

# FINANCIAL KPIs IN A IFRS 17 WORLD

January 2023



DELOITTE EMEA A&IS  
WORKING GROUP REPORT

**Deloitte.**



# Contents

Introduction

3

Financial KPI and impact of IFRS17

---

4

Main opportunities and challenges for insurers

IFRS17 for analysts and investors

Deep Dive on IFRS 17 KPIs

---

15

KPI Comparison: Capital Generation and Profit

KPI Comparison: Current GAAP Equity vs SII Own  
Funds vs IFRS9/17 Equity

KPI Comparison: VIF vs SII VIF vs CSM

KPI Comparison: NBV vs SII NBV vs NB CSM

Return on Equity: possible adjustments under  
IFRS17

Challenges and Opportunities in  
the short and medium term

27

Glossary

29

# 1

## Introduction

The purpose of this report is to provide a market overview of how the current KPIs could be integrated by the go-live, about the most valuable information added by the IFRS17 reporting and about the challenges - but also the opportunities - for insurers' managements and stakeholders.

One of the greatest concerns of the top management is to understand which indicators should drive the business in IFRS 17 and how they allow, in a transitory phase, comparability with the past.

The IFRS17 go-live is introducing multiple new challenges not only for insurance companies' management but also for shareholders, investors, financial analysts and policyholders. While insurers are currently mainly focused on the completion of the implementation and on the accounting choices finalization, the IFRS17 reporting figures have already been a key item of the 2022 capital markets day.

The new accounting standard aims at providing a more transparent and fair evaluation of insurance companies and at improving comparability within the insurance market and across the industries. IFRS17 is surely welcomed as an improvement since under current IFRS insurers evaluate the technical liabilities according to local standards and with a limited disclosure.

IFRS17 standard and the related new KPIs are flanked by Solvency II reporting and indicators that currently drive the earning guidance, especially in the top international players and in the northern european countries and are largely considered by rating agencies and analysts to rate companies.

However, it is currently unclear to what extent IFRS17 KPIs will replace Solvency II and "traditional" GAAP and non-GAAP indicators in the short-term, both in terms of management's strategy and investor's perspective.

Given the complexity of the new standard, some reporting periods will likely be necessary to make all the relevant users acquainted to the new IFRS and to the necessary reconciliations between current and present indicators.

However, the insurance market is preparing for these challenges since the deeper, more granular and complete information is unquestionably adding value.

## 2

# Financial KPI and impact of IFRS17

## Current practice and geographical differences

Financial KPIS currently used by companies can widely vary depending on the geographic area, the business and the market tier of the insurer.

The IFRS or Local Operating Result/Margin and the directly derived KPIS (like ROE, ROI, EBITDA ) are commonly considered in assessing performance, in setting targets and in defining dividend payouts. Insurers have also built specific non-GAAP KPIS to breakdown profit source and better represent profitability and growth perspective, based often on Solvency II reporting.

Specifically, in the top European insurer players and in general in the Northern European Countries (UK and Netherlands first) the Capital Generation KPIS are often the indicators that drive the disclosure guidance and that is used to set planning targets and cash remittance policies. Compared to traditional GAAP, it has the advantage of providing a market-consistent liability evaluation. Furthermore, the capital available to the shareholders is strictly dependent on the regulatory capital and this allows to reconcile profitability and the investment capital necessary to manage the liability portfolios. Capital Generation metric is often adjusted (called also organic or normalized) in order to exclude short-term market impact and to capture the “sustainable” growth as well as the outcome of the management strategy.

Also, in the Swiss market (not subject to Solvency II regulation), non-GAAP KPIS such as the Business Operating Profit (BOP) that excludes all the items not under the control of the management are commonly used.

It is nowadays less common to disclose the Traditional Embedded Value (TEV) and Market Consistent Embedded Value (MCEV metrics). The latter is less relevant in the countries


subject to Solvency II while is still common in the Swiss Market. However, the TEV and other similar non-GAAP KPIS are important metrics monitored by management especially in countries where the Capital Generation indicators are not common.

Hence, even if the Solvency II reporting provides a more transparent and consistent “forward-looking” picture, it is closer to “a market value” and subject to short-term market fluctuation. This holds especially for long-term insurers whose company asset portfolio is not aligned to the volatility adjustment reference portfolio. Hence, it could not fully reflect the fundamental company value and the long-term profitability picture. For this reason, Solvency KPIS (like Normalized Capital

Nowadays, there is not enough harmonization of business indicators. And, actually there is a considerable difference between the geographies subject to the SII regulation and the others.

In addition, the indicators do not always represent the reality of the business and therefore do not fully reflect the fundamental company value and the long-term profitability picture.

Generation or Organic Capital Generation) are often adjusted in order to provide a more stable information both for disclosure and planning purposes.



In this context, IFRS17 reporting provides a picture of the fundamental economic value through a definition of a liquidity premium consistent with the liability features, through the amortization of the embedded profit represented by the CSM and through the introduction of the company specific risk-appetite.

Hence, especially for Countries not subject to Solvency II regulation, IFRS17 could soon become the main tool for business decision making and steering.

With IFRS 17 new information will be available that could integrate or replace traditional KPIs in management decisions such as:

- granular information about business profitability thanks to the cohort granularity (mandatory for the general model) and the required disclosure of the contracts initially recognized during the year
- consistent definition of the Insurance Revenue across insurers
- consistent definition and disclosure of the factors that drive the gap between expected profit and actual profit through the experience variances

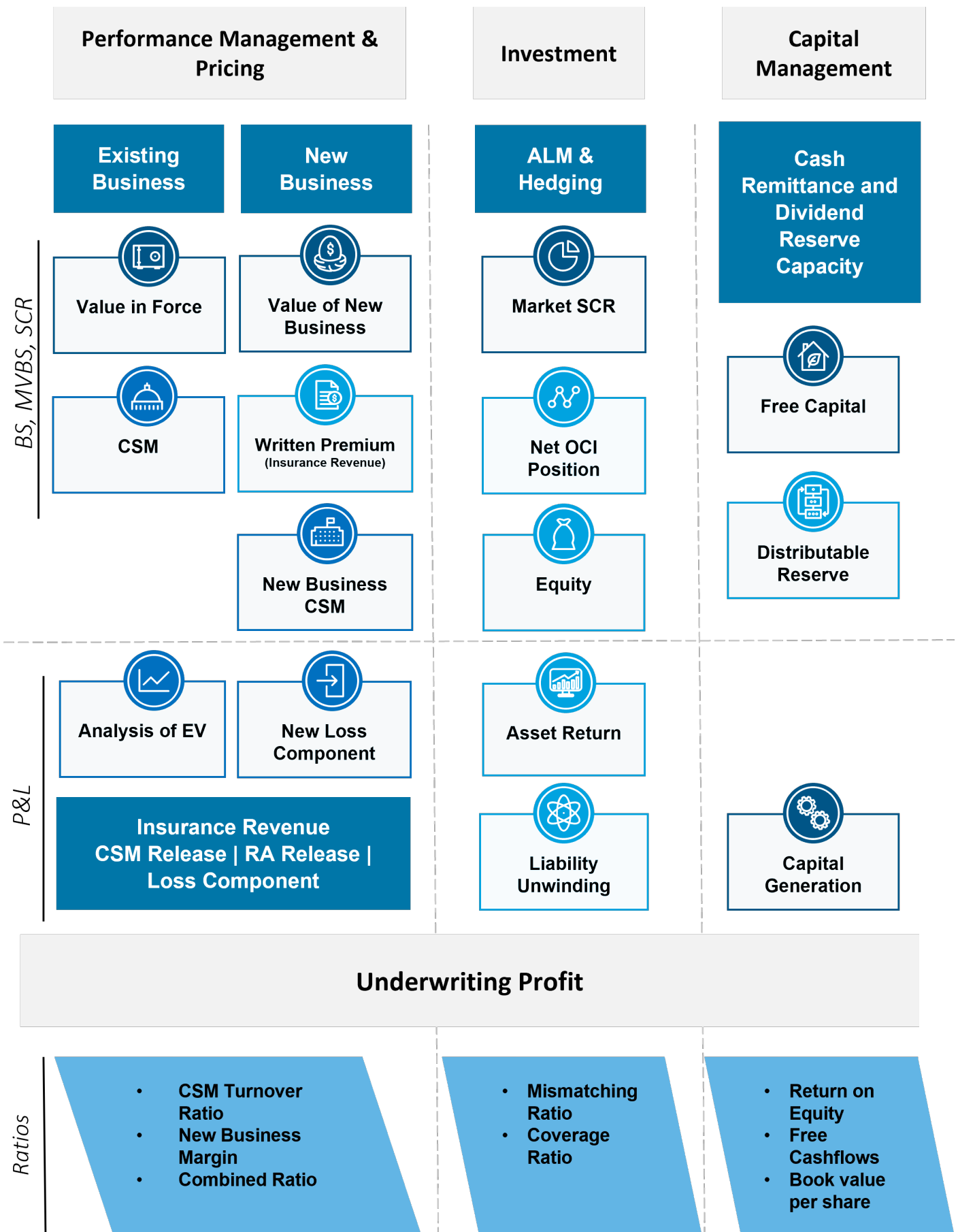


Figure 1 – KPI summary



# 2.1

## Main opportunities and challenges for insurers



	Performance Management & Pricing	Investment and ALM	Capital Management and Investor relations
Actions and Opportunities	Exploit IFRS17 granularity to understand P&L and volatility sources by segment, channel or product	Use ALM and Hedging framework to manage P&L and Balancesheet volatility	Define a new set of KPIs to monitor and manage financial result and cash/free capital generation
	Review product development/ structuring process	Consider possible changes in SAA process to meet new target KPIs	Develop monitoring process to timely detect earning warnings and distributable reserve constraints under IFRS 9/17
	Definition of new KPI to in force performance, new business profitability and underwriting result volatility	Analyze planning/ex-ante projections to assess Investment margin pattern and sensitivity to macro drivers	Tell a complete story about future profitability, growth and tools in place to manage financial volatility
	Adjust salesforce process and agency remuneration according to the new profit pattern		
	Improve reporting and data management process to deliver information and analyses in a timely manner	Ensure an adequate BS matching for both Solvency II and IFRS 9/17 standards	Full understanding and reconciliation of new KPIs with VIF/Local GAAP and Solvency II performance indicators
Challenges	Manage Loss Component and non performing portfolio disclosure to investors and other stakeholders	-	Less levers for management to shape financial results and KPIs
	Bridging between Local, IFRS and Solvency II reporting and profit pattern expected by investors and analyst at day 1		
	Detailed and transparent explanation of the accounting policies and actuarial judgements to support analysts in comparing performance across time periods and insurers		

# Performance Management and Pricing

## Embedded value KPIs and IFRS17

The VIF (Value in Force) is one of the most common traditional KPIs. However, it is often based on non-uniform assumptions (within TEV) among insurers even though some companies have been aligning their financial assumptions and contract boundaries to the Solvency II framework. Similarly, the technical profit (or the underwriting profit) provides a measure that can widely differ among geographies depending on the Local GAAP and on the discretionary adjustment applied (i.e., exclusion of the Experience Variance).

The IFRS17 CSM introduces a standard measure among companies and can enable management to detailed analysis at a line of business or product level to better identify the source of the profit and loss and to better optimize the product strategy leveraging on more reporting KPIs and on larger supporting datasets thanks to a deeper reporting granularity. The bridging between VIF and CSM is not straightforward since the latter is dependent on the historical experience built up over the period.

Furthermore, the CSM starting value and the resulting profit projection is largely dependent on the specific assumptions used by the company and on the transition methodology, which can reduce the comparability among peers. The CSM amortization can be independent from the current market environment especially when the assumptions used to value the liability are locked-in (OCI Option). Even if this ensures a stable profit pattern over time, an excessive insensitivity to the market environment could reduce the information related to the company's risk exposure. Hence, Capital Generation and other SII KPIs are still relevant.

In terms of income statement impact, multiple factors affect the change in the technical profit from the current reporting to IFRS17:

- cash flows and benefit recognition pattern of the products that can be slower or faster than the smooth CSM amortization. This leads to a general profit acceleration for UK with-profit products and to slower profit for UK annuities where the profit amortization removes the day 1 gain
- transition methodology and assumptions: In the Italian and in the Dutch life market, modified retrospective approaches lead generally to a higher CSM rather than fair value approaches and to a higher profit regardless of the coverage unit pattern.
- assumptions used in current IFRS/Local reporting that can be different from IFRS17. Prudent assumptions and the expense accounting standards of Malta and Cyprus local regulation could lead to an increase in profit under IFRS17. On the contrary, a drop in profit is expected in the Italian life market mainly due to the IFRS17 market consistent evaluation of with-profit/guaranteed products.

Since the impact can vary depending on the factors mentioned, insurers will be called to adequately explain the drivers behind the CSM amortization pattern in order to provide a solid profitability picture and to ensure the availability of the relevant information for business steering.



## New Business

Similarly to the VIF, NBV is a non-GAAP key indicator disclosed by insurers. Again, assumptions and methodology differ among geographies and only some companies (mostly in North-EU and UK) use a Solvency-like approach. Also for new business, CSM is expected to become a new leading metric in the disclosure. In particular, the replacement rate or turnover ratio of the CSM will provide management and investors with key information about growth at a very granular level.

Nevertheless, comparability among peers is impacted by the calibration methodologies applied and, for the mutualized business, the approach used to split the new business and in-force business can be an important driver of the result – especially for financial guaranteed products. However, an appropriate and extensive disclosure of the accounting policies and actuarial expert-judgements applied could improve the figures' reliability.

Especially for the life business, the understanding and the reconciliation of the Solvency NBV and the NB CSM is a key requirement for management. In addition to the potential difference in contract boundaries (like in the Spanish market), financial assumption differences, expense attributability, and the different treatment of onerous and profitable contracts in IFRS17 lead to a different profit release pattern. However, the Loss Component is an additional information for management and investors compared to Solvency II reporting and one

**Despite the strong focus of management on the new business CSM, it remains to be seen to what extent the pricing policies will consider the IFRS17 projection in the short term. Especially in UK and, in particular in the Life business, the most important driver is still the capital absorbed by the new business.**

of the main concerns for Life insurers that provide financial guarantees to policyholders.

Spanish and Italian insurers appear very sensitive about the reporting of onerous contracts and about the possible effect on the investors. Some insurers (especially in the Life with-profit business) are also considering an update of the pricing policies and of the product structures to align the policyholder financial benefits and the sales network remunerations to the faster or slower IFRS17 profit recognition. In this case, IFRS17 reporting can become not only a “disclosure” challenge but also a powerful tool to better optimize pricing policies and product structuring.

## Gross Written Premium and Non-Life business

Beside new business profitability evaluation, IFRS17 does not explicitly require disclosing the Gross Written Premium or other volume KPIs. However, those KPIs are expected to still be considered and disclosed since they can provide in a very simple way information about insurers' market share and selling capacity. Together with the Gross Written Premium, the Combined Ratio, Loss Ratio and Expenses Ratio are one of the most important indicators in the Non-Life Business. Also for these three KPIs, the conversion from the current standards to IFRS17 line items could become complex due to:

- sensitivity of the line items to the interest rates and coverage unit methodology unless PAA is applied
- adjustments applied to the Written Premiums in the definition of the insurance contract revenue
- net Loss Ratio inconsistency in case contracts accounted under PAA are covered by multiyear reinsurance contracts accounted under the GMM (or vice versa)

Hence, in the short term, insurers are expected to continue to disclose Local GAAP/current IFRS results and KPIs, since they are of relevant interest for investors and analysts. Some reporting periods will be probably necessary for managements and analysts to define new KPIs fully based on IFRS17 disclosure that can overcome the information provided by the current reporting standard.

# Asset-Liability Management

The introduction of IFRS17 is expected to improve the consistency with the measurement of assets under IFRS9. The new reporting standard adds an additional challenge to the Investment and Financial Risk units that already must deal with at least 2 bases – Current GAAP and Solvency.

The first target of the most common Investment and ALM frameworks is to provide to the shareholders a stable dividend over time and this is obtained mainly:

- achieving a stable profit according to the metric relevant for the dividend payout
- ensuring a Solvency coverage ratio within the regulatory and risk policy operating range

This is usually achieved optimizing the SAA to meet the return targets and to keep a Solvency Asset-Liability matching to minimize Solvency Coverage Ratio volatility. IFRS go-live brings an additional target that consists of ensuring an appropriate IFRS9/17 Asset-Liability matching. This can be relevant since

- investors and other stakeholders may use IFRS17 equity to define the economic KPIs and rate the company
- the equity value drives the dividend reserve capacity especially in case the OCI Option is not applied (as in the most of UK players). This holds also if non consistent accounting choices are applied to Asset and Liabilities.

Since the IFRS17 financial assumptions potentially differ from Solvency II (e.g. due to Liquidity Premium, long-term curve extrapolation, risk adjustment and other technical differences), a Solvency II optimized strategy may not also perfectly meet the IFRS 17 ALM targets.

This is one of the reasons why insurers would prefer to align the IFRS and the Solvency discounting curve dynamic and other technical assumptions as much as possible.

However, since the relevance of equity KPIs for investors and shareholders is still not clear, no massive changes of the investment policies are expected in the short-term.

# Capital Management

Surely IFRS17 is going to bring an additional challenge in terms of reporting to the management that is likely to impact different policies. Many insurers among all geographic areas are likely to report a drop in equity arising from the transition. However, according to the local regulations, the dividend is usually set according to the Local GAAP result and should meet the capital constraints stated in the EIOPA regulation and risk appetite framework policies. Hence, considering that in many Life insurance markets (especially in the Southern European Countries and Switzerland) Local GAAP result is not affected by the financial market volatility, the most important KPIs driving the Cash remittance are the Free Capital (or Surplus Capital) and the Capital Generation.

However, IFRS17 reporting is already an additional concern especially if the transition leads the insurer to a very low Retained Earnings amount that would imply a low Dividend Reserve automatically not compatible with the expected dividend payout. Since this is one of the key points of the capital market days,

the Dividend Reserve capacity (especially for insurers that have long-term asset accounted as FV to OCI in IFRS9) has been one of the targets of the management in the finalization of the accounting policies.

This holds also for the Swiss Market for which the possible drop in equity from the Local GAAP balance sheet – based on non-market consistent metric to IFRS9/17 is a real concern. In particular, the assumption setting implies a trade-off between equity opening value and profit.

Apart from the indirect influence over dividend reserve and retained earnings, the relevance of the new IFRS9/17 equity KPI is not yet fully clear. In particular, the year on year change in equity is a measure closer to the Capital Generation or to the

change in Own Funds rather than the traditional Local GAAP equity Value (if liabilities are accounted under a non-market consistent evaluation). Multiple factors affect the difference between Own Funds and IFRS 9/17 equity, like the discounting assumptions, the presence of the CSM as well as the difference between risk adjustment and risk margin. Impact of discounting is one of the most important drivers for Life insurers. This holds especially for the southern European countries where the illiquidity premium is generally higher than the Solvency II volatility adjustment. This increases the starting equity value and automatically reduces the expected equity YoY growth. However, for pension business the assumption related to the long-term interest rate is also pretty relevant.

As aforementioned, given the regulatory constraint arising from the capital position, Solvency metric is expected to be predominant at least in the short term. However, the impact of the equity in the classical financial KPI (ROI, ROE, Free Cash Flows) should be considered by the insurers' managements. In the next future, an extension of the Capital Management framework is probable especially if IFRS17 will become the leading profitability metric of shareholders and analysts.





HIGHER TRANSITION CSM IMPLIES A LOWER EQUITY BUT A LARGER PROFIT RELEASE IN THE FIRST YEARS AND A BETTER FINANCIAL STABILITY SINCE CSM AMOUNT CAN ABSORB MARKET VOLATILITY (IN VFA PRODUCTS) AND CHANGE IN ASSUMPTIONS.

Similarly, a larger transition Net OCI implies a lower starting distributable reserve but can absorb the equity volatility arising from market fluctuations. On the contrary, lower CSM and lower net OCI imply respectively a starting higher equity and distributable reserve but lower profits over the first years (as long as the business in force at transition drives the result).

In conclusion, in the short term no change in the dividend policies is expected. Even if IFRS17 equity and distributable reserve represent a constraint, insurers are setting their financial assumptions (i.e. discount curve) and accounting choices (transition) in order to report sufficient retained earnings at transition. Even if these amounts will be monitored, dividend reserve is expected to be still defined according to the current KPIs, as for example, Free Capital and Solvency II Capital Generation.

## 2.2

# IFRS17 for analysts and investors

The introduction of IFRS17 reporting will certainly provide new indicators to investors, financial analysts and rating agencies and an additional challenge for the management and the investor relations managers. Except for the IFRS17 specific “reporting” KPI (CSM, Equity, Underwriting Profit), the most common financial ratios (ROE, ROI, Financial leverage, OFCF) are expected to be still the main indicators even if the underlying quantities and dynamics will change.

However, as aforementioned, IFRS17 together with IFRS9 is welcomed as a real improvement of the insurance market reporting as the current heterogeneity and the limited transparency of liability accounting methods are inadequate to provide a fair picture of a company’s performance and risk exposure.

Nevertheless, a full adoption of IFRS17 KPIs as standard performance indicators is unlikely to happen in the short term. First, shareholders and stakeholders (including management) need to get acquainted with the new metrics, with the multiple available indicators and with the sensitivity of the profit pattern to market conditions.

Transition will massively affect the most common KPIs and since financial analysts usually consider medium-term/long-term time series, a reconciliation between pre-IFRS17 and post IFRS17 is necessary. Since only a part of the insurers adopted a full retrospective approach and usually only for few years, some reporting periods could be necessary to appropriately recalibrate financial historical series.

Furthermore, the new accounting standard allows for multiple discretionary methodological choices and for the use of expert judgements that can impact the intra-industry comparability, especially in regards of transition choices. Financial analysts and investors will be required to adjust KPIs to take into account assumption and methodological differences. This also holds for the use of the OCI options: the OCI-adopter’s profit will be barely subject to financial market volatility (if liabilities mirror asset accounting choices) compared to insurers that will prefer FV to PL choices (as expected in the UK Market).

Finally, Solvency KPIs (SCR, free capital, SR) will still be relevant since SCR represents the necessary capital to run the liability portfolio, from an

investment perspective. This is particularly relevant in the UK market.

However, the added value of the information provided by the new reporting is unquestionable even if insurers’ management will face several challenges to develop and improve investor communication on day 1 like:

- an accurate explanation of the IFRS17 figures especially in case of a drop in the equity/operating result as well as a reconciliation between Solvency II reporting should be a key target of the CFO units
- an ex-ante/planning projection that can explain the expected profit pattern, the impact of the new business as well as how the economic environment can affect the return projection
- a detailed and transparent explanation of the accounting policies and the actuarial judgement that increases trust and supports reporting users to perform comparisons within the industry

As mentioned, the main KPIs are expected to be similar to the current ones but the underlying quantities will change and reporting users could apply specific adjustments aimed at increasing comparability across insurers.

The new ROE could include the re-addition of the CSM and the RA to the equity term as they are expected to be released into the profit in the Best Estimate scenario. Furthermore, change in OCI could be added up to the profit in order to get a “market-consistent” value closer to Solvency/MCEV KPIs. An alternative option is to deduct OCI from the equity and to adjust the return for FVtoPL item in order to get a smoother indicator less subject to short-term market volatility and more representative of the economic fundamentals.

The above holds also for the definition of the Operating Result. Since the standards do not set any specific definition or disclosure requirement, insurers can discretionally apply their own adjustment starting from the Profit. However, it is generally expected that the Operating Result will remove the market volatility of Asset and Liability at P&L from the Investment Service. The choice would impact also the Operating Free Cash Flows (OFCF) that is a key KPI for the definition of the dividend payout.

In regards to credit ratings, no impact is expected in the short-term according to the agencies’ comments published since the underlying insurers’ economic position is not going to change due to the new standard. As the other investors and analysts, rating agencies are expected to adjust and improve the available KPI set and to develop their rating process in the upcoming years.



# 3

## Deep Dive on IFRS 17 KPIs

This section presents a synthetic technical explanation of the main factors driving the accounting differences between current reporting standards, Solvency II and IFRS 17. In particular, it focuses on:

- the comparison between a Capital generation projection and the IFRS 9/17 profit
- the transition from the traditional VIF to the IFRS 17 CSM
- the definition of the NBV according to the different metrics
- the possible future definition of the Return on equity after the IFRS 17 transition

# 3.1

## KPI Comparison: Capital Generation and Profit

In this section an illustrative comparison between the ex-ante Capital generation projection and the IFRS 17 profit is presented. As aforementioned, Capital Generation is a common KPI among northern and central European insurers, however the specific definition can vary across the industry. In this particular example Capital Generation is defined as the increase of Free Capital (excess of Shareholder Equity over Solvency Capital Requirement measured according to Solvency II principles) before dividend payment.

Usually, insurers adjust this KPI for internal purposes and disclosure (e.g. Normalized or Organic Capital Generation) to include only factors under the control of the management (i.e. excluding, market volatility or any one-off effect such as model changes).

However, in the projection proposed no market impact, experience variance/change in assumptions have been considered.

The underlying illustrative data assumes a Life insurer with moderate new business flows compared to the existing business and with most of the business being accounted under the General Measurement Model.

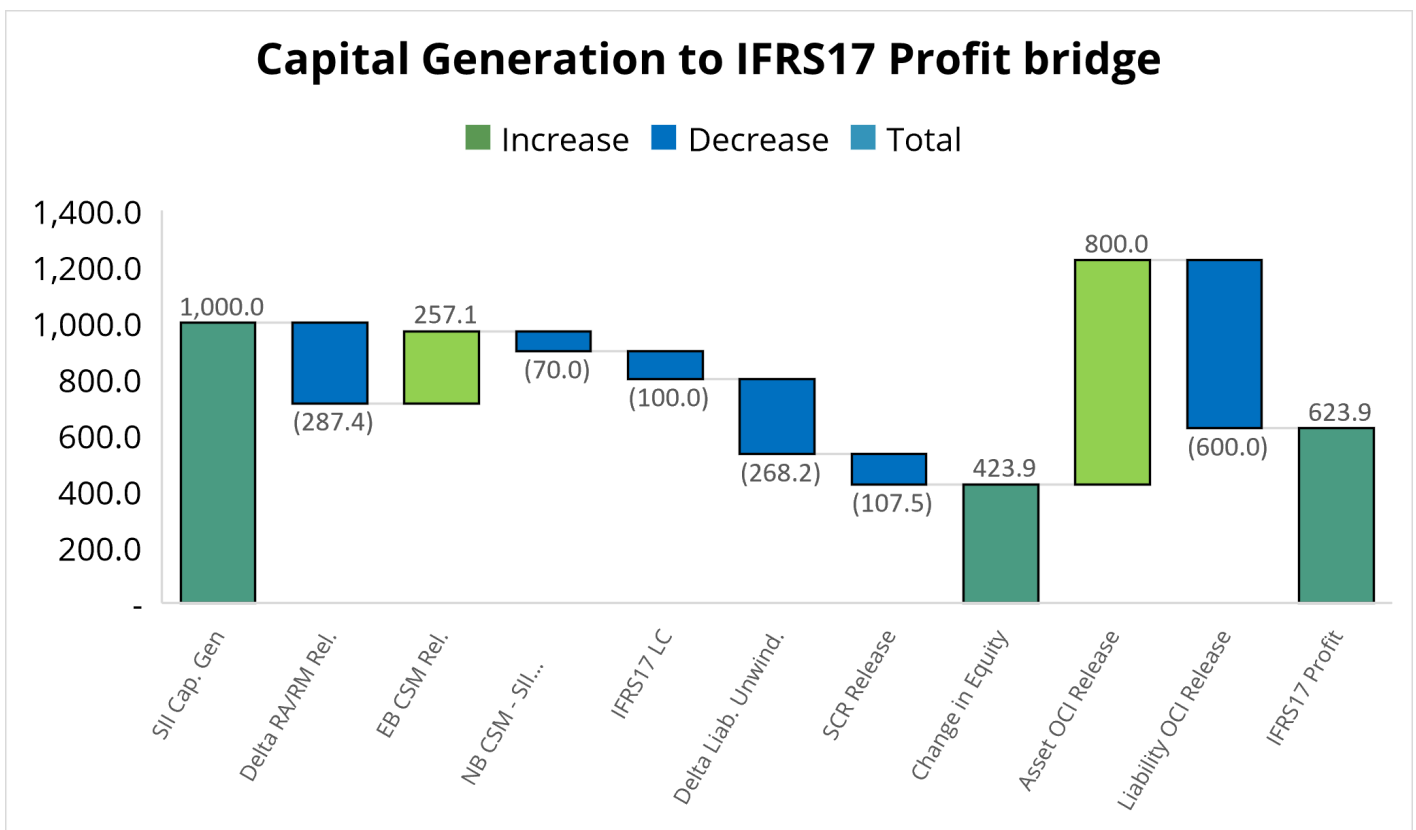


Figure 2: From Capital Generation to IFRS17 Profit

<b>Capital Generation</b>	
Delta RA/RM Release	Among insurers transition risk adjustment is generally lower. This leads to a higher starting equity and to a lower release over time.
Existing Business CSM Release	In IFRS17, the embedded profit is released over time. In Solvency it is already embedded within the Own Funds so there is no release over time.
Delta SII NB/NB CSM	In Solvency profitable business generates a day 1 gain. In IFRS 17, there is no profit recognition on day 1 from new business due to the CSM.
IFRS17 Loss Component	In IFRS17, Loss Component is separately disclosed and, differently from the CSM, is immediately expensed at P&L. Consequently, it is not possible to offset future profits arising from CSM with future expected losses.
Delta in Liability Unwinding	IFRS17 discount curve is usually higher than Solvency curve, especially if matching adjustment is not applied. This leads to a higher liability unwinding in IFRS17.
SCR Release	Capital item that increases the company free capital in case of de-risking or in case of portfolio run-off
Delta in Tax (embedded in the other items in the plot)	Possible change in tax treatment and deferred tax
IFRS17 Change in Equity (excluding OCI effects)	
Asset OCI Release	Difference between Book value and Fair Value that flows into the profit over time, where FV to OCI/cost approach is applied.
Liability OCI Release	Difference between Inception value and Fair Value (due to change of Interest Rates and FX rates) that flows into the profit over time, where the option is applied.
IFRS17 Profit	

# 3.2

## KPI Comparison: Current GAAP Equity vs SII Own Funds vs IFRS9/17 Equity

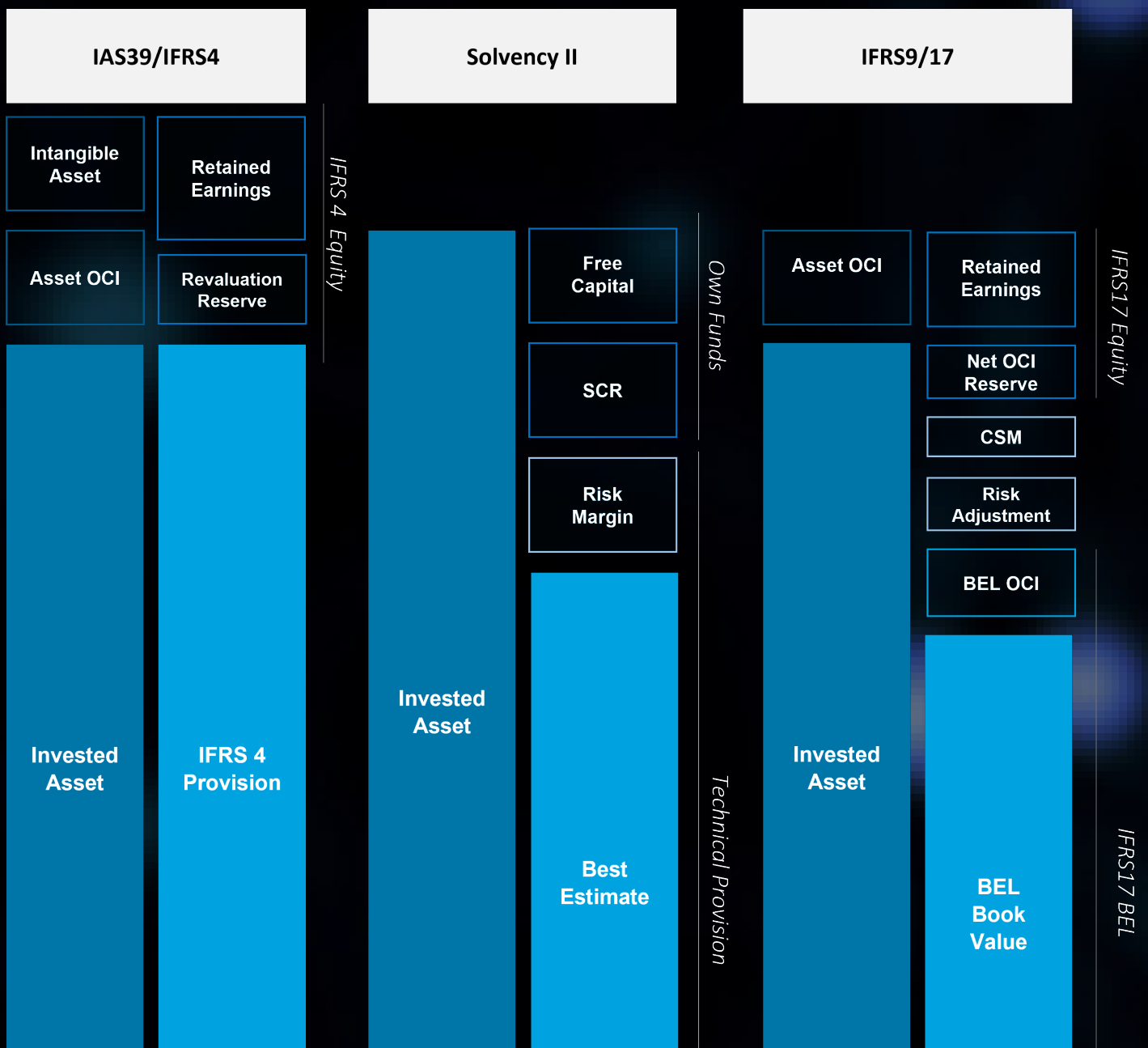


Figure 3: BS composition under different metrics

IFRS 4 / Traditional Local GAAP	<p>Express the shareholder value according to the traditional accounting metric. Local GAAP frameworks evaluation methodology, assumptions and accounting choices can widely differ among peers of the same country.</p> <p>IFRS reporting introduced a consistent accounting framework on the Asset side (IAS39) but in IFRS 4 liability evaluation is still mostly based on local accounting rules.</p>
SII Own Funds	<p>SII Own Funds provide a market-consistent evaluation of the shareholder equity according to a standardized approach.</p> <p>Even if the metric benefits from a standardized approach that eases the comparability among peers, SII Own Funds are not generally considered an economic value metric because of:</p> <ul style="list-style-type: none"> <li>- high exposure to short-term market impact because company-specific liability illiquidity is not considered except in the cases where matching adjustment is applicable</li> <li>- risk margin is based on a constant cost of capital not taking into account market environment and company risk-profile.</li> <li>- cost of capital not taking into account the target Solvency Ratio</li> <li>- illiquidity premium of long-term non fixed income investment not considered</li> <li>- other Solvency II specifications not based on economic evaluations</li> </ul>
IFRS 17 Equity	<p>IFRS 17 Equity could be considered more representative of the shareholder fundamental economic value rather than a volatile market value since:</p> <ul style="list-style-type: none"> <li>- risk adjustment is representative of company cost of capital and risk profile. Company specific risk-diversification assumptions could be applicable</li> <li>- even if the net-worth is market-consistent based, liability illiquidity premium allows for a more economic evaluation and decreases the equity dependency on short-term market fluctuations</li> <li>- shareholder value includes only the profit already released (amortized over contract life) instead of future profits</li> </ul> <p>However, equity could be subject to balance sheet A/L mismatch in case assets are accounted at cost or in case liabilities are not perfectly matched.</p> <p>As mentioned in section II, transition choices impact on starting equity and future profits related to the business In-force:</p> <ul style="list-style-type: none"> <li>- lower transition CSM/RA leads to a larger equity at transition and to lower profits</li> <li>- higher transition CSM/RA leads to a lower equity at transition and to higher profits</li> </ul>

# 3.3

## KPI Comparison: VIF vs SII

### VIF vs CSM

#### VIF

Value in Force (VIF) refers to the future profits expected to emerge from an existing block of life insurance business. It reflects the difference between the economic value of the in-force business to the shareholders and the net asset value under the statutory accounting framework.

Historic accounting frameworks frequently include prudent margins in the valuation of insurance business (i.e. the determination of the insurance liability). For example, such prudential margins could take the form of provisions for adverse deviation on individual assumptions or the zeroization of negative reserves. As such, the value of the VIF will depend on the extent to which the accounting framework is prudent and the best estimate assumptions used to determine the VIF.

There is no single standard definition of VIF and as such, its determination varies across companies (e.g. the precise definition of profits used). However, it would typically reflect the post taxation cash flows to the shareholder in respect of existing insurance liabilities and the associated assets backing those liabilities.

VIF is an intangible asset that is not reflecting on the balance sheet of insurers but may be tracked by management / disclosed to the market in order to provide a broader economic view of the value of the company's existing business than provided by the statutory accounts. Where an insurance company forms part of a wider non-insurance group then the VIF may be included as an intangible asset on the group balance sheet.

#### SII Own Funds

Solvency II usually reflects a best estimate (i.e. market consistent) view of the technical provisions so does not give rise to an explicit VIF asset. The VIF is included implicitly on the Solvency II balance sheet as part of the Own Funds. Expected profitability of the insurance business is already embedded in the Best Estimate Liability (BEL). It is also possible to calculate an alternative BEL using different contract boundaries to SII and the difference between this BEL and the Solvency II BEL considered as the Solvency II VIF.

It is important to note that VIF is distinct from the Solvency II concept of Expected Profits included in Future Premiums (EPIFP). EPIFP are profits which result from the inclusion in the Solvency II technical provisions of premiums on existing business that will be received in the future. This is a much narrower measure than VIF as it includes profits on future premiums within the Solvency II contract boundary while the VIF also reflected profits on premiums already paid in and potentially different contract boundaries.



## CSM

The IFRS 17 Contractual Service Margin (CSM) reflects the future profits expected to be earned on insurance contracts. The CSM is established at contract initial recognition such that there is no upfront recognition of profits. The 'stock' of expected future profits is reflected on the balance sheet as a liability and recognized as revenue as the insurance services are provided.

Profit recognition under historic accounting frameworks varies with some element of deferral typically achieved through a prudent valuation of the insurance liabilities but there can also be upfront recognition of at least some of the profits (or in some cases losses) associated with new business. That portion of future profits that is not recognized upfront would be included in the VIF asset as described above.

As IFRS 17 eliminates the upfront recognition of profits it also eliminates the VIF. Depending on the existing accounting practices of a company transition to IFRS 17 it may also result in the transfer of some profits that have already been recognized in equity on the balance sheet to the CSM to be recognized in the future.

Conceptually both the CSM and VIF represent future profits expected on existing business but there are a few key differences:

- the VIF measures the present value of future profits upfront while the CSM is a liability that defers the recognition of future profits.
- the VIF represents future profits to the extent they have not been recognized already in equity due to prudent reserves. The CSM reflects the full best estimate of future profits that have not already been earned in line with the provision of insurance service.

# 3.4

## KPI: Comparison: NBV vs SII NBV vs NB CSM

NBV according to Local accounting standard	<p>Local GAAP generally does not require disclosure of the new business value. For the purpose of the new business evaluation, profit testing techniques are typically used to highlight the profitability of new products. These techniques and the underlying assumptions are generally heterogeneous and vary from country to country and from entity to entity. Generally, in the southern part of Europe, valuations are non-market consistent.</p>
SII NBV	<p>Similarly, Solvency does not require a specific NBV disclosure. However, NBV is defined as the difference between the net premium and the new business Best Estimate.</p> <p>Furthermore, the effect of the cost of capital necessary to fulfil the SCR requirement (SII Risk Margin) is usually factored in the NBV indicator.</p> <p>Similarly to the other quantities described in the previous sections, Solvency NBV especially in the Saving products with embedded financial guarantees is largely affected by the market financial situation. In such cases, the underlying asset illiquidity is not fully reflected in the liability projection unless matching adjustment is applicable.</p> <p>Since no standard technical specification is applicable, different evaluation process can be applied by the insurers leading to a non-consistent NBV indicator. For example, insurers can evaluate NBV on a stand-alone basis or considering the effect of the overall asset portfolio return.</p>
NB CSM	<p>IFRS17 requires companies to disclose the value of NB CSM at initial recognition. The NB valuation differs from Solvency II or local GAAP metrics in the following:</p> <ul style="list-style-type: none"> <li>• Assumptions</li> </ul> <p>One of the main differences is the economic assumption, which considers, on the risk-free curve, a liquidity premium usually measured on the specific assets of the entity. The economic assumptions used have a significant impact especially in the mutualized VFA business, and particularly on products with financial guarantees. Generally, products under VFA, compared to those under GMM, are more sensitive to financial assumptions.</p>

---

- Recognition of Loss Component

Regarding the VFA business, where the identification of the economic result of a specific cohort is challenging, and where financial guarantees are often substantial, the initial recognition could lead to Loss Component (LC) - due to the risk premium embedded in the discounting curve, and due to the new business standalone evaluation. This could happen even in case of expected profitable business because, in mutualized contracts, the NB evaluation method could not take into account the expected return of the whole underlying asset portfolio. The LC recognized on a product is not included in the CSM, therefore the overall evaluation of new business value must be carried out by considering separately the CSM generated and the LC recognized. Furthermore, the recognition of a LC would entail the separation of the group of contracts from the other profitable ones belonging to the same generation. In case of mutualized business for which carve out option has been applied, the market has taken different positions: some still separate the LC on NB, others, considering existing business and new business as a whole, only value the total results, with the possibility of not revealing any loss component.

- Mutualization Approach and possible consistency with SII NBV Valuation

The need for disclosure of the NB Initial Recognition CSM – and therefore the possibility of highlighting initial “temporary” LCs entails for the entities a methodological choice between standalone or proportional evaluation. In standalone or greenfield valuations, NB is valued without considering the effect, in terms of return, provided by assets underlying existing business generations, and which will in fact contribute to the determination of the revaluation recognized to policyholders. This method, in case of financial guarantees and low market rates, can lead to the undue recognition of an initial loss component. The proportional evaluation, on the other hand, which already considers the return generated by the entire pool of assets (existing and new business), allows to recognize, in the cases above, a positive CSM. The latter is generally an end of period evaluation, while NB CSM should be disclosed at the beginning of the period. This involves the need to define the initial profitability of the NB using a backward approach. In general, the standard does not define a specific method for the valuation of the NB, consequently many entities are leveraging on process already in place for Solvency II evaluation.

- Risk Margin vs Risk Adjustment

The last element included in the LRC is the risk adjustment. In IFRS17, the risk adjustment represents a security amount set against purely underwriting risks - therefore risks relating to the market are not included in the calculation. Generally, the IFRS17 RA is lower than Solvency II risk margin. Similarly to the release of the RM, the release of the risk adjustment also represents a profit for the entity, but the latter is clearly indicated within the PL IFRS17. The calculation methodology for the RA is not defined directly by the standard and often it has been borrowed from the calculation of the RM Solvency II, with suitably specifics such as the percentile and the perimeter of the risks.

---

## CSM Trend and Turnover

Based on the transition level of the CSM, the CSM value generated by the NB may or may not be able to compensate for the release of the Existing Business CSM. In cases where the transition CSM is particularly high, for some years, the CSM of the NB may not be sufficient to compensate for the release, thus leading to a decrease in the company's CSM level. On the contrary, in cases where the transition CSM was limited, the issue of the NB could compensate or exceed the release of the EB. In both cases, to tend, the Companies could obtain a level of CSM of NB suitable to compensate for the release of EB, thus reaching a stable turnover of the CSM.

Since initial recognition CSM is based on a market-consistent methodology, a risk-premium is embedded in the discounting curve definition affecting the value of the financial guarantees.

Furthermore, as aforementioned, new business evaluation could reduce the CSM since it does not embed the overall asset portfolio profitability in case of mutualized business. The excess of the Asset return over the valuation assumptions flows into the CSM every year. Some insurers reflected this effect in the CSM release pattern at initial recognition under some conditions (Bow Wave effect). Understanding the duration of the NB issued, the expected profitability, and the timing of the emergence of profit can help to improve the CSM turnover stability.

Graphics below show the turnover CSM based on initial transition CSM level. The total CSM is defined as:

$$Total\ CSM_T = Transition\ CSM + \sum_{t=0}^T NB\ CSM_t + \sum_{t=0}^T Bow\ Wave_t^e - \sum_{t=0}^T CSM\ Release_t$$

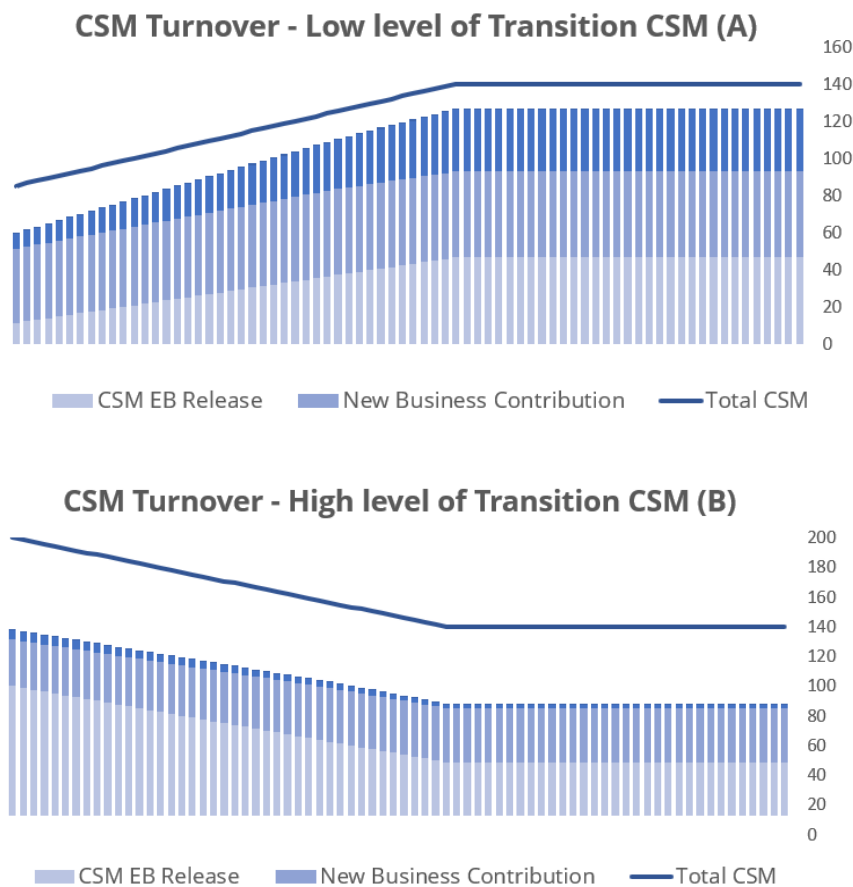


Figure 4 – Illustrative CSM Turnover in a low transition CSM scenario (A) and in a high transition scenario (B). In A, Existing Business (EB) release is lower than NB (New Business) CSM. Total CSM increases till the business In Force at transition is completely run off. B represents the opposite scenario. Bow Wave effect is assumed to be part of the EB CSM Release.

# 3.5

## Return on Equity: possible adjustments under IFRS17

At the moment it is expected that management and analysts will consider simply the ratio between Underwriting Profit and IFRS 9/17 equity.

However, three possible alternative definitions of the Return on Equity are described below:

---


$$\frac{\text{Underwriting Profit} + \Delta RA + \Delta CSM}{\text{Equity} + RA + CSM}$$

- Risk Adjustment and CSM are added back to the equity since they are embedded profits and risk premium that would flow into the equity in the Best Estimate scenario. Addition of the CSM makes the equity more consistent with the SII framework while the addition of the RA is not consistent with the Solvency II Risk Margin that is part of the technical provisions.

---


$$\frac{\text{Underwriting Profit} + \Delta OCI + \Delta RA + \Delta CSM}{\text{Equity} + RA + CSM}$$

- Inclusion of the Delta OCI on the numerator increases the dependency of the KPI on market conditions
- The adjustment makes the KPI more consistent to Solvency.
- The KPI could be unstable over time depending on the degree of the Asset-Liability matching

---


$$\frac{\text{Underwriting Profit} + \Delta RA + \Delta CSM}{\text{Equity} + RA + CSM - OCI}$$

- The removal of the OCI from the denominator increases the stability of the KPI over time. The indicator becomes more similar to a non-market consistent equity measure
- However, in case a material transition net OCI is reported, Underwriting profit can be heavily affected by the OCI release. For example, in case of a positive Net OCI the Underwriting profit will benefit from the OCI release. This portion of income is not an organic growth and fades out along with the Net OCI release. Since in this version of the KPI there is no offsetting in the denominator, indicator value could be misleading in the first years after transition.







# 4

## Challenges and Opportunities in the short and medium term

Several processes are impacted from the introduction of the new reporting standard together with the pure IFRS17 reporting implementation



We already mentioned the bridging between Local, Solvency and IFRS17 metric that will be likely expected by the investors at day 1. Some insurers have already had capital market day events that, in some cases, included preliminary disclosure of IFRS17 figures. In the future, narrative is expected to include an explanation about the main factors driving the difference between Solvency, Local and IFRS 9/17 pattern.



### Reporting Process

The go-live requires that insurers finalize the new reporting target operating model, with special regards of the reporting timeline. Even if the Solvency tools and models have been leveraged on, the typical strict deadlines of the accounting disclosure could not allow to adopt the same target operating model. In some cases (for example in case of a stochastic evaluation in the Life business where different set of scenarios need to be calibrated) the adoption of simplifications is unavoidable and has to be discussed with the internal validators and external auditors in advance. In this case the management can benefit from market insights and the top player best practices are valuable information that could help in shaping the reporting process.



### Governance and Validation Process

As part of the reporting framework, insurers should also set up a proper IFRS17 validation process even if neither the standards nor other regulations provide any guideline or specification. This implies not only the definition of validation procedures but also the implementation of the IFRS17 validation and internal audit governance. This could imply relevant changes since balance sheet managers do not always have the necessary actuarial skills and background to manage properly IFRS17 figures. A bridge that could ease the communication between actuarial units and balance sheet/capital management can prove to be necessary. Furthermore, this knowledge gap could lead to further governance improvements in terms of processes and responsibility.



### Product Development & Finance Transformation

IFRS17 is already largely considered part of the finance transformation stage. The standards pushed insurers to invest in the reporting process with an emphasis on data integration and data management. Even if part of this development is not directly driven by the regulatory requirement, this is also a chance to improve systems and processes in order to maximize the use of the available data to closely monitor product profitability and take business decisions in a timely manner. A relevant example is the aforementioned optimization of the product structure and agency fees driven by the CSM that some insurers are starting to investigate. This requires frequent monitoring over time. An appropriate target operating model and set of tools are necessary to ensure the efficacy of the data management process. In this context, RPA (Robot Process Automation) and probably farther in the future also Artificial Intelligence based tools can be of interest to insurers to improve the data integration and the data flow and to model the dependency of the CSM to the different product features.

Regarding the finance process, budgeting and planning are currently under transformation too. Some of the big international players started in advance to improve their methodologies and to implement the IFRS9/17 planning process while still designing the IFRS17 reporting process. In other cases, planning implementation has been postponed till the sign-off of the accounting process.

In any case, insurers are expected to focus on budgeting and planning soon since ex-ante projection is also one of the topics of interest of investors from day 1. Ensuring the availability of reliable projections, of the appropriate data granularity as well as the understanding of the drivers moving the bottom-line is a key requirement.



### Capital Management and Planning and Control

In the medium term, IFRS17 could of course impact other processes and areas of the insurers like:

- the capital management framework that should take into account not only the Local GAAP (still relevant for the legal dividend payout) and the Solvency but also the IFRS17 reporting. This can impact also the M&A choices in case IFRS9/17 balance sheet becomes the leading disclosure for investors and analysts;
- similarly to the capital management area, the financial performance measurement framework will likely be adjusted according to IFRS17 KPI. Some reporting periods will be necessary to get shareholders and stakeholders accustomed to the new metrics and to define the most relevant KPIs for the business planning targets.
- the definition of the role of the Actuarial function, as well as the design and the implementation of an internal validation process that ensures materially correct reporting.

In conclusion, the transition stage is not expected to be over after the go live. A specific IFRS17 knowledge widespread in the different units, the technology and specific tools as well as effective target operating models are high value assets to manage the complexity arising from the next stage of IFRS17 transition.

# Glossary

IFRS	International Financial Reporting Standards	International Accounting standards issued by the IFRS Foundation and the International Accounting standards Board (IASB)
GAAP	Generally accepted accounting principles	Common set of accounting rules, standards, and procedures issued by the Financial Accounting Standards Board (FASB)
KPI	Key Performance Indicator	Indicator that measures how effectively a company is achieving its defined targets
ROE	Return on Equity	Defined as the ratio between profit and Shareholder Equity
ROI	Return on Investment	Defined as the ratio between profit and the cost of the Investment
EBITDA	Earnings before interest, taxes, depreciation, and amortization	Common measure of company profitability
CG	Capital Generation	Free Capital generated by the company in a defined period. Often based on Solvency II Eligible Own Funds.
OCG	Organic Capital Generation	Capital Generation adjusted to exclude one-off effects, market variances and non-sustainable source of growth
TEV	Traditional Embedded Value	Equal to the Net Asset Value plus the present value of future profits
MCEV	Market Consistent Embedded Value	Market Consistent Shareholder value based on the definition provided by the CFO Forum
CSM	Contractual Service Margin	Unearned profit that the insurer expects to gain as it provided services according to IFRS17 standards
VIF	Value in Force	Expected present value of future profits related to Insurance Policies sold by the Company
NBV	New Business Value	Expected present value of future profits arising from new business in the period
OCI	Other Comprehensive Income	Includes gains/losses that have yet to be realized and are excluded from Net Income
LC	Loss Component	The Loss Component determines the amounts that are presented in profit or loss as reversals of losses on onerous groups and are consequently excluded from the determination of insurance revenue
PAA	Premium Allocation Approach	Simplified measurement model for IFRS17 that can be used in case the coverage period is lower than 1 year and in case additional conditions are satisfied
GMM	General measurement model	General Accounting approach for the measurement of Insurance Contracts under IFRS17
VFA	Variable Fee Approach	IFRS17 Accounting approach that generally applies in case of contracts with direct participation features
Free Capital		Amount of the Solvency II Eligible Own Funds in excess of the regulatory Solvency II Capital Requirement
OFCF	Operating Free Cashflows	Measure of the amount of Cash generated by a Company's normal business operation
Financial Leverage		Defined as the ratio between Total Debt and Shareholder's Equity
SR	Solvency Ratio	Defined as Solvency II Eligible Own Funds divided by Solvency II Capital Requirement

<sup>7</sup>[https://cfoforum.eu/downloads/MCEV\\_Principles\\_and\\_Guidance\\_October\\_2009.pdf](https://cfoforum.eu/downloads/MCEV_Principles_and_Guidance_October_2009.pdf)

# Main contacts



Marios Schizas,  
Partner,  
Deloitte Risk Advisory  
[mschizas@deloitte.com](mailto:mschizas@deloitte.com)



Maria Michaelides  
Director,  
Deloitte Risk Advisory  
[mamichaelides@deloitte.com](mailto:mamichaelides@deloitte.com)

The market report is written by an EMEA actuarial working group of Deloitte professionals and represents the view of the related member firms

Member firm	Working Group Leader	Lead Partner
Netherlands	Antonio Borelli, Manager, Risk Advisory	Pelle Van Vijmen Partner, Risk Advisory
	Working Group Member	Reference Partner
UK	James Thorpe, Senior Manager, Consulting  Janri Theron, Senior Manager, Consulting	Paul Coulthard Partner, Consulting
Ireland	Stuart Redmond, Director, Audit and Assurance	Ciara Regan Partner, Audit and Assurance
Cyprus	Maria Michaelides, Director, Risk Advisory	Marios Schizas, Partner, Risk Advisory
Italy	Michela Macellari, Manager, Actuarial and Insurance Solutions	Giovanni Di Marco, Partner, Actuarial and Insurance Solutions
Portugal	Joao Maria Duarte Senior Manager, Risk Advisory	Alexandra Ferreira De Fonseca, Partner, Risk Advisory
Spain	Antonio Sau Manager, Risk Advisory	Mario Martinez Menendez, Partner, Risk Advisory



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see About Deloitte for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

In The Netherlands the services are provided by independent subsidiaries or affiliates of Deloitte Holding B.V., an entity which is registered with the trade register in The Netherlands under number 40346342.

© 2023 Deloitte NL. All rights reserved.  
Designed by CoRe Creative Services. RITM1243301