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Pay attention to the fine print: an assessment of the true comparability of IFRS 17 Insurance Contracts disclosures

For most of human history timekeeping was a localised phenomenon. However, while the expansion of long-distance railway transportation during the late nineteenth century resulted in faster travel times, each town or city keeping to its own individual local time created significant scheduling confusion. It was clear that some form of standardisation was necessary to address this confusion. In 1878, Sir Sanford Fleming proposed the concept of dividing the world into equal time zones. The rest, as they say, is history – although it is not quite as tidy as it seems.

The concept of the time zone was revolutionary. It had simplified and structured something chaotic, but it was not implemented strictly as planned. Rather than the perfectly equidistant twenty-four time zones envisaged, the resultant patchwork of zig-zagged lines reflects an intricate puzzle of judgment and compromise developed over time, to suit the commercial and political interests of each country.

You may be asking what this has to do with insurance and, in particular, insurance accounting. In much the same way as each town and city set its clocktower to twelve with the midday sun, *IFRS 4 Insurance Contracts* (IFRS 4) allowed companies to, individually, largely account for insurance contracts as they saw fit. This resulted in the adoption of disparate accounting policies, with insurers publishing results that were difficult for stakeholders to meaningfully compare. Just as the proposal for worldwide standard time emerged to reduce the confusion resulting from a non-uniform system, the development of *IFRS 17 Insurance Contracts* (IFRS 17) sought to establish a consistent set of principles for the recognition, measurement, presentation and disclosure of insurance contracts with the ambition of enhancing comparability of financial statements for insurers.

While IFRS 17 has set a structure for improved alignment in reporting, it has not yet resulted in a perfect situation where every company's results are directly comparable. Detailed elements of judgement and slight but material differences in disclosure require a more detailed interpretation by users of the accounts than expected.

In this analysis, six of the large listed South African financial services groups with exposure to the life insurance market have been considered.

We focussed our analysis on life insurance business accounted for under the general measurement model (GMM) from each company's 2024 financial year-end disclosures (a mix of June and December year-ends). Particular attention has been paid to the following three seemingly directly comparable disclosure notes common to all insurers with GMM business:

01 The impact of contracts initially recognised in the period (as required by IFRS 17.107)

02 The recognition of CSM in profit/loss for insurance contracts issued (as required by IFRS 17.109)

03 The sensitivity of the profit or loss and equity position to changes in risk variables arising on insurance contracts (as required by IFRS 17.128(a)(i))

Given the volume of detailed IFRS 17 disclosures provided (particularly compared to those provided under IFRS 4), it may be surprising that while directly comparing the results of the disclosure notes yields interesting insights, it is difficult to give a definitive interpretation given the allowable areas of judgement. This could lead to users of the financial statements lacking the necessary context to potentially draw incorrect conclusions when comparing insurers' results – in direct contrast to the stated intent of IFRS 17. Can industry therefore play a role to work on developing meaningful areas of alignment and reasonable compromise to improve the comparability of IFRS 17 results for users?

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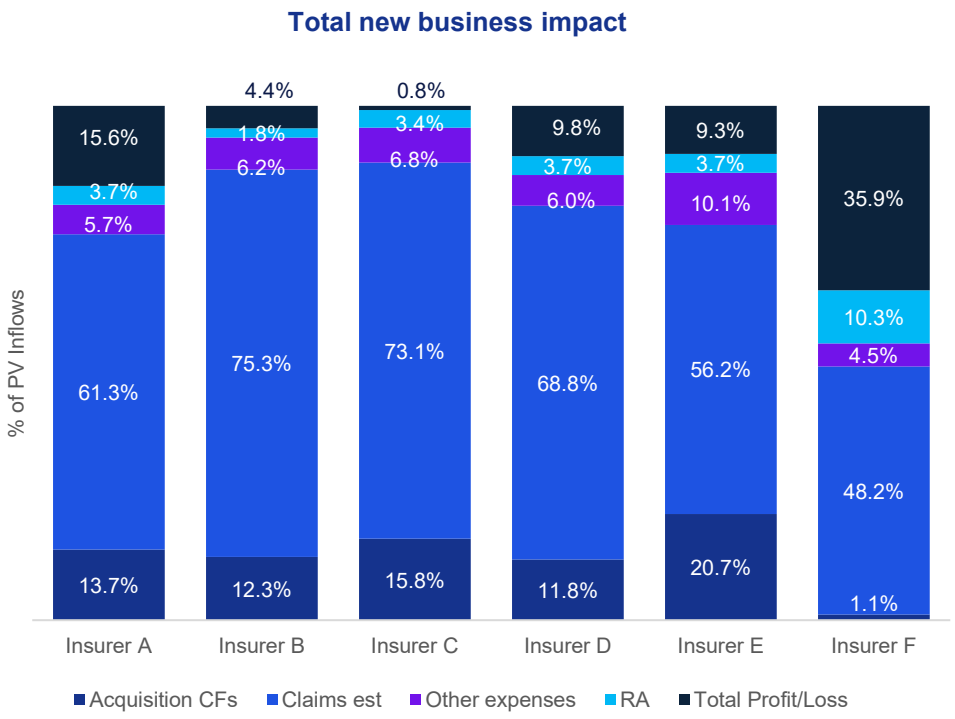
1. The impact of contracts initially recognised in the period

IFRS 17.107 requires the disclosure of the impact of contracts initially recognised in the period, split between contracts which were profitable and those which were onerous at initial recognition. In Graph 1, the sum of the impacts of profitable and onerous contracts is shown for the six entities analysed, with each component being expressed as a percentage of the present value (PV) of inflows.

This analysis represents how each Rand of premium expected to be earned from the policy is being allocated over its lifetime. An estimate has been made for the split of the claims and other expenses outgo for each insurer in an effort to more granularly reflect two large items which are grouped together in the IFRS 17 disclosure.

Graph 1: PV of outflows and margins expressed as a percentage of the PV of inflows for GMM life insurance business entered into in the 2024 financial year.



At a high-level, one can conclude that Insurer F sells the most profitable business per Rand overall, able to generate the highest margin in spite of a larger risk adjustment (RA) percentage, due to a significantly lower strain from acquisition costs attributable to insurance contracts and fundamentally generate a higher risk profit. Structurally, insurer F's results appear to be distinctly better than the other insurers. Insurer C on the other hand appears to be only marginally profitable at an overall level, with a combination of relatively higher acquisition costs and lower risk profit than the average. Beyond this high-level comparison, a definitive comparison is complicated by a number of complexities, split into themes in the following sections.

1.1 Differences in the type of business

The GMM business included by each insurer is heterogenous, with IFRS 17.96 presumably applied to aggregate the underlying portfolios of business disclosed as GMM. Little to no disclosure is provided regarding the split of business within the GMM disclosure. GMM business can include a range of products, from fully underwritten whole-of-life contracts to funeral business, life annuities or five-year guaranteed endowment contracts adjudged by the insurer to transfer significant insurance risk. Additionally, some insurers which sell funeral business may model these contracts under the premium allocation approach (PAA) rather than GMM which further complicates a direct comparison.

Taking into consideration the different policy characteristics, profit margins, contract boundaries, contract durations driven by expected lapses and maximum initial commission rules (significantly lower initial commission driving lower acquisition costs on life annuity business for instance), a more detailed insight into the split of each insurer's GMM portfolios would allow for more comprehensive analysis on the relative performance of each entity for the same class of business.

Given the difficulties in comparing the results relative to other insurers, one may conclude that a better approach would be to compare new business results for the same insurer period-on-period, particularly as the volume of IFRS 17 results develops over time. Even within this analysis, certain complications arise, as outlined in the following section.

1.2 Year-on-year analysis

There may be movement in the year-on-year components of the PV of claims and other expenses outgo, RA or contractual service margin (CSM) relative to the PV of inflows for several reasons. Currently, companies have provided little to no disclosure or reconciliations to assist users of financial statements to understand the drivers of any such changes in their new business results period-on-period. Included below are some examples of the complexities inherent with a year-on-year analysis. We therefore caution basic, direct analysis without consideration of the underlying drivers impacting these results.

- While initial commission is typically driven by each policy's annual premium income (API), and other directly attributable overhead costs are unaffected by yield curve movements, a significant increase or fall in the yield curve used for discounting could result in acquisition costs rising or falling as a percentage of the PV of inflows.
- As discussed in section 1.1, changes to the underlying mix of GMM business may significantly change the relative level of profitability or risk adjustment, while significant changes in the volumes of business overall may drive changes in the economies of scale affecting profitability.
- Basis changes made over a period may explicitly impact the overall profitability of new business by affecting the expected future inflows or claims progression or there may be more implicit impacts driven by changes in internal overhead expense allocations, as an example.

1.3 Split between profitable and onerous business

Insurers are required to disclose a split of each of the components shown in Graph 1 for contracts which are profitable or onerous at initial recognition. This split is shown in Graph 2 and Graph 3. While on the face of it, it seems that some companies are writing larger volumes of onerous business, there are further specific elements to consider.

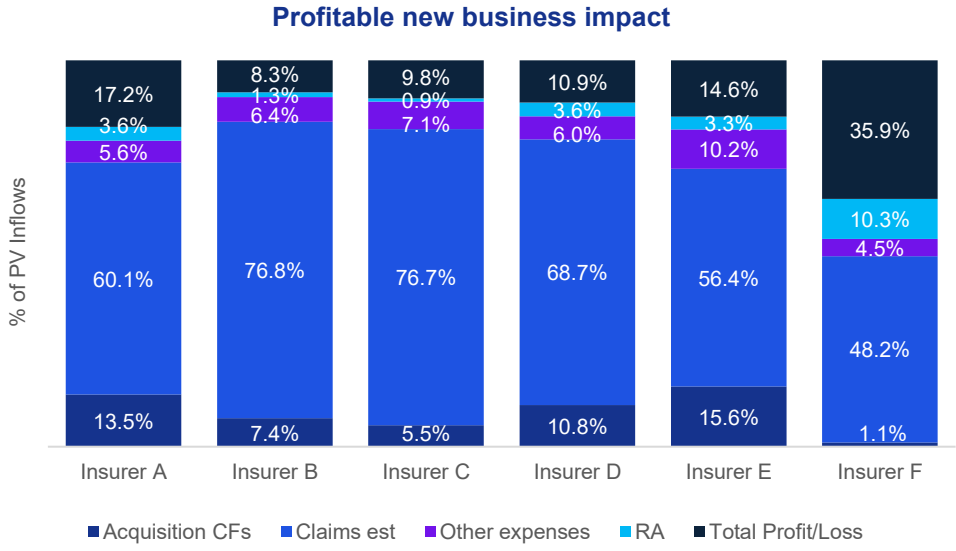
It can be seen in Graph 3 that Insurers B, C and E have acquisition costs which are a substantial proportion (>40%) of the PV of inflows on onerous policies, and the acquisition costs on onerous business for all insurers is larger than that observed on their profitable business[1].

[1] Note that Insurer F did not report any onerous contracts in the period

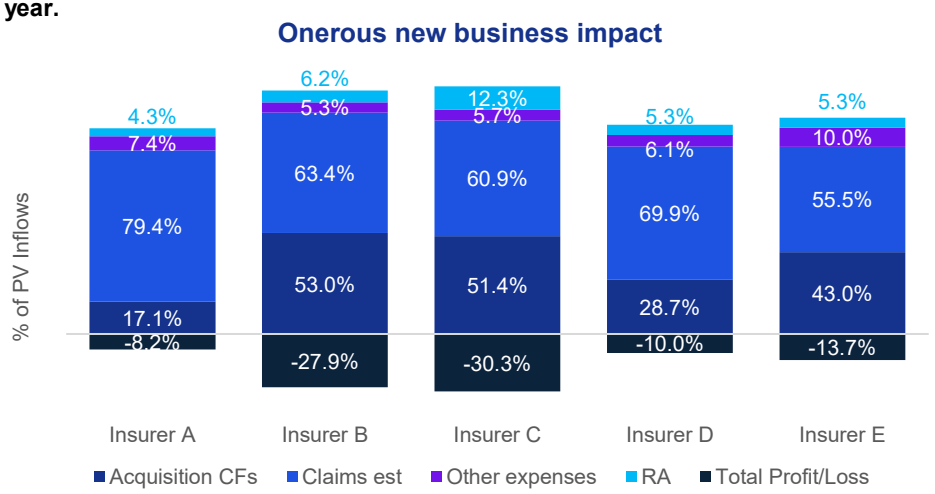
This could be driven by a number of factors:

- An insurer's internal allocation of fixed overhead costs directly attributable to new business can be a material driver of onerous business, and not all insurers disclose their expense allocation approach. Allocating a fixed amount to each policy can result in a larger volume of onerous business as smaller premium business and lower margin business carries a level of expense that was not taken into account in the pricing of these policies. Conversely, allocating these expenses in proportion to the size of the premium or PV of inflow will create greater alignment between profitable and onerous business. Given the divergence seen across the market, it is likely that insurers are following different approaches in practice.
- Initial commission is usually determined based on the API and consequently does not vary with the PV of inflows. For two contracts with the same API but different expected lapse and claims dynamics i.e. one contract has a shorter effective duration than another, the acquisition costs may reflect a larger proportion of the PV of inflows and this in turn may drive the onerous position of that contract.

Graph 2: PV of outflows and margins expressed as a percentage of the PV of inflows for profitable GMM life insurance business entered into in the 2024 financial year.

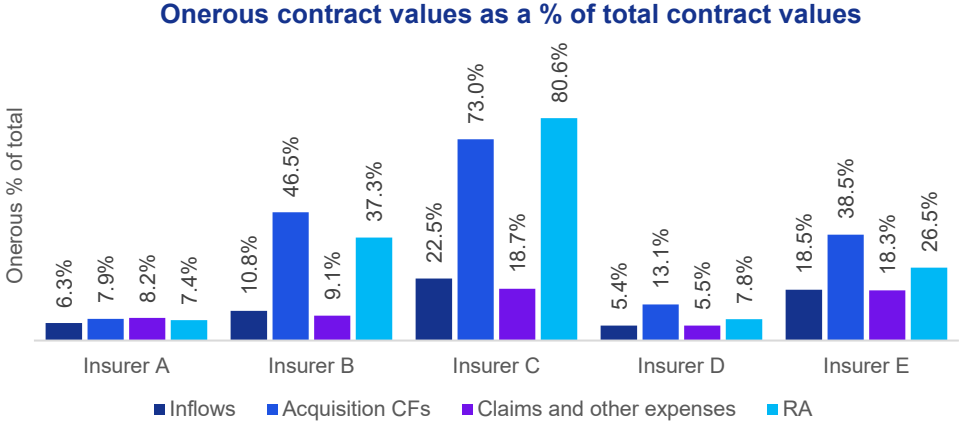


Graph 3: PV of outflows and margins expressed as a percentage of the PV of inflows for onerous GMM life insurance business entered into in the 2024 financial year.



It is also interesting to consider for each insurer and for each disclosed cash flow component, the proportion of the overall cash flow component which is contributed by contracts which are onerous at initial recognition, as shown in Graph 4.

Graph 4: Percentage contribution of onerous business to the total cash flow component for onerous GMM life insurance business entered into in the 2024 financial year.



A number of observations follow from Graph 2, Graph 3 and Graph 4:

- When measured as a percentage of PV of inflows, onerous business sold by each insurer in the market varies between 0% (for Insurer F) and 22.5% (for Insurer C) of all GMM business.
- PV of claims and other expenses is lower for almost all insurers compared to the PV of inflows on onerous business, measured as a proportion of the total cash flows. This would indicate that onerous business is not necessarily driven by large, expected claims and expense outgo relative to the premium charged. Rather, onerous business appears to be driven by relatively larger risk adjustments and/or acquisition cash flows attributed to onerous contracts.
- Insurers B and C have the lowest proportion of acquisition costs on profitable business but the highest proportion on onerous business. As discussed above, this could be driven by differences in business mix (i.e. a higher proportion of profitable annuity business sold relative to whole-of-life risk business), differences in sales channel (e.g. direct marketing compared to agent and broker commission) or differences in the fixed overhead cost allocations.
- In cases where an insurer's onerous contracts contribute a similar level to the overall PV of inflows and overall attributable acquisition cash flows, it may point to overhead expenses being allocated to policies based on the size of that policy's premium. In cases where the onerous contracts reflect a larger proportion of the total attributable acquisition cash flows relative to PV of inflows, this may indicate that overhead acquisition costs have been allocated to policies independently of the premium size which may result in a larger volume of smaller-premium onerous contracts.
- For Insurer C, the onerous business represents 22.5% of PV of inflows. However, this business accounted for 80.6% of the total RA on new business in the financial year. Given that the risk adjustment on all GMM business for a particular insurer would be assessed at the same confidence level, this illustrates the large degree of heterogeneity of risks between products and perhaps indicates a concentration of one type of business (subject to lower risk) in the profitable groups and other types of business (subject to larger relative risk) in the onerous groups.

1.4 Summary

As illustrated in this section, it is difficult for a user of this disclosure note to provide definitive interpretation given the explained differences between insurers, the consolidated nature of the disclosure and the allowable areas of judgement. To address this, we recommend that insurers consider disclosing additional qualitative or quantitative information, including:

- the relative size of the different types of business included in the GMM disclosure.
- information on the overhead expense allocation methodology given its potentially material impact on the split between profitable and onerous business at initial recognition.
- a description of material period-on-period changes and explanations for movements in the disclosure.

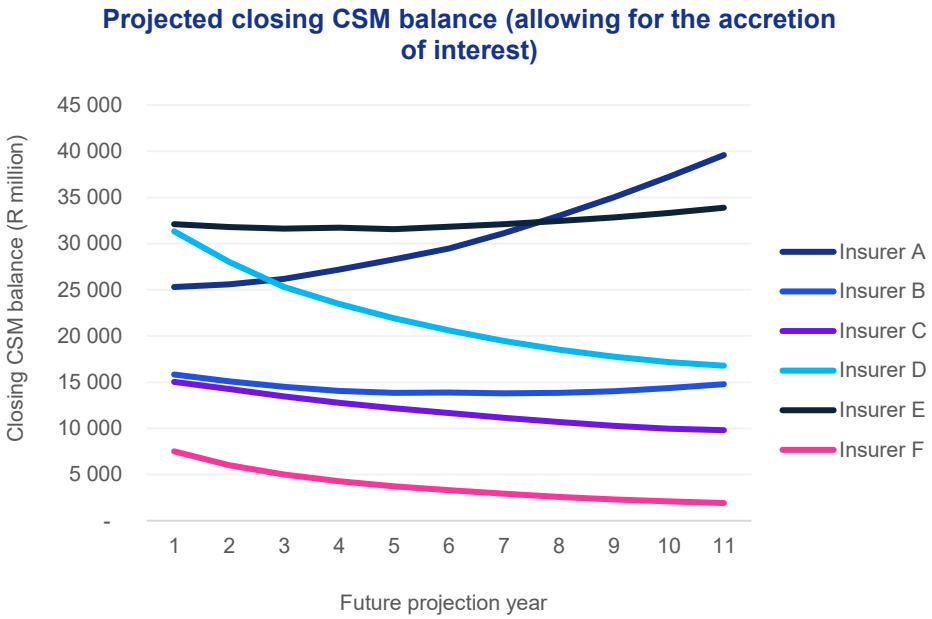
2. The recognition of CSM in profit/loss

IFRS 17.109 requires the expected recognition of the CSM in profit/loss to be disclosed. There are material differences in the approach taken by some insurers to present this information to the users of the financial statements. In particular, some insurers show the full projection and run-off of the CSM allowing for the expected accretion of interest in each year (with one insurer showing the expected total impact of discounting over 10 years separately), while others show the run-off of the CSM balance excluding interest accretion. Consequently, the disclosure tables provided are not directly comparable.

2.1 Comparison of absolute run-off

To effectively compare the CSM run-off between insurers, it is necessary to first ensure that all insurers' results are presented on a consistent basis. This is illustrated in Graph 5, where for Insurers C and E who have not presented the projected accretion of interest on the CSM, we applied an assumed interest accretion rate to allow for comparability. There are further discrepancies in the time bands which insurers use to illustrate the run-off of the CSM, requiring some degree of estimation, with the graph produced using linear interpolation (i.e. a straight-line estimate between two known points) where necessary.

Graph 5: Projected closing CSM balance over the first ten years for each insurer's life insurance GMM business allowing for the accretion of interest over time.



Allowing for the differences in the disclosure of the CSM run-off, at a high level, one can conclude that Insurer A has the most conservative approach to releasing the CSM over time, while Insurer D is the most aggressive. When a user of the financial statements is considering the future earnings growth potential of each company (of which the annual CSM release is likely a key component), they would be looking more to new business for Insurer D to contribute to the CSM release over time. This is due to the faster run-off of the CSM on existing business resulting in lower future releases of CSM to profit/loss with future earnings increasingly needing to be supplemented by a contribution from releases of CSM on new contracts issued.

2.2 Additional factors to consider in assessing the run-off

The absolute run-off of the CSM balance over time is however only one consideration:

- The coverage units (and hence the release of CSM) should take into account the duration of the underlying contracts, which, as discussed in section 1, can vary widely given the heterogenous underlying constituents of the GMM results. Coverage units also depend on the term of the contracts and the relative lapse and claims rates between products and their development over time.
- Aside from differences in the type and volume of products included in the GMM results, each insurer will also have varying exposure to business of a different nature. For example, benefits and premiums which remain level over time, those escalating at inflation and, in some cases, in excess of inflation, or credit life products with reducing outstanding balances over time.
- Differences in the target market, distribution method and underwriting practices could drive material variations in expected lapse and claims rates over time.
- An insurer's election of whether to allow for the time value of money in the equal allocation of CSM to coverage units when determining the recognition of CSM in profit/loss is another material area of judgment and difference between insurers, with a potentially material impact on the CSM projection.

Rather than only comparing relative to other insurers, one could argue that it makes sense to also consider each insurer's projected run-off of the CSM to the run-off of the insurance contract asset or liability to which that CSM is related to add additional insight around the reasonability of the chosen CSM run-off pattern.

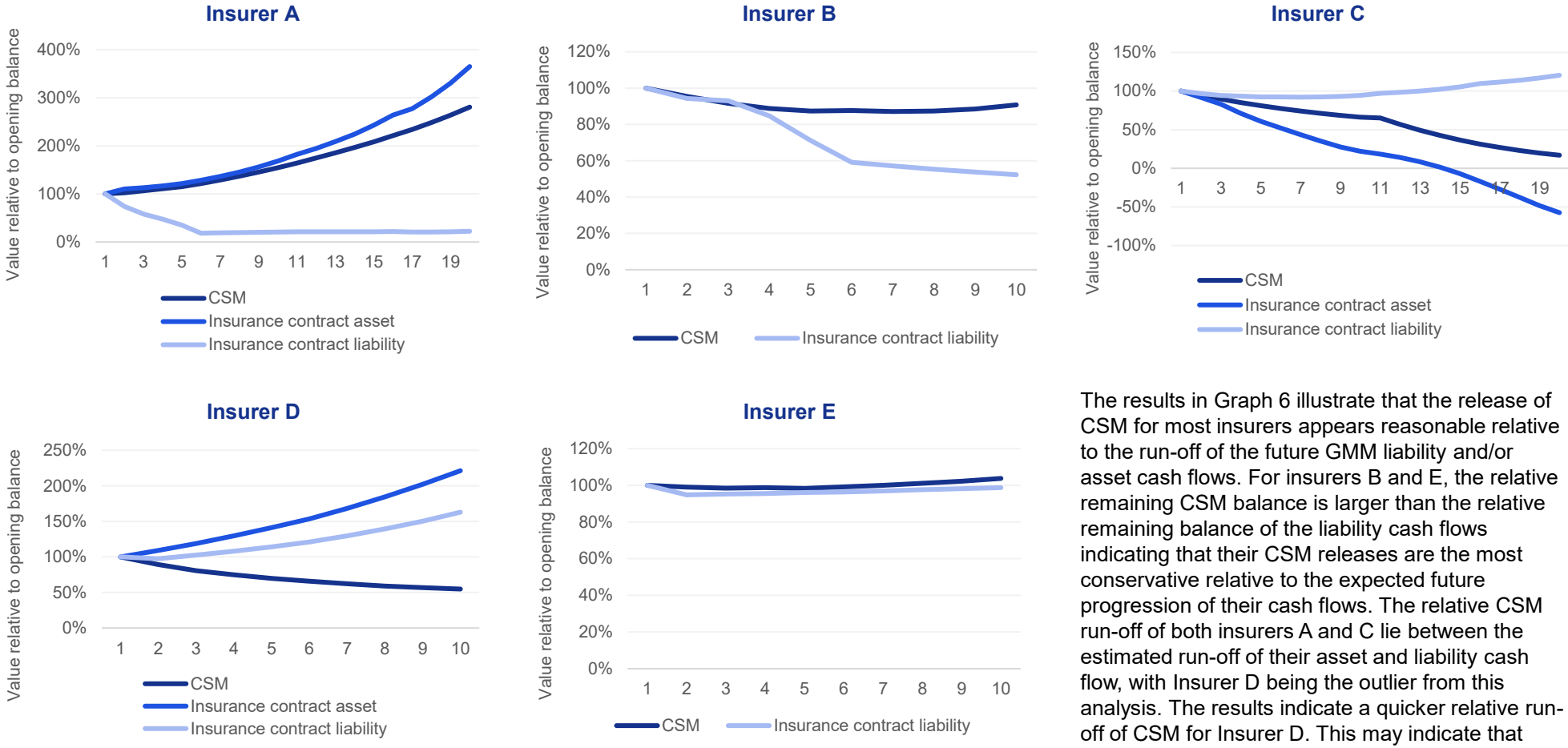
Each insurer produces a maturity analysis for the GMM insurance contracts issued, as is required by IFRS 17.132(b). Some insurers produce this on a present value basis while others produce this on an undiscounted basis. Most insurers in the sample considered produced this maturity analysis allowing for the run-off of the PV of future cash flows. However at least one insurer produced the run-off for the entire carrying value of the insurance contract liability (i.e. including the RA and CSM). The time bands for which the maturity analysis is produced also vary considerably, with all but one insurer producing more than the minimum required disclosure (i.e. more detail than the net cash flows for each of the first five years after the reporting date and in aggregate beyond the first five years).

Some insurers produced the maturity analysis separately for contracts in an asset and liability position while others only produced the disclosure for contracts in a liability position. Working through this complexity and allowing for the differences highlighted, one can produce an estimated projected run-off of the insurance contracts issued for each insurer, making assumptions about the illiquidity premiums added to the risk-free discount rates, the total term over which to run-off the asset or liability and interpolation where necessary.

As an example, a CSM balance that releases materially faster than the run-off of the related insurance contract liability could be seen to be aggressive and may leave the insurer more exposed to increases in losses on onerous contracts given a stress or negative basis change impact at some stage in the future. Once again, the difficulty in assessing this assumption is the inconsistency in the published disclosures.

While not exact given that assumptions need to be made, an estimate of the relative run-off of the future GMM liability and/or asset cash flows can be contrasted for each insurer with the run-off of the CSM, shown in Graph 6. It should be noted that Insurer F does not disclose a maturity analysis for its insurance contract assets and liabilities and so is excluded from this analysis.

Graph 6: Relative run-off of the future GMM insurance contract liability and/or asset cash flows and the run-off of CSM (both allowing for interest accretion over time)[2]



The results in Graph 6 illustrate that the release of CSM for most insurers appears reasonable relative to the run-off of the future GMM liability and/or asset cash flows. For insurers B and E, the relative remaining CSM balance is larger than the relative remaining balance of the liability cash flows indicating that their CSM releases are the most conservative relative to the expected future progression of their cash flows. The relative CSM run-off of both insurers A and C lie between the estimated run-off of their asset and liability cash flow, with Insurer D being the outlier from this analysis. The results indicate a quicker relative run-off of CSM for Insurer D. This may indicate that should a stress to the asset or liability cash flows occur at some point in the future, Insurer D would be most at risk from the CSM potentially being insufficient on the existing profitable groups of contracts at that point in time.

[2] Insurer B and Insurer E do not provide a maturity analysis for GMM insurance contract assets while Insurer F does not disclose a maturity analysis for insurance contract assets or liabilities

2.3 Summary

As illustrated in this section, a user of this disclosure note would need to consider the differences in the insurers' disclosures. This includes:

- differences between insurers in the disclosure note itself, i.e. whether an insurer allows for interest accretion in the disclosed recognition of CSM in profit/loss. This can materially impact comparisons of the absolute CSM run-off.
- differences in the underlying product mix and specific product features, such as premium and benefit escalation, different target markets, distribution methods and underwriting practices, with consequent differences in expected durational lapse and claims rates.

To address this, insurers could consider standardised disclosure of the recognition of CSM in profit/loss (for example, with all insurers allowing for the expected accretion of interest on the CSM balance over time in addition to the releases). In addition, disclosures could be provided of the run-off of the CSM relative to the run-off of the insurance contract asset or liability or work on standardising the maturity analysis of the insurance contract asset or liability itself to allow a user of the financial statements to calculate this for themselves without the need for extensive assumptions.

3. Comparison of sensitivity disclosures

3.1 Introduction

IFRS 17.128 requires each company to disclose a sensitivity analysis of how the profit/loss and equity position would be affected by changes in risk variables at the end of the reporting period, gross and net of reinsurance. Many insurers augment this by also presenting the impact of the sensitivity on the CSM.

For a given sensitivity disclosed, the total impact can be seen as the change in the fulfilment cash flows (FCF) i.e. present value of future cash flows plus risk adjustment under stress, measured using current discount rates. This total impact can be split into an impact on CSM and an impact on profit/loss and equity as set out below.

The split between CSM and profit/loss and equity will differ based on whether an election was made to disaggregate insurance finance income and expense (IFIE) through other comprehensive income (OCI).

No disaggregation through OCI

CSM: A

Profit/Loss and equity: B + (C – A) + (D – B)

Total impact = A + B + (C – A) + (D – B) = C + D

Disaggregation through OCI

CSM: A

Profit/Loss: B

Equity: P/L + (C – A) + (D – B)

Total impact = A + B + (C – A) + (D – B) = C + D

Where:

A: ΔFCFs not relating to loss components measured at initial recognition discount rates

B: ΔFCFs relating to loss components measured at initial recognition discount rates

C: ΔFCFs not relating to loss components measured at current discount rates

D: ΔFCFs relating to loss components measured at current discount rates

The following section discusses the challenges that impact a user's ability to directly compare sensitivity disclosures. While a direct comparison of the quantum and impact of the sensitivities between insurers requires consideration and nuance, it is more meaningful to consider a detailed analysis of each insurer's sensitivity disclosures. In this manner we can provide insight into the underlying business dynamics and offer a view into the detailed CSM position at an IFRS 17 reporting group level.

3.2 Challenges encountered when attempting to directly compare sensitivity disclosures

Some insurers combine their entire book (i.e. GMM and variable fee approach (VFA)) when presenting sensitivity analyses, while others split the disclosures by measurement model or at a more granular level.

The disclosure of a single stress belies complex policy-level dynamics and offsets within certain stresses:

- Depending on the policy characteristics, certain policies may have increased value under a lapse up stress while it may destroy value on other policies.
- The level of cross subsidisation under certain stresses may be larger for certain insurers than others, depending on the heterogeneity of their GMM or VFA books, giving a large relative difference in the quantum of the stress between insurers.

For certain stresses, some insurers have allowed for these complexities by splitting out stresses which would otherwise offset one another. In particular within the mortality stress, we have observed insurers splitting out mortality increases/decreases on annuity business and assurance business.

The impact of stresses is not necessarily symmetric, i.e. up and down stresses to certain assumptions do not necessarily have a symmetric impact on the fulfilment cash flows. Even for stresses which have a symmetric impact on the fulfilment cash flows, these will not necessarily have a symmetric impact on CSM and profit/loss given the remaining CSM balance on each IFRS 17 group of contracts and the individual impacts on each group under stress. This is a challenge for some insurers who only present the impact of stresses in one direction as one cannot necessarily assume an equal and opposite impact for the same stress applied in the opposite direction.

In respect of those insurers who disclose the impact of sensitivities on CSM, all but one disclose both gross and net of reinsurance impacts. All but two insurers assume that the sensitivity is applied at the end of the year i.e. to the closing CSM balance. The two remaining insurers assume the sensitivity is applied to the CSM calculation before the current period release of CSM to profit/loss. This would offset the impact on the CSM to an extent, i.e. a reduction in CSM under stress would lead to a smaller relative release and vice-versa.

The nature of stresses applied to assumptions vary amongst insurers in that some insurers combine stresses while others reflect stresses separately.

For GMM business, the impact of the sensitivity on fulfilment cash flows is measured at initial recognition discount rates through the CSM. The difference in impact of the sensitivity measured at initial recognition discount rates and current discount rates is taken through IFIE. For insurers who have not elected the OCI option, this amount is included in the disclosed impact on profit/loss. Large differences can emerge between these rates over time, with the impact between insurers depending on a number of factors such as the transition approach applied, the specific year in which the group of policies was sold and the prevailing yield curve at that time relative to today.

Table 1: Summary comparison of sensitivity disclosures

	GMM/VFA disclosed separately	Consistent positive and negative stresses applied	Gross and net CSM impacts shown	Gross and net P/L and equity impacts shown	Impact on CSM		Impact on P/L and/or equity	
					ΔFCF at initial recognition rates not relating to loss component	Impact on CSM release	ΔFCF at initial recognition rates relating to loss component	Impact of ΔFCF at current vs initial recognition rates (IFIE)
Insurer A	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Insurer B	No	Yes*	Net only	Yes	Yes	No	Yes	Yes
Insurer C	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Insurer D	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Insurer E	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Insurer F	GMM only	No	No CSM impact shown		Net of reinsurance only	No	Not clear	

** Disclosed that if stresses have a symmetric impact, both directions are not shown.*

3.3 Detailed analysis of decrement rate sensitivities

For each of the six insurers considered, a detailed analysis of their sensitivities in respect of the decrement rate assumptions (i.e. lapse, mortality and morbidity rates) was considered. The analysis focused on South African GMM business where separately disclosed. In cases where this was not disclosed, the total sensitivity provided was considered.

Insights into each insurer were considered separately, with a comparison provided to the other insurers along with the necessary caveats for factors confounding the comparison.

The results considered are gross of reinsurance where available (for Insurer B, only net of reinsurance CSM impacts were disclosed). The profit/loss impacts under each stress are more than offset by differences resulting from measuring the impact of the stresses at initial recognition discount rates and current discount rates. This means that an upward lapse stress which destroys economic value leads to a R0.5 billion increase in equity, while downward lapse stress reduces the equity of the insurer by R1.5 billion.

3.3.1 Insurer A

Insurer A elected to disaggregate IFIE through OCI. Consequently, the disclosed CSM, profit/loss and equity impact for GMM business can be used to assess the following:

- the CSM impact reflects the change in fulfilment cash flows, not relating to loss components, measured at each IFRS 17 reporting group's initial recognition discount rates.
- the profit/loss impact reflects the change in fulfilment cash flows relating to loss components measured at initial recognition discount rates, i.e. it reflects an increase or reversal of losses on onerous groups of contracts.
- the difference between the disclosed equity impact and the impact on profit/loss reflects the difference in the impact of the sensitivity measured at initial recognition discount rates and current discount rates. In instances where the current economic environment differs from the prevailing environment at the inception of a group, these impacts can be material.

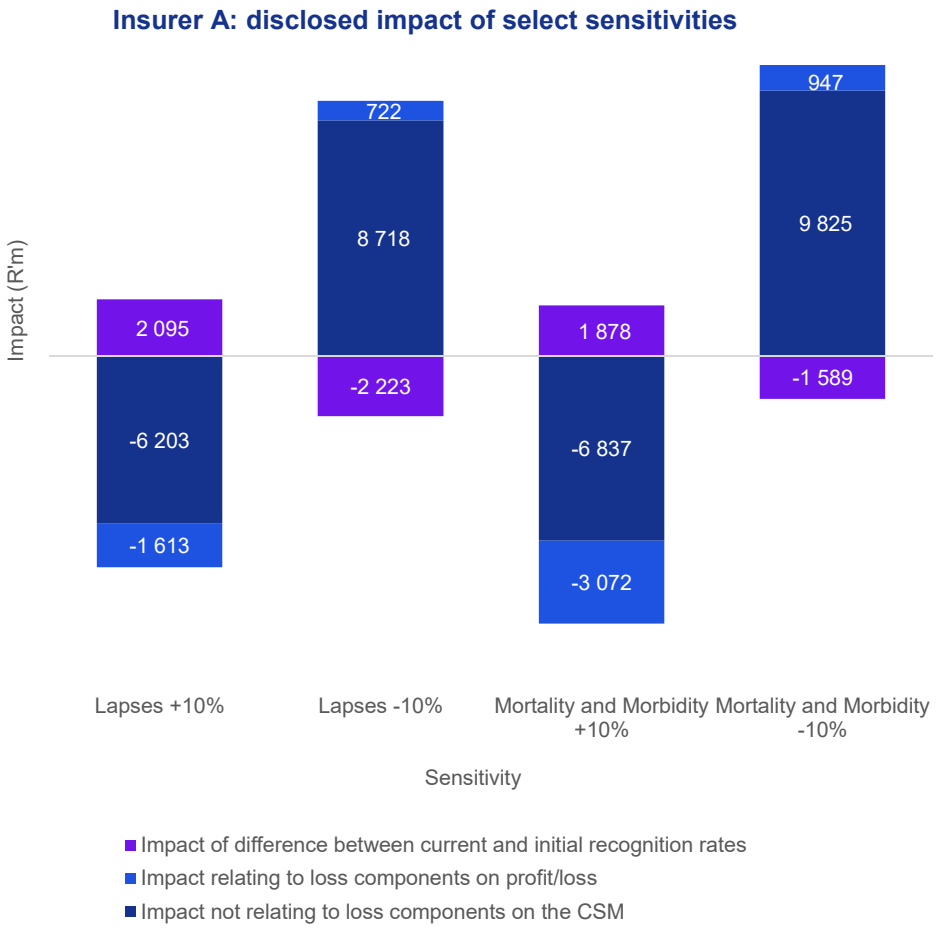
Focusing on the mortality and morbidity combined stress, the following is observed:	Focusing on the lapse stress, the following is observed:
The total stress on fulfilment cash flows is not symmetric, with an overall cost (measured at initial recognition discount rates) of R9.91 billion following a 10% increase in rates and an overall benefit (measured at initial recognition discount rates) of R10.77 billion following a 10% reduction in rates.	The total stress on fulfilment cash flows is not symmetric, with an overall cost (measured at initial recognition discount rates) of R7.82 billion following a 10% increase in lapse rates and an overall benefit (measured at initial recognition discount rates) of R9.44 billion following a 10% reduction in rates.
Further, the stresses have an asymmetric impact on CSM and profit/loss, as follows: i. 10% increase in mortality and morbidity rates: overall cost of R9.91 billion, with R6.8 billion (69%) relating to a reduction in CSM and R3.1 billion (31%) relating to an in-period loss. ii. 10% reduction in mortality morbidity rates: overall gain of R10.91 billion, with R9.8 billion (91%) relating to a gain in CSM and R0.9 billion (9%) relating to an in-period profit.	Further, the stresses have an asymmetric impact on CSM and profit/loss, as follows: i. 10% increase in lapse rates: overall cost of R7.82 billion, with R6.2 billion (79%) relating to a reduction in CSM and R1.6 billion (21%) relating to an in-period loss. ii. 10% reduction in lapse rates: overall gain of R9.44 billion, with R8.7 billion (92%) relating to a gain in CSM and R0.7 billion (8%) relating to an in-period profit.
The difference resulting from measuring the impact of the stresses at initial recognition discount rates and current discount rates is offsetting and material – a gain of R1.88 billion is observed following an increase in mortality and morbidity rates and a cost of R1.59 billion is observed following a reduction in mortality and morbidity rates.	The profit/loss impacts under each stress are more than offset by differences resulting from measuring the impact of the stresses at initial recognition discount rates and current discount rates. This means that an upward lapse stress which destroys economic value leads to a R0.5 billion increase in equity, while downward lapse stress reduces the equity of the insurer by R1.5 billion.

3.3.1 Insurer A (cont.)

Summary observations

- The asymmetric impact on CSM and profit/loss under the up and down stresses indicates that the insurer either has a number of currently profitable groups of insurance contracts which turn onerous under an upward lapse and mortality and morbidity stress, or a number of onerous groups which turn profitable in the reverse stress. This could indicate a degree of profit/loss volatility under stress which appears more pronounced compared to other insurers.
- The use of OCI allows the user of the financial statements to separately quantify the impact of each sensitivity measured at initial recognition discount rates and the same impact measured at current discount rates. It is useful to separately identify this component as this discount rate difference can either increase or offset the impact of the underlying stress and in some cases can more than offset the impact of the stress.
- In the case of Insurer A for instance, a stress which the insurer is sensitive to and destroys value at a policy level (the upward lapse stress) can be seen to have an overall positive equity impact, as the positive difference resulting from measuring the impact of the stresses at initial recognition discount rates and current discount rates more than offsets the losses on onerous business as a result of the stress. This is shown further in Graph 7, which shows the cumulative impact of the lapse and mortality and morbidity stress, split into the various components. The sum of the "impact of difference between current and initial recognition rates" component and the "impact relating to loss components on profit/loss" component reflects the equity impact.
- It should be noted that the quantum of this component is not necessarily the same for all insurers and depends to a large extent on the transition approach followed, the difference between the initial recognition discount rates locked-in for each group of business and the current discount rates, and the size of the impact of the sensitivity on each group of business.

Graph 7: Breakdown of the impact of select sensitivities gross of reinsurance into the components driving the impact (negative represents a reduction in value).



3.3.2 Insurer B

Insurer B differs to all others in the market by disclosing their stress impacts at a 1-in-10-year scenario (rather than a generic 5% or 10% stress scenario). In addition, they only present net of reinsurance CSM movements and the sensitivity impacts are not split out for GMM and VFA portfolios. Consequently, a direct comparison to other insurers is challenging. As insurer B does not disaggregate IFIE through other comprehensive income (OCI), the profit/loss and equity impact of each sensitivity are identical. In addition, it is not possible to disaggregate the impact of increases or reversals of losses on onerous contracts and the IFIE impact of differences between the impact of the sensitivity measured at current and initial recognition discount rates, this is in contrast to what was observed for Insurer A where the IFIE movements were disaggregated through profit/loss and OCI.

Focusing on the mortality, morbidity and longevity stresses, the following is observed:

The insurer noted that single direction stresses have been disclosed in cases where the impact of a sensitivity is linear. From this, it can be concluded that the overall impact of the mortality and morbidity stress are symmetric (different from Insurer A where the impact of these stresses was not symmetric).

Longevity stresses on annuity business are separated from mortality stresses on other risk business. This ensures that the mortality sensitivity impacts on annuity business do not offset the stress impact on other business.

Of the overall cost of the mortality sensitivity (R1.3 billion), 66.5% (R0.88 billion) relates to a reduction in CSM while the remaining 33.5% (R0.42 billion) relates to an in-period loss (driven by an increase in losses on onerous contracts together with the IFIE impact of measuring the mortality sensitivity on initial recognition discount rates relative to current discount rates). This split is consistent with what we observed for Insurer A on the mortality and morbidity stress.

The results indicate that the insurer's annuity business is potentially skewed more towards profitable groups (or groups with sufficient CSM to absorb the impact of the sensitivity) relative to their assurance business. This is illustrated by the minimal profit/loss impact of the longevity stress (although it is not clear to what extent, if any, an increase in losses on onerous contracts is being offset by the IFIE impact discussed above).

Focusing on the lapse stress, the following is observed:

The total stress on fulfilment cash flows is not symmetric, with an overall cost (measured at current discount rates) of R0.92 billion following a 10% increase in lapse rates and an overall benefit (measured at current discount rates) of R1.04 billion following a 10% reduction in rates. These impacts are significantly smaller than those seen for insurer A, potentially indicating a higher degree of offset between individual policies under lapse stresses for insurer B.

Unlike insurer A, the lapse stresses of insurer B have a symmetric impact on CSM and profit/loss. For the lapse up stress, c.82.5% (R0.76 billion of the total fulfilment cash flow impact of R0.92 billion) relates to a change in CSM while under the lapse down stress, this is c.83.6% (R0.87bn of the total fulfilment cash flow impact of R1.04 billion). This relative symmetry highlights that insurer B is potentially exposed to fewer profitable groups on the verge of turning onerous (or vice-versa), with a consequent lower degree of volatility in an up and down sensitivity.

3.3.3 Insurer C

Insurer C only presents stresses in a single direction and, unlike insurer B, no commentary is provided on whether this has been done because the impact of sensitivities is linear. Like insurer B, the sensitivity impacts provided appear to all relate to GMM and VFA portfolios which further hampers detailed analysis.

Focusing on the mortality and morbidity stress, the following is observed:

Like insurer A, insurer C runs a combined mortality and morbidity sensitivity. However, insurer C only stresses a reduction in rates.	Like insurer B, insurer C has separated the mortality sensitivity into stresses applied to assurance and annuity business.	Of the overall gain in the assurance mortality sensitivity (R4.17 billion), 70.4% (R2.93 billion) relates to an increase in CSM while the remaining 29.6% relates to an in-period profit (driven by a reversal of losses on onerous contracts together with the IFIE impact of measuring the mortality sensitivity on initial recognition rates relative to current rates). This is a similar split to insurers A and B on the mortality/morbidity stress.	As with insurer B, (although to a lesser extent) the results indicate that insurer C's annuity business is potentially skewed more towards profitable groups (or groups with sufficient CSM to absorb the impact of the sensitivity). This is illustrated by the fact that 17.1% of the annuity stress relates to an in-period loss (if one assumes a symmetric impact, 29.6% of an increase in non-annuitant mortality and morbidity rates would result in an in-period loss).

Focusing on the lapse stress, the following is observed:

The impact through profit/loss moves in a different direction to the impact through CSM – the downward lapse stress sensitivity results in an increase in CSM but an overall reduction in profit/loss. This may be due to either:

The downward lapse stress having a different impact on heterogenous underlying policies, i.e. resulting in gains on policies in profitable groups and losses on policies in onerous groups.	It may also be driven by the IFIE impact resulting from the difference in measuring the impact of the lapse sensitivity at current discount rates and initial discount recognition rates. This IFIE component is readily observable for insurer A due to its election of the OCI option and can be seen in that case to be material, potentially more than offsetting other impacts and leading to equity gains where the sensitivity is otherwise a cost and vice-versa. It has been noted that the quantum of this component is not necessarily the same for all insurers and depends to a large extent on the transition approach followed by the insurer, the difference between the initial recognition discount rates locked-in for each group of business and the current discount rates, and the size of the impact of the sensitivity on each group of business.	Without additional disclosure, it is not clear which of these factors is driving the impact seen on insurer C.

3.3.4 Insurer D

As with insurer C, insurer D only presents stresses in a single direction, however these are split between GMM and VFA impacts.

Focusing on the mortality and morbidity stress, the following is observed:

Like insurers A and C, insurer D runs a combined mortality and morbidity sensitivity. However, like insurer C, insurer D only stresses a reduction in rates.

Like insurers B and C, insurer D separated the mortality sensitivity into stresses applied to assurance and annuity business.

Of the overall gain in the assurance mortality sensitivity (R4.63 billion), 86.7% (R4.02 billion) relates to an increase in CSM while the remaining 13.3% (R0.61 billion) relates to an in-period profit (driven by a reversal of losses on onerous contracts together with the IFIE impact of measuring the mortality sensitivity on initial recognition discount rates relative to current discount rates). This reflects a higher proportion of the stress impact relating to the CSM compared to that seen on insurers A, B and C, and potentially indicates the company is less susceptible to volatile income statement movements under stress given the level of CSM at an underlying group level. A caveat to this conclusion is that it relates to a decrease in mortality rates with an assumption that an increase in rates would result in a symmetric impact on the CSM.

As with insurer B and C, the results indicate that insurer D's annuity business is potentially skewed more towards profitable groups, with 7.1% of the annuity stress relating to an in-period loss.

3.3.5 Insurer E

Insurer E presents the impact of sensitivities applied in both directions and splits out the GMM and VFA results.

Focusing on the mortality and morbidity stresses, the following is observed:

Like insurer B, insurer E discloses separate mortality and morbidity stresses and also separates the mortality sensitivity into stresses applied to assurance and annuity business.

The total mortality stress on fulfilment cash flows is symmetric, with an overall cost (measured at current discount rates) of R3.56 billion following a 5% increase in mortality rates and an overall benefit (measured at current discount rates) of R3.60 billion following a 5% reduction in rates.

This symmetric impact extends when considering the resultant impact on CSM and profit/loss with 75.8% of the increase in mortality rates and 76.3% of the decrease in mortality rates relating to a change in CSM with the difference relating to the impact on profit/loss. This reflects a higher proportion of the stress impact relating to the CSM compared to that seen on insurers A, B and C but is below that of insurer D. A similar pattern emerges when considering the morbidity sensitivity.

Consistent with insurer B, the results show a minimal profit/loss impact of stresses to annuitant mortality rates which could indicate that the annuity business is skewed towards more profitable groups. This appears to be a common trend in the industry, observed (to varying extents) for all insurers producing separate annuitant mortality sensitivity impacts.

3.3.6 Insurer F

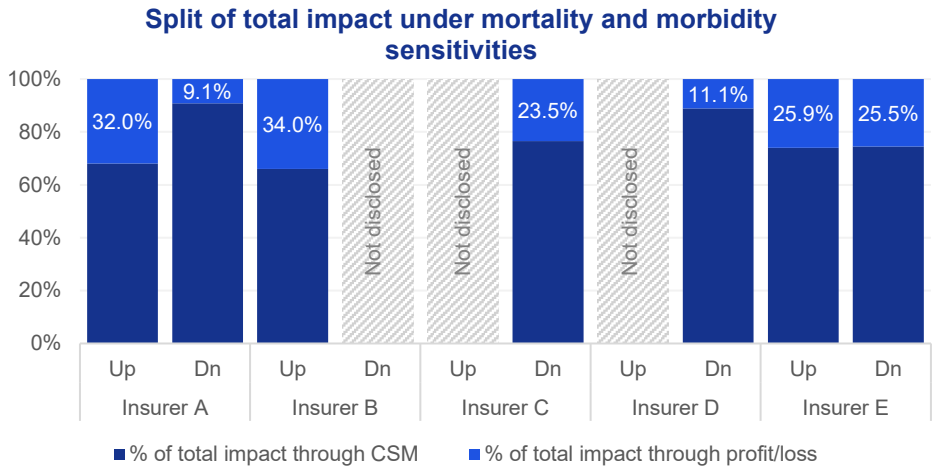
Insurer F only provided net of reinsurance profit/loss and equity impacts which, given they have not elected to disaggregate through OCI, are equal. No CSM impacts are provided so it is difficult to provide further commentary on the sensitivity results.

3.4 Industry comparison

Notwithstanding the differences between the sensitivity disclosures of the various insurers discussed in the sections above, Graphs 8, 9 and 10 summarise the overall impact of different sensitivities split between the impact reflected through a change in CSM and the impact on profit/loss for both increases and decreases in the applicable decrement rate (where available). For the reasons noted above, insurer F is excluded from this comparison. Given that insurer B only presents net of reinsurance CSM impacts, the results of all insurers are considered net of reinsurance in this section. Please note that this may lead to differences in the percentages quoted in section 3.3 as these results were considered gross of reinsurance for all insurers except for insurer B.

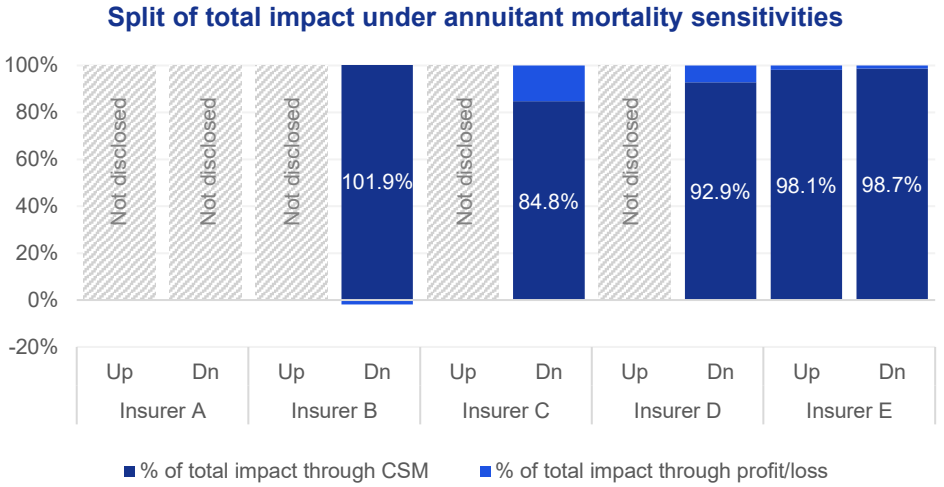
As discussed above, a significant difference in the proportion of the impact reflected through profit/loss under an up and down sensitivity indicates that the insurer either has a number of currently profitable groups of insurance contracts which turn onerous under the sensitivity, with a loss component being established (or onerous groups changing to a profitable position through a reversal of losses). Consequently, insurers with a larger degree of asymmetry could face more pronounced profit/loss volatility under stress compared to other insurers.

Graph 8: CSM and profit/loss split of the total impact on fulfilment cash flows under a mortality (non-annuity business) and morbidity up and down[3] sensitivity.



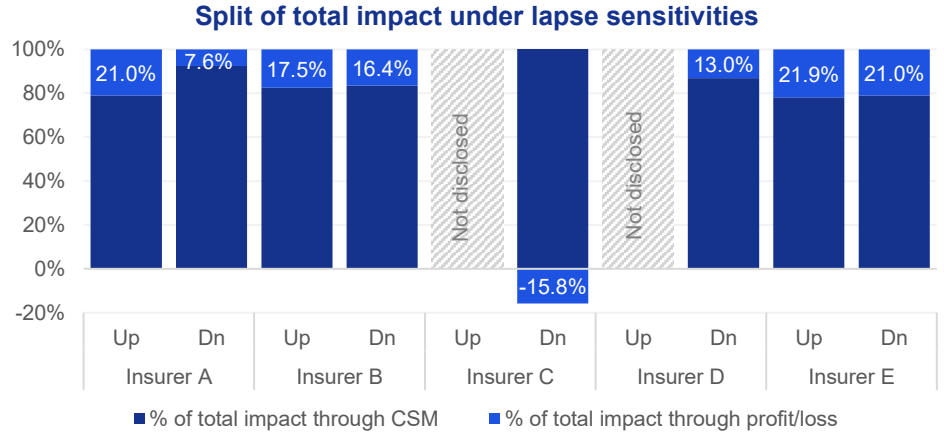
[3] For insurers who present mortality and morbidity sensitivities separately, these impacts have been added together in the graph, with the average split of the impact of the mortality and morbidity stress being shown.

Graph 9: CSM and profit/loss split of the total impact on fulfilment cash flows under an annuitant mortality up and down sensitivity.



Graph 9 illustrates what appears to be a consistent trend across the industry, with profit/loss impacts appearing more muted when stressing mortality rates on annuity business. This indicates that annuity business is potentially skewed more towards profitable groups where the majority of any stress impact can be offset through a release of CSM.

Graph 10: CSM and profit/loss split of the total impact on fulfilment cash flows under a lapse up and down sensitivity.



Consistent with the results in Graph 8, insurer A demonstrated a higher degree of asymmetry in the split of the impact of the sensitivity between up and down lapse stresses compared to the other insurers who present the impact of the sensitivity in both directions, namely insurer B and insurer E.

As noted above, for insurer C, the impact through profit/loss moves in a different direction to the impact through CSM – the downward lapse stress sensitivity results in an increase in CSM but an overall reduction in profit/loss. Without additional disclosure, it is not clear which of these factors is driving the impact seen on insurer C however it is noted that this may be due to either:

- the downward lapse stress having a different impact on heterogenous underlying policies; or
- the IFIE impact resulting from the difference in measuring the impact of the lapse sensitivity at current discount rates and initial discount recognition rates.

3.5 Summary

As discussed in this section, a user of the sensitivity disclosures would need to keep a number of items in mind when comparing sensitivity results between insurers. This would include:

- the level and direction of the stress applied, together with whether the sensitivity covers a single or combined risk driver(s).
- the difference in impact of the sensitivity measured at initial recognition discount rates and current discount rates taken through IFIE. For GMM business where OCI has not been elected, the isolated impact of this item is not observable given the current disclosure and may result in potentially unintuitive equity impacts given the true economic impact of the stress (e.g. stresses which overall destroy value may result in increases in equity and vice-versa).

To address the differences in insurers' disclosures, standardisation of disclosures can be considered by providing a list of suggested or required sensitivities and the level of stress to be tested. In addition, insurers could provide additional information on the drivers of the profit/loss and equity impacts of the sensitivities, including a further split of any impact due to increases or reversals of losses on onerous contracts and the difference in impact of the sensitivity measured at initial recognition discount rates and current discount rates.

Conclusion

IFRS 17 has introduced a degree of consistency to insurance accounting in terms of principles and items of disclosure not seen under IFRS 4. However, much like a time zone which is redrawn to include or exclude specific pockets of land, there are specific nuances and detailed areas of judgement which means that the disclosure items are not as easily comparable as initially anticipated. Direct comparisons between insurers for an item of disclosure which, on face value, may appear to be consistent may require a more intricate and nuanced comparison than may initially appear necessary.

In the analysis of the impact of contracts initially recognised in the period, areas of judgement such as the method chosen by a company to allocate attributable overhead expenses can have a material impact on comparative conclusions. In other areas, additional detail, such as disclosure of the components and relative size of each of the GMM portfolios, can allow for more effective comparison and definitive comment to be made on the relative performance of each entity for the same class of business.

When comparing the patterns of recognition of CSM in profit/loss, a greater degree of standardisation in the disclosure across the industry would reduce the risk of a casual user of the financial statements missing certain context and potentially drawing incorrect conclusions.

Standardisation and the stipulation of required sensitivities would help address the current disclosure differences observed, while a more granular break-down will provide users of financial statements useful insight into the drivers of the disclosed profit/loss and equity impacts.

This is perhaps an area where the actuarial profession in South Africa could contribute in terms of new practice guidance notes for IFRS 17 as maturity evolves in the local market.