IFRS 17 & 9 – Keeping the end goal in mind

Keeping the end goal in mind – from a Business, an Audit and Investor perspective

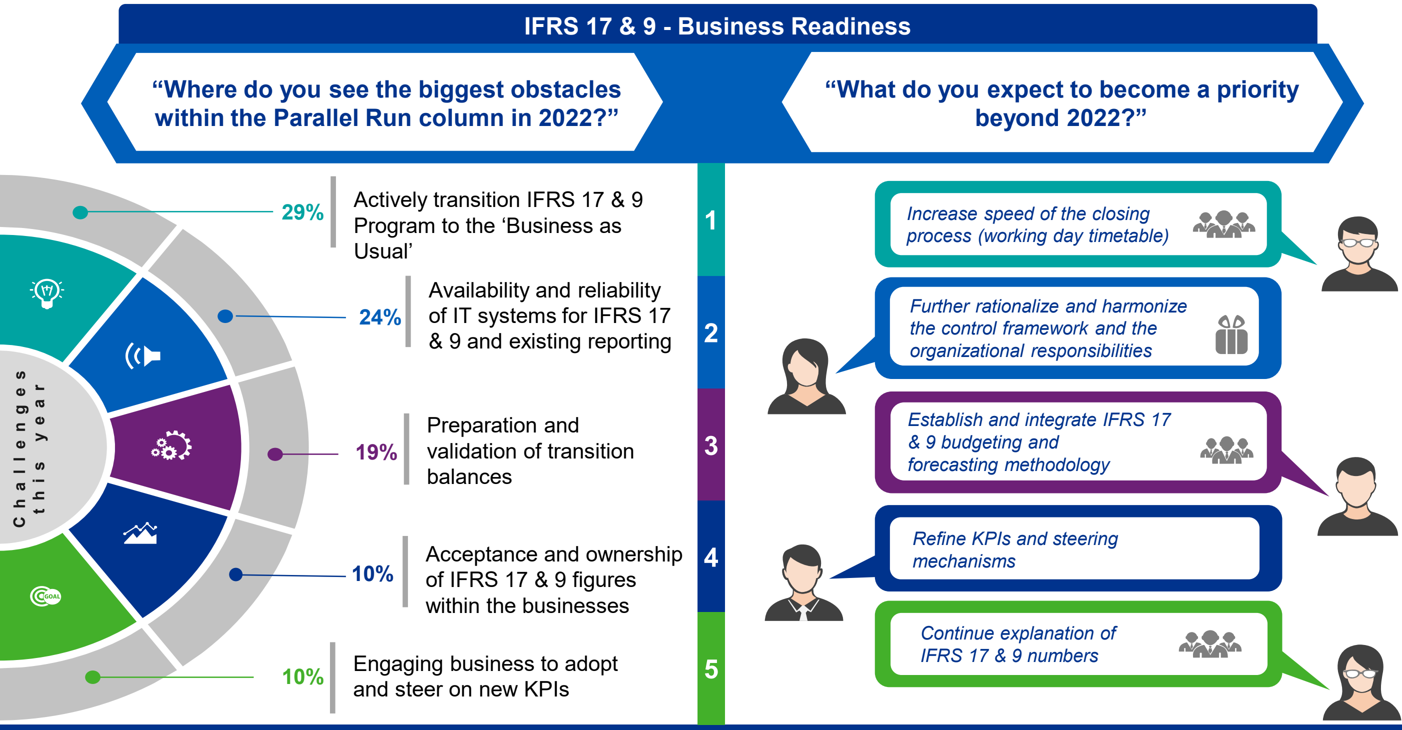
For the past few years, insurance companies across the world have been busy designing, implementing and updating systems and metrics in order to produce their first IFRS 17 & 9 figures. With Dry Runs and the current Parallel Run experiences fresh in mind they are transitioning towards an entirely new reporting standard in a 'Business as Usual' situation.

However, the closer insurance companies get to finalizing the implementation, the more complex the remaining challenges become, because previous decisions based on conceptual considerations are now becoming more tangible as real data is becoming available. Most insurance companies have also arrived at the stage where they are actively discussing their methodological decisions with their auditors. Not a moment too soon, since the Opening Balances per 1 January 2022 form an integral part of the first Financial Statements under IFRS 17, effective for periods beginning on or after 1 January 2023. While technical professionals continue to discuss the intricate details of the methodology, we were curious to learn whether shareholders, amongst other users of the financial statements, would be able to understand and appreciate the final methodology choices. Or to put it in another way: are insurance companies prepared to explain to investors what the consequences are from IFRS 17 for their equity story in a clear and transparent way?

In discussion with the insurance companies

On 2 March, 2022, KPMG hosted a round table, which included Finance and IFRS program representatives of the largest Dutch insurance companies. During the round table we had two main discussion topics: 1) Business and audit readiness for reporting under IFRS 17 & 9, and 2) The investor's point of view and their expectations regarding IFRS 17 & 9.

The figure below reveals that insurance companies, based on a limited benchmark, are focused on getting operational processes prepared for IFRS 17 & 9, and expect to continue optimizing these processes well beyond 2022. But as much as this is important from a compliance point of view, the question arises whether this has the most impact on the outside world, keeping the end goal in mind.



IFRS 17 & 9 - Audit Readiness

Prepare for auditable disclosures

Keeping the end goal in mind also means being ready for the Audit, centered specifically around three key questions: 1) what information are insurance companies going to publicly disclose, 2) when are they going to do so and 3) what is included in the audit scope? The figure below describes in high-level terms what considerations insurers are facing now and in the near future.

FY 2021

- Qualitative disclosures; '*Limited information on quantitative impacts, describing impact qualitatively*'

FY 2022

- Quantitative disclosures (interim reporting and/or financial statements); potentially
  - Opening equity 1/1/2022
  - Results 2022
  - Closing equity
  - OBS
  - Other metrics / bridges

FY 2023

- Interim Reporting on IFRS 17 & 9, including first time application impact, etc.
- Financial statements 2023 on IFRS 17 & 9, including third balance sheet and restated comparative figures

Analyst briefings / capital market days

Disclosure roadmap

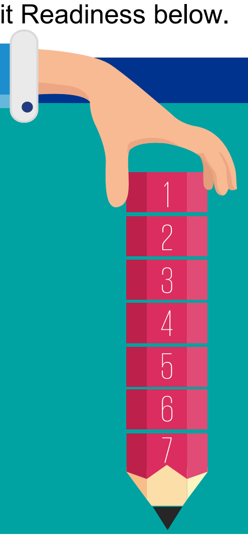
Increasing Auditor involvement

The disclosure roadmap is an essential tool for Audit Readiness

During the round table discussion there was a clear consensus amongst the insurance companies: there is close to zero additional time available to overhaul and rethink implementation of major methodology decisions. There is some wiggle room for finetuning here and there, but generally speaking most insurance companies are locked regarding their IFRS 17 & 9 methodology decisions.

The preparation and use of a disclosure roadmap could play an essential part in timely addressing key decisions and considerations to the stakeholders. For example, by identifying and actively communicating to the auditor when the point of no return is reached for important decisions, the risk of late audit findings can be reduced. On this topic, we present seven key focus areas from our experience that can help prepare for Audit Readiness below.

Key focus areas for Audit Readiness



1. Develop a disclosure roadmap
2. Discuss detailed planning and audit approach with the auditor
3. Involve staff experienced in auditor interaction during the financial close process
4. Incorporate 2nd and 3rd line in the audit approach
5. Agree with the auditor on key accounting policy choices
6. Provide insights into simplifications & practical expedients
7. Anticipate audit findings

Present complex numbers without getting lost in details

Ultimately, the question remains how these decisions resonate with the financial markets. During the round table it was noted that only after the implementation of Solvency II, have investors been able to better appreciate insurers' reporting figures. This is clearly visible in the higher performance of insurance stock since the introduction. This demonstrates investors need for insurance companies to clearly bridge the gap between Solvency II and IFRS 17 so that investors can relate to the numbers easily and with confidence.

IFRS 17 & 9 – An investor's outside-in view

An investors point of view on IFRS 17 & 9: where are the numbers?

So, when keeping the end goal in mind, it is important to understand the investor's point of view. During the round table discussions, we noticed some conformity but also surprising differences between what insurance companies think investors want, and what the investors say they actually need.

Point of view of insurers versus investors

- Both insurers and investors expect Solvency II capital generation for the time being to remain dominant over IFRS capital generation as an important metric for investors' understanding of insurance companies' dividend capacity. Likewise, there is agreement that investors will be interested in IFRS 17 numbers before go live in 2023. Surprisingly, however, most insurers have not yet provided, and likely will not provide, IFRS 17 numbers before the end of 2022, since their first priority is getting the implementation completed. For investors this is a disadvantage, since they will need to get their heads around the new figures in a very short period of time and pass judgement on valuations with insufficient understanding.
- Investors prefer a limited set of key figures over extensive disclosures. Many investors find insurance disclosures very hard to follow and too opaque. Insurers should be careful not to add too many metrics. Investors care about the CSM but will need to learn from an Equity story perspective how to translate complex assumptions into cash projections and dividend expectations.

Ultimately, investors are attracted to healthy returns. IFRS 17 has the risk of making insurance companies less transparent to investors than was already the case. This in turn may lead to a further increase in Cost of Equity and limit the clarity of the investment case for investors. A way to turn this risk into an opportunity is by providing clear and concise information about the most important underlying assumptions used, and what the accounting numbers actually mean. Some concerns of investors discussed during the round table are described below.

Turning reporting risks into investment opportunities

01 **Volatility reduces predictability**

Investors like the insurance market because of its predictability. IFRS 17 creates increased volatility in the P&L, reducing investor's much liked predictability of the sector

02 **Complexity reduces visibility**

The introduction of IFRS 17 makes it increasingly difficult for investors to relate reported earnings to cash, potentially negatively affecting dividend predictability

03 **Lack of guidance with increased flexibility**

As an outsider, investors note a lack of guidance and disclosure from insurers. Given the additional room for (mis)interpretation of the assumptions it is hard for investors to anticipate the impact of changes

04 **Need to improve assumption disclosure and comparability**

Operational capital generation disclosures will not provide sufficient additional disclosures to bridge the gap from IFRS accounts to cash / remittances and dividends without improving the disclosure and comparability around assumptions as well

05 **Keep it rational**

Ultimately, IFRS 17 changes the accounting in regard to the timing of profit recognition. The insurance companies need, therefore, make it clear to the market that this should not affect total profits over time

Left with questions or simply captivated and interested to learn more? Feel free to contact:

Paul Rothwell – Partner
E: Rothwell.paul@kpmg.nl
P: +31 6 8208 3708

Frank van den Wildenberg – Partner
E: Vandenwildenberg.frank@kpmg.nl
P: +31 6 5157 3332