Moody's Analytics

Better Faster Decisions

Impact and implementation of new accounting standards on the Insurance Industry

September, 2019

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

IFRS9

CECL

New Allowance Standard

In millions of euro	*Note*	31 December 2021
Assets		
Cash and cash equivalents*	*19*	20,794
Financial investments	*20*	
– Measured at fair value*[d]		412,526
– Measured at amortised cost		8,765
– Transferred under securities lending and repurchase agreements		8,267
Receivables*	*21*	7,609
Current tax assets		791
Insurance contract assets	*29*	717
Reinsurance contract assets	*29*	12,775
Investment property*	*22*	5,870
Equity-accounted investees	*23*	2,588
Property and equipment	*24*	
– Owner-occupied property at fair value*		492
– Other		4,150
Intangible assets and goodwill	*25*	12,090
Deferred tax assets	*18*	260
Other assets	*26*	1,561
Total assets		**499,255**

In millions of euro	*Note*	31 December 2021
Liabilities		
Payables	*27*	10,401
Derivative liabilities*[d]	*20*	1,240
Current tax liabilities		1,980
Investment contract liabilities	*28*	23,977
Third party interests in consolidated funds	*28*	491
Insurance contract liabilities	*29*	379,951
Reinsurance contract liabilities	*29*	894
Loans and borrowings	*30*	7,405
Provisions	*31*	201
Deferred tax liabilities	*18*	3,052
Other liabilities	*32*	652
Total liabilities		**430,234**
Equity		
Share capital and share premium		23,291
Retained earnings		38,720
Other reserves		6,033
Equity attributable to owners of the Company	*33*	**68,044**
Non-controlling interests	*34(C)*	**977**
Total equity		**69,021**
Total liabilities and equity		**499,255**

IFRS17

LTDI

Insurance Contracts Standard

Fair Value: Market Consistent Valuations of Assets and Liabilities

Reference: KPMG Illustrative Disclosures for Insurers

Insurers Balance Sheet

Comprehensive impact of new standards

> “All participants in the financial reporting supply chain need to work together to provide investors with decision-useful information.”
>
> AICPA conference 2018

IFRS9

CECL

New Allowance Standard

In millions of euro	Note	31 December 2021
Assets		
Cash and cash equivalents*	19	20,794
Financial investments	20	
– Measured at fair value*[d]		412,526
– Measured at amortised cost		9,765
– Transferred under securities lending and repurchase agreements		8,267
Receivables*	21	7,609
Current tax assets		791
Insurance contract assets	29	717
Reinsurance contract assets	29	12,775
Investment property*	22	5,870
Equity-accounted investees	23	2,588
Property and equipment	24	
– Owner-occupied property at fair value*		492
– Other		4,150
Intangible assets and goodwill	25	12,090
Deferred tax assets	18	260
Other assets	26	1,561
Total assets		**499,255**

In millions of euro	Note	31 December 2021
Liabilities		
Payables	27	10,401
Derivative liabilities*[d]	20	1,240
Current tax liabilities		1,980
Investment contract liabilities	28	23,977
Third party interests in consolidated funds	28	491
Insurance contract liabilities	29	379,951
Reinsurance contract liabilities	29	884
Loans and borrowings	30	7,405
Provisions	31	201
Deferred tax liabilities	18	3,052
Other liabilities	32	652
Total liabilities		**430,234**
Equity		
Share capital and share premium		23,291
Retained earnings		38,720
Other reserves		6,033
Equity attributable to owners of the Company	33	**68,044**
Non-controlling interests	34(C)	**977**
Total equity		**69,021**
Total liabilities and equity		**499,255**

IFRS17

LTDI

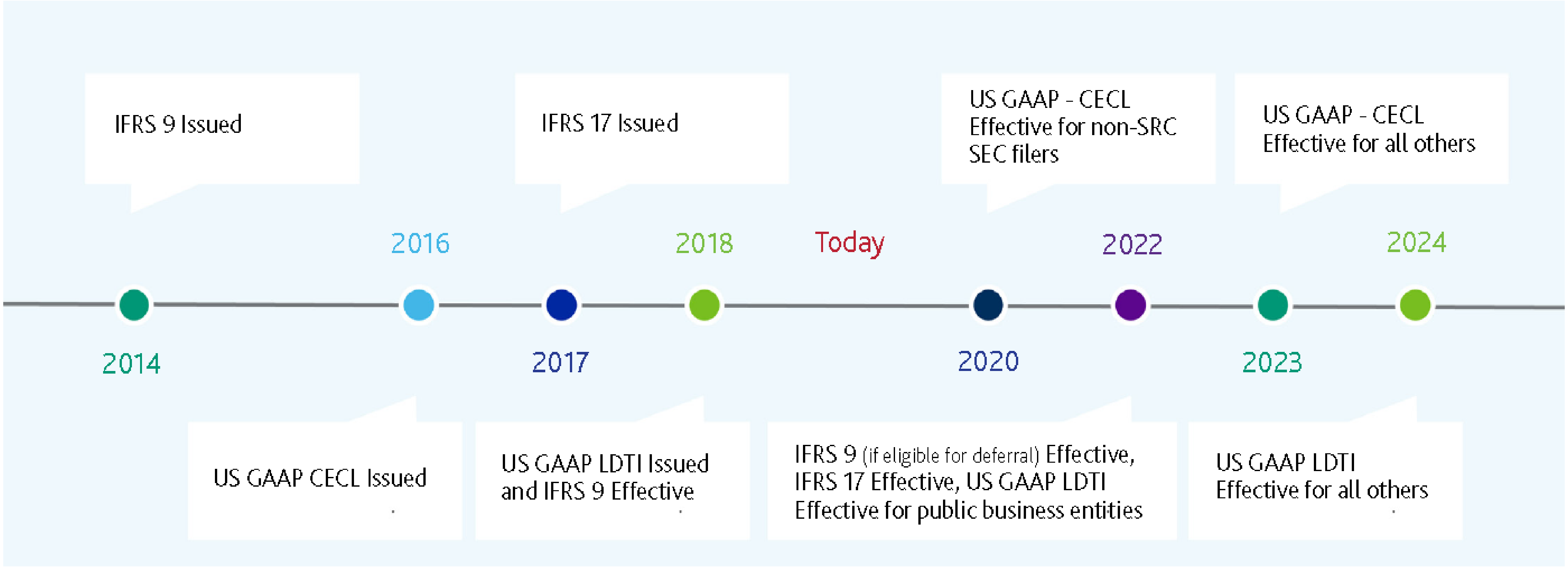
Insurance Contracts Standard

Fair Value: Market Consistent Valuations of Assets and Liabilities

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 | *LRC (Remaining coverage)*

Fulfillment Cashflows	General Measurement Model	Premium Allocation Approach	Variable Fee Approach

Discount Rates (Reflect Contract Cashflows) | **Explicit Risk Margin**

Gross of Reinsurance Contracts	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 | *LRC (Remaining coverage)*

- Fulfillment Cashflows
- General Measurement Model
- Premium Allocation Approach
- Variable Fee Approach
- Discount Rates (Reflect Contract Cashflows)
- Explicit Risk Margin
- Gross of Reinsurance Contracts
- Updated Estimates In each period
- Appropriate release to CSM vs P&L vs OCI
- Rollforwards and calculation of Liability
- Presentation and Disclosures

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

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

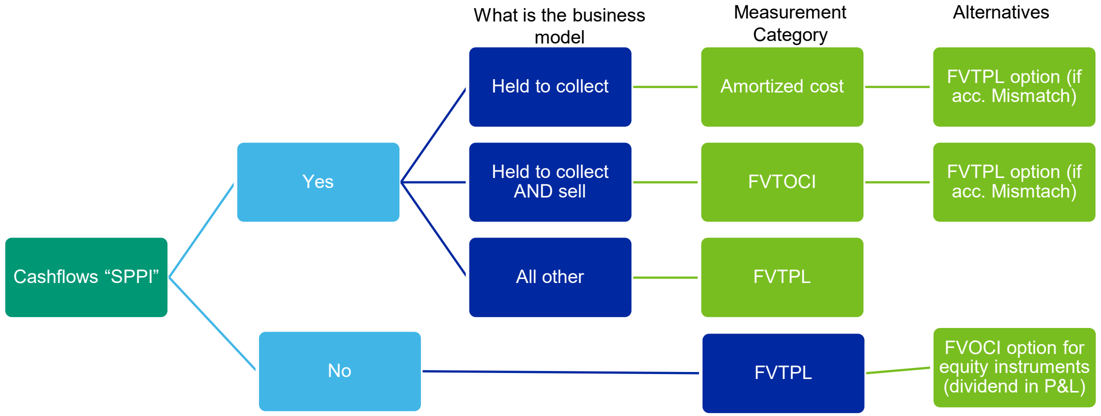
New Allowance Standards

IFRS9 and CECL standard – Asset Side Impact

Classification and measurement

Impairment

General hedge accounting



New Allowance Standards

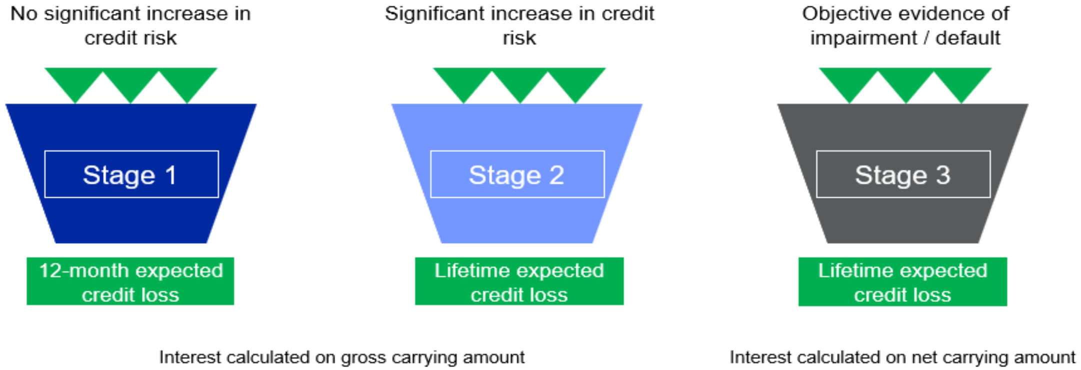
IFRS9 and CECL standard – Asset Side Impact

Classification and measurement

Impairment

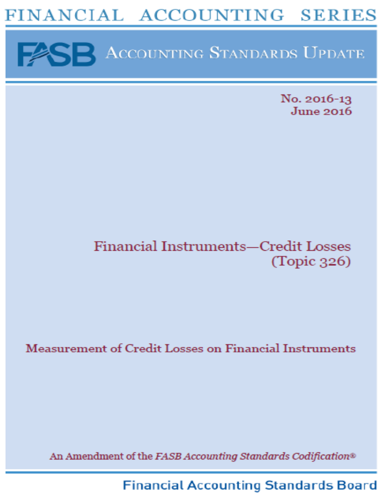
General hedge accounting

Expected Credit Loss Model



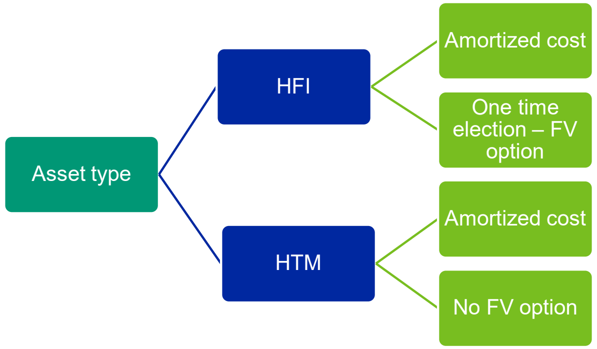
New Allowance Standards

IFRS9 and CECL standard – Asset Side Impact



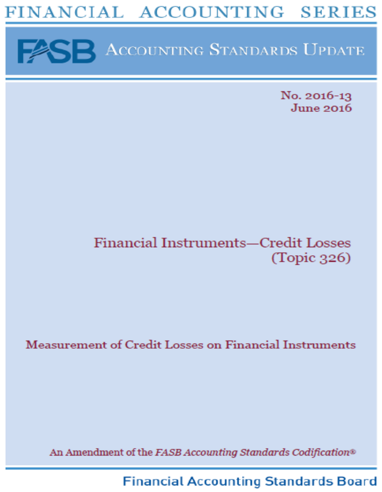
In Scope	Out of Scope
• Loans • Trade receivables • Debt securities classified as held-to-maturity • Loan commitments • Financial guarantee contracts not accounted for as insurance • Net investment in leases recognized by a lessor • Reinsurance receivables	• Equity instruments • Debt securities classified as available-for-sale* • All financial instruments measured at fair value through net income • Loans and receivables between entities under common control

Expected Credit Loss Model



New Allowance Standards

IFRS9 and CECL standard – Asset Side Impact



In Scope

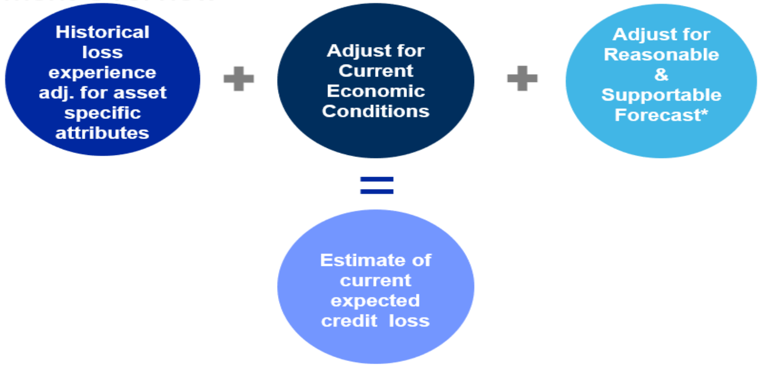
- Loans
- Trade receivables
- Debt securities classified as held-to-maturity
- Loan commitments
- Financial guarantee contracts not accounted for as insurance
- Net investment in leases recognized by a lessor
- Reinsurance receivables

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

Expected Credit Loss Model

Measurement Overview



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

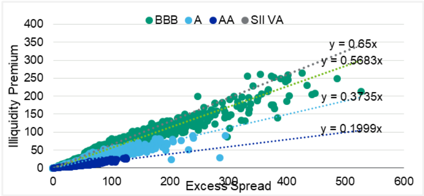
- Classification and separation of Insurance Contract aspects
- Grouping of insurance contracts and alignment with assets backing
- Discount Rate + Illiquidity Premium

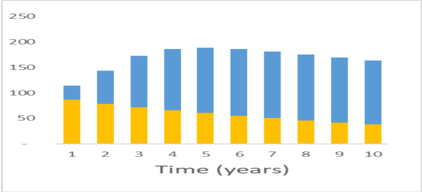
… …

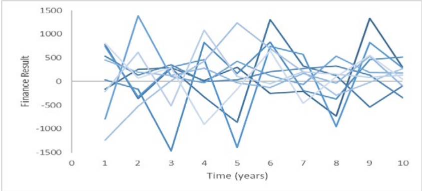
IFRS 9 / CECL

- 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



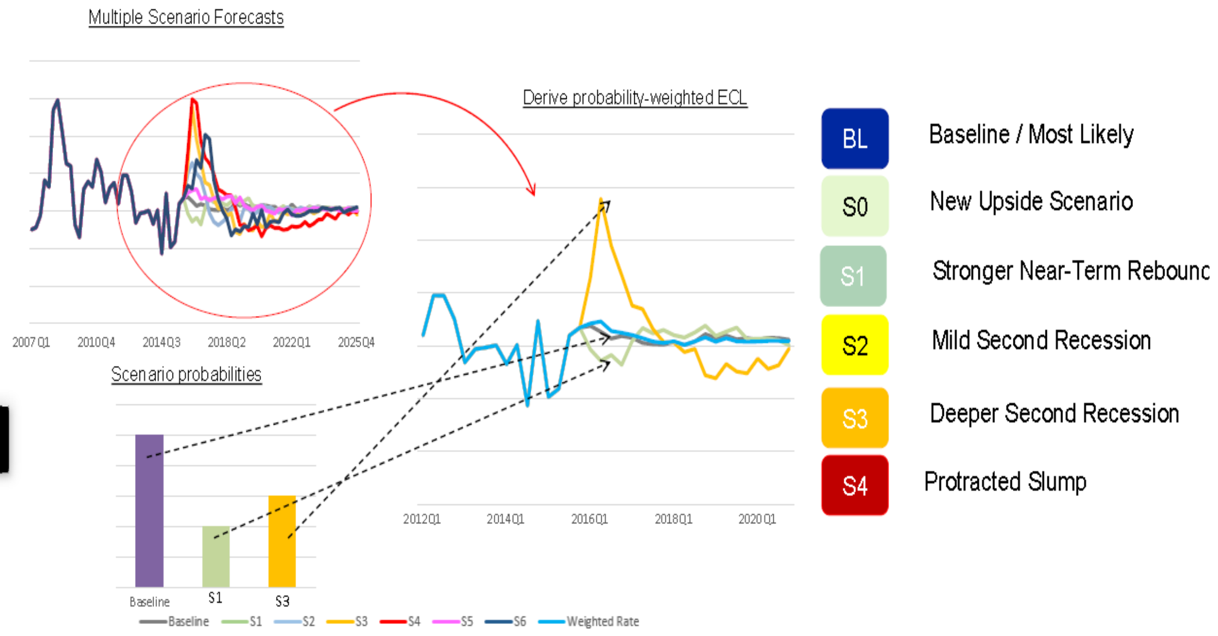




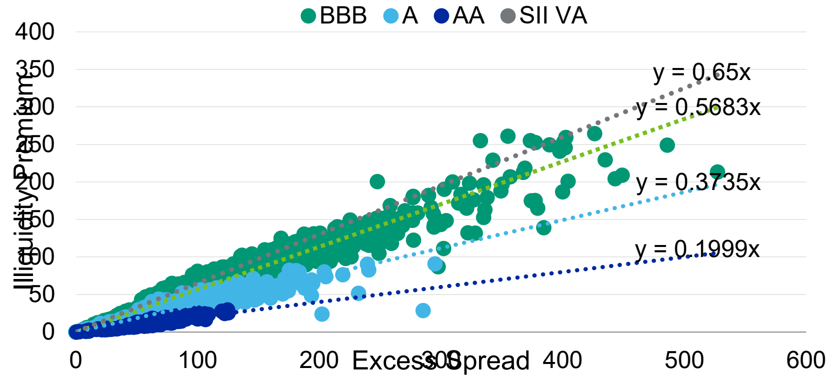
Impact of Economic Assumptions

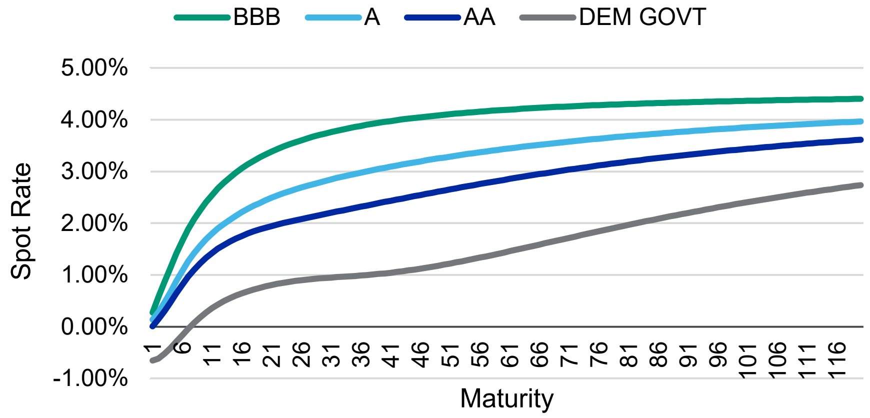
Macroeconomic Scenarios

Probability-weighted expected loss



Discount Rate and Illiquidity Premium Modelling





Impact of Discount Rate Assumptions

Profit Emergence Pattern

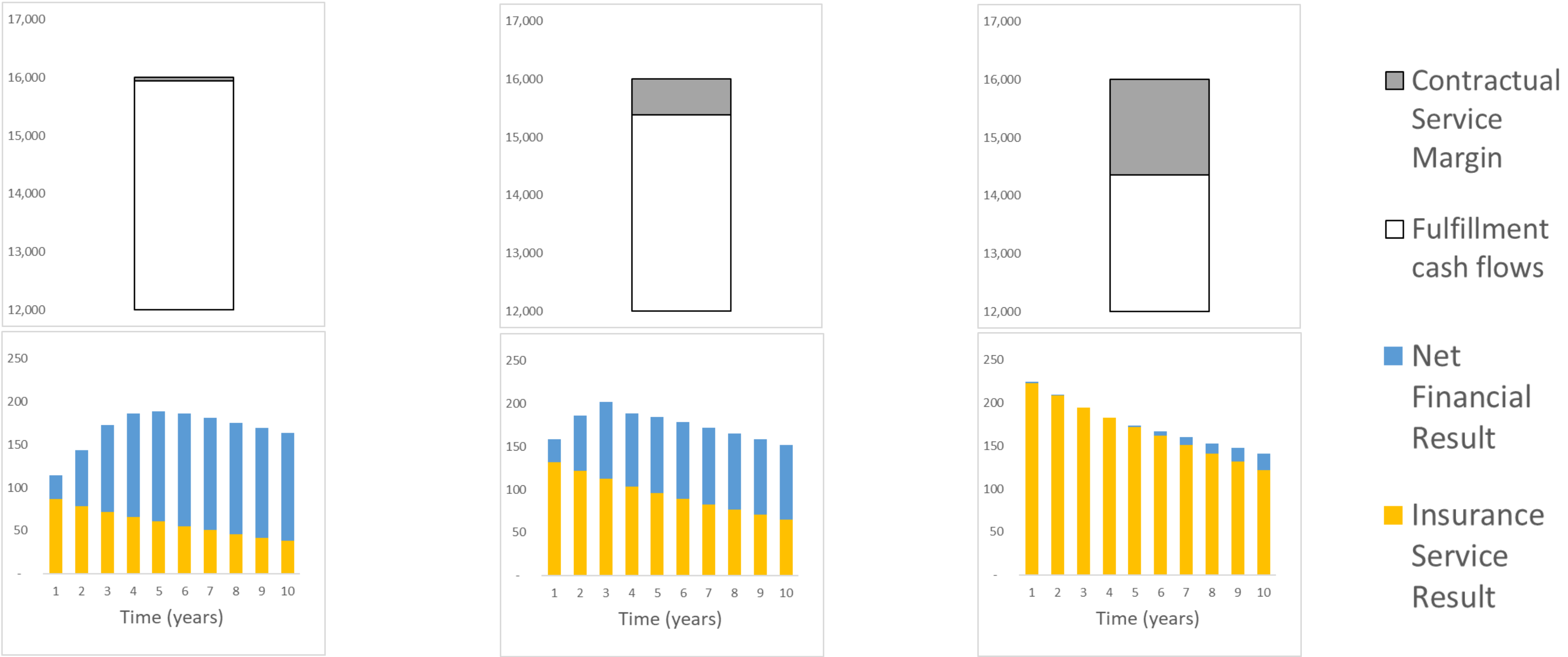
(1) Liability discount rate = Risk-free rate

(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

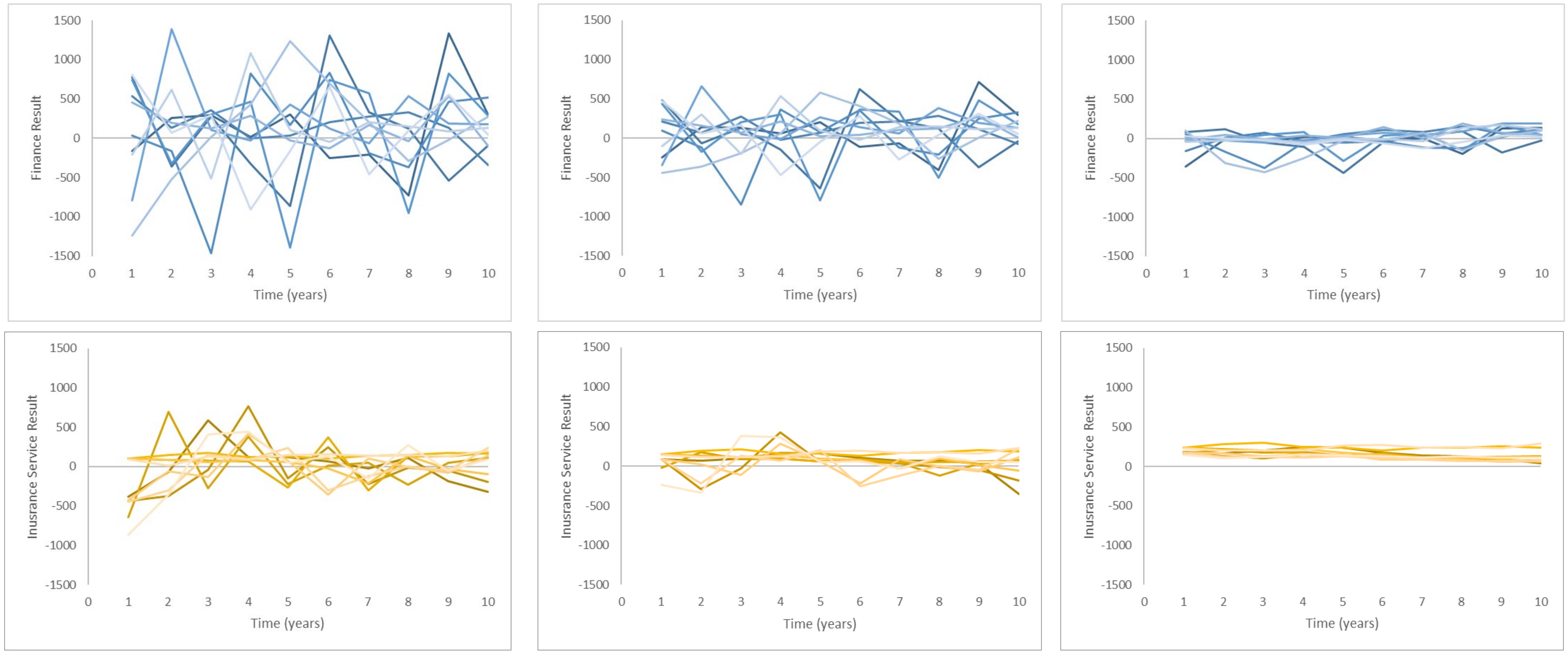
Liability discount rate = Risk-free rate

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 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

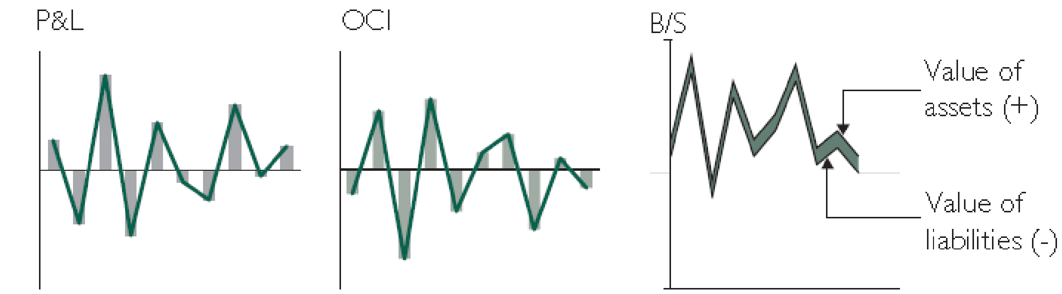


Fig.2

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

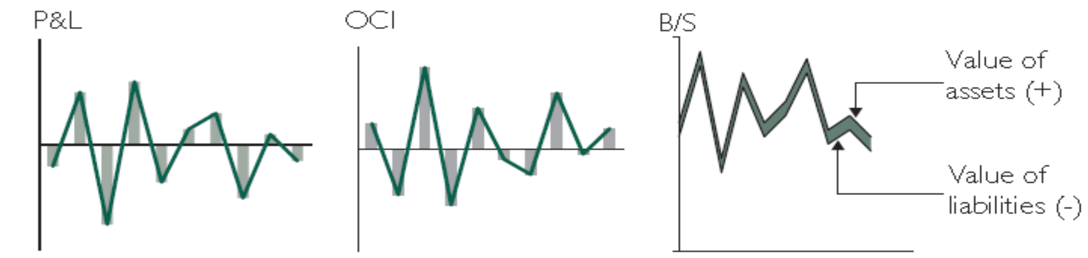


Fig.3

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

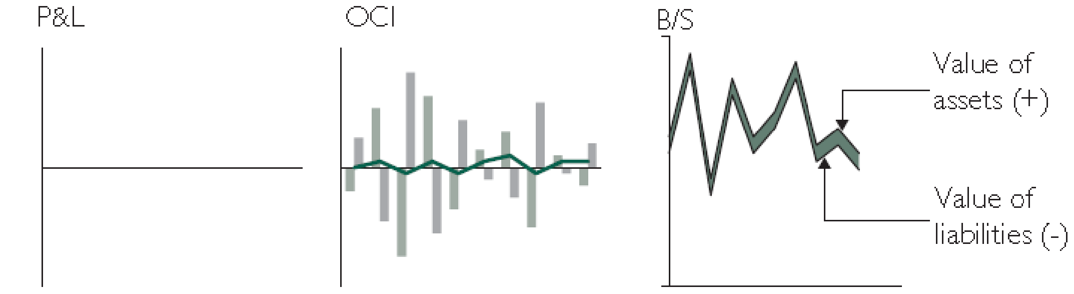
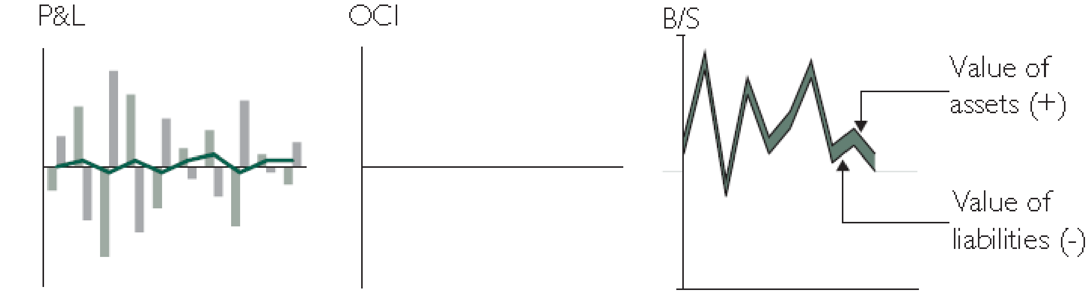


Fig. 4

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



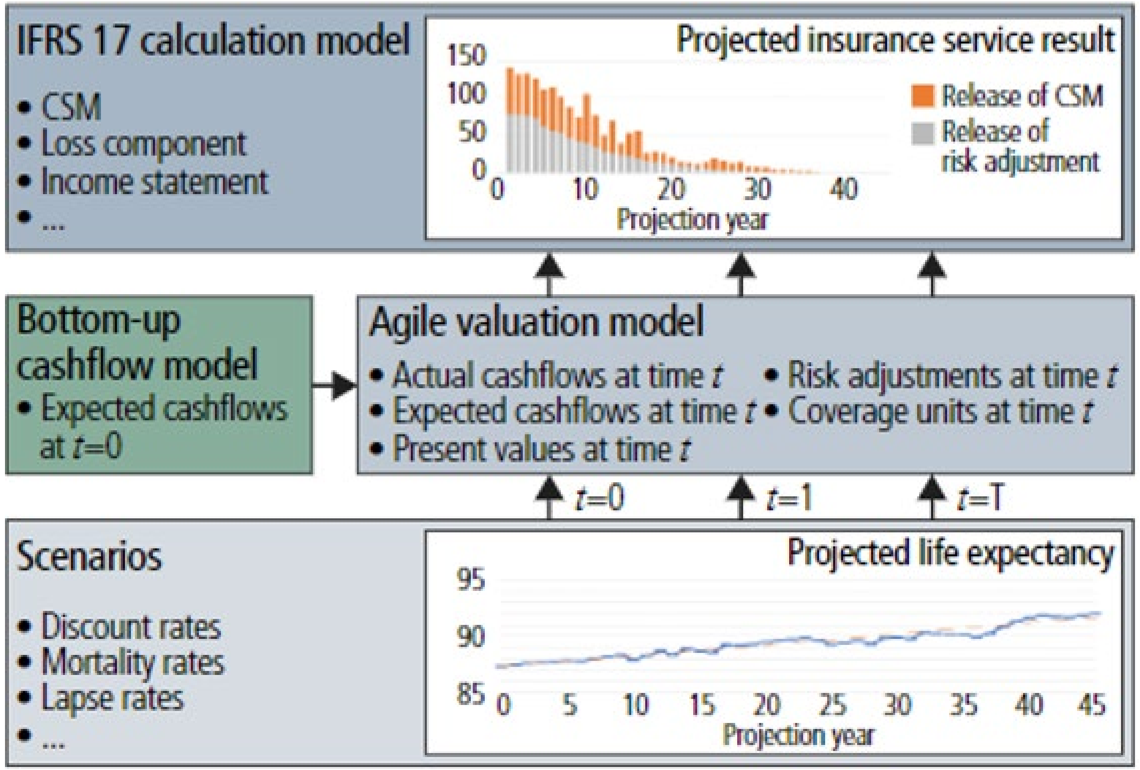
Source: IFRS17 and IFRS9: Bridging the Gap, Bhana and Schaeffer Deloitte

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

3 | Implementation Considerations

Broad Implications of CECL and IFRS9

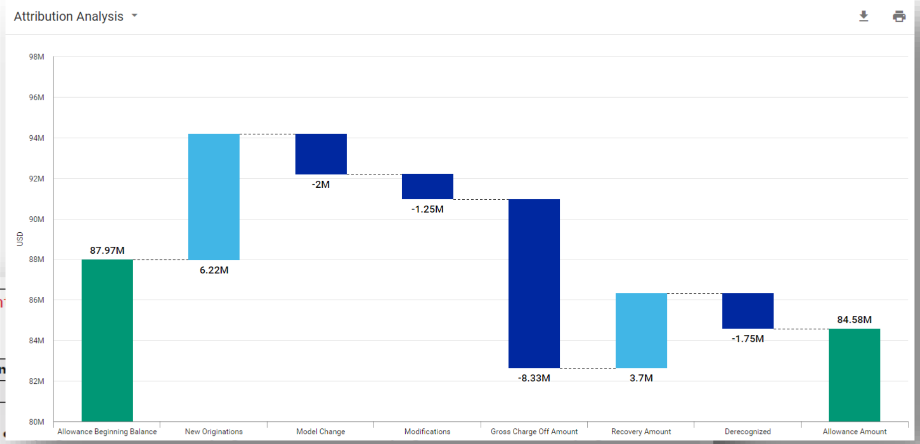
IFRS 9

- 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

Waterfall Reconciliation



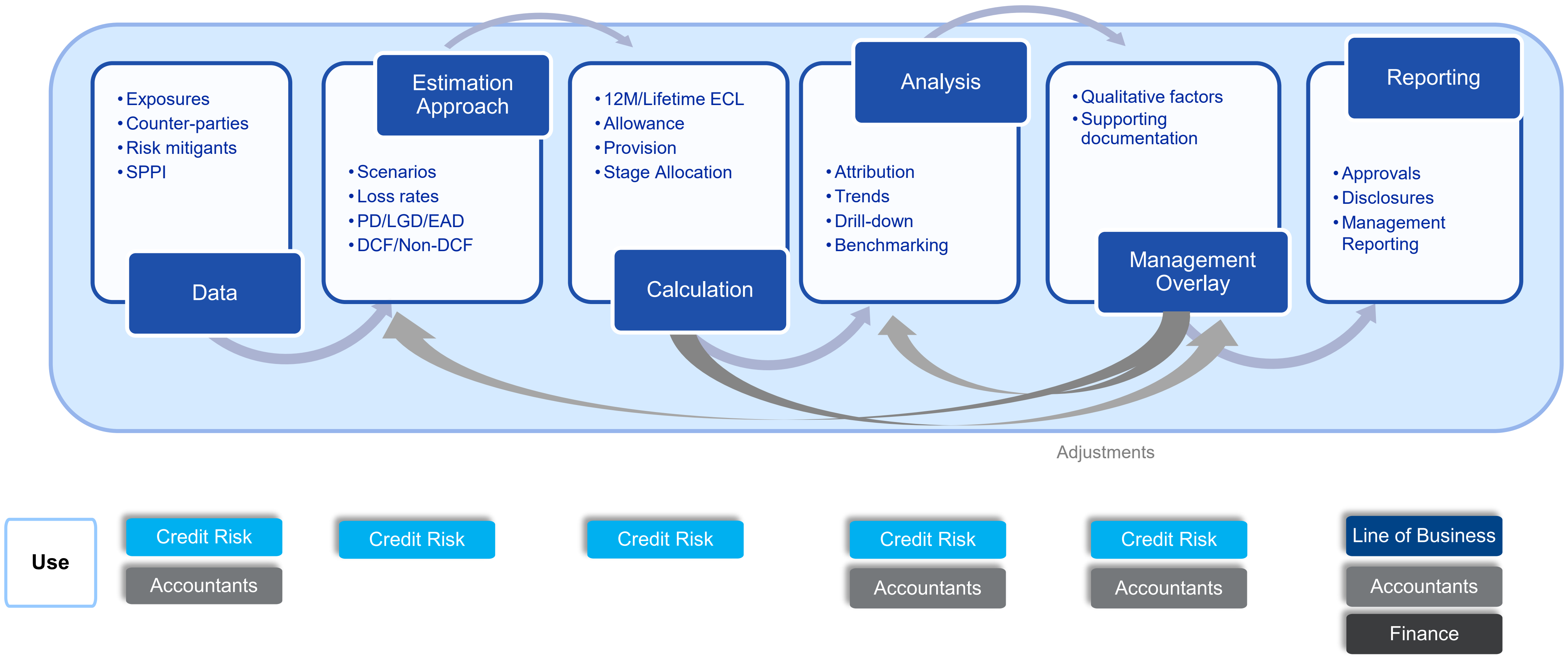
Reconciliation of changes in gross carrying/nominal amoun loan commitments and financial guarantees[8]

(Audited)

	Non-credit in									
	Stage 1									
	Gross carrying/ nominal amount	Allow-ance for ECL	nominal amount	ance for ECL	nominal amount	ance for ECL	nominal amount	ance for ECL	nominal amount	ance for ECL
	$m	$m	$m	$m	$m	$m	$m	$m	$m	$m
At 1 Jan 2018	1,446,857	(1,469)	102,032	(2,406)	15,083	(5,722)	1,042	(242)	1,565,014	(9,839)
Transfers of financial instruments:	(8,747)	(685)	3,582	1,185	5,165	(500)	–	–	–	–
– transfers from stage 1 to stage 2	(84,181)	319	84,181	(319)	–	–	–	–	–	–
– transfers from stage 2 to stage 1	77,325	(999)	(77,325)	999	–	–	–	–	–	–
– transfers to stage 3	(2,250)	35	(4,439)	607	6,689	(642)	–	–	–	–
– transfers from stage 3	359	(40)	1,165	(102)	(1,524)	142	–	–	–	–
Net remeasurement of ECL arising from transfer of stage	–	620	–	(605)	–	(103)	–	–	–	(88)
Net new and further lending/repayments	126,868	(512)	(16,162)	564	(2,902)	733	(587)	42	107,217	827
Changes in risk parameters – credit quality	–	423	–	(1,087)	–	(2,238)	–	(51)	–	(2,953)
Changes to model used for ECL calculation	–	–	–	–	–	–	–	–	–	–
Assets written off	–	–	–	–	(2,568)	2,552	(1)	1	(2,569)	2,553
Foreign exchange	(52,983)	76	(2,863)	99	(636)	232	(26)	6	(56,508)	413
Others	(156)	98	(348)	(28)	90	(89)	(94)	50	(508)	31
At 31 Dec 2018	1,511,839	(1,449)	86,241	(2,278)	14,232	(5,135)	334	(194)	1,612,646	(9,056)
ECL release/(charge) for the period		531		(1,128)		(1,608)		(9)		(2,214)
Recoveries										408
Others										(87)
Total change in ECL for the period										(1,893)

Target Operating Model for IFRS9/CECL

Connecting the Accounting and Credit Risk worlds



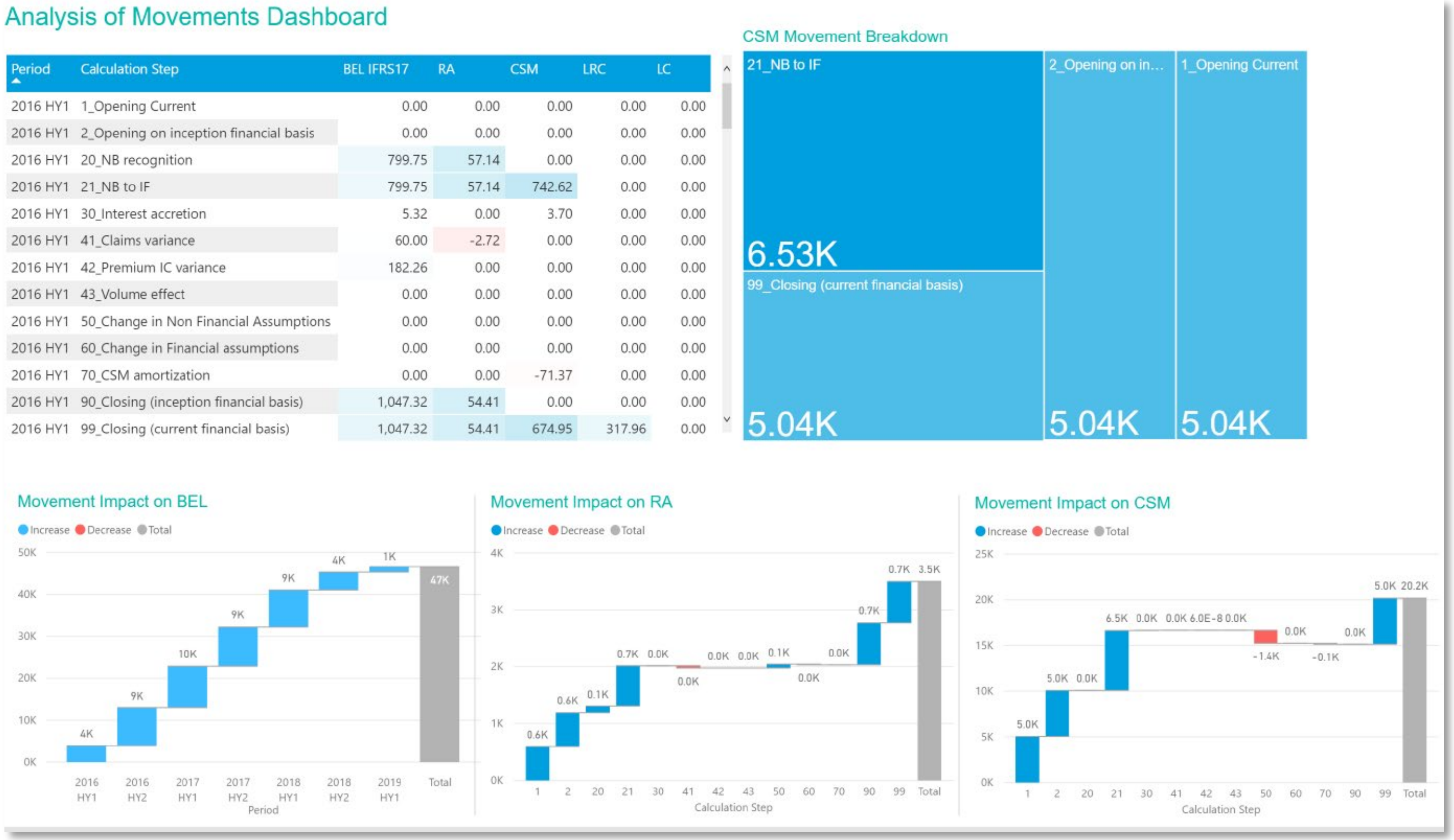
Broad Implications of IFRS 17 and LDTI

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

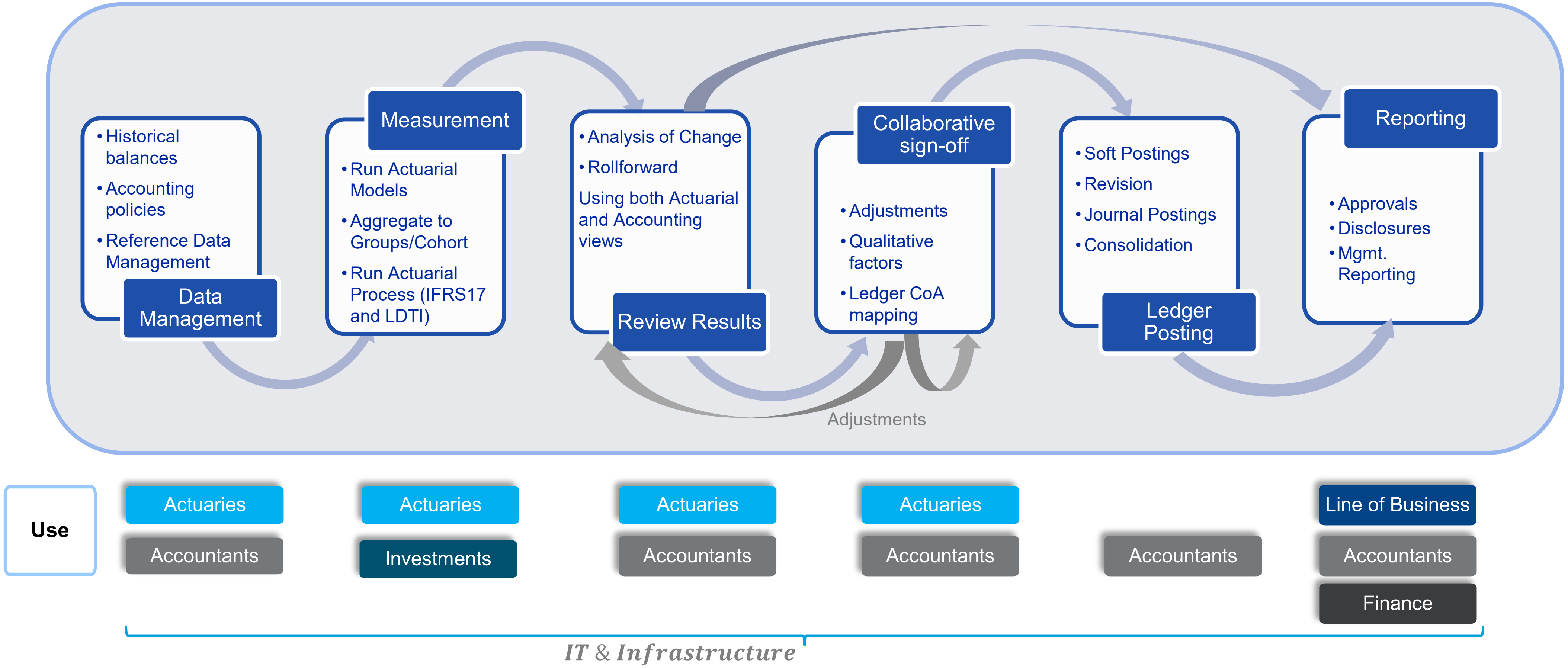
- New cohort level calculations
- Historic data input
- Unlocking by cohort
- New DAC, Discount Rate, MRB
- Income components from revaluations
- Components for expanded disclosures



Period	Calculation Step	BEL IFRS17	RA	CSM	LRC	LC
2016 HY1	1_Opening Current	0.00	0.00	0.00	0.00	0.00
2016 HY1	2_Opening on inception financial basis	0.00	0.00	0.00	0.00	0.00
2016 HY1	20_NB recognition	799.75	57.14	0.00	0.00	0.00
2016 HY1	21_NB to IF	799.75	57.14	742.62	0.00	0.00
2016 HY1	30_Interest accretion	5.32	0.00	3.70	0.00	0.00
2016 HY1	41_Claims variance	60.00	-2.72	0.00	0.00	0.00
2016 HY1	42_Premium IC variance	182.26	0.00	0.00	0.00	0.00
2016 HY1	43_Volume effect	0.00	0.00	0.00	0.00	0.00
2016 HY1	50_Change in Non Financial Assumptions	0.00	0.00	0.00	0.00	0.00
2016 HY1	60_Change in Financial assumptions	0.00	0.00	0.00	0.00	0.00
2016 HY1	70_CSM amortization	0.00	0.00	-71.37	0.00	0.00
2016 HY1	90_Closing (inception financial basis)	1,047.32	54.41	0.00	0.00	0.00
2016 HY1	99_Closing (current financial basis)	1,047.32	54.41	674.95	317.96	0.00

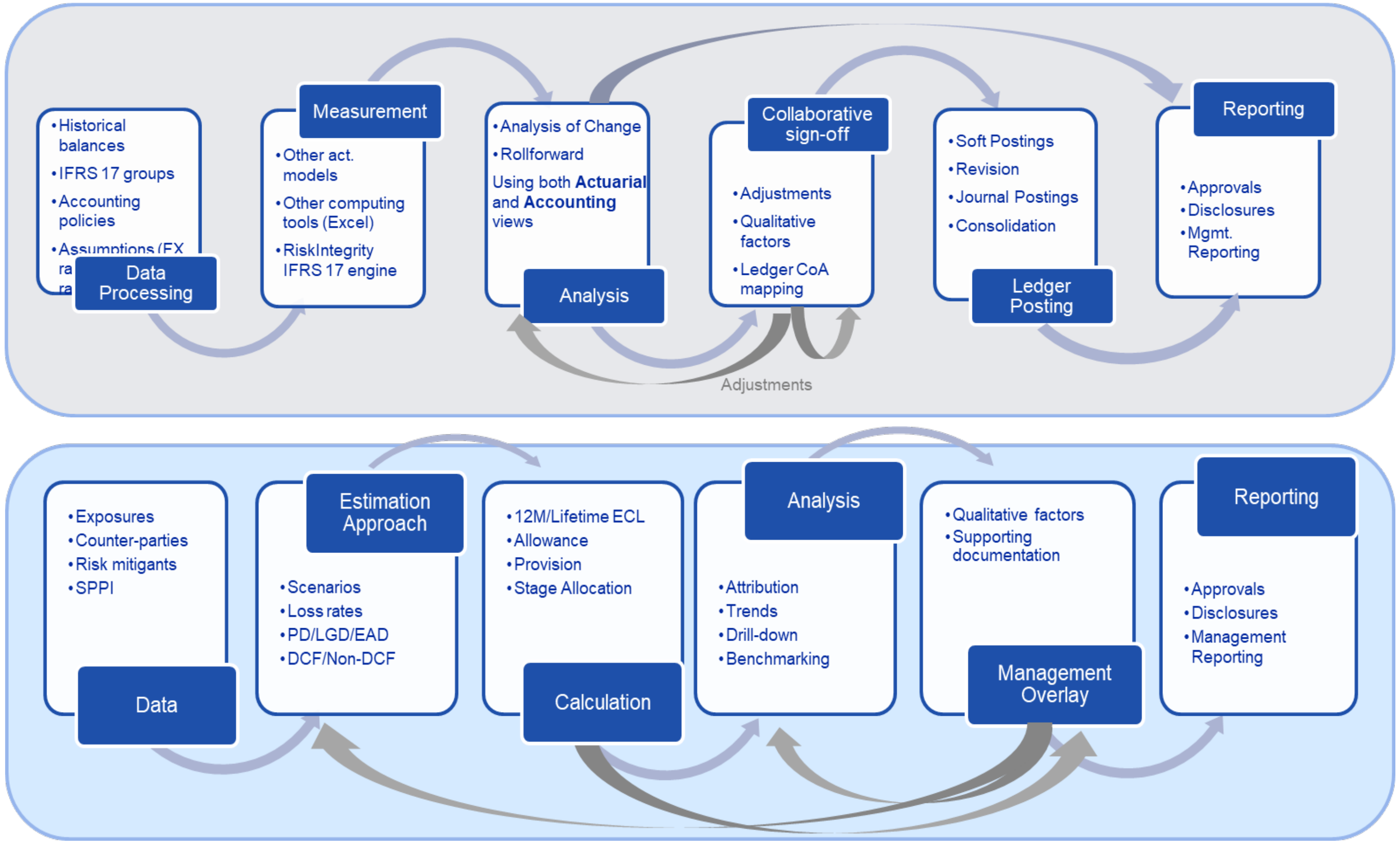
Target Operating Model for LDTI/IFRS

Connecting the Accounting and Actuarial worlds



Aligning Target Operating Models

Alignment of assumptions across the balance sheet



Systems Architecture - Synergies

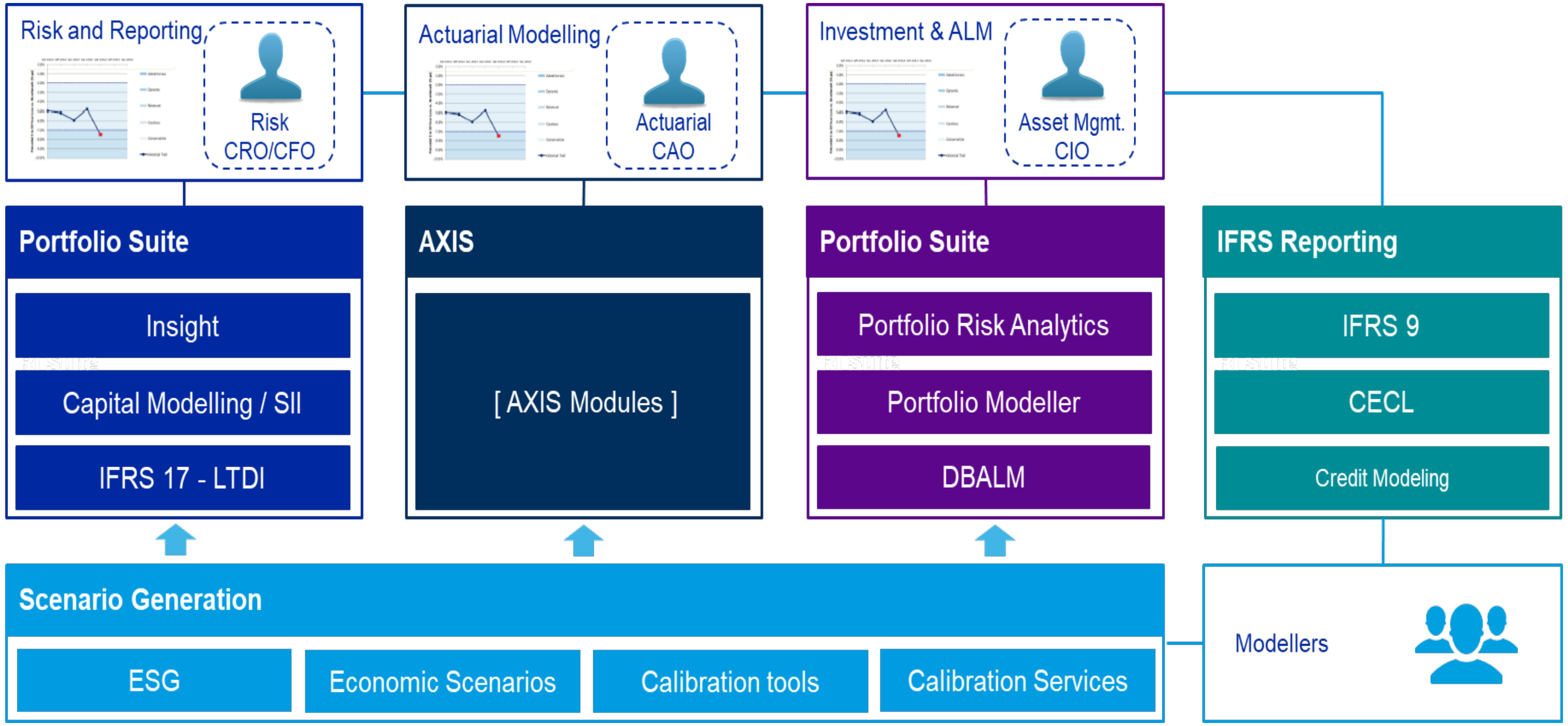
Resource optimization

Consistency of assumptions and optionality

Implementation Considerations & Transition choices

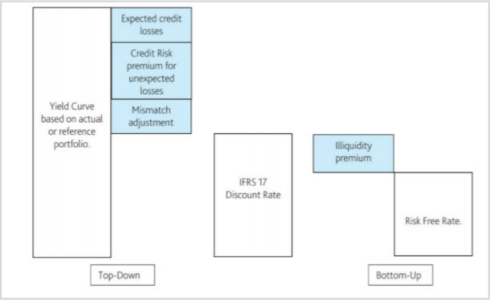
Our Focus Areas

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

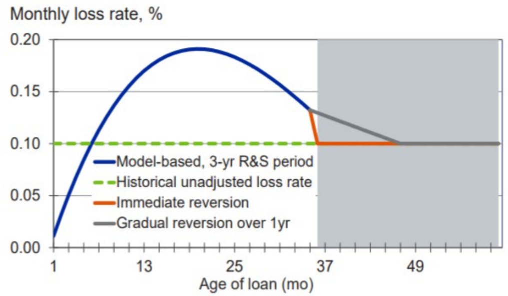


Moody's Analytics Thought Leadership

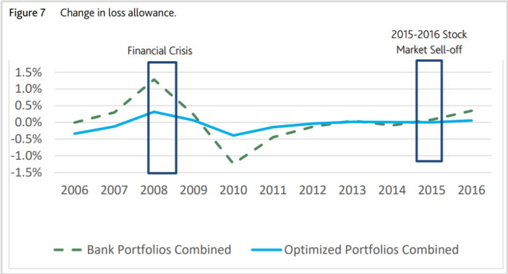
[Profit emergence under IFRS 17]



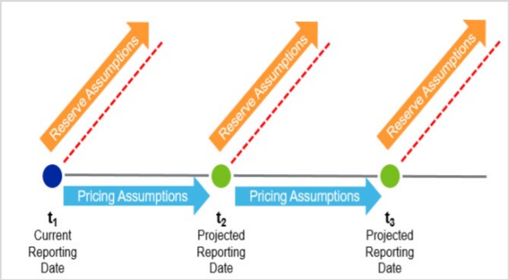
[Permitted approaches for constructing IFRS 17 Discount Rates]



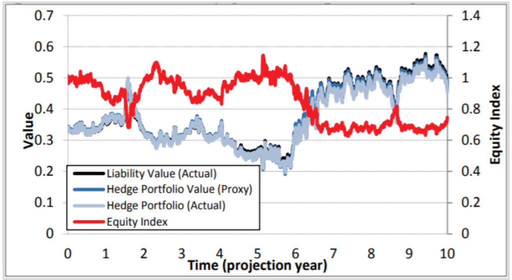
[Reasonable and supportable forecast from principle to practice]



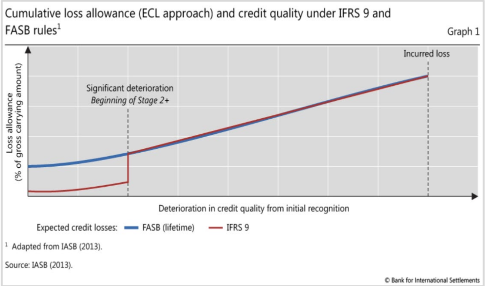
[Earnings Volatility, Share Price Performance, and Credit Portfolio Management Under CECL and IFRS 9]



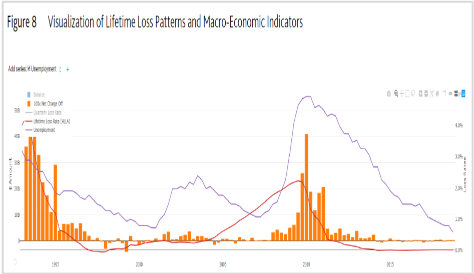
[Managing assumptions for BEL under US GAAP LDTI]



[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:
[Quant Research site]
[IFRS17 and LDTI leadership site]

Available at:
[IFRS9 site]
[CECL Leadership site]

Questions and Answers

Moody's ANALYTICS

Better Faster Decisions

Laurent Birade
Senior Director
Laurent.Birade@Moodys.com
+1 (212) 553-3914

Srini Iyer
Senior Director
Srinivasan.Iyer@Moodys.com
+1 (212) 553-5930

Appendix