

## Winning the waiting game? Insurers' preparations for the new IFRS accounting rules



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## About this report

Between April and May 2012 the Economist Intelligence Unit, on behalf of Deloitte, surveyed 210 insurers headquartered in Europe and North America to investigate the views of insurance companies on the intricacies of the International Financial Reporting Standards (IFRS) and their level of preparation for implementation.

Respondents were drawn from the UK, France, Germany, Spain, Italy, Switzerland, the Netherlands, Canada and the United States. Insurers were grouped by net written premiums (NWP), with 21 very large insurers with more than €5bn NWP; 24 large insurers with €1bn-€5bn; 47 with €500m-€1bn; and 118 with NWP of less than €500m.

In addition, in-depth interviews were conducted with five experts from insurers, regulators and trade bodies. Our thanks are due to the following for their time and insight (listed alphabetically):

Gerald Harlin, CFO at AXA  
Jackie Hunt, CFO at Standard Life  
Susanne Kanngiesser, group head of accounting at Allianz  
Jan Nooitgedagt, CFO at Aegon  
Tim Tookey, CFO at Friends Life

The report was written by Neil Baker and edited by Monica Woodley of the Economist Intelligence Unit.

# Foreword

I am delighted to present the *Global IFRS Insurance Survey – Winning the waiting game?*, an international and independent analysis of insurers' attitudes towards, and preparations for, the new accounting rules.

With the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) continuing their deliberations on achieving a single global accounting framework, Deloitte\* commissioned the Economist Intelligence Unit (EIU) to survey over 200 senior finance executives from insurers operating across the globe to understand their perspectives on the impact of the proposed changes and what they are doing to prepare.

The findings identify an overwhelming alignment in opinion across borders towards adopting a global framework for insurance reporting. Yet the difficulties the IASB and FASB have displayed in meeting their own timetable and their continuing disagreements on how to build the new rules on a global basis have resulted in uncertainty surrounding the timing for adoption of the standards being cited as the biggest challenge the industry faces right now. Despite insurers acknowledging that these new rules will require a major effort over many years to implement, the prolonged rule-making stalemate has led most companies to adopt a 'wait and see' approach.

In a climate of uncertainty and procrastination, a study such as this can be a useful tool in assessing the true state of play across the industry and support insurers' early decision making. As the survey highlights, early movers who have already recognised the 'high' impact of the changing standards on their business are de-risking their business by taking action now.

I am grateful to the EIU for their impartial and insightful analysis and to all participants for their contribution to this research.

Please do contact me or our IFRS Insurance leaders in your local market if you would like to discuss any aspect of this report.



**Francesco Nagari**  
Partner, Global IFRS Insurance Leader



\*Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity.

# Executive summary

When the International Accounting Standards Board (IASB) was created 11 years ago, it inherited a fairly developed project on a new accounting standard for insurance contracts that its predecessor had started in 1997. Insurance companies have been waiting since then for a single global accounting standard that fits their uniquely complex industry. Over the next 12 months they might finally get it. Accounting rule-makers at an international level are close to agreeing on a new reporting framework for insurers. But even at this stage the U.S. industry could find itself left with new International Financial Reporting Standards (IFRS) that do not align with U.S. accounting standards.

The industry is not celebrating yet. There are still technical issues to resolve stemming from some key differences the rule-makers on either side of the Atlantic have so far failed to reconcile. Given the public interest surrounding rules for the insurance sector's profit reporting, reaching international agreement is not easy and this project has had many dead ends and false dawns. The finishing line may be in sight, but nobody is sprinting to be first across it.

Indeed, considering the magnitude of accounting change that is likely to be required, many companies are doing little to prepare. Is this a mistake? Or given the uncertainty over what form the final standards will take, is a more cautious approach justified? What steps could insurers take now that would help them benefit from the transition, regardless of how and when the timing and technical aspects of the rules are finally resolved?

In April and May 2012 the Economist Intelligence Unit (EIU), on behalf of Deloitte, surveyed over 200 senior executives at insurance companies from across the globe to ascertain their views on the impact of the likely accounting changes on their business, and what – if anything – they are doing to prepare. This report presents the highlights of the survey findings, along with additional insights from senior executives.

## Key findings from the research include:

- **The big problem is uncertainty.** The proposed accounting changes in IFRS 9 and IFRS 4 Phase II<sup>1</sup> and the corresponding proposals in the United States are highly complex, and implementing them will require considerable time and expense. But insurers' main concern is the uncertainty as to when they will have to adopt them – according to 52 percent of survey respondents this is a worry. Senior executives fear that a confusing transition will put off investors and potentially damage the sector's market valuation and investor appeal further.
- **Insurers fear political meddling.** Both standards have been beset by delays and insurers fear this could happen again. This is particularly the case in North America, where 42 percent of insurance companies worry that political considerations could interfere with the standard-setting process.
- **Insurers want a global framework.** Overwhelmingly, insurance companies want to be able to use one set of global accounting standards. Almost one-half of respondents (47 percent) want the U.S. to abandon its national accounting standards in favour of IFRS. If that does not happen, they would accept a compromise, whereby the two accounting regimes are aligned, so long as the core principles remain intact. But their priority is to get the technicalities and timeline resolved, so that they can start work on implementation.

<sup>1</sup> IFRS 9 refers to the IASB project to introduce a new accounting standard for financial instruments. This would primarily affect the reporting of insurers' investments and their returns. IFRS 4 Phase II refers to the IASB project to introduce a new accounting standard for insurance contracts. This would primarily affect the reporting on insurers' income, expenses and liabilities from the insurance contracts they sell. The U.S. accounting rule-making body, the Financial Accounting Standards Board (FASB), is working on equivalent projects with the goal to bring U.S. accounting rules into line with IFRS.

- **Companies are stuck in a 'wait and see' mode.** Preparations for the new standard are low at many companies. One-half of those who rate the insurance contracts standard as high-impact have not even conducted a business impact assessment. Nearly one-quarter (24 percent) of the largest companies have not allocated a budget to the transition.
- **Boards have little awareness of changes.** It may be too early to give the board a view on how the company's financial statements will change, but the survey finds that many are not even being kept up to date with the progress that standard-setters have made and when implementation might begin. Executives at two-fifths of insurance companies say their board has no awareness of or involvement in these accounting changes.
- **Investor engagement has yet to start.** A big fear among insurance executives is that the transition to new accounting rules will confuse investors. Yet few of them have been talking to investors about this issue. It may be too early for a detailed shareholder engagement drive, but insurers could talk to analysts about the possibilities and the potential impact under different scenarios. Just 11 percent of western European companies and virtually none in the U.S. (2 percent) have started an investor engagement programme.
- **Insurers doubt the benefits.** With the exact nature and timing of the required changes uncertain, companies are finding it hard to work out whether the benefits will justify the costs. So far, about one-fifth (21 percent) think the insurance contracts changes will not be worthwhile. The picture is worse for the financial instruments standard: 37 percent think the costs will exceed benefits. Insurers may need to think harder about how to secure value here. They have pushed long and hard for an accounting regime that meets their needs. Now they need to make sure it delivers the expected benefits.

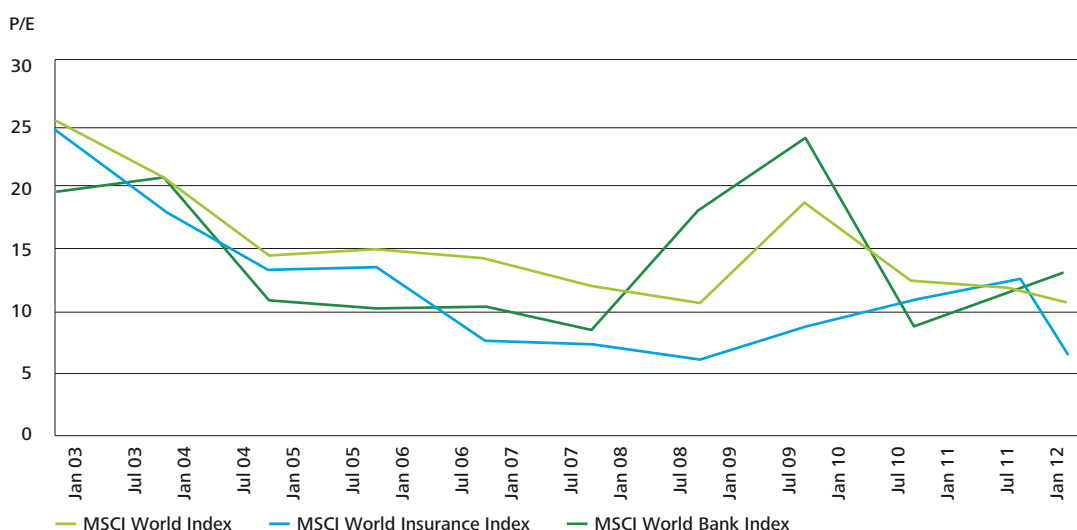
# A long wait for accounting reform

Insurance industry accounting is notoriously complex. Very few outsiders understand all of the assumptions, estimates and actuarial models that underpin an insurance company's financial statements.

One consequence is that companies in the sector feel they achieve lower stock market valuations than they deserve. "We risk losing investor confidence as an industry because of the very complicated reporting bases and metrics that we use, and the fact that this makes comparability between institutions very difficult," says Tim Tookey, CFO at Friends Life.

The industry needs a new accounting framework that would make it more understandable to investors, according to Gerald Harlin, CFO at AXA. "If the market valuation of the insurance industry is low, it's partly because it is so complex. We have a multiplicity of accounting frameworks."

**Chart 1. The insurance sector's market valuation**



Source: Bloomberg

The move to IFRS has done nothing to help insurers deal with this problem. Over the last decade or so, more than 100 countries around the world have adopted the IFRS accounting framework, enabling their companies to produce financial statements that investors in all the main capital markets can understand. But the IFRS rules we have today lack a standard that deals specifically with insurance contracts.

The IASB, which writes IFRS, has been trying to plug this hole since it was founded over a decade ago. It issued a stopgap standard – IFRS 4<sup>2</sup> – in 2004. But it only dealt with some basic areas. The tougher accounting questions were left unresolved.

<sup>2</sup> This is known as the IFRS 4 Phase I accounting standard which will be replaced by IFRS 4 Phase II when the IASB completes its development.

Jan Nooitgedagt, CFO at Aegon, says the insurer has to use one set of insurance accounting rules in the U.S., a different one in the UK, and different ones again in the Netherlands and the other countries where it operates. "A limited IFRS 4 did nothing to change that," he says.

### Waiting for change

The IASB has been trying to resolve this for years. But progress to a better standard – IFRS 4 Phase II – has been slow. The U.S. has kept deferring a decision about whether it will abandon its national accounting rules and join most of the world in using IFRS, and in the meantime its own standard setter, the Financial Accounting Standards Board (FASB), has been working on changing parts of its own accounting rules, the United States Generally Accepted Accounting Principles (US GAAP), where they affect insurance accounting. The international and U.S. rule-makers have tried to co-ordinate their efforts, but have not always agreed, whether on broad principles or on technical details.

There has also been the not-so-small matter of a global financial crisis, which forced standard-setters to prioritise other accounting changes. These include new rules on the accounting treatment of financial instruments, IFRS 9, which will also have a major impact on insurance companies. These rules have been hotly disputed, by politicians as well as accounting experts. Decisions and implementation timetables have been torn up more than once, most recently in January 2012 when, under pressure from the insurance industry, the IASB and FASB agreed to re-open the IFRS 9 classification and measurement project for limited improvements and to consider the interaction of the financial instruments and insurance projects.

U.S. and international standard-setters have still not resolved their differences, but that outcome is now tantalisingly within reach. Final standards are promised by next year. Normally, now would be the time for companies to start preparing, especially as compliance with these new rules could require significant work. Yet many are reluctant and few are moving forward, preferring instead to wait and see what happens.

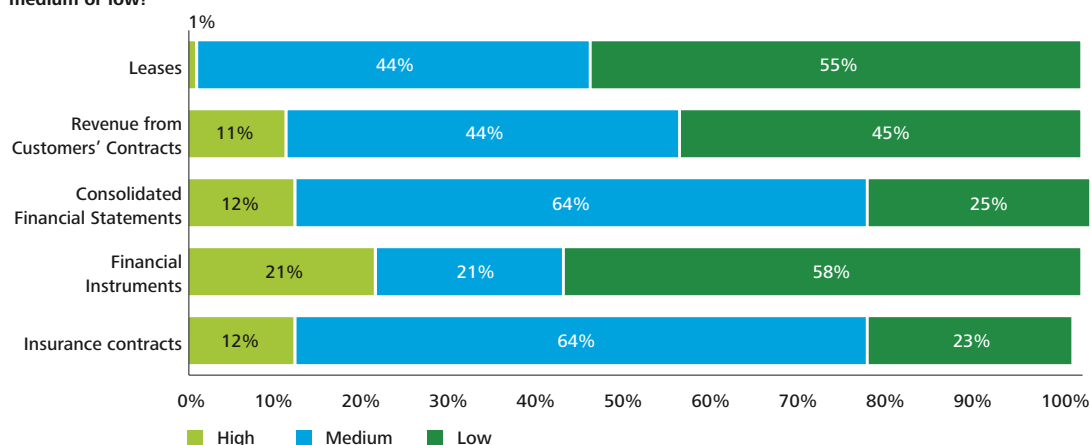
# Uncertainty is the biggest problem

There is no doubt that the move to IFRS 4 Phase II, IFRS 9 and corresponding standards in the U.S. has the potential to have a strong impact on insurance companies (see chart 2). But with important technical details still undecided, “for the time being it’s very difficult to measure what the impact will be on our business,” says Mr Harlin of AXA.

One of the key issues is to what extent changes in the market value of assets and liabilities have to flow through the profit and loss account. With the financial instruments standard, accounting rule-makers are under political pressure on both sides of the Atlantic to ensure that banks report the impact of capital market movements on their performance. They feel that the rules that were in place during the 2008 financial crisis allowed banks to cover up how much money they were losing on market positions.

But insurance companies are not banks, says Mr Harlin; their assets and liabilities tend to be long-term and held to maturity. If they are made to carry their financial investments at market value, and report fluctuations via their profit-and-loss account, that would generate unreasonable levels of volatility, and an accounting mismatch between their assets and liabilities, he argues. Respondents to our survey agree – this is one of their main concerns.

**Chart 2. For each of the following accounting changes, do you believe the impact on your organisation will be high, medium or low?**



Note: Figures do not add up to 100% in all rows due to rounding

Source: Economist Intelligence Unit

The latest draft of IFRS 9 “works perfectly for banks,” says Susanne Kanngiesser, group head of accounting at Allianz, “but the insurance industry has made it clear to the IASB that we cannot live with it. Combined with the approach set out in the insurance contracts exposure draft, it would put us at a competitive disadvantage to banks.”

A tentative May 2012 agreement between the boards (FASB and IASB) on two key points should fix this, says Mr Nooitgedagt of Aegon. First, insurance companies would not have to report in their profit-and-loss account changes in the value of insurance contracts caused by changes in discount rate as a result of market interest rate fluctuations. Instead, they would go through the equity section of the balance sheet under Other Comprehensive Income (OCI). Second, movements in fair value of certain eligible debt instruments would go through the same equity section. Together, these two changes would balance each other out and remove the related volatility from reported earnings.

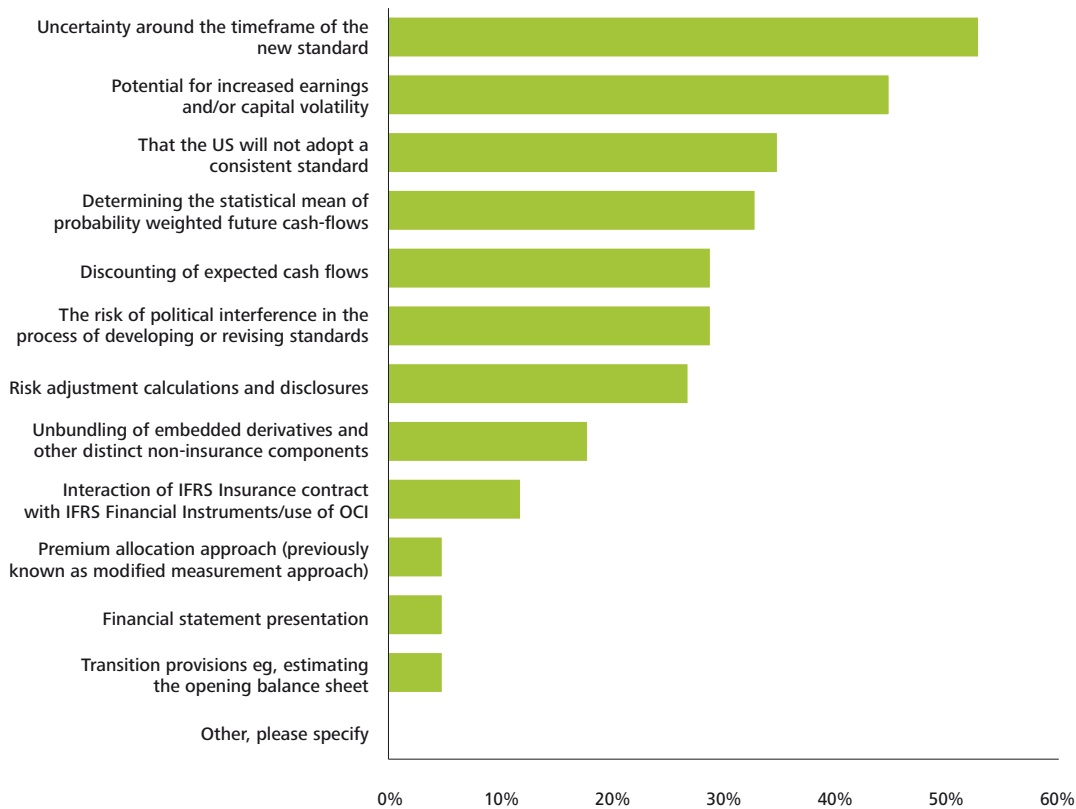
“This is a very important step, and one we’ve been lobbying for for a long time,” says Mr Nooitgedagt. “It will solve our concern about too much volatility through the profit-and-loss account. And with that hurdle taken away, I am quite positive about the rest of the issues, because now we are really only talking about the details and less about the principles.” But, he adds: “When I talk to my people who are closer to the accounting, they still have a long list of technical issues.”



### The big issue now is timing

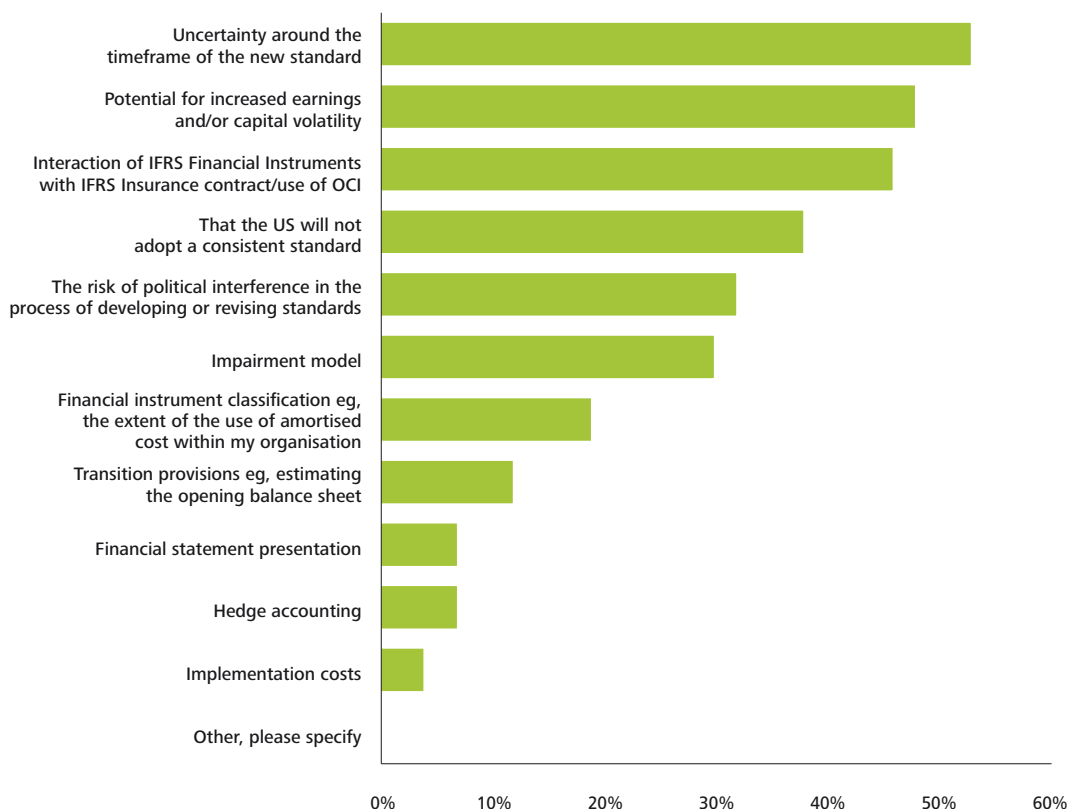
The impact of accounting changes in the two standards will balance each other out, so it is important that they take effect at the same time, says Mr Nooitgedagt. However, the implementation timeline is cloudy, and this uncertainty is the biggest concern for over one-half (52 percent) of respondents to our survey (see charts 3 and 4).

**Chart 3. What do you think are the most challenging aspects of IFRS Insurance Contracts? Select up to three**



Source: Economist Intelligence Unit

**Chart 4. What do you think are the most challenging aspects of the new IFRS for Financial Instruments (IFRS9)?**  
**Select up to three**



Source: Economist Intelligence Unit

“It would be so much better if we could align the timetables,” says Mr Tookey of Friends Life. “Otherwise we are going to risk serious investor confusion, with companies moving at different paces through the change period, which might take several reporting periods. If you confuse investors, they lose a bit of confidence and you can lose support.”

This is not just a question of waiting for the standard-setters to sort out their technical differences. Many respondents fear that even at this late stage there could be further political interference in the standard-setting process. North American companies are especially concerned about this – 42 percent say it is a concern, almost twice as many as in western Europe.

The level of political meddling that has affected the standards so far makes Mr Tookey sceptical. “There isn’t a timeline that anyone can rely on,” he says. Ms Kanngiesser agrees: “Experience tells me that with this project, IFRS 4 [Phase II], they have never met their deadlines.”

If the U.S. Securities and Exchange Commission (SEC) was clearer about whether it wanted to adopt IFRS or not, that would remove a lot of doubts. One-half of survey respondents (47 percent) say the U.S. should abandon its national accounting rules. Larger companies are especially keen to see this happen. Only 14 percent say they should stay. And companies that operate in the U.S. are just as happy to see them go as companies that operate elsewhere. Companies with operations beyond Europe and the U.S. are especially keen for change – three-fifths of those who operate in Asia (including Japan) want the U.S. to move to IFRS.

Those most affected by IFRS 9 and IFRS 4 Phase II are especially keen for the SEC to clarify its plans. Ideally, they would like to see the U.S. make a clean move to using international standards, rather than trying to align its own framework with IFRS. Over two-thirds (69 percent) of those who say the insurance contracts standard would be 'high-impact' want the U.S. to abandon US GAAP in favour of IFRS, compared with just 41 percent of those who rate it as 'low-impact'. For the financial instruments standard, the trend is even more pronounced – 79 percent of those who say it is high-impact want to see US GAAP replaced. Moreover, these high impact companies are also much less likely to be content with closer alignment – they clearly want one set of global standards.

### Dealing with frustration

Insurance companies want to see technical points resolved so that they can move forward with their implementation planning. But over one-quarter of respondents (27 percent) are resigned to the view that any U.S. adoption of IFRS will be a question of politics, not business need. That position is more widely held among the largest companies and those operating outside the U.S. and Europe.

"Some people just want to get on with it, and I can understand some of the frustration," says Jackie Hunt, CFO at Standard Life. "We may need to accept that we'll never find the perfect solution. But if there are too many compromises, people will be able to continue with other non-GAAP<sup>3</sup> forms of reporting. I think if that happens, it would have been a waste of effort."

If the effort to produce mutually agreed standards produces many more delays, Ms Hunt would prefer a workable compromise. Ms Kanngiesser is cautious about that. "We are convinced that ultimately it is an advantage to have a single set of financial reporting standards, but it should not be at any price," she says. "If the price is that we do not get this thing done, then I think the IASB should go ahead – the FASB then has the chance to follow if it wants to."

**3 Non-GAAP forms of reporting refer to measures of profit that a company develops outside the accounting rules that apply to its financial statements. A form of non-GAAP reporting in the insurance industry has been the embedded value profit.**

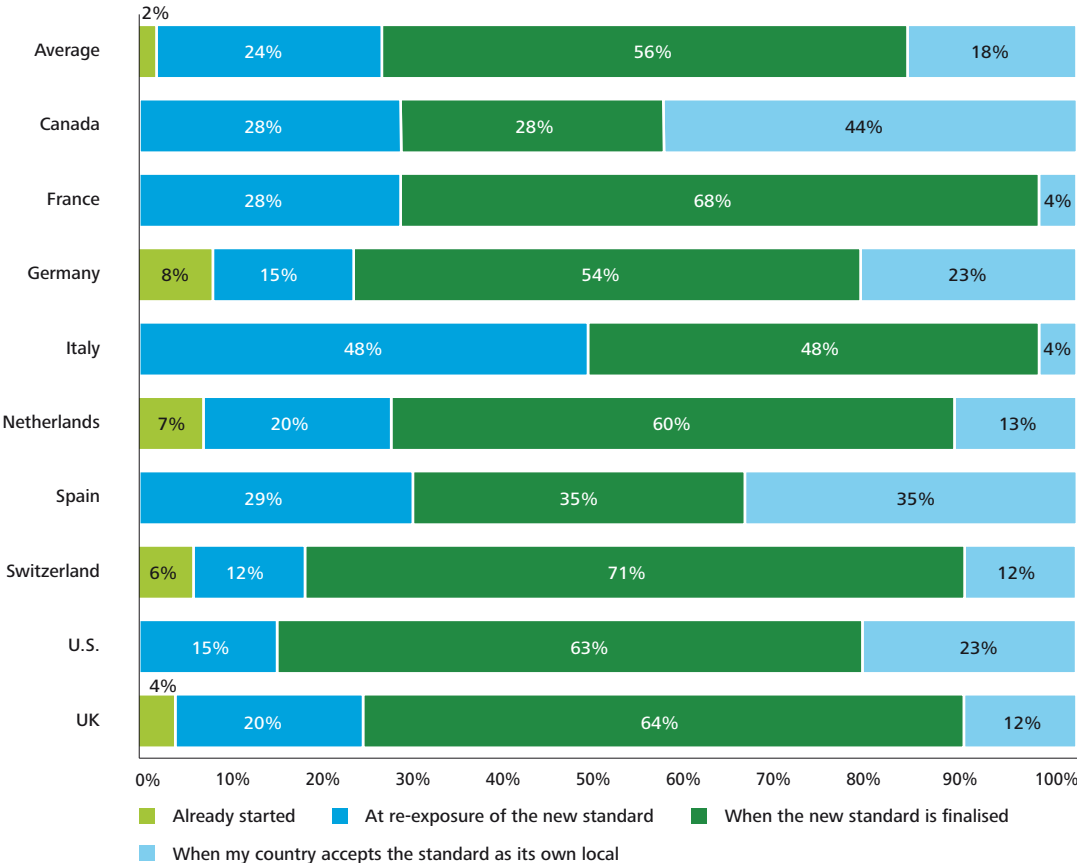
# Stuck in a ‘wait-and-see’ mode?

With so much uncertainty over the final form of the standards, and the deadline by which they will have to be implemented, few companies are doing anything significant to prepare.

Mr Tookey of Friends Life says he will not accelerate his company’s preparations until he has seen the next drafts and determined whether they are likely to gain support in the industry or whether more change is likely. “I think if we had high confidence that the exposure draft was effectively a final draft, then we would start to do our impact studies with a bit of a more focused mind,” he says.

He is not alone – one-quarter of respondents from Europe are waiting for the new exposure drafts due out later this year. But a majority of respondents (56 percent) say they will wait even longer, until the standards are finalised, before taking any action (see chart 5). And nearly one-third from the U.S. (29 percent) are planning to leave it as late as possible – they do not plan to act until their country has actually adopted the standards. Just under half that number in Europe plan to wait that long (14 percent).

**Chart 5. When do you expect to start your IFRS Insurance Contracts project?**



Note: Figures do not add up to 100% on all rows due to rounding

Source: Economist Intelligence Unit

When to act is largely a question of workload. Mr Tookey's finance function is busy dealing with other regulatory changes and getting on with "normal" business tasks, such as integrating acquisitions. He says: "I'm not sure I could yet justify deploying our limited resources to accounting standards where the timing and final form is not yet certain." His company did plan early when the initial version of the insurance contracts standard was introduced back in 2005, only to be caught out when the rules changed before they were implemented. "We don't want that to happen again," he says.

The IFRS 9 standards are still too uncertain for Ms. Hunt of Standard Life. "We have a rough view of the likely implications, we know broadly the sorts of technical questions we have that are unresolved, we are working with each of the big industry bodies to give feedback," she says. "But we are at that level, rather than engaging in detailed implementation planning. I think that would be premature."

For European insurance companies, another complex regulatory change is taking precedence. The Solvency II directive imposes stringent new capital requirements, creating a more risk- focused approach designed to better protect policyholders from future financial crises. The legislation is far-reaching and complex, and has forced insurers to analyse everything from data management and risk analysis to asset allocation and product ranges. Other regulatory changes – such as the U.S. Solvency Modernization Initiative – are having a similar impact outside Europe.

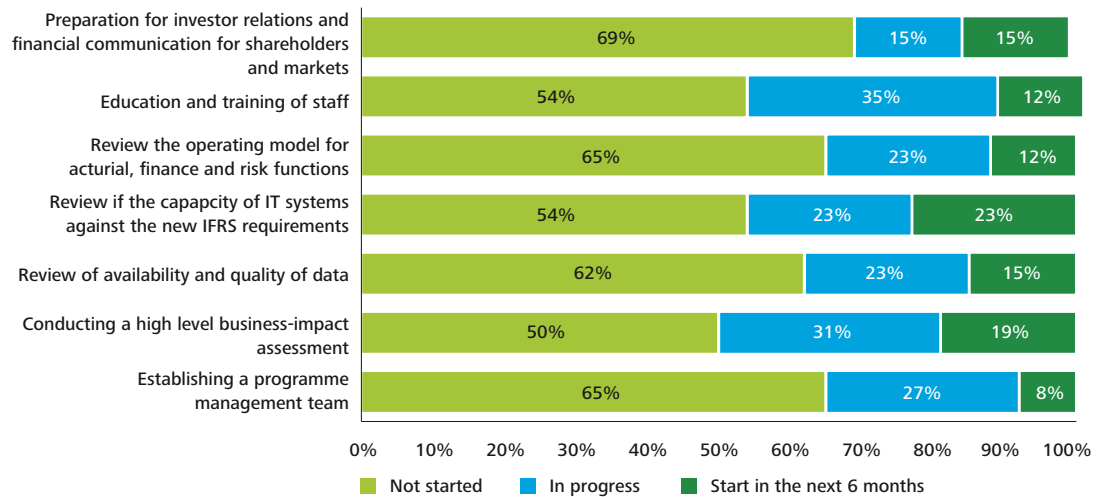
"There are some similarities between Solvency II and IFRS 4 Phase II," says Mr Tookey, "so it's been our intention to build on the work of our Solvency II project and use these processes as a base for deriving the IFRS position. But obviously, the Phase II proposals are not complete. When they are more concrete, it will be easier to do a detailed gap analysis between the two."

### **What are companies doing?**

Despite the uncertainties surrounding the new accounting standards, some of the survey respondents have a business impact assessment in progress (38 percent from the U.S. have done so, as have 34 percent from western Europe). But should more companies have done this by now?

One-half of those who rate the insurance contracts standard as 'high-impact' have not conducted a business impact assessment (see chart 6). However, action among this group is likely to accelerate soon: nearly one-third (31 percent) say they have an assessment underway and one-fifth (19 percent) plan to start within six months. But even more of those who rate IFRS 9 as 'high-impact' have yet to do a business assessment (see chart 7).

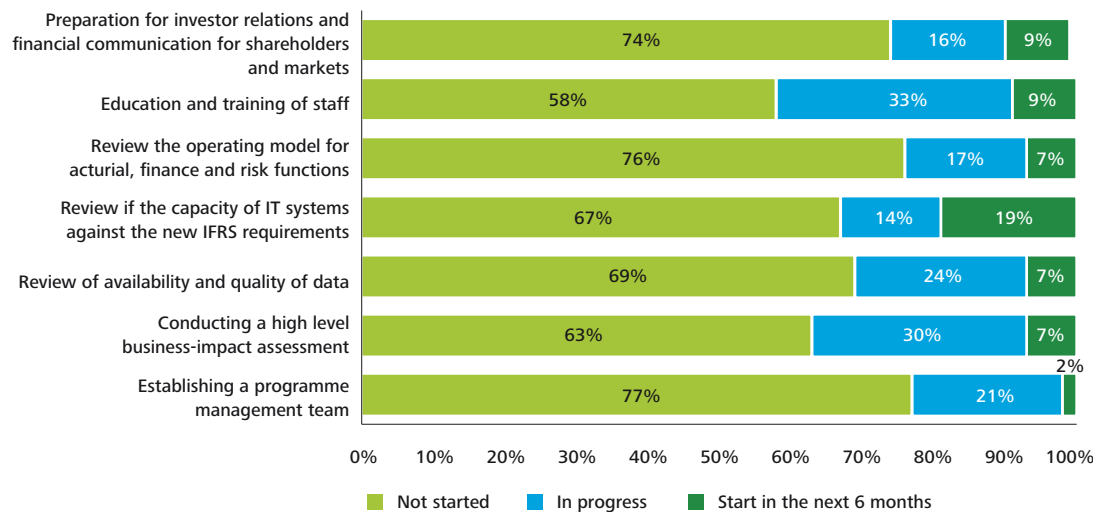
**Chart 6. What is the status of the following elements of your IFRS Insurance Contracts implementation?**  
 (% of respondents who believe the impact of Insurance Contracts will be high)



Note: Figures do not add up to 100% on all rows due to rounding

Source: Economist Intelligence Unit

**Chart 7. What is the status of the following elements of your IFRS Insurance Contracts implementation?**  
 (% of respondents who believe the impact of Financial Instruments will be high)



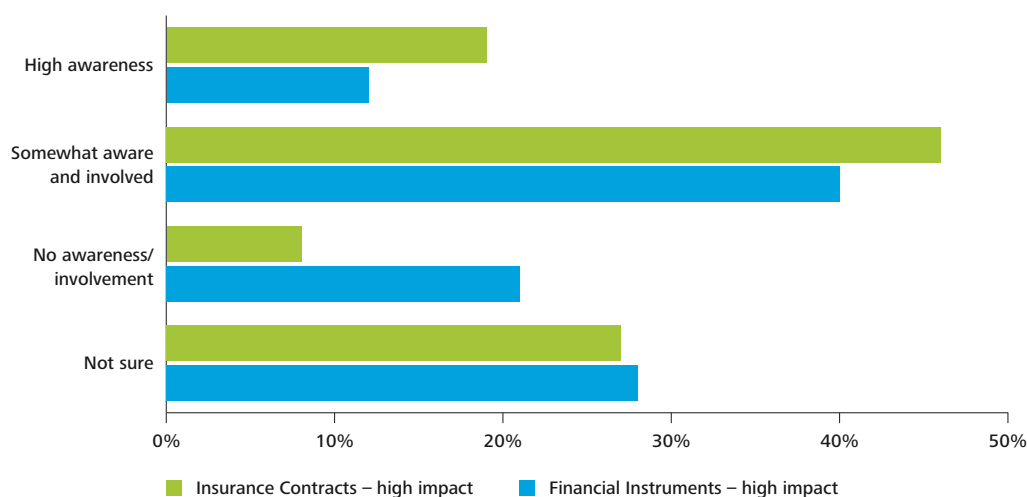
Note: Figures do not add up to 100% on all rows due to rounding

Source: Economist Intelligence Unit

Are companies being complacent? The survey invited respondents to indicate what kind of common preparatory actions they were taking, such as reviewing IT systems and training staff. Nearly one in ten (9 percent) of those who have not yet begun any of these activities say IFRS 4 Phase II would have a 'high-impact' on their business. One-quarter of them (27 percent) have yet to set a budget. Activity levels are just as low for those who feel that the impact of IFRS 9 will be high.

Moreover, boards have had little involvement (see chart 8). None of the respondents from companies headquartered in the U.S. feel their board's awareness of the accounting changes is 'high'. The boards of companies headquartered in western Europe are much better informed, but only 16 percent are described as highly aware. Interestingly, almost twice as many Canadian firms (79 percent) as western European companies (39 percent) describe their boards as highly or somewhat aware and involved in the accounting changes at their organisation. Worryingly, 46 percent of boards in the U.S. and over two-fifths in western Europe (43 percent) are described as having no awareness or involvement at all. This improves for companies which believe that the impact of the standards will be high but not by too much.

**Chart 8. What is the level of involvement/awareness of the upcoming accounting change at your organisation's board level? (% of respondents who predict a high impact on their organisation from either Insurance Contracts or Financial Instruments implementation)**



Source: Economist Intelligence Unit

### Talking to investors

Companies are also doing little to discuss the potential impact of the accounting changes with investors, despite their concerns that the changes to their reported financials might confuse them. Just 11 percent of western European companies and virtually none in North America (2 percent) have started an investor engagement programme.

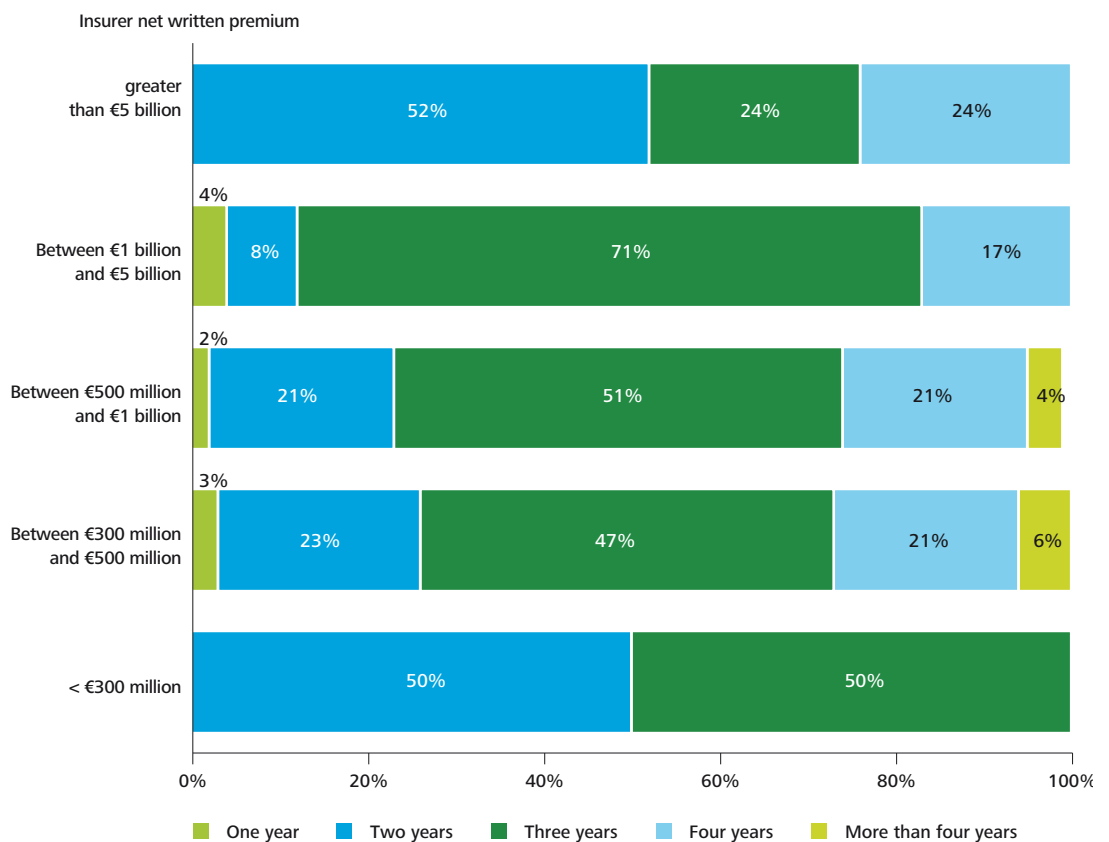
It may be too early for a detailed engagement exercise, but insurers such as AXA and Allianz are talking to analysts about some of the possibilities.

"We have included our major analysts in our discussions because at the end of the day we would like to achieve an accounting standard that serves all of the users' needs," says Ms Kanngiesser of Allianz. "In particular we have talked about whether they can live with the OCI solution and I think we have reached a common agreement between the industry and users." Mr Harlin of AXA adds: "We are in regular contact with analysts. We get questions and I update them about where we are."

However, Mr Tookey is hesitant to say too much at this stage. "We haven't had [a] big investor communication programme in place; that would happen quite quickly when the standards look like they have settled," he says. "But one thing you can't say in response to investor questions is 'I don't know what the impact might be because we haven't been thinking about it'."

One reason for the lack of action could be that most survey respondents believe the standards will take several years to implement. One-half of them expect it to take three years (49 percent), one-fifth say it would take four years (21 percent). Bigger companies believe they can move faster than smaller ones (see chart 9).

**Chart 9. How long do you require between the new Insurance Contracts and Financial Instruments standards being approved by the IASB and the required implementation date?**



Source: Economist Intelligence Unit

Is that realistic? Mr Nooitgedagt of Aegon expects a start date of 1 January 2016. But his company is SEC listed and will therefore have to comply with its requirement to disclose two years of comparative financial statements. “So basically, if implementation is 1 January 2016, we have to start from 1 January 2014, which is one and a half years from now.”

Is that enough time to prepare? “We have a plan for what we have to do,” he says. “We will finalise our Solvency II work and then go through a long list of differences between Solvency II and the new IFRS rules. There are some questions still, but because we are involved in the debate, we know what the differences are likely to be. But the coming months are very important. With a little bit of luck, Solvency II will have to happen from 1 January 2014. That means 2013 will be the year that we make the full transition from where we are now to the new standards.”



# Where are the benefits?

## What are the early-movers doing?

The respondents who rate the impact of IFRS 4 Phase II and IFRS 9 as 'high', and who have begun preparations are taking the following actions or plan to start them in six months:

- 1 Train and educate staff
- 2 Conduct a high level business-impact assessment
- 3 Review capability of IT systems
- 4 Review availability and quality of data
- 5 Review operating model for actuarial and risk
- 6 Establish a project management team
- 7 Preparation for investor relations etc

(Ranked in order of the percentage of respondents taking the action)

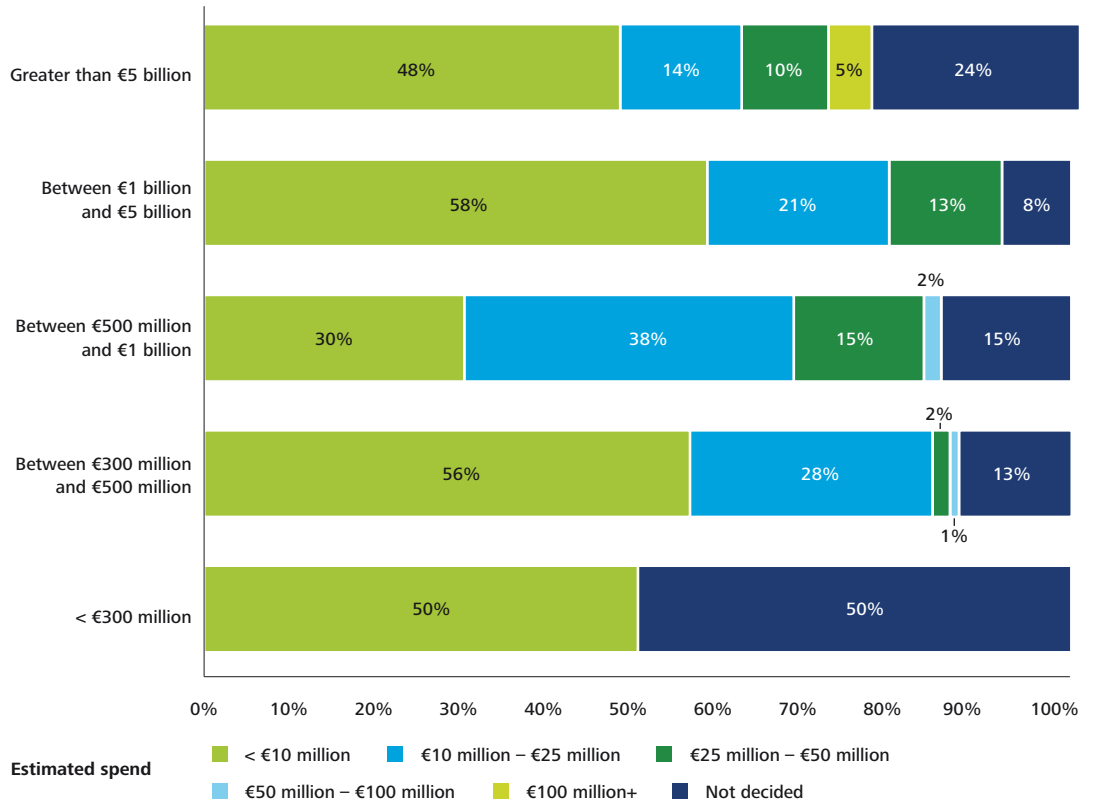
Their implementation plans may only be in the early stages, but most insurance companies think the move to new accounting standards for insurance contracts and financial instruments could require significant investment. However, whether the benefits will justify the cost remains to be seen.

Again, uncertainty over the final form of each standard is making it hard for insurers to estimate the level of change required in their reporting, actuarial and risk management systems. Only 13 percent of respondents say no changes would be needed here, but 45 percent are still undecided.

With the level of systems change unknown, nearly one-quarter of the companies with annual revenue of more than €5 billion (24 percent) have yet to allocate a budget to the project. Overall half of those who have set a budget are planning to spend less than €10 million, with over a quarter (28 percent) planning on spending between €10 million and €25 million (see chart 10).

**Chart 10. What is your estimated global budget (including internal costs and external fees) to meet the new IFRS requirements (including technology spend), approved or otherwise?**

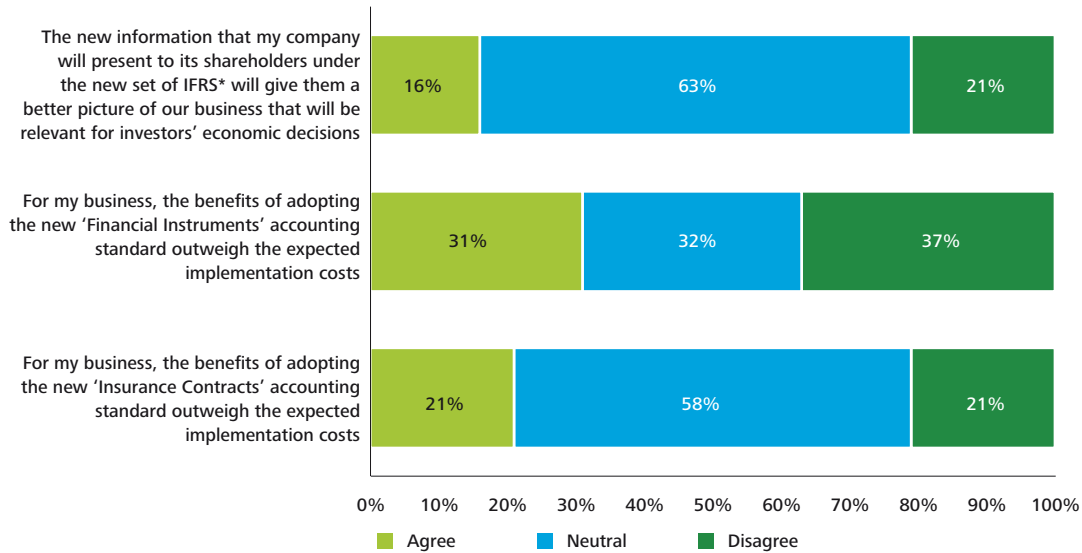
**Insurer Net Written Premium**



Source: Economist Intelligence Unit

Uncertainties aside, many of the respondents doubt that the benefits of the transition will justify the cost. For insurance contracts, about one-fifth (21 percent) of survey respondents say they will not. Western European companies report more concern than their U.S. counterparts. The view is even gloomier on IFRS 9. Over one-third (37 percent) say the benefits will not justify the cost (see chart 11).

**Chart 11. Do you agree or disagree from the following statements?**

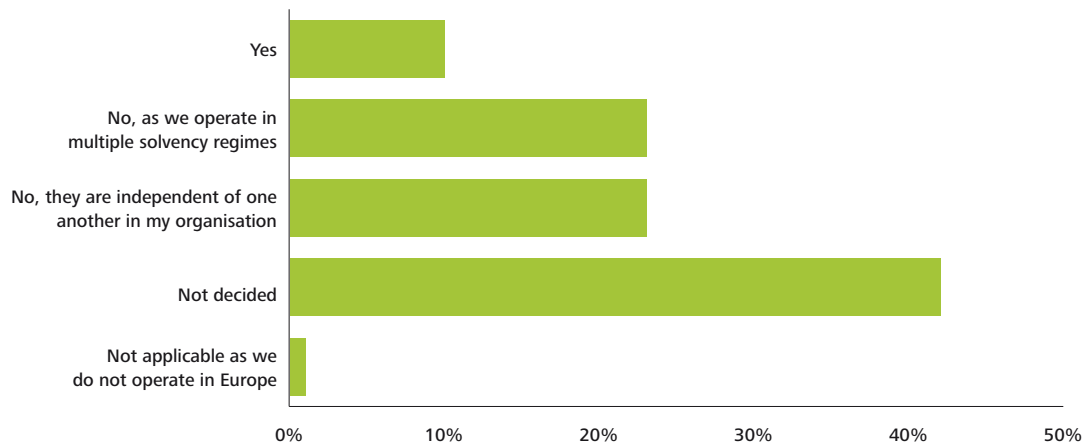


Note: \*Inclusive of Insurance Contracts and Financial Instruments accounting standards

Source: Economist Intelligence Unit

Are there better ways of yielding benefits? It is notable that very few companies are treating likely accounting changes and the adoption of a new capital adequacy regime (Solvency II for Europeans) as a combined project (see chart 12). One in ten insurers are going down this road, and a significant percentage (42 percent of all companies rising to 62 percent for those with annual revenue above €5 billion) has not yet decided whether or not to use a combined approach. But those who are keeping the two projects close together believe this is helping them to minimise costs and maximise benefits.

**Chart 12. Do you plan to have a single integrated programme that will both implement and manage the transition to the new accounting requirements, including those from Insurance Contracts and Financial Instruments, with your country's solvency and capital adequacy regime (such as Solvency II)?**



Source: Economist Intelligence Unit

Clearly, a lot of the work we have been doing around liabilities and valuations for Solvency II will form the basis of any future accounting reporting for IFRS 4 Phase II," says Ms. Hunt of Standard Life. "And as we go through our Solvency II programme, we are ensuring that everything we do is flexible enough to work with the accounting standards, as they are currently drafted or as they have been discussed."

But there will be areas where the accounting standards and Solvency II do not overlap, such as how to deal with the residual margins on insurance contracts. Under IFRS 4 Phase II as it stands, insurers would have to release the profit associated with a new contract across its lifespan, not taking it all on day one.

"We can certainly mitigate some of the expense of the new accounting standards by building off our Solvency II processes, I would hope that we can use them as a base," says Mr Tookey of Friends Life. "But that would leave some gaps. The run-off on the residual margin is probably the biggest one from a technical perspective. We will need to build something completely new and bespoke to deal with that."

He adds: "That would require us to monitor and determine the pattern of profit release up to a standard that can [be] audited, and then be able to communicate better with investors, who won't see a day-one profit on new business. We'll have to work out ways of explaining that latent profit has been achieved, but can't be reported."

"Our financial reporting systems will not change too dramatically from the group perspective, because they are basically consolidation and data gathering systems," says Ms Kanngiesser. "It is more the local companies that are affected, because they need to feed information into our systems." She says Allianz will need to build much more developed actuarial systems to cope with the shift from deterministic to stochastic modelling required by Solvency II and IFRS 4 Phase II.

She also says the company's accounting, risk management, actuarial and investment management staff will need to work more closely together to generate the required data and judgments. "We will need to collaborate much more intensively than in the past," she adds.

Outside of Europe, even more work may be needed. "Our sense is that there is a fair amount of project work required on some of our overseas businesses," says Ms Hunt. For example, Standard Life's Canadian operation has to comply with the country's national accounting and regulatory regime. "If Canada doesn't adopt something that is equivalent to Solvency II, and it says at the moment that it's not going to, we could well have a different regulatory regime to what sits in IFRS and Solvency II."

For now, her company is working on a best-case scenario. It wants to build a financial reporting framework that has one store of data so that each of its different reporting requirements can be generated from the same store, rather than having to keep reconciling data. "But the key thing is how complex it will be to value liabilities in each of our overseas businesses, how much that will have to change, and how much it will align with Solvency II," says Ms Hunt. "There may be very little additional investment required. We just don't know yet."

Against uncertain costs, insurers have to balance benefits that are mainly intangible. One big attraction of moving to a single, global accounting framework is that the insurance sector as a whole will be more intelligible to investors, which should eventually lead to higher share ratings and a lower cost of capital. "This is a benefit that you cannot easily translate into euros, but it will be a benefit," says Ms Kanngiesser.

Over one-third (37 percent) of respondents say the new standards will not create information of benefit to shareholders. "We all think it's a good idea to have a common standard, but I'm not sure that the cost-benefit assessment is possible yet and I'm not sure it would fly if it was done," says Mr Tookey. "It would depend on the ultimate impact on investor transparency and cost of capital."

But there is no guarantee that the new standards will deliver on this point. Ms Hunt says: "Having one basis of reporting that everyone understands would be hugely beneficial. But I think we need to see whether the standards are going to deliver that."

However, companies will have to comply nonetheless, so it makes sense to try to achieve operational benefits from the changeover. "The move to the new standards will be very important for investors, but it is important for our own internal purposes too," says Mr Nooitgedagt of Aegon. "We use different methods of accounting for insurance contracts all around the world in our business, so a move to one framework would make these business units more comparable, simplifying our accounting and reduce costs."

Standard Life is also looking to achieve "an operationally leveragable financial reporting system, where things that we apply in one geography work elsewhere," according to Ms Hunt. "In an ideal world, what I'd like is for us to have just one balance sheet."

Will that happen? "I really don't want to end up in an environment where we have a different Solvency II balance sheet versus an IFRS balance sheet versus a local regulatory balance sheet. But I think there is a risk that we might end up in that place," she cautions. The onus now is on the standard-setters to deliver.

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**"We can certainly mitigate some of the expense of the new accounting standards by building off our Solvency II processes, I would hope that we can use them as a base."**

Mr Tookey, Friends Life

# Conclusion

Insurance companies have waited a long time for an international accounting standard that deals with the complexities of their industry. Some feel it has been too long, but the desire to produce a single, global approach and the chaos of the financial crisis have delayed an already difficult project.

Whether the final outcome is a standard that companies in the U.S. also use, or an IFRS that is closely aligned to a new US national standard, senior executives just want to see a resolution. But they do not want clarity at any price. If the IASB and FASB cannot agree on a way forward, they would rather the former struck out on its own.

The lack of certainty about what form the final accounting rules will take, when they will be ready and when they will have to be implemented, is discouraging many companies from starting their preparations. Delay and dithering from the standard setters has made them especially sceptical.

In the meantime, the industry has been lobbying hard to have a key part of the proposed standards changed – one that would have obfuscated their underlying profitability by bringing into their earnings the effect of financial variables' short-term fluctuations. It now looks as though that problem has been dealt with, clearing the way for companies to ramp up their preparations.

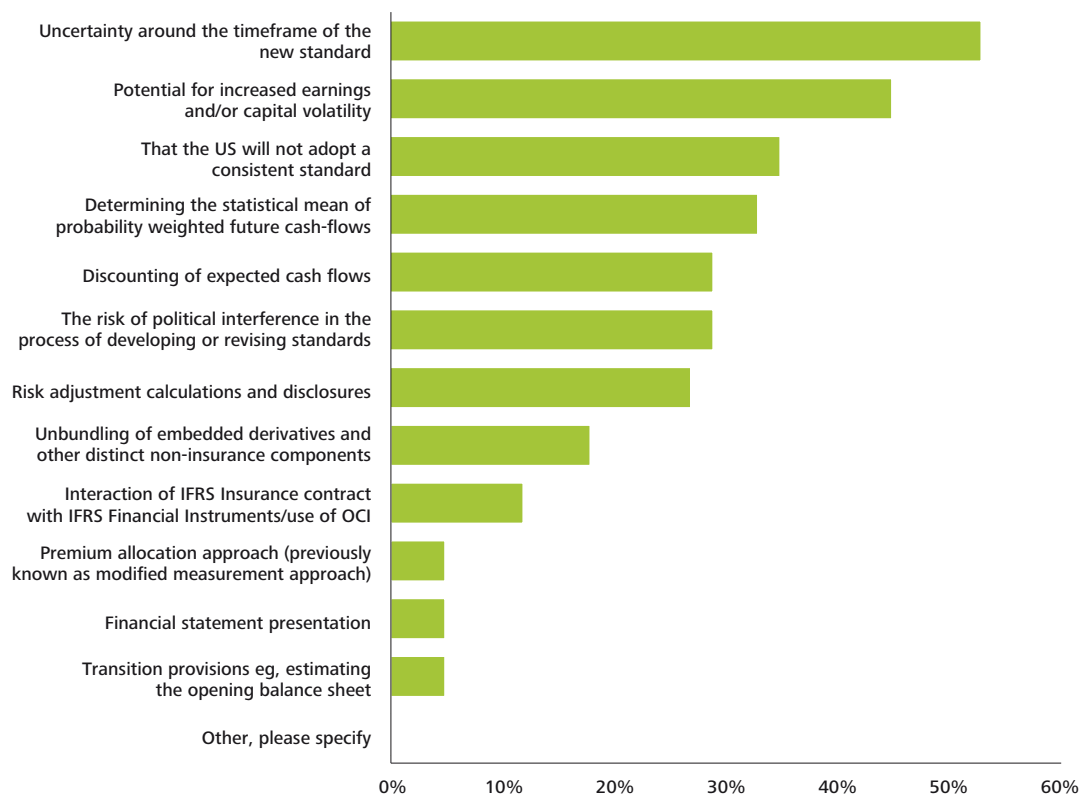
Some may still want to wait for the release of the final standards before investing significantly in any change programmes, but there are benefits to acting sooner rather than later.

The following are some points for insurers to consider:

- **Combine your efforts.** Companies that also have to comply with the new Solvency II (or a local equivalent) regulatory regime can potentially reduce the effort – and cost – of IFRS 4 Phase II compliance if they bring the two projects together.
- **Talk to investors.** The accounting changes should give investors and other stakeholders a better understanding of an insurance company's performance. But the transition will be complex. Early engagement will help to clarify the potential impact on key financials, even if the discussion is limited to likely scenarios.
- **Look for business benefits.** This is a project driven by regulatory change, but it creates an opportunity for companies to streamline their internal accounting and financial reporting systems, and to generate more comparable and meaningful performance data. Companies are more likely to secure those benefits if they approach the transition as a business opportunity and not just as a compliance project.
- **Build internal relationships.** The new standards will require better collaboration between internal business functions, such as actuarial, risk management and accounting. The work to clarify expectations and to ensure that each function can deliver what is required can start now.

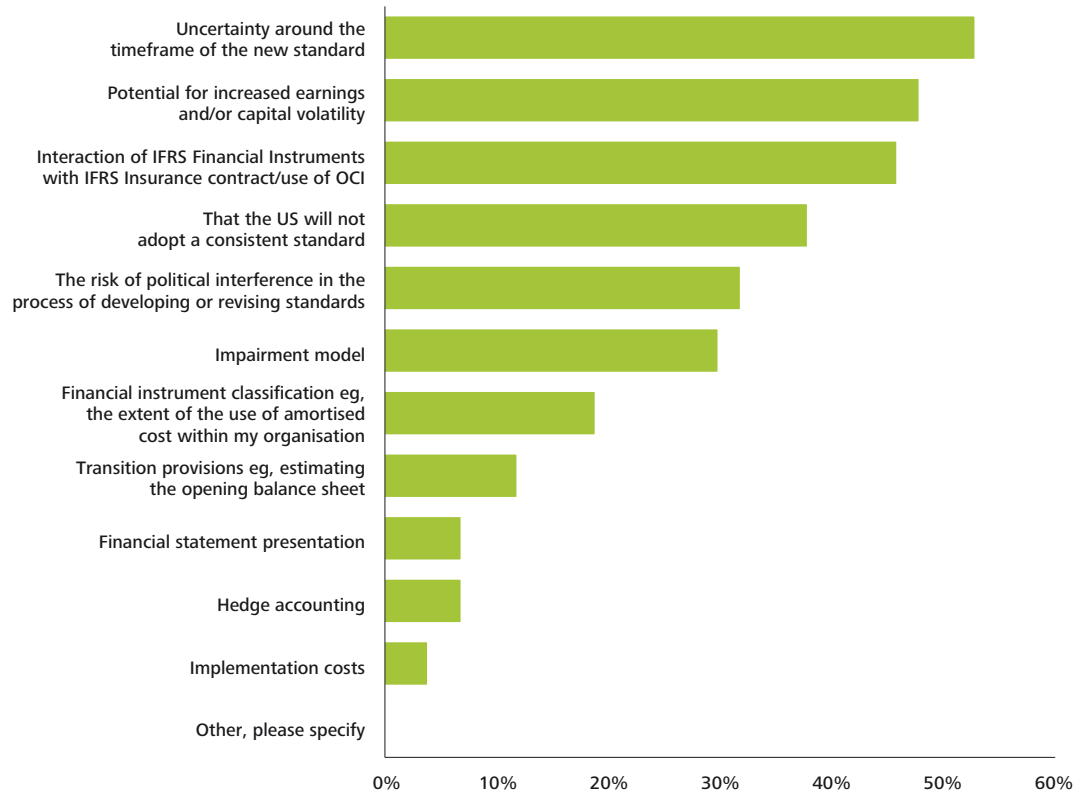
# Appendix – overall survey results

What do you think are the most challenging aspects of IFRS Insurance Contracts? (select up to three)



Source: Economist Intelligence Unit

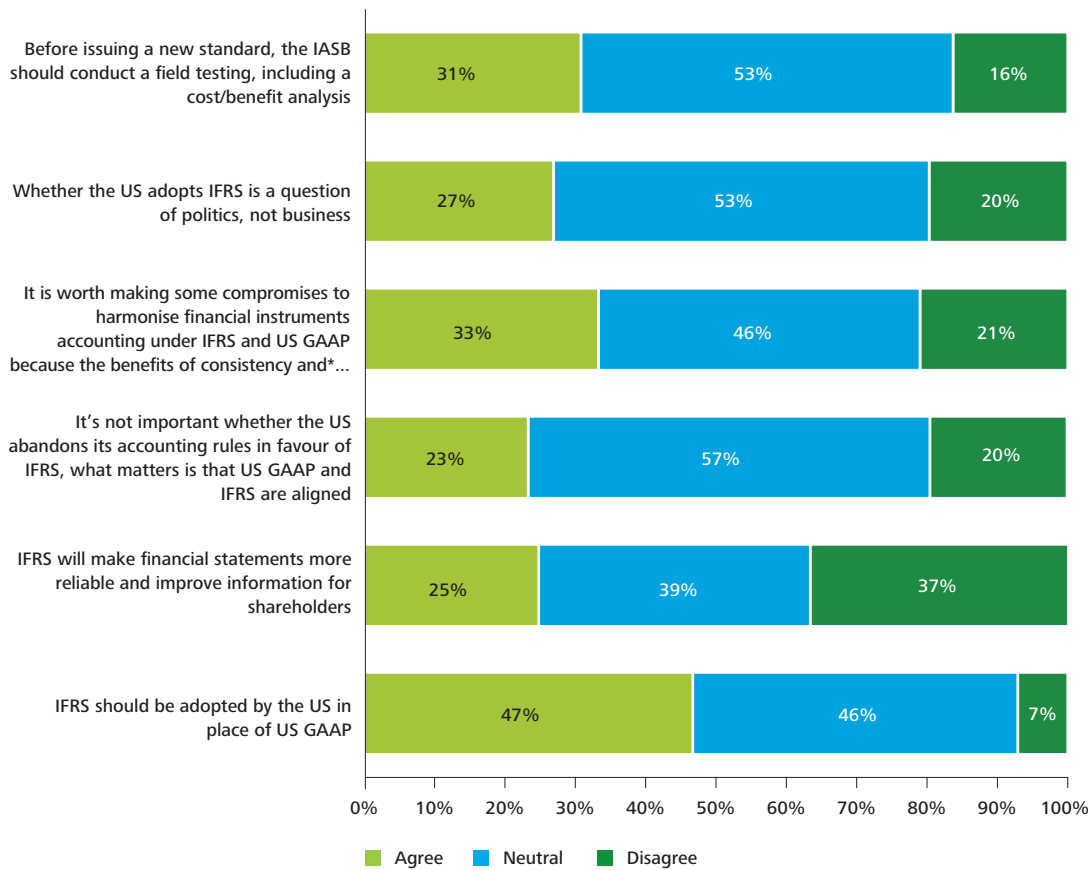
**What do you think are the most challenging aspects of the new IFRS for Financial Instruments (IFRS9)? (select up to three)**



Source: Economist Intelligence Unit

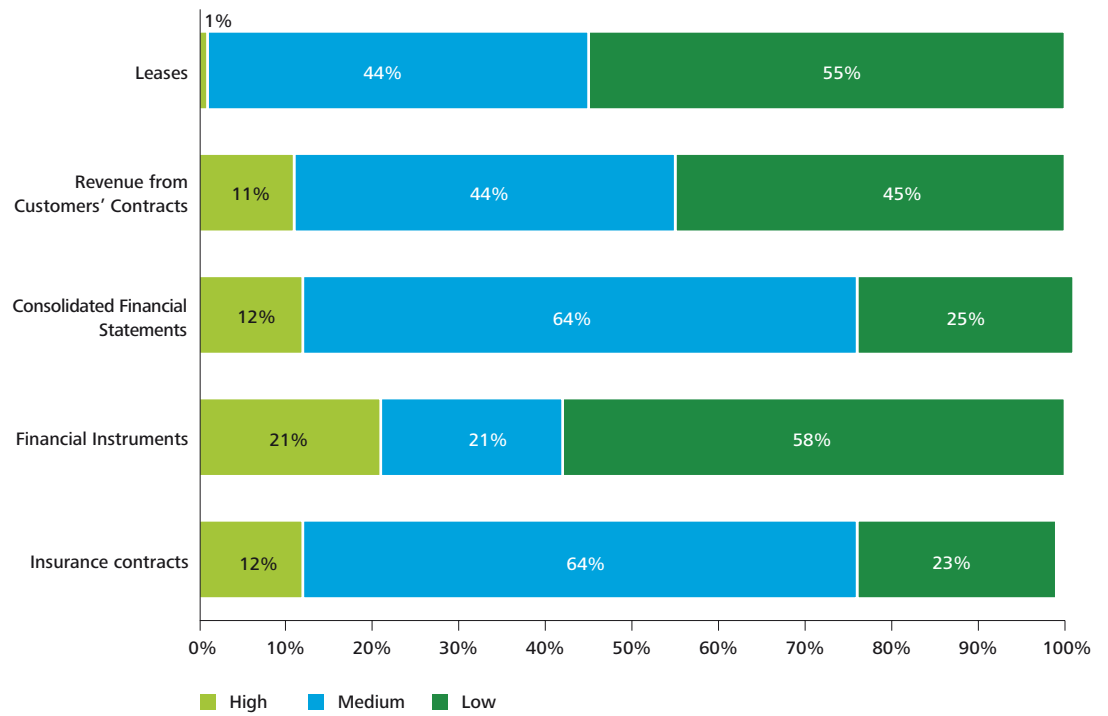


**Do you agree or disagree with the following statements?**

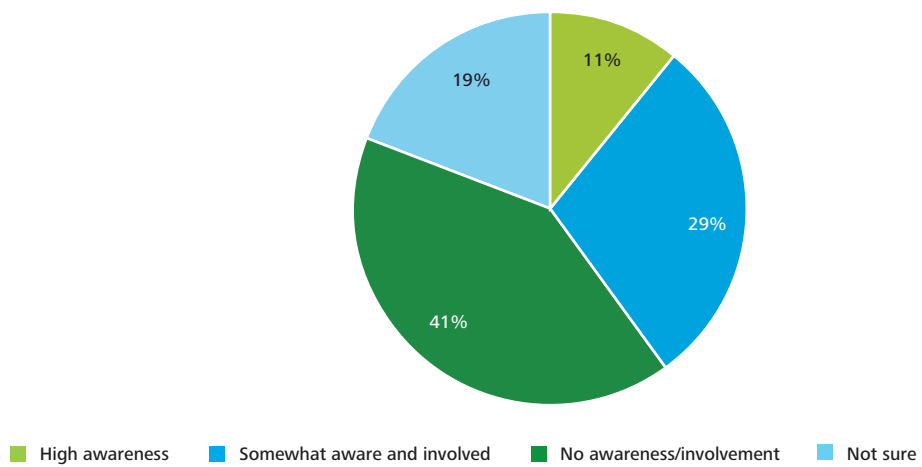


Note: \*...freedom from accounting arbitrage would be considerable.

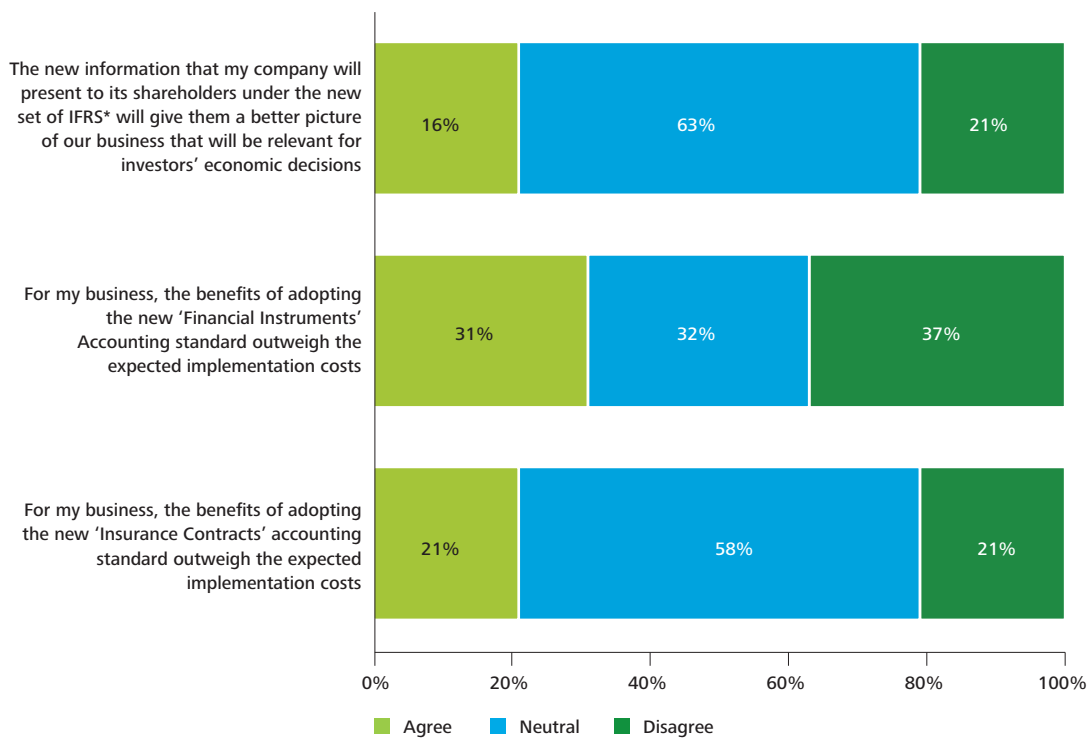
For each of the following accounting changes, do you believe the impact on your organisation will be high, medium or low?



What level of involvement/awareness of upcoming accounting change is there at your organisations board level?

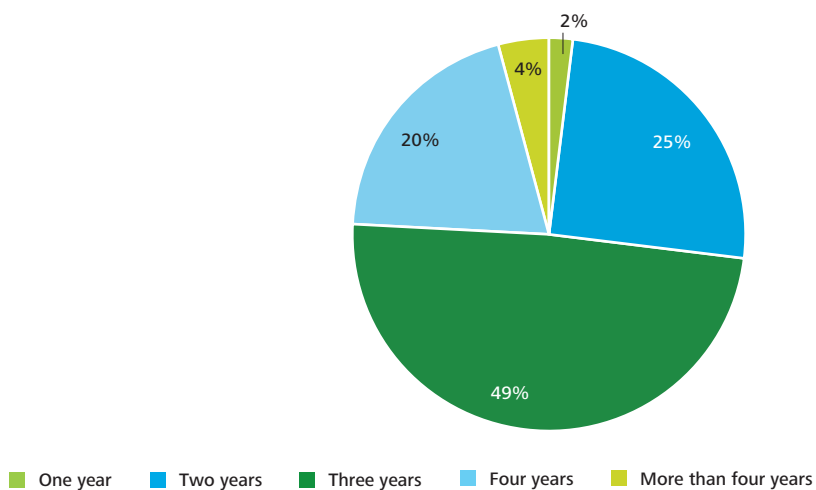


**Do you agree or disagree from the following statements?**

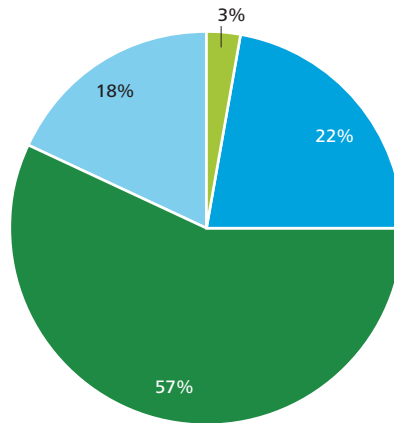


\*inclusive of Insurance Contracts and Financial Instruments accounting standards

**How long do you require between the new Insurance Contracts and Financial Instruments standards being approved by the IASB and the required implementation date?**

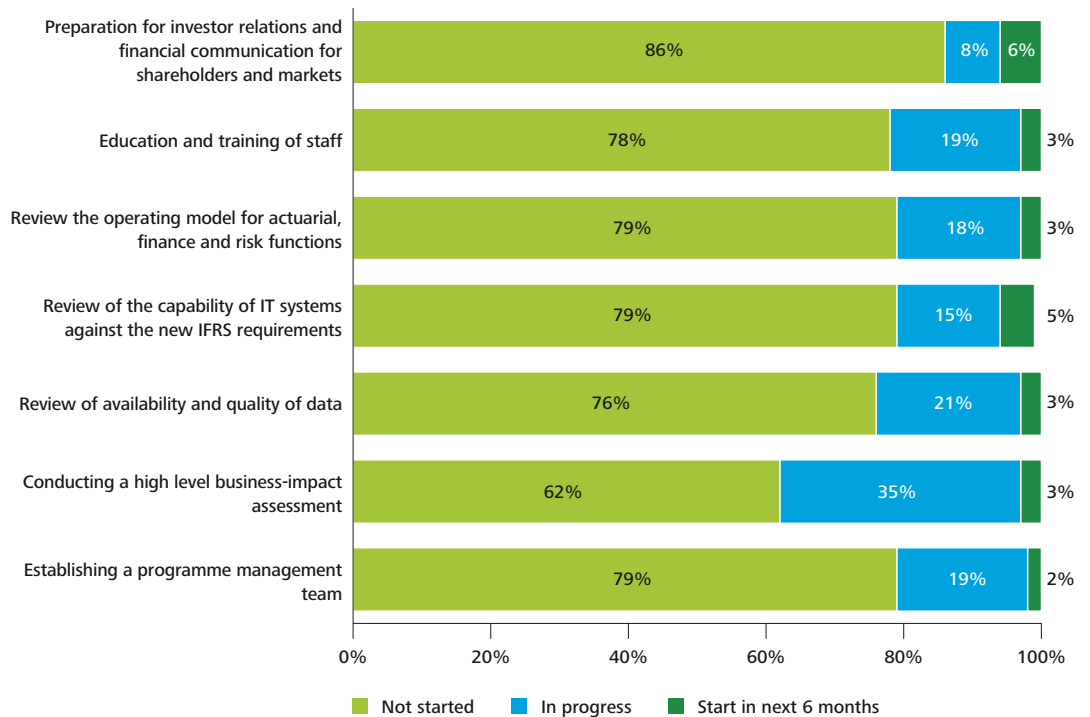


**When do you expect to start your IFRS Insurance Contracts project?**

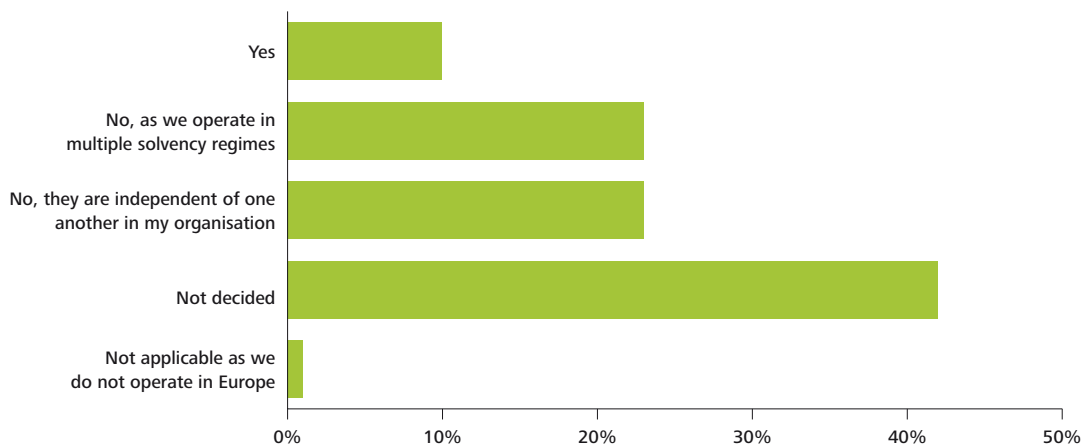


- Already started
- At re-exposure of the new standard
- When the new standard is finalised
- When my country accepts the standard as its own local

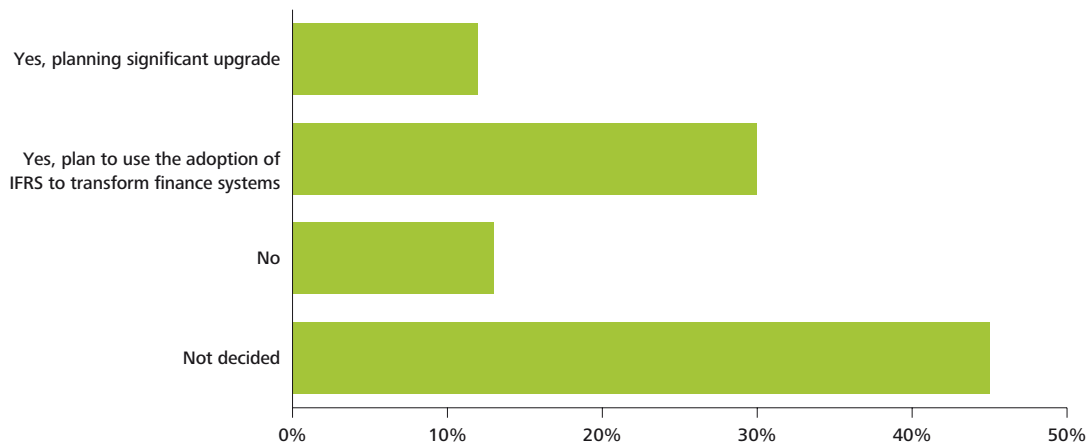
**What is the status of the following elements of your IFRS Insurance Contracts implementation?**



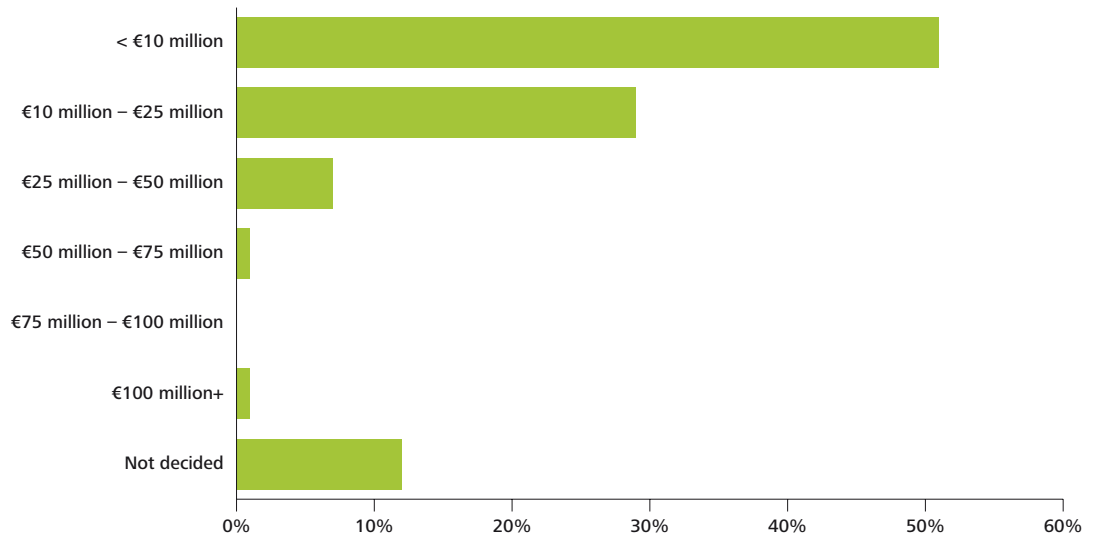
**Do you plan to have a single integrated programme that will both implement and manage the transition to the new accounting requirements, including those from Insurance Contracts and Financial Instruments, with your country's solvency and capital adequacy regime (such as Solvency II)?**



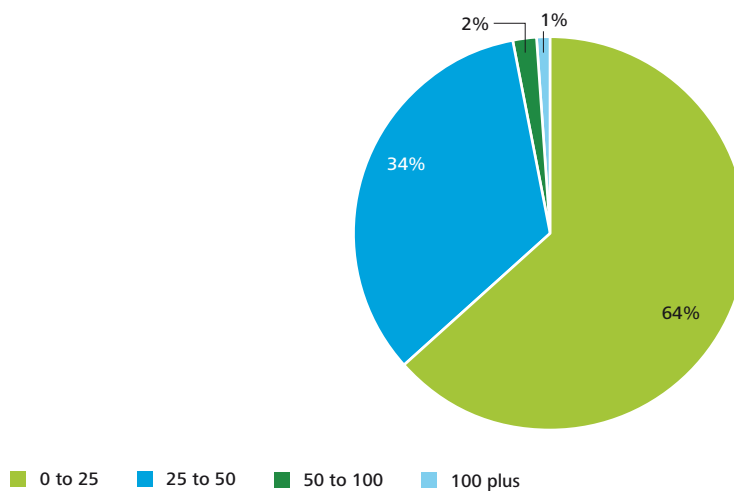
**Do you plan to change your financial reporting, administrative and/or actuarial systems as part of the implementation of IFRS Insurance Contracts and Financial Instruments, and if so to what extent?**



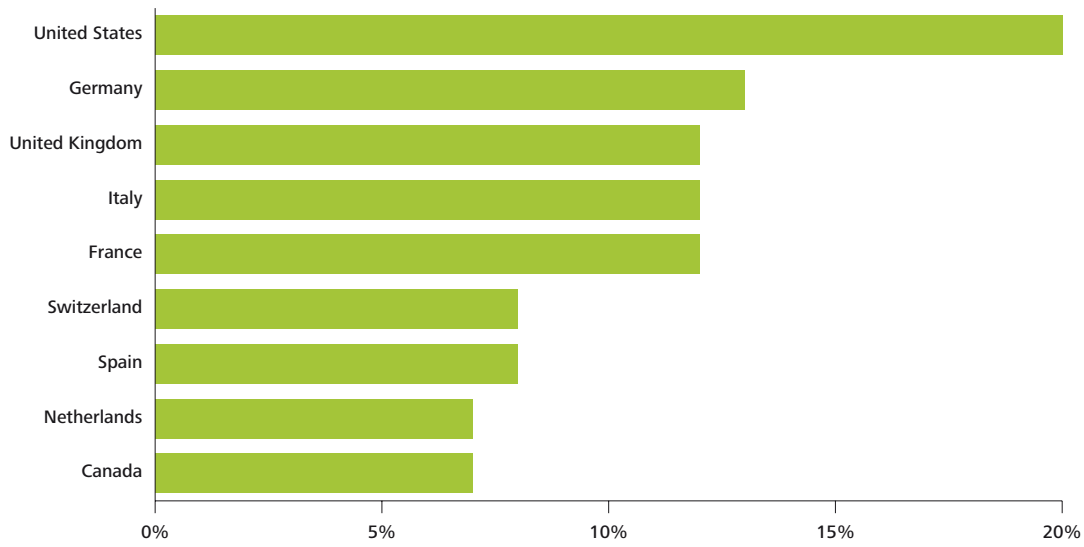
What is your estimated global budget (including internal costs and external fees) to meet the new IFRS requirements (including technology spend), approved or otherwise?



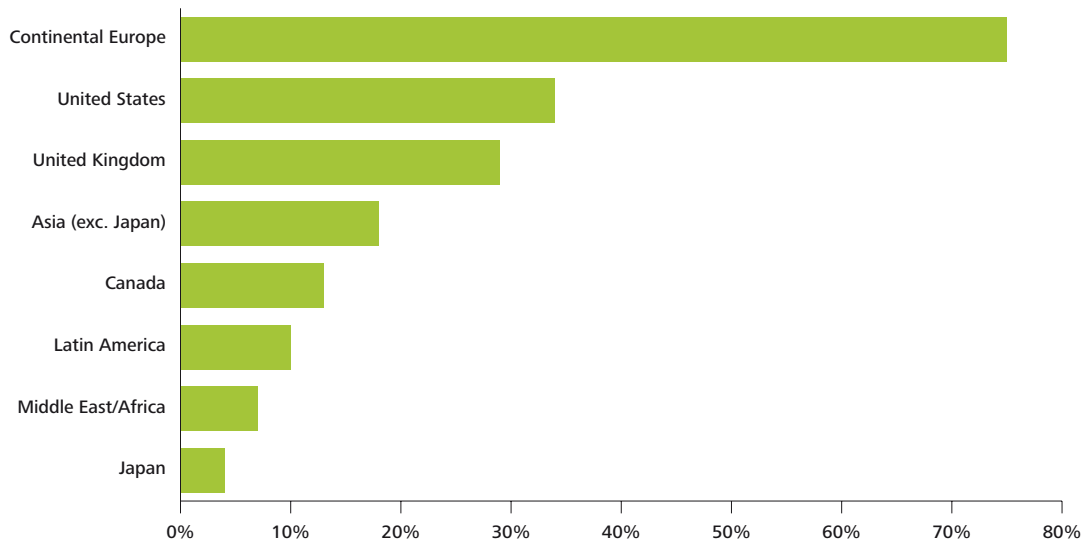
How many FTE (Full Time Employees) do you predict to be involved in delivery of your IFRS Insurance Contracts project during implementation?



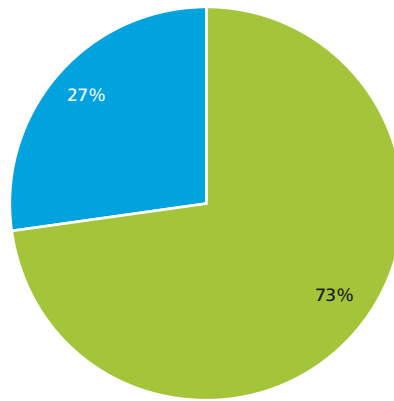
### Where is your head office domiciled?



### Where does your group operate? (select all that apply)

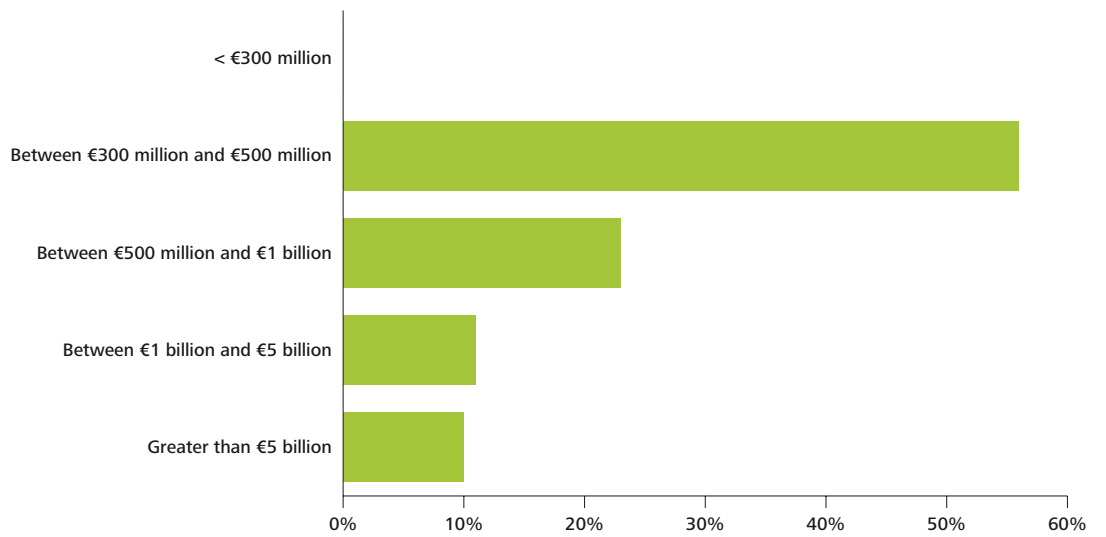


**In which region are your company's global headquarters?**



■ Western Europe ■ North America

**What is your organisation's Net Written Premium (NWP)?**





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