

talanx.

Insurance. Investments.

The world of insurance reporting is changing

A simplified guide to IFRS 17 and IFRS 9

12 Oct 2022

Workshop

Jan Wicke (CFO) and team





Agenda

- 1** Introduction
- 2 Most important changes
- 3 Appendix

1 We are doing this workshop to...



...familiarise you with the new accounting regime



...substantiate our view that IFRS 17 is positive for the insurance sector



...acquaint you with the Talanx Finance team that manages the transition

1 Why we need new accounting standards

Balance sheet



**Inconsistent valuation
of assets and liabilities**

Market values



**Not all assets
marked to market**

Comparability



**Limited comparability
with peers, different
lines of business, and
other sectors**

1 Why we like IFRS 17 and 9



- Comparison with peers, different lines of business, and other sectors will be easier
- Better alignment between IFRS and Solvency 2
- Better earnings predictability (in life)



- Cash flows and economic profitability will not change but...
- ...markets will need time to adjust and understand new rules



More comparability



More transparency



1 Timeline for application of IFRS 17 / 9





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- 1 Introduction
- 2 Most important changes**
- 3 Appendix

The most important changes from new IFRS accounting

1

Discounting of claims reserves

2

Economic presentation of life insurance

3

Stricter fair value approach for investments (IFRS 9)

4

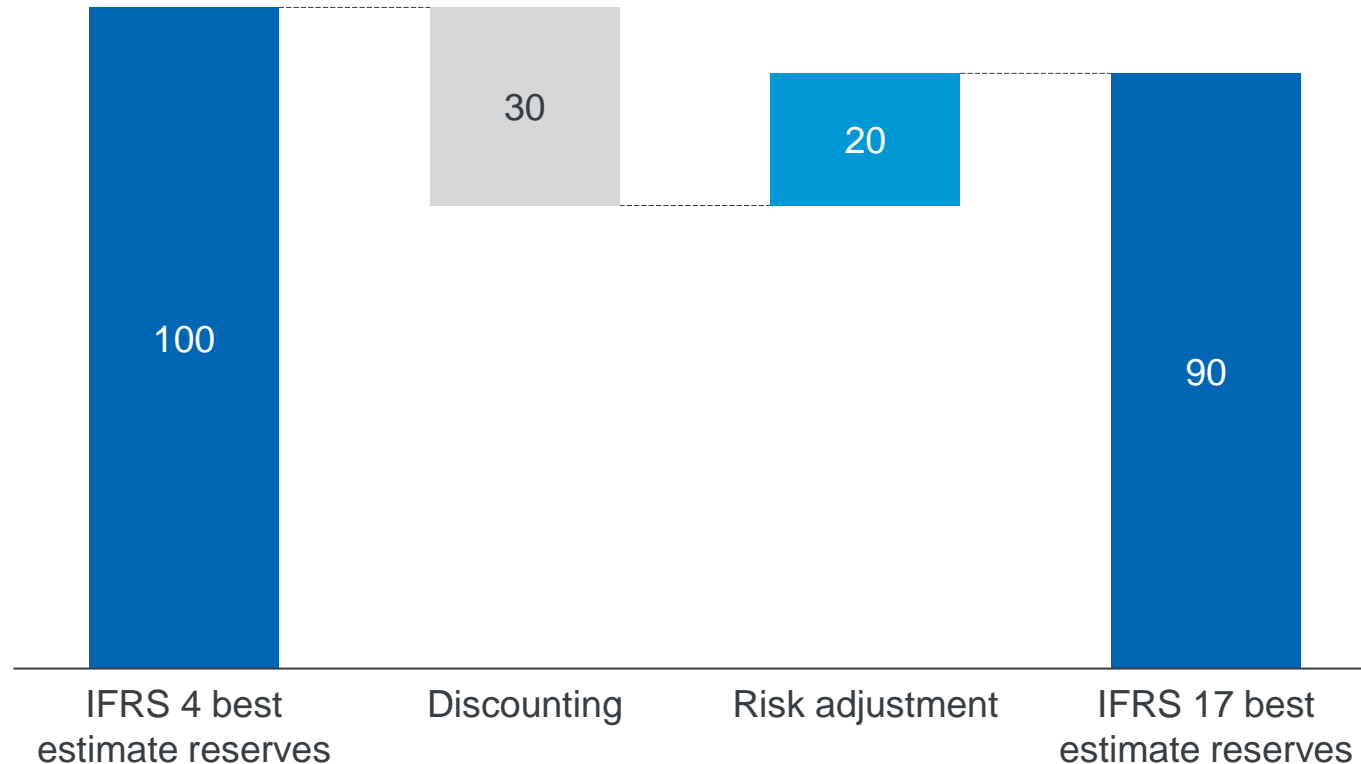
New structure of income statement

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Change in Key Performance Indicators

P/C claims reserves will be discounted and supplemented by „risk adjustment“

Illustrative example, balance sheet view



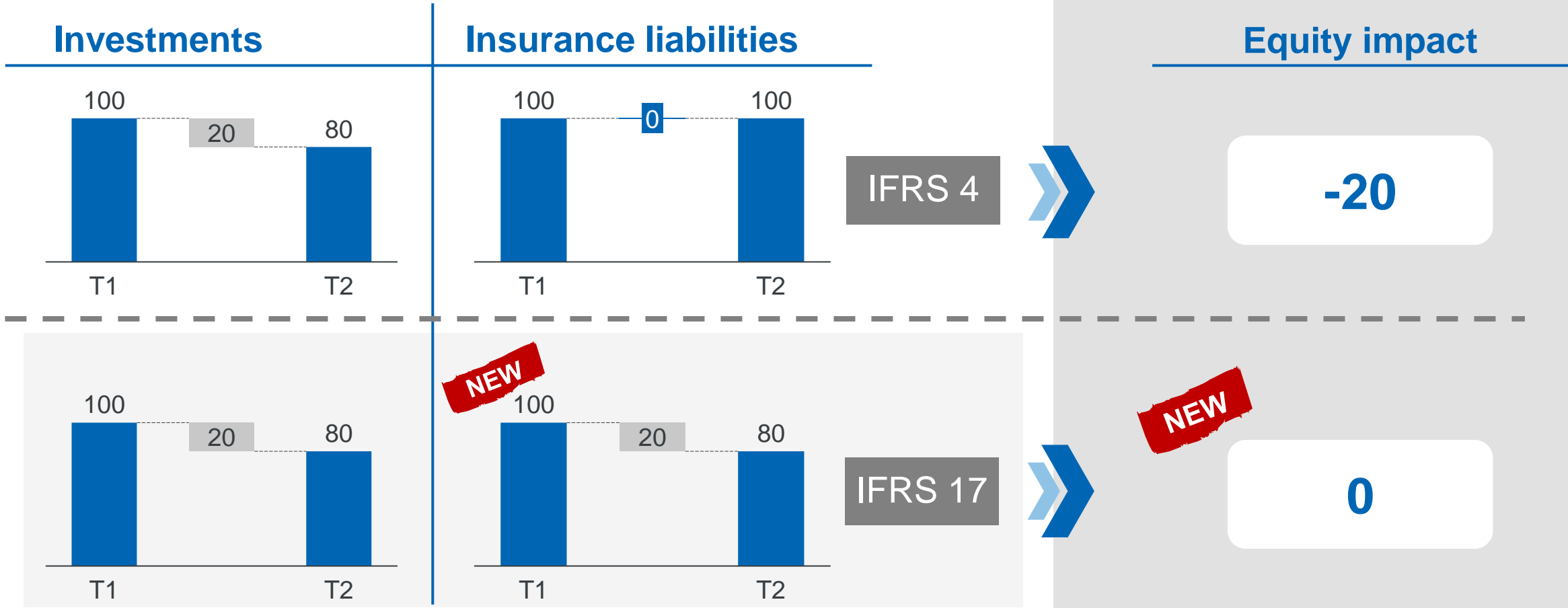
Comments

- Reserves discounted with applicable market rates at each accounting date
- Risk adjustment applied to reflect non-financial risk, in particular uncertainties arising from amount and timing of cash flows
- Reserves will fluctuate broadly in line with asset base as interest rates change over time (no p&l impact)
- IFRS and Solvency 2 balance sheets will converge as a result of claims reserve discounting
- Resiliency reserves impacted marginally only, but will be shown in discounted form

2 Equity more stable due to consistent discounting of assets and liabilities in P/C

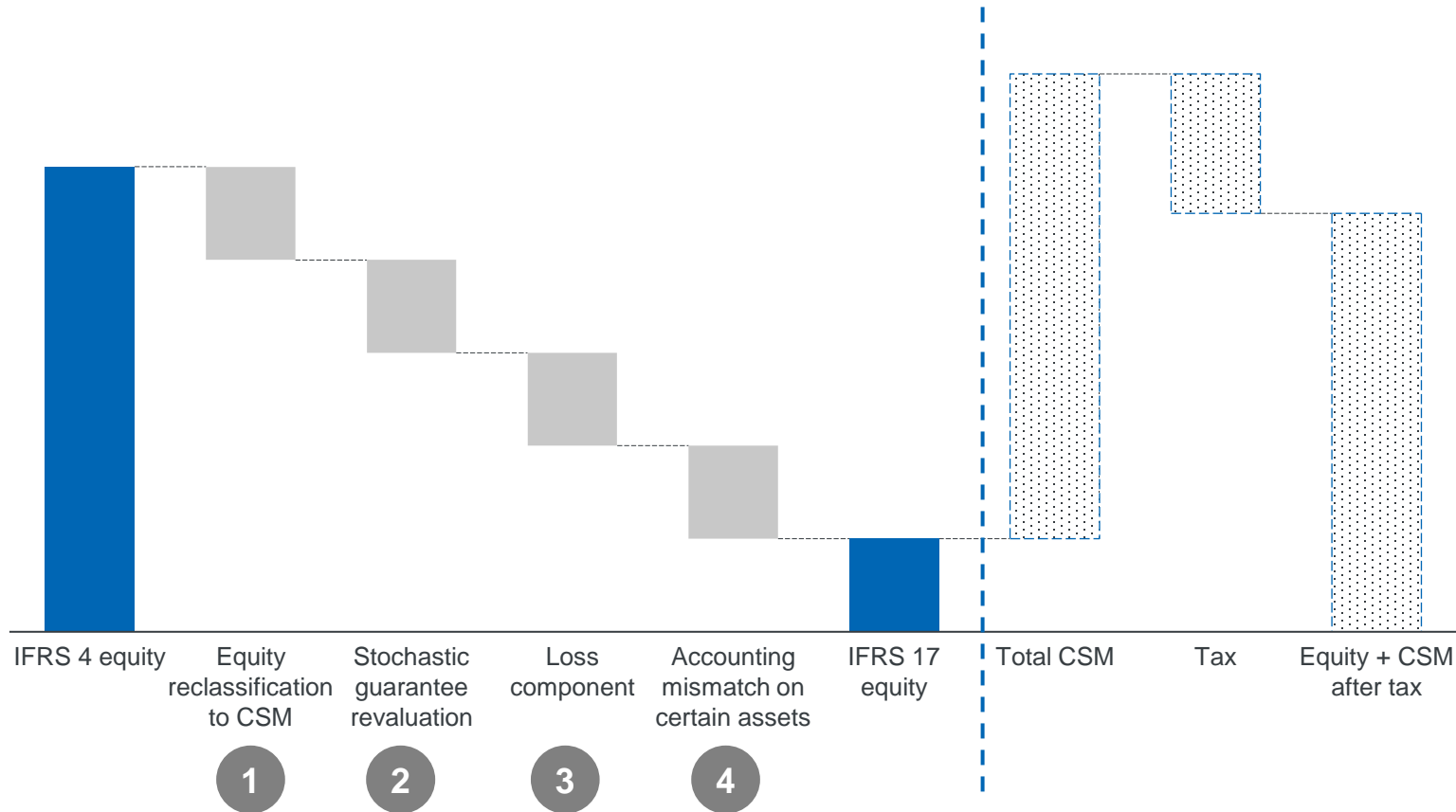
Illustrative example: Impact of interest rate increase

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2 Rise in L/H liabilities and loss recognition results in significant initial drop in equity

Illustrative example: Opening balance sheet in Retail Germany Life, as of 1 Jan 2022

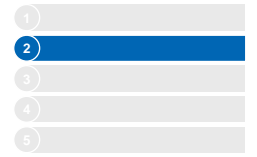


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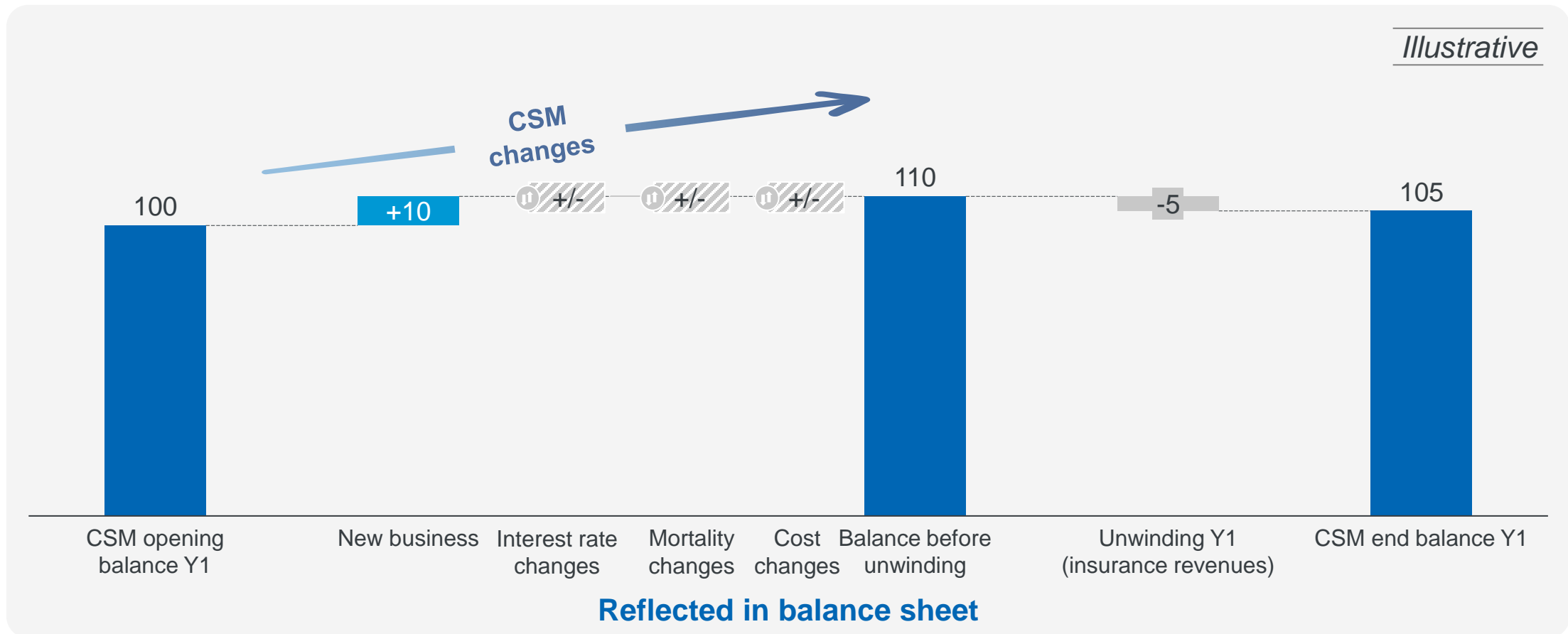
Comments

- 1 Under IFRS 17, profits have to be spread over the lifetime of contracts to a larger extent than before; as a result, a portion of profits moved from equity to contractual service margin (CSM, „profit margin“) to be unwound over time
- 2 Guarantees now valued with stochastic approach (average of probability-weighted scenarios); results in higher liabilities versus previous deterministic method (consensus expectation only)
- 3 Onerous contracts represented as Loss Component (i.e. „negative CSM“)
- 4 Self-occupied property and mortgage loans not held at fair value (but amortized costs), which results in mismatch with corresponding liabilities

All operational and economic variances will be absorbed by Contractual Service Margin ...



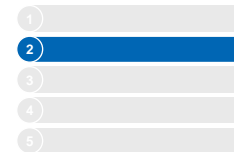
Illustrative example: Contractual service margin (CSM) in German Life (Variable Fee Approach, VFA) – balance sheet changes over the service period of profitable insurance contracts



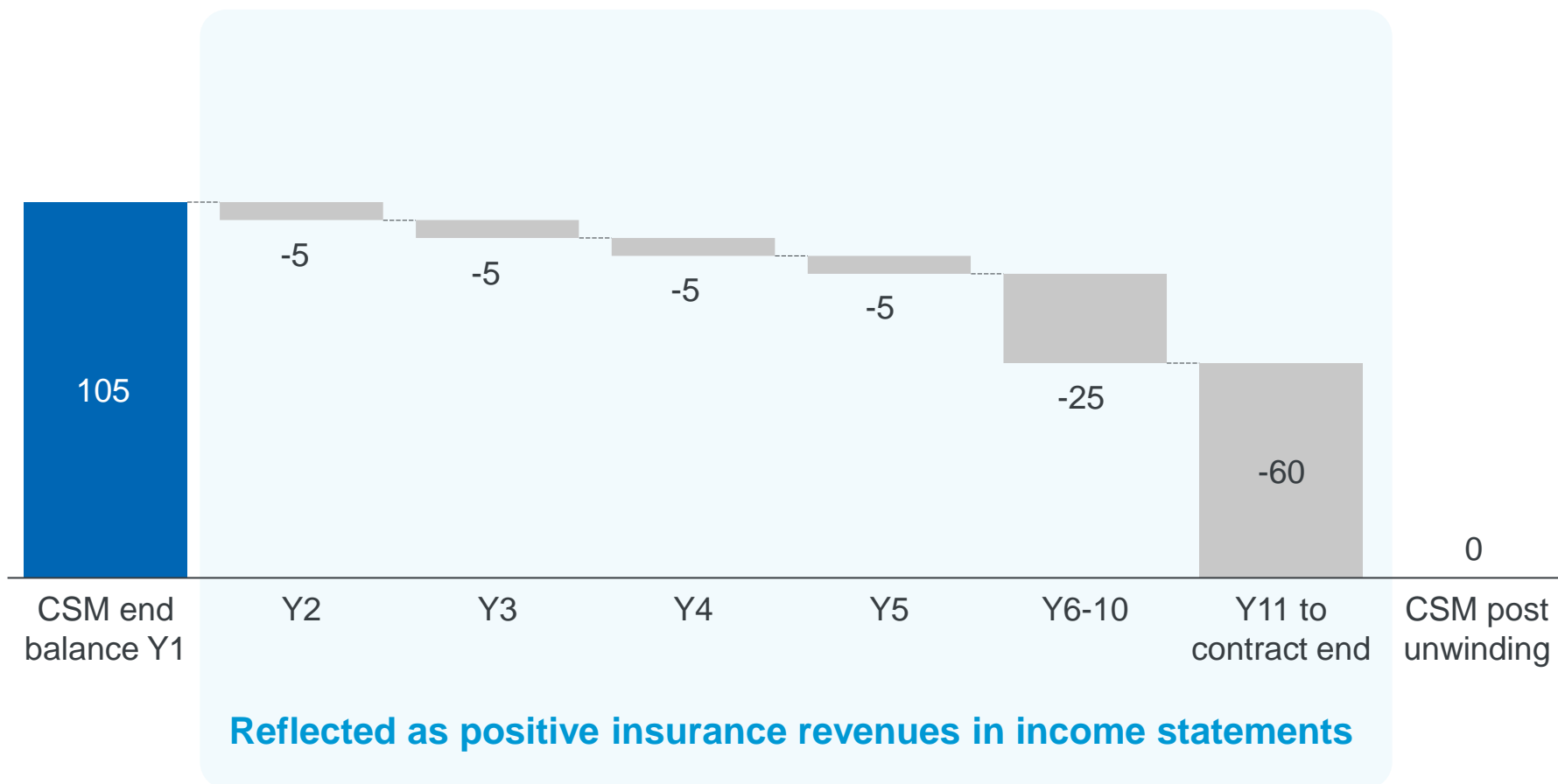
Note: If total CSM including all changes is negative for a group of insurance contracts (GIC), this results in formation of a loss component.

2 ... and unwound over contract lifetime

Illustrative example: Contractual service margin (CSM) of German Life (Variable Fee Approach, VFA) – balance sheet changes over the service period of profitable insurance contracts



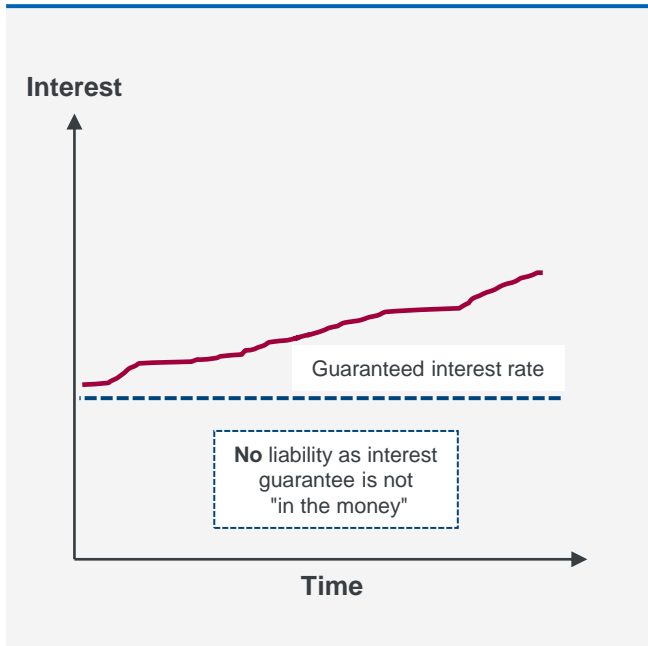
Illustrative



Different valuation methodology for guarantees reduces equity in L/H

IFRS 4 (old)

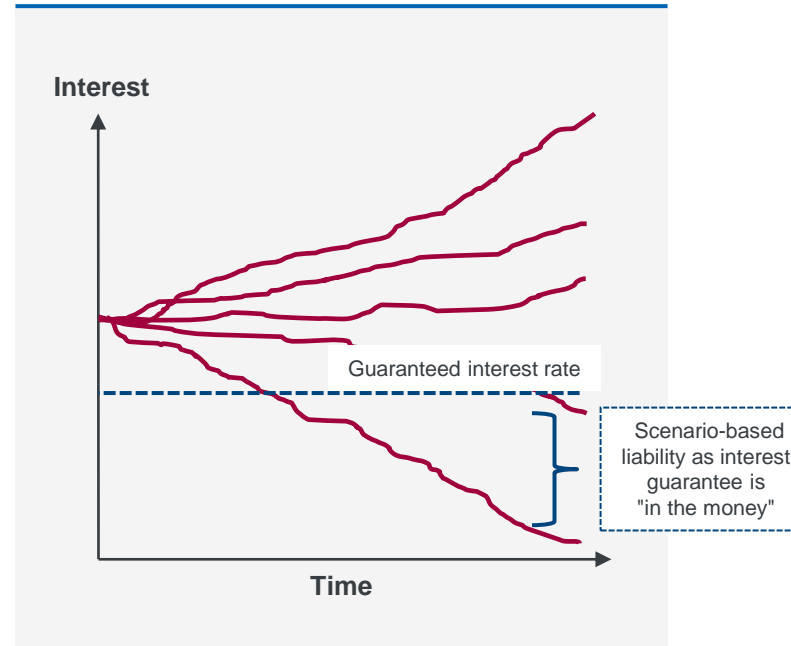
Deterministic valuation



Calculation based on **static consensus estimate assumptions** on interest rates

IFRS 17 (new)

Stochastic valuation

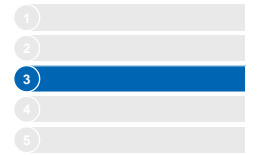


Calculation based on **probability-weighted multiple scenario** analysis for possible interest rate developments

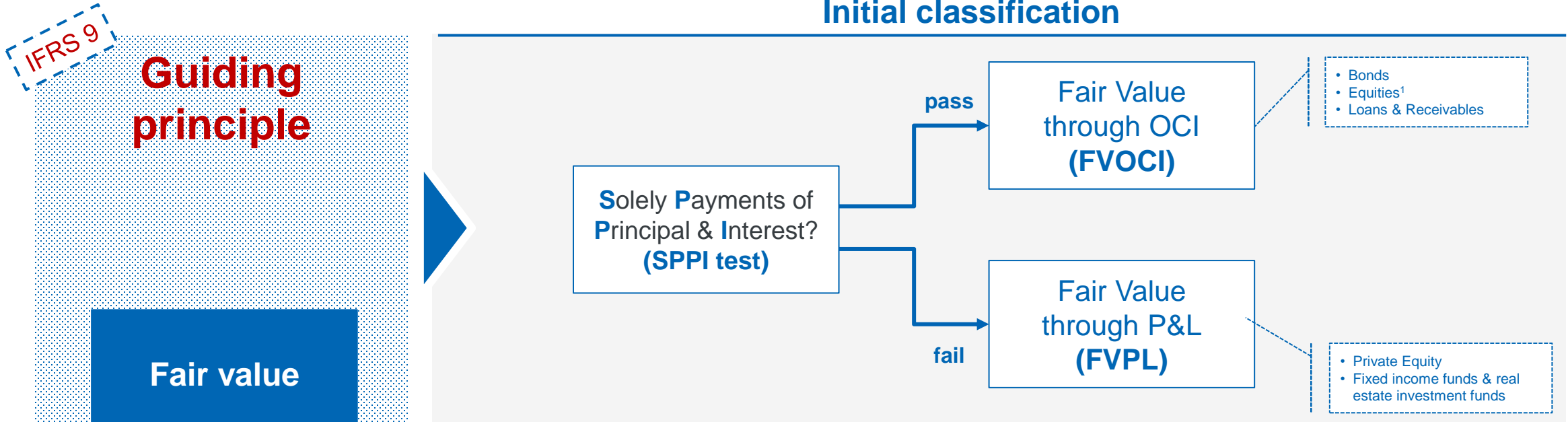
Comments

- Stochastic valuation considers not only one (ie the current consensus) scenario but the probability-weighted average of numerous scenarios, thus better reflects the lack of predictability
- Per opening balance sheet, such stochastic valuation includes scenarios with much lower interest rate expectations than the consensus view at the time
- As a result, technical provisions increase per opening balance sheet
- Higher reserve requirement results in lower equity upfront

2 Stricter fair value approach leads to more earnings volatility



Initial classification



Quarterly impairment test



1 If FVOCI is not chosen for equities, FVPL applies

2 The new income statement

NEW

Consolidated statement of income	
1	Insurance revenue
2	./. Insurance service expenses
	Insurance service result (gross)
3	Net result from reinsurance contracts (ceded)
4	Insurance service result (net)
	Net investment income for own risk
5	Result from unit-linked contracts
	Net investment income
6	Net insurance finance result (before currency effects)
	Net insurance finance and investment result (before currency)
7	Net currency result
8	Other Result
	Operating result (EBIT)
	Financing costs
	Taxes on income
	Profit for the year
	Minority interest on profit and loss
	Net income

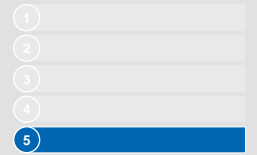
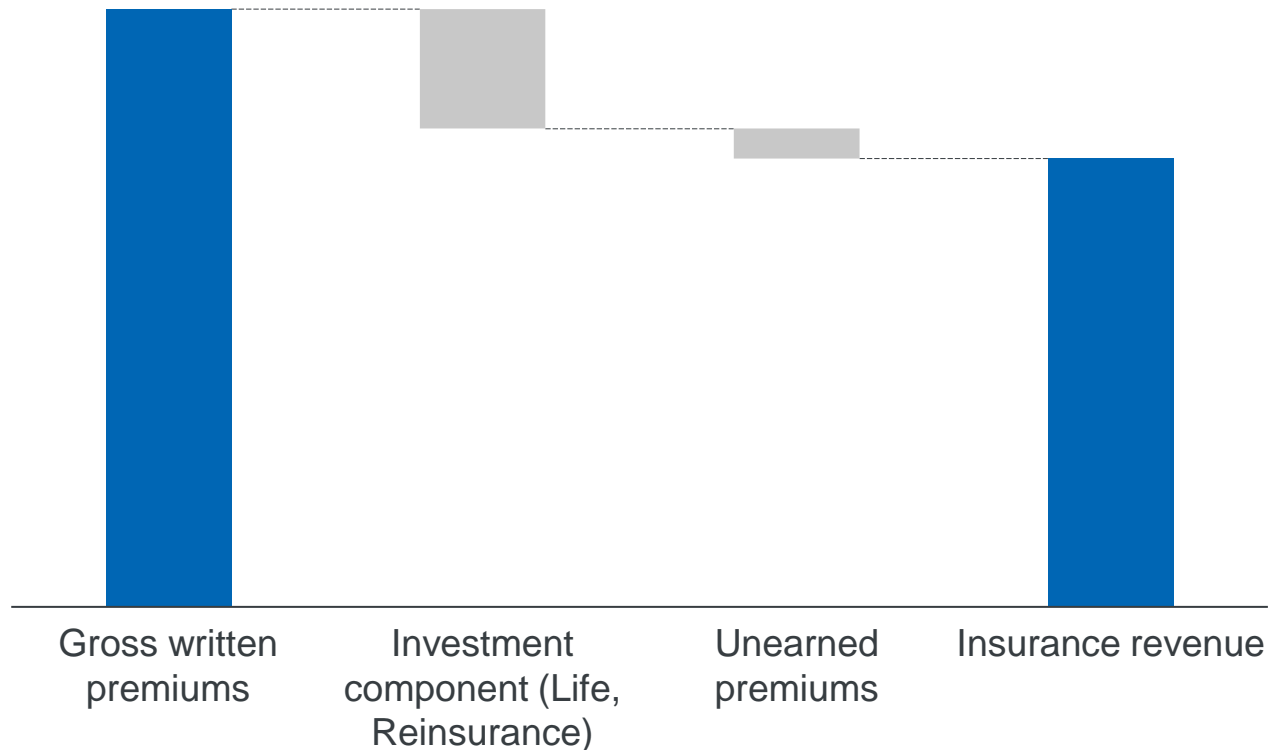
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Comments

- 1 Gross written premiums replaced by insurance revenues (excluding investment component, including unearned premium reserves; see next page)
- 2 Includes claims expenses, distribution and administration expenses directly related to insurance contracts
- 3 Shows economics of reinsurance structure explicitly
- 4 P/C: Lower claims due to discounting, lower allocation of technical cost
L/H: Excludes investment results allocated to policyholders
- 5 Not included in P&L previously; fully reversed in net insurance finance result (because owned by policyholders)
- 6 New line in P&L: Includes accrual of discount on claims reserves. In L/H includes allocation of 100% of investment results to policyholders
- 7 Now shown separately in P&L; previously included in Other Result
- 8 Includes higher portion of administration expenses, where not directly related to insurance contracts

Insurance revenues will be lower than gross written premiums

Illustrative example



Comments

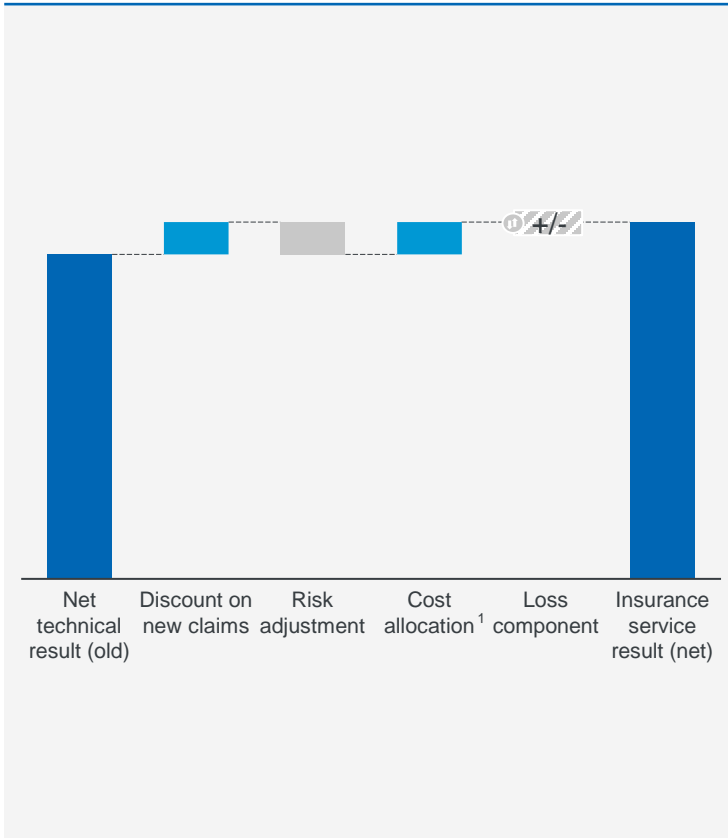
- Investment component (savings portion included in life premiums, cost reimbursements to primary insurers) reflects amount repayable upon expiration of contract irrespective of insured event
- Premiums will be reflected in revenues in line with the services (including claims coverage) provided for the reported period
- Insurance revenue will therefore also reflect accrual of claims reserves, risk adjustment, and contractual service margin (profit margin)

2 P/C combined ratio will look different

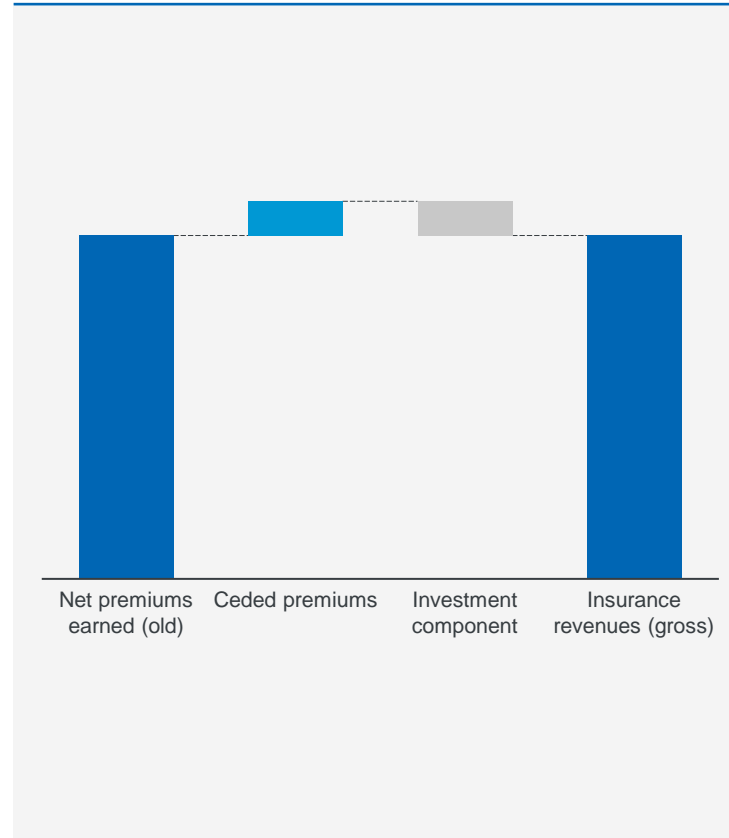
Illustration

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Insurance service result (net)



Insurance revenue (gross)



Combined ratio (new)

Insurance revenue (gross)²
 - Claims expenses (gross)
 - Distribution and administrative expenses (gross)
 - Net result from reinsurance contracts
 = Insurance service result (net)

$$1 - \left[\frac{\text{Insurance service result (net)}}{\text{Insurance revenue (gross)}} \right]$$

Combined ratio (old)

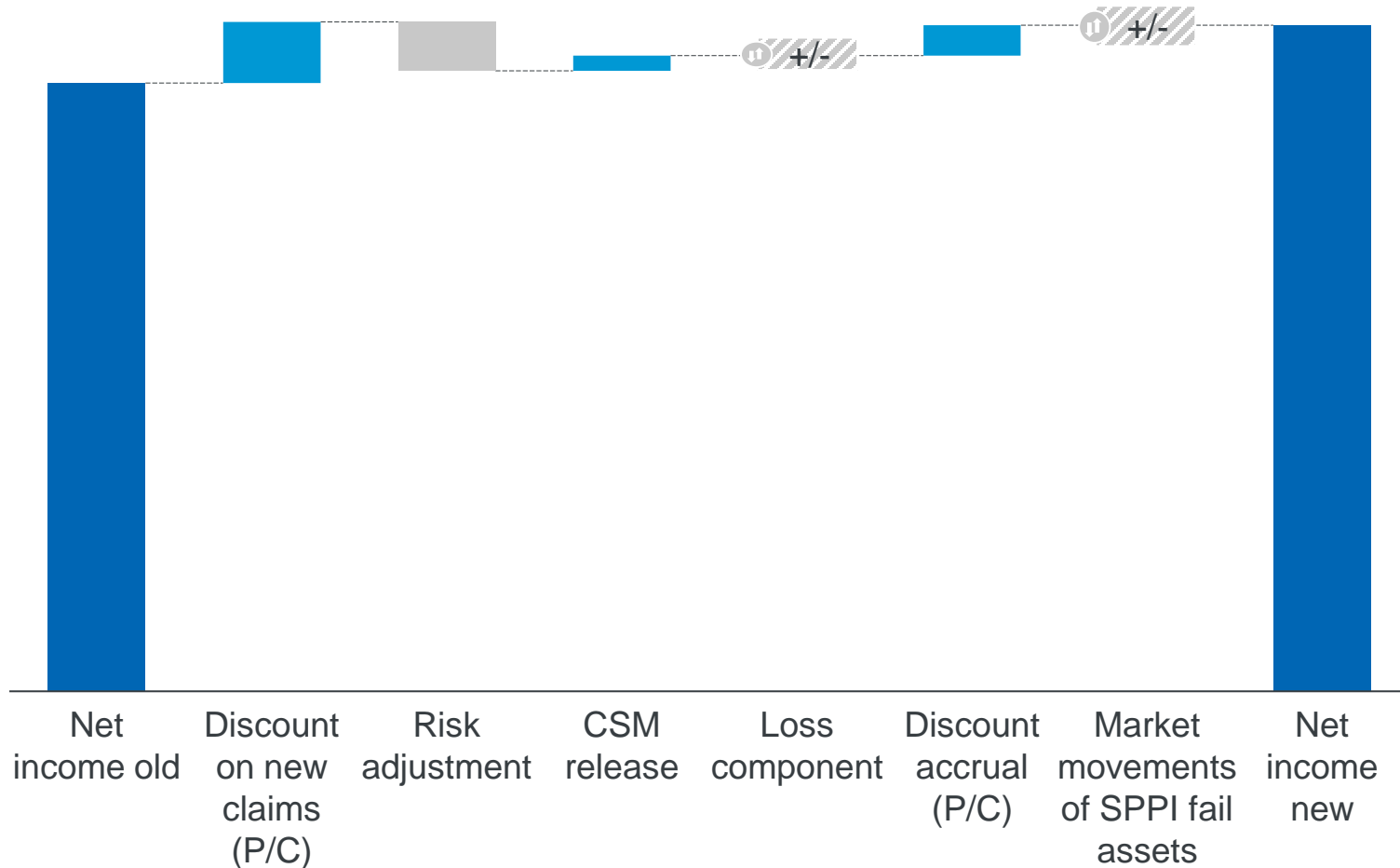
$$1 - \left[\frac{\text{Net technical result}}{\text{Net premiums earned}} \right]$$

¹ Under IFRS 17, only cost directly related to insurance contracts can be allocated to insurance service result

² Under IFRS 17, there are no insurance revenues net of premiums ceded to reinsurance

2 Changes in net income

Illustrative example: Net income – changes for periods after opening balance sheet



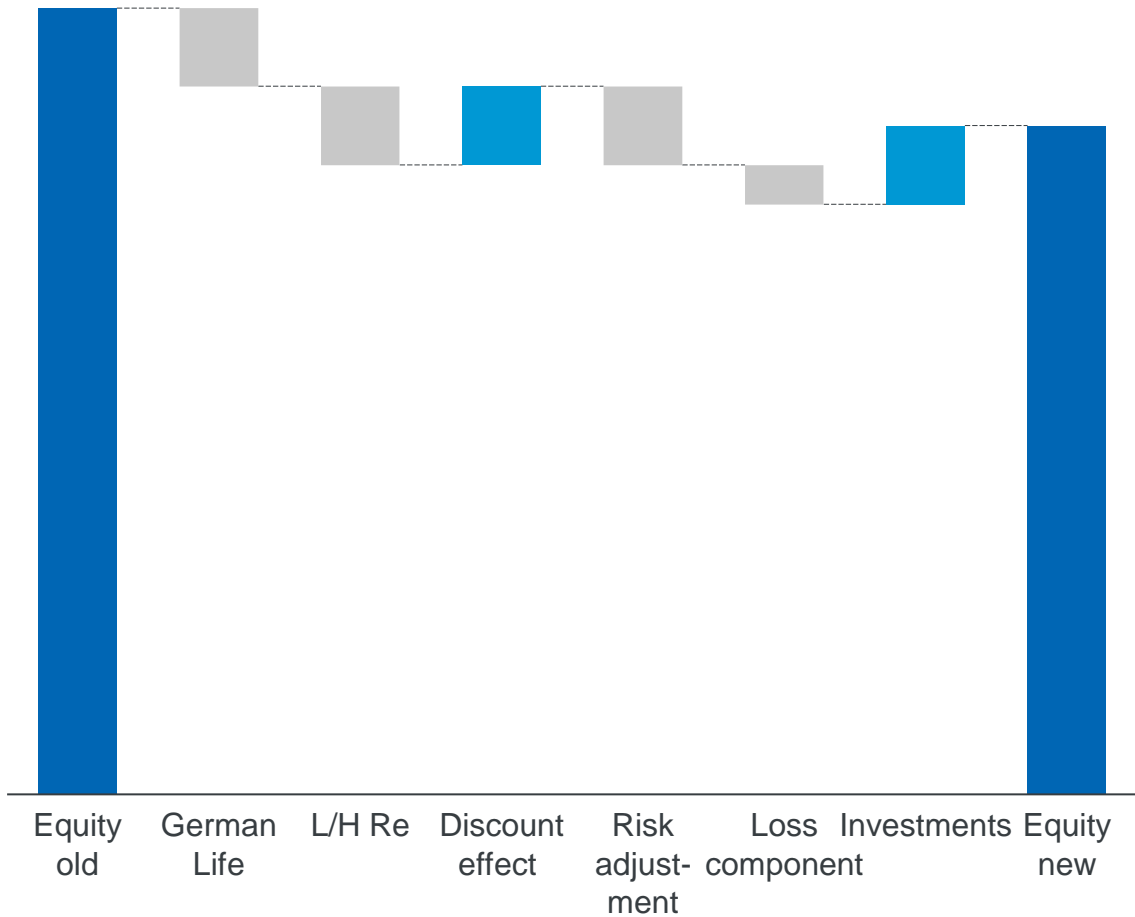
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Comments

- Discounting of reserves on new claims will result in lower claims expenses than before (change on claims discount relating to prior years is reflected in FVOCI)
- Net income reflects net change of risk adjustment on new claims and release of risk adjustment on previously booked claims
- Unwinding of Contractual Service Margin booked in opening balance sheet (reducing equity) will come as additional profit via insurance revenues
- Discount accrual on claims reserves from previous periods shown in insurance finance result
- More volatility due to fair value accounting through P&L for investments which have failed the SPPI test

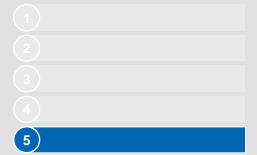
2 Initial changes in equity

Illustrative example: Shareholders' equity – changes in opening balance sheet as of 1 Jan 2022



Diverging initial equity impact

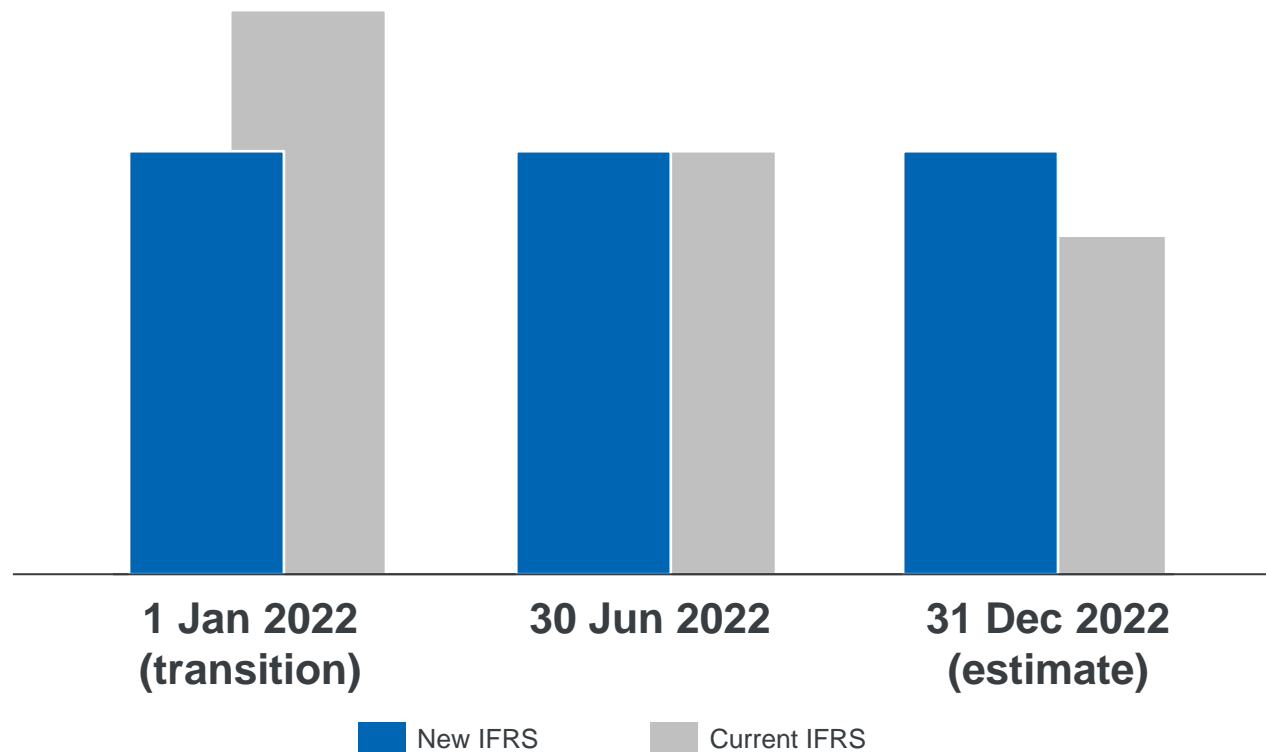
- ↗ **P/C:** Discounting of reserves and initial recognition of unrealized gains on investments result in increase of equity
- ↓ **L/H:** Higher liabilities resulting from interest rate guarantees reduce equity



Equity more stable under new accounting regime

Shareholders' equity, illustration, in EUR bn

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Comments

- Due to accounting mismatch under current IFRS regime, equity is significantly more volatile than under IFRS 17 and 9
- Strong increase of interest rates in 2022 has resulted in significant devaluation of investments, in both regimes, whilst under current regime claims reserves are not discounted to reflect change in interest rates
- New accounting regime more adequately reflects economic status of assets and liabilities

Summary: Some challenges, but significant benefits



- Markets will need time to adjust and understand new rules
- Earnings volatility will increase to some extent



Preliminary uncertainty



More earnings volatility



- Comparison with peers, different lines of business and other sectors will be easier
- Better alignment between IFRS and Solvency 2
- More meaningful equity representation
- Better earnings predictability (in life)



More comparability



More transparency



More meaningful disclosure





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- 1 Introduction
- 2 Most important changes
- 3 Appendix**

3 IFRS 17 distinguishes between three valuation models

Valuation model	General Measurement Model (GMM)	Premium Allocation Approach (PAA)	Variable Fee Approach (VFA)
Type of business	Interest rate-sensitive contracts with maturity over one year	Contracts with maturity \leq one year or less interest rate-sensitive	Strong dependence on „underlying item“ (typically investments)
TX application	Standard@Hannover Re	Standard@HDI (P/C business)	Standard@HDI (Life business)

Glossary IFRS 17 / 9 (1/2)

Deutsch	Englisch	Kategorie
Anschaffungskosten	cost	IFRS 9
fortgeführte Anschaffungskosten	amortised cost	IFRS 9
erwartete Kreditverluste (ECL)	expected credit loss (ECL)	IFRS 9
Zu Anschaffungskosten bewertete Finanzinstrumente	Financial instruments measured at cost	IFRS 9
erfolgsneutral zum Zeitwert bewertete Finanzinstrumente	Financial instruments measured at fair value through OCI	IFRS 9
erfolgswirksam zum Zeitwert bewertete Finanzinstrumente	Financial instruments measured at fair value through profit or loss	IFRS 9
über die Laufzeit erwarteter Kreditverlust (über die Laufzeit erwarteter ECL)	life time expected credit loss (LtECL)	IFRS 9
kurzfristige Kapitalanlagen	Short Term investments	IFRS 9
Versicherungsvertrag	insurance contract	IFRS 17
Kapitalanlagen für eigenes Risiko	Investments for own risk	IFRS 9
Kapitalanlagen für Rechnung und Risiko von inhabern von Lebensversicherungspolicen	Investments for the benefit of life insurance policyholders who bear the investment risk	IFRS 9
Investmentverträge	investment contracts	IFRS 9
Schuldinstrumente	debt instruments	IFRS 9
Eigenkapitalinstrumente	equity instruments	IFRS 9
Ausfallwahrscheinlichkeit	probability of default	IFRS 9
De-minimis	De-minimis	IFRS 9
nicht "echte" Eigenschaft	not genuine characteristic	IFRS 9
Verlustquote bei Ausfall (LGD)	Loss given default (LGD)	IFRS 9
Forderungshöhe bei Ausfall (EAD)	Exposure at default (EAD)	IFRS 9
Bruttobuchwert	Gross carrying amount	IFRS 9
Nettobuchwert	Net carrying amount	IFRS 9
Buchwert	Carrying amount	IFRS 9
ausschließlich Tilgungs- und Zinszahlungen (SPPI)	solely payments of principal and interest (SPPI)	IFRS 9
bereits bei Erwerb oder Ausreichung beeinträchtigter Bonität (POCI)	purchased or originated credit-impaired (POCI)	IFRS 9
Zeitwert	fair value	IFRS 9
erfolgswirksam zum Zeitwert (bewertet)	fair value through P&L	IFRS 9
erfolgsneutral zum Zeitwert (bewertet)	fair value through OCI	IFRS 9
Sicherungsbeziehung	Hedge relation	IFRS 9
Deckungszeitraum	Coverage period	IFRS 17
vertragliche Servicemarge (CSM)	Contractual Service Margin (CSM)	IFRS 17
Prämienallokationsansatz (PAA)	Premium Allocation Approach (PAA)	IFRS 17
Allgemeines Bewertungsmodell (GMM)	General Measurement Model (GMM)	IFRS 17
Variabler Gebührenansatz (VFA)	Variable Fee Approach (VFA)	IFRS 17
Versicherungsverträge mit direkter Überschussbeteiligung	insurance contracts with direct participating features	IFRS 17

Glossary IFRS 17 / 9 (2/2)

Belastende Verträge	onerous contracts	IFRS 17
Deckungsrückstellung (LRC)	Liability for remaining coverage (LRC)	IFRS 17
Rückstellung für noch nicht abgewickelte Versicherungsfälle (LIC)	Liability for incurred claims (LIC)	IFRS 17
Erfüllungswert	fulfilment cash flows	IFRS 17
Abschlusskosten	insurance acquisition cash flows	IFRS 17
Leistungen gemäß dem Versicherungsvertrag	insurance contract services	IFRS 17
Kapitalanlagekomponente	investment component	IFRS 17
Kapitalanlagekomponente mit ermessensabhängiger Überschussbeteiligung	investment contract with discretionary participation features	IFRS 17
Portfolio von Versicherungsverträgen	Portfolio of insurance contracts	IFRS 17
Gruppe von Versicherungsverträgen	groups of insurance contracts	IFRS 17
zugrunde liegende Referenzwerte	underlying items	IFRS 17
Leistungen zur Erwirtschaftung von Kapitalerträgen	investment-return service	IFRS 17
kapitalanlagebezogene Leistungen	investment-related service	IFRS 17
Versicherungsnehmer	policyholder	IFRS 17
Erfahrungsbedingte Anpassungen	experience adjustments	IFRS 17
Deckungseinheiten	coverage units	IFRS 17
Risikoanpassung für nicht-finanzielle Risiken	risk adjustment for non-financial risk	IFRS 17
Abzinsungssätze	discount rates	IFRS 17
erstmaliger Ansatz	initial recognition	IFRS 17
Folgebewertung	subsequent measurement	IFRS 17
Vollständig rückwirkender Ansatz	Full retrospective Approach	IFRS 17
Modifizierter rückwirkender Ansatz	Modified retrospective Approach	IFRS 17
Fair-Value-Ansatz	Fair Value Approach	IFRS 17
Übergangszeitpunkt	transition date	IFRS 17
Übergangsbeträge	transition amounts	IFRS 17
Als Vermögenswert angesetzte Abschlusskosten	Asset for insurance acquisition cash flows	IFRS 17
Änderung eines Versicherungsvertrags	Modification of an insurance contract	IFRS 17
ausgestellte Versicherungsverträge	Insurance contracts issued	IFRS 17
gehaltene Rückversicherungsverträge	reinsurance contracts held	IFRS 17
Versicherungstechnische Finanzerträge oder -aufwendungen	Insurance finance income or expenses	IFRS 17
Jahreskohorten	annual cohorts	IFRS 17
Aggregationsniveau	level of aggregation	IFRS 17
Gruppe von Versicherungsverträgen (GIC)	group of insurance contracts (GIC)	IFRS 17
Verlustkomponente	loss component	IFRS 17
Versicherungstechnische Erträge	insurance revenue	IFRS 17
Versicherungstechnische Aufwendungen	insurance service expenses	IFRS 17
versicherungstechnisches Ergebnis	insurance service result	IFRS 17
Ermessensentscheidung	judgement	IFRS 17
Ergebnis aus gehaltenen Rückversicherungsverträgen	Net income or expenses from reinsurance contracts held	IFRS 17

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