AcSB
Accounting Standards Board

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ASAF

IFRS 17 Implementation Experience

Disclaimer
This slide deck has been prepared by the staff of the Canadian Accounting Standards Board (AcSB) to facilitate a discussion and does not represent the views of the AcSB. Comments on the application of IFRS Accounting Standards do not purport to set out acceptable or unacceptable application of IFRS Accounting Standards.

Background and purpose of this discussion

- IFRS 17 *Insurance Contracts* came into effect on January 1, 2023.
- The purpose of this discussion is to **share Canadian insurers' implementation experience** from the first year and a half of reporting under IFRS 17, including challenges identified. We think this information can help the IASB assess whether/how the objectives of IFRS 17 are being achieved, and inform its eventual post-implementation review.
- In addition, we would like to **understand how these experiences compare to other jurisdictions**.

IFRS 17 implementation in Canada

In Canada, all entities that meet the publicly accountable definition must apply IFRS Accounting Standards

All insurers, whether publicly listed or not, transitioned to IFRS 17

As a result, over 250 insurance entities transitioned to IFRS 17 in Canada*

The insurance industry represents a significant portion of the market capitalization in Canada

The top four insurers alone represent a market capitalization of CAD $193.3B

*Obtained from Canadian Life and Health Insurance Association and Insurance Bureau of Canada Fact Books 2023

Transition came with both benefits and challenges

Benefits

- **Increased transparency**
  more intuitive P&L for insurance results and increased disclosures
- **Greater consistency**
  similarities to other Standards (e.g., IFRS 15 *Revenue from Contracts with Customers*)
- **Operational improvements**
  systems improvements and enhanced cross-departmental, cross-regional collaboration

Challenges

- **Complexity**
  significant judgment required, steep learning curve for both preparers and users
- **Data intensity**
  increased granularity and systems demands
- **Resource investment**
  substantial costs and employee time
- **Applicability to non-insurers**
  challenging to navigate the various scope provisions

What we heard from analysts

AcSB staff spoke with analysts who cover both life & health (L&H) and property & casualty (P&C)† insurers to ask for their views on IFRS 17 reporting. Here is what we heard:

- The separation of investment and insurance results under IFRS 17 is useful
- Many analysts appreciate Canadian insurers' "Drivers of Earnings" non-GAAP measure and prefer it over the P&L
- Some analysts like that profit is no longer front-ended and instead goes into CSM*
- Analysts are not using all the IFRS 17 disclosures – it is not feasible to go through these details in time to write their reports
- Some policy choices/areas of judgment make it challenging to compare insurers
- For analysts, IFRS 17 was not as important a change for P&C, so some P&C insurers are "reversing out" IFRS 17 so results look similar to before (more useful)
- There are some areas where more education may help users (e.g., treatment of experience adjustments, nuances between GMM and VFA*)

† P&C insurance is also referred to as general insurance

*CSM = contractual service margin
GMM = general measurement model
VFA = variable fee approach

New Standard, new non-GAAP measure

- Canadian insurers have historically used non-GAAP measures to provide information on the sources of earnings under a prescribed format.
- Upon adopting IFRS 17, several publicly listed Canadian insurers developed a new common approach to disclose drivers of earnings in an effort to provide relevant and consistent information to users.
- Such non-GAAP measures are important because the IFRS 17 results are not always as intuitive or as meaningful to users as they could be. For example:
  - Reporting direct business and reinsurance held business on a gross basis may not be as intuitive as a net basis.
  - Knowing the source of investment results, and not just what the net number is, would be meaningful to users.

A sample of the challenges we have encountered

- Reinsurance held accounting
- Annual cohorts
- Disaggregation of liability roll-forward tables
- Interim financial statements for multinationals
- Disconnect between mortality and longevity
- Locked-in vs. current discount rates

A summary of these is included in this slide deck

- Contracts acquired in their settlement period

We will walk through this issue in more detail

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Summary of key challenges (1/2)

Reinsurance held accounting

- The current guidance continues to **give rise to mismatch issues in practice**
  - Ex. 1: An entity cedes 100% of a direct contract in an asset position to a reinsurer. Economically, this should net off, but it does not under IFRS 17 as reinsurance held cannot be onerous.
  - Ex. 2: An entity has two subsidiaries, where one reinsures the other's VFA contracts. Under IFRS 17, reinsurance held cannot be measured using VFA, so the subsidiaries incur extra costs to produce figures that would just be eliminated upon consolidation. The difference in measurement models does not reflect the fact that this is a transaction between entities under common control.

Annual cohorts

- As time passes, maintaining a growing number of cohorts containing fewer contracts **becomes very costly** (e.g., data storage costs) **with diminishing value to users**
- This issue is amplified for long-term business and with quarterly reporting in Canada (managing quarterly cohorts)

Liability roll-forward tables

- Depending on how the requirements are interpreted, these disclosures can be quite granular and extensive
- E.g. may have a table for each reporting segment, for each of direct business and reinsurance held, for each quarter and each year-to-date period reported
- These detailed disclosures are **not widely used by analysts**

Summary of key challenges (2/2)

Interim financial statements

- Multinational entities often have subsidiaries/branches subject to different reporting frequencies from the parent (e.g., parent quarterly vs. subsidiary annually)
- Some interpret IFRS 17.B137 to mean a subsidiary would have to produce IAS 34-compliant interim financial statements or keep two sets of estimates (one quarterly and one annual) – both are **costly and burdensome**

Mortality losses/longevity gains disconnect

- All insurance experience that results in a change in future cash flows (e.g., due to a death claim) goes through CSM rather than earnings (where the related death claim is reported)
- This creates a disconnect between revenue and expenses, and has caused some insurers to enter into reinsurance arrangements that they otherwise would not (accounting driving the economics)
- This **disconnect has been flagged by users** and is inconsistent with other Standards (e.g., IFRS 15 where revenue is recognized when the related performance obligation is completed)

Locked-in vs. current rates

- Fulfillment cash flows (FCF) are measured using current rates, whereas CSM interest accretion is determined using locked-in rates from initial recognition of the contract
- The impact of non-financial experience on FCF impacts the CSM, but is determined by using locked-in rates rather than current rates
- This **can lead to unintuitive impacts** when current rates are materially different from locked-in rates

Spotlight: contracts acquired in their settlement period

Issue

- Relates to the accounting for short-term contracts with long-tail claims, when they are acquired in their settlement period through a business combination in the scope of IFRS 3
- Under IFRS 17:
  - acquiree (issuer) treats these as LIC*
  - acquirer treats these as LRC* (insured event is the adverse development of incurred claims)
- For P&C insurers that otherwise only apply the premium allocation approach (PAA), the change to LRC would require implementing GMM (very costly)
- Results in insurance revenue being booked twice for the same underlying contract

IASB deliberations

- IFRS 17.C9A enabled entities to classify these contracts as LIC, only at transition
- The IASB considered whether to expand this beyond transition in January 2020 IASB AP2C, but was concerned about:
  - needing to change the definition of an insured event
  - how to account for the difference between the consideration and FCF, if not as CSM
- IASB concluded that exempting these contracts from the general requirements in IFRS 17 would create complexity for users and reduce comparability with requirements for other transactions (Project Summary and Feedback Statement on IFRS 17 Amendments)

*LIC = liability for incurred claims
LRC = liability for remaining coverage

How is this different from other interactions with IFRS 3?

Changing models

Some P&C insurers have had to implement GMM when they otherwise only use PAA (simplified model), only to reverse the effects through non-GAAP measures.

We heard from analysts that the use of different models (GMM vs. PAA) adds complexity to an already complex Standard. For a P&C insurer that only uses PAA, requiring GMM for these contracts (if they are to be classified as LRC) adds unnecessary complexity.

Decreasing usefulness

We heard from users that changing from LIC to LRC is not meaningful to them because in their view, the economics of these contracts have not changed.

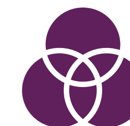
Insurers are backing out these effects through non-GAAP measures, which users support.

This signals that it may not be useful to align the accounting for insurance contracts acquired in their settlement period with other types of acquired contracts.

Driving the economics

This accounting requirement is driving the economics, as P&C insurers noted that:

- it may deter acquisitions;
- it may lead to acquiring contracts instead of businesses; and
- they may be willing to pay more if the issuer keeps old claims (to avoid the accounting).



Reducing comparability

This treatment reduces comparability with issued contracts because:

- unlike other issued contracts, the revenue does not come from premiums; and
- for a given entity, contracts acquired in their settlement period would be treated as LRC whereas issued contracts in their settlement period would be treated as LIC .

Wrap-up

- We recognize that there have been many benefits of IFRS 17, including improving transparency and comparability.
- We look forward to any opportunities to work with the IASB to better achieve these objectives and to address some of the challenges identified when it begins preparing for the post-implementation review.