WHITE PAPER

Steering for value under IFRS17/9

A CEO perspective

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IFRS17/9 is finally going live, and management implications are well beyond accounting. Insurers need to act on 4 levels: strategy, steering & control processes, business operations and change management.

1 IFRS17/9 is finally going live

After many years and significant sums invested by the industry, IFRS17/9 new accounting standard will come into force on 1st January 2023 for most countries. It will apply to ~450 listed insurers globally accounting for ~USD13tn total assets, and its main objective is to foster consistency and comparability of results.

From a CEO perspective 3 key changes are being introduced

- Different reporting granularity: results will be more disaggregated according to group structure and business (e.g., by line of business, geography or segments), based on more granular units of account / cohorts
- Different Income Statement and Balance Sheet metrics: for instance, traditional metrics like GWP will be replaced by insurance revenue while new items like Contractual Service Margin (CSM) will redefine the Balance Sheet (e.g. AXA reported its 2022 CSM to amount to 34B€)
- Different measurement logic: results will be measured on a fair value logic, recognizing profits as insurance services are provided impacting the timing of profit recognition

Exhibit 1: Higher reporting granularity

3 options for aggregation logic…

Type of contract
- e.g., major product lines

Geographical areas
- e.g., region, country

Reportable segments
- as per IFRS 8 Operating Segments

… with disaggregation on Unit of Accounts in 3 steps

Portfolio definition
- All insurance contracts within a product line subject to similar risks

Disaggregation into annual cohorts
- Groups of contracts issued within a calendar year

Disaggregation based on onerous test result
- Contracts that are onerous at initial recognition
- Contracts that at initial recognition have no significant possibility of becoming onerous subsequently
- Remaining contracts

Exhibit 2: Income statement: from IFRS4 to IFRS17

IFRS4 income statement	IFRS17 income statement
Gross written Premiums	(+) Insurance revenue
(-) Reinsured premiums	(-) Insurance service expenses
Net written premiums	(+/-) Gain (or loss) from reinsurance
(+) Fee and commission income	Insurance service result
(+) Investment Income	(+) Investment return
Total income	(+/-) Insurance finance income / expense
(-) Claims paid	(+) Net reinsurance finance income / expense
(+/-) Changes in technical reserves	Net investment result
(-) Fee and commission expenses	(+) Other income
(-) Acquisition and administration costs	(-) Other expenses
Operating profit	Profit before tax
(-) Non-operating expenses	(-) Income tax expense
(-) Taxes	Profit for the year
Net result	

Main concept changes

Insurance revenue is formed by:
- CSMrecognized for provided service
- Change in risk adjustment
- Expected claims and expenses

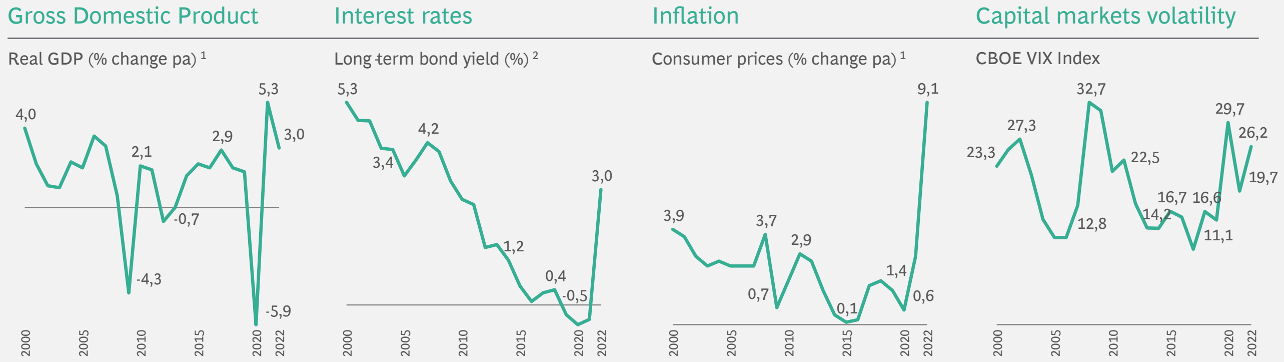
Insurance service expenses is formed by:
- Incurred claims and expenses
- Changes for past service
- Losses & reversals on onerous contracts

Investment return is formed by:
- Underlying assets
- Other investments

Insurance finance income / expense is formed by:
- Change in fair value of underlying assets
- Interest accreted
- Effect of changes in financial assumptions
- Effect of changes in rates adjusting CSM
- Effect of changes in foreign exchanges rates

Concepts not mentioned anymore on IFRS17

Exhibit 3: Increased volatility of macro drivers

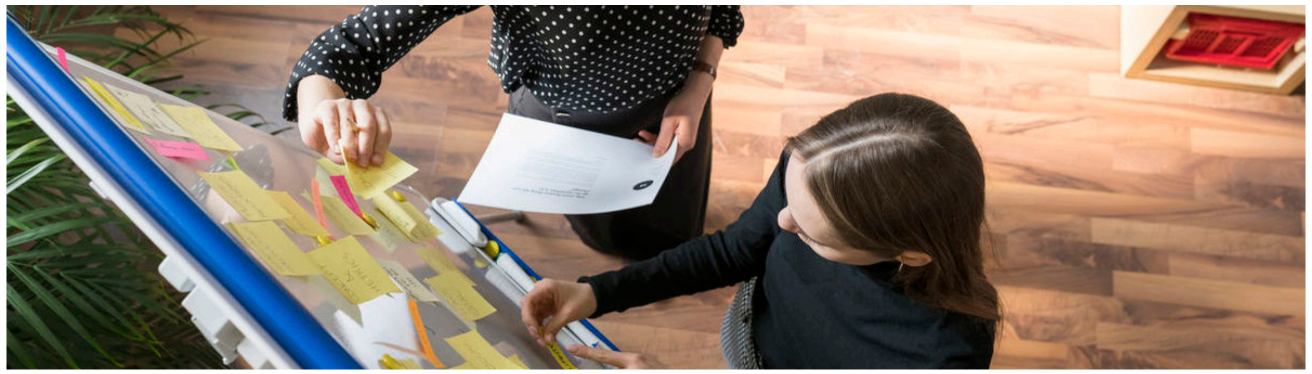


1. Weighted average of EU 27 data; 2. Data for Germany
Source: The Economist Intelligence Unit, FRED, VIX Index

2 Expected changes on consolidated reporting are significant

On the one hand, the IFRS17/9 will not change the underlying cash generation of the business, with no impact expected on dividends in most jurisdictions. Some insurers are expecting changes in equity and core earnings at Day 1 impacting capital management. However, the overall impact on consolidated reporting will be material

- Higher investor scrutiny: reporting granularity will significantly increase (e.g., a European insurer will move from ~20 to ~400 unit of accounts), with higher investor scrutiny on portfolios performance and their underlying drivers
- Increased volatility of Net Result, Equity, and ROE: many insurers expect profits to become more volatile and evolve differently over the lifetime of the books for both new accounting rules and the higher uncertainty of macro drivers influencing some accounting values



The fallout of these changes will unfold in 2 steps

- In 2023, when some KPIs will change value (e.g., CoR at a European company will decrease by 6%), insurers will need to work hard to explain to a range of external stakeholders the reasons for such changes in an accounting-focused discussion
- In the following years, year-on-year results will be discussed with a higher level of granularity, with a level of scrutiny that the industry is not yet used to from increased transparency

3 Management implications are well beyond accounting

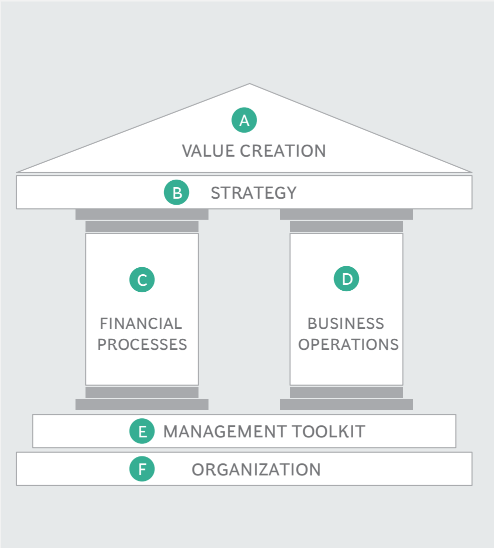
It's just accounting, but business performance will be looked at with different lens-es. This will have implications, which will not be the same across companies, e.g.

- For some companies (e.g., the ones more P&C focused, or with accounting already based on US GAAP) implications will be probably more limited
- In some countries where IFRS is also used as local GAAP (e.g. Hong Kong, Croatia, Slovenia) volatility may also influence areas such as dividend capacity
- Also, as the old IFRS regime is closer to local GAAP than the new one, listed insurers may be at a disadvantage relative to unlisted insurers being restricted by 3 main metrics (IFRS17/9, local GAAP, and local solvency rules), with non-listed ones only by 2 (local GAAP and local solvency)

More broadly, we anticipate long-lasting impacts to emerge on many dimensions that CEO's and their wider management teams will need to plan for

- Value creation: key TSR drivers (e.g., Earnings, P/E, ROE) will remain the basis of insurance valuation, therefore the increased volatility will challenge the promise of steady and predictable results that insurers sold to capital markets for years
- Strategy: the forward-looking accounting will increase CEOs focus on understanding the potential movements in, and managing, the Balance Sheet, becoming more important than the Income Statement especially in Life insurance

Exhibit 4: Management implications are well beyond accounting



A Value creation
- Insurers' promise of steady and predictable results challenged by higher volatility (key TSR drivers still at the basis of insurance valuation)

B Strategy
- Increasing CEOs focus on managing B/S due to forward looking accounting, especially in Life insurance

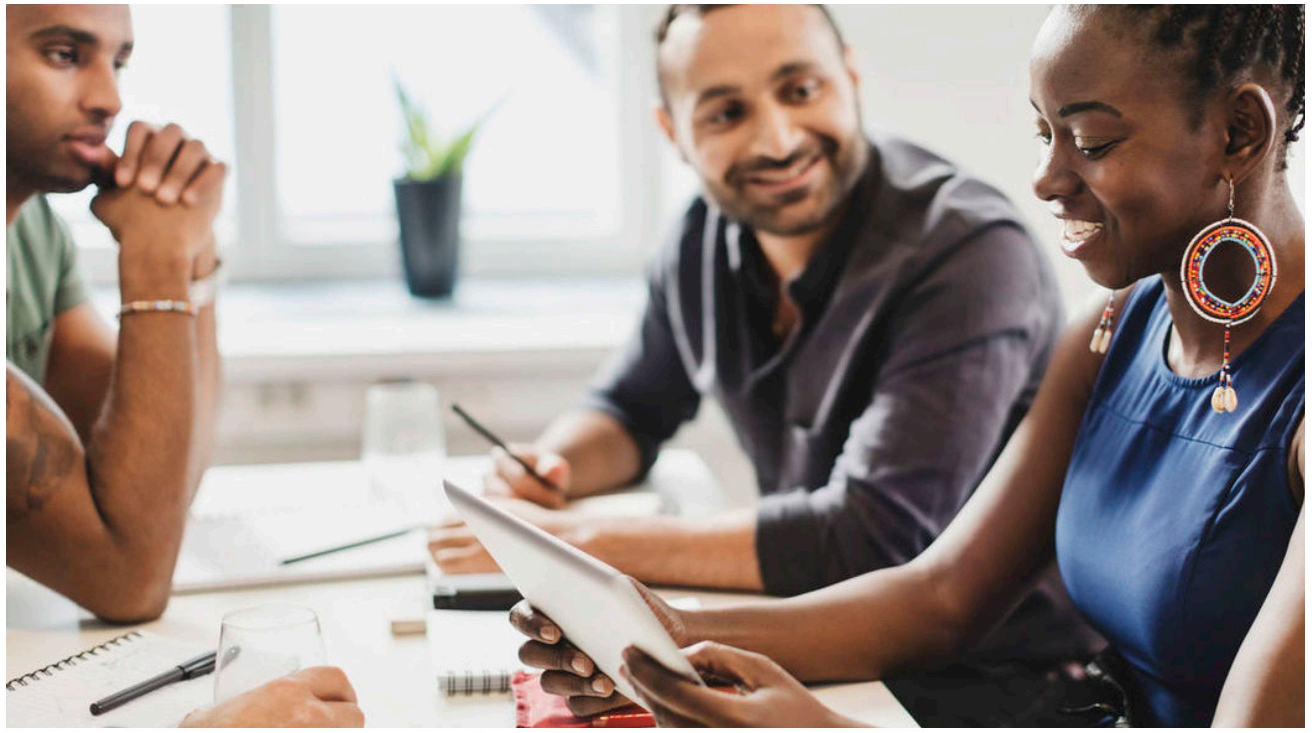
C Financial processes
- Cash generation predictability, financial practices and strength of steering & control crucial to deliver on dividend targets despite increased earnings volatility

D Business operations
- Operating practices to be tightened to limit volatility and manage profitability by unit of account to address investor pressure on underperforming portfolios

E Management toolkit
- Fewer managerial levers available to influence annual P&L results due to the fair value logic

F Organization
- Orga. setup to be reviewed and strengthened following higher interdependency between finance and actuarial activities

- Management toolkit: so far, management could influence annual Income Statement results through flexibility in reserving and investment realization, transferring profits over the years and across generations. In a fair value logic this management lever will disappear
- Financial processes: cash generation predictability, financial practices (e.g., ALM, reinsurance, hedging), and strength of steering & control processes will become more important than ever to signal an insurer ability to deliver on dividend targets despite increased earnings volatility
- Product, sales and pricing: managers will have to tighten operating practices in areas such as customer segmentation, new product design, revisiting existing products, sales incentives and marketing strategies to limit volatility and manage profitability by unit of account to address investor pressure on underperforming portfolios
- Organization: the new approach needs to bring much closer cooperation between finance / actuarial activities with other functions such as product development and reinsurance; therefore, insurers will review their organizational setup and look for talents skilled on both accounting / actuarial practices with other functions



4 Insurers need to act on 4 types of initiatives

These broad impacts can be addressed taking actions on four fronts

On strategy and value creation, CEOs should assess the attractiveness of their business under higher transparency and higher volatility; therefore, they should

- Sharpen understanding of the underlying volatility of segments, channels, products, and differences between insurance and asset management
- Upgrade business strategy to focus by unit of account, understanding the drivers of underperforming portfolios and having a plan to fix them
- Review type and importance of top management KPIs to manage volatility (e.g., introducing "earnings at risk" to define the acceptable volatility band)
- Increase emphasis on cash generation and its predictability to strengthen investor confidence on the dividend promise
- Derive business plans with IFRS17 numbers across the planning cycle to understand the longer term financial impact of decision made in the shorter term
- Assess possible M&A opportunities under new metrics to validate value creation assessments

On the functional level, financial levers and steering & control processes and tools need to be upgraded to engrain the new way to look at the business

- Enhance key processes (e.g., ALM & investments, In-Force management, capital management and hedging) to tilt decision making towards value

Exhibit 5: 4 types of initiatives to be undertaken

Initiative	Dimensions	Actions (examples)
1 Reassess business portfolio attractiveness		• Sharpen understanding of the underlying volatility of segments, channels, products • Upgrade business strategy, understand underperforming portfolios and have a plan to fix them • Review type and importance of top management KPIs to manage volatility • Increase emphasis on cash generation and its predictability
2 Upgrade steering & control processes		• Enhance key processes to tilt decision making towards value • Review Life products development to increase attractiveness under new requirements • Redesign managerial dashboard to include value based KPIs and align with new segment reporting • Develop methodology and agile tools to translate Group targets into actionable KPIs
3 Review business initiatives to steer the business		• Decrease emphasis volumes, increase focus on insurance margin • Increase focus on volatility reduction (e.g., target selection, pricing, pruning) • Increase sophistication on salesforce initiatives, driven by target production mix • Improve In-Force management capabilities, review product design frameworks
4 Manage change into the whole organization		• Onboard Business Units and operating managers • Align salesforce and channels

- Review Life product development process and profit testing to design products that are more attractive under IFRS17/9 requirements (e.g., with higher insurance revenue)
- Redesign managerial dashboard to include value based KPIs at both a corporate and employee level and align with the new segment reporting, to allow active steering of insurance and investment results as well as definition of products and distribution strategy on the profile and needs of the specific market niche
- Create tools to stress-test plan KPIs and CSM value to understand and report sensitivity to macro-drivers and demonstrate control on volatility and value creation and plan for tools to manage future volatility
- Develop methodology and new agile tools (e.g., proxy functions) to translate Group targets into actionable KPIs to enable BUs to flexibly measure and plan their business in line with the new lenses

On business operations, BU leaders need to review their initiatives to steer more tightly the business, for instance

- Top line growth will not be measured in GPW, so quest for volumes will lose emphasis
- Levers with impact on volatility (e.g., target selection, pricing, pruning, churning, lapsing) will be managed differently
- Salesforce incentives will become more sophisticated and driven by target production mix by unit of account
- Excellence of In Force Management actions in Life insurance will become more visible in CSM value

- Product design process and pricing will need revisiting along with the impact to marketing / product sales strategies as products with high volatility exposure (i.e. longer contract terms, higher frequency of claims) may need to be redesigned, replaced or offered at a higher premium
- For some insurers underwriting enhancements may be needed to clearly identify onerous contracts, and discuss the implications of this, so greater links will be needed between underwriting and finance teams (as extra scrutiny is expected from auditors)
- New product development, especially in Life, will have to consider visibility and impact on unit of account reporting

Finally, change management actions are required to make the whole organization ready, willing, and able to look at the business in a new way

- Significant education efforts needed to take the new accounting lenses out of the Finance area to Business Units and operating managers
- Salesforce and channels also have to be targeted as desired behaviors and incentives will have to be adapted to the new reality
- HR teams will need to look to align individual KPIs to corporate KPIs as a way to reinforce behaviours
- Engagement will be needed with a variety of external stakeholders such as tax authorities, regulators, rating agencies, analysts, parent companies and reinsurers

In conclusion, IFRS17/9 is a new way to interpret insurance and will significantly influence the dialogue with investors. So far, the industry has mainly focused on technical accounting, actuarial and systems aspects to drive towards compliance, but in some months as numbers start to become more reliable, CEOs will need to plan and operate according to new metrics and the entire management chain needs to be upgraded to be ready.

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