Insurers' initial views – IFRS 17 and IFRS 9

Detailed analysis

—

December 2022

Scope and contents

This document contains our detailed analysis of information provided by 26 insurers across the globe on the potential impacts of IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments*[1].

This information was shared as part of their investor education sessions and/or their quarterly or half-yearly reporting (where relevant).

01 Accounting mismatches and related volatility

02 Impact on shareholders' equity

03 Key accounting policy choices and judgements

04 Life insurers vs non-life insurers

05 Key performance indicators

06 Other insights to note

[1] Many of the 26 insurers have applied the temporary exemption from IFRS 9 and expect to apply it at the same time as IFRS 17 – i.e. from 1 January 2023.

KPMG

2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Document Classification: KPMG Public

01 Accounting mismatches and related volatility

On 1 January 2023, many insurers will apply IFRS 9 and IFRS 17 at the same time. They expect accounting mismatches and related volatility in the income statement to be significantly reduced under these new standards.

Insurers that have elected to apply the other comprehensive income (OCI) option[1] for insurance liabilities noted the following key drivers of volatility.

- **Financial assets that do not have cash flows that are solely payments of principal and interest** under IFRS 9 ('non-SPPI assets') will be measured at fair value through profit or loss (FVTPL). A mismatch will arise in the income statement when insurance finance income and expenses related to the insurance liabilities are disaggregated between profit or loss and OCI.
- Those insurers that have provided quantitative information noted that the assets that could cause volatility in the income statement (including non-SPPI assets) constitute between 5 and 24 percent of their investment portfolio. This also includes debt instruments at amortised cost, measurement of real estate at cost or FVTPL, joint ventures and associates measured using the equity method, and private equity investments at FVTPL.
- **Equity investments** measured at fair value through OCI (FVOCI) under IFRS 9 whose gains or losses on disposal are not recycled through profit or loss, or those equity investments measured at FVTPL, may also cause mismatches in the statement of comprehensive income.
- **Actual duration mismatches** between assets and liabilities may cause volatility in the income statement, especially where no long-duration assets are available to match long-duration insurance liabilities.

Insurers that have elected not to apply the OCI option for insurance liabilities

For these insurers, potential accounting mismatches arise mainly from:

- assets that are measured at cost or amortised cost (i.e. no fair value remeasurements are recognised in the income statement); and
- actual duration mismatches.

[1] Under the OCI option for insurance liabilities, companies can choose to disaggregate insurance finance income or expense between profit or loss and OCI for a portfolio of insurance contracts.

2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

02 Impact on shareholders' equity

Quantitative impacts presented thus far focus on the change in shareholders' equity and future profitability between IFRS 4 and IFRS 17.

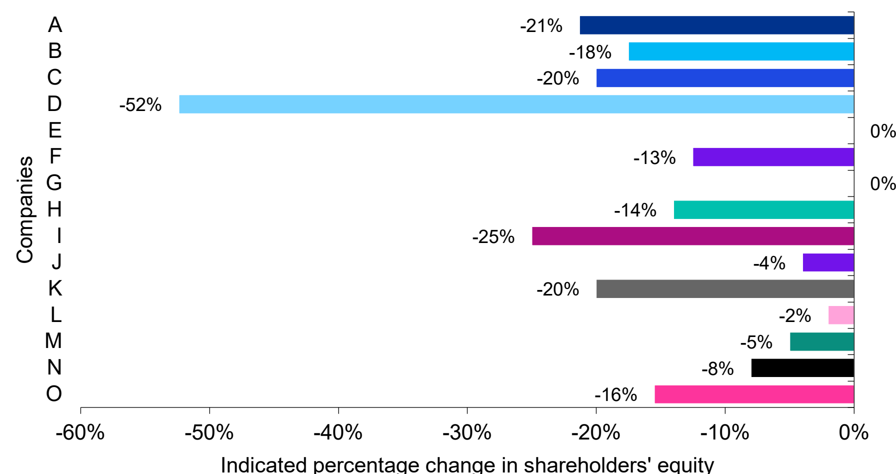
Generally, shareholders' equity as at 1 January 2022 will decrease significantly, especially if the insurer mainly issues life insurance contracts.

Although the factors affecting the changes in shareholders' equity under IFRS 17 may differ for each insurer, several frequently mention the following.

- **Interest rates** – At 1 January 2022, shareholders' equity is expected to decrease significantly. However, interest rates have increased during 2022 and the difference between IFRS 4 and IFRS 17 shareholders' equity at 30 June 2022 is not expected to be so significant. This is because rising interest rates under current accounting reduce the value of debt instruments with typically no compensating effects on insurance liabilities. Under IFRS 17, this mismatch will be significantly reduced.
- **Release of margins for prudence and recognition of an explicit risk adjustment** – IFRS 4 prudence margins expected to be released (fulfilment cash flows are measured using an unbiased expected value under IFRS 17) and the new explicit risk adjustment recognised under IFRS 17 may differ significantly between insurers.
- **Measurement of options and guarantees** – Some insurers only measure in-the-money instruments under IFRS 4. Under IFRS 17, they will need to measure the time value of options and guarantees, which will reduce equity.
- **Emergence of profits** – The recognition of profits may differ significantly between IFRS 4 and IFRS 17. Under IFRS 17, profits are recognised over the life of the contract as services are provided.

Of the 26 insurers we analysed, 15 have provided indicative quantitative information on the impact of IFRS 17 and IFRS 9 on shareholders' equity. For some insurers, this included additional changes in accounting policies related to other standards – e.g. changing the measurement of real estate from cost to fair value to better align with the measurement of insurance liabilities.

IFRS 17 and IFRS 9 change in total shareholders' equity[1, 2]



In our analysis of life insurance companies, we have included further information on indicative future profitability. This is provided for the nine companies A–I above. Companies J–O have not provided this information.

Notes

1. Where a range was indicated, we selected the middle of the range.
2. 0% indicates the information provided – i.e. no expected impact on shareholders' equity.

2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

03 Key accounting policy choices and judgements

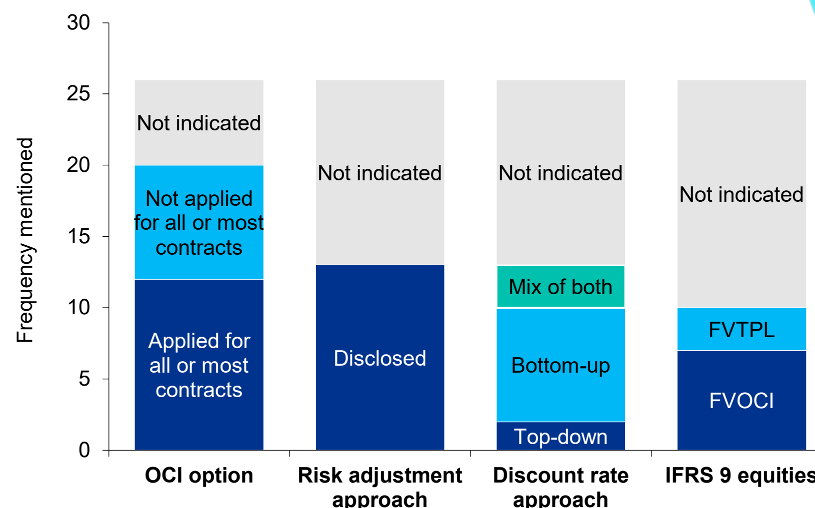
Many insurers have already explained the principles they have applied to their key IFRS 9 and IFRS 17 accounting policy choices and judgements.

IFRS 17 allows a number of explicit accounting policy choices – e.g. the OCI option. In addition, insurers will need to make and disclose significant judgements under IFRS 17.

Based on information from the 26 insurers, key accounting policies and judgements under IFRS 9 and IFRS 17 include the following.

- **OCI option** – Applying the OCI option is mixed and often depends on whether:
  - an insurer currently recognises certain changes in financial assets in OCI under IAS 39 *Financial Instruments: Recognition and Measurement;* and
  - stakeholders are familiar with the use of OCI by the insurer.
- **Risk adjustment approach** – The majority of the 13 insurers that disclosed their approach intend to apply a percentile approach under IFRS 17, with others applying a cost of capital or other approach.
- **Discount rate approach** – Approaches differ by insurer, but there appears to be some consistency for the types of product – e.g. the top-down rate, which is generally used for annuities and contracts that qualify for the variable fee approach.
- **Accounting policy for IFRS 9 equities** – Seven insurers have indicated that they intend to measure equity investments at fair value and recognise changes in OCI with no recycling of disposal gains or losses in profit or loss. However, in cases where equities are underlying items for contracts measured under the variable fee approach (VFA), these instruments will normally be measured at FVTPL.

Key accounting policies and judgements under IFRS 17 and IFRS 9



Other

- Some non-life insurers have indicated that, for contracts under the premium allocation approach, they will immediately recognise insurance acquisition cash flows in profit or loss – i.e. when they are incurred.
- A few companies have indicated that they will use the EU carve-out with an exemption to apply the annual cohorts requirement.

KPMG

2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Document Classification: KPMG Public

04 Life insurers vs non-life insurers

IFRS 17 is expected to impact life insurers significantly; non-life insurers less so.

Life insurers

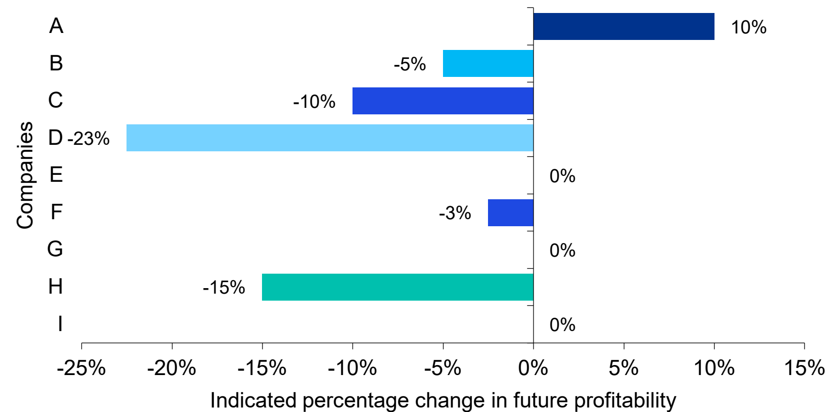
Insurers expect to apply the general measurement model or the variable fee approach for life insurance contracts. They also expect to measure annuities under the general measurement model, unless policyholders participate in underlying items.

These new measurement models will cause significant accounting change compared with current accounting under IFRS 4. However, the impacts may differ depending on the accounting policies currently selected under IFRS 4.

For health insurance contracts, the impact will depend on whether these contracts are determined to have a long or short contract boundary under IFRS 17 and also how they were treated under IFRS 4.

Forecasts of future profitability from nine insurers showed a percentage impact specifically for the life segment, as shown below.

IFRS 17 and IFRS 9 change in future profitability: Life segment[1, 2, 3]



Notes

[1] Where a range was indicated, we selected the middle of the range.

[2] The impact on future profitability was provided using results calculated under IFRS 17 and KPIs – e.g. operating profit, net income. Therefore, the impacts are indicative only.

[3] 0% indicates the information provided – i.e. no expected impact on future profitability.

2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

04 Life insurers vs non-life insurers (cont.)

Some non-life insurers indicate that the impacts could be more significant for contracts with long-tail claims reserves and longer coverage periods.

Non-life insurers

Insurers will generally apply the premium allocation approach (PAA) to most non-life insurance contracts during the coverage period. This approach is largely similar to the unearned premium model used by many insurers under IFRS 4.

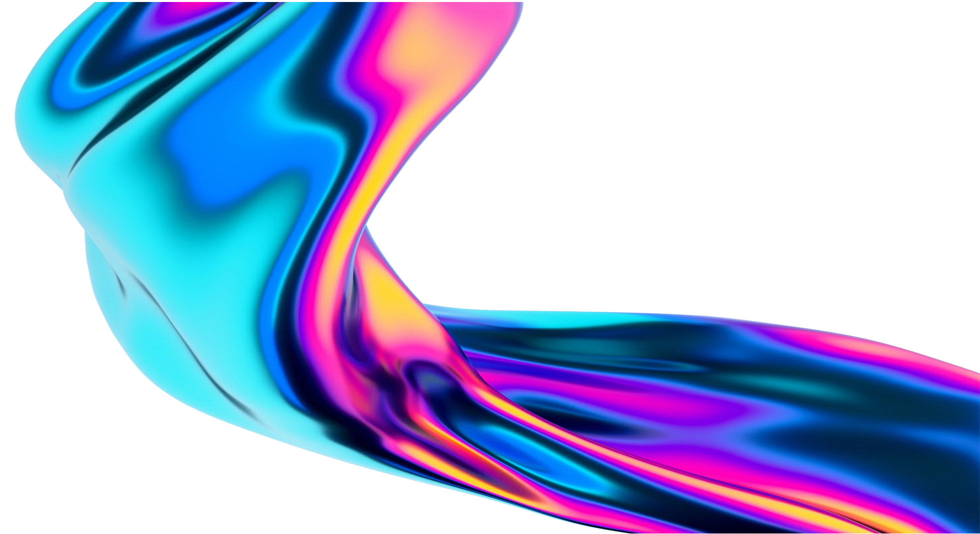
Insurers that have provided information for their non-life segments expect nearly all contracts to be eligible for the PAA.

Notably, one insurer has indicated that it has elected not to apply the PAA for various reasons, including:

- increasing transparency on earning patterns and value creation;
- comparability between lines of business; and
- improving alignment with both regulatory reporting and internal performance measures.

In terms of the quantitative impact on shareholders' equity, we see some similarities for non-life insurers. Opening shareholders' equity is generally comparable between IFRS 4 and IFRS 17. This is because the positive impact from discounting liabilities for incurred claims is offset by the inclusion of an explicit risk adjustment.

For many insurers, the insurance service result is expected to be slightly higher than the underwriting result under IFRS 4 because of the impact of discounting in the current interest rate environment. Insurers expect that this will be offset to some extent by the interest accretion on the insurance liabilities, which is recognised as insurance finance expense in the net investment result.



2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

05 Key performance indicators

Some life insurers indicated that they expect there will be new KPIs and changes to existing KPIs. For non-life insurers, the common KPIs used (e.g. gross written premiums and combined ratio) are not expected to change significantly.

Life insurers' KPIs

- **Return on (adjusted) equity (RoE)** – Many insurers have indicated that they expect to increase their targets for return on equity, because the denominator (i.e. shareholders' equity) has decreased as at the date of transition (1 January 2022). However, some insurers are considering an adjusted-equity KPI that includes the contractual service margin (CSM). This could lead to a decrease in RoE.
- **New business value and new business margins** – Most insurers expect to adopt the CSM as an element of new business reporting. The adjustments that they will make are expected to vary. Some insurers will adopt the IFRS 17 new business CSM amount and others a 'net CSM' (taking into account various adjustments, such as tax and non-directly attributable expenses); others will adopt the growth in the CSM balance as one or more of their new metrics.
- **Adjusted earnings measures** – Some insurers have indicated that they expect to continue using metrics such as operating profit, underlying earnings or net income. However, these will be based on IFRS 17 rather than differing reporting bases, as is currently the case under IFRS 4.

  Common adjustments indicated by insurers include investment returns (stabilised across years), foreign currency impacts, impairments, specific expenses (e.g. restructuring costs) and exceptional operations.
- **Leverage or gearing ratios** – These metrics are generally calculated by dividing financial debts by the total of financial debts and shareholders' equity. Many insurers have indicated that they expect to add the CSM to the denominator, leading to an expected decrease in leverage ratios.
- **Regulatory capital ratios** – Because these are usually based on a separate regulatory framework, they will not be (significantly) impacted. However, the local regulator in some jurisdictions has indicated that the CSM may qualify as capital, which could cause an increase in the solvency ratio.

Non-life insurers' KPIs

- **Gross written premiums (GWP)** – Insurers expect to continue to report GWP for some time. However, as a non-GAAP measure it will no longer be visible in the income statement. They also expect to use the new IFRS 17 insurance revenue measure as a volume measure. This measure excludes investment components and is adjusted for the time value of money, where relevant.
- **Combined ratio** – Most insurers report that this ratio is likely to be lower under IFRS 17. Some insurers intend to calculate this as follows.

$$\frac{\text{Insurance service expenses + Non-directly attributable expenses +/- Net reinsurance result}}{\text{Gross insurance revenue under IFRS 17}}$$

Others have indicated that they intend to align with IFRS 17 as much as possible – i.e. including only directly attributable expenses in the combined ratio or using the net insurance result under IFRS 17. Insurers that intend to report the net insurance result believe that using an IFRS 17 measure rather than a non-GAAP KPI (e.g. the combined ratio) will increase comparability.

2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

06 Other insights to note

Our analysis of the information provided by the 26 insurers shows a few other specific areas of interest, as follows.

- **Transition approaches for determining the CSM** – The key unknown in the opening balance sheet is the opening CSM. Insurers are required to apply a full retrospective approach, unless this is impracticable. If it is impracticable, then the CSM can be calculated through either:

    - a modified retrospective approach, which aims for an outcome as close as possible to a full retrospective approach; or
    - a fair value approach, which is based on an exit value notion.

  Seven insurers have indicated percentages that range between 30 and 95 percent for the proportion of the CSM determined under retrospective approaches (full and modified); the proportion under the fair value approach varies between 5 and 70 percent. Some insurers have also noted only the proportion of insurance liabilities under each transition approach, which does not necessarily relate directly to the proportion of the CSM determined under each of the transition approaches.

  This is a wide range and for some insurers it may be driven by specific circumstances. Therefore, we look forward to reading the quantitative transition disclosures under IFRS 17 related to the opening balance sheet and accompanying qualitative explanations to better understand the differences in transition approaches between insurers.

- **Confidence level disclosures for the risk adjustment** – Some insurers have provided insight on how they have measured the risk adjustment in their insurance liabilities but have given only a broad indication of what their confidence level may be under IFRS 17. Further, some insurers provided this for part of their business – e.g. only for the life or non-life segment.

  Insurers have indicated confidence levels that vary in percentiles ranging from 62.5 to 99, but the detailed methodologies are generally not mentioned, which further complicates a meaningful comparison at this point.

- **CSM that insurers expect to release** – The CSM release percentage varies broadly between 6 and 11 percent annually, depending on the duration of the related insurance contracts. However, the pattern of the profit emergence over the life of groups of insurance contracts is not yet clear.

- **'Other' line item** – Some investors expressed concerns about potentially significant items of income or expense reported outside the insurance service result – e.g. non-directly attributable expenses. The information provided on the size of the 'other' line item is limited, but some insurers have indicated that they will consider any non-directly attributable expenses in their KPIs.

2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights

Keeping in touch

Bob Owel
Director
KPMG International
bob.owel@kpmgifrg.com

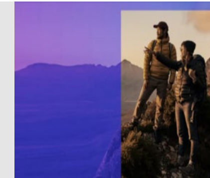
Follow 'KPMG IFRS' on LinkedIn or visit home.kpmg/ifrs for the latest news.

Whether you are new to IFRS® Accounting Standards or a current user, you can find digestible summaries of recent developments, detailed guidance on complex requirements and practical tools such as illustrative disclosures and checklists.

Guide to annual financial statements – Illustrative disclosures for insurers: IFRS 17 and IFRS 9

Acquiring insurance contracts – Transfer of insurance contracts and business combinations under IFRS 17 and IFRS 3

Insurers – Reporting now and into 2023: IFRS 17 and IFRS 9 – Seven-step action plan to help you prepare



Interim reporting choices under IFRS 17

IFRS 9 for insurers – Are you good to go? Application guidance

First Impressions – Insurance contracts 2020 edition: IFRS 17

KPMG

2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

Document Classification: KPMG Public

home.kpmg/ifrs

© 2022 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

KPMG International Standards Group is part of KPMG IFRG Limited.

KPMG refers to the global organization or to one or more of the member firms of KPMG International Limited (“KPMG International”), each of which is a separate legal entity. KPMG International Limited is a private English company limited by guarantee and does not provide services to clients. For more detail about our structure please visit https://home.kpmg/governance.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

This publication contains copyright © material and trademarks of the IFRS® Foundation. All rights reserved. Reproduced by KPMG IFRG Limited with the permission of the IFRS Foundation. Reproduction and use rights are strictly limited. For more information about the IFRS Foundation and rights to use its material please visit www.ifrs.org.

Disclaimer: To the extent permitted by applicable law, the Board and the IFRS Foundation expressly disclaims all liability howsoever arising from this publication or any translation thereof whether in contract, tort or otherwise (including, but not limited to, liability for any negligent act or omission) to any person in respect of any claims or losses of any nature including direct, indirect, incidental or consequential loss, punitive damages, penalties or costs.

Information contained in this publication does not constitute advice and should not be substituted for the services of an appropriately qualified professional.

‘ISSB™’ is a Trade Mark and ‘IFRS®’, ‘IASB®’, ‘IFRIC®’, ‘IFRS for SMEs®’, ‘IAS®’ and ‘SIC®’ are registered Trade Marks of the IFRS Foundation and are used by KPMG IFRG Limited under licence subject to the terms and conditions contained therein. Please contact the IFRS Foundation for details of countries where its Trade Marks are in use and/or have been registered.

Document Classification: KPMG Public