IFRS 17 Preparedness Report

TheActuary

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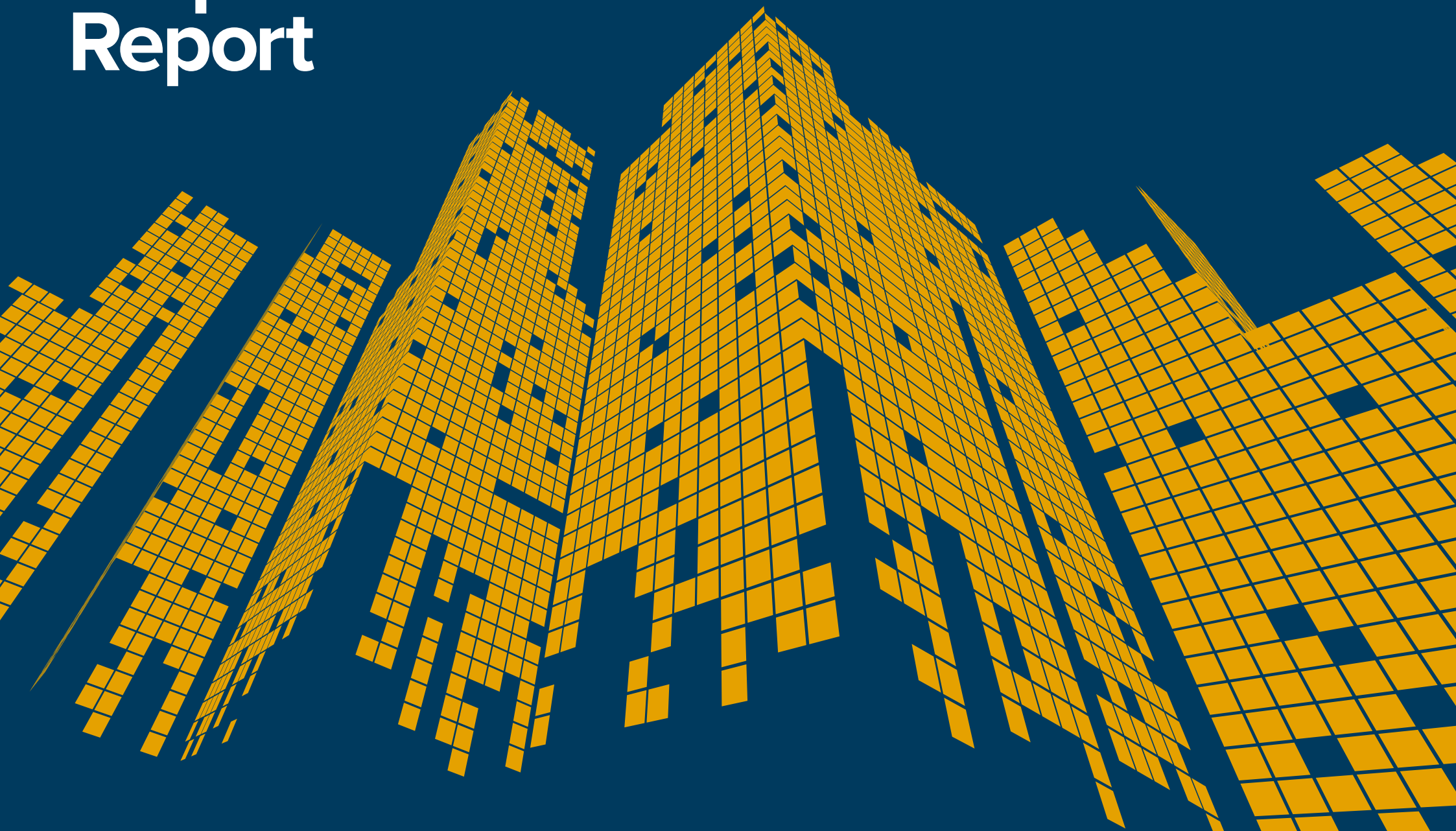

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1.0 Executive summary

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The Actuary and Moody's Analytics conducted a survey in Q2 2021 to seek actuarial practitioners' views on IFRS 17 preparedness. The survey aimed to capture a sense of the progress made to date on IFRS 17 implementation, particularly during the past year.

The survey contained 31 questions and explored several key areas of methodology. This report summarises those responses and compares them to the survey carried out in 2020.

Risk adjustment

IFRS 17 allows for different approaches in the calculation of the risk adjustment, and the responses show that the calculation has been further refined since last year's survey.

Surprisingly, with parallel reporting looming, one third of respondents have still not finalised their methodology choice. Of those that are further progressed, the cost of capital remains most popular for general insurers and VaR has become most popular for life insurers (in a change from last year, when it was margins/provisions for adverse deviation). In addition, the risk adjustment calibration appears to have been further refined, with more respondents expecting to disclose an equivalent confidence level in the 80–90% range.

Most respondents indicated that the risk adjustment will be calculated off-cycle, or off-cycle with some form of approximation. This suggests that firms are considering IFRS 17 in the context of the wider reporting cycle and are planning to leverage existing processes.

Discount rates

IFRS 17 allows for two different approaches to yield curve construction and discounting – the 'top-down approach' and the 'bottom-up approach'. The survey results imply that we can expect to see a mixture of both approaches across the industry in the first set of financial statements published under IFRS 17. However, the bottom-up approach – where the discount rate is constructed by adding an illiquidity premium onto the risk-free curve – appears to be most popular, with two thirds of participants choosing it.

Considering the popularity of the bottom-up approach, it is surprising that only a quarter of participants envisage using liquidity buckets. Under IFRS 17, the discount curve should reflect the characteristics of the insurance contract, and liquidity buckets provide one way to do this. Perhaps the approach to classification is deemed too subjective, or companies are adopting a similar approach to the volatility adjustment under Solvency II. Regarding the latter and aligning as closely as possible with the regulatory regime, European insurers will be aware that the volatility adjustment is under review, and one of the changes proposed is to include an application ratio that involves three illiquidity buckets.

Contractual service margin

The contractual service margin (CSM) is a complex part of the calculation under IFRS 17, and the results of the survey suggest that there are several aspects where the industry has not reached a consensus. The most important area is probably coverage units. Although some progress has been made, the survey results indicate that, for many products, there is still uncertainty around the appropriate definition of coverage units. Regarding contract grouping, most firms intend to have additional CSM groupings beyond the level at which the CSM is calculated in order to support internal management reporting.

Implementation planning

Last year's survey results indicated that many companies expected to make significant progress in 2021. However, this year's results show that this progression has not materialised. Firms are at similar stages to last year when it comes to end-to-end dry runs, producing business plans under IFRS 17, and reporting sensitivity analysis. This may indicate that implementation has been more difficult than expected, that the IFRS 17 delay was used to re-plan and revisit methodology, calculation and implementation decisions rather than push ahead, or that COVID-19 delays were greater than anticipated.

1.0 Executive summary

Transitional measures

Comparing this year's results to last year's indicates that firms are finding more barriers to implementing the full retrospective approach and are opting to use the modified retrospective and fair value approaches.

Business readiness and concerns

The survey results show more detailed consideration of actuarial cash flow models, with many firms indicating that more dramatic changes are required than they expected last year. Similarly, many more firms opted this year for outsourced or vendor-packaged solutions over in-house solutions, supporting other responses which indicate that implementation has been more difficult than anticipated.

The International Accounting Standards Board confirmed a limited set of amendments to IFRS 17 in 2020. As not all the matters raised were amended, it is not surprising that the survey results show that concerns remain in areas such as reinsurance, coverage units and interim financial reporting.

Accounting

Respondents offer useful insights on calculation and consolidation challenges, frequency of reporting and disclosures.

Many respondents are subject to quarterly external reporting.

Respondents find foreign exchange challenges when the contract currency differs from the functional currency, when the functional currency differs from the presentation currency, and when groups of contracts have multiple currencies. Respondents also face challenges such as dual CSMs driven by different assumptions, intercompany transactions and contract grouping.

When it comes to consolidation, respondents with more than one consolidation level prefer the step-by-step approach over the direct approach. Most indicate that they plan to use a thin general ledger approach, with the detailed calculations for IFRS 17 being produced in a subledger or actuarial system.

Many of these challenges require more granular calculation and reporting systems that can consolidate on multiple levels.

We hope you will find this report insightful. Please contact Moody's Analytics representatives if you would like more information.

2.0 Risk adjustments

2.1 Risk adjustment methodology

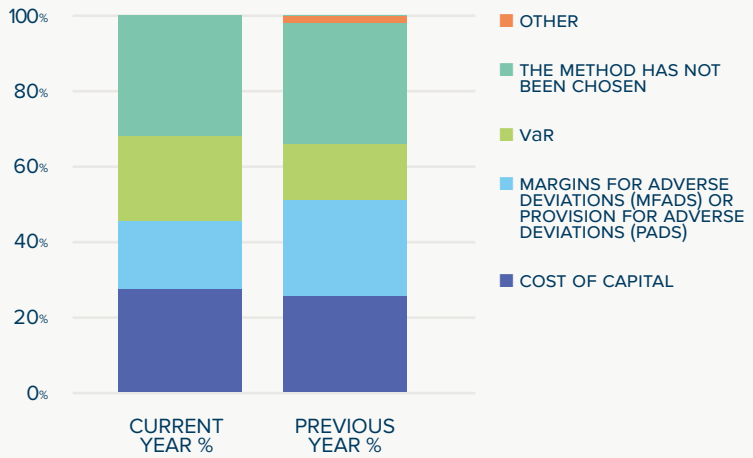
There has not been much movement in the choice of risk adjustment approach since the previous survey. A third of respondents (**33%**) are still indicating that a method has not been chosen. This is surprising, suggesting that firms are first focusing on other components of IFRS 17. Where a method has been chosen, choices are in line with those made in the previous survey. Cost of capital remains the most prevalent method, at **28%**, and there was a small shift towards value at risk (VaR) (**21%** currently versus **16%**% last year) and away from margins for adverse deviations (MfADs) (**18%** currently versus **21%** last year).

The responses indicate that there is a tendency for firms to take advantage of existing systems in order to support different reporting regimes. For EU firms already reporting under Solvency II, the cost of capital approach and VaR may be adapted for IFRS 17 reporting. Similarly, insurance firms that are already using MfADs under IFRS 4 may prefer to continue using the approach, calibrating it differently to aid external disclosure.

(Number of respondents: 67 this year, 62 last year.)

SURVEY FINDINGS:

What methodology will your company use for risk adjustment?



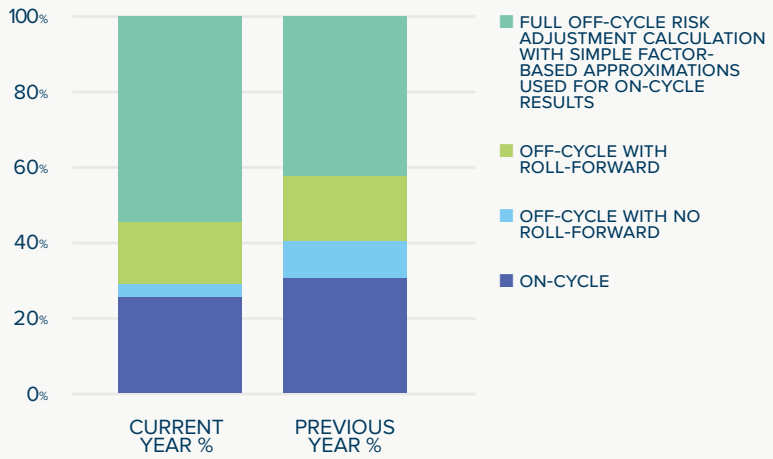
2.2 Calculating the risk adjustment and all required analysis of movement

Nearly **76%** of respondents indicate that the risk adjustment will be calculated off-cycle, or off-cycle with some form of approximation, compared to **69%** last year. This is common practice for the solvency capital requirement calibration for Solvency II and is consistent with the view that many firms will aim to leverage existing processes, which can be very time consuming and resource intensive.

(Number of respondents: 62 this year, 55 last year.)

SURVEY FINDINGS:

How will your company calculate the risk adjustment and all required analysis of movement?



2.3 Total risk adjustment compared with IFRS 4 provision for adverse deviation

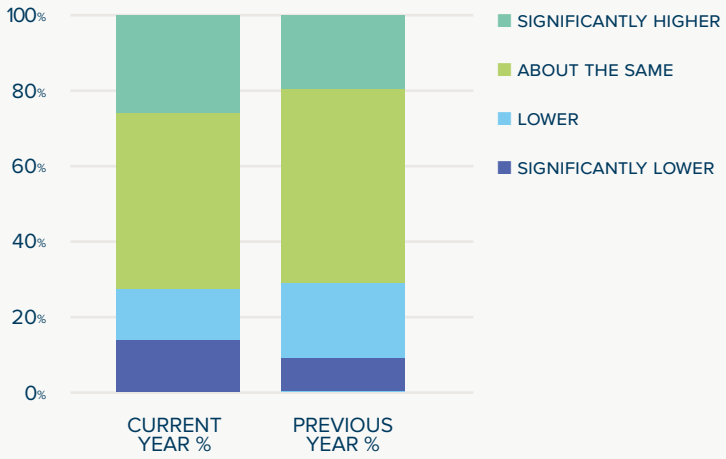
Most respondents (**46%**) expect that the level of total risk adjustment will be about the same as the IFRS 4 provision for adverse deviations (PADs), falling from **51%** last year. This shift is mostly to the 'significantly higher' category, selected by **26%** of respondents this year compared to **20%** last year. The 'lower' categories have remained relatively stable, at around **28%** this year compared to **29%** last year, but the mix has shifted down, with the 'significantly lower' category increasing from **9%** last year to **15%** this year.

This suggests that firms are moving away from targeting a similar level of IFRS 4 PADs, instead considering the risk adjustment on its own. The nature of the re-calibration and the explicit disclosure of the confidence level may result in slightly higher or lower levels of risk adjustment.

(Number of respondents: 61 this year, 55 last year.)

SURVEY FINDINGS:

How does your company expect the level of the total risk adjustment to compare with your IFRS 4 provision for PADs?



2.4 Confidence levels

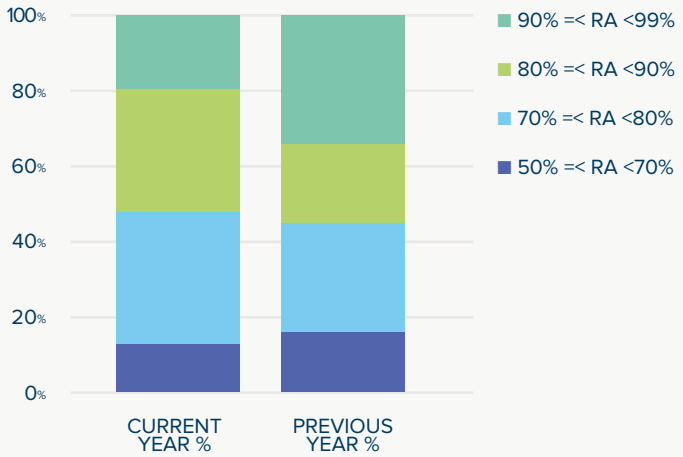
There are significantly fewer responses in the 90%–99% category (**20%** versus **36%** last year), with many shifting into the 80%–90% category (**31%**, up from **18%** last year). The 70%–80% category also showed a small increase (**36%**, up from **32%** last year). This shift in the expected confidence level suggests that firms have made good progress on refining the risk adjustment calibrations this year.

Responses in the 90%–99% category may be from firms that are planning to use existing Solvency II processes and calibrations.

(Number of respondents: 61 this year, 56 last year.)

SURVEY FINDINGS:

At what confidence level does your company expect to set the risk adjustment? (If not using VaR, what is the equivalent confidence level that will be disclosed?)



3.1 Benchmarks for the risk-free curve underlying the discount curve

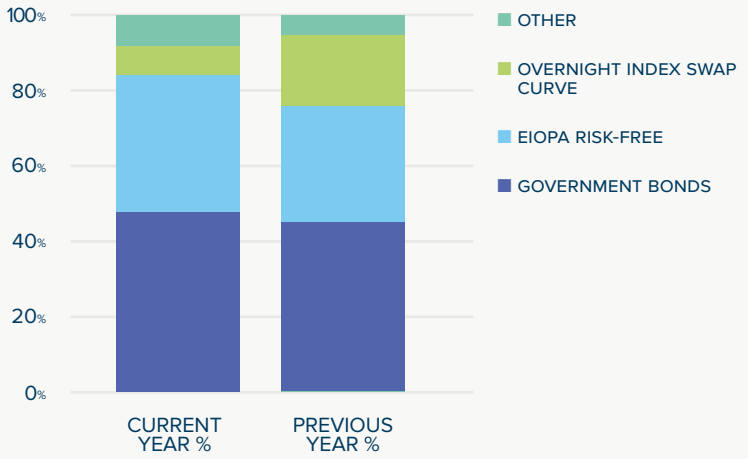
When it comes to benchmarks, **48%** express a preference for government bonds, **36%** for the European Insurance and Occupational Pensions Authority (EIOPA) risk-free rate, and **8%** for the overnight index swap curve. The corresponding proportions last year were **46%**, **30%** and **18%** respectively.

Answers in the 'Other' category increased from **6%** last year to **8%** this year. Some of these responses can be mapped back to one of the other categories, resulting in updated proportions of **48%**, **35%** and **8%** compared to **47%**, **30%** and **15%** before reallocation. The remaining responses in the 'Other' category indicate that the choice would vary by portfolio, probably due to firms operating in multiple territories with differences in the availability of underlying benchmark curves.

(Number of respondents: 62 this year, 50 last year.)

SURVEY FINDINGS:

What will your benchmark be for the risk-free curve underlying the discount curve?



3.2 Deriving the discount rate

Under IFRS 17, the discount rate can be set using a 'bottom-up' or 'top-down' approach that takes account of illiquidity:

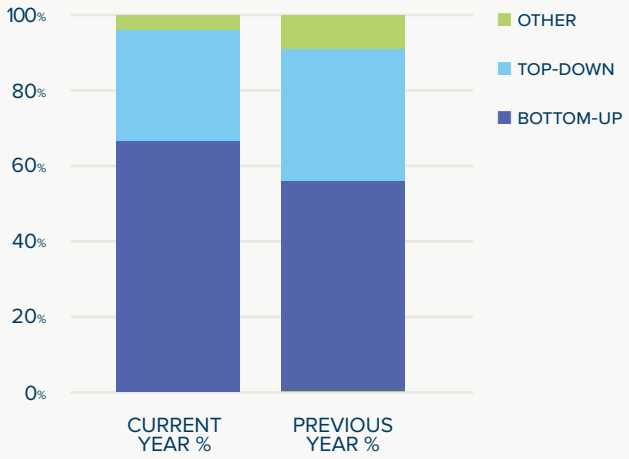
- *Bottom-up:* Start with the risk-free curve and add a liquidity premium
- *Top-down:* Start with the total yield on a reference portfolio and deduct credit risk and mismatch adjustment.

There has been an increase in the popularity of the bottom-up approach, from **56%** last year to **68%** this year. The popularity of the top-down approach decreased from **36%** to **29%**. Responses in the 'Other' category again indicate that the approach varies by portfolio. Only one respondent indicates that the approach has not been decided, compared to three last year, again indicating that firms have made good progress in this area.

(Number of respondents: 62 this year, 48 last year.)

SURVEY FINDINGS:

What methodology will your company use for deriving the discount rate?



3.3 Discount rate liquidity buckets

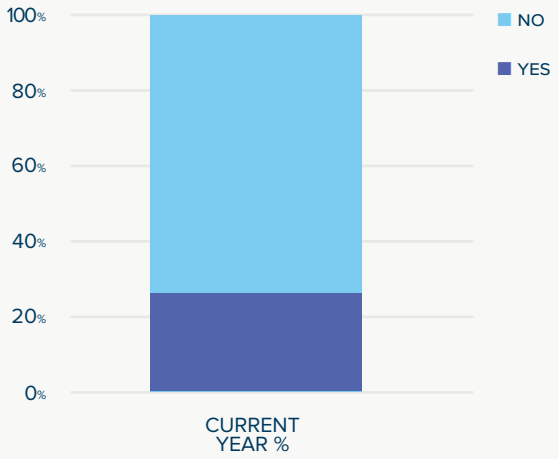
While IFRS 17 does not set any requirement for granularity in setting the discount rate, the liquidity premium reflects the characteristics of the insurance contracts. We therefore expect that different discount curves will depend on the currency and liquidity characteristics of the underlying portfolios.

In this year's survey, new questions were added to determine whether firms will be using liquidity buckets and, if so, how many. Those using liquidity buckets are in the minority, at **26%**. The number of buckets planned by these firms vary, with most indicating two to four buckets and a few indicating six to eight; some firms have not yet decided on the number of buckets they will use.

(Number of respondents: 57 this year.)

SURVEY FINDINGS:

Will you be using liquidity buckets?



3.4 Default and downgrade allowance when calculating discount rates

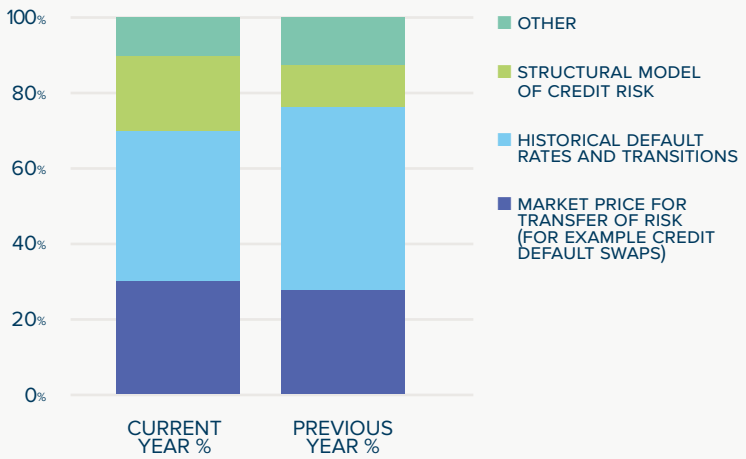
There has been a decrease in the number of respondents estimating the discount rate by using historical default rates and transitions (**40%**, down from **49%** last year). Instead, **21%** are using a structural model of credit risk, up from **13%** last year. Market price for transfer risk has also seen a small increase to **30%**, from **28%**. Responses in the 'Other' category indicate that the approach varies by portfolio or has not yet been finalised.

These responses are in line with what we expected. It is not surprising that historical default rates and transitions are the dominant approach, given that this approach is used for Solvency II.

(Number of respondents: 53 this year, 47 last year.)

SURVEY FINDINGS:

When calculating discount rates, how will your company estimate the allowance for default and downgrade?



4.0 Contractual service margin

4.1 Contract groupings for supporting internal management reporting

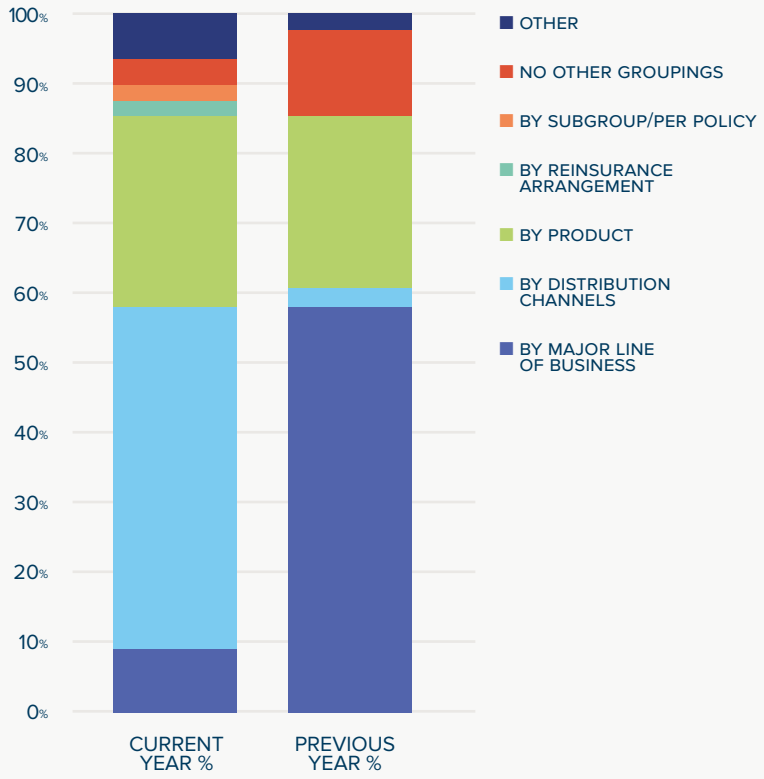
Nearly **90%** of respondents (versus **85%** last year) indicate that contractual service margin (CSM) will also be grouped by major product line of business, distribution channel, product or other subgrouping. There have been shifts in the choices of additional groupings, with product grouping and distribution channel seeing the biggest increases and major business line the biggest decrease. Only **4%** (versus **13%** last year) indicate that there will be no other groupings beyond the groupings at which CSM is calculated.

These responses are in line with what we expected. It is common to have additional CSM groupings for large groups with similar risk characteristics, profit emergence profiles or other aspects that are meaningful for managing the business, as this provides information that can help with managing and monitoring insurance contracts.

(Number of respondents: 49 this year, 39 last year.)

SURVEY FINDINGS:

Beyond the groupings at which CSM is calculated, which of the following distinct contract groupings will your company use to support internal management reporting?



4.0 Contractual service margin

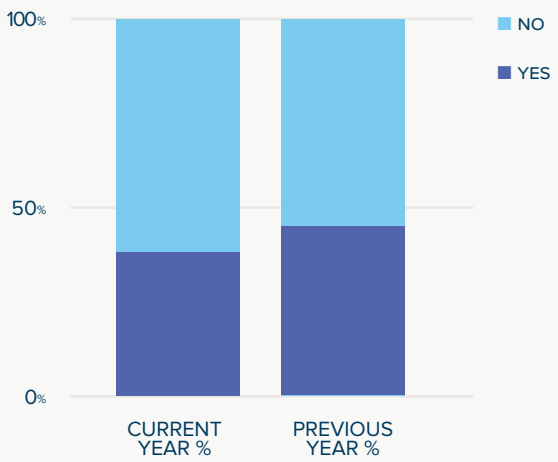
4.2 Multiple CSM values from different entity perspectives

This question is relevant only for groups with different legal entities that need to consolidate reporting at group level. The number of respondents selecting 'Yes' is the same as last year, indicating that the concerns have remained for the affected firms. For those respondents that indicate yes, we look at the reasons for multiple CSM values in the next question.

(Number of respondents: 47 this year, 39 last year.)

SURVEY FINDINGS:

Does your company have any concerns about multiple values of the CSM for the same block of business when valued from different entity prespectives?



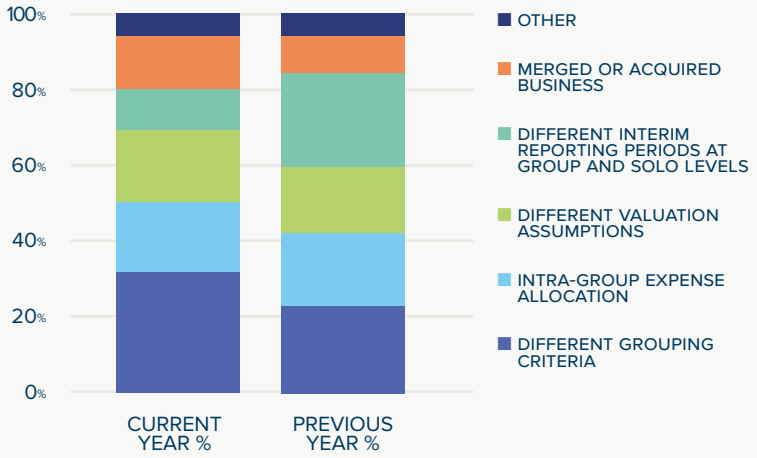
4.3 Reasons for multiple CSM values

Many respondents indicate multiple contributing reasons for there being multiple CSM values. This is clearly an issue among practitioners who work in firms that have complicated organisational structures. Different interim reporting periods at group and solo level are less of an issue this year than they were last year, indicating that organisations may have been making adjustments in order to facilitate IFRS 17 reporting. Different grouping criteria and merged or acquired business has increased. This may be due to firms refining their methodology and starting to have more discussions with auditors during the year.

(Number of responses: 28 this year, 24 last year.)

SURVEY FINDINGS:

If you answered yes, what are your reasons for multiple CSM values?



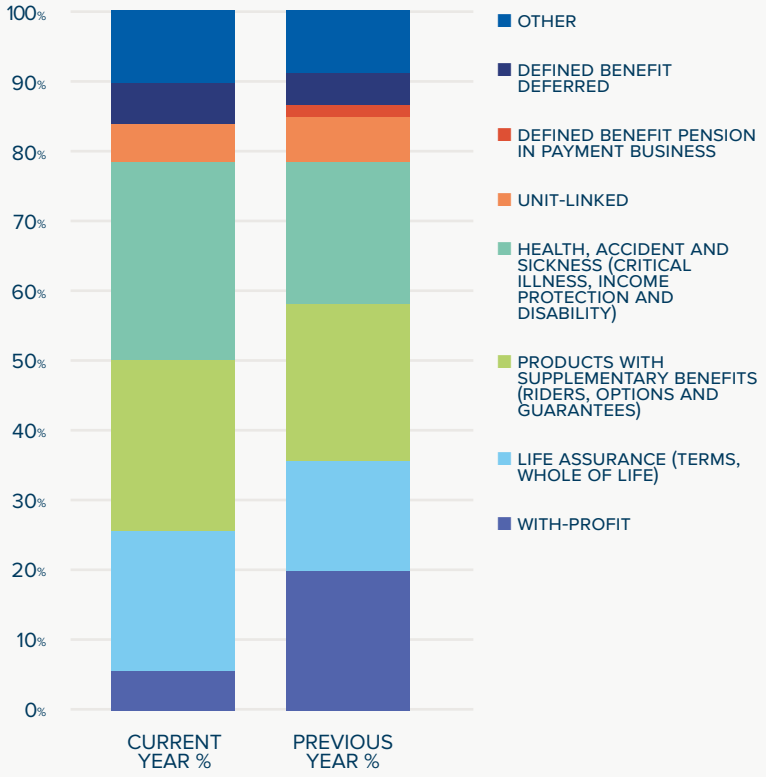
4.4 Appropriate definition of coverage units for products

The coverage unit is a significant factor in determining the amount of the CSM that is recognised in profit or loss in the reporting period. Some progress appears to have been made in with profits and unit-linked areas during the year, and defined benefit pension in payment is now no longer selected as an issue by any respondent. Other areas, such as life insurance, health insurance and multiple benefits on the same policy, remain a concern for a similar number of respondents to last year.

(Number of respondents: 29 this year, 27 last year.)

SURVEY FINDINGS:

Are there any products for which your company is concerned about the appropriate definition of coverage units?



4.5 Bases for loss component systematic allocation

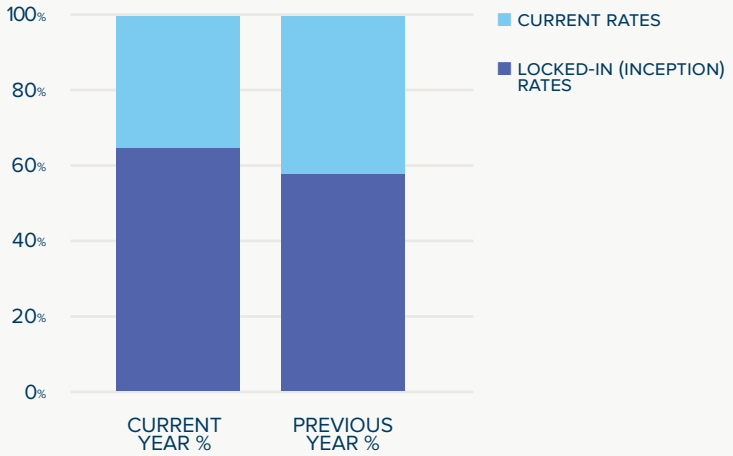
IFRS 17 is explicit in requiring the use of locked-in discount rates at inception for the adjustment to CSM. However, there is no explicit requirement for the loss component. Firms can choose how the loss component balance will be adjusted, by changes in fulfilment cash flows on a locked-in interest basis or current interest rate basis. It is important to note that there are different views on the subject, but the locked-in interest rate basis and current interest rate basis are the two dominant ones.

In this year's survey result there has been a small increase in the proportion opting for locked-in (inception) rates, from **59%** last year to **64%**.

(Number of respondents: 47 this year, 39 last year.)

SURVEY FINDINGS:

Which of the following will your company use as a basis for loss component systematic allocation?



5.1 Reporting sensitivity analysis results

IFRS 17 disclosure requires sensitivity analysis to be disclosed in a way that explains the relationship between sensitivities to changes in risk exposures arising from insurance contracts, and those arising from financial assets held by the entity. This question explores the methodologies that firms are using to support sensitivity analysis. Permissible approaches are:

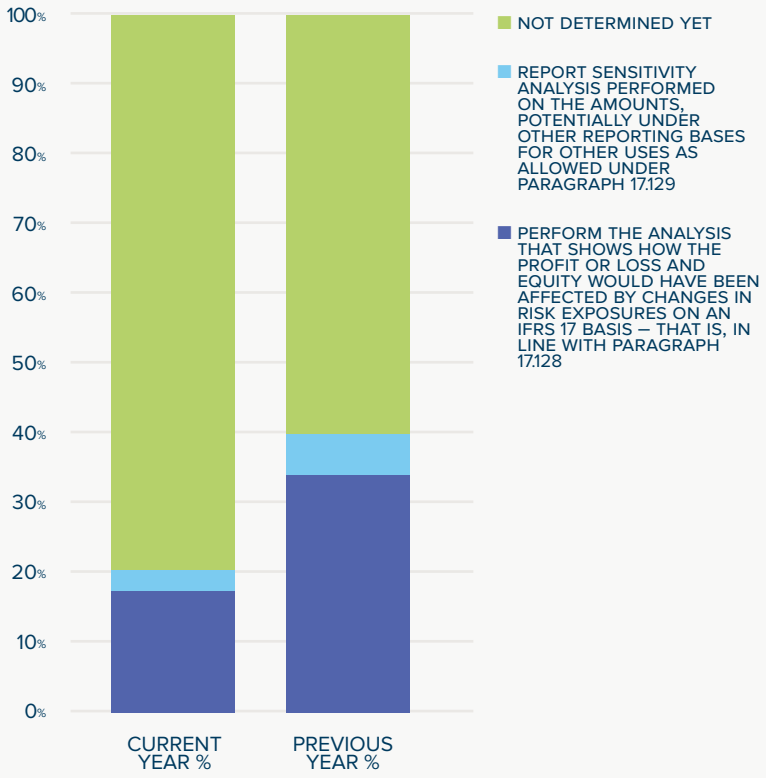
- Perform analysis that shows how the profit or loss and equity would have been affected by changes in risk exposures on an IFRS 17 basis – that is, in line with paragraph 17.128
- Report sensitivity analysis performed on other amounts, potentially under other reporting bases for other uses, as allowed under paragraph 17.129.

This seems to be an area that has not progressed much by firms, with the proportion indicating that the approach is not decided having increased since last year from **60%** to **80%**. Where an approach was selected, the first approach in the bullet points above is still the favoured approach.

(Number of respondents: 35 this year, 42 last year.)

SURVEY FINDINGS:

Which method will your company use to report sensitivity analysis results?



5.2 Re-calibrating key performance indicators and key risk indicators

The introduction of the CSM under IFRS 17 reporting means that, for profitable new business, the IFRS profit will be set to zero at inception – that is, no profit recognition at inception. Instead, profit is released as contract service is dispensed during the contractual period. For existing business, changes to CSM will be spread over the remaining contractual period. This significant change means that existing performance and risk indicators may need to be re-calibrated or developed further.

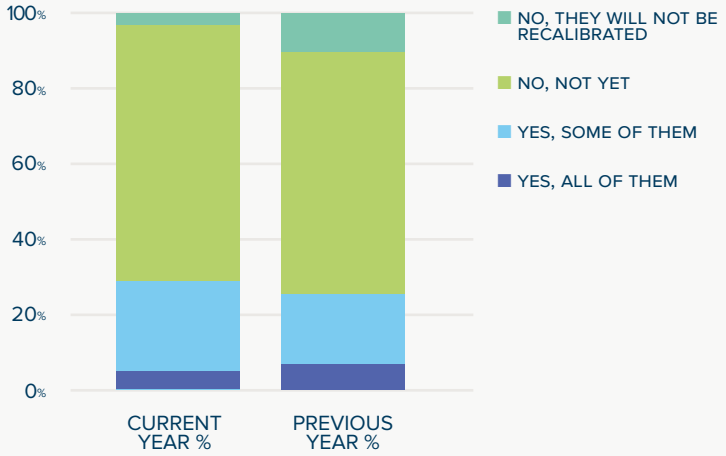
Based on the survey results, more than **67%** have not re-calibrated key performance indicators (KPIs) or key risk indicators (KRIs) under IFRS 17 – a similar proportion to last year. Nearly **30%** indicate that all or subsets of KPIs/KRIs have already been re-calibrated, up from **24%** last year; this indicates that some progress was made in this area.

Those who indicate that internal management KPIs/KRIs will not be recalibrated may work in businesses that are managed primarily using other metrics based on different reporting regimes, such as embedded value and solvency capital. This proportion has fallen from **10%** last year to **3%** this year.

(Number of respondents: 34 this year, 42 last year.)

SURVEY FINDINGS:

Have KPIs and KRIs been re-calibrated based on IFRS 17?



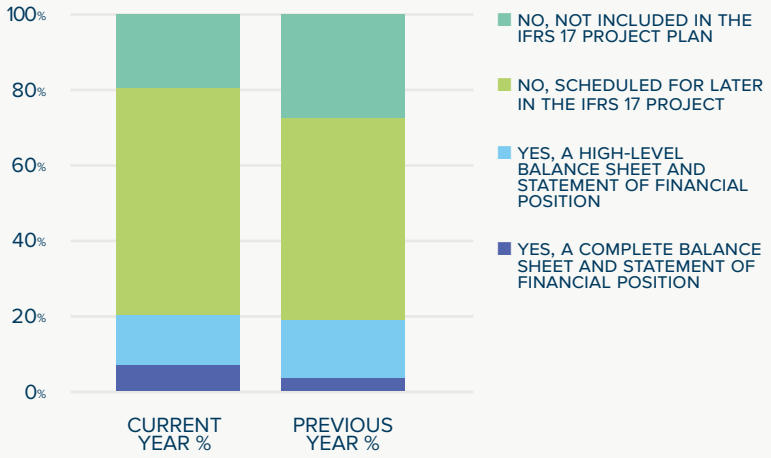
5.3 Business plans based on IFRS 17

Not much progress has been made in this area, with **20%** of respondents indicating that they either have completed or have a high-level balance sheet and statement of financial position based on IFRS 17. This is compared to **19%** last year. The remaining **80%** indicate that the work is either scheduled for later in the IFRS 17 project or is out of scope of the project. This suggests that firms still have much to do before progressing onto other aspects of IFRS 17 implementation, such as preparing a business plan based on IFRS 17.

(Number of respondents: 35 this year, 42 last year.)

SURVEY FINDINGS:

Has your company prepared a business plan based on IFRS 17?



5.4 Business plan time schedules

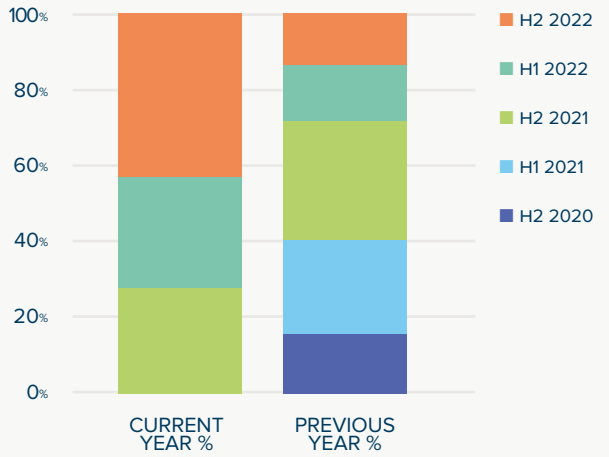
Last year, when excluding the 'not applicable' responses, **16%** intended to prepare a business plan based on IFRS 17 by 2020, **56%** by 2021 and **28%** by 2022. It is clear from this year's responses that these ambitions have been shifted down the line as companies focus on implementation of the main IFRS 17 requirements; most respondents (**73%**) indicate that the business plans on IFRS 17 basis will only be done in 2022. Plans may also have been impacted negatively by the COVID-19 pandemic.

Of the five respondents who indicate that they have already completed a business plan on IFRS 17, four completed this in H1 2021 and one in H2 2020.

(Number of respondents: 32 this year, 42 last year.)

SURVEY FINDINGS:

If you answered no, when does your company intend to do so?



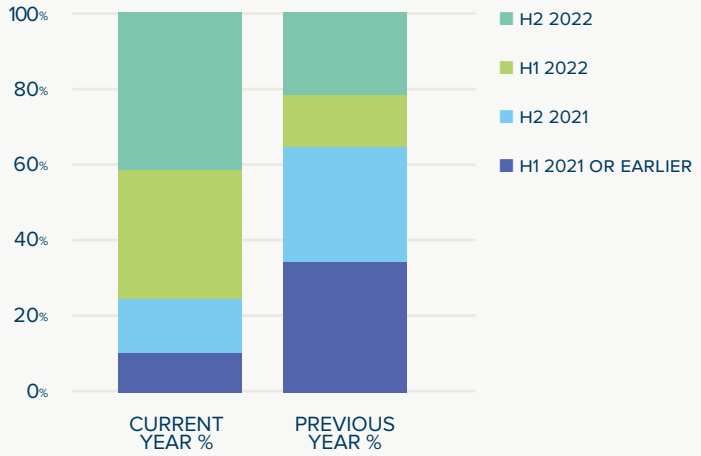
5.5 Readiness for an end-to-end dry run

Last year, **65%** indicated that they expected to be ready for an end-to-end dry run by 2021 H2; however, in this survey, only **24%** express this expectation. Most respondents (**41%**) now only expect to carry out end-to-end dry runs in H2 2022. This may indicate that implementation of the core IFRS 17 functionality is proving more time-consuming than firms originally expected, or that project plans were disrupted by the COVID-19 pandemic.

(Number of respondents: 34 this year, 40 last year.)

SURVEY FINDINGS:

When does your company expect to be ready for an end-to-end dry run?



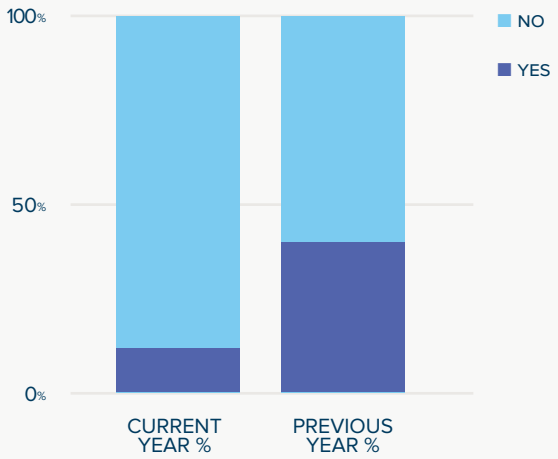
5.6 Early adoption of IFRS 17 or parallel reporting

More than **88%** of respondents indicate that they will not consider early adoption of IFRS 17 or parallel reporting. This response is consistent with the previous question, indicating that the implementation of IFRS 17 is taking longer than originally expected.

(Number of respondents: 34 this year, 40 last year.)

SURVEY FINDINGS:

With the pushback of the mandatory IFRS 17 effective date, will your company consider early adoption of IFRS 17 or parallel reporting?



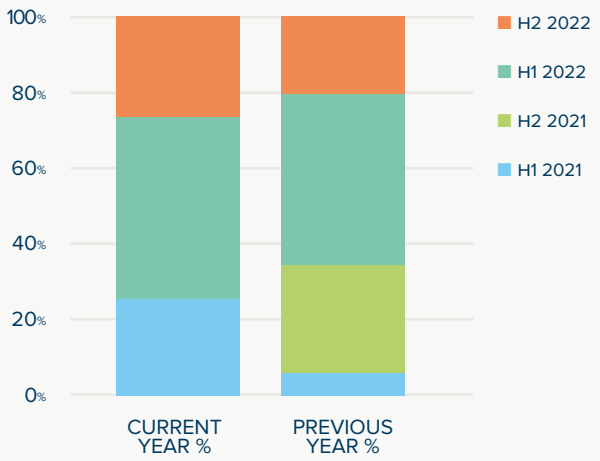
5.7 Early adoption schedules

Of those who answered 'Yes', **25%** have already adopted in H1 2021. Of the remainder, **50%** expect early adoption from H1 2022 (versus **44%** in the previous survey) and **25%** from H2 2022 (versus **19%** in the previous survey).

(Number of respondents: 24 this year, 40 last year.)

SURVEY FINDINGS:

If you answered yes, when did your company start or when does your company intend to do so?



6.1 Transition method usage

We asked respondents to what proportion of the business they expect to apply the following transition methods (based on size of reserves): the full retrospective approach (FRA), the modified retrospective approach (MRA) and the fair value approach (FVA).

Based on the survey results, the average proportion of liabilities expected to use each transition methodology is as follows:

- Although the average proportion of liabilities expected to be transitioned at full retrospective method remains at **43%**, the number of respondents indicating that less than 20% of liabilities will fall into this category has increased from **46%** to **61%**.
- With a smaller proportion of liabilities using full retrospective transition, the proportions using modified retrospective and fair value methods have increased.

This suggests that firms are finding more barriers to implementing full retrospective transition and opting to use the alternatives available to them.

Transition method	This year		Previous year	
	% of liabilities	Number of respondents	% of liabilities	Number of respondents
Full retrospective	43%	31	43%	26
Modified retrospective	37%	25	29%	25
Fair value	57%	26	48%	22

7.0 Business readiness and concerns

7.1 Remaining concerns

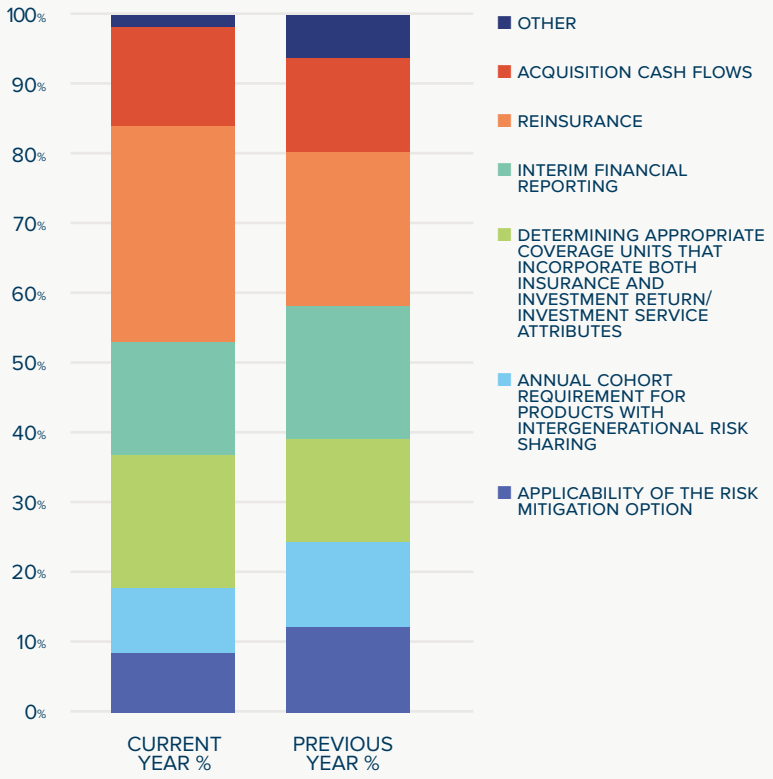
The survey indicates that concerns remain across the industry, despite amendments to the standard having been implemented. Most respondents select more than one area of concern. Reinsurance remains a key problem area (**32%** of responses this year compared to **23%** last year). Coverage units have also increased in prevalence as an area of concern (**19%** this year versus **14%** last year).

These responses are not surprising, given that not all of the concerns raised with the International Accounting Standards Board by stakeholders hoping for amendments were accommodated.

(Number of respondents: 35 this year, 30 last year.)

SURVEY FINDINGS:

Now that exposure draft discussions have concluded, which of the following items remain a concern for interpretation and implementation?



7.2 Status of issues in relation to IFRS 17 implementation challenges

In line with what was expected, the survey indicates that workstreams related to the building blocks of implementing IFRS 17 have progressed over the year, or been completed. These include contract grouping, coverage units and discount rates. Workstreams that rely on the building blocks being completed, such as business planning and projection or tax and sensitivities, are largely still to be started, but fewer respondents indicate that these are still to be decided, indicating that there has been progress on methodology for these aspects.

(Number of respondents: 34 this year, 31 last year.)

SURVEY FINDINGS:

The progress made by companies on IFRS 17 implementation challenges.

	CURRENT YEAR %				PREVIOUS YEAR %			
	Not started	In progress	Complete	To be decided	Not started	In progress	Complete	To be decided
Discount rates	14.71%	44.12%	35.29%	5.88%	25.81%	41.94%	25.81%	6.45%
Risk adjustment	14.71%	58.82%	17.65%	8.82%	16.67%	60.00%	16.67%	6.67%
Contract grouping	9.09%	36.36%	51.52%	3.03%	12.90%	51.61%	32.26%	3.23%
Coverage units	14.71%	47.06%	35.29%	2.94%	17.24%	55.17%	24.14%	3.45%
Disclosures	29.41%	58.82%	5.88%	5.88%	25.81%	51.61%	9.68%	12.90%
Sensitivities	50.00%	32.35%	5.88%	11.76%	46.67%	36.67%	0.00%	16.67%
Business planning and projections	58.82%	35.29%	2.49%	2.49%	46.67%	40.00%	0.00%	13.33%
Tax	51.52%	39.39%	6.06%	3.03%	41.94%	32.26%	3.23%	22.58%
Reporting timelines	17.65%	58.82%	14.71%	8.82%	23.33%	66.67%	3.33%	6.67%
Software	9.09%	57.58%	27.27%	6.06%	13.33%	73.33%	10.00%	3.33%

7.0 Business readiness and concerns

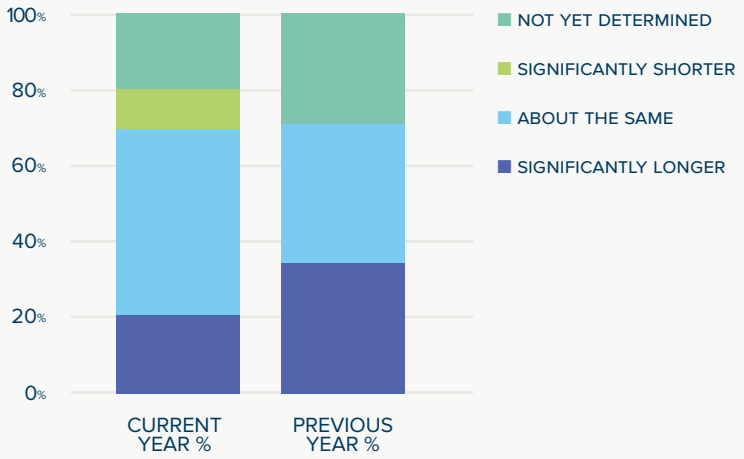
7.3 The impact of IFRS 17 on time frames for public financial report production

Respondents seem more optimistic about the impact of IFRS 17 on reporting time frames than in the previous survey, with **50%** indicating that it will be about the same, compared to **34%** last year; **9%** are indicating that it will be significantly shorter, compared to **0%** last year. This could be the result of firms investing resources into improving reporting processes to facilitate the increased requirements of IFRS 17.

(Number of respondents: 34 this year, 35 last year.)

SURVEY FINDINGS:

How will IFRS 17 affect your company's time frame for producing public financial reports?



7.0 Business readiness and concerns

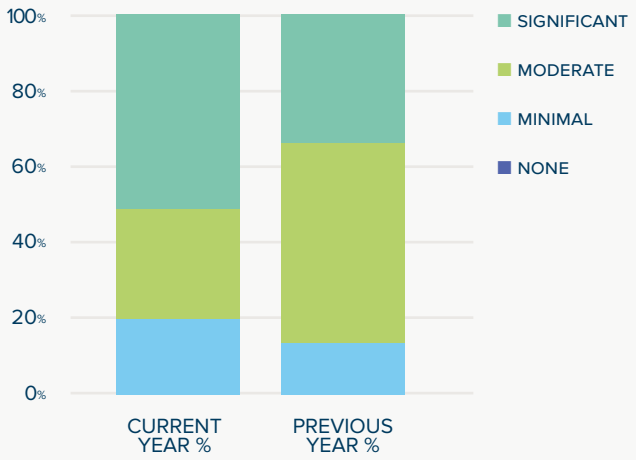
7.4 Development of actuarial cash flow models in relation to IFRS 17

Firms seem to have found that their actuarial cash flow models will require more development work than expected, with a shift from the moderate category (**51%** last year versus **29%** this year) to significant (**34%** last year versus **50%** this year). This may account for some of the delays in the implementation time frame indicated by the responses to other survey questions.

(Number of respondents: 34 this year, 35 last year.)

SURVEY FINDINGS:

How much development of your actuarial cash flow models do you expect to have to make for IFRS 17?



7.0 Business readiness and concerns

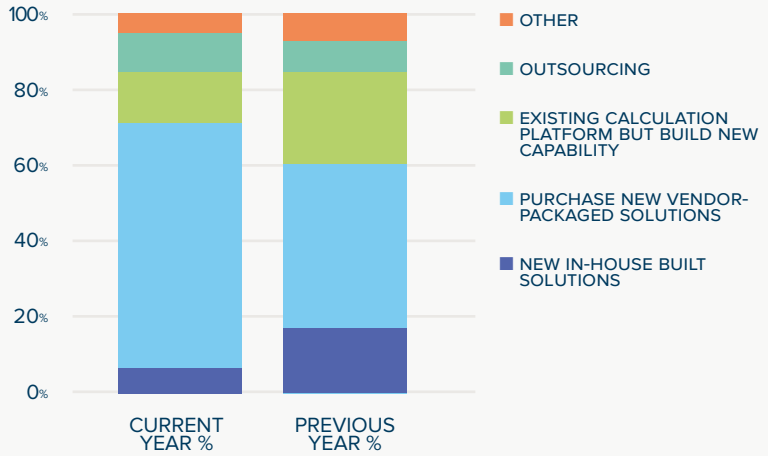
7.5 Company solutions for IFRS 17 calculation platforms

There has been a shift away from in-house solutions (**24%** this year versus **40%** last year) in favour of vendor-packaged or outsourced solutions (**71%** this year versus **51%** last year). This may be due to a combination of improvements in the offerings from vendors, combined with difficulties experienced when implementing in-house solutions.

(Number of respondents: 34 this year, 35 last year.)

SURVEY FINDINGS:

What do you expect your company solution to be for the IFRS 17 calculation platform?



8.0 Accounting

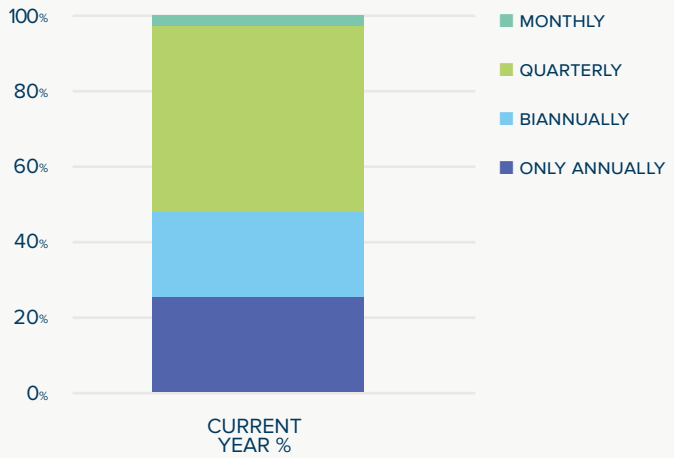
8.1 Frequency of external reporting

Most respondents – **49%** – are subject to quarterly external reporting, **26%** to biannual and **23%** to annual. Only **3%** of respondents report externally on a monthly basis.

(Number of respondents: 35.)

SURVEY FINDINGS:

What is the frequency of your external reporting (disregarding any additional internal reporting requirements)?



8.2 Dual CSM problem

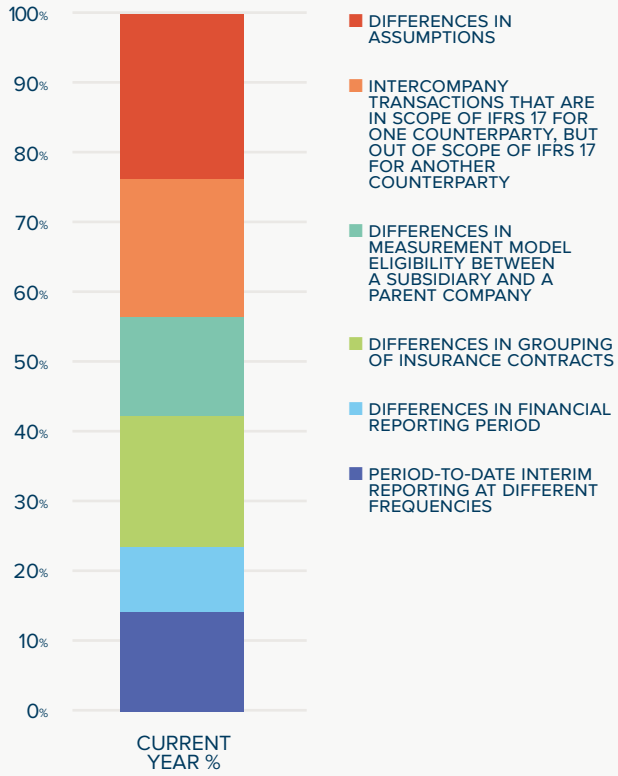
A 'dual CSM' problem can arise when there are differences between measurement results in what an entity reports to two different parties, such as a local regulator versus a foreign parent company, or, for example, internal reporting versus external reporting. Of the survey respondents, 20 indicate that they are exposed to this problem, and most select more than one reason for this exposure. The reasons are, in order of prevalence:

- Differences in assumptions (for example the parent company applies different discount rates, or different non-financial assumptions, than the subsidiary does) (**23%**)
- Intercompany transactions that are in scope of IFRS 17 for one counterparty but out of scope for another counterparty (for example a parent company provides administrative services to a subsidiary. The subsidiary measures these as part of its insurance expenses under IFRS 17, while the parent company does not consider this as insurance business but as revenue from contracts with customers, in scope of IFRS 15) (**21%**)
- Differences in grouping of insurance contracts between, for example, a subsidiary and a parent company (**18%**)
- Period-to-date interim reporting (not year-to-date reporting) at different frequencies (for the two stakeholders) (**15%**)
- Differences in measurement model eligibility between a subsidiary and a parent company (for example the parent company applies the variable fee approach while the subsidiary applies the general measurement model on the same group, or the parent company applies the general measurement model and the subsidiary applies the premium allocation approach) (**15%**)
- Differences in financial reporting period (for example an entity whose financial year does not coincide with the calendar year) (**9%**)

(Number of respondents: 20.)

SURVEY FINDINGS:

Which of the following challenges may lead you to have a 'dual CSM problem'?



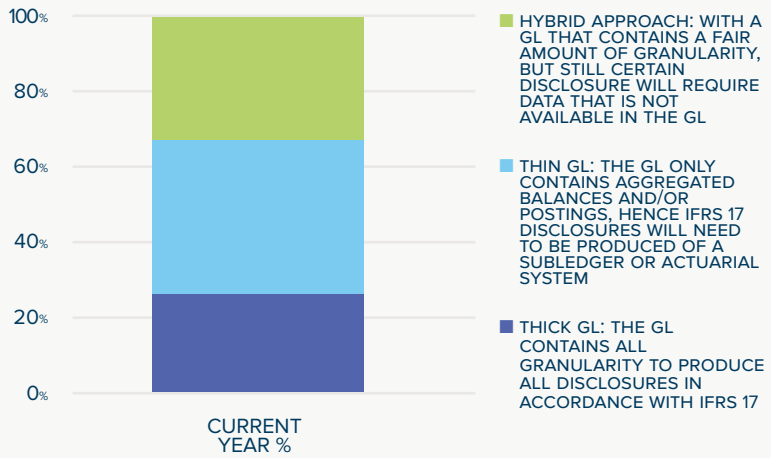
8.3 General ledger approach

Most respondents (**44%**) indicate that they plan to use a thin general ledger (GL) approach, with the detailed calculations for IFRS 17 being produced in a subledger or actuarial system. The hybrid approach is the next most prevalent, at **32%**. This is consistent with the responses from question 7.5, which indicate outsourcing or vendor-supplied solutions as the preference for the CSM calculation platform.

(Number of respondents: 25.)

SURVEY FINDINGS:

With respect to IFRS 17, will you apply a thick GL or a thin GL approach?



8.4 Foreign exchange challenges

Most respondents indicate multiple reasons for exposure to foreign exchange challenges, with the most prevalent reasons being:

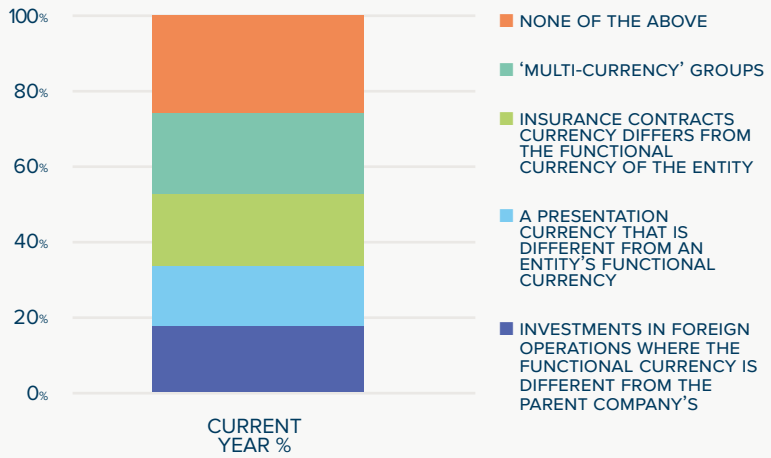
- 'Multi-currency' groups: Groups of insurance contracts that hold cash flows in more than one currency (**21%**)
- Financial consolidation of investments in foreign operations where the functional currency is different from the parent company's (**19%**)
- Groups of insurance contracts in a currency that is different from the functional currency of the entity (**19%**)
- A presentation currency that is different from an entity's functional currency (**16%**).

Of the respondents, **25%** selected 'None of the above', indicating that there may be other reasons for foreign currency exposure that are not covered by the question, or that the firms are not exposed to foreign exchange challenges.

(Number of respondents: 25.)

SURVEY FINDINGS:

Which of the following foreign exchange challenges will you be facing with respect to IFRS 17?



8.5 Multi-level financial consolidation

Multi-level financial consolidation is consolidation by a parent company whose subsidiaries are parent companies with subsidiaries of their own. We consider two methods:

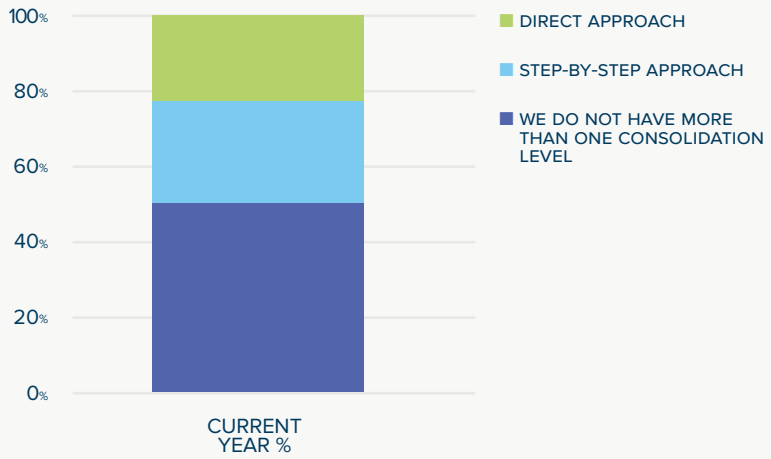
- A direct approach, where the higher-level parent company ignores its subsidiary's consolidated statement and directly consolidates all individual reporting entities. As such, it performs all intercompany eliminations
- A step-by-step approach, where lower-level parent companies conciliate first (including intercompany eliminations) and the high-level parent starts from that consolidated statement of its subsidiary.

Of respondents, **48%** do not have more than one consolidation level. For the remaining respondents, **30%** apply the step-by-step approach and **22%** the direct approach.

(Number of respondents: 23.)

SURVEY FINDINGS:

How do you perform multi-level financial consolidation of the insurance business?



9.0 Research methodology

9.1 Research methodology

For this research, we undertook a quantitative online survey. It was sent to firms involved in the IFRS 17 process and we were pleased to receive responses from more than 100 actuarial practitioners, IFRS 17 programme leads, risk managers and accountants from across the globe.

Of the survey respondents (previous year's values in brackets):

- **25%** (**20%**) practise in the UK, **46%** (**42%**) in Europe (excluding UK), the Middle East and Africa, **25%** (**24%**) in Asia-Pacific, and **5%** (**14%**) in the rest of the world.
- All work in insurance – **30%** (**28%**) specialise in general insurance, **40%** (**47%**) in life insurance and **30%** (**25%**) in other areas of insurance business.
- **37%** (**40%**) are in a managerial role, **33%** (**43%**) work as actuaries and **30%** (**17%**) are in more junior actuarial roles.

The response rate for each question varies depending on the relevance of the subtopic to the context of the firm that the respondent operates within.

Glossary

Term	Description
Contractual service margin (CSM)	The component of the assets or liabilities that represents the unearned profit from an insurance contract that the company will recognise as it provides future service under the contract
Discount rate	The rate applied to future cash flows to calculate the present value
Discount curve	The curve of different discount rates for each future time period included in the projection
European Insurance and Occupational Pensions Authority (EIOPA)	The organisation that sets capital standards (such as Solvency II) for European insurers and pension funds
Full retrospective approach (FRA)	The preferred transition approach under IFRS 17. Under this approach, the CSM at transition date is set by assessing the CSM for groups of contracts at inception, applying all the IFRS 17 requirements and rolling it forward to the transition date
Fair value approach (FVA)	An alternative transition approach allowed under IFRS 17 when full retrospective and modified retrospective approaches are impracticable. Under this approach, the CSM at transition date is set by reference to the fair market value of the group of insurance contracts
General ledger (GL)	An organisation's main accounting record
General measurement model (GMM)	The default measurement approach for most contracts under IFRS 17. It defines the principles for the initial and subsequent measurement of insurance contracts
International Accounting Standards Board (IASB)	The organisation that sets International Financial Reporting Standards (IFRS)
International Financial Reporting Standard 4 (IFRS 4)	The current international reporting standard for insurance business from 2005

Term	Description
International Financial Reporting Standard 17 (IFRS 17)	The new international reporting standard for insurance business from 2023
Key performance indicator (KPI)	A metric calculated to measure and/or anticipate performance
Key risk indicator (KRI)	A metric calculated to measure and/or anticipate risk
Margin for adverse deviation (MfAD)	The buffer in assumptions for outcomes that are worse than best-estimate assumptions
Modified retrospective approach (MRA)	An alternative transition approach allowed under IFRS 17 when full retrospective approach is impracticable. This approach is similar to the full retrospective approach, but applying permitted simplifications
Premium allocation approach (PAA)	An alternative measurement approach under IFRS 17 for short-duration contracts
Provision for adverse deviation (PAD)	The capital buffer held for outcomes that are worse than best-estimate assumptions
Risk adjustment	Compensation for cash flow uncertainty caused by non-financial risks
Solvency II	The capital regime for insurers in Europe
Value at risk (VaR)	A metric that specifies loss over a given time horizon with a given probability, used for the risk adjustment in the financial disclosures
Variable fee approach (VFA)	An alternative measurement approach under IFRS 17 for profit-sharing contracts

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