MILLIMAN SURVEY RESULTS

IFRS 17 in Portugal: A general overview after implementation

Status and outlook one year after the standard's adoption

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The global implementation of the IFRS 17 accounting and reporting standard has posed a significant challenge for insurance companies everywhere—and Portugal is no exception. To better understand the status of this standard's adoption and the progress companies have been making, we surveyed leading industry professionals to explore key aspects of IFRS 17 implementation, including the valuation methodologies chosen, their organizations' understanding of the standard, and the main challenges encountered in the adaptation process.

Our research aimed to form a comprehensive view of the progress of transition to IFRS 17 in Portugal, identifying both best practices and areas requiring further attention. The questions ranged from general aspects of implementation to more specific questions about the valuation methodologies adopted and the level of familiarity with the standard's technical requirements.

The survey included participants representing 70% of total reserves in the Portuguese market in 2024, ensuring a representative sample of the Portuguese market.

We hope the results will provide a solid basis for assessing Portugal's IFRS 17 adoption and the resources needed to refine its implementation in the future. While the focus has been on the Portuguese market, we believe these insights can be useful in other markets as well.

General

This section covers general questions about IFRS 17.

QUESTION: WHICH ACCOUNTING APPROACH HAS BEEN SELECTED FOR THE IFRS 17 CLOSING?

92%

Year-to-date

The year-to-date approach is the method of choice, with only 8% of respondents choosing the period-to-period accounting approach.

The year-to-date method is an accounting approach that always starts from the last year-end closing figures as the opening position, regardless of the actual calculation and reporting frequency (monthly, quarterly, etc.), reconstructing everything that happened since that moment up to the current reporting date. Conversely, the period-to-period approach always starts from the last reported closing figures as the opening position (e.g., previous quarter or month closing).

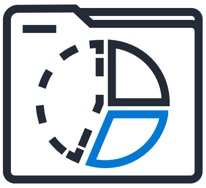
In case of annual reporting frequency, these two approaches are equivalent. In case of more frequent reporting (e.g. quarterly), however, the disadvantage of the period-to-period approach is that it can generate more perceived volatility if there are substantial changes between the two closings. In extreme cases, one can even face situations where some groups of insurance contracts may go from onerous to profitable (or the other way around) and back multiple times during a year. In the case of the year-to-date approach, by reconstructing everything from the last annual close, these problems are usually limited, making the results more stable.

QUESTION: WHICH SOFTWARE DO YOU USE AS A DASHBOARD TOOL FOR IN-DEPTH ANALYSIS OF IFRS 17?

70%

Excel dashboard

Most use Excel as their main in-depth IFRS 17 analysis tool, while only 15% use a more complex dedicated tool.



Based on the results of the survey, we observe that actuaries continue to primarily use Excel for IFRS 17 analysis. In the vast majority of surveyed cases, the tool used for analyzing IFRS 17 results is based on spreadsheets. Time will tell if this is just a temporary situation due to recent IFRS 17 adoption. Given room for improvement in understanding the reported figures (see following questions), perhaps companies will upgrade to a more robust dedicated tool over time.

QUESTION: WHAT TYPE OF BUDGETING TOOL DO YOU HAVE IN PLACE UNDER IFRS 17?

54%

In-house business plan tool

Only 15% use a vendor solution, and 31% do not have any IFRS 17 business planning tool yet.

IFRS 17 business planning is a process of projecting the company's IFRS 17 balance sheet and profit-and-loss statement in line with its expected business plan. There are different approaches that can be used for this purpose, although typically companies employ a mixed real-world projection and a risk-neutral valuation approach using their cash-flow projection model as the underlying data source combined with actual accounting data. As we see from the survey results, IFRS 17 business plan is in most cases done by a dedicated in-house tool. In almost one-third of the cases, however, no specific tool has been reported, presumably meaning companies are using ad hoc Excel reporting.

IFRS 17 process

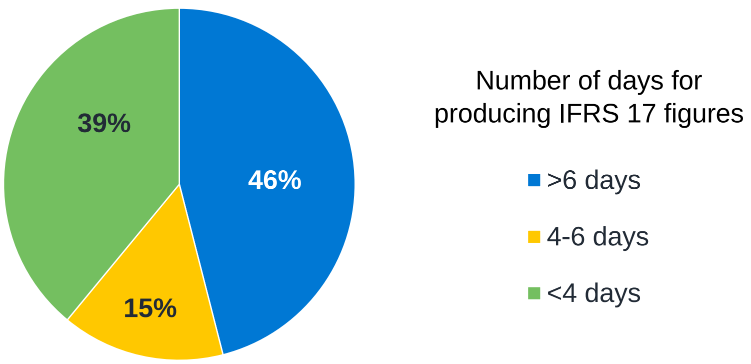
This section covers the time spent by the respondents producing and analyzing IFRS 17 figures.

In this section, respondents have been asked about the time spent producing and analyzing IFRS 17 results.

By producing results, we refer to the process of generating cash flows in the projection models, defining the discount curves to be used, generating the accounting 'actuals' data, calculating the movements in the CSM, obtaining the profit-and-loss statement and producing the IFRS 17 balance sheet.

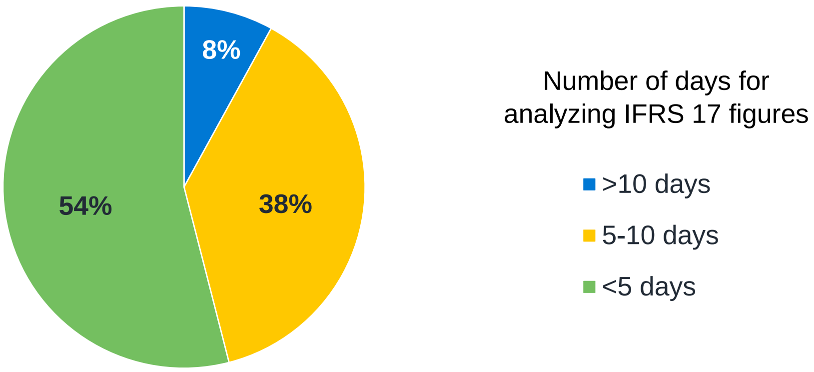
By analysis of the results, we refer to the steps leading to understanding the figures and becoming comfortable with them, e.g. checking the overall consistency of the results obtained, such as the consistency of the CSM movement with accounting movements and changes in future cash flows, the impacts on the income statement and the consistency of official reporting disclosures.

QUESTION: HOW LONG DOES IT TAKE TO PRODUCE THE IFRS 17 FIGURES WITHOUT INCLUDING THE ANALYSIS OF THE RESULTS?



Nearly half of the respondents stated that they need more than six days to produce the results. Due to the tight time frames for completing accounting closings, we believe optimization mechanisms should be implemented to reduce the time required. On the other hand, nearly 40% already use less than four days, which we consider to be an efficient time frame.

QUESTION: HOW LONG DOES IT TAKE YOU TO ANALYZE THE IFRS 17 FIGURES?



On the other hand, most of the respondents spend up to four days analyzing the figures to feel comfortable with the results.

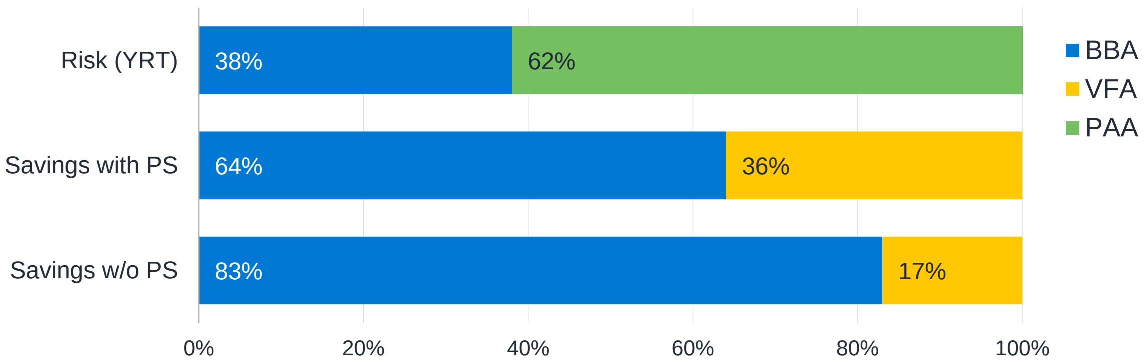
When examining the results on an individual company basis, it becomes evident that most organizations spend less time producing IFRS 17 results than analyzing them. Only in cases where the production of results takes more than six days do some companies spend comparatively less time on analysis. This may suggest a need for optimization in the IFRS 17 results calculation processes to free up more time for the analysis phase.

IFRS 17 methods

This section covers IFRS 17 valuation and transition methods by business type.

VALUATION METHODS

QUESTION: WHAT IFRS 17 PRIMARY METHODS HAVE YOU CHOSEN FOR DIFFERENT LINES OF BUSINESS?



We have broken down the saving business into two separate categories: saving business without profit sharing and saving business with profit sharing. In general, the saving business has been mostly valued using the Building Block Approach ("BBA") method.

- In the case of products without profit-sharing, 83% applied the BBA method. The remaining 17% indicated that they complied with the eligibility test for Variable Fee Approach ("VFA") method. However, only 50% of respondents had saving products without profit-sharing in their portfolios.

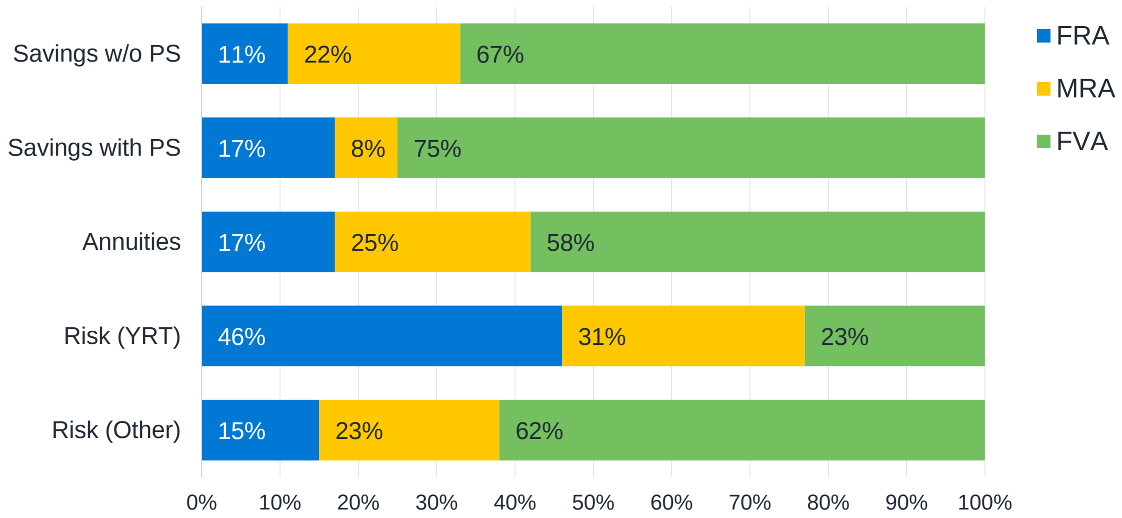
- In the case of products with profit-sharing, 64% applied the BBA method. For this line of business, the market has chosen to call it "*modified BBA*." This is due to a number of adjustments to the general method that must be made to avoid considering financial risks stemming from profit-sharing in the Contractual Service Margin ("CSM") calculation. The remaining 36% complied with the requirements for the VFA approach.

In the case of yearly renewal term (YRT) risk products, 62% have decided to apply the Premium Allocation Approach ("PAA") approach. The PAA is a simplified approach primarily applied in non-life business, and it is very similar to the IFRS 4 profit-generation method for natural premiums. The remaining 38% have applied the BBA method. A probable explanation for this could be not applying contract boundaries and projecting future premiums, thus incorporating the future profit into the CSM.

With regards to unit-linked business, only one respondent includes unit-linked in the IFRS 17 scope. Majority of the companies have chosen to value it under IFRS 9, which is contingent on the lack of insurance risks included in the contracts.

TRANSITION METHODS

QUESTION: WHAT IFRS 17 TRANSITION METHODS HAVE YOU CHOSEN FOR DIFFERENT LINES OF BUSINESS?



Due to difficulties obtaining complete historical information necessary to apply the full retrospective approach ("FRA") or partial historical information to apply the modified retrospective approach ("MRA"), most respondents opted for the fair value approach ("FVA") at transition for most types of products.

The YRT risk business is the only line of business for which the FRA method was chosen by most companies (46%). This is directly related to the choice of the PAA method (see previous section), since its simplified calculation makes it much easier to apply FRA.

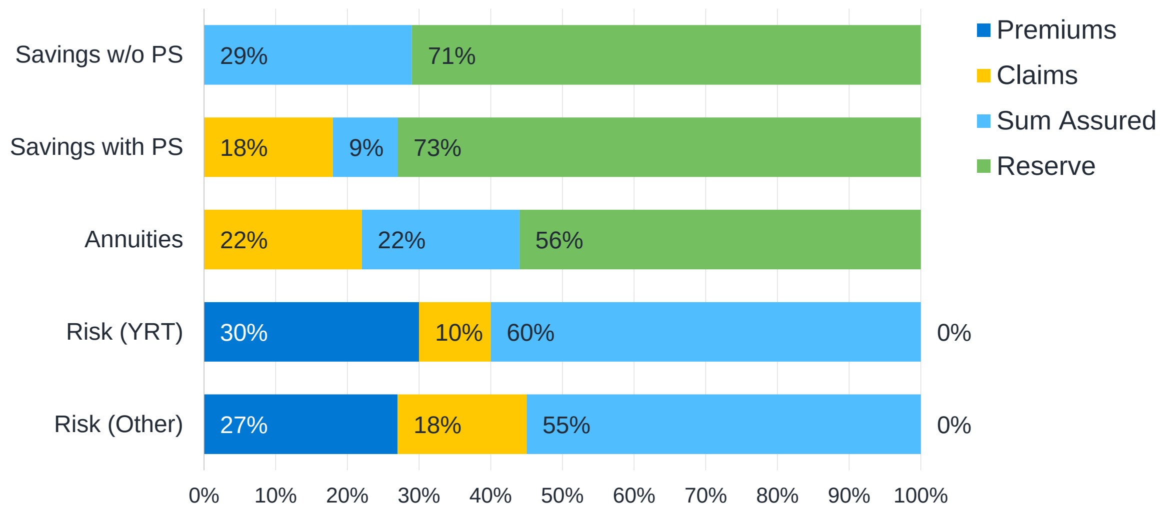
However, choosing the FVA method is also not trivial, as it has significant implications for the CSM obtained at transition. In the Portuguese market, in simplified terms, applying the Fair Value Approach would result in a small CSM in comparison with the use of the Modified Retrospective Approach. In various other countries the application of the Fair Value Approach resulted in more substantial CSM amounts and represents more than 40% of the total CSM per year end 2024.

Coverage units

This section covers questions about IFRS 17 coverage units.

IFRS 17 standard requires to release the profit included in the CSM as the insurance service is provided. The provision of this service is measured using the concept of coverage units. Coverage units refer to the method and metric used to quantify the amount of service provided and are used to determine the appropriate release of the CSM over time in the BBA and VFA models. In each closing, the CSM release rate is calculated based on the comparison between the coverage units of the current reporting period and the coverage units of the remaining future service.

QUESTION: WHAT IFRS 17 COVERAGE UNITS HAVE YOU CHOSEN FOR DIFFERENT LINES OF BUSINESS?



Reserves clearly dominate as the main choice of coverage unit for the saving and annuity businesses, while for the risk business (both YRT and other traditional risk business) sum assured is used most, followed by premiums. In each case, the second choice is at most at half the popularity, compared to the first one.

QUESTION: DO YOU APPLY DISCOUNTING ON COVERAGE UNITS?

54%

Discount CU

Accelerating profit recognition (through the CSM release) in the first years.

The decision to use discounting on the coverage units of the remaining service has a clear benefit of allowing an earlier profit recognition, due to an earlier release of the CSM. However, only slightly more than half of the respondents decided to go down this path. The decision not to discount the coverage units may stem from various factors. These range from strategic financial choices such as avoiding excessive up-front profit recognition and mitigating the risk of future volatility (leading to a loss recognition) to purely technical or operational limitations within the IFRS 17 results-generated systems used by the participants.

QUESTION: IN SAVINGS PORTFOLIOS VALUED UNDER VFA, IS ANY ADJUSTMENT BEING APPLIED TO AVOID SLOWING DOWN THE RELEASE OF THE CSM ('BOW WAVE EFFECT')?

0%

Bow wave

None of the respondents that apply VFA are applying an adjustment to increase CSM release due to the bow wave effect.

The term 'bow wave effect' is used to describe the behavior of CSM under the VFA method. Specifically, this term refers to the difference between how the CSM is accrued and how the profit is released in the income statement, if the contract's initial valuation is done by projecting risk-free investment returns, but the actual profit uses risk-adjusted investment returns. The accrual of the CSM at each reporting date reflects the total return of the underlying items.

Therefore, in such case, at each closing date, the CSM grows at a higher rate than initially estimated, as well as with the growth due to the release of the time value of future options and guarantees ("TVFOG"), resulting in a cumulative increase in the expected future profits to be earned on the contracts. This distorts the initial profit pattern.

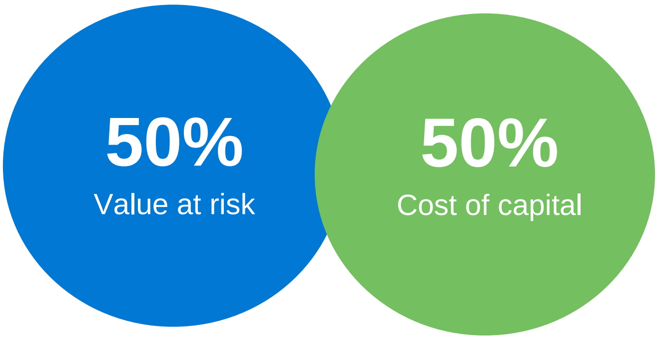
There are several mechanisms that allow companies to smoothen the result over time and avoid the deferral of the profit. Those mechanisms increase the coverage units of the current reporting period, relative to the remaining future service, in order to increase the amount of CSM released in the current period. Based on the results of the survey, it remains an opportunity for the companies in the Portuguese market to improve their projected P&L under IFRS 17.

Risk adjustment

This section covers methodologies for risk adjustment calculation.

METHODOLOGY APPLIED

QUESTION: WHAT METHODOLOGY DO YOU USE TO CALCULATE THE RISK ADJUSTMENT?

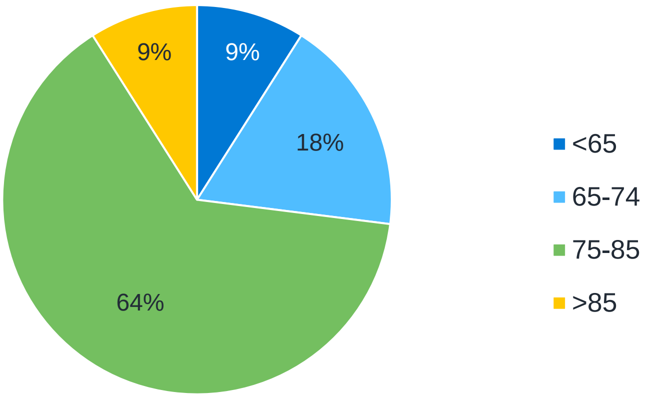


The risk adjustment calculation methodology is not explicitly defined in IFRS 17. However, the market has primarily used two methodologies: the value-at-risk (VAR) methodology (which is similar to the shock-adjusted underwriting SCR calculation) or the cost-of-capital (COC) methodology (which is similar to the calculation of Solvency II's risk margin).

We can clearly see there is no winner among these methodologies. What is worth noting is that even though applying a different methodology is allowed by the standard, none of the respondents has chosen that path, what is consistent with what we observe in the vast majority of European markets.

CONFIDENCE LEVEL

QUESTION: WHICH CONFIDENCE LEVEL ARE YOU USING FOR THE RISK ADJUSTMENT CALCULATION?

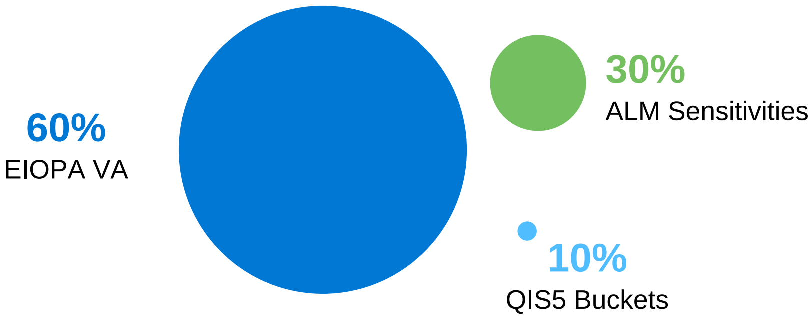


The vast majority of respondents apply a confidence level between 75% and 85%. Respondents who selected the COC approach are more likely to apply a higher confidence level.

Financial topics

This section covers methodologies regarding the OCI option and the discounting illiquidity premium.

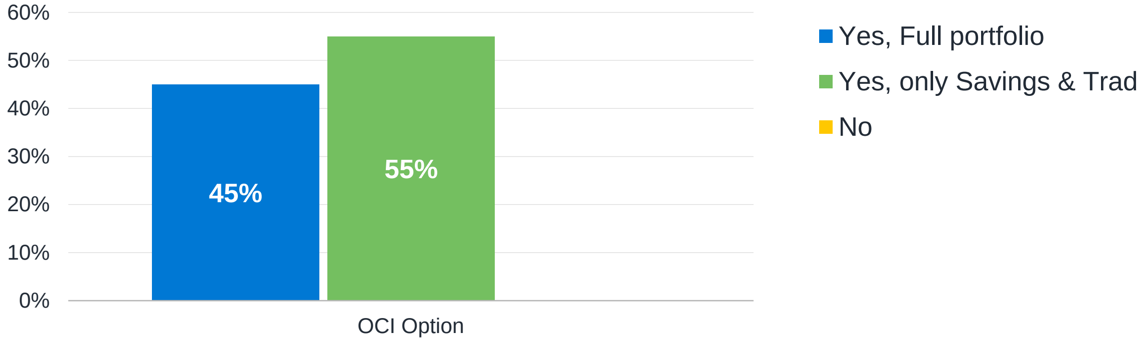
QUESTION: WHICH METHOD DO YOU USE TO CALCULATE THE ILLIQUIDITY PREMIUM REQUIRED IN THE DISCOUNT CURVES?



As in the case of the risk adjustment methodology, the standard does not clearly specify the method of calculation for the illiquidity premium to be included in the discount curve. Presumably, for practical reasons of reusability and simplicity, most of the respondents are using EIOPA's volatility adjustment as the main approach for the IFRS 17 illiquidity premium. There is, however, a small number of respondents who are using the QIS5 fixed percentages depending on the business type.

The ALM sensitivities option is related to the analysis of the company's portfolio—both assets and liabilities—to derive a company-specific illiquidity premium. This illiquidity premium is typically determined by type or line of business. This option generates the highest workload, but also is the most accurate, as it uses own portfolio information.

QUESTION: ARE YOU APPLYING FOR THE OCI OPTION FOR ANY OF YOUR LINES OF BUSINESS? SELECT ALL THAT APPLY.



The other comprehensive income (OCI) option under IFRS 17 refers to the accounting choice that allows entities to present the effects of changes in financial assumptions—specifically discount rates—in profit, loss or other comprehensive income. When the OCI option is elected, changes in the present value of future cash flows due to movements in the discount rate or due to profit sharing are recognized in OCI, rather than affecting the insurance financial income and expense in the profit or loss statement.

This option is particularly relevant for insurers aiming to reduce volatility in the income statement caused by interest rate fluctuations. It aligns the presentation of insurance liabilities with the accounting treatment of assets measured at fair value through OCI under IFRS 9, promoting consistency in financial reporting.

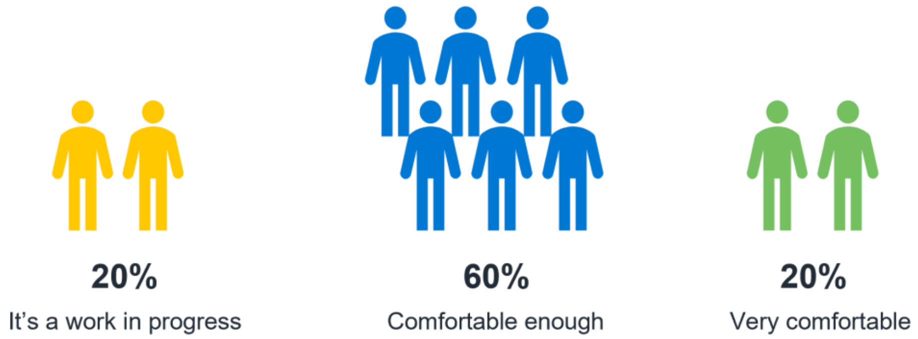
All the respondents are eligible to apply for the OCI option, either for their full portfolio or only for savings and traditional business. All of them decided to apply for it, in line with their eligibility.

IFRS 17 knowledge

This section covers understanding of the different IFRS 17 areas.

GENERAL CALCULATIONS

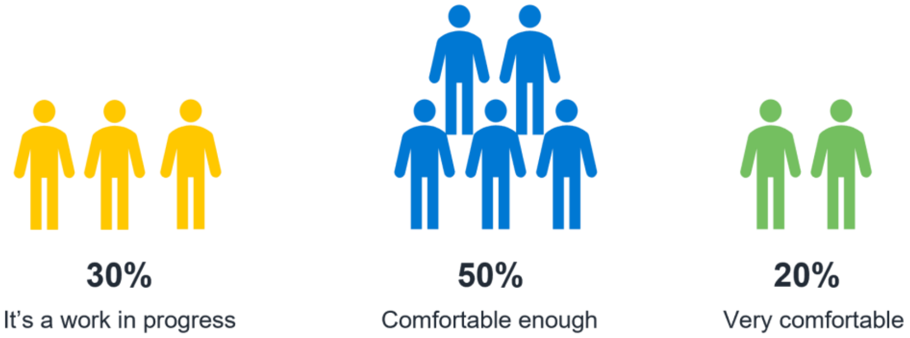
QUESTION: HOW COMFORTABLE IS YOUR TEAM WITH THE IFRS 17 CALCULATIONS?



Sixty percent of respondents claim they feel fairly comfortable with their process of producing IFRS 17 results, while the remaining are equally split between feeling very comfortable and those still in the learning process.

INCOME STATEMENT

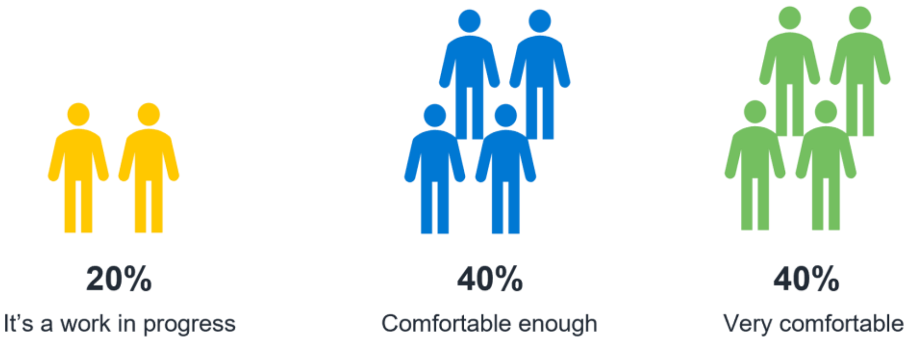
QUESTION: HOW COMFORTABLE IS YOUR TEAM WITH THEIR UNDERSTANDING OF THE INCOME STATEMENT UNDER IFRS 17?



Fifty percent of respondents claim they feel comfortable enough with their understanding of the income statement of IFRS 17. In the remaining group, the majority feel that there is still some room for improvement in this area.

LOCAL GAAP BRIGDE

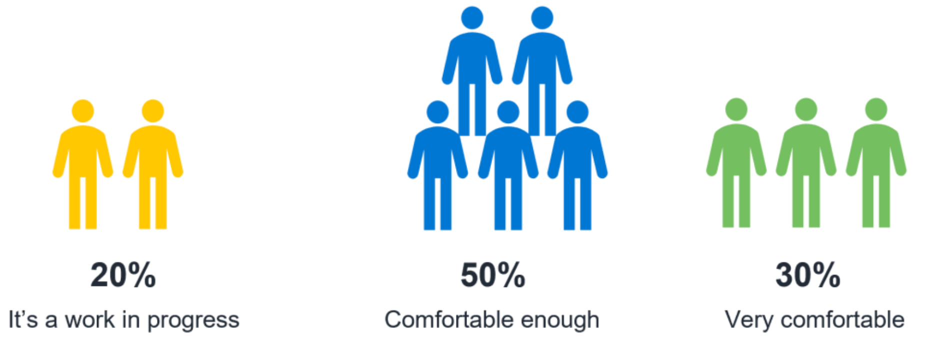
QUESTION: HOW COMFORTABLE IS YOUR TEAM WITH THEIR UNDERSTANDING OF THE DIFFERENCES IN FIGURES BETWEEN LOCAL GAAP AND IFRS 17?



Forty percent of respondents claim they feel comfortable enough with their understanding of the bridge between the results under the previous reporting standard (IFRS 4) and the new one (IFRS 17). An equal proportion feels very confident about it, and only twenty percent feel they should still improve their understanding in this area.

SII BRIGDE

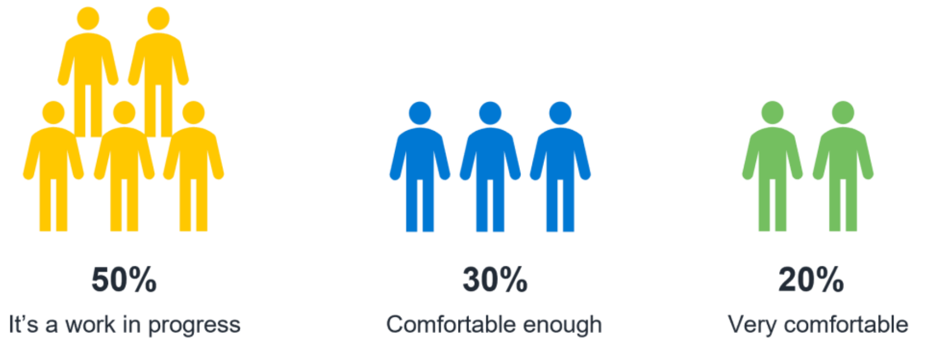
QUESTION: HOW COMFORTABLE IS YOUR TEAM WITH THEIR UNDERSTANDING OF THE BRIDGE BETWEEN SII AND IFRS 17?



Half of the respondents claim they feel comfortable enough with their understanding of the bridge between the results under Solvency II and the new accounting standard (IFRS 17). In the remaining group, the majority feel very confident about it.

DISCLOSURES

QUESTION: HOW COMFORTABLE IS YOUR TEAM WITH THEIR UNDERSTANDING OF THE OFFICIAL IFRS 17 DISCLOSURES?



While generally respondents feel comfortable enough with their teams' knowledge of IFRS 17, this remains an area of the biggest uncertainty, with half of our respondents seeing potential for improvement in their understanding of the IFRS 17 disclosures.

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