

# IFRS 17 update

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verzekeringen



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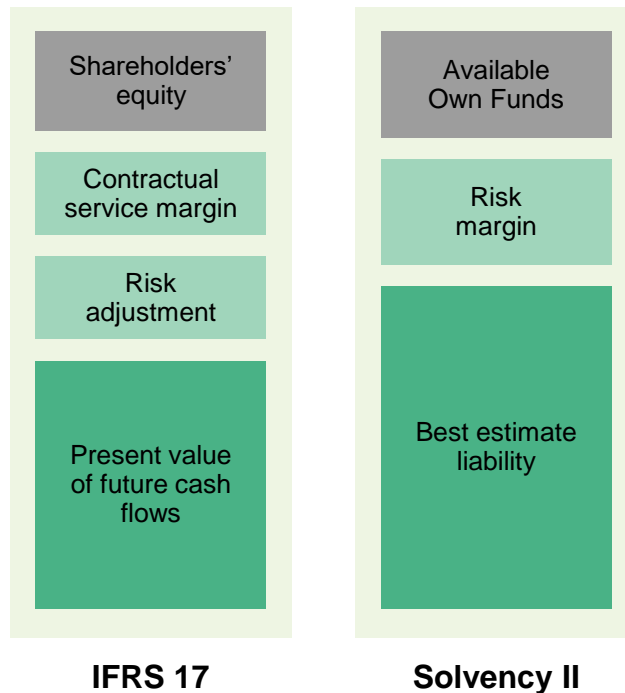
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# Key principles and objectives of a.s.r.'s IFRS 17 project

-  Operational efficiency through alignment with Solvency II framework
-  No impact on business steering, value over volume approach continued
-  Maintain flexibility in management of investment portfolio, no introduction of hedge accounting complexity
-  Prioritize cost efficiency and avoid undue effort
-  Contribute to a robust, flexible and future-proof finance department
-  Alignment between introduction of IFRS 17 and IFRS 9, one 'catch it all' transition

# Balance sheet: IFRS 17 versus Solvency II; similar but not the same

## Comparing balance sheets (Liability side)



*Note: The relative size of the diagram is purely for illustration purposes*

- The aim of IFRS 17 is to facilitate comparability and transparency from an accounting perspective, similar to Solvency II from a regulatory perspective.
- Both apply a market valuation approach.
- Both place emphasis on the insurer's own assessment and management of risks facing the business and both are based on similar underlying cashflows.

While aiming at alignment between IFRS 17 and Solvency II, detailed reconciliation is complex, as multiple differences exist:

- Differences in discount curve (see slide 7 for more information).
- Expected future profits embedded in contractual service margin (IFRS 17) to be recognized over time.
- Risk adjustment (IFRS 17) vs risk margin (Solvency II).
- Possibility to use different (actuarial) assumptions.
- Other differences (e.g. foreseeable dividends, goodwill).

# Transition methods and measurement approaches

## Measurement approach

- IFRS 17 requires a current measurement model, where estimates are remeasured in each reporting period. The measurement is based on the building blocks of discounted, probability-weighted future cash flows, a risk adjustment and a contractual service margin (CSM) representing the unearned profit of the contract.
- Three measurement approaches possible under IFRS 17.

## Transition method

- Opening balance of IFRS 17 will be determined as from 1 January 2022 (start of the comparative year).
- Various balance sheet components will be highly dependent on the transition method and the discount curve applied.
- If feasible, IFRS 17 requires a full retrospective application of the standard, resulting in a complex transition (e.g. at a.s.r. the retrospective application for Funeral starts from 2002).
- If the transition is based on the fair value approach the insurance liabilities will be valued as if a third party were to acquire these liabilities. In this approach an implicit profit-assumption is included.

### Overview different measurement approaches

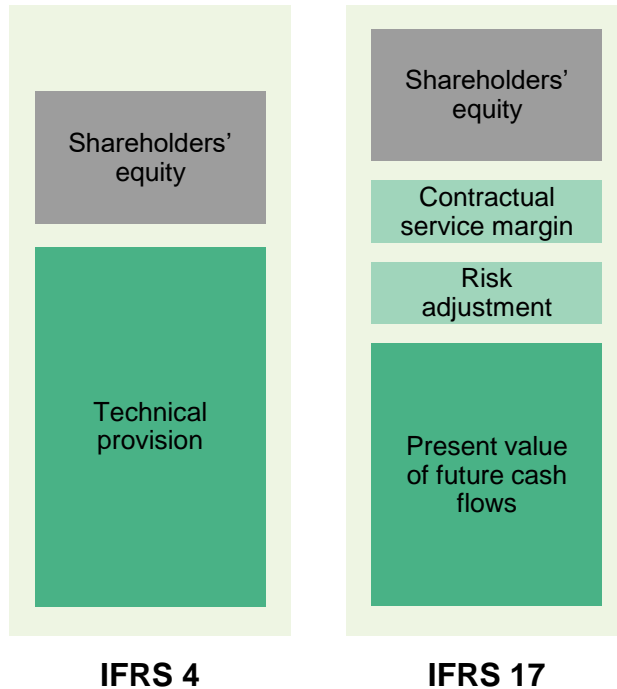
General Measurement Model (GMM)	Default measurement model for all insurance contracts. Includes a CSM.
Premium Allocation Approach (PAA)	Optional simplified approach for short term contracts with little pre-claim variability (e.g. P&C and Health). No CSM.
Variable Fee Approach (VFA)	To deal with participating business where payments to policy-holders are linked to underlying items (e.g. unit-linked).

### Overview different transition methods

Full retrospective approach	When all historical data is available.
Modified approach	When not all, but some, historical data is available or can be constructed.
Fair value approach	When no historical data is available.

# Opening balance: important changes from IFRS 4 to IFRS 17

## Comparing balance sheets (Liability side)

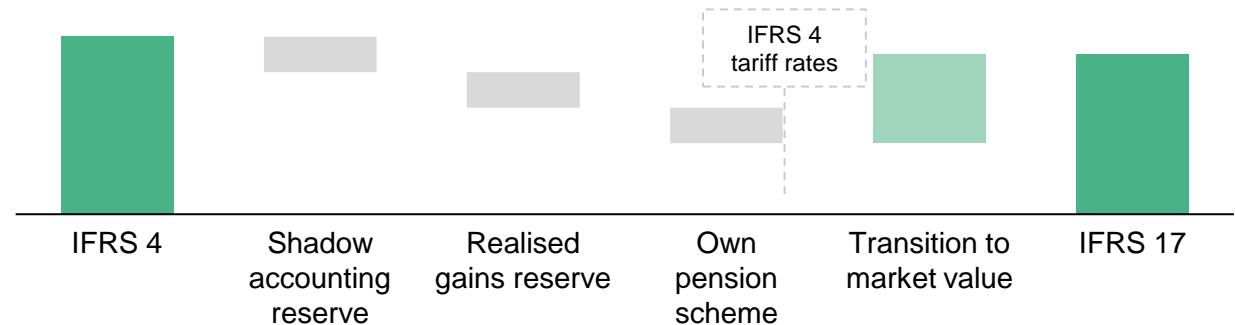


Note: The relative size of the diagram is purely for illustration purposes

## IFRS 17 changing the IFRS balance sheet

- IFRS 4 based on tariff rates and book value compared to market-based value in IFRS 17.
- IFRS 4 technical provision includes shadow accounting, which is not used in IFRS 17.
- Contractual service margin provides insight into expected future profits.
- Risk adjustment is introduced to account for future uncertainty of non-financial risks and may support future profits should the risks not materialize.
- IFRS 9 is implemented simultaneously and its impact is limited to the revaluation of mortgages and loans (from amortised cost to fair value). Other assets are already on market value.

## Expected reconciliation between IFRS 4 and IFRS 17 insurance liabilities of the Life segment (Illustrative view)



# IFRS 17 discount curve – no prescribed standard

## Balance sheet composition and future volatility largely determined by discount curve applied

- Comparability of IFRS 17 reporting dependent on the emergence of a market standard.
- Currently two “schools of thought” around the use of market observations seem to exist:
  - An approach (similar to Solvency II) incorporating 20-30 year market observations in the extrapolation from a 20-year First Smoothing Point.
  - An approach using only market observations up to a Last Liquid Point of 30 years.
- The resulting discount curves are significantly different and will impact comparability of both the balance sheet and the P&L.

### 'building blocks' for IFRS 17 discount curve

Risk free rate

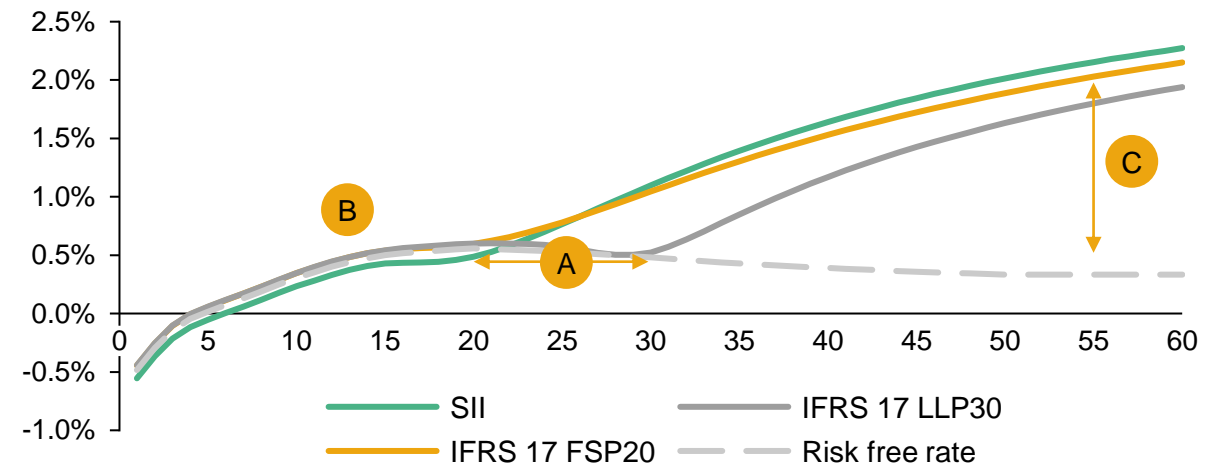
**A** Last Liquid Point ('LLP') / First Smoothing Point ('FSP')

Interpolation method

**B** Liability Illiquidity Premium ('LIP')

**C** Extrapolation (UFR)

### Illustrative graph with different discount curves<sup>1</sup>

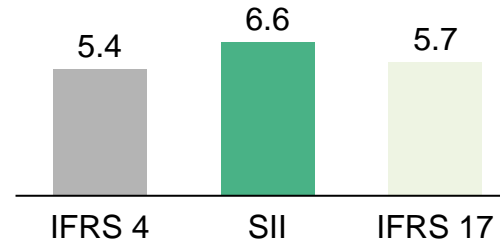


# Indicative composition of balance sheets on different frameworks

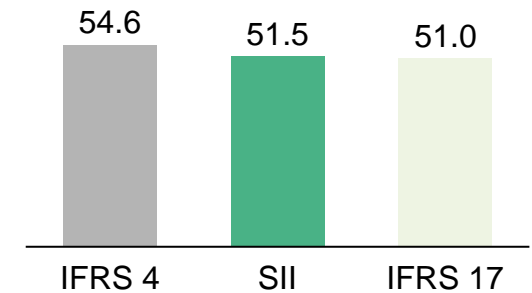
- The shareholders' equity of a.s.r. under IFRS 17 is lower compared to SII, mainly due the application of the CSM, which under SII is recognized under own funds.
- The insurance liabilities under IFRS 17 were marginally lower in the FY20 proxy figures compared to SII. The higher curve <20 years under IFRS 17 lowers the reserves while the lower curve beyond 20 years increases the reserves.
- The risk adjustment under IFRS 17 is lower compared to SII risk margin due to three reasons:
  - The risk margin is discounted excluding VA while the risk adjustment is discounted including LIP;
  - The risk margin includes operational risk and reinsurance counterparty risk while the risk adjustment excludes those;
  - Various technical differences in application method.
- The assets under IFRS 9 are similar to SII, while under IFRS 4 some assets are accounted for at amortised cost.

The IFRS 17 FY20 proxy figures shown are highly indicative and include various high-level assumptions (e.g. a 20-year FSP discount curve and fair value transition method)

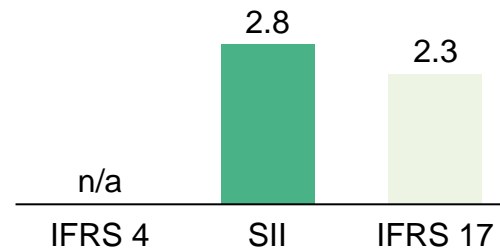
Equity<sup>1</sup> (in € bn)



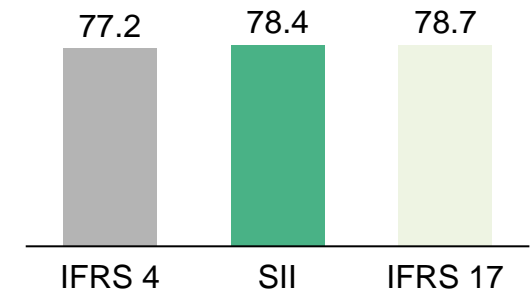
Insurance liabilities (in € bn)



Risk margin / risk adjustment (in € bn)



Assets (in € bn)





# Profit recognition: P&L comparison

IFRS 4	IFRS 17
Premiums written	Insurance revenue, including;
Investment income	<i>Release of CSM</i>
Income	<i>Release in Risk Adjustment</i>
Incurred claims and expenses	<i>Expected claims and expenses</i>
Change in insurance liability	Incurred claims and expenses
Expenses	Insurance service result
Profit or loss	Investment income
	Insurance finance expenses
	Finance result
	Other result
	Profit or loss

## Insurance service result

- Insurance service result for Life & Disability is primarily impacted by the release of the CSM and the risk adjustment.
- The impact of experience adjustments will be more transparent as part of CSM.

## Finance result

- Fair value movements of all assets (except equities which are accounted for FV-OCI) go through P&L as part of the finance result.
- Movements in the liabilities, driven by market rate movements, also go through P&L under the finance result.
- Theoretically the movements in assets and liabilities will partly offset each other. However, the stability provided by shadow accounting under IFRS 4 will disappear. Hence, increased P&L volatility is to be expected.
- In line with the principle to avoid undue cost and effort and to prioritize economic steering of the business, a.s.r. has elected not to apply hedge accounting as this is a cumbersome and restrictive way to manage accounting earnings. Not applying hedge accounting safeguards interest rate hedge adaptation to economic circumstances.

## Steering on results

- Given the inherent volatility introduced by IFRS 17, a.s.r. will primarily be steering on OCC, operating result and other segment-specific metrics like the combined ratio in Non-life, in a similar manner to that applied in the current situation.

# Bridging IFRS 17 result to operating result and OCC

## From IFRS 17 result to operating result

IFRS 17 result (pre-tax)

-/- Finance result

+/+ Excess returns – similar methodology to OCC (SII)

-/- Incidental items Insurance Service Result

-/- Other incidentals

IFRS 17 operating result (pre-tax)

Operating result is still under construction but aiming to provide insight into underlying business performance.

In time, market practice on operating result may evolve but is not expected to be present at the start of IFRS 17 reporting.

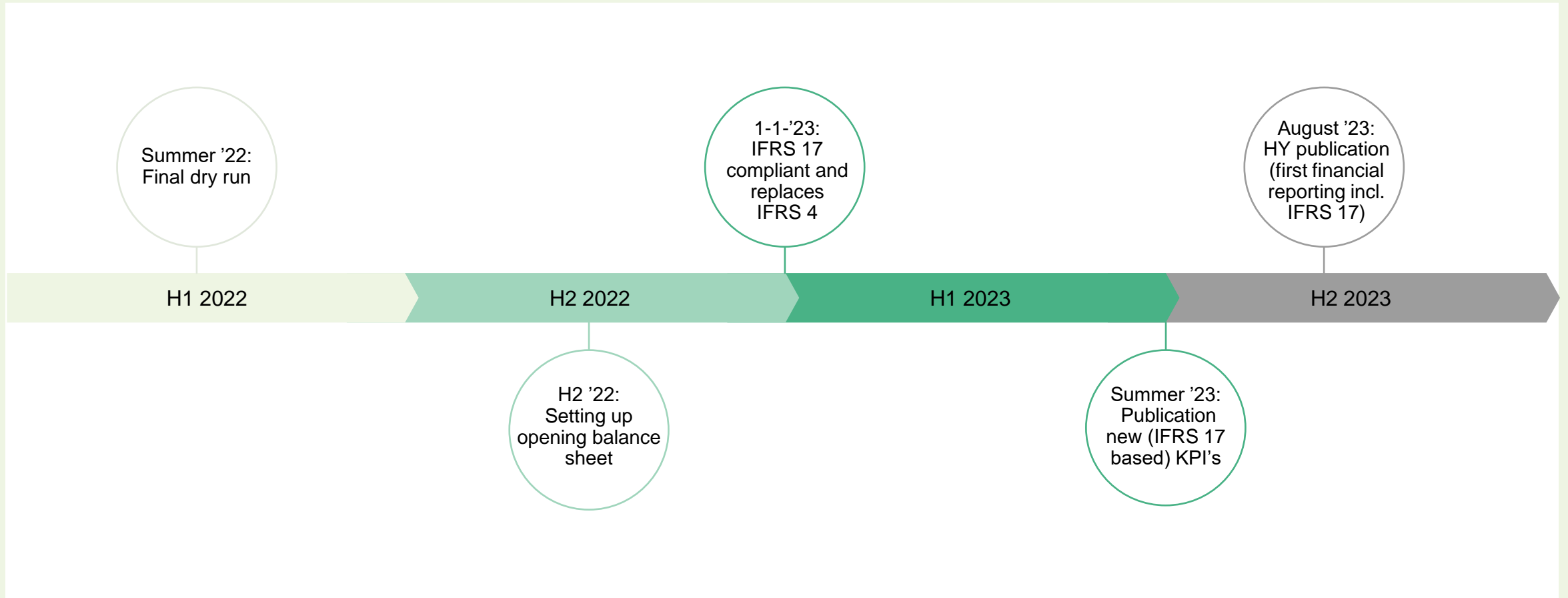
The a.s.r. operating result is derived from the IFRS 17 result. Differences include:

- Finance result excluded and excess return methodology applied, similar to OCC (SII).
- Insurance service result corrected for incidental items.
- Other incidentals relate to incidentals in non-core activities, for example restructuring costs or M&A activities.

Differences between IFRS 17 operating result (post-tax) and Solvency II Organic Capital Creation (OCC) include:

- Excess returns: Accrual of reserves based on applicable discount curve, applying a VA versus the LIP (including mortgage spreads).
- Insurance result: due to the CSM release in IFRS 17 the result is smoothed and aligned with the services rendered.
- SCR release: no SCR release present in IFRS 17.
- Other: includes differences in hybrid expenses, UFR write-off, risk margin release.

# Timelines



# Key take-aways

- ▶ IFRS 17 is an accounting regime change, no changes to underlying business fundamentals or cashflows
- ▶ Change in timing of earnings recognition, mostly impacting (similar to) Life products
- ▶ Higher expected volatility in IFRS net result, steering primarily on operating result
- ▶ No impact on existing share buyback commitment and progressive dividend policy
- ▶ IFRS 17 more comparable with Solvency II framework, comparability with peers highly dependent on choices made

# Appendix

# List of abbreviations

**AIP:** Asset Illiquidity Premium.

**CSM:** Contractual Service Margin.

**FSP:** First Smoothing Point.

**FV-OCI:** Fair Value through Other Comprehensive Income.

**FVPL:** Fair Value through Profit or Loss.

**GMM:** General Measurement Model.

**ISR:** Insurance Service Result.

**LIP:** Liability Illiquidity Premium.

**LLP:** Last Liquid Point.

**NEA:** Non-Economic Assumption.

**OCC:** Organic Capital Creation.

**PAA:** Premium Allocation Approach.

**RA:** Risk Adjustment.

**RM:** Risk Margin.

**SCR:** Solvency Capital Requirement.

**SII:** Solvency II.

**UFR:** Ultimate Forward Rate.

**VA:** Volatility Adjustment.

**VANB:** Value Added by New Business.

**VFA:** Variable Fee Approach.

# Overview per segment

## Life

- Funeral: Opening balance sheet likely to include a positive retrospective CSM due to historical VANB, positive new business and successful acquisitions.
- Life & Pensions: Transition largely fair value approach. CSM of Life and Pensions therefore dependent on the valuation at opening balance. Positive CSM from both a.s.r. originated portfolio as well as acquired portfolios.

## Non-life

- P&C and Health: On PAA, with limited changes compared to current framework given short-term nature. There is a difference between IFRS 4 and IFRS 17 related to application of risk adjustment.
- Disability: On General Model, thus including CSM. Partly retrospective and partly fair value approach. Future profitability determined by combination of CSM and risk adjustment release.

## Asset management

- Asset management: Implementation IFRS 9 finalised and embedded in reporting process.
- Interest rate hedge adaptation to economic circumstances safeguarded by not applying hedge accounting.

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