Gjensidige

Transition to IFRS 9 Financial Instruments and IFRS 17 Insurance Contracts

An introduction to the effects of adopting IFRS 9 and IFRS 17 in Gjensidige Forsikring Group's accounts

Content

1. Summary

IFRS 9 Financial Instruments and IFRS 17 Insurance Contracts are significantly altered from the previous standards on accounting for financial instruments and insurance contracts. For Gjensidige Forsikring Group the impact is largest when it comes to presentation in the financial statement and accounting for pension contracts as well as the introduction of risk adjustment, discounting and contractual service margin.

The transition to IFRS 9 and IFRS 17 will not affect the Group's solvency position or dividend capacity. Nor will the transition influence day-to-day operations, how the business is run, cash flows or the underlying profitability. How tax expenses will be calculated after the transition has yet to be decided. The changes following the adoption of the new standards are related to the presentation of the accounts, new models, disclosures and the timing of accounting effects. This means that the current KPIs, such as the combined ratio, loss ratio, cost ratio and return on equity, will still apply, although the figures will change slightly.

The IFRS 9 and 17 accounting standards are intended to ensure consistency in the accounting for financial instruments and insurance contracts and increase comparability between insurance companies, although company-specific choices made within these principle-based standards must be adjusted for before full comparability is possible.

For General Insurance the simplified method, Premium Allocation Approach (PAA) will be implemented. The transition effects related to IFRS 17 are:

- Discounting of claims provisions with market interest rates
    - Claims provisions for all lines of businesses will be discounted
- Risk adjustment
    - The compensation required for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk when the insurance contracts are fulfilled
    - New liability in the statement of financial position, will be included in the liability for incurred claims (LIC)
- Loss component for onerous contracts
    - Similar to the existing unexpired risk provision, but at a more granular level
- Release of excess reserves will be adjusted in the opening balance since IFRS 17 requires best estimate calculations

For Pension, the Building Block Approach (BBA) will be used, and the transition effects are:

- Discounting of technical provisions based on market interest rates, instead of guaranteed interest rates.
- Risk adjustment
    - The compensation required for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk when the insurance contracts are fulfilled
    - New liability in the statement of financial position will be included in liability for remaining coverage (LRC)
- Loss component for onerous contracts
    - Expected losses in the remaining coverage period for onerous contracts
- Contractual service margin (CSM)
    - Unearned profit that an entity expects to recognise as it provides services
    - New liability in the statement of financial position, will be included in LRC

The transition to IFRS 9 implies for Gjensidige that all portfolios of financial instruments will be measured at fair value through profit or loss.

The preliminary effect of the transition to IFRS 9 and IFRS 17 as at 1.1.2022 (on the opening balance) is shown in section 6.

2. Introduction

The new standard IFRS 17 Insurance Contracts replaces IFRS 4 Insurance Contracts and is effective from 1 January 2023. IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurements, and is effective from the same date, due to the option to defer the effective date until IFRS 17 is effective.

The purpose of this guide is to explain the impact on Gjensidige Forsikring Group of implementing IFRS 9 and 17. The focus will be on describing the chosen principles and the consequences for the opening balance and the first three quarters of 2022. The figures presented are indicative and may be altered in the audited financial statement for 2023. IFRS 9 and 17 will be implemented in Gjensidige Forsikring Group's consolidated financial statement and in the financial statements of Gjensidige Forsikring ASA. IFRS 17 is not applicable to the financial statement of Gjensidige Pensjonsforsikring AS (GPF), but GPF will report IFRS 17-figures to the Group for consolidation purposes.

There are several new terms in the standards, and section 5 shows the link between the terms used today and the new terms.

3. IFRS 17 Accounting Principles

IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of issued insurance contracts. IFRS 17 is a complex standard that entails some fundamental differences from current accounting for liability measurement and profit recognition.

On initial recognition, insurance contracts will be recognised at a risk-adjusted present value of the future cash flows plus an amount representing the unearned profit in the Group of contracts (the contractual service margin). This is referred to as the BBA model. If a group of contracts is or becomes loss-making, the loss will be recognised immediately. The onerous test is performed at a granular level, ensuring that the group of contracts is homogenous and that profit-making contracts are not subsidising loss making contracts. For profit-making contracts, the earnings are based on accrued services.

An entity may simplify the measurement by using the PAA if the entity expects such simplification to produce a measurement of the liability for remaining coverage that will not differ materially from the measurement that would be produced by applying the BBA model described above, or if the coverage period of each contract in the Group is one year or less.

Liabilities for insurance contracts consist of LRC and LIC. LRC represents liabilities for remaining coverage, while LIC represents liabilities for claims that have already been incurred.

Assets for reinsurance contracts consist of the asset for remaining coverage (ARC) and the asset for incurred claims (AIC) (reinsurers' share of claims that have already been incurred).

Reinsurance will be presented separately from gross insurance.

Please see section 5 for the link between old and new terms.

The insurance liabilities under IFRS 17 should be based on the expected cash flows, and excess reserves beyond what is expected cannot be part of the best estimate. Gjensidige has recognised excess reserves in 2022 that are not in accordance with IFRS 17. This amount is therefore adjusted for in the preliminary opening balance as at 1 January 2022.

3.1 General Insurance contracts: measurement model

For the general insurance contracts, Gjensidige has decided to use PAA. Most of Gjensidige's contracts have a coverage period of one year or less. For the contracts where the coverage period is more than one year, Gjensidige has calculated that the liability for remaining coverage will not differ materially from the liability that would be arrived at by applying the general measurement model called the BBA, and it will therefore also use PAA for those contracts.

Applying the PAA model, Gjensidige will measure the LRC on initial recognition. The carrying amount of the liability comprises the premiums received upon initial recognition.

At the end of each reporting period, the carrying amount of the LRC is the carrying amount at the start of the period plus the premium received during the period, minus the amount recognised as insurance revenue for services provided in that period. LRC corresponds to the provision for unearned premium deducted by premium receivables.

The LIC, comprising the fulfilment cash flows related to past services, is measured according to best estimate of future payments for incurred claims and claims expenses.

Gjensidige has chosen to expense the acquisition costs directly when applying the PAA, as has been done under IFRS 4.

3.2 General Insurance contracts: discounting

Pursuant to IFRS 17, LIC should be discounted when payments are expected to take place more than one year after the occurrence of the claim. A major part of the LIC stems from long-tailed business with a duration of more than one year, and Gjensidige has therefore decided to discount LIC for all products. Swap rates, which are a well-known market-based yield curve, will be used for the respective currencies. The swap rates have a duration of up to 30 years and are a fairly good hedge for the investments.

LRC could also be discounted to reflect the time value of money. This adjustment is not mandatory under PAA. For LRC, most of the premiums are received in the same year as coverage is provided. In addition, a substantial part of the premium is paid monthly or quarterly. This means that the financial component of LRC is very limited, and discounting will therefore not be performed.

3.3 General Insurance contracts: risk adjustment

The risk adjustment (RA) is the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts. The percentile approach is chosen and risk adjustment for each legal entity within the Group is chosen to represent the 85 per cent percentile of the ultimate probability distribution for the claim’s provisions.

The percentile of 85 per cent is aligned with Gjensidige’s cost of capital until final run-off of the claim's provisions. Ultimate risk is chosen because the accounting balance shows the liabilities as estimated until final run-off.

For Gjensidige Forsikring ASA, the Partial internal model (PIM) with own calibration is used to determine the risk adjustment. The percentile can be derived from the probability distribution for reserve risk.

Insurance companies in the Group, other than Gjensidige Forsikring ASA, develop their own models, based on the Solvency II risk margin, in order to determine the RA. The calculation of RA is adjusted to comply with the Group principle of a percentile of 85 per cent and based on ultimate risk.

The percentile level of 85 per cent until final run-off corresponds to a level of 95 per cent for one-year risk.

3.4 General Insurance contracts: transition

The retrospective approach has been used for all general insurance contracts, starting from recognition of contracts.

3.5 Pension contracts: measurement model

The following pension products are within the boundaries of IFRS 17:

- Occupational pension
- Paid-up policies
- Disability pension
- Children's disability pension

Gjensidige has classified all pensions contracts as fulfilling the requirements for the use of the BBA.

The paid-up policies have a guaranteed rate of return, and it is assessed whether the contracts fall under the definition of the Variable Fee Approach (VFA). To qualify for measurement under the VFA , Gjensidige must expect to pay the policyholder an amount equal to a substantial share of the fair value returns on the underlying items and a substantial proportion of any change in the amounts paid to the policyholder will vary with the change in fair value of the underlying item. These conditions are not met, and the paid-up policies will therefore be measured based on the BBA.

On initial recognition, the LRC for a group of contracts will be measured as the total of:

- The fulfilment cash flows, which comprise:
    - Estimates of future cash flows
    - An adjustment to reflect the time value of money and the financial risk related to the future cash flows
- A risk adjustment for non-financial risk
- The contractual service margin (CSM)

The CSM is a component of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit the entity expects to recognise as the insurance contract services are provided. The risk adjustment is described in 3.3 and 3.7.

3.6 Pension contracts: discounting

An entity shall adjust the estimates of future cash flows to reflect the time value of money and the financial risks related to those cash flows, insofar as the financial risks are not included in the estimates of cash flows.

Gjensidige has decided to use the EIOPA interest rate curve without volatility adjustments. The EIOPA interest rate fulfils the bottom-up requirement in IFRS 17 and is considered to be risk-free. The pension contracts' liabilities are mainly long-term pensions, and the EIOPA curve is based on an extrapolation method that also produces very long-term interest rates.

3.7 Pension contracts: risk adjustment

Pension has developed its own model for calculation of the risk adjustment using the BBA model. The model is based on the models for cash flows, taking into consideration the uncertainty in timing and size of the cash flows. The model is a percentile approach (85 per cent), for ultimate risk.

3.8 Pension contracts: transition

The modified retrospective approach has been used for all pension contracts, starting from 31 December 2016.

3.9 Group risk adjustment

The risk adjustment for the Group is the sum of risk adjustments for each legal entity, less risk adjustment on internal reinsurance. As there is a diversification effect between the entities the percentile level of the risk adjustment at Group level will be 89 per cent for ultimate risk, corresponding to 97 per cent for one-year risk.

4. IFRS 9 Accounting Principles

IFRS 9 is based on the concept that financial instruments should be classified and measured at fair value, with changes in fair value recognised in profit or loss as they arise (FVTPL), unless restrictive criteria are met for classifying and measuring the asset at either amortised cost or fair value through other comprehensive income (FVOCI).

Equity instruments and derivatives that do not pass the SPPI (solely payment of principal and interest) test will therefore be classified at fair value through profit or loss. Debt instruments will be classified based on the business model and on the cash flow characteristics of the financial asset.

The match portfolio in General Insurance is intended to correspond to the cash flows from the underwriting business. It is invested in debt instruments with a duration and currency that matches the duration and currency of the cash flows for the underwriting business. A major part of the investments would pass the SPPI-test and could be accounted for according to amortised cost. However, Gjensidige has chosen to use the fair value through profit or loss option to reduce the accounting mismatch between investments and insurance liabilities.

The free portfolio consists of various assets, which are managed based on fair value and Gjensidige's risk appetite. Hence, the financial assets fall into the Non-holding/Other category and will be classified as fair value through profit or loss.

The financial assets in Pension's group policy portfolios are intended to correspond to the cash flows from the underwriting business, with debt instruments with a duration and currency that matches the duration and currency of the cash flows for the underwriting business. A major part of the investments would pass the SPPI-test and could be accounted for according to amortised cost. However, Gjensidige has chosen to use the fair value through profit or loss option to reduce the accounting mismatch between investments and insurance liabilities.

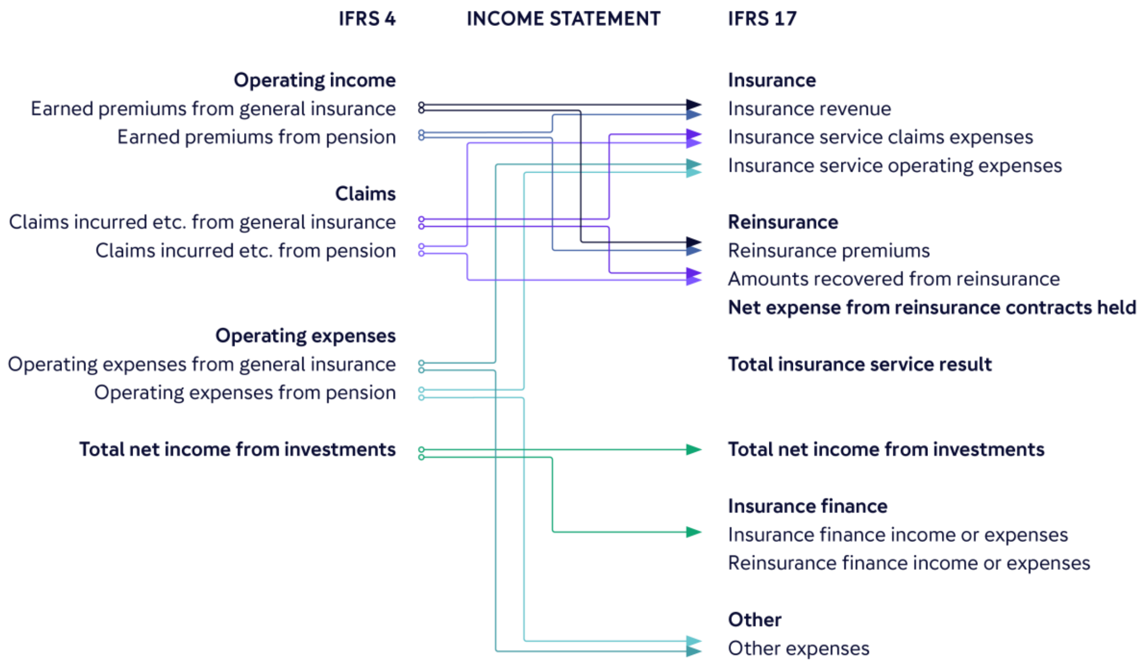
The financial assets in the unit-linked and corporate portfolio are measured at FVTPL.

5. Classification Group income statement and financial position

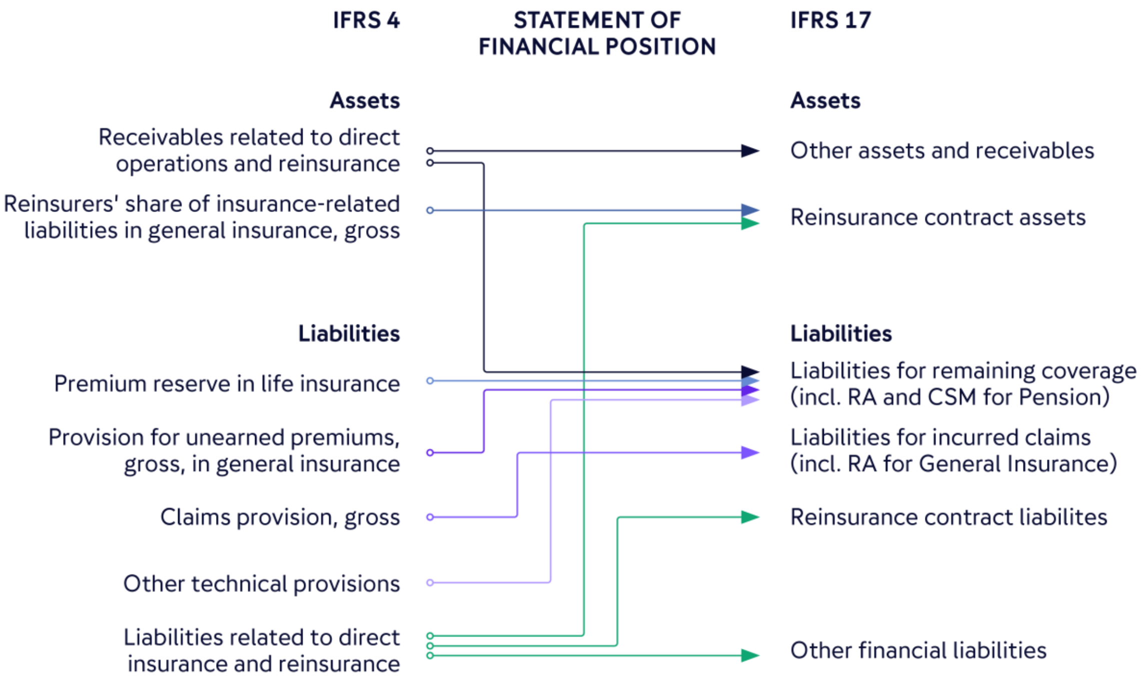
The tables show the relationship between the current statement plans according to IFRS 4 and the new statement plans according to IFRS 17.

Insurance revenue, claims and operating expenses are presented separately from reinsurance premiums and amounts recovered from reinsurance.

Insurance finance is a new item in IFRS 17. Insurance finance consists of the unwinding and interest rate change effect that stems from discounting the insurance liabilities. For the Swedish and Danish branches, which already discount their long-tail insurance liabilities (annuities), this effect is allocated from net changes in fair value on investments to insurance finance.



Indirect costs should not be included in the fulfilment cash flow when calculating the insurance liability. It has been decided that costs related to the training of newly hired personnel in sales and distribution and certain costs related to new products are indirect in Gjensidige, and will be classified as Other expenses.



6. Group opening balance and equity reconciliation 1 January 2022

6.1 Opening balance

This section presents the preliminary consolidated statement of financial position according to IFRS 17 compared to the current standard IFRS 4, and explains the differences.

NOK millions	Notes	IFRS 17 31.12.2021	IFRS 4 31.12.2021	Change
ASSETS				
Goodwill		3,955	3,955	
Other intangible assets		1,732	1,732	
Investments in associates and joint ventures		5,529	5,529	
Owner-occupied and right-of-use property, plant and equipment		1,440	1,440	
Pension assets		263	263	
Financial assets				
Interest-bearing receivables from joint ventures		1,735	1,735	
Financial derivatives		696	696	
Shares and similar interests		6,464	6,464	
Bonds and other fixed income securities	1	31,087	31,086	
Loans and receivables	1	21,790	21,338	452
Assets in life insurance with investment options		42,990	42,990	
Receivables related to direct operations and reinsurance	2		8,220	(8,220)
Other assets and receivables	2	3,522	939	2,584
Cash and cash equivalents		2,348	2,348	
Other assets				
Reinsurance contract assets	3	1,132	1,043	89
Deferred tax assets	4	19	24	(5)
Prepaid expenses and earned, not received income		16	22	(6)
Total Assets		**124,716**	**129,822**	**(5,106)**

NOK millions	Notes	IFRS 17 31.12.2021	IFRS 4 31.12.2021	Change
EQUIITY AND LIABILITIES				
Equity				
Share capital		1,000	1,000	
Share premium		1,430	1,430	
Natural perils capital		2,829	2,829	
Guarantee scheme provision		762	762	
Other equity	5	18,455	19,183	(728)
Total equity attributable to owners of the company		**24,476**	**25,205**	**(728)**
Non-controlling interests		1	1	
Total equity		**24,477**	**25,205**	**(728)**
Insurance liabilities	6	45,229	49,324	(4,095)
Liabilities related to direct insurance and reinsurance	3		832	(832)
Reinsurance contract liabilites	3	19		19
Financial liabilities				
Subordinated debt		2,396	2,396	
Financial derivatives		498	498	
Liabilities in life insurance with investment options		42,990	42,990	
Other financial liabilities	3	4,140	3,378	762
Other liabilities				
Pension liabilities		712	712	
Lease liability		1,271	1,271	
Other provisions		613	613	
Current tax		1,523	1,523	
Deferred tax liabilities	4	385	614	(229)
Accrued expenses and received, not earned income		463	465	(2)
Total Liabilities		**100,240**	**104,617**	**(4,377)**
Total Equity and Liabilities		**124,716**	**129,822**	**(5,106)**

The main changes are explained in the notes below.

Note 1
The increase in the carrying amount of bonds and other fixed instruments as well as loans and receivables is due to transition to IFRS 9 where all financial instruments are measured at fair value through profit or loss for the measure of financial instruments.

Note 2
Receivables related to direct operations are presented as an asset under IFRS 4, while they are deducted from the LRC according to IFRS 17. The increase in Other assets and receivables are due to parts of the receivables also containing other insurance-related elements that are not solely receivables from customers, such as trafikkforsikringsavgift (vehicle insurance tax) collected on behalf of the authorities. Those elements are reclassified as Other assets and receivables.

Note 3
The increase in reinsurance contract assets consists of several elements. The amount increases due to risk adjustment and decreases due to net presentation (liabilities related to reinsurance are deducted from the reinsurance contract assets). Reinsurance contract liabilities consist of reinstatement premiums that cannot be reclassified as reinsurance contract assets. The increase in Other financial liabilities is due to different classification under IFRS 17 than IFRS 4.

Note 4
The decrease in deferred tax liabilities is due to effects on accounting differences of the calculated deferred tax asset on equity when implementing IFRS 9 and 17. The calculated deferred tax asset is deducted from the deferred tax liabilities. The tax authorities have not announced changes to the rules for taxable income calculation in connection with the implementation of IFRS 17.

Note 5
The decrease in equity is explained below under Equity reconciliation IFRS 4 to IFRS 17.

Note 6
Insurance liabilities decrease due to the new measurement model in accordance with IFRS 17. The effects are described under Equity reconciliation IFRS 4 to IFRS 17. The deduction of insurance receivables from liabilities for remaining coverage comes in addition. Hence, the underlying insurance liabilities increase. The risk adjustment and loss component increase the liabilities, while the discounting decreases the liabilities.

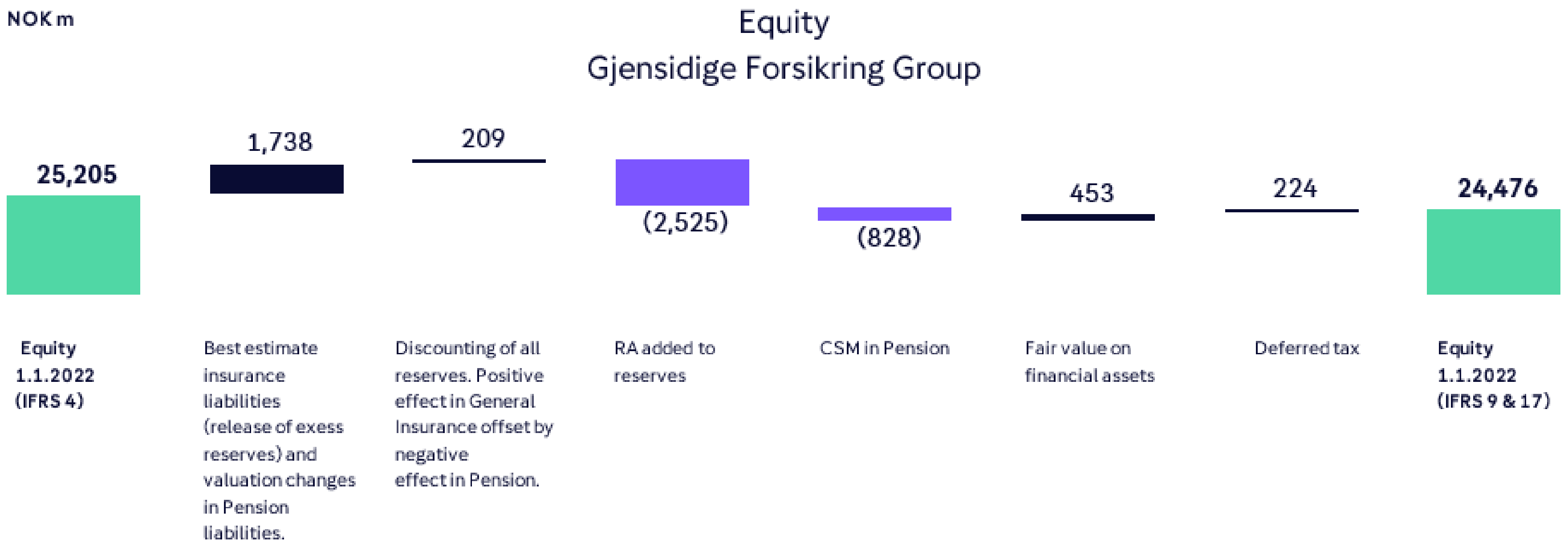
6.2 Equity reconciliation IFRS 4 to IFRS 17

This section presents the preliminary equity according to IFRS 17 compared to the current standard IFRS 4, and explains the differences.

Group

There will be lower equity in the opening balance as at 1 January 2022 due to the implementation effect.

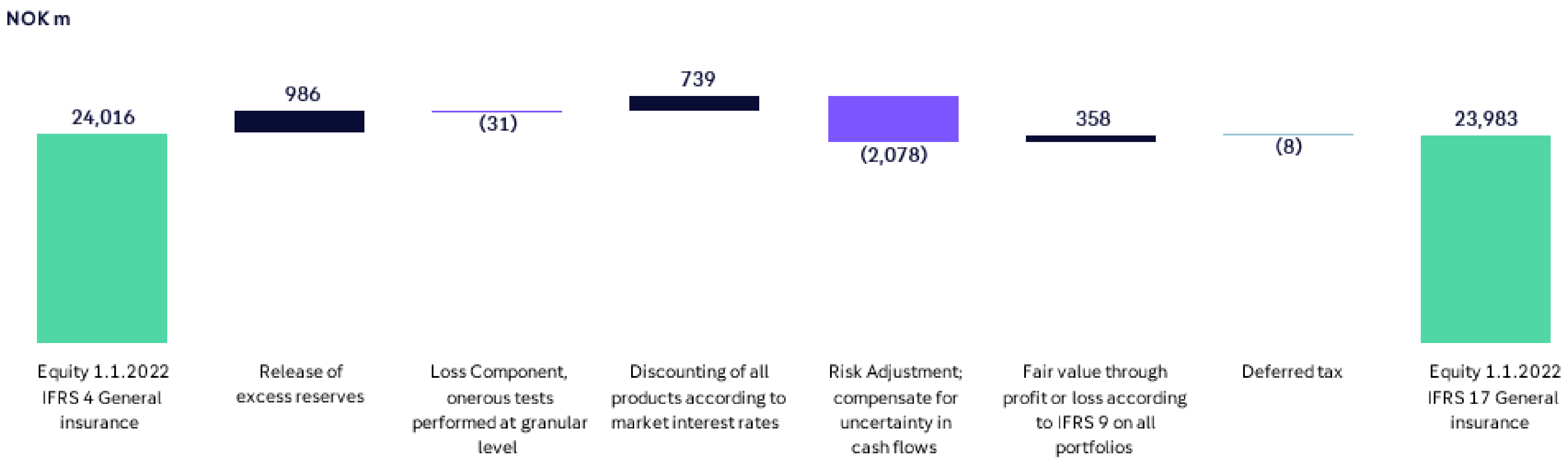
The decrease in equity of NOK 0.7 billion is mainly due to risk adjustment and the contractual service margin.



General Insurance

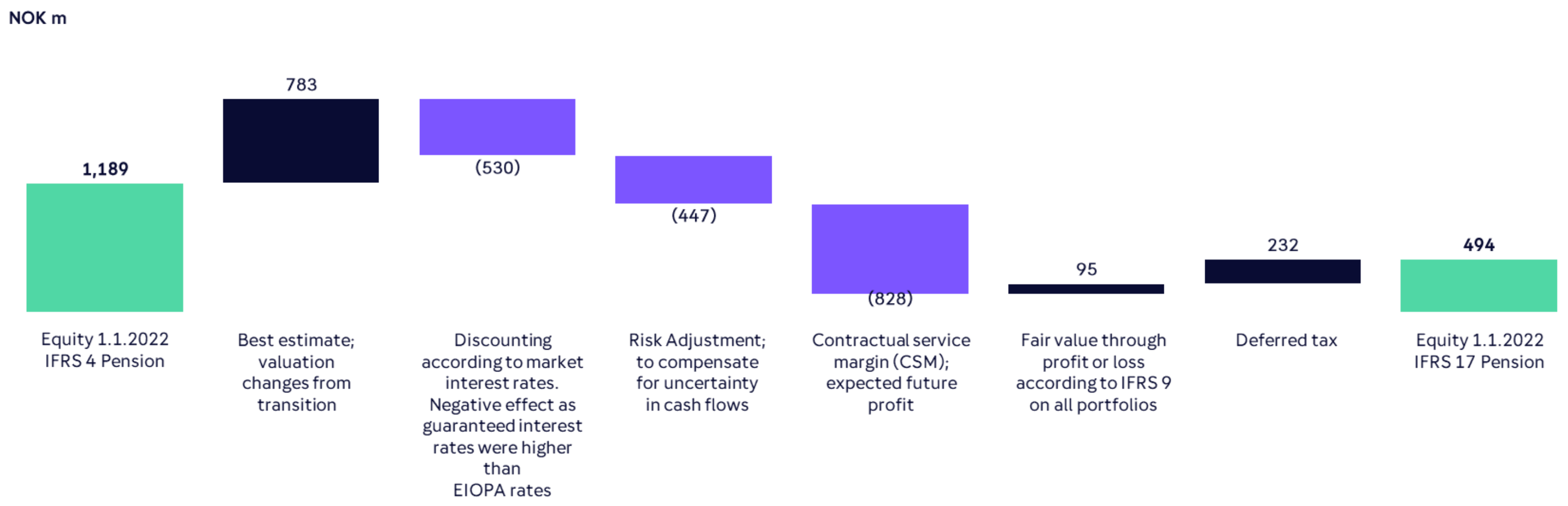
There are minor changes in equity in the opening balance for General Insurance.

The release of the above-mentioned excess reserves and discounting is more than offset by risk adjustment. General Insurance is defined as Group less Pension and is not a legal entity.



Pension

Pension's equity in the opening balance is significantly lower, due to larger negative effects under the BBA model.



7. Consolidated income statement YTD Q3 2022

NOK millions	1.1.-30.9.2022
Insurance revenue	24,215
Insurance claims expenses	(16,647)
Insurance operating expenses	(3,229)
Total insurance service result before reinsurance contracts held	**4,339**
Reinsurance premiums	(508)
Amounts recovered from reinsurance	292
Net expense from reinsurance contracts held	**(216)**
Total insurance service result	**4,123**
Results from investments in associates and joint ventures	38
Interest income and dividend etc. from financial assets	906
Net changes in fair value of investments (incl. property)	(5,300)
Net realised gain and loss on investments	1,172
Interest expenses and expenses related to investments	(244)
Total net income from investments	**(3,428)**
Insurance finance income or expenses	2,163
Reinsurance finance income or expenses	6
Other income	756
Other expenses	(907)
Profit/(loss) before tax expense	**2,714**
Tax expense	(539)
Profit/(loss)	**2,175**

The table shows the preliminary consolidated income statement according to IFRS 17. Profit before tax declines compared to IFRS 4. The main reasons are removal of excess reserves under IFRS 17, decrease in value of bonds recorded at amortised cost under IFRS 4 compared to fair value under IFRS 17, partly offset by a positive effect from interest rate increase.

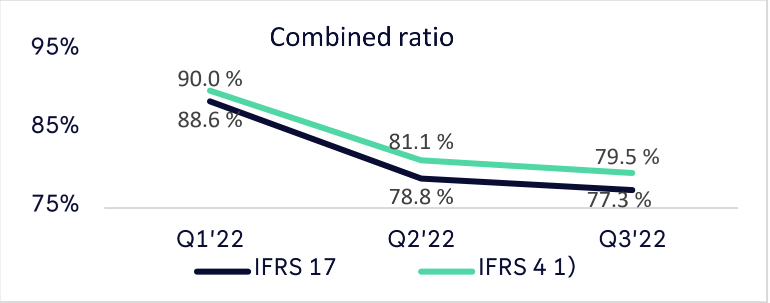
8. KPIs

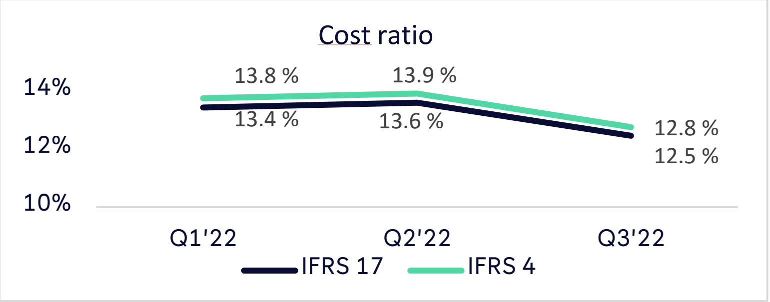
General Insurance will report on the same KPIs under IFRS17 as under IFRS 4. However, when calculating the ratios, we will use insurance revenue as presented in the new statement plan as the denominator. Insurance revenue is reported before ceding for reinsurance while the current KPIs are calculated based on earned premiums net of reinsurance. Further we will define a new reinsurance ratio as net of reinsurance premiums and amounts recovered from reinsurers. The combined ratio going forward will be the total of the loss ratio, reinsurance ratio and cost ratio.

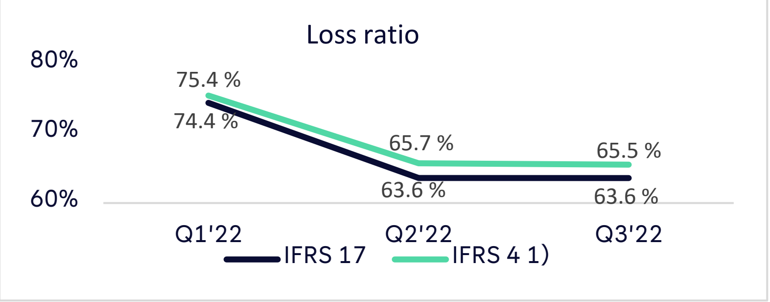
The charts to the right show the quarterly KPIs under IFRS 17 (compared with the KPIs under the current IFRS 4 published in 2022, adjusted for the release of the excess reserves in the opening balance). The KPIs under IFRS 17 improve due to effects from discounting the reserves, risk adjustment and reclassification of costs related to training and new products, in addition to using the insurance revenue as the denominator. This effect is expected to continue going forward.

There are no new KPIs for Pension at this stage. The reason for this is that we wish to see what the market practice practice will be.

The KPI for Group, Return on Equity, will be positive impacted by lower equity under IFRS 17.







1) Excess reserves not included

9. Briding the gap between IFRS 17 equity and Solvency II capital as at 1.1.2022

The chart below illustrates the bridge between equity according to IFRS 17 and Solvency II eligible own funds. The differences between IFRS and Solvency II are less with the new standards. Our choices under IFRS 9 imply that there are no differences in the valuation of assets.

Discounting insurance liabilities at market interest rates under IFRS 17 reduces the differences with regards to discounting, and the only difference left is that general insurance claims provisions under IFRS are discounted at swap interest rate while EIOPA-interest rates are applied under Solvency II. The risk adjustment is similar to risk margin under Solvency II although there are some differences in methods and principles.

The premiums provisions for Pension are different due to profit from future exposure being part of technical liabilities under IFRS 17 and part of equity under Solvency II. In addition, there are different definitions of contract boundary. The premium provision (liability for remaining coverage under IFRS 17) in General Insurance is discounted under Solvency II but not under IFRS 17.