

Appendix 9 : Interview PwC

LD : Thank you for giving me this interview. Before we can start, can I record our interview?

JM : Yes I have no problem with that but note that what I am going to say reflects my personal point of view and not the one from PwC.

LD : That's exactly what I want, that's not a problem. Could you start by presenting yourself?

JM : My name is Johan Meuleman, I have been working at PwC for 5 years now. I have started being a consultant for financial services firm because of my interest for Basel, the regulation for banking. From there, I worked on projects about IFRS 9 since it is a complicated regulation about financial products that's necessary in the banking and insurance industries. I did this for two years before starting projects on IFRS 17 in Belgium and abroad and I have been doing this for the past 2 or 3 years.

LD : So I have a couple of questions obviously for some of them, I have already seen solutions/answers on the documents and so on but I need to confront them with your opinion as a professional so I'm going to ask them regardless.

First I focused on the general model because the other two are less practical and for a matter of size of my thesis, it's wasn't feasible to focus on all three. So the general model is divided in different blocks from the cash flows which are discounted, the risk adjustment and the CSM. First things first do you think that this model is a better way to calculate the liability that comes from the insurance contracts, in a more reliable way and why of course?

JM : What I think is that it's mainly a fairer way to represent. It more a market value kind of way of measuring it and it aims to give a general view of how it is done in the insurance companies increasing the comparability not only between the companies but also between the markets. The first norm was basically just do what you do in your local GAAPs and do some small adjustment. But the Belgium GAAPs is not the same as Italian GAAPs for example so it's very easy to end up with very big differences. In that sense yeah the idea that is there to make it more comparable is definitely a good one. I think with the building blocks that they are creating, they are covering everything. So if successful, if they can create sufficient comparability so yes that's definitely a big improvement.

LD : So the CSM is created to depict the future profitability of the insurance contracts and taking it in the balance sheet before taking it in result afterwards. For the reinsurance contracts, they are allowed to take profit or loss in result (hence without the amendments that would change things up), what are your thoughts on the mismatch there, what would be a good solution?

JM : I think it's always better if you can avoid those accounting mismatches. There has been some recent exposure drafts, published by the IASB in June. I don't know to what extent you take that into scope in your thesis.

LD : I'm trying to follow it the best way that I can.

JM : Reinsurance is something that IASB is always looking on deeply because there is so much movement about it. That we in the professional are not really focusing that much on it unless it's a reinsurance company only. And even the traditional insurance company, they look mostly at their insurance book and wait for the reinsurance book that it has stopped moving. However, if you read the post amendments by the IASB in the exposure draft. They agree with the statement that I made that whenever you could reduce accounting mismatches, you should. And they have in that sense included for proportional reinsurance a way of accounting for it that doesn't fully create the accounting mismatch.

LD : yes that allows to take the gain that results from the reinsurance contracts which is onerous.

JM : Yes that's right

LD : I will come back with RA and cash flows latter. In the disclosures, they require the entities to disclose information about things like cash flows and elements that have an impact on them, calculations and whatever. I think that it's not very different than what was asked under IFRS 4 beside the fact that it's spread across the different types of contracts because there are different types now. Do you think they should have asked for more requirements or is that ok in that sense?

JM : I think that it's ok in that sense. Because the aim of the standard is not to change everything and what is presented to the investors because they are used to have this kind of disclosures and work with them. It is more to make sure that the calculation for these contracts and behind the disclosures better represent the economics behind the contracts. Like it's the case with disclosures, an entity is always allowed to present more than what is asked. So if an entity thinks there are more

elements that need to be presented, that are important for the investors, that will give them additional information, they always can do this.

LD : Yeah but for a matter of complexity, those disclosures are enough for the purposes.

JM : Yes they might be enough. It will be ...Well, the pout of the pudding is in the eating. So we will see what the investors think, whether they think it's enough of they think they need additional information stuff.

LD : The investors are the primary goal so obviously.

LD: The first presentation separation requirements set that the insurance companies should present their balance sheet by separating the different types of contract (groups), the ones that are onerous, non-onerous and so on. There is also an amendment that proposes to allow them to present their balance sheet by portfolio of contracts and no longer in groups. That's mainly to offset the onerous and non-onerous in the balance sheet maybe?

JM : No, you have to look at it in a different way. What you're are looking here is that the financial statements, what you have on the assets and on the liabilities has to truly represent what is an asset and what is a liability. There cannot be any netting in between. Even you were making that at the level of the contract, sorry at the level of the group, at the final point on time, really just before presenting your balance, you would be making these nettings to a certain extent. What has really changed there is that you don't really that you have to do the presentation, the assessment whether the bunch of contract is a liability or an asset, no longer at the group level but you can now do this at the portfolio level. So at a higher .. euh sorry lower level of granularity. That is what they said, you're still making your calculation at the level of the group, you're still separating between onerous and profitable at the level of the group and then calculate your CSM. But then when it comes to presenting it on the balance sheet, on the asset or on the liability side, that's when it becomes now a portfolio.

LD : yes the calculation is still the same so that may not have that much of an impact.

JM : It stays the same but well the impact is huge on an operational. It's very difficult for insurance companies to work cash-based, which is basically what you have to do under IFRS17, you can't use accrued accounting but you have to use cash-based accounting. This is a completely different problematic and changing that is extremely difficult. What you see, what insurance companies are

trying to do is that the first calculation is on an accrued base and then they use their receivables and their payables to have an approximation of the cash base. If you do on a portfolio level, you have already to ensure that you get your receivable at a lower level than what you are actually used to, which is already tricky. If you have to do that on a portfolio level, this becomes virtually impossible. So that is a bit why this leniency has come in, more for practical reasons.

LD : So for reporting the financial performance, so in P&L, they require a certain number of lines of items like insurance service expense, insurance income and insurance finance income depending on what changes are in the balance sheet. My question is would it not have been better had they separated line per line depending on what elements changes for example or another way with more separate lines.

JM : Nothing stops an insurance company to include that in their disclosures. You know it's very for an IFRS standard to be concise and to give some leeway on how to interpret and how to further publish.

LD : yeah just give principles

JM : Principles and minimum requirements and then that's up to the company. If the entire market starts doing it the way you said, then others will follow.

LD : that's true. There are also a possibility to disaggregate part of the profit coming from the risk adjustment between P&L and OCI. And on the liability side for IFRS 17 and on the asset , there are different elements that should be accounted for under IFRS 9 which will bring a bunch of new options as well. Don't you think, it's a little difficult to make them transition towards the two standards together even though there are different solutions like the overlay approach for example?

JM : I think it's essential to look at both at the same time because if you look at an insurance company's balance sheet, you see that almost all of his assets are financial instruments. This is about how you're going to apply this OCI option and how the business model assessment model in IFRS 9 is rolling out. When you're looking at IFRS 9, I think from a practical perspective, the way you set your business model, you probably want to put it in perspective with how you manage your liabilities when you are an insurance company.

You'll see that for example, when you look at the assets with unit-linked portfolio, those are one-on-one link, segregated account, that will probably be one business model, then you look at how

you manage those under IFRS 17 and then look at how have to manage your assets under IFRS 9. And not the other around. In this particular case, under IFRS 9, a business model for unit-linked might be difficult to classify under hold to collect or hold to collect and sell. It might already be FVTPL as a given. That also means that you have to take that into account when you make such options on the liability .

LD : Yes to avoid the mismatches between P&L and OCI as we have set an example earlier with gain and losses.

JM : Exactly.

LD : The transition may also be difficult to apply like the full retrospective approach especially for older contracts when you don't necessarily have the data it. It may be difficult to use. Do you think it would have been possible to make it easier or not?

JM : I think what is still open is the request from the market that is to be a little more transparent lets say, more transparent in the sense that the use of estimates in the sense of IAS 8 is allowed. But not every data element that you'd need, you will really need to gather but potentially you can estimate. That is a way to give a little more leeway applying the full retrospective approach or the modified approach.

LD : I don't know if you also work on Solvency II or not.

JM : Way less but I have some bases as well.

LD : I read documents and some elements that I have put in my thesis that say that some elements of Solvency II might be used as a basis to implement IFRS 17 for example, for the discount rates, the method of Solvency II could be used as the bottom-up approach under IFRS 17 or again the risk adjustment that may be similar, so what elements do you think could be used or not?

JM : I think there is a tendency to rely as much as possible from Solvency and deviate when necessary or when desirable. The way that Solvency models are used to project the cash flows and come up with the best estimate are probably going to be used by everyone. Actuarial estimates are not supposed to be different. Some changes might be expected for the expenses like directly attributable might be different under Solvency II. The contract boundaries are not exactly the same. These assumptions they can play with but the mortality tables or other kinds of tables are expected

to be the same. When you have a look at the discount curve, yeah, you cannot use exactly the same discount curve but you can indeed have a similar approach, it could be the bottom-up approach as you mentioned. The risk-adjustment is really defined how you can estimate it. You can use the cost of capital like in Solvency II or other approaches. So again, there will be some leveraging but they will be more in narrow in scope because the standard give you some additional freedom make some remarks on some operational risks that you may not need to cover or that you may not want to cover it. 6% is also not fixed so I see some leveraging that some entities not all but some might want to use. But yeah also a lot of deviations that they want to include.

LD : Before I came here in September, I also went to the national bank to have the same kind of discussion and they mentioned that the difference in the granularity level required by the two standards might be a problem to use the concept since they may very well be at different levels. What do you think about it?

JM : No not the concepts, if you calculate at the levels, yes you may encounter problems because as you mentioned , Solvency II is on higher level, with portfolios and such but with IFRS 17 you need the CSM groups which are more granular with levels that you don't see or recognize from Solvency II at all. I think the issue is mainly there for the CSM because there is a very big calculation there and if you do it at a higher level, there is no way that you go back. For other elements, I think with some clever ways other, you could still use most of the concept, and the calculation.

LD : Yeah even if you calculate them at a higher, you could still dispatch them.

JM : Allocation is one way but even with the calculation at a lower level, you could still tweak the calculation and keep the methodologies as long as you have the data for it. Or do a bit in between.

LD : I don't know if you have other remarks on the accountancy side of the standard before I go on with the more hmm practical implications of it.

JM : No I don't really see anything..... Well it's very general but based on what we discussed one thing to keep in mind because you spoke about the differences between IFRS 17 and 4 with Solvency II. The differences will for a large extent need to be explainable. The users are used to have some kind of explanations and they already had it with Solvency II, you need to know why things are different. I also know that in quite some countries, some CFO's, are really trying to

minimize differences, to have a result from IFRS 17 that is as close, that will mimic IFRS 4 so that there are not too many differences for the investors. But yeah again, it's not fully clear to what extent they will be successful in doing that.

LD : I have a few other questions which are more on the practical side of consequences of things, less accounting I would say.

JM : ok

LD : The investors of the insurance companies are used to a certain sort of performances and its metrics, some sort of KPI with the performance under IFRS 4. Since this reporting of performance will change, how do you think that these indicators will change?

JM : That's a very difficult question. I think that it is something that we will really see evolving and that we will only see materialize later. I do believe there will be changes. Some example would be the leverage ratio, would you take the CSM into account or not as equity yes or not. This kind of elements. Also the CSM, is it important to have a big CSM, is it important to have a growing CSM. Is only the CSM release important? We will see with the CSM release if it's still the total profit that matters? We don't know, it's still a bit unclear. We don't know what the investors will do in the end but you with all the new parameters, you can expect that they will be taken into account one way or another. But the importance of which and to what extent they will influence, it's still a bit too early to predict. There is still companies that have not started yet on IFRS 17, maybe not in Belgium but in the world, there are some that haven't started.

LD : So in the companies in scope, there will be a need of formation over IFRS 17 obviously because it will be very different and more difficult. Do you think that this need will arise in all departments if I can so of the insurance companies or that it will affect about everyone?

JM : No, I think if you look at the standard, it goes beyond that of course. Finance and actuarial are impacted but beyond that, IT's will also be impacted because there are systems that will need changes and also new systems that need to be added. The data office is also changing because you will need a higher level of data with more granularity to understand you data better, to store it better, to be able to pull more granular reports. And it goes all the way to marketing and product because there could be products that you could no longer include because it would a difficult impact on how you're implementing it and marketing promotes it so it could all the way top there as well.

LD : And beside the difficulty of implementing, there are also product that could now have a much worse impact on the financial statements so they may scrap them.

JM : Yes exactly, now you would expect that companies have also captured that in their BNB but it's true that some new elements might lead to some types of products being more onerous than originally expected and thus lead no longer being sold by some type of companies;

LD : Would you have an example of what type of products could be in that case?

JM : No I haven't seen it first hand yet but I can imagine that products that are already under a lot of stress if the way that ... hmm, the cost allocation that is somehow reinforced now that you have a larger directly attributable cost that goes their way. If that was not properly reflected in the BNB for example, then that would cause onorosity. Or just the fact that maybe you sold products that you were bundling under IFRS 4 and that you no longer could. You have profitable writers and onerous hosts maybe by putting together, you could no longer have that rentability, maybe the writers had to be put on longer contract boundaries to absorb more of the cost but there are many other ways how it could happen.

LD : But once again it will depend on what happens when it's first applied.

JM : It will happen but yes it will depend.

LD : Well that's always a problem with IFRS 17 that there is no clarity on how it's going to work out.

JM : But it also creates the opportunity of course.

LD : Overall, the implementation of IFRS 17 will have a lot of costs from implementation, development, formation, whatever...., Do you think it will, well the gain it will bring in terms of comparability, clarity, do you think it will outweigh the costs.

JM : It depends on how you implement. I think if you want to go purely for compliance and you want to be compliant with the standard and you don't take advantage of this wave to bring you up to speed to get a new vision for finance and change your CFO office into a new partner for business of the front office. Yes I don't think you will get the gain that you think. You will just do a compliance exercise and at the end of the day you get a reporting out and that will be it but now if you do see this opportunity and you take that necessity of getting that compliance number to

improve your data management, to change and improve your systems and the speed that you can report then you could get those and the hindsight's you mentioned for the branches of products or whatever where you can get that information quickly, then yeah it could be very beneficial exercise.

LD : Do you think that due to the complexity of the norms, the first years could in financial statements that wouldn't be so qualitative, that there would be things that aren't so well reported?

JM : Well it shouldn't happen.

LD : I know it shouldn't happen but...

JM : I don't know I find that a difficult question to answer. What could happen when you say "not that qualitative" is you see some discrepancies in the way that companies are reporting things. Interpretation should be more or less aligned, the market will mature in the next years so that interpretation of things are more or less the same. But you could see indeed if company A decides to have full disclosures, company B decides to have not. But in the coming years, practices will converge but yeah in the first years, what you could see is that reports will not be all structured the same way that you could see the coming next years because things will still change and like. And also companies will look at their investors to know what information they would appreciate more, what information they can put in their report to look better than their competitors now that I know they are publishing this.

LD : So we have talked about the first measurement to put the contracts in the balance sheet but then there is the subsequent measurement that shows that calculates the liabilities in two parts the liabilities for remaining coverage and incurred claims. Do you think this is really a better way to do those calculation over the liability adequacy test that was required under IFRS 4?

JM : The thing is with the liability adequacy test, if you passed it, you would just keep your reserves the way you had it and wouldn't change it. It's only if you failed, then ok here I have to change it and see the difference while here with the new way of calculating things, you are sure that you always reflect a current market view a current assessment of your liabilities, risk adjustment and the CSM. So in theory yeah it should be better. Now because you create more alignment, you have a better reflection of the reality. Now it remains to be seen to what extent the products that are on the market will be fit for the measurement model in a way that still reflects an economic truth. And

yeah the projects are still ongoing are there is still changes but in theory and in goal your answer is yes.

LD : We will see until the end but it's always the recurrent problems because you never really know.

JM : Yes no one has a crystal bowl that tells the truth, that would help me a lot.

LD : We have talked about the link between IFRS 17 and Solvency II. I have focused on this one but I was wondering whether there were other regulations that could be used to help for implementation or not.

JM : I don't know if you have some knowledge on MCV, this could be used as a help as well, I can see it used by some of my clients even though I'm not an expert myself. Understanding the interactions with IFRS 9 because the two are interlinked and there is no way around it. Those two are the key ones. It's always important that you don't focus only on your financial accounting but you also have the data you need to be compliant. So your management accounting needs to be fit. The granularity that you choose and the way you choose to do your calculations should revolve around it. Just not really regulations but still. I think that's about it, I don't know if you had others in mind?

LD : No I had mainly focused on IFRS17/9 and Solvency II. I think they are the most important and relevant so.

JM : Yes I agree.

LD : I don't have any other questions, I don't know if you have anything else to say any remarks or..?

JM : No I don't know if I have answered your questions to the extent that you were expecting but if you need any further precisions or you have any other questions, you have my e-mail I think.

LD : Yes I do.

JM : Don't hesitate to ask if you need something.

LD : Thank you for your time and contribution.

JM : That was a pleasure.