DAV
Deutsche
Aktuarvereinigung e.V.

Ergebnisbericht des Ausschusses Rechnungslegung und Regulierung

Asset-Liability-Management im Zusammenhang mit IFRS 17 (ALM in the context of IFRS 17)

Köln, 4. November 2024

Präambel

Die Unterarbeitsgruppe „IFRS 17 – KPI“ der AG IFRS des Ausschusses Rechnungslegung und Regulierung der Deutschen Aktuarvereinigung e. V. (DAV) hat den vorliegenden Ergebnisbericht erstellt.[1]

Anwendungsbereich

Der Ergebnisbericht betrifft Aktuarinnen und Aktuare[2] bei der Ausführung aktuarieller Aufgaben im Rahmen der internationalen Rechnungslegung (IFRS 9 & IFRS 17).

Der Ergebnisbericht ist an die Mitglieder und Gremien der DAV zur Information über den Stand der Diskussion und die erzielten Erkenntnisse gerichtet und stellt keine berufsständisch legitimierte Position der DAV dar.[3]

Inhalt

Der Ergebnisbericht behandelt Fragestellungen zum Zusammenspiel von Kapitalanlagen bilanziert nach IFRS 9 und Versicherungsverträgen bilanziert nach IFRS 17 sowie die Auswirkung auf ausgewählte KPI, unterschieden nach den Bewertungsansätzen unter IFRS 17. Zunächst werden die verschiedenen Bewertungskombinationen aus IFRS 9 und IFRS 17 beschrieben und welche Kombination welchen Einfluss auf die ausgewählten KPI hat, bevor auf die Frage eingegangen wird, was dies für die Vergleichbarkeit der KPI zwischen den Unternehmen bedeutet.

Schlagworte

IFRS 17, IFRS 9, Versicherungsverträge, KPI, OCI, Asset, Liability, ALM

Verabschiedung

Dieser Ergebnisbericht ist durch den Ausschuss Rechnungslegung und Regulierung am 4. November 2024 verabschiedet worden.

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[1] Der Ausschuss dankt der Unterarbeitsgruppe *KPI* der Arbeitsgruppe *IFRS* ausdrücklich für die geleistete Arbeit, namentlich Thorsten Ante, Dr. Robert Bahnsen (Leitung), Jan-Christopher Köhler, Reinhard Lenz, Katrin Ruess, Dr. Claudio Schmidt-Wegenast, Ulrike Schwarz, Dr. Thorsten Wagner.

[2] Auch wenn hier und im Folgenden die Aktuarinnen und Aktuare explizit genannt werden, spricht die DAV alle Geschlechter und Identitäten gleichermaßen an. Dies gilt auch für alle anderen hier genannten Personengruppen.

[3] Die sachgemäße Anwendung des Ergebnisberichts erfordert aktuarielle Fachkenntnisse. Dieser Ergebnisbericht stellt deshalb keinen Ersatz für entsprechende professionelle aktuarielle Dienstleistungen dar. Aktuarielle Entscheidungen mit Auswirkungen auf persönliche Vorsorge und Absicherung, Kapitalanlage oder geschäftliche Aktivitäten sollten ausschließlich auf Basis der Beurteilung durch eine(n) qualifizierte(n) Aktuar DAV/Aktuarin DAV getroffen werden.

This abstract summarises the report on findings „ ALM in the context of IFRS 17"" which was approved by the DAV committee Rechnungslegung und Regulierung on 04.11.2024.

Asset Liability Management in context of IFRS 17

This report deals with aspects relating to the interaction of investments accounted for in accordance with IFRS 9 and insurance contracts accounted for in accordance with IFRS 17 as well as the impact on selected KPI, differentiated by the measurement approaches under IFRS 17.

First, the various measurement combinations from IFRS 9 and IFRS 17 are described, and which combination has which impact on selected KPI, before the question of what this means for the comparability of the KPIs is addressed.

Reports on findings are summaries of the results of work carried out by DAV committees or working groups,

- where their application can be freely decided upon within the framework of the code of conduct,
- that should inform discussion of the current opinion among actuaries or also among the broader public.

As working results of a single committee, they do not, for the time being, represent any recognised position within the DAV and do not comprise any actuarial standards of practice. In this respect they are clearly distinguishable from any standards of practice.

Inhaltsverzeichnis

1. Introduction

Asset and liability management (ALM) is the practice of managing financial risks that arise due to mismatches between the assets and liabilities as part of an investment strategy in financial accounting. This document does not explain the general aspects of corporate management or ALM of insurance groups but discusses the impact of ALM on some insurance KPI. First, the valuations according to IFRS 9 and IFRS 17 are briefly presented, before the various measurement models of IFRS 17 and the respective interaction with the asset side are discussed. In addition to exemplary ALM scenarios and their effects on KPI, we point out that, because of the introduction of IFRS 17, classic technical results and thus also KPIs no longer depend solely on the liability side, but that the assets and financial variables like interest rates have an influence on them.

IFRS 9

Under IFRS 9, financial assets are measured in the balance sheet at either amortized cost or fair value. When financial assets are measured at fair value, unrealized gains and losses are recognized either in profit or loss (fair value through profit or loss, FVTPL), or in other comprehensive income (fair value through other comprehensive income (OCI)). Derivative financial instruments (when not used in hedge accounting), equity instruments (per default) and financial assets that do not meet the "Solely Payments of Principal and Interest" criteria (SPPI) are measured at FVTPL. Equity instruments not held for trading may be designated at FVOCI without recycling (see below). Financial assets that meet the SPPI test when held to collect are measured at amortized cost and when held to collect and sale are measured at FVOCI with recycling. Recycling means that when the financial instrument is sold, the effects recognized in OCI must be reclassified to the income statement.

Please note that this paper does not consider insurance contracts measured as financial liabilities according to IFRS 9 but focuses on insurance contracts accounted under IFRS 17 with financial instruments accounted under IFRS 9.

IFRS 17

Under IFRS 17, insurance contract liabilities are required to be evaluated at current interest rate, which means the current fulfilment value of insurance liabilities. This might enhance the transparency for asset and liability mismatching risks including currency and duration mismatches which result in volatilities of financial earnings and solvency ratio. Thus, to the extent the insurance liabilities are economically matched with the relating assets, the income and expenses reported in profit or loss, because of changes in current interest rates, are expected to offset, as long as assets and liabilities follow the same accounting measurement (e.g. FVTPL). Both IFRS 9 and IFRS 17 include options to reduce accounting mismatches. Whereas IFRS 9 allows entities to elect to measure financial assets at fair value through profit or loss where this addresses an accounting mismatch, IFRS 17 allows entities to make an accounting policy choice between:

(i) including insurance finance income or expense for the period in profit or loss; or

(ii) disaggregating finance income or expense between profit or loss and OCI.

When considering IFRS 9 and IFRS 17, it is important to understand the accounting options an insurer has for financial asset accounting under IFRS 9 as well as for the accounting of the liabilities under IFRS 17. The aim is to reflect changes in insurance liabilities and movements of associated backing assets in the same manner, i.e. either in P&L or in OCI. If the related changes are reported differently, performance reporting does not provide useful information. Actuaries must be aware of FVTPL vs. FVOCI and how financial assets are accounted for, as it might change the way how financial effects are considered in the P&L.

After exercising available accounting choices consistently (IFRS 9 and IFRS 17), any remaining mismatch is not an accounting but an economic mismatch. If an entity would like to reduce such mismatches, changes to the investment strategy and/or investment mix might be considered.

Currently, ALM analyses mostly focus on market consistent balance sheets and seek to optimize ALM under frameworks such as Solvency II, while not completely excluding the effects on IFRS and statutory balance sheets. Going forward, given that IFRS balance sheets will come closer to market consistency, they might also be included and analyzed in ALM studies.

In the following, we will discuss the impact of the different measurement approaches under IFRS 17 on ALM, how balance sheet and P&L measures are determined distinguishing between assets, VFA and non-VFA (i.e., GMM & PAA). The description will also use various scenarios to illustrate how ALM can impact selected KPIs. Please note that for the further description it is assumed that the valuation of the asset side was chosen to match the liability side.

2. Asset Liability Management for Non-VFA Business

We take a look at some details about asset liability management under GMM or PAA to calculate our technical reserves for IFRS 17. Since there is no underlying item defined like under VFA, a quite similar idea of locked-in interest rate for each cohort or claim occurance year is given for non-life or non-profit-participating insurance business. The locked-in interest rate for a cohort or occurance year defines the expected future yield (i.e. interest expense for insuance liabilities) and is essential for the initial recognition and the calculation of movements of the LRC and LIC in the P&L. The locked-in interest rate has crucial impacts:

Effects on Balance Sheet and P&L

On the one hand, applying the OCI option, the locked-in rate determines the insurance finance expense in terms of the unwind of discount and on the other hand it determines the present value of especially the CSM (GMM) and the value of the incurred claims in the P&L. Thus the locked-in interest rate massively influences the distribution of future profits and expenses from insurance contracts to the insurance service result or the insurance finance result in the profit and loss statement. Relativly low interest rates would lead to higher present values of technical reserves and thus lower insurance service results in terms of a lower CSM or higher amounts for incurred claims. On the other hand the insurance finance expense in terms of unwind of discount in the future would be lower, leading to a better net investment result. Relativly high interest rates would lead to opposing effects, meaning higher insurance service result (through lower incurred claims as expense line item) and higher expenses in the insurance finance result. Depending on the investment return of the assets high locked-in interest rates or a high unwind of discount could even lead to negative net investment results. So the net investment result as part of the profit and loss statement shows the reader how good returns from investmens and expenses arising from the unwind of technical reserves finally fit together.

In case that a company has chosen the OCI Option under IFRS 17, changes in interest assumptions in comparison to locked-in rates will change the reserves and the insurance OCI part of equity for GMM and PAA. As part of equity it will be netted with the OCI arising from assets under IFRS 9 and thus the net OCI within equity in total will show the reader how good assets and liabilities are matched.

In case that a company is not applying the OCI Option under IFRS 17, the above mentioned match with possible OCI arising from assets under IFRS 9 would be missing. Thus the equity would be more volatile. The missing OCI movement would show up in the insurance finance result and hence also bring more volatility to the P&L. Hence not chosing the OCI option for the financial assets would be the preferable solution to avoid accounting mismatch in P&L.

Effects on KPIs

For GMM business the locked-in interest rate does not only influence the profit and loss statement and the balance sheet. As already mentioned, it determines the present value of the future cash flows and thus the CSM at initial recognition. So possible KPIs like the CSM itself or the CSM of new business as possible part of a new business value are also massively influenced by the locked-in rate at inception and could differ from one year to another, even if the sold insurance product stays the same.

For PAA business, especially for incurred claims, the locked-in interest rate at the date of the claim incurrence determines the amount of incurred claims as part of both, balance sheet and profit and loss statement. Thus it directly influences the insurance service expenses and the KPI combined ratio. Higher locked-in rates lead to lower insurance service expense for actual incurred claims whereas lower or even negative locked-in rates would lead to a rising combined ratio.

For both, PAA and GMM, the locked-in rate and the actual interest rate of the reporting date determine the OCI for insurance contracts as part of the representation of the asset liability mismatch. So the interest rates even influence the equity and thus the KPI Return on Equity (RoE). In case a company did not exercise the OCI Option, the mentioned effect would not arise in the OCI but in the net investment result with impact on net income.

Conclusion

The mentioned effects will make it much more difficult to compare insurance companies, because the locked-in rate can be defined individually, especially for the combined ratio or the CSM of new business. High locked-in rates would lead to lower combined ratios, lower CSMs of new business and higher insurance finance expense. High differences between the locked-in rates and the actual interest rate from the reporting date inflict the equity in terms of OCI. So if we try to get a fair view for our comparison of companies, we always have to look at a set of KPIs, balance sheet items and P&L measures and not only on a few of them. The quality of each company's Asset Liability Management will be apparent and fullfills the transparency purpose of IFRS 17.

3. Asset Liability Management for VFA Business

For VFA business, the term "underlying item" (short: UI) is essential for the accounting according to IFRS 17. The UI refers to "items" that determine at least a part of the insurance benefits to be paid to policyholders. In most cases, UI is defined by a financial asset portfolio – either the Unit-linked fund for Unit-linked policies or the asset portfolio covering reserves of a with-profit portfolio. Since ALM is not at all demanding for Unit-linked business, we just concentrate on ALM for with-profit business measured as VFA under IFRS 17 – e.g. the German traditional life business.

Coming back to IFRS 17: Why is the UI so "essential"? It's because of the smoothing nature of the CSM for VFA business. As known, for GMM, at least for non-financial variables, as well as for VFA business any effect of changes in future assumptions (or more precise: "changes in fulfilment cash flows relating to future service") will be absorbed by the CSM. However, for VFA business, the CSM also absorbs the Shareholder part of changes in the UI – especially changes in the UI caused by change of capital markets – or in other words: changes of market values of assets held by the entity to cover the with-profit business.

The CSM absorbs "only" the Shareholder part of changes in the UI since the policyholder part is already reflected in the change of Fulfilment Cash Flows, i.e. changes in the UI are totally absorbed by CSM and FCF.

Effects on Balance Sheet and P&L

In the following, we restrict our view only to with-profit business and assets covering that business – i.e. without referring to any other liabilities or any other assets which might cover shareholder's equity or such other liabilities[4].

What is the result of IFRS 17 in relation to any ALM or real asset portfolio structure?

[4] For example, interest on shareholder equity which has no influence on IFRS 17 features such as CSM.

- Any market value movements of the asset portfolio will result in off-setting movement of the LRC as sum of the Fulfilment Cash Flows (which refers to the effect of asset's market movements on the policyholders) and of the CSM (which refers to the effect of asset's markets movements on the shareholders).
- Of course, this is only true if the CSM will stay positive – let's assume that this is valid.
- As a result, the IFRS balance sheet would react on capital market movements on asset side and liability side in exact the same way – assuming that all assets are accounted for as "fair value" (and nothing at "amortised costs" – we assume this is done also in the following discussion).
- In consequence, there shouldn't be any direct P&L effect resulting from such market movements!
- There is only the "indirect way of P&L effects" since CSM will be in the first instance affected by this absorbing mechanism, and, in a second step, from CSM the CSM release will be recognised in the P&L: A smaller (higher) CSM (after adjustments oder recalibration) will therefore lead to smaller (higher) profits – recognised as CSM release and therefore shown as "insurance revenue" under IFSR 17.

In consequence: The quality of asset-liability "matching" will primarily affect the CSM. The CSM works therefore as a buffer.

Another consequence is that IFRS 17 allows to choose the OCI option for VFA business (IFRS 17.89) in a way that it defines the insurance finance expenses in the P&L just to neutralize the P&L-relevant investment results of the UI assets. If using the OCI option under IFRS 9 for (parts of) the UI assets, the OCI option leads also to equalizing OCI movements stemming from UI assets on the one hand and from LRC on the other.

Effects on KPIs

Of course, depending on the actual asset allocation of the UI portfolio and therefore depending on the asset-liability "mismatch", the portion of change of the amount of UI that is deemed to belong to the shareholder and therefore changes the amount of CSM may vary:

- A very good A-L matching may have only slight effects on CSM
- If the UI portfolio contains a higher portion on non-fixed-income assets or fixed-income assets with significant spreads, different duration or currency of the "related" liability, capital market movements may have a much more significant effect on the CSM

Usually, the current asset portfolio as well as the projected strategic asset allocatino (SAA) will have a significant influence on the Fulfilment Cash Flows (actuaries used to cash flow models know this especially as the influence of "Time Value of option and Guarantees", TVOG) – and therefore also (and especially) on the value of the CSM for New Business.

Conclusion

The IFRS 17 has been designed to absorb market value movements for VFA business largely within the CSM, therefore, the ALM is not as relevant to VFA business as for GMM business *from an accounting point of view*. But of course, the economic impact of the ALM strategy can be enormous – however, the impact will be recognised in the IFRS P&L only smoothly and over several years by the release of the CSM.

Of course, the volatility of the CSM induced by market movements may give some hints about the direction of SAA and therefore the ALM adopted by the insurer.

Nevertheless, due to the smoothed P&L realisation, an investment strategy focussing on higher yields by allowing a relative high asset-liability mismatch has no drawbacks from an accounting perspective – IFRS 17 is constructed as a long-range standard with some smoothing features and does not request immediate recognition of P&L or equity effects in years with turbulent market movements.