

STAFF PAPER

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Project	Insurance Contracts		
Paper topic	<i>Investor reactions to IFRS 17 Insurance Contracts</i>		
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Purpose and structure of the paper

1. This paper summarises the investor reactions to IFRS 17 *Insurance Contracts* from 35 discussions with 153 investors and analysts conducted from mid-May to the beginning of July 2017.
2. This paper is set out as follows:
 - (a) background;
 - (b) population of investors and analysts;
 - (c) overall comments on IFRS 17;
 - (d) main areas of support;
 - (e) main areas of concern;
 - (f) future educational activities for investors; and
 - (g) Appendix A—statistical information about the discussions with investors and analysts by type and by region specialty.
3. This paper does not include any questions for the Board.

Background

4. The International Accounting Standards Board (Board) issued IFRS 17 on 18 May 2017. IFRS 17 replaces the requirements for accounting for insurance contracts in IFRS 4 *Insurance Contracts* from 1 January 2021.
5. IFRS 17 introduces fundamental changes to existing insurance accounting practices for some entities. Investors and analysts will need to assess the implications for their analyses of the significant changes introduced by IFRS 17 to the information reported by those entities.
6. The Board has planned some educational activities for investors and analysts to help them understand the results of applying IFRS 17. Those activities include:
 - (a) the publication of informative materials providing an overview of the requirements in IFRS 17 and discussing the likely effects of IFRS 17 on an insurance entity's financial statements. The Board published an effects analysis and a project summary accessible to all investors and analysts together with the new Standard in May 2017.
 - (b) discussions with investors and analysts to illustrate the information that IFRS 17 will provide to users of financial statements compared to today. The staff has developed a presentation on IFRS 17 to support those discussions which is available in Agenda Paper 2B *Example of investor handout on IFRS 17 Insurance Contracts*. The presentation offers simple worked examples of:
 - (i) an insurance entity's statement of financial performance and statement of financial position when applying IFRS 17; and
 - (ii) disclosures about the movements in insurance contract liabilities analysed:
 1. by components (estimates of the present value of future cash flows, risk adjustment for non-financial risk and contractual service margin); and
 2. between liabilities for remaining coverage and liabilities for incurred claims.

Population of investors and analysts

7. From mid-May to the beginning of July 2017, Board members, the project team and the investor engagement team met with 153 investors and analysts to discuss IFRS 17. There were 35 discussions, including five roundtable meetings and one conference. The majority of these discussions were in-person meetings; the other discussions were telephone calls. All discussions were held in private and included at least one Board member, a member of the investor engagement team and often one or more project team members.
8. The majority of those we spoke to are equity analysts, but we also met with analysts from the credit rating agencies. We met both sell-side and buy-side analysts—most focus on the insurance sector, while a few cover the markets more generally and a few are accounting analysts.
9. The investors and analysts we spoke to are located in Europe (France, Germany, Italy, Switzerland and the United Kingdom), the United States, Canada, Hong Kong and Australia.
10. Appendix A to this paper includes statistical information about the discussions held by investor type and by region specialty.

Overall comments on IFRS 17

11. Most investors and analysts we spoke to welcomed the improvements in financial reporting transparency and comparability introduced by IFRS 17. They believe that IFRS 17 will improve the transparency of financial reporting for insurance entities, particularly in explaining the source of profits for long-term insurance contracts. They noted that the disclosures required by IFRS 17 about the contractual service margin and the risk adjustment for non-financial risk will provide the users of financial statements with more realistic and readily comparable data than when entities apply IFRS 4. In the context of the lack of consistency among entities applying IFRS 4 in different jurisdictions, those investors and analysts agreed with the need for a comprehensive IFRS Standard for insurance contracts to be applied globally.

12. Many investors and analysts we spoke to were interested in understanding the information that IFRS 17 will provide about entities operating in the life business and about entities operating in the non-life business.

Life business

13. Those investors and analysts specialising in the life business noted that the reconciliation of the opening and closing balances of the contractual service margin will provide information about the future profitability of new insurance contracts. They considered such information to be similar to non-IFRS information voluntarily provided by some insurance entities today, for example embedded value information. They support the provision of the information about the value of new insurance contracts by all entities using IFRS Standards and the use of a consistent methodology to measure those contracts (as opposed to the use of various methodologies to determine the current value of insurance contracts when providing embedded value information). However, some were concerned that the level of judgements required by IFRS 17 for determining the discount rates and the risk adjustment for non-financial risk would limit the comparability between entities.
14. IFRS 17 requires an entity to report as insurance revenue the amount charged for insurance coverage when it is earned. Investors and analysts generally welcomed that the requirements in IFRS 17 for the recognition of revenue are consistent with the recognition of revenue for most contracts with customers in other industries (ie entities using IFRS Standards generally recognise revenue when a service is provided to a customer). In particular, most investors and analysts:
- (a) recognised that the premium information presented by many entities in applying IFRS 4 is often a cash measure rather than an accruals-based measure; and
 - (b) welcomed that deposits included in premiums will not be presented as insurance revenue when entities apply IFRS 17 as this will increase comparability between the profit or loss of insurers and that of banks.

Non-life business

15. Those investors and analysts specialising in the non-life business were pleased to hear that IFRS 17 retains some information they consider useful that entities currently disclose in applying IFRS 4. This information includes the amount of premiums received and actual claims compared with previous estimates of claims (sometimes referred to as ‘claims development triangles’ or ‘loss reserve triangles’). In addition, they agreed with the Board’s conclusion that the IFRS 17 requirements to discount liabilities for incurred claims and to calculate and disclose an explicit risk adjustment for non-financial risk for all entities using IFRS Standards will provide more transparent and comparable data. This is because, when applying IFRS 4, entities may report liabilities for incurred claims on either a discounted or an undiscounted basis and may measure incurred claims on a different basis.
16. Some of those specialising in the non-life business said they consider the combined ratio (ie incurred claims and operating expenses expressed as a percentage of earned premiums) as a key profitability measure to assess the financial performance of insurance entities. They agreed with the Board’s conclusion that this measure should be calculated in a more consistent way when entities apply IFRS 17.

Interaction with regulatory frameworks

17. Virtually all investors and analysts specialising in the European insurance market were interested in understanding the similarities and the differences between IFRS 17 and Solvency II requirements.¹ The similarities regarding the measurement of insurance contract liabilities between IFRS 17 and Solvency II made it easier for many of those investors and analysts to understand the measurement approach of the insurance obligations in IFRS 17. Those similarities include using:
- (a) estimates of future cash flows;

¹ Solvency II is a regulation adopted the European Union. It substantially concerns the amount of capital that insurance entities must hold considering their risk profile. It is applicable from 1 January 2016.

- (b) discount rates consistent with current rate in the financial markets; and
 - (c) an adjustment for risk.
18. In addition, many investors and analysts we spoke to expressed interest about how reported profits in applying IFRS 17 will affect entities' dividend payout policies and the interaction with Solvency II capital requirements.

Main areas of support

Information about financial performance

19. Many investors and analysts we spoke to said that IFRS 17 will help them to understand the sources of profit for insurance services as it requires an entity to:
- (a) show the insurance service result separately from the net financial result;
 - (b) recognise profit for insurance services in the statement of financial performance as the insurance services are provided;
 - (c) identify onerous contracts at initial recognition and subsequently;
 - (d) use discount rates that reflect the insurance contract liability characteristics, independently of asset allocation choices; and
 - (e) provide information about reinsurance contracts held, including explanations of changes in reinsurance contract assets separately from changes in insurance contract liabilities.
20. Many investors and analysts we spoke to appreciated that when IFRS 17 is implemented the profit recognition pattern (ie timing) for insurance services in the statement of financial performance will no longer depend on the type of insurance contract. They also welcomed that in applying IFRS 17 an entity does not recognise any gain (ie unearned profit) at initial recognition.

Disclosures

21. Many investors and analysts we spoke to agreed with the Board's conclusion that the disclosures IFRS 17 requires will help them understand the reasons for changes in the amounts reported in insurance entities' financial statements. In the light of IFRS 17 requirement to measure insurance contracts using assumptions updated at each reporting date, some of those investors and analysts noted the importance of comprehensive disclosures about:
- (a) changes in insurance contract liabilities; and
 - (b) the significant judgements and changes in judgements made in applying IFRS 17, including the confidence level used to determine the risk adjustment for non-financial risk.
22. Many investors and analysts we spoke to welcomed:
- (a) the requirement in IFRS 17 for an entity to consider the level of detail necessary to give a basis for users of financial statements to assess the effect that insurance contracts have on an entity's financial position, financial performance and cash flows; and
 - (b) the following examples of aggregation bases in IFRS 17 that might be appropriate for information disclosed about insurance contracts:
 - (i) type of contracts (for example, major product lines);
 - (ii) geographical area; and
 - (iii) reportable segment, as defined in IFRS 8 *Operating Segments*.

Main areas of concern

Entity-specific judgements

23. Some investors and analysts we spoke to expressed concerns that the principle-based nature of IFRS 17 could limit comparability between insurance entities. This is because the accounting for insurance contracts is heavily reliant on assumptions and IFRS 17 requires entities to use judgement to determine key

factors for the measurement of insurance contracts, such as the discount rates, the risk adjustment for non-financial risk and the amount of the contractual service margin at initial recognition.

24. However, many noted that, although IFRS 17 allows flexibility to determine the discount rates and risk adjustment for non-financial risk, the process for estimating these two components for the measurement of insurance contracts must be described and disclosed. Consequently, they expect that IFRS 17 will result in the disclosure of information to help users of financial statements understand the amounts recognised in the financial statements and the changes in those amounts.

“We think there will be a huge amount of information given to help investors understand the movement of value and cash components that are currently either ignored or wrapped into a single black box under IFRS 4.” – Extract from an analyst report for investors commenting on IFRS 17

Option for the presentation of the effects of changes in financial assumptions

25. IFRS 17 permits an entity to choose to present the effects of changes in financial assumptions (ie discount rates and other financial variables) either in profit or loss or disaggregated between profit or loss and other comprehensive income.
26. Most investors and analysts we spoke to expressed concerns that permitting, but not requiring, a presentation of the effect of some changes in financial assumptions in other comprehensive income could impair comparability between insurance entities.
27. Although IFRS 17 requires an entity that chooses to disaggregate this effect between profit or loss and other comprehensive income to disclose an explanation of the methods used to determine the amounts recognised in profit or loss and therefore provides users of financial statements with a basis to adjust information reported by entities to make them more comparable, some expressed the view that this option adds unnecessary complexity to their analysis of the information reported by entities in applying IFRS 17.

Transition

28. IFRS 17 requires retrospective application, where practicable. If a full retrospective application is impracticable, an entity can apply alternative transition methods to determine the contractual service margin for groups of insurance contracts in force at the date of transition.
29. Most investors and analysts we spoke to agreed with the Board’s conclusion that retrospective application of IFRS 17 provides the most useful information by allowing comparison between contracts written before and after the date of transition. Those investors and analysts were therefore concerned that the use of alternative transition methods could result in a loss of trend information for some groups of insurance contracts. Many were pleased to learn that entities will be required to separately disclose the ‘transition contractual service margin’ in subsequent periods and agreed that this disclosure requirement could be a mitigating factor that is helpful in their future analysis.

Disclosure requirements relating to the above areas of concern

30. Some investors and analysts noted that the following disclosure requirements in IFRS 17 should help them in analysing the effect of significant judgements used by entities in applying IFRS 17, including the effect of the use of options on comparability.

Topic	Disclosure requirement in IFRS 17
Discount rates	<p>The approach used to determine discount rates.</p> <p>The yield curve (or range of yield curves) used to discount the cash flows that do not vary based on the returns on underlying items. When an entity provides this disclosure in aggregate for a number of groups of insurance contracts, it shall provide such disclosures in the form of weighted averages, or relatively narrow ranges.</p>

Topic	Disclosure requirement in IFRS 17
Risk adjustment for non-financial risk	<p>The approach used to determine the risk adjustment for non-financial risk.</p> <p>The confidence level used to determine the risk adjustment for non-financial risk or, if an entity uses a technique other than the confidence level technique for determining the risk adjustment for non-financial risk, the technique used and the confidence level corresponding to the results of that technique.</p>
Contractual service margin	<p>A reconciliation from the opening to the closing balances of the contractual service margin, showing:</p> <ul style="list-style-type: none"> (a) the changes in estimates that adjust the contractual service margin; (b) the effects of contracts initially recognised in the period; (c) the insurance finance expenses on the contractual service margin; (d) the amount of the contractual service margin recognised in profit or loss to reflect the transfer of services; and (e) any additional items that may be necessary to understand the change from the opening to the closing balances of the contractual service margin.
Insurance finance income or expenses	<p>An explanation of:</p> <ul style="list-style-type: none"> (a) the methods used to determine the insurance finance income or expenses recognised in profit or loss, if an entity chooses to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income; and (b) the relationship between insurance finance income or expenses and the investment return on assets held by an entity.

Topic	Disclosure requirement in IFRS 17
Transition amounts	<p>The reconciliation of the contractual service margin and the amount of insurance revenue separately for:</p> <ul style="list-style-type: none"> (a) insurance contracts to which an entity has applied the alternative transition methods; and (b) all other insurance contracts. <p>An explanation of how an entity has determined the measurement of insurance contracts at transition date.</p>

Future educational activities for investors

31. In 2017 our plans are focused on raising awareness of IFRS 17 requirements at a high-level. In the second half of 2017 we will continue to have educational meetings with investors and analysts across the major IFRS regions as well as meeting with those that do not specialise in the insurance sector.
32. Beyond 2017, we expect education efforts to progress into more detailed areas to support investors and analysts. However, our experience with past major Standards (IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*) reveals that many investors and analysts postpone their education on a new IFRS Standard until it is around 18-12 months away from being implemented. Therefore we will take this into consideration in targeting activities.

Appendix A—Overview of the discussions by investor type and by regional specialty

A1. The following charts provide an overview of the 35 discussions with 153 investor and analyst participants.

A2. Overview of the number of discussions and participants by investor type



Investor type	Discussions	
	Number	Percentage
Sell side	18	51%
Buy side	8	23%
Mixed group	6	17%
Credit rating agency	3	9%
Total	35	100%



Investor type	Participants	
	Number	Percentage
Mixed group	75	49%
Sell side	42	27%
Buy side	21	14%
Credit rating agency	15	10%
Total	153	100%

A3. Overview of the number of discussions and participants by regional specialty



Regional specialty	Discussions	
	Number	Percentage
Europe	17	49%
Global	13	37%
Asia Pacific	4	11%
North America	1	3%
Total	35	100%



Regional specialty	Participants	
	Number	Percentage
Europe	66	43%
Global	59	38%
North America	21	14%
Asia Pacific	7	5%
Total	153	100%