Deloitte.

IFRS 17 Business Impacts

Originally published in MSA Quarterly Outlook Report Q2-2018, published by MSA Research Inc.,
a Canadian-owned, independent analytical research firm focused on the Canadian insurance industry.
www.msaresearch.com/outlook

Introduction

Background

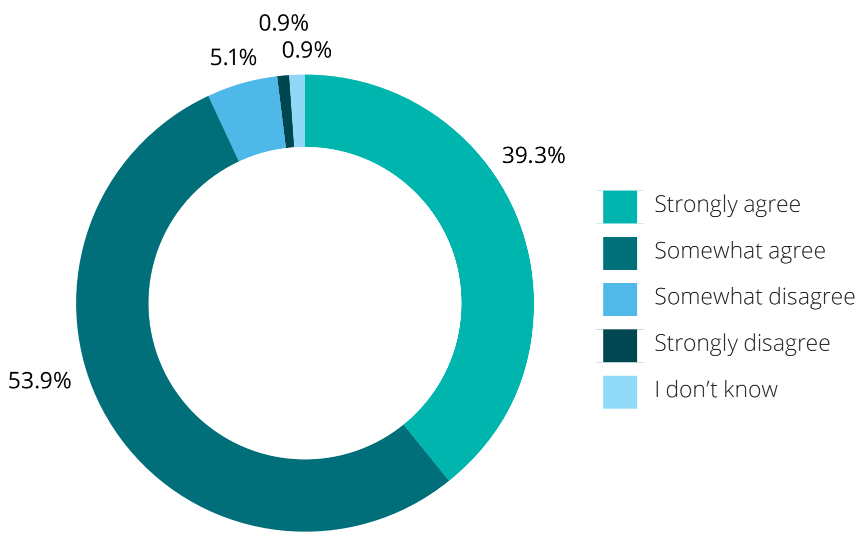
In the year since the International Accounting Standards Board (IASB) issued the Insurance Accounting Standard known as IFRS 17, various insurance industry and professional forums, globally and in Canada, have clarified IFRS 17's requirements—and there are more practical and business implications for Canadian Property & Casualty (P&C) insurers than was originally thought.

The 2018 Deloitte IFRS 17 global survey[1] (the Survey) results reveal that over 50 percent of global and Canadian insurers somewhat agree that the benefits of IFRS 17 outweigh the expected costs. Sixteen percent of Canadian insurers strongly agree with this as compared to almost 40 percent of the global insurers. About 28 percent of Canadians disagree that the benefits outweigh the costs, while only 5 percent of global insurers have the same view.

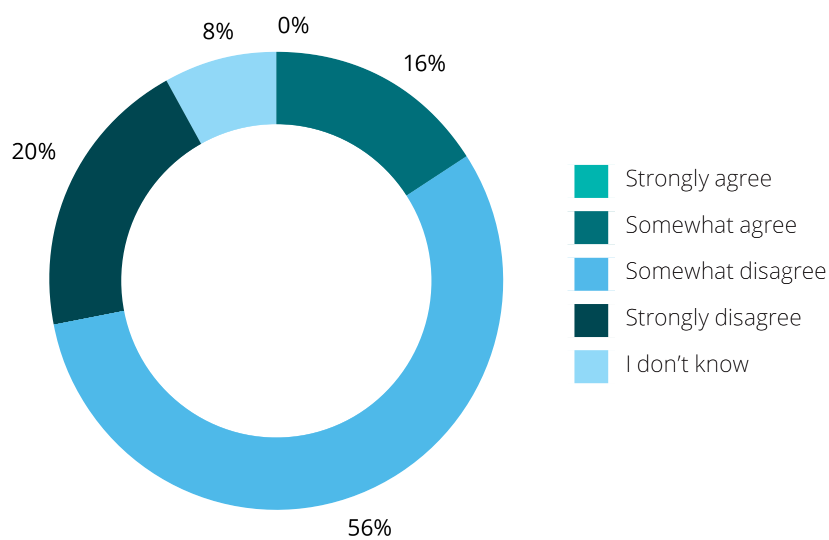
Global respondents are budgeting to spend from $7.5 million to over $150 million on IFRS 17 compliance. This certainly indicates the implications of IFRS 17 go beyond the mere revision of financial statements. And it's in stark contrast to what many P&C insurers initially considered about the Simplified Approach: that the Premium Allocation Approach, or PAA, to measure their insurance contract liabilities and assets would be similar to the current day accounting treatment for Unearned Premium, Deferred Acquisition Costs and Liability for Outstanding Claims. In fact, the IASB indicates [2] there is no financial difference in overall net financial results between today's approach and the PAA. This assumes no changes to current portfolio constructs and onerous contract assessments, which could have significant impacts for insurers.

But the IFRS 17 accounting framework does have business impacts, as this article addresses.

Global Insurers' views of IFRS 17 benefits outweighing the expected costs



Canadian Insurers' views of IFRS 17 benefits outweighing expected costs



How an insurer manages its business will impact how IFRS 17 is applied and implemented

IFRS 17 provides guidance and examples of where judgements and decisions will be based on insurer-specific information and/or circumstances. How the insurer's business is managed today impacts the implementation of the accounting standard. With two-and-half years to implement IFRS 17, insurers have the opportunity to consider how they manage their contracts. This will need to be demonstrated and evidenced by current day management information. For example:

- Whether the insurer manages its insurance contracts as one—in portfolios, or in different, more granular, lines of business or business units;
- The performance metrics of the business, whether at an aggregated or more granular level of reporting to key stakeholders;
- The performance metrics used to determine incentive remuneration for management and leaders could influence the determination of which insurance contracts are managed together as one.

Management reporting information will be an indicator of where under the PAA, an insurer needs to perform an onerous contract assessment on initial recognition of its insurance contracts. Indicators of onerous contracts will most likely be contained in lines of business information such as:

- Management reporting information providing loss ratios (premium less claims) by line of business;
- Pricing and product development information;
- Risk-management information.

An insurer's risk appetite and product pricing approaches will influence both the risk adjustment determination to be used in the measurement of the outstanding claims liability, and when an insurer is to apply the IFRS 17 General Measurement Model (GMM).

The current day terms of reinsurance contracts, such as repricing and cancellation clauses, could impact the assessment of the contract boundary and its resulting coverage period, impacting whether the PAA or GMM are required. The IFRS 17 requirements could result in accounting mismatches and volatilities in profit and loss—a direct consequence of the insurer's reinsurance management strategy and contracts entered into today.

Impacts on insurers' business areas

Much as has been expressed during the 20+ year development of the IFRS 17 accounting standard about its impact on an insurer's business. For example:

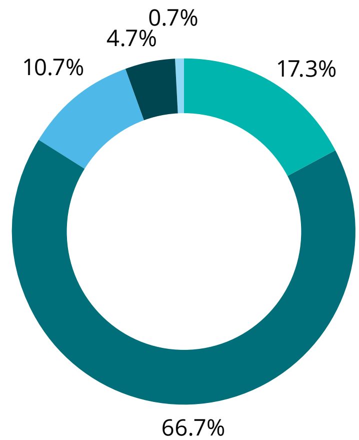
Portfolios of contracts

The aggregation of contracts into portfolios is most likely going to be different among insurers, requiring enhanced data management and storage functionalities; some will also require system enhancements.

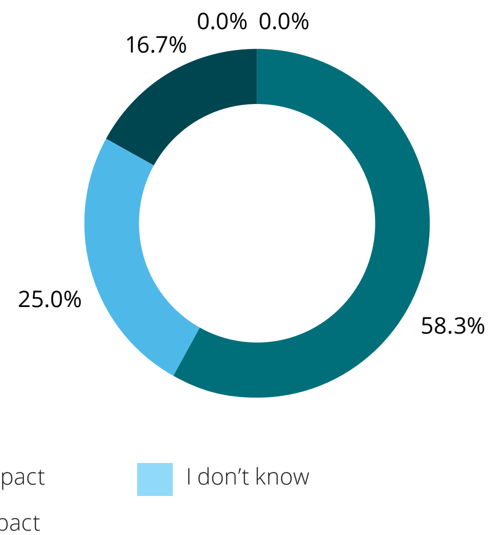
Product, pricing and product cross-subsidization

The portfolio construct will result in onerous contracts having to be separated from profitable ones. Onerous contracts will be recognized at inception, not netted off against profitable contracts, as occurs today. This could impact an insurer's product offerings and pricing strategies as shown by the Survey results when insurers were asked what impact IFRS 17 will have on their product design - only 4.7 percent of global and 16 percent of Canadian P&C insurers said there will be no impact. Close on over sixty percent of all P&C insurers think there will be a moderate impact, with a quarter of Canadians indicting a minimal impact while only 10 percent of global insurers held this view. Fifty percent of Canadian reinsures believe their product design will be moderately impacted, with the balance seeing no impact. While 12 percent of global insurers see significant impact to their product design, only 4 percent see no impact and 65 percent think a moderate impact.

Global P&C Insurers' view of IFRS 17 impact on product design

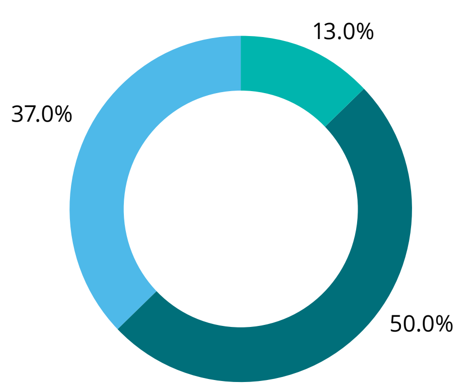


Canadain P&C Insurers' view of IFRS 17 impact on product design

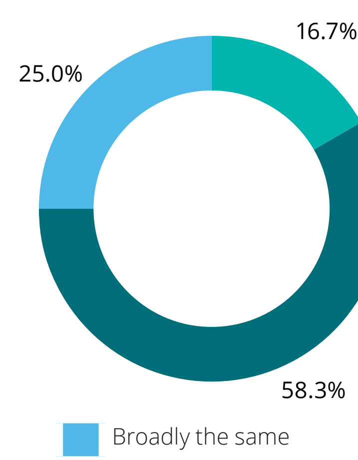


Survey results further show that over 50 percent of all insurers expect their first year IFRS 17 profits to be lower, with only 25 to 37 percent of insurers expecting broadly the same profits under IFRS 17.

Global P&C Insurer view of First Year IFRS 17 Profits



Canada P&C Insurer view of First Year IFRS 17 Profits



No gross written premiums

This is a headline metric in IFRS 17 financial statements. Today this is used by stakeholders to:

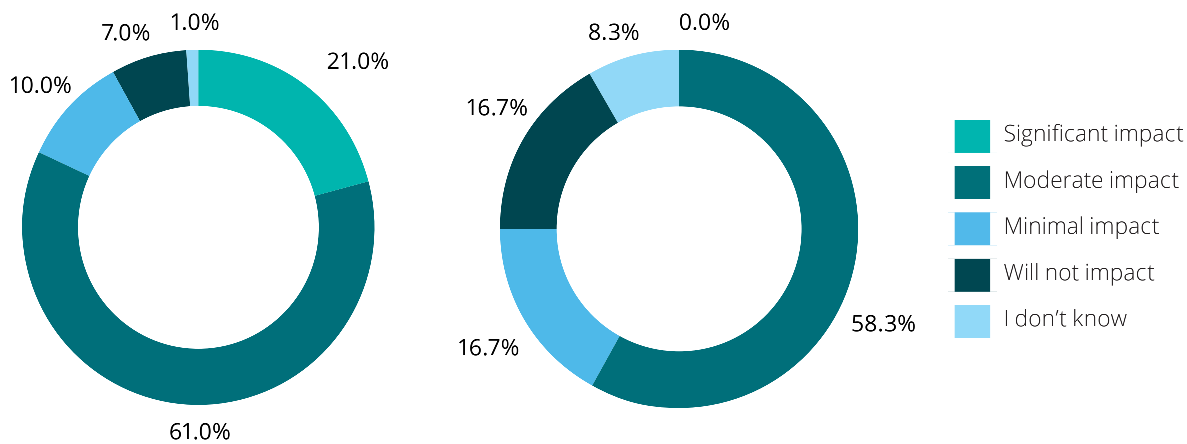
- assess business volume and size of P&C insurers;
- levy provincial premium taxes;
- determine acquisition costs;
- Determine management incentive remuneration.

Almost 60 percent of respondents to the Survey indicated that IFRS 17 would have a moderate impact on their Key Performance Indicators (KPI’s). There are mixed views, with over 20 percent of global insurers expecting a significant impact and 16 percent of Canadian insurers seeing no impact on their KPI’s, compared to the 7 percent global view.

Under IFRS 17, insurance revenues will be recorded only in the income statement when earned over the period of providing services under the insurance contract to the policyholder. Given the above uses of current day gross written premium, while insurers revise their recognition and recording of insurance contract revenue to comply with IFRS 17, they could still need to provide the gross written premium measures going forward, with the annual regulatory returns still requiring this premium information to be reported.

Global P&C Insurers' view of IFRS 17 Impact on KPI's

Canada P&C Insurers' view of IFRS 17 Impact on KPI's



P&C insurers therefore may be required to maintain dual reporting of IFRS 17 insurance revenue and today’s gross written premiums. It is expected that, over time, regulators may get comfortable with the IFRS 17 revenue metric and use this for levying provincial premium taxes.

> “Almost 60 percent of respondents to the Survey indicated that IFRS 17 would have a moderate impact on their Key Performance Indicators, (KPI’s).”

Acquisition cash flows

Insurers applying the PAA can include their acquisition costs as part of their insurance contract liability determination, with amortization thereof, or expense the acquisition costs attributable to a portfolio of contracts immediately. This could require system changes and the insurer may want to:

- Change its process to determine which expenditures now qualify as acquisition costs, compared with current requirements;
- Eliminate the current practice of capitalizing acquisition costs and amortizing them over the contract's duration.

Quantify and separate non-distinct investment components of certain claims

This is instead of all amounts paid out to the policyholder being recognized and recorded as a claim. This will impact claims processes, claim and investment component quantifications as well as data recording.

Change general ledger configurations to accommodate new required accounts

Changes could include investment components of claims and mapping of accounts to the financial statements – unearned premiums, deferred acquisition costs and reinsurance receivables will be included in the insurance contract liability for the remaining coverage period.

Redesign management information

Depending on how contracts are to be aggregated into portfolios, insurers could be redesigning their management information and reporting lines. Some insurers are using IFRS 17 implementation as an opportunity to leverage new and more granular data to develop insights into their business.

Additional modelling required

Some products and reinsurance contracts will require GMM for measurement, requiring new modeling and processes. This must happen for insurance contracts longer than 12 months, as eligibility to use the PAA is not automatic for them. Insurers wanting to follow the PAA for longer contracts will need to demonstrate that the PAA would achieve a materially similar result to the GMM, requiring GMM capabilities and using all its components: best estimate fulfillment cash flows; discounting; risk adjustment; and contractual service margin, with amortization of the CSM and the determination of insurance revenue. Also, insurers eligible to apply the PAA to their direct business may find their reinsurance contracts are longer than 12 months and will need to model them under GMM to demonstrate the PAA outcome is not materially different.

Examples of non-distinct investment components in P&C insurance claims

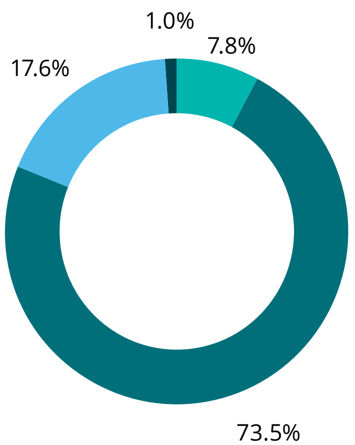
Where an amount included in incurred claims is required by the contract to be repaid, even if no insured event occurs.

Where a no-claims bonus included in premiums is repaid if no claims occur. Not to be confused with no-claims discount, which is not an investment component, as any cash flows resulting from the promise are not within the contract boundary as the discount is applied to premiums relating to future coverage periods.

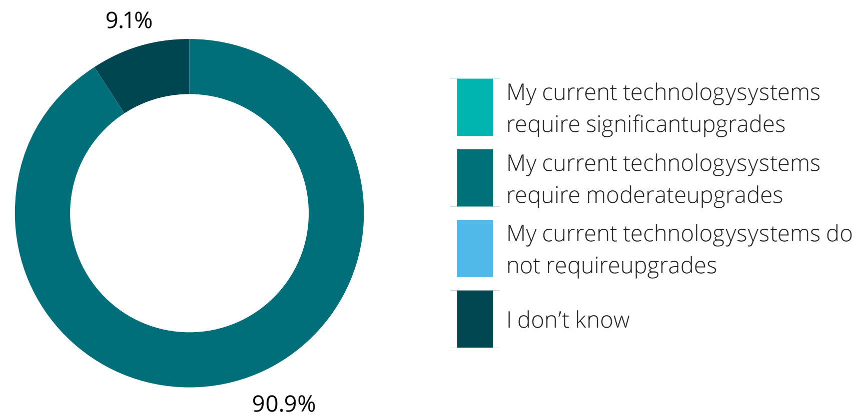
System implications

This varies for P&C insurers, as revealed by the 2018 Deloitte IFRS 17 global survey. It showed that 91 percent of Canadian P&C insurers believe moderate system upgrades will be required, compared with only 73.5 percent of global P&C insurers.

Global P&C Insurers' extent of IT system changes with IFRS 17



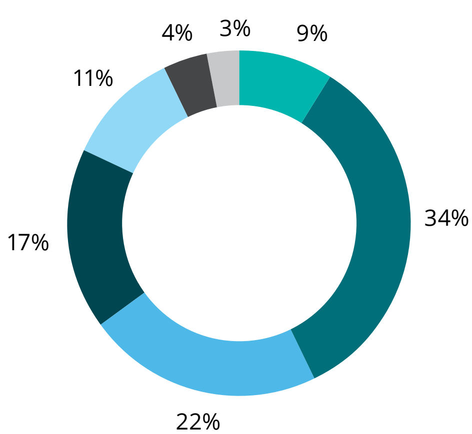
Canadian P&C Insurers' extent of IT system changes with IFRS 17



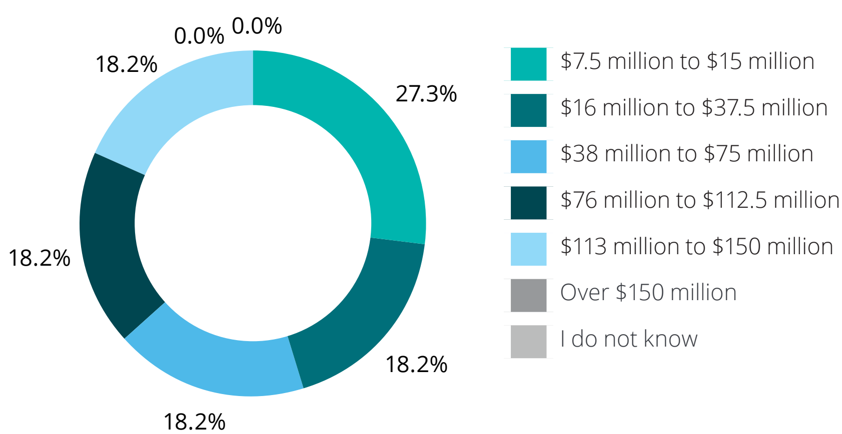
Implementation budgets, costs and resourcing

These will be significant, as confirmed by the Survey results. More than two thirds of Canadian P&C insurers are budgeting from $16 million to more than $150 million for IFRS 17 implementation; some 90 percent of global P&C insurers are budgeting that range. Only 27 percent of Canadian respondents estimate the cost will be $15 million or less (global respondents: 9 percent).

Global P&C Insurers Estimated IFRS 17 Budget



Canadian P&C Insurers Estimated IFRS 17 Budget



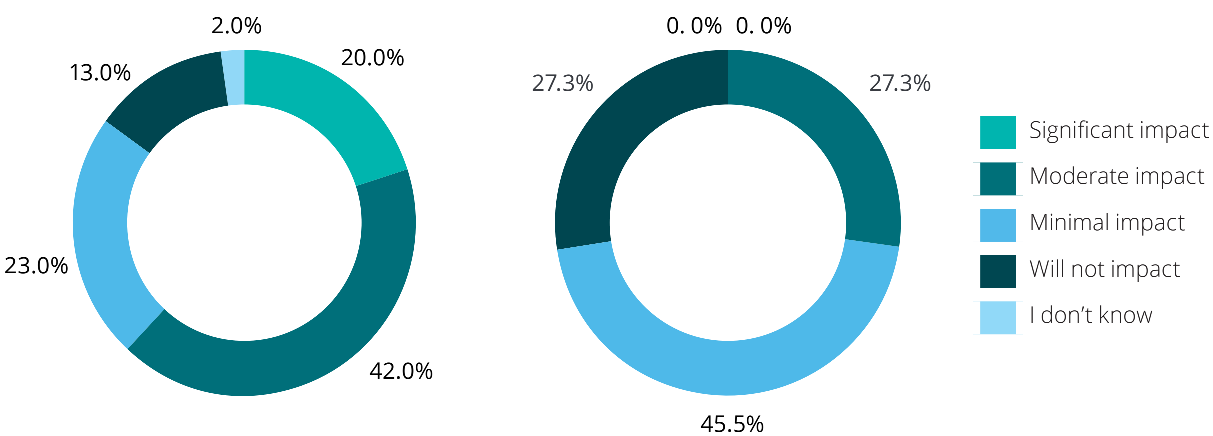
Talent scarcity

The resource requirements anticipated by global and Canadian insurers to implement IFRS 17 will be significant. A challenge for all in the sector in the run up to 2021 will be overcoming the talent scarcity of IFRS 17 skilled accountants and actuaries.

The Survey has an interesting view between global and Canadian P&C insurers about the impact that IFRS 17 will have on corporate culture. Almost a third of Canadian insurers say IFRS 17 will not impact their corporate culture, while only 13 percent of the global insurers have this view and just under a third believe there will be a moderate impact, with 42 and 20 percent saying a moderate or significant impact, respectively. Twenty percent of global insurers expect a significant impact on corporate culture.

Global P&C Insurers' view of IFRS 17 Impact on Corporate Culture

Canada P&C Insurers' view of IFRS 17 Impact on Corporate Culture

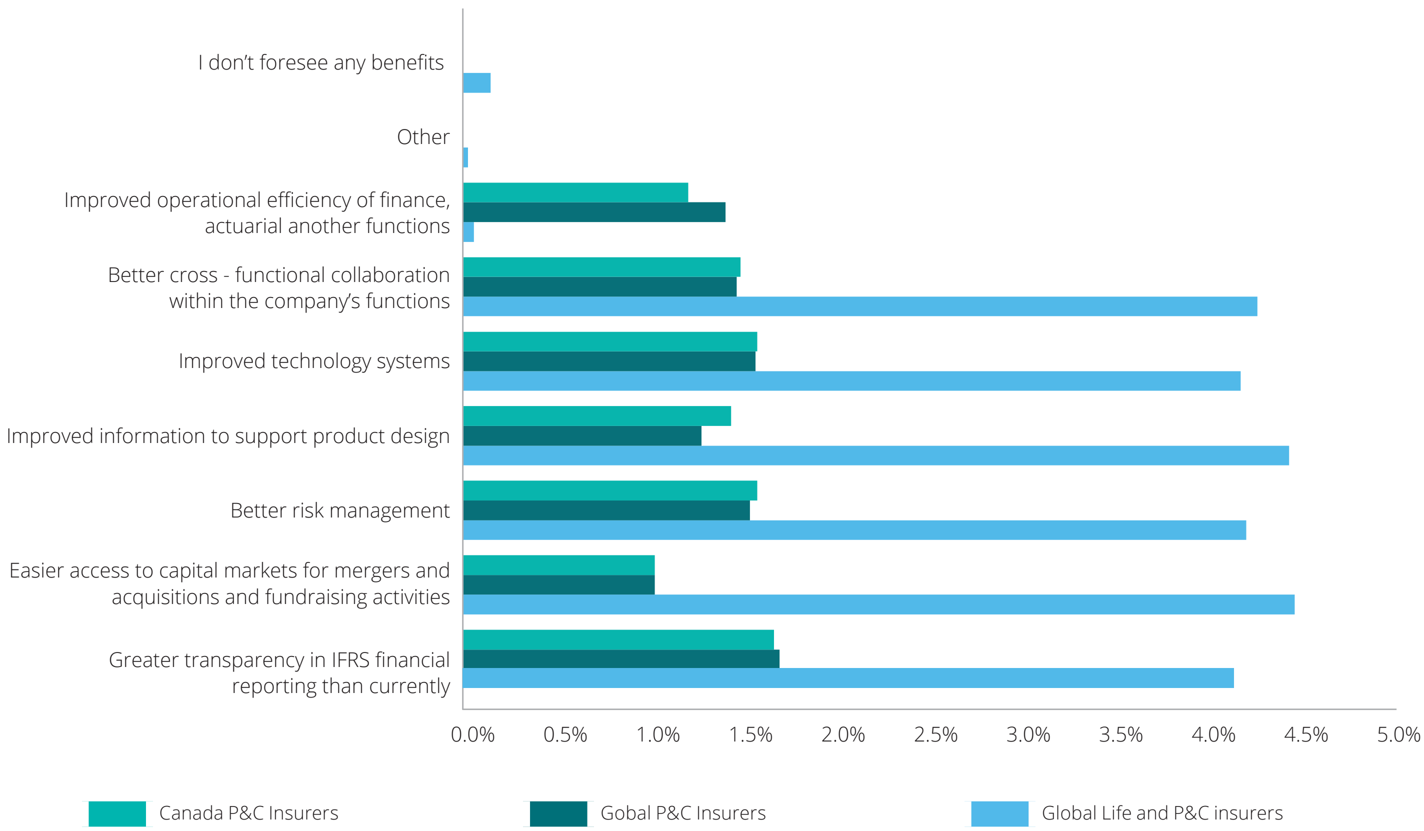


Not only are insurers resourcing up on these skills and project managers to ensure successful implementation in 2021, change management is a key requirement, given the changes and impacts on people as we all become comfortable with the new norm. Change can be challenging in an organization, and how it's executed needs to be managed; it must be done through transparent communication, education and knowledge-sharing. This will go a long way for an organization dealing with change on the IFRS 17 journey, ahead of going live on January 1, 2021.

Other business impacts

Survey respondents were asked which areas in their business would benefit from IFRS 17. The graphic below presents the responses of the global and Canadian P&C insurers, indicating that far more life insurers see benefits from IFRS 17. At least 10 to 15 percent of P&C insurers indicate that there are benefits to be had from IFRS 17.

Insurers' view of IFRS 17 benefits



"The required changes will disrupt traditional operating models, involve functional and business areas enterprise-wide, and require significant effort and associated cost. Leading insurers are seeking synergetic, opportunistic, and strategic benefits to drive value from the anticipated costs of compliance in order to enhance the target operating model. By understanding and anticipating disruptive forces driven by IFRS 17, leading insurers can take proactive steps to innovate their strategies, embrace complexity, and accelerate performance." [3]

Conclusion

Industry participants have been collaborating on interpreting and understanding the IFRS 17 requirements and its impacts. However, it is clear that one standardized approach, set of policies or chart of general ledger accounts will not fit all insurers. An assessment of current day processes against the "to be" sustainable state under IFRS 17 will help crystalize what is appropriate for an insurer's size and business complexity. Each must weigh up the operational risks, costs and benefits reporting close timeframes and maintaining the strategic imperatives of the organization.

1. 2021 Countdown underway. Insurers prepare for IFRS 17 implementation. Global IFRS insurance Survey 2018. Economist Intelligence Unit.
2. IASB Website: https://www.ifrs.org/-/media/feature/supporting-implementation/ifrs-17/premium-allocation-approach-example.pdf
3. *"IFRS 17 Insurance Contracts - Harnessing compliance risks to drive strategic opportunities".* July 30, 2018. A blog post by Wallace Nuttycombe, principal, Deloitte & Touche LLP; Azer Hann, partner, Deloitte Canada; Bryan Benjamin, senior manager, Deloitte & Touche LLP; Marianne Davitjan, senior manager, Deloitte Canada; and Saad Malik, manager, Deloitte Canada.

Contact

Elaine Hultzer
Partner, IFRS 17
Deloitte LLP
ehultzer@deloitte.ca

Deloitte.

www.deloitte.ca

Designed and produced by the Deloitte Design Studio, Canada. 18-6104H