averaged over e.g. five years?<br>  ▪ KPI is not an indicator for an ultimate profitability as in the P&C business<br>  ▪ High dependency on interpretation of “investment component” |

# Dividends and Sustainability

# Earnings / Dividends per Share

… and Dividend Payout Ratio

## Our view

- KPIs like the following will remain unchanged:
  - Earnings per share
  - Dividends per share
  - Dividend payout ratio
- Of course, amounts may change significantly compared to current values
- With IFRS 17, the question comes up how sustainable and stable earnings or dividends can and will be

## Dividend Strategy

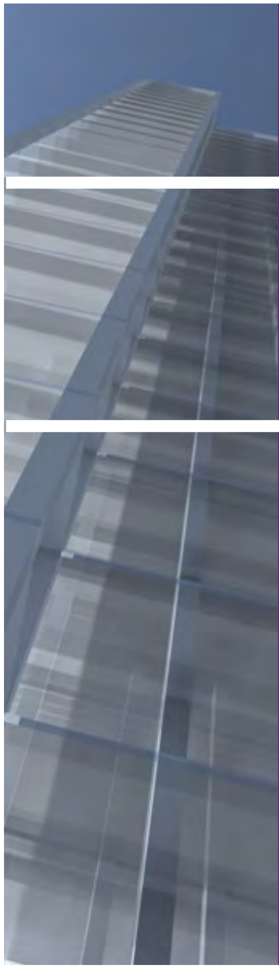
- Most entities have a dividend strategy based on non-decreasing dividend payout capabilities
- Dividend payments financed by the company’s financial substance are commonly avoided (see further regarding Sustainability)

## Dependency of Earnings

- Influencer “Transition”: Split “Equity vs. CSM”
- Other item which will influence the emergence of future earnings and therefore also dividends
  - Choice of coverage units: fast vs. slow CSM recognition
  - Definition of interest rate structure, especially regarding Illiquidity Premium and Extrapolation
  - Amount of Risk Adjustment and its amortisation pattern

# Sustainability

## Some preliminary remarks



**1**

Example:

- An entity has “designed” the transition in a way to have a high CSM while a low equity at the start of accounting under IFRS 17.

**2**

Consequences might be:

- The CSM release and therefore the profits in future periods may start high, but will decrease unless the new business’ profitability may help through

**3**

What does this mean:

- If investors and analysts prefer a sustainable (and non-decreasing) dividend stream, high profits in the near futures produced by the use of some “freedom of design” under IFRS 17 could evoke unfavourable expectations if the CSM release cannot be compensated by new business
- Furthermore, the IFRS 17 disclosure requirements will reveal both the profitability of new business and the future pattern of CSM releases according to IFRS 17.109
- Therefore, analysts may conclude with the following easy-to-calculate KPIs about the sustainability of earnings and dividends

# Sustainability

## Possible new KPIs for this new focus

| | |
|---|---|
| **Reconciliation of CSM** | Reconciliation of CSM from opening to closing, showing separately:<br>▪ Effects on CSM of new business<br>▪ CSM recognized in P&L<br>▪ Other changes in CSM (finance effects and changes in Fulfilment Cash Flows from assumption updates) |
| **CSM Sustainability Index** | The CSM Sustainability Index can be defined as CSM recognized by new business divided by the CSM recognized in the P&L. A value equal or above 1.0 would indicate that IFRS results are sustainable and not achieved out of financial substance. |
| **Physicists will love it: CSM Half-Value Period** | According to IFRS 17.109, quantitative explanations about the future CSM recognition pattern has to be disclosed. Analysts will easily conclude on the “speed” compared to other players in the market, for example by deriving the half-value period which may serve as a meaningful indicator.<br><br>Example with a precarious situation made transparent by IFRS disclosures:<br>▪ A value of the CSM Sustainability Index far below 1.0 together with …<br>▪ … a comparatively short CSM half-value period would lead to the conclusion …<br>▪ … that earnings and dividends should be questioned for the (near) future |
| **Further Remarks** | ▪ If a significant portion of the life business is accounted for according to the Premium Allocation Approach (PAA) further enrichments are deemed to become necessary, e.g. for the Half-Value<br>▪ If the new business contains significant onerous parts this should also be reflected, e.g. as deduction in the nominator of the CSM Sustainability Index<br>▪ “CSM duration” may also be derived and used instead of the Half-Value Period |

# Volume and New Business

# Volume and Growth

## Gross Written Premium (GWP) vs. Insurance Revenue

### Our view

- Currently, GWP is often used to indicate “volume” and to measure growth
- However, IFRS 17 does not account for any “premium”, but “insurance revenue”
- The methodologic concepts are totally different
  - It may easily happen that an entity has a growth in premium but a drop of insurance revenue at the same time
  - Due to the fundamental differences we also do not foresee the possibility to reconcile both amounts

### GWP and NBP

- We expect that GWP will remain as a well-known measure for volume as well as NBP (New Business Premium) for growth
  - Measurement of cash receipts, but no consideration of benefits payments (and their timing)

### Insurance Revenue according to IFRS 17

- We expect that Insurance Revenue might be considered as additional magnitude to measure volume and growth
  - Advantage: It brings in a kind of “benefit view”
  - Challenges:
    - What’s the meaning of an in/decrease? How to measure NB?
    - How can differences to GWP / NBP can be explained?
    - Dependency from interpretation of “investment component”

# New Business

… and its measurement

## Our view

- Volume measures like APE or PVNBP will remain unchanged
- We expect, however, that the information of VNB according to the "MCEV" metric may be replaced by the CSM of the new business according to disclosure requirements by IFRS 17.107 (d)
- Margin measures will use the (adjusted?) CSM as new magnitude in relation to the established volume measures APE or PVNBP

## Transition Period?

- In the first few years, companies may present some reconciliation from the VNB to (adjusted?) CSM and explain differences, induced e.g. by:
  - Differences in the method to derive interest rates, to reflect risk in technical reserves or contract boundaries
  - Allowing for Mutualisation under IFRS 17

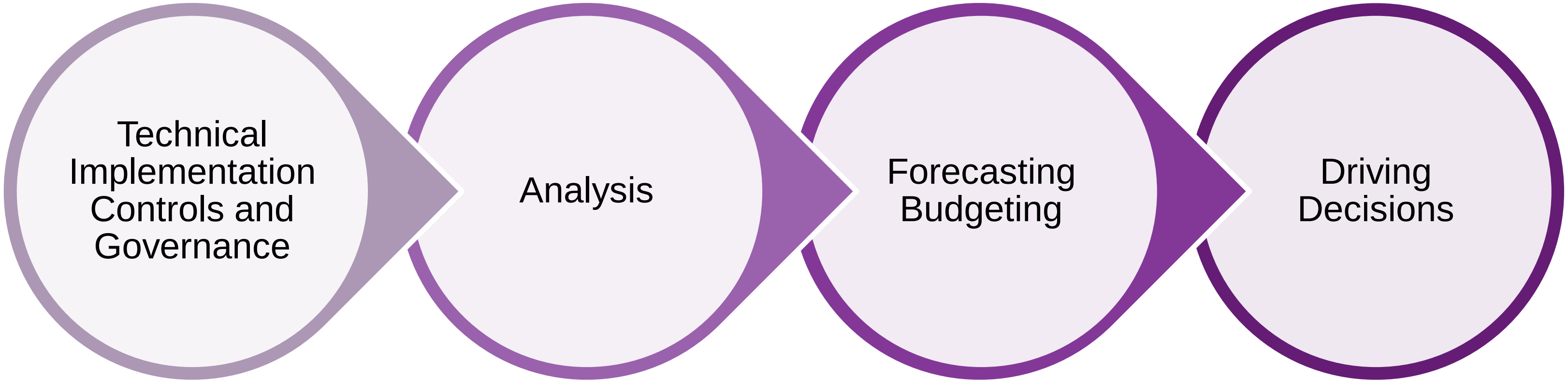
## Possible (and sensible?) Adjustments of the CSM

- The CSM itself may not be regarded as "complete" magnitude of the profitability of new business:
  - Onerous contracts create immediately a P&L loss
  - PAA business may be profitable without contributing to the CSM; similarly, IFRS 9 investment products
  - Overall profitability depends also on the size of the risk adjustment as well as on PV(non-attributable expenses)

# Managing business through IFRS 17

With illustrative examples

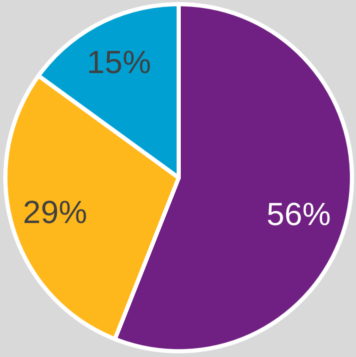
# Evolution stages of using IFRS 17 for business decisions




# Understanding profit or loss (insurance service result)

- Contractual service margin (CSM) is a key to defer the profit
  - Set up at initial recognition and amortized over life time
- CSM can represent value of deterred profit but…
- Not all group of contracts have CSM
  - Conservatism - CSM cannot be negative (loss component for onerous underlying contracts)
  - Group of contracts using Premium Allocation Approach (PAA) will not have CSM
- May not fully align with management's view or economic view

How much of your business do you expect to cover under the three measurement models?




% of reserves

- Premium Allocation Approach (PAA)
- Variable fee approach (VFA)
- General Measurement Model (GMM)

Willis Towers Watson global IFRS 17 survey, 2020
Based on 105 Life and Health insurers' responses

# CSM and company's value definition

## CSM Adjustments or Reconciliation to Value

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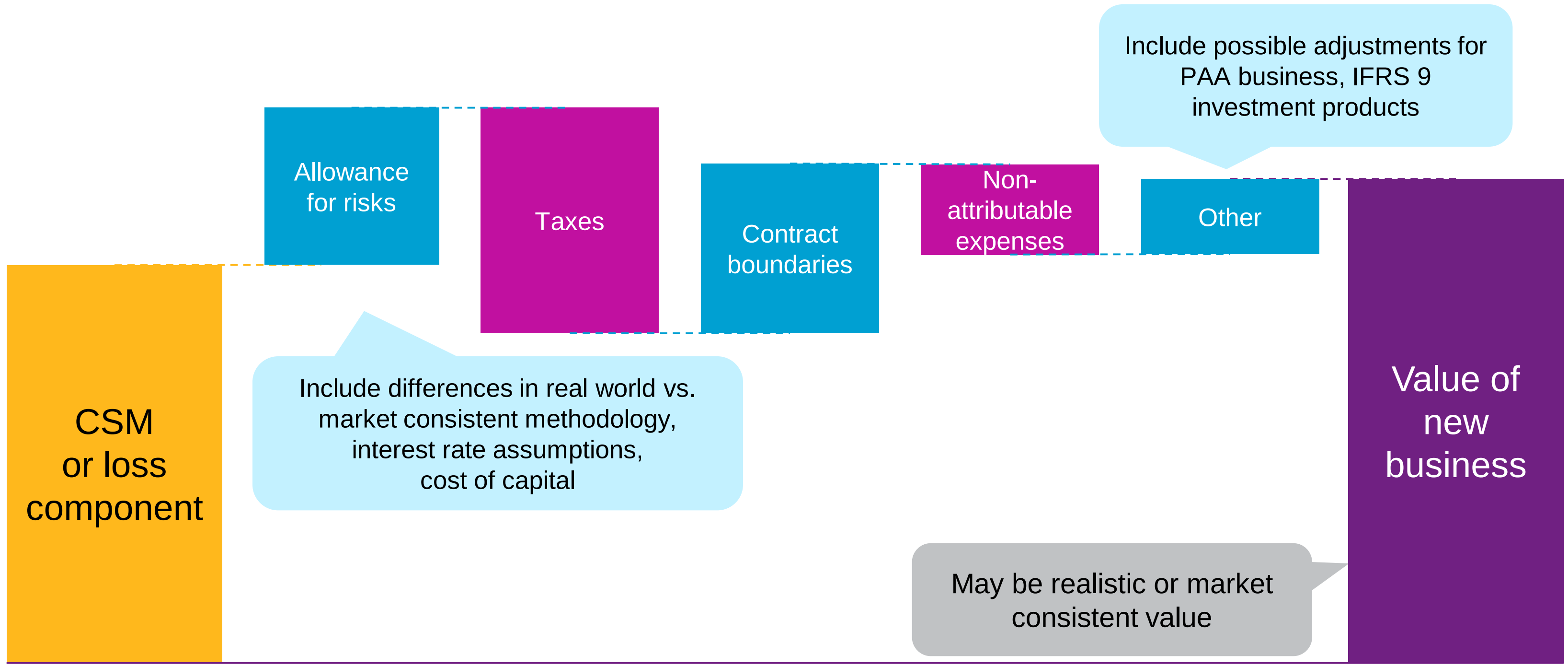


| | CSM | Risk allowance | Taxes | Contract boundary | Not-attributable expenses | Other | VNB |
|---|---|---|---|---|---|---|---|
| **Division A** | | | | | | | |
| Sub-product | $ | $ | $ | $ | $ | $ | $ |
| Sub-product | $ | $ | $ | $ | $ | $ | $ |
| **Division B …** | | | | | | | |
| **Total** | $ | $ | $ | $ | $ | $ | $ |

# Value added from New Business

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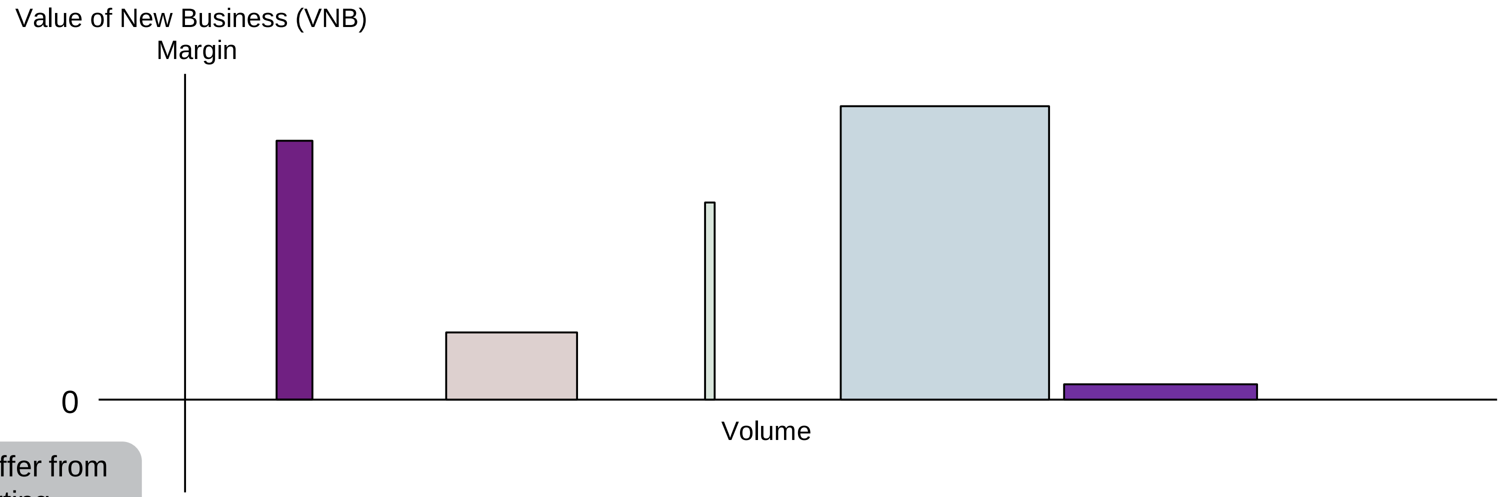


Granularity may differ from IFRS 17 reporting (e.g., division vs. product)

| | Product 1 (PAA) | Product 2 (Reinsured product) | Product 3 | Product 4 | Product 5 | TOTAL |
|---|---|---|---|---|---|---|
| **A) Volume (PV Premium)** | $700 | $1,600 | $300 | $2,000 | $1,900 | $6,500 |
| **B) VNB** | 49 | 32 | 17 | 160 | 10 | 268 |
| **C) VNB Margin (%) (B/A)** | 7.0% | 2.0% | 5.5% | 8.0% | 0.1% | 4.1% |
| **D) Initial CSM or loss component** | n/a | 40 | 21 | 115 | -2 | 174 |
| **E) Adjustment (B – D)** | 49 | -8 | -4 | 45 | 12 | 94 |

PAA business has no CSM

May combine the reinsurance held business

May include future renewals

Different risk allowance (e.g., real world VNB)

Implement-ation Analysis Forecasting Decisions

# CSM movement steps can be comparable to value of in-force business (VIF) movement

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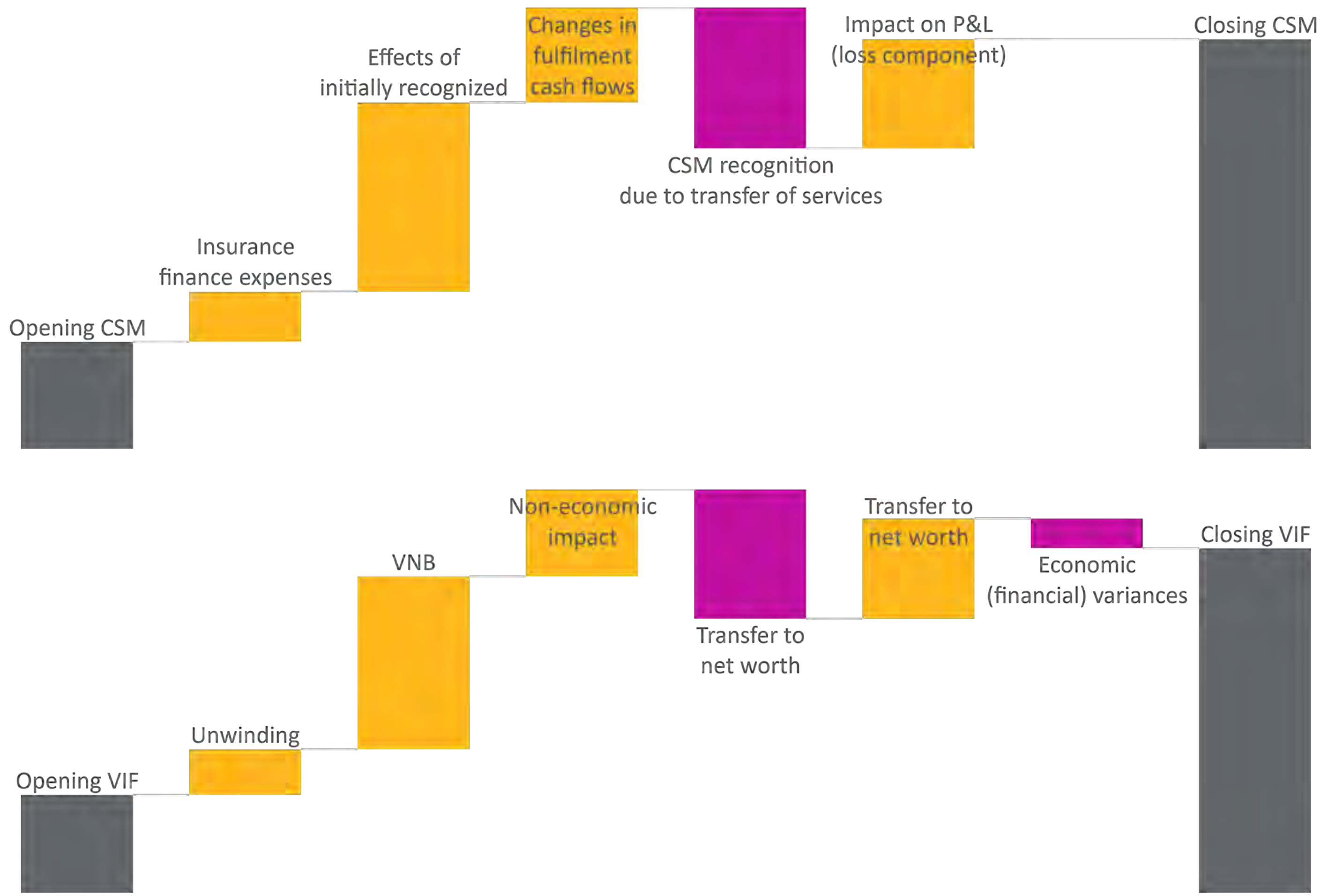


# Analysis of value creation through IFRS 17

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- Disclosure requirement - reconciliation of changes in insurance contracts
- This table will tell stories of your business

Value: deferred profit

| Reconciliation Of Changes In Insurance Contracts | Present Value of Future Cash Flows | Risk adjustment | CSM | Total |
|---|---|---|---|---|
| **Insurance contracts liability (asset) at beginning of period** | **1,432,721** | **12,400** | **61,515** | **1,506,637** |
| | | | | |
| **Changes that relate to future service** | | | | |
| Changes in estimates that adjust CSM | (5,303) | 530 | 4,773 | **0** |
| Changes in estimates that do not adjust CSM | (1,070) | 0 | 0 | **(1,070)** |
| Effects of contracts initially recognised in period | (17,521) | 5,891 | 19,439 | **7,809** |
| | | | | |
| **Changes that relate to current service** | | | | |
| Recognition of CSM in P&L to reflect transfer of services | 0 | 0 | (8,687) | **(8,687)** |
| Change in risk adjustment that does not relate to future or past service | 0 | (1,084) | 0 | **(1,084)** |
| Experience adjustments | 3,214 | 0 | 0 | **3,214** |
| | | | | |
| **Changes that relate to past service** | 0 | 0 | 0 | **0** |
| **Insurance service result** | **(20,681)** | **5,337** | **15,525** | **181** |
| | | | | |
| Insurance Finance expenses | 8,063 | 0 | 52 | **8,115** |
| **Total amounts recognised in comprehensive income** | **(12,618)** | **5,337** | **15,577** | **8,296** |
| | | | | |
| **Total cash flows** | **565,186** | **0** | **0** | **565,186** |
| **Insurance contracts liability (asset) at end of period** | **1,985,288** | **17,737** | **77,092** | **2,080,118** |

Changes in fulfilment cash flows (include impact on onerous products)

Value through New Business (reminder: sustainability index)

Realization of profit

Experience variance vs. risk adjustment allowance
Further analysis (A/E ratio)

Compare to investment income

Is CSM increasing?


# Forecasting and Value Creation Strategy

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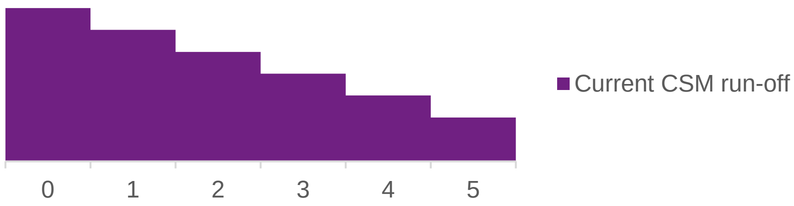


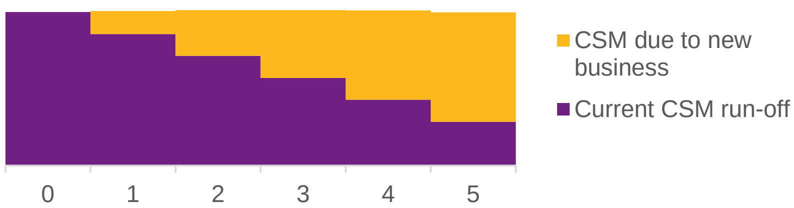


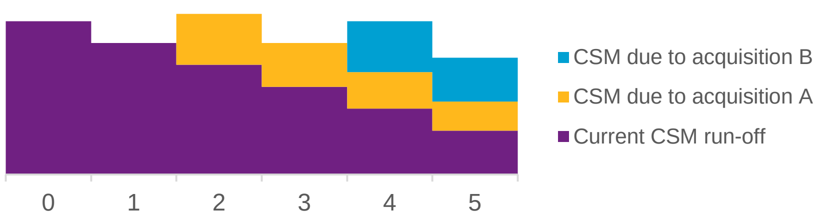


- Forecasting the CSM will give insights to future profits growth and dividend sustainability
- Does the current strategy support your business objective?


# CSM run-off pattern and New Business

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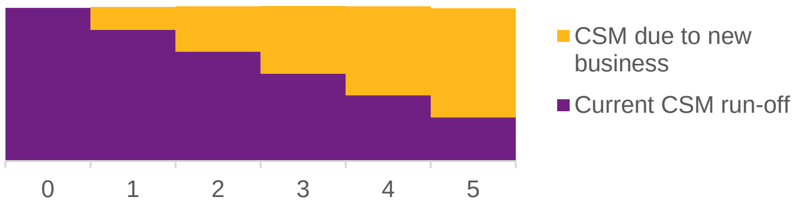


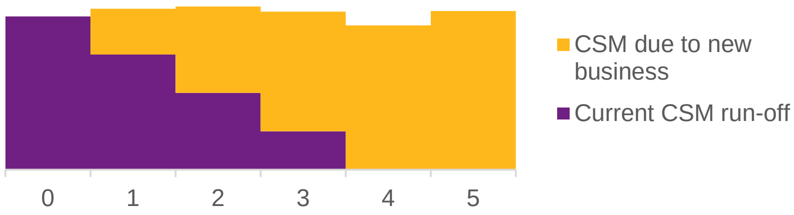


- Both show similar CSM Sustainability Index but different CSM run-off pattern
- How do you want to allocate your resources (e.g., in-force management vs. new business/pricing)?

# Summary

| Metric | Impact |
|---|---|
| **Profit** | ▪ IFRS profit usually top metric for insurers<br>▪ Will become more complex under IFRS 17 and new measures might arise |
| **Distributable cash flow** | ▪ Top priority for investors<br>▪ Impact of IFRS 17 on dividend paying capacity may vary by sustainability of earnings |
| **Value** | ▪ IFRS 17 equity may add back CSM<br>▪ “Adjusted” CSM may represent embedded value metric |
| **Driving decisions** | ▪ IFRS 17 and supplementary reporting (reconciliation of values, movement analysis of value, forecasting) can provide insights and support align business strategy to business objective |

# Thank you!