IFRS 17
Perspective from AXA

Presentation to the EFRAG Board

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20/07/2017 - Brussels

Current Insurance Accounting Practices Calls for a Change

Current accounting practice...	... and its consequences
IFRS 4 broadly allows the continuation of existing accounting practices	Financial statements of insurers are complex and lack comparability
Leading to the use of very diverse accounting models; they range from fair value based concepts to prudent at-cost based principles	Widespread use of so-called non-GAAP measures
	Higher cost of capital for insurers

AXA welcomes the adoption of an international accounting standard striving for a better comparability and understandability of insurers' financial statements

Key Changes Expected from IFRS 17…

	Current Accounting Practice	IFRS 17
Recognition and Measurement	• Reserves based on statutory GAAP, partly linked to regulatory requirements • Undiscounted reserves in P&C • Level of granularity based on line of business	→ Use of current estimates → Explicit disclosure of risk margin → Reserves generally discounted → Further split of portfolios required → Premium allocation approach closer to current accounting practice in P&C for premium reserves
Profit Patterns	• Diverse patterns in use	→ Should aim at reflecting pattern of services rendered → Introduces the "contractual service margin" concept (reserve for future profits)
Presentation	• Inclusion of investment component in insurance revenues	→ Exclusion of investment component from insurance revenues → Additional disclosures

IFRS 17 is not only a new accounting standard; it is a complete change of insurers' financial reporting

… and Its Impact on Insurers

- Impact on business model itself (product strategy and pricing) should in theory be limited
- However, certain elements of IFRS 17 could result in an inadequate reflection of the economics of insurance:
  - Risk pooling and mutualisation
  - Hedging strategies (derivatives)
- Furthermore, the role of insurers as long-term investors will be impacted

A new accounting standard should :

- better reflect business reality
- not affect insurance business model
- not discourage insurers' role as long-term investors

Risk Pooling and Mutualization

Insurance business model

- Insurance business is managed on a portfolio basis:
  - ➢ risks are being pooled, reflecting the law of large numbers
  - ➢ asset-liability management is based on contracts grouped in portfolios
- For certain policies -even when written in different years- profit sharing is based on an intergenerational mutualization by sharing the same pool of assets and / or technical result (expense and underwriting margins)

Reflection in Financial Statements based on IFRS 17 (CSM measurement)

Short-term P&C		• Excessive granularity leads to: ➢ Operational complexity ➢ Undue costs • Need to define pragmatic and workable approaches in defining levels of aggregation
Long term Life & P&C	• Annual cohort requirement for mutualized business leads to artificial separation of economically linked contracts and unnecessary complexity	
Life VFA		

Hedging Strategies / Derivatives

Insurance business model

- Insurers apply different hedging strategies based on derivatives
- Main objectives of hedging strategies are the protection of the value of financial assets and related income, so as to ensure stable returns to policyholders and shareholders
- Strategies mostly focus on mitigating:
  - Upward interest rate shocks potentially triggering higher lapses
  - Re-investment risk by hedging guaranteed rates
- Furthermore, insurers use derivatives for duration management purpose, including for short-term business

Reflection in Financial Statements based on IFRS 17

Short-term P&C **Long term Life & P&C**	• No consistent P&L treatment of hedging instruments and hedged assets • This will generate artificial P&L volatility and is detrimental to sound risk management/ ALM management practices
Life VFA	• Hedge accounting option will allow mitigation of P&L volatility stemming from hedging strategies • Retrospective application should be allowed

Insurers as Long-Term Investors

Insurance business model

- Insurers are one of the most important investors, investing in a wide range of instruments, durations, etc.
- Based on sound ALM principles:
  - ➢ Insurers strive to match the duration of investments with duration of insurance liabilities
  - ➢ Making insurers a key long-term investor in financial markets

Insurers need an accounting framework avoiding undue P&L volatility

Reflection in Financial Statements based on IFRS 17

Short-term P&C

Long term Life & P&C

- IFRS 9 requires accounting of fair value changes of riskier assets (e.g. equities, private equity, structured products) in P&L
- Leading to:
  - ➢ artificial P&L volatility inappropriately reflecting risk management/ ALM management practices
  - ➢ Eventually discouraging investments in these asset types

Life VFA

- As the variable fee approach allows neutralizing P&L volatility, **no negative consequences** expected for eligible business

Other Technical Considerations on IFRS 17

Comparability	• Many insurers (in particular US-based ones) will not report under IFRS 17; therefore **no international level playing field.** • Insurance will be the **only major sector reporting** basically **under a full fair value framework.** • Scope of the VFA: **restrictive variable fee approach criteria** lead to **similar businesses** accounted for under **different IFRS 17 accounting models**.
Profit pattern	• **CSM release pattern might improperly reflect actual emergence of profits**. This is likely to be the case for direct participating business with insurance riders, for which the CSM release drivers are not expected to adequately reflect the **transfer of investment services**.
Operational challenges	• The implementation of IFRS 17 will be a **major project** impacting **all aspects of financial management and communication.** • Given these impacts, **testing** and **parallel runs** will be necessary.
Non-GAAP	• As **artificial P&L volatility** will remain, insurers will still need to keep on **applying non-GAAP** measures to ensure adequate communication on performance.
Value	• **IFRS 17 should strive to become a referential for value measurement**. The sum of shareholders' equity including other comprehensive income plus contractual service margin less subordinated debt should provide indications on insurance companies' embedded value.

Conclusion

IFRS 17 is the unique opportunity for the insurance industry to have an international and high-quality accounting standard allowing for full comparability

In order to achieve this, certain key elements need to be further refined to ensure an appropriate reflection of the insurance business model and avoid artificial P&L volatility

A close dialogue between all stakeholders as well as the European endorsement process will be key to address and resolve these points
AXA is fully committed to support this process in order to achieve the best possible outcome for all stakeholders