



EUROPEAN INSURERS' IFRS 9 BENCHMARK STUDY

Deferral or no deferral, progress in implementation and expected impacts
as per Year-End 2017 financial reporting



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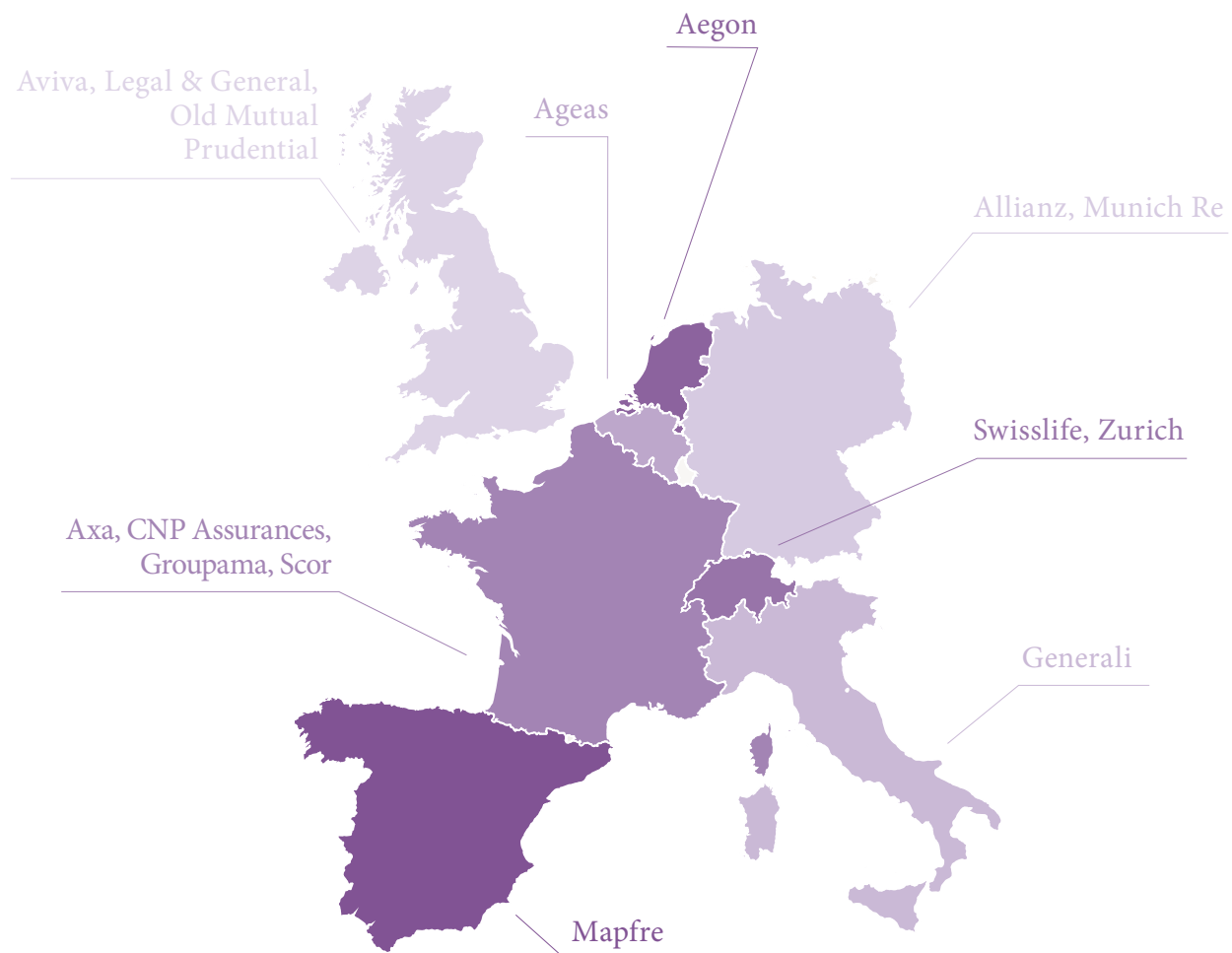
1. BENCHMARK STUDY PRESENTATION

Our panel is composed of 16 European insurance and reinsurance groups, including two Swiss companies publishing their financial statements under in the IFRS framework, as presented below.

- Study based on financial reports for the Year Ended 31 December 2017.



- Regarding the deferral or not of IFRS 9 by insurance companies that are subsidiaries of bank insurers, we enlarged the sample to include 10 banking groups (see section 2.2 below).



16 European insurers and reinsurers

Sections 3 to 7 of this publication only present the findings from our main panel of 16 insurance and reinsurance groups (i.e. these sections do not cover bank insurers which are analysed in section 2.2 only).

2. DEFERRAL OR NO DEFERRAL?

2.1 Insurance and reinsurance groups

Fifteen groups will opt for deferral at **consolidated** level, so IFRS 9 will only be applied starting 2021 financial statements.

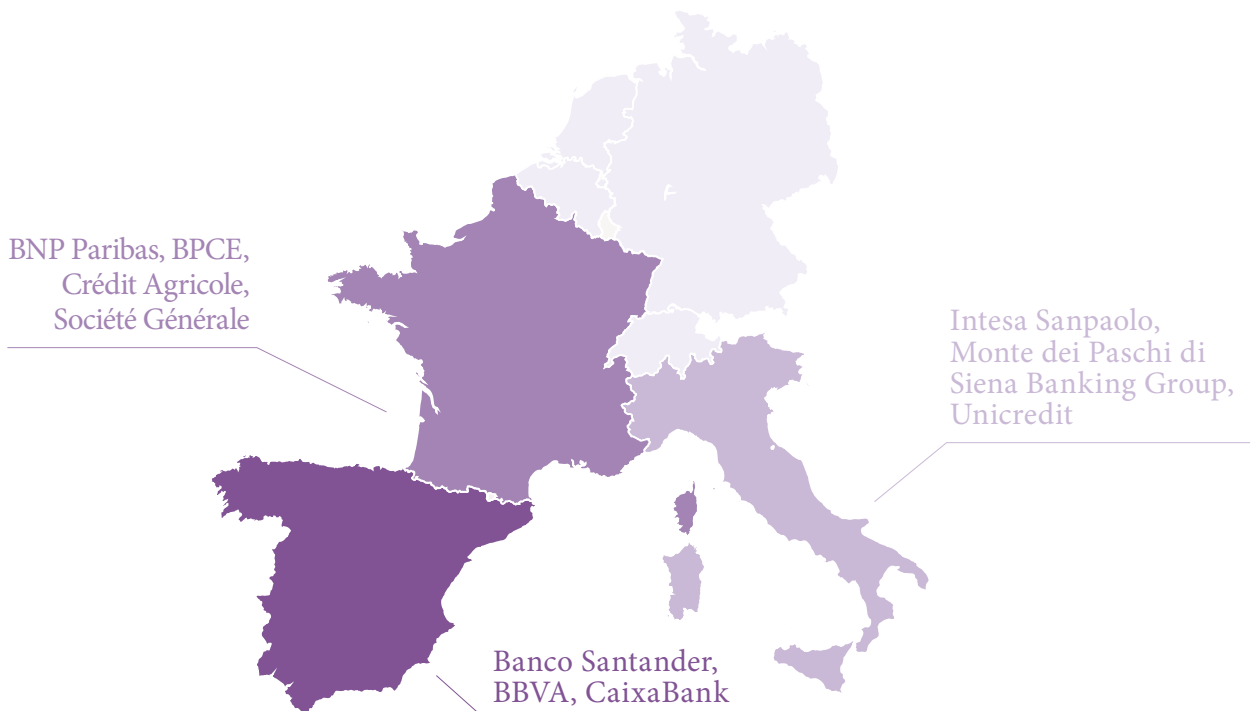
- One group (Old Mutual) in our panel will apply IFRS 9 from 2018 as IFRS 9 is particularly relevant to the group's lending businesses.



- One of these entities indicates that at its **stand-alone** company level IFRS 9 is effective from 1 January 2018 as the company is not eligible to apply the deferral option.

2.2 Financial conglomerates with banking as main activity

We enlarged the sample to include 10 European financial conglomerates whose main activity is banking but that also have insurance activities.



 **10** Bank insurers

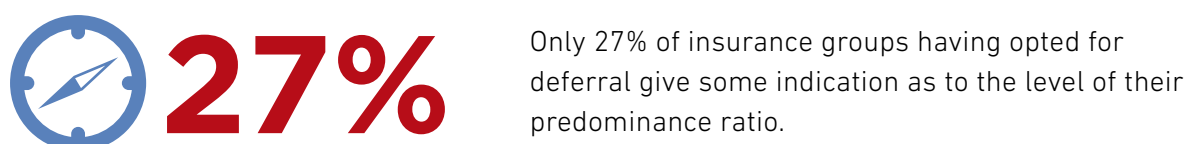
We checked how the insurance entities of these groups are planning to implement IFRS 9. Below are the main findings:

- Six groups plan to **defer** the application of IFRS 9 to 2021 for their insurance activities .
 - one group explains the reasons for deferral (to reduce potential impacts in terms of increased volatility for the insurance business), and indicates that the 2018 statements will be a mix of IFRS 9 and IAS 39 for the group.
 - one group gives a full list of its subsidiaries that will benefit from the deferral.
- One group plans to apply IFRS 9 to its insurance activities starting from 2018 but will use the **overlay** presentation option, as permitted by the amended standard IFRS 4.
- Three groups did **not specify what they will do**:
 - two groups describe the two options introduced by the amendment to IFRS 4 (overlay vs deferral) but they do not indicate whether they plan to apply any of these options.
 - one group specifies that the amendment to IFRS 4 should not have significant impact.



3. DEFERRAL-RELATED INFORMATION

Most entities from our panel of 16 insurance and reinsurance groups explicitly mention that they meet the criteria for the temporary exemption in IFRS 4 (either by simply stating this fact, or by providing the predominance ratio level and / or by indicating that their activities are predominantly issuing contracts within the scope of IFRS 4 / are predominantly connected with insurance or reinsurance).



- Indication of the **predominance ratio level** given by 4 groups:

- three groups indicate that their ratio is above 90% .
 - to be noted that one group indicates the carrying amount in EUR of their (re) insurance-related liabilities as of YE 2017 and YE 2015, which permits to calculate the exact predominance ratio.
- one entity indicates the exact level of ratio (96.5%).

- **Date of assessment** of the deferral criteria explicitly mentioned by three groups (YE 2015, as required by the amendment to IFRS 4).
 - one of them states there have been no changes to their business activities since YE 2015 that would necessitate a reassessment.
- Other deferral-related information:
 - three groups mention that **specific disclosures** will be provided during the deferral period.
 - Two of these indicate that they are already working on producing these disclosures.
 - one group mentions the accounting considerations in the financial statements of its shareholders / parent companies that operate in the banking industry (as this group is consolidated by its parent companies using the equity method, the temporary exemption from applying IFRS 9 still works and the group is not obliged to produce the consolidation package under IFRS 9).
 - Two groups (Generali, SCOR) provide a full list of the different natures of **insurance-related liabilities** included in the numerator of the predominance ratio, as shown in the extracts below:

EXTRACT 1: GENERALI, Annual Integrated Report and Consolidated Financial statements 2017, p. 159

As previously mentioned, the Group has decided to apply the deferral application of IFRS 9, having the requirements for eligibility the deferral, provided by IFRS 4. In fact, the Generali Group's activities are predominantly connected with insurance; The Group's liabilities connected with insurance include, for example:

- insurance liabilities within the scope of application of IFRS 4;
- liabilities measured at fair value through profit or loss based on IAS 39, relating to contracts issued by insurance companies for which the investment risk is borne by policyholders;
- subordinated financial liabilities qualifying as eligible own funds;
- liabilities for defined benefit plans relating to Group companies belonging to the life segment and the non-life segment;
- tax liabilities related to insurance business.

EXTRACT 2: SCOR, Registration document 2017, p. 165

SCOR's predominant activity is issuing (re)insurance contracts, which is reflected in the significance of liabilities arising of (re)insurance activities representing more than 90% of total liabilities. Liabilities related to (re)insurance activities amounted to EUR 32.9 billion compared to total liabilities of EUR 35.2 billion as at December 31, 2015. For calculating the predominance ratio, subordinated debt, accounts payable on assumed and ceded reinsurance transactions, pension liabilities and deferred tax liabilities have been considered in addition to the contract liabilities in scope of IFRS 4.

CONCLUSION

The type of information and the level of detail provided varies across groups. Few groups have provided information going beyond the mere fact that they will defer the application of IFRS 9, such as the level of the predominance ratio having permitted to qualify for the deferral, the date of assessment or the list of the insurance-related liabilities included in the predominance ratio.

4. IFRS 9 IMPLEMENTATION-RELATED ISSUES

Half of the companies in our panel of 16 insurance and reinsurance groups, provide information on their progress in implementing IFRS 9, and the level of detail provided is quite heterogenous across these 8 companies.

- Information provided by ZURICH INSURANCE can be considered as a good example of communicating on the implementation of IFRS 9:



- they indicate that significant progress was made in defining group methodologies and data requirements.
- they also describe the priority works for the coming years: in 2018, their focus will be on local and central implementation efforts and preparation for a **dry-run simulation scheduled for 2019**.
- and, lastly, they provide detailed information on the internal organisation with regards to the **joint IFRS 17 and IFRS 9 Group Implementation Program**, describing the sponsor of the Program, the composition of its Steering Committee and how the Steering Committee interacts with the methodology work stream and with the implementation work stream.

EXTRACT 1: ZURICH INSURANCE GROUP, Consolidated financial statements 2017, p. 15

In order to further evaluate the effects of adopting IFRS 17 in the consolidated financial statements, a joint IFRS 17 and IFRS 9 Group Implementation Program (Program) has been set up sponsored by Group Chief Financial Officer. A steering committee comprised of senior management from various functions (finance, risk, operations and investment management) oversees the work performed by individual work streams. The methodology work stream covers Group accounting policies, actuarial methodologies and disclosure requirements to be consistently implemented throughout the Group. The implementation work stream takes responsibility for analyzing systems implications and data flows. In 2017 significant progress was made in defining Group methodologies and data requirements. In 2018, the focus of the Program will be on local and central implementation efforts and preparation for a dry run simulation scheduled for 2019.

- One group indicates that their implementation project started in 2017 and will be combined with the implementation of **IFRS 17**.
- One group mentions that a narrow-scope task force focused on the classification of financial assets has been put in place with the aim of producing the **deferral disclosures** starting 2018.
- One group indicates that the implementation is in progress and aims (a) to meet the **deferral disclosure** requirements and (b) to ensure the correct and consistent application of the IFRS 9 accounting principles in conjunction with the entry into force of **IFRS 17**.
- One group states that due to the great importance of IFRS 9 for the group, they have established a **group-wide project** to analyse IFRS 9 provisions in detail, and they are currently driving forward the required implementation project.
- One group indicates that their IFRS 9 project is being implemented in conjunction with **IFRS 17** and that the group is currently assessing the **scope of assets to which Phase 2** will apply.
- One group just indicates that the implementation works are in progress.
- One group, the only one planning to adopt IFRS 9 starting 2018, indicates that it **continues to refine its expected credit loss model** and embed its operational processes and will continue working on Phase 1 during 2018, which may change the actual impact on adoption. A list of **implementation works carried out in 2017** is also provided.

CONCLUSION

The information provided in 2017 financial statements on the progress of IFRS 9 implementation and project governance is quite generic and varies across groups. Interactions with IFRS 17, deferral disclosures and impairment related works are mentioned at several occasions as key issues groups will have to deal with.



5. EXPECTED IMPACTS OF IFRS 9 APPLICATION

5.1 Impacts expected by groups having opted for deferral

5.1.1 Quantitative impacts

None of the 15 companies having chosen to defer IFRS 9 to 2021 provide an estimation of the expected **quantitative impacts** of IFRS 9.

The 16th group, which plans to adopt IFRS 9 starting 2018, provides some quantitative information (see section 5.2 below).

5.1.2 IFRS 17-related considerations

IFRS 17

Five groups indicate that it is **not possible or practicable to assess / quantify** the effect of adopting IFRS 9 as they have elected to apply the deferral approach permitted by IFRS 4 and / or because of the interactions between IFRS 9 and IFRS 17 on insurance standards. These interactions have yet to be analysed and taken into account to assess the combined impact of both standards.

- One group considers that the higher P&L volatility induced by IFRS 9 could be mitigated by the options taken under IFRS 17 (*“Though overall profit or loss volatility is expected to increase under IFRS 9, the measurement approach for direct participating contracts in IFRS 17 allows such volatility to be largely absorbed in the measurement of insurance liabilities with an option to reflect in shareholders’ equity (OCI) the effect of any asset-liability mismatch”*¹).

5.1.3 Qualitative impacts

Some groups provide **qualitative information** on the expected impacts.

- As of 2017 Year End, **significant impacts** are expected on the date of FTA (on shareholders’ equity and / or net income and / or OCI and / or disclosures, if specified) by three groups.
- Some groups are quite cautious, indicating that the exact full impact is not yet known.
- Five **groups** specifically identify **one or several chapters of IFRS 9** (Classification, Impairment...) **as being the main source of the potential impacts**. There is some heterogeneity in this respect, with several groups pinpointing specifically to Phase 1 of IFRS 9 as the most impacting one, because of a bigger share of financial assets to be fair valued through P&L:



- two groups, while noting that the assessment is still ongoing, expect that the main impacts will be due to the **new classification rules** for financial assets (**Phase 1** of IFRS 9), because of an increase in securities measured at FVPL.
 - one of these two groups expects a potential material increase in securities measured at FVPL based on the fieldwork tests performed for EFRAG.
 - the second group explicitly states that the new expected credit loss impairment model should have less relevant impacts on the financial statements, supposedly because of the creditworthiness of the debt securities held.

1 - ZURICH INSURANCE GROUP, Consolidated financial statements 2017, p. 15

- one group discloses information in a way to imply it **does not expect** significant changes to the **classification** rules for financial assets, as most investments are to remain at FVPL. This Group considers the new **impairment** requirements (**Phase 2**) as the most complex aspect of IFRS 9 to implement, which will involve significant judgments and estimation processes.
 - two groups assume that the main impacts will arise **both** from the new classification rules **and** from the new impairment model.
 - both groups expect to have more instruments at FVPL.
 - one group expects there should be more allowances for credit losses under IFRS 9 due to the introduction of the expected credit loss methodology.
 - two groups note that the impact of IFRS 9 (**Phase 3**) on the group's hedge accounting should not be significant.
 - one group specified that this remains under review.
- One group explains that IFRS 9 will have impact on the group's accounting policies (which are currently uncertain but IFRS 9 should alter the timing of IFRS profit recognition).

CONCLUSION

Few groups provide entity-specific information on the impacts they expect upon the first-time application of IFRS 9. Some of these groups explain this cautious approach by the fact that there will be interactions with the new standard IFRS 17 the full extent of which has not yet been apprehended.

Among the 5 groups distinguishing between the impacts of different phases of IFRS 9, the main findings are as follows:

Phase 1

2 groups expect Phase 1 to have the most impact.



Phase 1 & Phase 2

2 groups expects impacts from both Phase 1 and Phase 2 of IFRS 9.



Phase 2

1 group expects Phase 2 to have the most impact.

5.2 Impacts expected by 1 group in our panel that will apply IFRS 9 starting 2018

- One Group (OldMutual) is planning to adopt IFRS 9 starting 2018 and as a result has provided the most detailed quantitative and qualitative information about the expected impact of IFRS 9. For instance:
 - it states that in 2018 the comparative figures for 2017 will **not be restated**.
 - under IFRS 9 the group will continue applying the hedge accounting requirements of IAS 39.
 - the new **impairment** requirements are identified as the main driver of IFRS 9 impacts, especially for the banking division of the group. The exact financial impact on the impairment allowance and on reserves is provided (in m£). The group draws attention to the fact these amounts are “management’s best estimate” as of YE 2017, and therefore are **subject to change**.
 - with regards to the impacts from the new **classification** requirements, the group explains the main reclassifications to be operated as of 1st January 2018 and also quantifies the impact on reserves of these reclassifications.
 - they also state that the impact of IFRS 9 adoption is not expected to result in the capital ratios being below their statutory minimum.
 - last but not least, the group considers that adoption of the amendments brought to IFRS 7 by IFRS 9 will result in **improved credit risk disclosures** and increased transparency with respect to impairment judgments and estimates.

5.3 Specific focus on the impacts in stand-alone financial statements

- One group indicates that the adoption of IFRS 9 is not expected to have a significant impact on the **stand-alone** financial statements of the company (with the company not being eligible for the deferral at its stand-alone level, whereas its consolidated group statements will qualify for deferral).



- please note that in some European countries (such as the UK) the stand-alone statements are permitted / required to be under IFRS, whereas in others (such as France) the IFRS framework is not allowed for the stand-alone statements.



6. APPLYING IFRS 9 REQUIREMENTS ON OWN CREDIT RISK FOR FINANCIAL LIABILITIES OPTIONALLY DESIGNATED AT FVPL

Reminder of what's new in IFRS 9 on this topic compared to IAS 39:

- For financial liabilities that are designated as measured at fair value through profit or loss, under IAS 39, the entire amount of the changes in fair value is recognized in profit or loss.
- IFRS 9 requires that:
 - the changes in fair value that are attributable to changes in the credit risk of those liabilities be recognized in other comprehensive income, unless the recognition of the effect of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch.
 - changes in fair value attributable to the financial liability's credit risk are not subsequently reclassified to profit or loss, but instead remain in other reserves when the financial liability is derecognized.

These requirements of IFRS 9 on own credit risk may be applied independently from the other chapters of IFRS 9.

- One group has decided to early-apply these new requirements in its 2017 financial statements and has quantified the impacts of this new accounting policy:



- the application was retrospective, but – as permitted by IFRS 9 – without restating the comparative figures for 2016.
- this resulted **in a net loss in other reserves** within the shareholder's equity.

- One group disclosed planning to designate one bond issued at FVPL upon the adoption of IFRS 9 in 2018.

CONCLUSION

Groups having decided to defer the application of IFRS 9 to 2021 may still choose to apply the requirements in IFRS 9 on own credit risk for financial liabilities optionally designated at FVPL **before 2021**, as one of these groups has done in 2017.

7. SOME CONCLUDING REMARKS



- Most insurance groups in our panel (as well most of the insurance entities of 10 banking groups described in section 2.2) have **decided to defer** the first-time application (FTA) of IFRS 9 to January 1, 2021 as allowed by the amendment of IFRS 4. Supposing the mandatory effective date of IFRS 17 remains unchanged, these groups will thus align the FTA date of IFRS 9 with the date on which the new standard on insurance contracts, IFRS 17, enters into force (also January 1, 2021 as of today).
- Some groups indicate that they are unable to estimate the impacts of IFRS 9 without taking into account the interaction with IFRS 17. Nevertheless we can expect that it will introduce additional P&L volatility for non-participating business.
- The sources of potential impacts are not homogenous across the groups having provided this level of detail, with several groups expecting the Phase 1 to be the most impacting one as more assets should be fair valued through P&L.
- The level of detail provided as to the progress made in implementing IFRS 9 is also heterogenous, with several groups highlighting the importance of preparing the disclosures on IFRS 9 deferral required by IFRS 4.

We expect that over the coming years the 15 groups having chosen to defer the application of IFRS 9 to 2021 will continue gradually expanding the information published in their financial statements on the anticipated impacts of IFRS 9 application, in line with the recommendations of regulators and with the requirements of the standard IAS 8 regarding disclosures on new IFRS standards that have been issued but which are not yet effective.



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