New KPIs under IFRS 17

Helping investors understand your IFRS 17 performance – A focus on new business metrics

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pwc

Introduction

IFRS 17 will provide all stakeholders access to a wealth of new information about the performance of your business. Analysts and investors will see new information in published results, while internal stakeholders may be concerned about how that information is reflected in key internal performance metrics. In the run up to implementation, it is important to fully educate these key stakeholders on how newly published results and key internal performance metrics will differ under IFRS 17. This will help you best communicate with your stakeholders after IFRS 17 is implemented.

This article focuses on new business metrics, a key focus area for stakeholders. IFRS 17 is unlikely to change the focus of analysts and investors on the growth in new business volumes and to the profitability of new business. As a result, new business KPIs are often also a key component of executive remuneration.

The new Standard changes the drivers of your accounting performance, and requires disclosures of the effect of new business on each of the components of the insurance contract liability, i.e. the cash flows, risk adjustment and Contractual Service Margin ('CSM').

However, the market is not familiar with these new metrics and may not know how to interpret them. Further, many existing new business volume metrics, such as Annual Premium Equivalent ('APE'), Present Value of New Business Premiums ('PVNBP') or Net/Gross Written Premiums ('NWP/GWP') will not be produced as part of the IFRS 17 disclosures, and IFRS 17 disclosures on their own won't allow investors and analysts to understand future dividend capacity or show how successful management is in generating value for shareholders.

You need to consider carefully how best to help investors and analysts understand your growth story from this new information. In doing so, you will need to consider whether to replace existing new business volume metrics with new ones, whether to develop new volume and value metrics from IFRS 17 numbers, or to provide supplementary analysis e.g. solvency metrics. It is important to consider what story you want your results to tell, both internally or externally, and how you can visualise your KPIs to make that story more impactful.

Existing New Business KPIs

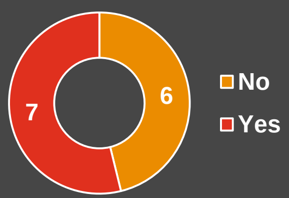
Currently most life insurers provide an Alternative Performance Measure (APM) as their primary new business disclosure, and the majority of insurers do not provide a bridge of the new business measures to reported IFRS balances. Instead they bridge the new business measures to either Solvency II or to Embedded Value (EV) information.

We analysed the 2019 annual reports of 13 European insurance companies to investigate which new business metrics were disclosed as KPIs. We found that 7 of these insurers disclose measures relating to new business value and 10 disclose measures relating to new business volume.

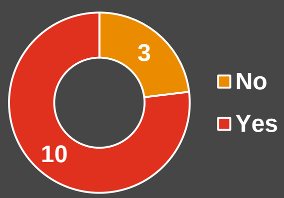
Of the insurers that disclosed a new business value measure, 2 used an adjusted Solvency II basis and 5 used an Embedded Value measure. The new business volume metrics commonly used were Annual Premium Equivalent (APE), Gross Written Premiums (GWP) and the Present Value of New Business Premiums (PVNBP).

With regards to General Insurers our analysis of a sample of annual reports showed that all disclose new business volume measures; with many electing to disclose more than just gross or net written premium. Additional metrics include the number of customers or in-force policies. However, we observed none to be disclosing information on the profitability of new business as distinct from profits or losses emerging from prior business.

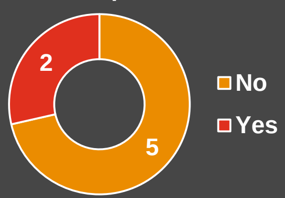
New Business Value



New Business Volume



Bridge of New Business APM to reported metric



New business profitability metrics

For new business accounted for applying the General Measurement Model ('GMM') or Variable Fee Approach ('VFA'), IFRS 17 provides (re)insurers with information about the expected profitability of new business – the new business CSM. Insurers may continue to disclose some of the existing metrics after transition to IFRS 17, but may replace or supplement those existing measures with an IFRS 17-based measure, such as an adjusted or unadjusted new business CSM.

Even if insurers choose not to use the new business CSM as a new business KPI, they may want to think about reconciling their existing new business value measures to the reported new business CSM. Entities may wish to consider if they provide the reconciliation to existing measures as a one-off transition disclosure or if they wish to provide this reconciliation for a number of periods.

We anticipate that insurers that use significant amounts of reinsurance will disclose a net of reinsurance new business CSM as a KPI. Other adjustments could also include:

- Risk adjustment (RA) held against new business: the release of this balance over the life of the contract will contribute to future profits.
- Loss Component (LC) for new business: to ensure any losses incurred on new business are also reflected in new business KPIs.
- Loss Recovery Component (LRC) for reinsurance on new business: to capture any offsetting of loss components on underlying contracts which is provided by profitable reinsurance contracts.

A major consideration when looking to adopt new business IFRS 17-based KPIs is how non-insurance business would be captured. Solvency II and EV-based measures may continue to be preferable for insurers who have material portfolios of non-insurance business who want to present a profitability metric that captures both their insurance contracts and investment/unit linked contracts. However, it is important for these insurers not to ignore the new business CSM, as analysts and investors may see it as a key measure that provides guidance over the future profitability of the insurance company.

To the extent that general insurers have business accounted for applying the GMM, information about new business CSM will be available. However, general Insurers currently disclose fairly limited information about the profitability of new business. Their APMs are primarily based on loss ratios on an aggregated basis, and allow for prior period business. Our emerging view is that the market will not move away from loss ratio based value measures. If this is the case, decisions will need to be made about how to explicitly define those measures on an IFRS 17 basis.

For general (re)insurers using the Premium Allocation Approach ('PAA'), please see the next page.

New business volume metrics

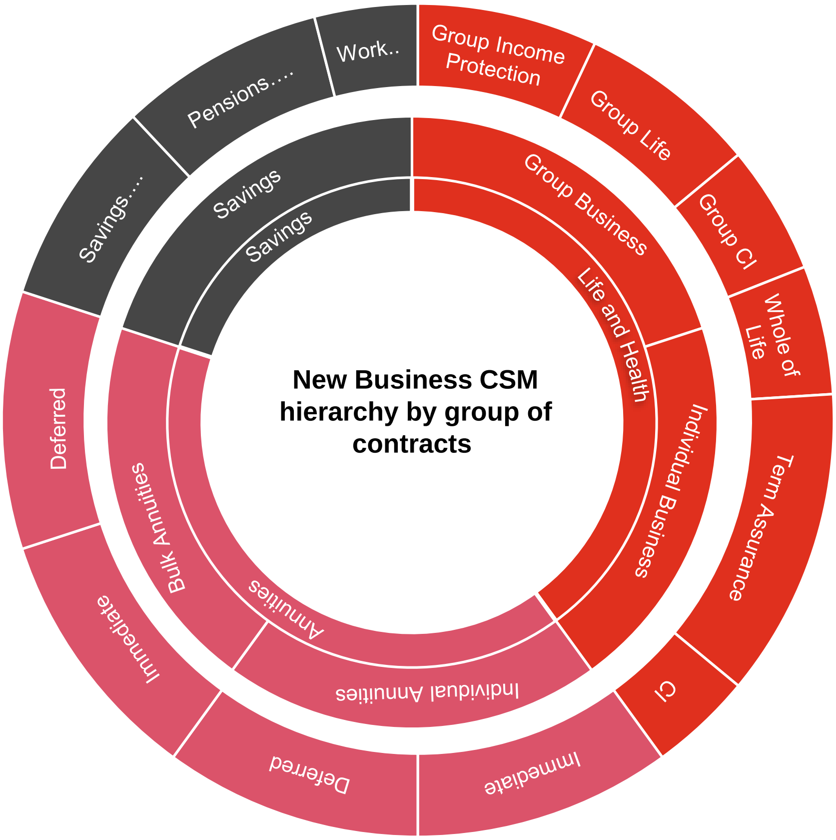
IFRS 17 introduces a new insurance contract revenue measure. This differs from the Gross Written Premium ('GWP') currently disclosed, in that it provides information about the amount of service provided in the year. Depending on the duration of the contracts, the magnitude of the difference might be material, particularly for long-duration contracts.

Current industry consensus on the future of Gross Written Premium as a KPI remains divided, but it is likely that some companies will continue to voluntarily disclose this figure in the Alternative Performance Indicators section of the Financial Statements, at least in the period of transition.

Many insurers also currently disclose APE or PVNBP as KPIs, which provide a view of the volumes generated over the period. We believe these are likely to continue to be disclosed, ideally with a reconciliation to IFRS 17 revenue.

Premium Allocation Approach (PAA)

For general (re)insurers using the PAA measurement model, except for onerous contracts, there is no requirement to disclose the ultimate expected profitability on new business and doing so would require additional calculation. We anticipate that PAA companies will look to retain any existing reported non-IFRS metrics over new business as KPIs, for example current underwriting year loss ratio estimates.



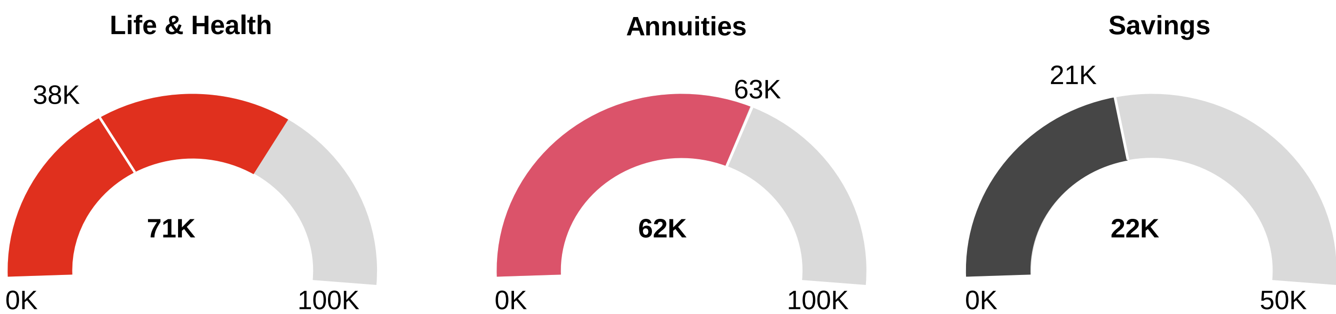
Data Visualisation

Tell your story with impact

Contract revenue KPIs lend themselves well for insightful visualisations either for external or for internal reporting. Insurers should consider what the key message they are trying to relay is and how to best visualise it. For example, for external purposes the focus may be on demonstrating the value (and hence future profits) that management is generating year-on-year through the new business it is selling.

For internal purposes management may want to show the distribution of revenue per Business Unit or group of contracts or how each BU or group of contracts performs against budget or plan. An executive level dashboard could provide this information without being cluttered or overloaded with information.

New Business Value – Actuals vs Budget



Gauge charts, spider charts, maps and waterfall charts can be very useful depending on the message.

Other considerations

Reinsurance contracts

IFRS 17 represents a significant divergence in the accounting of reinsurance contracts, in particular the treatment of reinsurance contracts in their own right, separate from the underlying. Reinsurance could have a big impact on new business profitability measures and is highly complex to determine, for example, the application of the loss-recovery component.

Reinsurance companies

For reinsurers the choice of new business metrics may be different to direct writers of insurance contracts. Reinsurers may develop alternative or additional metrics as they may be interested in the risk that has been accepted relative to the size of the new business CSM, rather than just the size of the CSM itself.

Granularity of reporting

Where insurers have material volumes of new business being sold under different measurement models, insurers could disclose the new business metric separately as the drivers and level of profitability may vary greatly between these products.

Loss components

How to explain the loss components on new business given it is reported on a gross basis separately, but could be profitable alongside reinsurance.

Practical challenges, stakeholder buy-in and change management

Consistency in the market

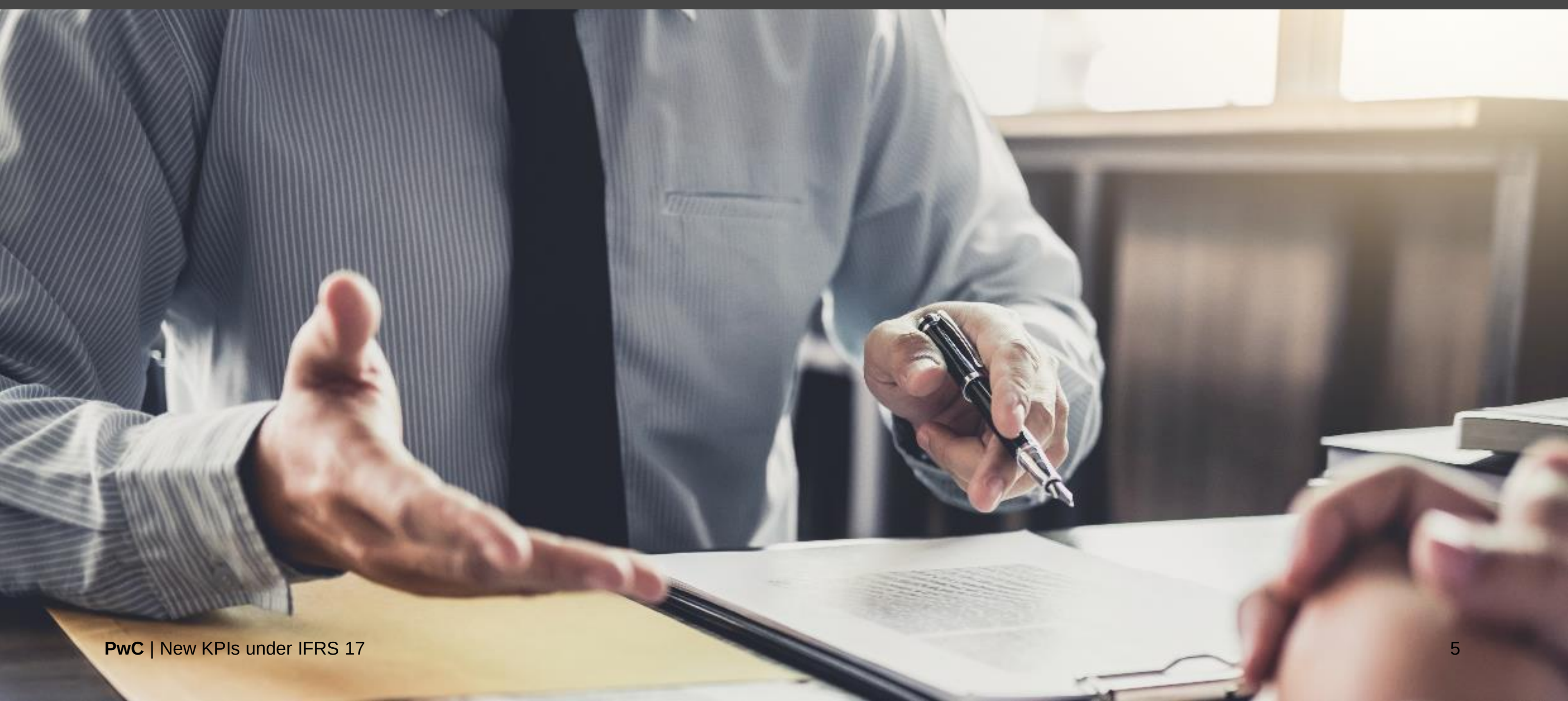
Insurers using the GMM and VFA models are likely to disclose a new business value metric using an adjusted new business CSM that reflects their view of new business profitability. It would be beneficial for investors if insurers were able to reach a consistent definition of new business value under IFRS 17, to enable easier comparability across the market.

Analyse the impact on internal MI

New business data is a key component of internal MI that is monitored on a regular basis. Alignment of external KPIs with internal MI should be a priority. Indeed, early sight of more detailed analysis produced for internal MI may help to identify the key drivers of profit, which can help to focus the external KPIs on the most important areas.

Early stakeholder buy-in is vital

New business KPIs are often a key component of executive remuneration. Gaining sign off on new business KPIs from management and remuneration committees can take a period of time and the decisions made will impact long and short-term incentive plans. Insurers who take stakeholders on this journey early on will benefit from a smooth transition and avoid surprises. Additional time also needs to be allowed for in order to revisit KPIs should they need to be redeveloped, if they do not meet the needs of all relevant stakeholders.



Conclusion

- It's important to consider how to use your IFRS 17 KPIs to portray the volume and profitability of new business to the market.
- The way you communicate your new business CSM and what this tells the market about your business is very important. If existing new business performance metrics, such as loss ratios, are retained these will need to be redefined on an IFRS 17 basis.
- Insurers are also considering how to adjust new business volume metrics under IFRS 17, and whether to make transition-specific disclosures. Industry consensus is forming on retaining existing volume metrics such as GWP for general insurers.
- It's important to start this journey now, as it will take a period of time to make the necessary data, systems, models and process changes, and to gain the appropriate stakeholder buy-in to the new KPIs.
- Whilst this article is focused on new business metrics, the profitability of existing business is also important, and the focus of alternative KPIs.

How PwC can support insurers develop their IFRS 17 KPIs

- To date, we have undertaken more than 140 IFRS 17 implementation projects around the globe. We have a deep understanding of current reporting processes and how the requirements will change under IFRS 17. We focus on the aspects that allow insurers to optimise their delivery of an IFRS 17 story that provides sufficient insight into the underlying performance of the business.
- We have a team experienced in building KPI systems, implementing the required data architecture to source and store the necessary data and business intelligence applications to provide impactful, reliable insights tailored to different audiences.
- We have unparalleled access to emerging company, investor and analyst thinking on disclosure practices and requirements and have specialists and subject matter experts in all areas of insurance, including technical accounting, actuarial, technology, target operating model, data architects, etc. This enables us to advise on the broader business implications of the data and process requirements that underpin the desired reporting and KPI outputs.
- For more insights, find our IFRS 17 KPI articles on our website:[1] 'New measured, new perspective: The impact of IFRS 17 on insurance performance and reporting', 'Helping investors understand your IFRS 17 performance - a focus on transition' and 'Adjusted operating profit in an IFRS 17 world-telling your story with confidence'.
[1]http://bit.ly/IFRS17KPI2

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