New KPIs under IFRS 17

Helping investors understand your IFRS 17 performance – a focus on transition

October 2020

IFRS 17 will provide analysts and investors access to a wealth of new information on the performance of your business. In the run up to implementation, it is important to fully educate these key stakeholders on how newly published results would differ under IFRS 17. This will help ensure your results are well understood after IFRS 17 is implemented.

Introduction

Our previous articles[1] on IFRS 17 KPIs analysed the suite of KPIs communicated to the markets by 20 of the largest European insurers. We assessed how companies may need to respond to the effect of IFRS 17 on these metrics, including potential changes to adjusted operating profit (AOP), an important KPI currently reported by life insurers.

Given the wide range of changes brought about by IFRS 17, early sight of new IFRS 17 KPIs will result in (i) ensuring that investors are not surprised when they see the IFRS 17 financial statements for the first time, and (ii) the ability to build the production of KPIs into the core systems of the reporting process, realising operational benefits.

This article specifically focuses on how best to communicate the impact of transitioning to IFRS 17 to the market and disclosures about the transition balances. We also consider the steps you may want to consider to meet the practical challenges in implementing these changes.

Future articles will consider new business and CSM-based disclosures, and return on equity (ROE) & in-force metrics. Transition can have a major impact on these metrics, in particular ROE, so it is important to consider transition at the same time as the overall approach to KPIs under IFRS 17.

Timeline to implementation

The diagram below illustrates an indicative roadmap for developing KPIs in the lead up to implementation, including the key stages of design, build and review.

Even with the 2023 implementation date of IFRS 17[2], time is running out to investigate KPI options, build and test processes, test these processes through dry runs, set targets and get the various sign-offs.

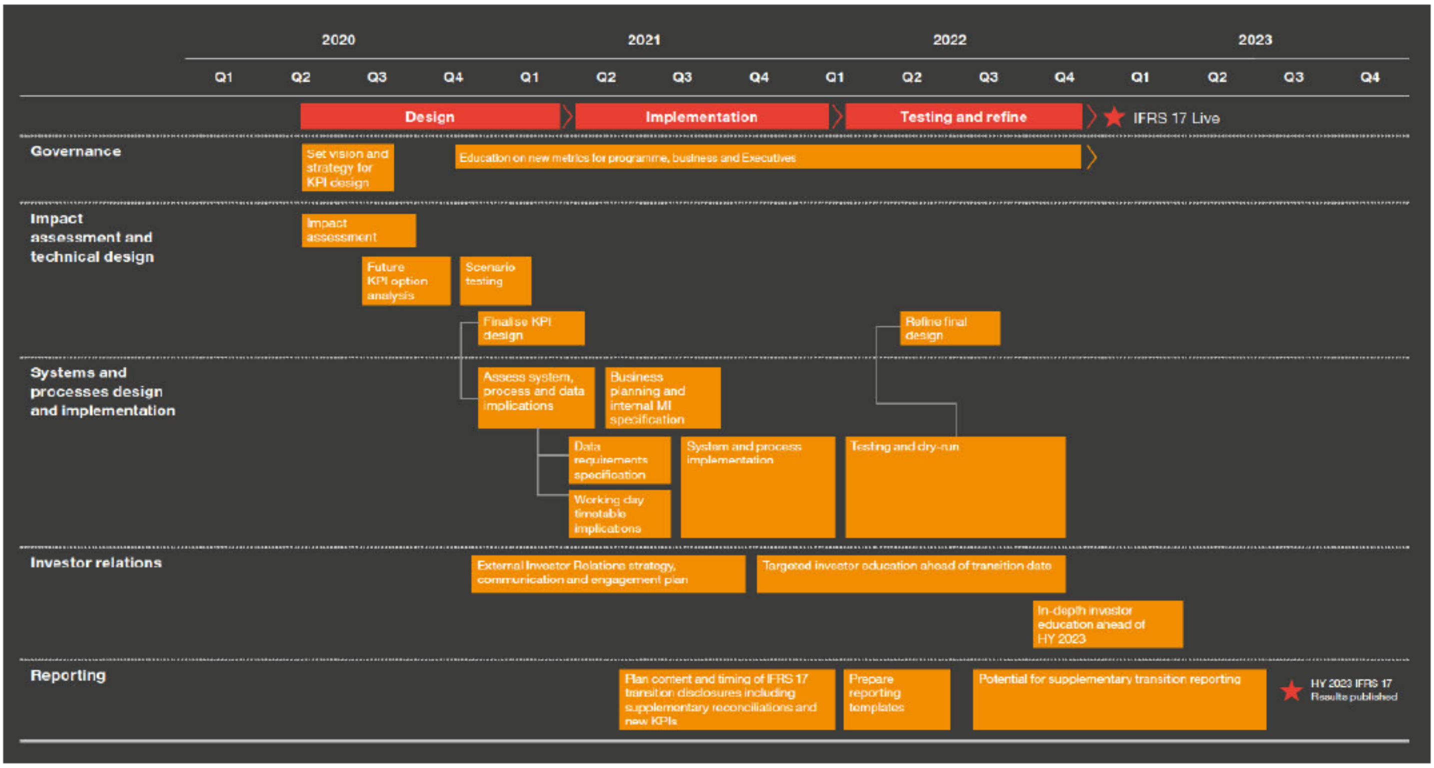
Early planning will allow companies to provide investors and analysts with both initial awareness education and more in-depth education closer to the implementation date. It will also allow management time to revisit KPI's, should they need to be redeveloped, if they do not give satisfactory results.

Insurers should also be alert to the outcomes from the IASB's Primary Financial Statements Exposure Draft[3] as this could also impact on use of KPIs in the future.

[1] http://bit.ly/IFRS17KPI2

[2] https://www.ifrs.org/news-and-events/2020/03/ifrs-17-effective-date/

[3] https://www.ifrs.org/projects/work-plan/primary-financial-statements/#current-stage



Disclosures about the effect of implementing IFRS 17 ('the transition impact')

Most companies will provide additional disclosure/information when they first implement IFRS 17 to help investors 'bridge' between what was there before and the new KPIs under IFRS 17. For example, for life insurers, such bridging disclosures could include information about how KPIs such as AOP, ROE and new business value (NBV) change, comparing IFRS 17 figures to existing IFRS (IFRS 4), Solvency II, MCEV or other metrics.

Consideration of how these headline KPIs (AOP, ROE, etc.) will change under IFRS 17 and how this will be communicated to the market is vitally important. As ROE and AOP are largely driven by the in-force portfolio (as opposed to new business) they will be greatly impacted by the transition to IFRS 17, therefore this should be thought through carefully and will be discussed in further detail in a future article.

Some of the 'bridging' disclosures may only be relevant until IFRS 17 is implemented, so a proportionate approach should be taken to avoid investing lots of time and effort into disclosures with a limited life. Care should also be taken to ensure that the key messages on performance over the year and future trajectory are clear, and to avoid confusing readers of the financial statements. However, some bridging disclosures may continue to be relevant over the longer term and these should be embedded properly into BAU processes and systems.

Disclosures about the transition balances

When designing the disclosures about the effect of implementing IFRS 17, you might want to consider what information will be disclosed about the transition balances themselves and what they represent in terms of the profitability of the business (past and future). This could include, for example, an indication of the maturity profile of the transition CSM for life insurance business. This may help you explain to investors/analysts the difference between the old and new metrics and will avoid misinterpretation of the new metrics, such as the run-off of CSM being misunderstood to represent future shareholder cashflow, leading to an impact on shareholder value.

Practical challenges, stakeholder buy-in and change management

Get plans in place now to manage the change effectively	It will take time to educate the business, governance committees, the Board, and investors on the impact of IFRS 17, so insurers should facilitate education sessions over the next 2-3 years so that stakeholders can understand the results as reported under the new accounting Standard. Reconciliations between the new and existing KPI's should be produced in the short term and consideration should be given to the treatment of previously released profits that may appear again in future through CSM releases after transition.
Early stakeholder buy-in is vital	Gaining sign off on KPI's and targets from management and remuneration committees can take a period of time and the decisions made will impact long and short-term incentive plans. A range of scenarios should be presented so stakeholders can understand what all the metrics look like in market downturns and upturns, and how the KPIs evolve when the underlying business changes. Insurers who take stakeholders on this journey early on will benefit from a smooth transition and avoid surprises. Additional time also needs to be allowed for in order to revisit KPI's should they need to be redeveloped, if they do not give satisfactory results.
Aim to build KPI processes and systems into the TOM	Data, systems, models and processes will take time to be designed and developed to incorporate any new measures. The target operating model for KPI production should be part of an insurer's core systems and processes. Testing should include sensitivities and scenario testing. A dry run should be performed by the business so that management has time to redevelop KPI's and processes if they do not give satisfactory results.
Don't forget to analyse the impact on internal MI	Alignment of external KPIs with internal MI should also be considered. Indeed, early sight of more detailed analysis produced for internal MI may help to identify the key drivers of profit, which can help to focus the external KPIs on the most important areas.

Considerations for general insurers

The majority of general insurers have indicated that they intend to continue to use metrics that are broadly equivalent to existing KPIs. Whilst this expectation may evolve over time to be based purely on IFRS 17 measures, on transition, insurers should consider:

- Defining equivalent metrics using IFRS 17 balances. For example, how to derive
  - Claims loss ratios given the complexities introduced by, for example, discounting
  - Meaningful expense ratios
  - New volume measures given written premium is no longer a concept under IFRS 17
- Developing bridging disclosures to explain key movements, for example, the impact of removal of any regulatory prudence margins and inclusion of a risk adjustment; and
- Disclosure of key sensitivities over variables which balances are now exposed to, such as interest rates.

The Premium Allocation Approach (‘PAA’) measurement model may be relatively easy to grasp for users of financial statements that are used to the current IFRS 4 approach. However, the new concepts in the General Measurement Model (‘GMM’) means that general insurers using the GMM, either fully or partially, should consider whether detailed bridging disclosures or other information are required to educate stakeholders.

Considerations relating to reinsurance contracts

IFRS 17 also introduces the requirement to separately measure outwards reinsurance covers from underlying business. There can be differences between the underlying business and outwards reinsurance amounts, arising due to differences in units of account, discount rates, coverage units and other factors. In addition, there is a direct impact on the level of offsetting that reinsurance can provide for gross loss components through the rules around loss recovery components. Insurers may therefore consider developing their KPIs, or including additional supplementary disclosures, to allow for the different reinsurance measurement requirements. This is particularly true for the transition balances as there could be a large shift in the level of offsetting that reinsurance provides once IFRS 17 goes live.

Considerations relating to measurement model

Other measurement differences also arise under IFRS 17, such as when using the variable fee approach (VFA) and for participating business. The impact of any such mis-matches on KPIs, and whether these are adjusted for, should also be considered, and where there is a large impact on transition balances, supplementary disclosures should be considered.

Conclusion: Use the transition period to your advantage to maximise the impact of IFRS 17

Now is the time to consider how you might use your disclosures to portray the performance of your business to the market. In doing so, insurers should bear in mind:

- The transition balances will have a major impact on some of the headline KPIs, such as ROE, so careful consideration is required on how to define and communicate the future changes to these KPIs
- Developing stakeholder buy-in to the new KPIs will be critical to ensuring a smooth transition and avoiding unexpected surprises
- Disclosures should be used to ensure investors understand the difference between the old and new metrics, enabling you to maximise the beneficial impact on shareholder value
- It will take a period of time to make the necessary data, systems, models and process changes, and to gain the appropriate stakeholder buy-in to the new KPIs, so insurers should consider this now

How PwC can support insurers develop their IFRS 17 KPIs

- To date, we have completed/are in delivery of more than 140 IFRS 17 implementation projects around the globe. We have a deep understanding of current reporting processes and how the requirements will change under IFRS 17. We focus on the aspects that allow insurers to optimise their delivery of an IFRS 17 story that provides sufficient insight into the underlying performance of the business.
- We hold important roles and positions on industry fora, working parties and lobbying bodies. This gives unparalleled access to emerging company, investor and analyst thinking on disclosure practices and requirements.
- We have the IFRS 17 technical and regulatory subject matter experts (‘SMEs’) to provide the right focus on the requirements. Our specialists in all areas of insurance, e.g. actuarial, technology, target operating model, data architects, etc. means that we can advise on the broader business implications of the data and process requirements that underpin the desired reporting and KPI outputs.

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