Impact and implementation of new accounting standards on the Insurance Industry

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Speakers

Laurent Birade
Senior Director, Regulatory and Accounting Solutions
Moody’s Analytics

Srini Iyer
Senior Director, Regulatory and Accounting Solutions
Moody’s Analytics
Today’s Discussion Points

1. Accounting Standards – Definitions
2. Business Implications and Interactions
3. Implementation Considerations
1 Accounting Standards Definitions
## Insurers Balance Sheet

### Comprehensive impact of new standards

<table>
<thead>
<tr>
<th>Description</th>
<th>Notes</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents*</td>
<td>19</td>
<td>20,794</td>
</tr>
<tr>
<td>Financial investments</td>
<td>20</td>
<td>412,526</td>
</tr>
<tr>
<td>- Measured at fair value*</td>
<td></td>
<td>8,715</td>
</tr>
<tr>
<td>- Measured at amortised cost</td>
<td></td>
<td>9,267</td>
</tr>
<tr>
<td>Receivables*</td>
<td>21</td>
<td>7,580</td>
</tr>
<tr>
<td>Current tax assets</td>
<td></td>
<td>791</td>
</tr>
<tr>
<td>Insurance contract assets</td>
<td>29</td>
<td>717</td>
</tr>
<tr>
<td>Reinsurance contract assets</td>
<td>29</td>
<td>12,775</td>
</tr>
<tr>
<td>Investment property*</td>
<td>22</td>
<td>6,017</td>
</tr>
<tr>
<td>Property and equipment</td>
<td>31</td>
<td>2,580</td>
</tr>
<tr>
<td>-Owes unearned property of fair value*</td>
<td></td>
<td>482</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td>4,150</td>
</tr>
<tr>
<td>Intangible assets and goodwill</td>
<td>35</td>
<td>12,000</td>
</tr>
<tr>
<td>Deferred tax assets</td>
<td>18</td>
<td>250</td>
</tr>
<tr>
<td>Other assets</td>
<td>26</td>
<td>1,961</td>
</tr>
<tr>
<td>Total assets</td>
<td></td>
<td>400,256</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Notes</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums</td>
<td></td>
<td>27,10,401</td>
</tr>
<tr>
<td>Dividends &amp; liabilities*</td>
<td>20</td>
<td>1,240</td>
</tr>
<tr>
<td>Current liabilities</td>
<td></td>
<td>1,883</td>
</tr>
<tr>
<td>Insurance contract liabilities</td>
<td>20</td>
<td>23,907</td>
</tr>
<tr>
<td>Third party interests in consolidated funds</td>
<td></td>
<td>491</td>
</tr>
<tr>
<td>Surplus contract liabilities</td>
<td>20</td>
<td>379,961</td>
</tr>
<tr>
<td>Reinsurance contract liabilities</td>
<td></td>
<td>20,834</td>
</tr>
<tr>
<td>Loans and borrowings</td>
<td>31</td>
<td>7,445</td>
</tr>
<tr>
<td>Provisions</td>
<td>91</td>
<td>240</td>
</tr>
<tr>
<td>Deferred tax liabilities</td>
<td>16</td>
<td>3,062</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>52</td>
<td>462</td>
</tr>
<tr>
<td>Total liabilities</td>
<td></td>
<td>430,234</td>
</tr>
</tbody>
</table>

**Equity**

<table>
<thead>
<tr>
<th>Description</th>
<th>Notes</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital and share premium</td>
<td></td>
<td>22,291</td>
</tr>
<tr>
<td>Retained earnings</td>
<td></td>
<td>30,770</td>
</tr>
<tr>
<td>Other reserves</td>
<td></td>
<td>6,605</td>
</tr>
</tbody>
</table>

**Equity attributable to owners of the Company**

<table>
<thead>
<tr>
<th>Description</th>
<th>Notes</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-controlling interests</td>
<td>35%</td>
<td>90,441</td>
</tr>
</tbody>
</table>

Total equity | | 69,021 |

<table>
<thead>
<tr>
<th>Description</th>
<th>Notes</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total equity</td>
<td></td>
<td>69,021</td>
</tr>
<tr>
<td>Total liabilities &amp; equity</td>
<td></td>
<td>400,256</td>
</tr>
</tbody>
</table>

Reference: KPMG Illustrative Disclosures for Insurers
Impact and implementation of new accounting standards on the Insurance Industry

Insurers Balance Sheet

Comprehensive impact of new standards

New Allowance Standard

IFRS9

CECL

Insurance Contracts Standard

IFRS17

LTDI

Reference: KPMG Illustrative Disclosures for Insurers
Timeline for CECL, IFRS 9, LDTI, and IFRS 17

Alignment of the LDTI and IFRS 17 effective dates allows insurers to implement simultaneously and efficiently.
Insurance Contracts Standards
IFRS17 and LTDI – Liability Side Impact

**IFRS 17**

**LIC**
- Fulfillment Cashflows
- Discount Rates (Reflect Contract Cashflows)
- Gross of Reinsurance Contracts

**LRC (Remaining coverage)**
- General Measurement Model
- Premium Allocation Approach
- Updated Estimates In each period
- Appropriate release to CSM vs P&L vs OCI
- Rollforwards and calculation of Liability

**Presentation and Disclosures**
Insurance Contracts Standards
IFRS17 and LTDI – Liability Side Impact

IFRS 17

LIC
- Fulfillment Cashflows
- Discount Rates (Reflect Contract Cashflows)
- Gross of Reinsurance Contracts

LRC (Remaining coverage)
- General Measurement Model
- Premium Allocation Approach
- Variable Fee Approach
- Explicit Risk Margin
- Updated Estimates in each period
- Appropriate release to CSM vs P&L vs OCI
- Rollforwards and calculation of Liability

LDTI
(Targeted Improvements to the Accounting for Long-duration Contracts)
- Current assumptions for liability measurement.
- Cohort based calculation. Changes recorded in net income.
- Discount Rates (upper-medium Grade credit risk)
- Consistency in measurement of Market risk benefits
- Constant Rate approach for DAC
- Removal of PAD
- Updated Assumptions
- Rollforwards and calculation of Liability

Presentation and Disclosures

MOODY’S ANALYTICS
Impact and implementation of new accounting standards on the Insurance Industry 9
IFRS 17 and LDTI continue to have broad implications for Insurers

**Ratings and Investor:** Increase in earnings volatility for most Insurers. Impact on ratings will depend on comparison to peers.

**Business Mix:** Detailed reporting and earnings transparency could influence strategy and product mix.

**ALM and Hedging:** Fair Value approach in IFRS 17 and LDTI should help with hedging.

**Operational Challenge:** Finance, Risk, Systems, Data, Target Operating Model.

Source: Swiss Re and Moody’s Investor Service
New Allowance Standards
IFRS9 and CECL standard – Asset Side Impact

Classification and measurement

Impairment

General hedge accounting

What is the business model
- Held to collect
- Held to collect AND sell
- All other

Measurement Category
- Amortized cost
- FVTOCI
- FVPL

Alternatives
- FVTPL option (if acc. Mismatch)
- FVTPL option (if acc. Mismatch)
- FVOCI option for equity instruments (dividends in P&L)
New Allowance Standards
IFRS9 and CECL standard – Asset Side Impact

Classification and measurement

Impairment

General hedge accounting

Expected Credit Loss Model

- No significant increase in credit risk
  - Stage 1
    - 12-month expected credit loss
    - Interest calculated on gross carrying amount

- Significant increase in credit risk
  - Stage 2
    - Lifetime expected credit loss
    - Interest calculated on net carrying amount

- Objective evidence of impairment / default
  - Stage 3
    - Lifetime expected credit loss

New Allowance Standards
IFRS9 and CECL standard – Asset Side Impact
New Allowance Standards
IFRS9 and CECL standard – Asset Side Impact

**Expected Credit Loss Model**

- No significant increase in credit risk
- Significant increase in credit risk
- Objective evidence of impairment / default

- Stage 1
  - 12-month expected credit loss
  - Interest calculated on gross carrying amount

- Stage 2
  - Lifetime expected credit loss

- Stage 3
  - Lifetime expected credit loss
  - Interest calculated on net carrying amount

**In Scope**
- Loans
- Trade receivables
- Debt securities classified as held-to-maturity
- Loan commitments
- Financial guarantee contracts not accounted for as insurance
- Net investment in leases recognized by a lessor
- Reinsurance receivables

**Out of Scope**
- Equity instruments
- Debt securities classified as available-for-sale
- All financial instruments measured at fair value through net income
- Loans and receivables between entities under common control

**Asset type**
- HFI
  - Amortized cost
  - One time election – FV option
- HTM
  - Amortized cost
  - No FV option

Impact and implementation of new accounting standards on the Insurance Industry
New Allowance Standards
IFRS9 and CECL standard – Asset Side Impact

Expected Credit Loss Model

- No significant increase in credit risk
- Significant increase in credit risk
- Objective evidence of impairment / default

Measurement Overview

Historical loss experience adj. for asset specific attributes

Adjust for current economic conditions

Adjust for reasonable & supportable forecast

Result: Estimate of current expected credit loss

In Scope
- Loans
- Trade receivables
- Debt securities classified as held-to-maturity
- Loan commitments
- Financial guarantee contracts not accounted for as insurance
- Net investment in leases recognized by a lessor
- Reinsurance receivables

Out of Scope
- Equity instruments
- Debt securities classified as available-for-sale*
- All financial instruments measured at fair value through net income
- Loans and receivables between entities under common control

Cashflows “SPPI”
- Held to collect
- Amortized cost
- FVTPL option (if acc. Mismatch)
- Held to collect AND sell
- FVOCI option for equity instruments (dividend in P&L)
- FVTPL for all other

MOODY’S ANALYTICS

Impact and implementation of new accounting standards on the Insurance Industry
IFRS 9 and CECL will have broad implications for Insurers

Ratings and Investor: Shareholder’s Equity, Earnings Volatility, Results and Roll Forward

Business: Investment Mix Shift, Duration, Portfolio Management, Maximizing risk return with allowance constraints…

Regulatory: ECL reporting, Stress Testing, Capital Planning

Operational Issues: Finance, Risk, Accounting, internal Audit, Validation
2 Interactions and Implications
Interactions Among the Standards
New standards could drive big changes to profit timing and volatility

IFRS 17 / LDTI
- Classification and separation of Insurance Contract aspects
- Grouping of insurance contracts and alignment with assets backing
- Discount Rate + Illiquidity Premium

IFRS 9 / CECL
- Loans and Debt Securities (AFS, HTM, HFI)
- FVTPL, FVOCI, Amortized Cost
- 12 ECL vs Lifetime ECL
- Discount Rate Assumptions

Impact of Economic Assumptions
Impact of Discount Rates
Impact of Accounting choices
Impact of Modeling Assumptions
Transition approaches
Hedging and Asset Liability mismatch
Profitability and Product Composition
Impact of Economic Assumptions

Discount Rate and Illiquidity Premium Modelling

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Impact and implementation of new accounting standards on the Insurance Industry

Impact of Discount Rate Assumptions

Profit Emergence Pattern

(1) Liability discount rate = Risk-free rate

(2) Liability discount rate = Risk-free rate + liquidity premium

(3) Liability discount rate = Asset discount rate

Initial balance sheet

Expected profits

Profit Emergence under IFRS 17
Source: https://www.moodysanalytics.com/articles/2018/profit-emergence-under-ifrs17
Impact of Discount Rate Assumptions
P&L volatility

Liability discount rate = 
Risk-free rate

Liability discount rate = 
Risk-free rate + illiquidity premium*

Liability discount rate = 
Asset discount rate

Net Financial Result

Insurance Service Result

Profit Emergence under IFRS 17
Source: https://www.moodysanalytics.com/articles/2018/profit-emergence-under-ifrs17
Impact and implementation of new accounting standards on the Insurance Industry

Impact of Classification and Policy Choices

Fig. 1
Fair value through P&L (assets) and OCI option (liabilities)
- Change in value of assets (as a result of changing interest rates) to P&L
- Change in the value of liabilities (discount rate) to OCI
- Impacts largely offset in balance sheet, but mismatch in P&L and OCI

Fig. 2
Fair value through OCI (assets) and P&L option (liabilities)
- Change in value of assets (as a result of changing interest rates) to OCI
- Change in the value of liabilities (discount rate) to P&L
- Impacts largely offset in balance sheet, but mismatch in P&L and OCI

Fig. 3
Fair value through OCI (assets) and OCI option (liabilities)
- Change in value of assets (as a result of changing interest rates) to OCI
- Change in the value of liabilities (discount rate) to OCI
- Impacts largely offset in balance sheet and OCI, minimal mismatch

Fig. 4
Fair value through P&L (assets) and P&L option (liabilities)
- Change in value of assets (as a result of changing interest rates) to P&L
- Change in the value of liabilities (discount rate) to P&L
- Impacts largely offset in P&L and balance sheet, minimal mismatch

Source: IFRS17 and IFRS9: Bridging the Gap, Bhana and Schaeffer Deloitte
A Modeling Framework for Business Insight

1. **Business insight.** Need to understand the changes to profit emergence introduced by IFRS 17 (& 9), their impact on KPIs and resulting impact on business.

2. **Investor communication.** Need to clearly communicate these changes to investors and other external stakeholders.

3. **Methodology decisions.** Need to understand the impact of different choices available e.g. coverage units, risk adjustment, discount rates.

IFRS 17 Thought Leadership Centers
Source: [https://www.moodysanalytics.com/microsites/ifrs17/ifrs17-thought-leadership-center](https://www.moodysanalytics.com/microsites/ifrs17/ifrs17-thought-leadership-center)
3 Implementation Considerations
Broad Implications of CECL and IFRS9

IFRS 9
- Data Management
- Support for credit deterioration
- Support for all Measurement approaches
- Cashflow models
- Volatility cliff for stage 2 migration
- Period over period analysis of changes
- Narrative behind the numbers

CECL
- Vintage and credit quality disclosures
- AFS impairment model
- Loans and other assets ECL volatility
- Granularity of segmentation
- Requirement for Historical data in low loss portfolios
- Election of Fair Value in certain cases
- Period over period analysis of changes
- Narrative behind the numbers
Target Operating Model for IFRS9/CECL
Connecting the Accounting and Credit Risk worlds

Data
- Exposures
- Counter-parties
- Risk mitigants
- SPPI

Estimation Approach
- Scenarios
- Loss rates
- PD/LGD/EAR
- DCF/Non-DCF

Calculation
- 12M/Lifetime ECL
- Allowance
- Provision
- Stage Allocation

Analysis
- Attribution
- Trends
- Drill-down
- Benchmarking

Management Overlay
- Qualitative factors
- Supporting documentation

Reporting
- Approvals
- Disclosures
- Management Reporting

Use
- Credit Risk Accountants
- Credit Risk Accountants
- Credit Risk Accountants
- Credit Risk Accountants
- Line of Business Accountants

Adjustments
Broad Implications of IFRS 17 and LDTI

IFRS 17
- Data Management
- Dealing with granularity different from IFRS 17 groups
- Support for all Measurement approaches
- Tracking CSM and LC separately
- LRC/LIC calculations
- Reinsurance held/ceded
- Flexible Analysis of Change
- Flexible Accounting Engine

LDTI
- New cohort level calculations
- Historic data input
- Unlocking by cohort
- New DAC, Discount Rate, MRB
- Income components from revaluations
- Components for expanded disclosures
Impact and implementation of new accounting standards on the Insurance Industry

Target Operating Model for LDTI/IFRS
Connecting the Accounting and Actuarial worlds

- Historical balances
- Accounting policies
- Reference Data Management

Data Management

- Run Actuarial Models
- Aggregate to Groups/Cohort
- Run Actuarial Process (IFRS17 and LDTI)

Measurement

- Analysis of Change
- Rollforward
- Using both Actuarial and Accounting views

Review Results

- Adjustments
- Qualitative factors
- Ledger CoA mapping

Collaborative sign-off

- Soft Postings
- Revision
- Journal Postings
- Consolidation

Ledger Posting

- Approvals
- Disclosures
- Mgmt. Reporting

Reporting

- Use
  - Actuaries
  - Accountants
  - Investments

- Line of Business
  - Accountants
  - Finance

IT & Infrastructure
Aligning Target Operating Models

Alignment of assumptions across the balance sheet

- Systems Architecture - Synergies
- Resource optimization
- Consistency of assumptions and optionality
- Implementation Considerations & Transition choices

Impact and implementation of new accounting standards on the Insurance Industry
Our Focus Areas

- Definitions of the standards and its implications
- Interactions and importance of a projections model
- Implementation Considerations
- Tactical vs Strategic Solution Approach

Diagram:

- Risk and Reporting
  - Risk
  - CRO/CFO
- Actuarial Modelling
  - Actuarial
  - CAO
- Investment & ALM
  - Asset Mgmt
  - CIO

Focus Areas:

- Portfolio Suite
  - Insight
  - Capital Modelling / SII
  - IFRS 17 - LTDI

- AXIS
  - [ AXIS Modules ]

- Portfolio Suite
  - Portfolio Risk Analytics
  - Portfolio Modeller
  - DBALM

- Scenario Generation
  - ESG
  - Economic Scenarios
  - Calibration tools
  - Calibration Services

- IFRS Reporting
  - IFRS 9
  - CECL
  - Credit Modeling

- Modellers
Moody’s Analytics Thought Leadership

Impact and implementation of new accounting standards on the Insurance Industry

Available at:
- Moody’s Analytics Quant Research site
- IFRS17 and LDTI leadership site

- Earnings Volatility, Share Price Performance, and Credit Portfolio Management Under CECL and IFRS 9

- Reasonable and supportable forecast from principle to practice

- Permitted approaches for constructing IFRS 17 Discount Rates

- Profit emergence under IFRS 17

- Managing assumptions for BEL under US GAAP LDTI

- Dynamic Hedge Projection and the Multi-period modeling of Greeks

- CECL, IFRS 9 and the Demand for Forecast Stability

- Leveraging Historical Loss Data for CECL

- Available at: IFRS9 site
- CECL Leadership site
Questions and Answers