From: opaleye olatunde <opaa.2nde@yahoo.com>
Sent: Thursday, February 29, 2024 4:18 AM
To: Methodology Public
Subject: Public Comment

[You don't often get email from opaa.2nde@yahoo.com. Learn why this is important at https://aka.ms/LearnAboutSenderIdentification]

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Hello Team,

I appreciate the opportunity to provide feedback on the proposed application of Best's Credit Rating Methodology (BCRM) and related criteria procedures to IFRS 17-reporting companies.

Firstly, I commend AM Best for its commitment to global consistency and transparency in credit ratings. The assurance that BCRM and criteria procedures remain agnostic to accounting standards is crucial for maintaining a level playing field in the insurance industry.

While understanding that no material changes are proposed due to IFRS 17, I emphasize the importance of continued engagement with stakeholders. This collaborative approach ensures that the methodology remains robust and adaptive to industry dynamics.

The option to choose the visibility of comments, including the choice to keep them confidential, reflects a balanced approach to stakeholder input. This flexibility is appreciated and aligns with the principles of openness and inclusivity.

In conclusion, I express gratitude for the ongoing efforts to uphold industry standards and invite further dialogue on evolving methodologies. I look forward to witnessing the positive impact of this engagement on the stability and reliability of credit ratings.

Best regards,

Olatunde Opaleye

From: Philippe Angelis <Angelis@cfoforum.eu>
Sent: Thursday, March 28, 2024 9:51 AM
To: Anthony Silverman <Anthony.Silverman@ambest.com>; Mahesh Mistry <Mahesh.Mistry@ambest.com>; Greg Carter <Greg.Carter@ambest.com>
Cc: Robert Raber <Robert.Raber@ambest.com>; Maura McGuigan <Maura.McGuigan@ambest.com>; Myles Gould <Myles.Gould@ambest.com>; Alban De Mailly Nesle <alban.demaillynesle@axa.com>; Fabio Cleva <fabio.cleva@generali.com>
Subject: RE: AM Best response to joint CFOF CROF letter, re IFRS 17 implementation

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Dear Mr Carter,

Hope this email finds you well.

In response to the AM Best “Request for Comments” published on 26 February, please find attached the European CFO Forum’s comment letter concerning AM Best’s Credit Rating Methodology (BCRM) and related criteria procedures to IFRS 17 reporting companies.

We believe that the AM Best approach is not appropriately incorporating the additional insights and transparency that IFRS 17 offers into its rating methodology and further creates an unfair disadvantage for European players versus their United States peers.

Furthermore, in our letter we comment on key areas of feedback including where we believe further changes are required to the Insurers methodology to reflect the economic reality of the insurance business undertaken in the European insurance industry.

For more details, please refer to our attached comment letter.

Best regards,
CFO Forum VPO

CFOFORUM

Greg Carter – Managing Director Analytics
Mahesh Mistry – Senior Director, Head of Analytics
Anthony Silverman – Director
AM Best Europe
8th Floor
12 Arthur Street
London EC4R 9AB
United Kingdom

27 March 2024

Dear Mr Carter, Mr Mistry and Mr Silverman,

AM Best Requests Comments on application of Best's Credit Rating Methodology to IFRS17

This letter has been drafted by the European Insurance CFO Forum ("CFO Forum"), which represents the views of Europe's 22 largest insurance companies. Accordingly, it represents the consensus view of a significant part of the European insurance industry.

Following our letter dated 9 February 2024, in which we commented on published AM Best statements on the implementation of IFRS17, we hereby send a more specific answer to your Request for Comments published on 26 February, and requesting we take position on three specific documents by 27 March 2024.

In our previous letter, we asked for a formal RfC process, in line with the standards set by ESMA in case of change in the 'key rating assumptions and key variables used in the rating (see ESMA Q&A Regulation Q&A, Part III, Q7, July 2023).

We thank you for setting up this process, however the proposed timeline is not acceptable given that it lasts for only four weeks and coincides with a peak reporting period for the industry.

We regret that the content we are being asked to collectively comment on, lacks a comprehensive methodology. Indeed, the materials do not appear to have been updated from before the industry had provided detailed stakeholder education sessions and more recently full audited financial statements and annual reports which have been prepared under IFRS 9 and IFRS 17. Furthermore, we are concerned about the continued reference to selected legacy 'IFRS 4' metrics (for example deferred acquisition costs) which are no longer produced and would anyway not be meaningful when considered in isolation. Necessarily, to complement the three specific documents listed above, we find that the changes in the BCAR are communicated on an ad-hoc bilateral basis with industry members, which results in inconsistent levels of information shared.

We reiterate our call for AM Best to consider presenting a comprehensive proposal – including an accompanying BCAR model spreadsheet – which reflects our previous technical feedback on IFRS 17. Currently we fear that the AM Best approach is not appropriately incorporating the additional insights and transparency that IFRS 17 offers into its rating methodology and further creates an unfair disadvantage for European players versus their United States peers.

In the meantime, we reiterate key areas of feedback including where we believe further changes are required to the Insurers methodology to reflect the economic reality of the insurance business undertaken in the European insurance industry.

1. Classification of the life CSM and RA as forms of equity

We understand that the proposed provisional methodology is to typically consider no more than half of the CSM and RA as being equivalent to equity, with a possible range of between 40% - 65% for specific well-defined cases. We believe that the CSM and RA should be viewed as equity and thus should be included at 100% and not be subject to any constraints for the following reasons:

- The CSM can be made available for loss absorption within a reasonable time frame, either by the very fact it will directly absorb non-financial changes and financial changes (for participating contracts) in the fulfilment cash flows relating to future service, or by its ability to be monetised within an adequate time frame via sale of the portfolio.
- In a purely economic valuation method, the full economic value creation would be shown already at initial recognition (increasing equity), whereas any experience and/or changes in non-economic assumptions would be part of the P&L of future periods (adjusting the equity position). As this comes with increased volatility in a long-term business model like (re-)insurance, the CSM and similarly the Risk Adjustment mechanic was introduced as a deferral concept in IFRS17 for profits from business that is already incepted. However, an economic assessment should fully reflect those deferred profits as a strong contribution to the company's capital position.
- The RA represents explicit prudence which should be expected to be released as profit in future years,
- The CSM and RA is explicitly disclosed within the financial statements, and subject to significant audit scrutiny. In particular, auditors will consider the methodology applied and any key judgements in its calculation.
- Inclusion of the CSM and RA within available capital would be consistent with the methodology adopted by S&P within the risk-based capital ("RBC") adequacy and ensure alignment in its treatment.
- Further, it would be more in line with other regulatory regimes (Swiss Solvency Test, Solvency II), where the VIF is fully recognised as available capital.

We also understand based on recent communications that the financial leverage ratio (adjusted and unadjusted) will take into consideration the CSM. However, we believe that the CSM and RA (both net of tax) should be included at 100% along with reported shareholders equity as capital. Excluding these items:

- Results in a calculation that is not agnostic to the accounting regime applied by an insurer. Reported shareholders equity will vary depending on the accounting methodology and calibration and will also change significantly for those recognising a CSM while the economics are unchanged.
- Reduces transparency if there are qualitative considerations of CSM and RA.
- Increases uncertainty for stakeholders.

2. Treatment of haircut for value-in-force ("VIF") for PAA contracts and IFRS 9 life contracts

We understand based on recent communications that the proposed provisional methodology is to not adjust non-life business for the long-term economic value attributable to such contracts. Our view is that there should be no difference in treatment (including any haircut applied) for those contracts that fall within the scope of IFRS 17 and are accounted for under the general measurement model ("GMM") or variable fee approach ("VFA") and those contracts that don't. This relates to business where:

(i) contracts are accounted for under the premium allocation approach (PAA), often non-life contracts - where there is no equivalent allowance due to it not having a CSM, but a VIF exists; and

(ii) IFRS 9 investment contracts written by an insurance company - where there is no equivalent allowance due to it not having a CSM, but a VIF exists.

Our main concern about this is that the accounting classification can depend on a (re)insurer's geography or local regulation / local market practice. This therefore leads to purely accounting differences creating bias on the result of the capital model. Further, it creates an inconsistency with other regulatory regimes (Swiss

Solvency Test, Solvency II), where the VIF is fully recognised as available capital. There should be no distinction in the treatment of the future expected profits between CSM and VIF, which only reflects a different accounting approach under IFRS 17.

Further the calculation of the VIF for such business would be performed on consistent systems to those used for deriving the CSM. Given these systems are subject to significant audit scrutiny, there is a similar assurance over the calculation of the VIF.

3. Treatment of DAC for IFRS 17 contracts

Our view is that the treatment of DAC for IFRS 17 contracts, as set out the Q&A, is unclear and does not reflect the new accounting under IFRS 17. For example, it states that "in-force DAC" will be deducted from available capital. However, for business measured under GMM or VFA, "in-force DAC" is not a balance sheet item (or component of any balance sheet item). Whilst a figure could be imputed from the amount of acquisition expenses which remain to be taken through (insurance service revenue and expenses in) the income statement, this figure is unlikely to be comparable across different firms. If reference / equivalence to the "insurance acquisition cashflows" as defined under IFRS 17 is instead intended, this should be clarified within the methodology, since DAC has a specific meaning under the previous IFRS standard but is not referenced in IFRS 17.

Under IFRS 17, the IASB requires that the contract acquisition costs related to the in-force business to be included in insurance contract fulfilment cash flows. Therefore, they do not constitute a separate asset in the balance sheet but are reflected in the overall insurance contract liability. This means that they are offset against the CSM. While AM Best recognizes the CSM as part of the economic capital, the netting of the contract acquisition costs with the CSM can be viewed as a 100% charge and would correspond with the AM Best approach to DAC treatment under IFRS 4. Any further action in this regard would lead to an unjustified double counting and is to be avoided.

Further, we understand that the proposed provisional methodology is to apply a 100% haircut to the "IFRS 17 DAC" (which relates to paid acquisition costs allocated to expected future new business) for P&C business. We are unclear on how the 100% haircut has been derived and we believe that, whilst a haircut to the balance could be justified, the exclusion of the full amount is overly penal as a requirement of IFRS 17 is that the asset is tested for recoverability each period.

4. Future Discretionary Benefits (FDB) and unallocated surpluses for participating business

Our view is that the expected value of future discretionary benefits ("FDB") included within technical provisions should be included within available capital. We strongly believe that FDB should be allowed for within available capital for the following reasons:

- The primary purpose of such contracts which contain FDBs is to share the losses and gains with policyholders, thus excluding this amount does not reflect the economic nature of the contracts.
- The FDB can absorb a wide range of shocks, such as adverse market movements, policyholder behaviour and to absorb adverse demographic experience.
- In the event of positive market movements, the exclusion of the FDBs leads to counter-intuitive outcomes from the capital model, as the risk capital would increase at a faster rate compared to the available equity, implying a worsening credit position when the opposite is true.

If, regardless of the above considerations, you determine that the available capital will not include the full expected value of the FDB, we believe at a minimum that it should allow for the benefit of the FDB included in the required capital in the regulatory position, e.g. Solvency II.

Further within the leverage ratio calculation, we would expect that the policyholder share of unallocated surplus, previously disclosed separately as the UDS under IFRS 4, be included within the denominator. Given the introduction of IFRS 17 should not lead to a change in the leverage ratio of a company, including this will

maintain consistency with the treatment under IFRS 4. However, it is recognised that some or all of this amount may be included implicitly within the fulfilment cash flows under IFRS 17. Therefore, we would propose that companies who wish to include this unallocated amount as an element of equity within their leverage ratio disclose this amount voluntarily within their IFRS financial statements, thus also making it subject to audit.

5. BCAR and SRQ disclosure requirements for discounting and risk adjustment

None of the documents shared provide with a comprehensive view of the BCAR input, output and calibration specific to IFRS17 reporting companies. We suggest that AM Best either amends the methodology with clear instructions on how IFRS 17 data are to be applied or issues a separate user manual for the application of the methodology with IFRS 17. Such clear and written guidance would support transparency with the industry and comparability across peers. We request a list of changes in the model to accommodate IFRS 17 inputs and how these influence the BCAR. For example, the impact of including the non-life risk margin in the reserves indirectly affects the reserve equity adjustment. As these changes have not been comprehensively communicated to the industry, the changes are intransparent, and there is a risk of being unaware of further implications of other unknown changes.

We understand based on recent communications that additional disclosures will be required showing the effect of discounting and the risk adjustment by line of business, and in-force DAC. We believe that these additional disclosures should not be mandated for the following reasons:

- There is limited insight that can be gained from having the information at this level of granularity compared to the significant effort that would be required to produce these disclosures.
- Judgement may be required in producing information at this level which could lead to spurious accuracy. An example of this is the risk adjustment which may be calculated at a higher level of aggregation requiring an allocation approach to obtain the information at the required level of granularity.
- We do not believe that reversing the discounting of non-life reserves and then discounting them again using flat AM Best discount rates is expedient. We consider the aim of achieving a level playing field and better comparability through this approach to be questionable as companies might use different approaches to generate these non-published figures. We would therefore suggest that the already discounted, audited and published non-life reserves should be used in the BCAR model. It would be in the interest of better transparency and comparability to simply adjust the discount factors in the model for IFRS17 reporting entities.
- In the case of in force DAC, as mentioned earlier, this is not a concept that is defined within IFRS 17 so is unlikely to be comparable across different firms.

6. Inconsistency in the tax treatment between available and required capital

Our view is that there should be consistency in the tax applied to both the available capital and required capital component. Where there is inconsistency, we believe that this poses the following issues:

- It could lead to those companies, which are subject to relatively high taxation, having a systematic disadvantage in comparison to companies that are located in low-tax countries. The difference in treatment based on geographical location is counterintuitive, given the different tax rate does not impact either counterparty or credit risk for policyholders and bondholders.
- It does not reflect within the risk-based capital calculation that any losses incurred can reduce future tax payments and partially compensate the impact on capital.

For the above reasons we expect that the tax applied to available capital and required capital should be included on a consistent basis - either both gross or both net of tax.

Yours sincerely,

Alban de Mailly Nesle
Chair
European Insurance CFO Forum

About the European Insurance CFO Forum and its work

The European Insurance CFO Forum ('CFO Forum') is a high-level discussion group formed and attended by the Chief Financial Officers of major European listed, and some non-listed, insurance companies. Its aim is to influence the development of financial reporting, value based reporting, and related regulatory developments for insurance enterprises on behalf of its members, who represent a significant part of the European insurance industry. The CFO Forum was created in 2002.

From:
Sent: Wednesday, March 27, 2024 5:46 PM
To: Methodology Anonymous
Subject: AM Best Requests Comments on application of Best's Credit Rating Methodology to IFRS17

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Dear all,

With reference to your request for comments on the IFRS 17 treatment in AM Best's methodology we would like to address the below outlined comments on 1. CSM and RA classification as equity and 2. Disclosure requirements for discounting and RA under IFRS 17.

Classification of the CSM and RA as forms of equity

We understand that the proposed provisional methodology is to typically consider no more than half of the CSM and RA as being equivalent to equity, with a possible range of between 40% - 65% for specific well-defined cases. We believe that the CSM and RA should be viewed as equity and thus should be included at 100% and not be subject to any constraints for the following reasons:

- The CSM can be made available for loss absorption within a reasonable time frame, either by the very fact it will directly absorb non-financial changes and financial changes (for participating contracts) in the fulfilment cash flows relating to future service, or by its ability to be monetised within an adequate time frame via sale of the portfolio.
- In a purely economic valuation method, the full economic value creation would be shown already at initial recognition (increasing equity), whereas any experience and/or changes in non-economic assumptions would be part of the P&L of future periods (adjusting the equity position). As this comes with increased volatility in a long-term business model like (re-)insurance, the CSM and similarly the Risk Adjustment mechanic was introduced as a deferral concept in IFRS17 for profits from business that is already incepted. However, an economic assessment should fully reflect those deferred profits as a strong contribution to the company's capital position.
- The RA represents explicit prudence which should be expected to be released as profit in future years,
- The CSM and RA is explicitly disclosed within the financial statements, and subject to significant audit scrutiny. In particular, auditors will consider the methodology applied and any key judgements in its calculation.
- Inclusion of the CSM and RA within available capital would be consistent with the methodology adopted by S&P within the risk-based capital ("RBC") adequacy and ensure alignment in its treatment.
- Further, it would be more in line with other regulatory regimes (Swiss Solvency Test, Solvency II), where the VIF is fully recognised as available capital.

We also understand based on recent communications that the financial leverage ratio (adjusted and unadjusted) will take into consideration the CSM. However, we believe that the CSM and RA (both net of tax) should be included at 100% along with reported shareholders equity as capital. Excluding these items:

- Results in a calculation that is not agnostic to the accounting regime applied by an insurer. Reported shareholders equity will vary depending on the accounting methodology and calibration and will also change significantly for those recognising a CSM while the economics are unchanged.
- Reduces transparency if there are qualitative considerations of CSM and RA.
- Increases uncertainty for stakeholders.

BCAR and SRQ disclosure requirements for discounting and risk adjustment

None of the documents shared provide with a comprehensive view of the BCAR input, output and calibration specific to IFRS17 reporting companies.

We understand based on recent communications that additional disclosures will be required showing the effect of discounting and the risk adjustment by line of business, and in-force DAC. We believe that these additional disclosures should not be mandated for the following reasons:

- There is limited insight that can be gained from having the information at this level of granularity compared to the significant effort that would be required to produce these disclosures.
- Judgement may be required in producing information at this level which could lead to spurious accuracy. An example of this is the risk adjustment which may be calculated at a higher level of aggregation requiring an allocation approach to obtain the information at the required level of granularity.
- We do not believe that reversing the discounting of non-life reserves and then discounting them again using flat AM Best discount rates is expedient. We consider the aim of achieving a level playing field and better comparability through this approach to be questionable as companies might use different approaches to generate these non-published figures. We would therefore suggest that the already discounted, audited and published non-life reserves should be used in the BCAR model. It would be in the interest of better transparency and comparability to simply adjust the discount factors in the model for IFRS17 reporting entities.
- In the case of in force DAC, as mentioned earlier, this is not a concept that is defined within IFRS 17 so is unlikely to be comparable across different firms.

Thanks for giving the opportunity to comment on AM Best's methodology and we would very much appreciate if those are taken into consideration.

Kind regards,

From: [redacted]
Sent: Wednesday, March 13, 2024 2:53 AM
To: Methodology Anonymous
Cc: [redacted]
Subject: RE: AM Best Requests Comments on Application of Best's Credit Rating Methodology to IFRS 17-Reporting Companies

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Dear AM Best team,

Thanks for sharing the below request. We do have some questions regarding the application of the rating methodology to IFRS17 reporting companies. While we are happy that our questions and comments to be made public, we would like to keep our **company's name and contact details anonymous**.

1. How the economic capital will be calculated and whether it will be used to calculate the financial leverage.
2. To the extent that the BCAR calculation will now incorporate IFRS17 financials; it makes sense that premium risk calculation (for example) uses net revenue as its exposure measure. At the same time, we observe that the $ net revenue in the IFRS17 income statement may be lower than the existing exposure measure (i.e. NPW) due to the need to net-off fixed commissions when calculating the revenue in IFRS17. As a result, we assume that any such change will be mirrored by AM Best reviewing the associated % risk charge recalibrations?
3. Under IFRS17 the $NAV on the balance sheet is affected directly by the $ risk adjustment carried within the liabilities balance. Given that IFRS17 rules allow firms are to select their own view of the probability of adequacy linked to the risk adjustment, how will AM Best normalize the varying risk adjustment adequacy levels adopted in practice?
4. We recognize that many P&C companies will elect to use PAA accounting method and that where this happens there is no requirement to compute a $CSM in the balance sheet presentation. At the same time, PAA use is subject to eligibility criteria and we note that it is significantly harder to justify PAA use by dedicated reinsurers because 1 year proportional treaty business (for example) will typically imply an IFRS17 coverage period of 2 years given the period associated with the underlying business bound by a reinsurer's client. Consequently, many reinsurers will be exclusively using the GMM measurement model and therefore the $CSM is available. More to the point, the $CSM is likely to be material and therefore it seems penal to ignore this under an economic assessment of capital.
5. We think 100% of the CSM should be permitted and we're unsure on the rationale for only recognising 50% of CSM as economic capital? For example, in the case of a P&C writer the $CSM can be reasonably expected to crystalise over a short time frame. In contrast, while we acknowledge that traditional L&H companies may be booking a $CSM reflective of many years' future profit; the use of discounting means that there is a reduction for more distant profit cashflows; so similarly it seems penal to ignore such profits under an economic framework.

We would appreciate if you could share with us your replies to the above questions.

With thanks and regards,