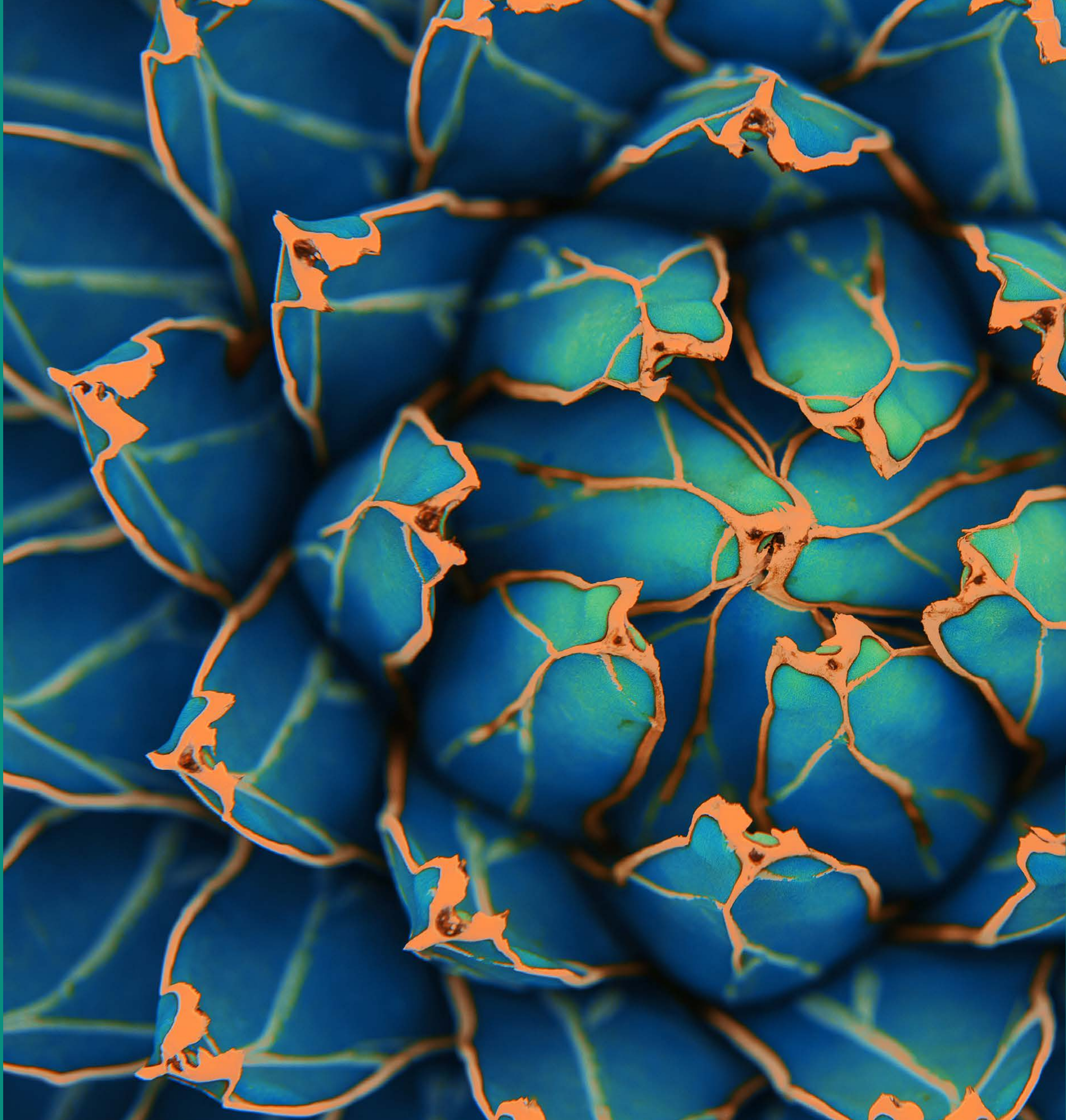

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IFRS 17 Insurance Contracts – a first look at a new world

After a prolonged build-up and an extensive amount of preparation effort that went into implementation projects, *IFRS 17 Insurance Contracts* (IFRS 17) became effective on 1 January 2023. While most insurers had hoped that their implementation projects would be nearing completion by the end of 2022, very few insurers managed to achieve this. With a heavy strain on resources across all work streams, including accounting, actuarial and IT, as well as a delay in the close out of many technical topics across both the global and local insurance industries, implementation of IFRS 17 carried on into much of the IFRS 17 'live environment' in 2023.

As a result of these delays, disclosures included in the final set of financial statements prepared under IFRS 4 Insurance Contracts (IFRS 4) regarding the anticipated impact of IFRS 17 adoption was limited. Many insurers only provided directional steering of equity impacts of whether the adoption of IFRS 17 was expected to result in an overall increase or decrease in equity. Some insurers were able to provide an indicative range of the expected impact, and very few insurers were able to disclose a pinpointed estimate of the expected impact on equity. This limited disclosure was an early indication of how far the industry still had to progress to get adoption of IFRS 17 over the line. Another reason for insurers not disclosing the equity impact was due to the late finalisation of tax law amendments which were, at that point, still being analysed by insurers.

With a tremendous push by the industry over the last year, insurers have largely reached their goal of producing their first set of IFRS 17 compliant annual financial statements. Starting with the December 2023 year-ends, these new look IFRS 17 financial statements have been released to market, and trends have started to emerge regarding accounting policy choices made by insurers, as well as the look and feel of IFRS 17 disclosures.

In this article we will take a look at the results released to date and consider how these are aligning locally, as well as compared to the global market. Earlier this year KPMG International released 'Real-time IFRS 17 – Insurers' first annual reporting under IFRS 17 and IFRS 9'[1], an analysis performed over 53 global insurance companies where we share our key observations on:

- IFRS 17 and IFRS 9 accounting policies, disclosures and significant judgements applied by insurers;
- the impacts of IFRS 17 on key performance indicators (KPIs); and
- transition to IFRS 17 and IFRS 9.

As an add on to this global KPMG publication, and for South African context, in this article we have analysed 19 South African insurers' reports, which comprise 12 non-life insurers and 7 life insurers with December 2023 year-ends. As many insurers are still in the process of finalising their first set of IFRS 17 compliant financial statements, this is only a snap-shot analysis of the very first results released. This view will likely shift and mature as more results are released for non-December year-ends and the industry begins to settle into an IFRS 17 business as usual world.

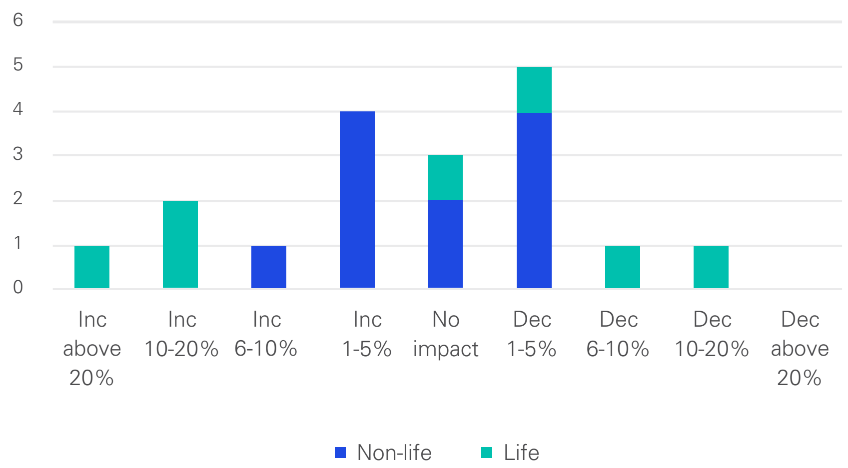
[1] https://kpmg.com/xx/en/our-insights/ifrg/2024/full-year-reports-real-time-ifrs17.html

Adoption of IFRS 17

Equity impact on adoption: of the 12 non-life South African insurers, 5 increased their equity on transition to IFRS 17, 4 decreased their equity, and 2 had no impact to equity. The percentage change on equity for these insurers ranged between 0% to 7% of total equity. This limited impact on non-life insurers is very much in line with the global trend. The remaining entity is a mutual insurer and due to the significant change IFRS 17 introduces for mutual insurers, the retained earnings is not comparable under IFRS 17 and IFRS 4. The impact for life insurers was far more prominent, with 3 life insurers experiencing an increase in equity, 3 experiencing a decrease, and only 1 having no impact on transition. The percentage change on equity ranged between 8% and 18%, with one outlier having a 43% impact on equity.

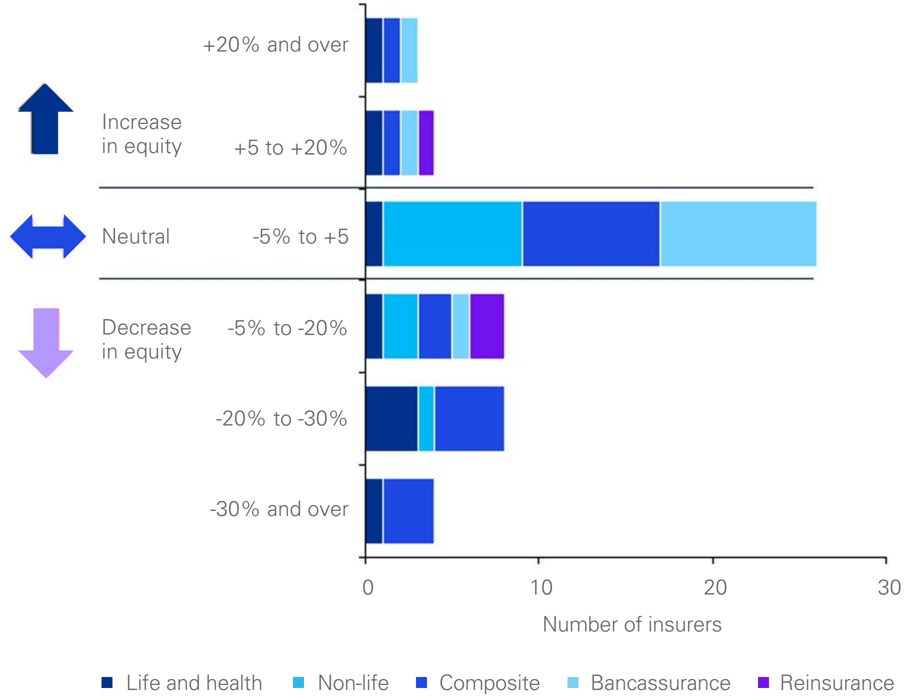
For South African insurers, the equity impact on adoption of IFRS 17 is summarised below:

Equity impact on transition



The KPMG International survey indicated the following results:

Impact on equity as at 1 Jan 2022 as disclosed in the FY23 accounts[2]

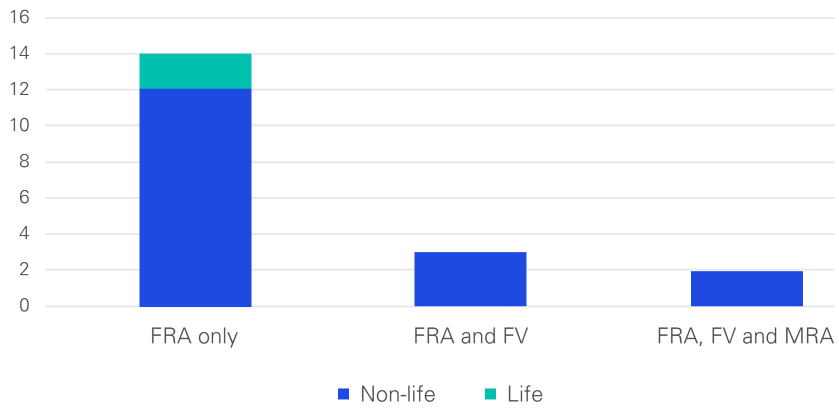


Very few South African insurers included the impact on the restated profit or loss for the comparative period, making it difficult to analyse the impact on profit or loss between what was previously reported and the restated comparative profit or loss.

[2] Where possible, we have included the impact on total shareholders' equity, including accumulated OCI. The impact includes changes in policies from consequential amendments to other accounting standards.

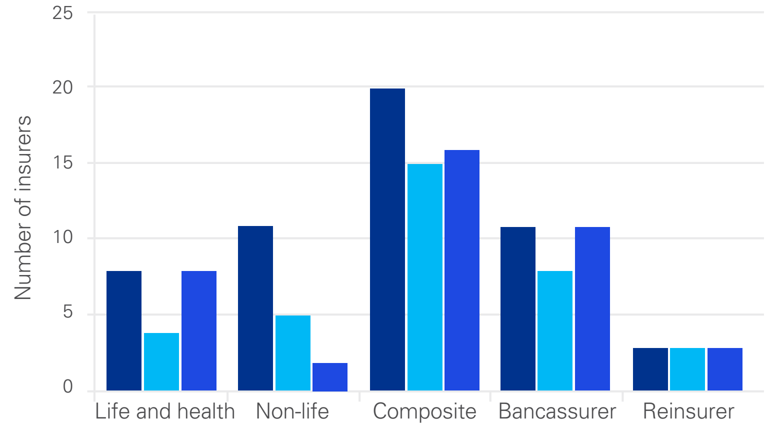
Transition approach: all 12 non-life insurers were able to apply the fully retrospective transition approach (FRA), with no indication of the use of the modified retrospective approach (MRA) or the fair value (FV) approach. This is in line with expectation, given the shorter terms of non-life insurance products. Of the 7 life insurers, 2 were able to apply the fully retrospective transition approach for their entire in force book of business. Where fully retrospective adoption was impracticable, 3 life insurers elected to apply the fair value approach, with the remaining 2 applying a mix of the fair value and modified retrospective approach. Disclosure regarding the impracticability of applying the fully retrospective approach varied across these insurers, with some insurers providing significant detail regarding the reasons for impracticability and others providing limited detail. Some insurers provided specific information on the periods for which it was impracticable to apply the FRA. Where dates for impracticability were provided, these were largely around the 2016/2017 years. The level of detail regarding the assumptions used in determining fair value (where this transition approach was used) also varied greatly between insurers, with some insurers having provided significant detail, and others only high-level disclosure.

Transition approach applied



Transition approaches applied, as included in the KPMG International survey:

Transition approaches by segment[3]



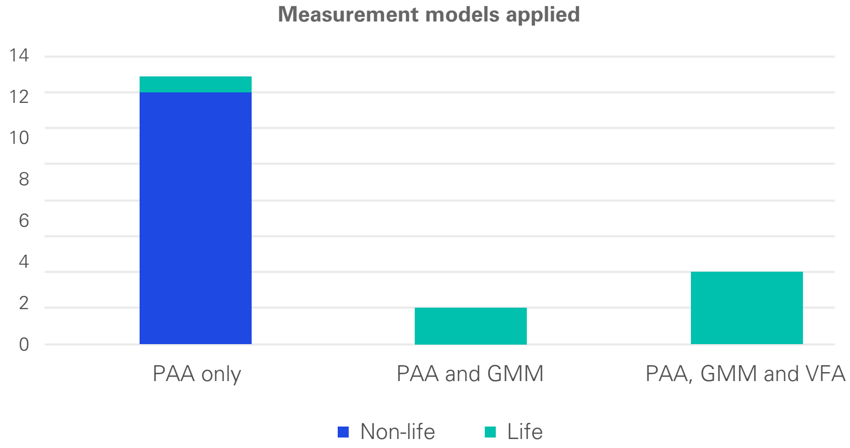
Adoption of *IFRS 9 Financial Instruments* (IFRS 9): sixteen of the insurers surveyed had already adopted IFRS 9, with only 3 insures having delayed adoption of IFRS 9 to align with the adoption of IFRS 17. This is largely due to many South African insurers being part of larger groups that chose not to defer the adoption of IFRS 9 until the adoption of IFRS 17.

Delays in reporting: twelve of the insurers reported within the four-month Prudential Authority (PA) deadline, although many of these reporting dates were very close to the PA regulatory deadline date. The remaining 7 reported after the four-month deadline. It should be noted, however, that this ratio may be skewed as many insurers with delayed reporting results were not able to be included in this initial analysis due to the delays, and the ultimate ratio once all insurers have completed first-time IFRS 17 reporting is likely to indicate a significant portion of insurers being delayed in their initial reporting. These observations provide an indication of the significant time and resource pressures financial reporting teams were working within in producing their first set of IFRS 17 compliant financial statements.

[3] Insurers can apply multiple transition approaches as the approach is determined for each group of insurance contracts.

Measurement under IFRS 17

Measurement model: of the 12 non-life insurers considered, all have applied the Premium Allocation Approach (PAA) in accounting for their insurance contracts, with no contracts measured using the General Measurement Model (GMM) or the Variable Fee Approach (VFA). Of the 7 life insurers, only 1 applied the PAA, 2 applied both the GMM and PAA, and 4 applied the PAA, GMM and VFA in measuring their insurance contracts.



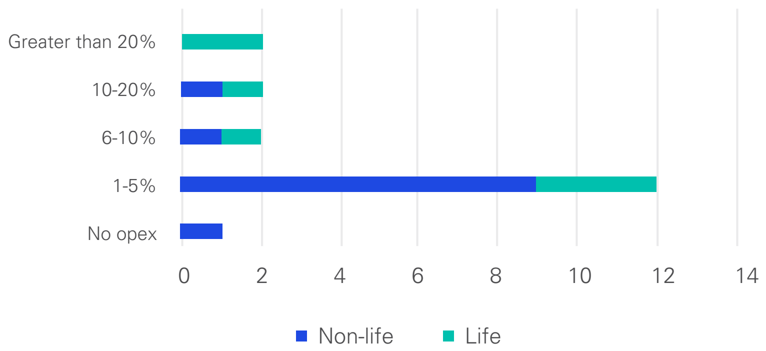
PAA eligibility: the level of detail included in the disclosure regarding eligibility assessments performed to use the PAA varied greatly between insurers. Almost all insurers indicated that at least a portion of their contracts have a coverage period of more than one year, but only a handful of insurers provided further disclosure regarding how the entity believes that the use of the PAA would produce a measurement of the liability for remaining coverage for the group that would not differ materially from one that would be produced applying the GMM, and whether this is a significant judgement area or not. As a future refinement, insurers should consider whether this should be disclosed as a significant judgement, and whether the level of disclosure regarding PAA eligibility is sufficient and appropriate given the value of contracts with a coverage period of more than one year.

Unit of account: of the 19 insurers, 6 indicated that the unit of account is not the legal contract, and the legal contract was split on the basis of substance over form. This is, for example, where multiple risks are written into the same policy, but the insurer accounts for these risks separately. While some insurers included this as a significant judgement with sufficient detail to enable a user to understand the accounting applied, this may be considered as an area of refinement for insurers that split the legal contract for accounting purposes, as the base assumption of the standard is that the unit of account is at a contract level. For the remaining 13 insurers, the disclosure seems to indicate the unit of account is the legal contract, but this was not always made clear in the disclosures.

Loss component: only 5 of the 12 non-life insurers recognised a loss component on gross business, with the loss components contributing a small portion of the total business underwritten. Five of the 7 life insurers recognised a loss component on at least a portion of their business. Interestingly, only some insurers that recognised a loss component on the gross business also recognised a loss recovery component on reinsurance contracts held.

Other operating expenses: with the adoption of IFRS 17, many costs which were previously recognised as other operating expenses within the income statement, have been reallocated to insurance service expense as directly attributable costs. As a result, the remaining other operating expenses caption within the income statement decreased significantly when compared to the reporting under IFRS 4. Costs which are not considered directly attributable to the servicing of insurance contracts remain within this line item. For 12 of the insurers, other operating expenses now range between 1% to 5% of insurance revenue, and between 6% to 12% for 3 of the insurers. Three of the larger life insurers have other operating expenses at between 20% to 25% of insurance revenue. Only 1 insurer (non-life) does not have any other operating expenses shown within the income statement.

Other operating expense as a % of insurance revenue



Insurance finance income and expense (IFIE): of the insurers that only applied the PAA, 2 insurers indicated that there was no IFIE impact. Of the other 11 insurers, 5 indicated that the IFIE impacted only the liability for incurred claims (LIC) (i.e. no IFIE impact on the liability for remaining coverage (LRC)). The remaining 6 insurers disclosed an IFIE impact on both the LRC and LIC. Across the board, the IFIE impact for insurers that only applied the PAA remains relatively small, especially with regards to the impact to the LRC. A limited number of insurers made it clear in their disclosures whether the paragraph 56 and 59(b) simplifications within the standard were applied or not. All insurers that applied GMM or VFA indicated an IFIE impact.

Other comprehensive income (OCI) option for IFIE: only 1 of the insurers elected to utilise the option to split IFIE between OCI and profit or loss. This is far below the 56% take up noted in the KPMG International survey.

Insurance acquisition cash flows (IACF) asset: only 2 non-life insurers recognised a separate IACF asset that is deferred for recognition in line with future renewals of currently underwritten contracts. None of the life insurers recognised a separate IACF asset.

Significant judgements, assumptions and estimates

Best estimate cash flows: a key theme throughout all the insurance disclosures provided is the judgement involved in the determination of best estimate cash flows. For life insurers this focused on the cash flows within the LRC, and for the non-life insurers this focused specifically on cash flows within the LIC. Much of this disclosure is what was previously made under IFRS 4, and we saw only minor changes to it for IFRS 17 purposes. Many of the insurers' qualitative disclosure still referred to outstanding claims (OCR) and incurred but not reported (IBNR) provisions, as well as allocated loss adjustment expense (ALAE) and unallocated loss adjustment expense (ULAE) provisions. While these terms are not IFRS 17 terms, the concepts relate to the broader considerations of LIC under IFRS 17. Understandably, these terms are understood and still used by the South African insurance industry, and insurers have ensured that the principles of these terms are carefully aligned to the principles of IFRS 17. Some insurers included the determination of all cash flows as a significant judgement, whereas others pinpointed specific cash flows where the estimation lies, for instance the estimation of those cash flows relating to claims incurred but not yet reported for non-life insurers. Among the life insurers, the disclosure regarding models and assumptions varied significantly, largely driven by the size of the organisation.

Discount rates: while all insurers included some detail on discount rates, the level of detail included varied considerably between insurers. This ranged from a single sentence detailing 'discount rates used are current rates', to more comprehensive disclosure of the various curves used and the adjustments made to those curves. The majority of insurers applied a bottom-up approach, with very few having indicated that they used a top-down approach.

Insurers provided disclosure around the use of a risk-free curve, adjusted for an illiquidity premium. Some insurers indicated that this illiquidity adjustment is included 'as appropriate' and others disclosed that this adjustment was not deemed necessary. Commonly used risk-free curves include the risk-free rates published by the Prudential Authority, the 10-year government bond risk-free curve, the observed mid-price swap yield curve for AA-rated banks and a curve derived from internally calculated swap curves.

Not all insurers included discount rates as a significant judgment or estimate, although this may be based on the quantitative impact for those insurers. However, where some insurers included this as a significant judgement, sensitivities for discount rates were not always included. This may be an area of future refinement for insurers.

Risk adjustment: as with discount rates, all insurers included some detail on risk adjustment, but the level of detail of this disclosure varied significantly between insurers. The method used to determine the risk adjustment was not always included within the disclosure. Eight insurers applied a confidence level or value at risk approach, with others noting a margins approach, a cost of capital approach, the use of an internal capital model and mixed approaches to determine the risk adjustment. Eleven insurers indicated a confidence level at the 75th percentile, with 7 between the 75th and 90th percentiles, and 1 not having disclosed the confidence level. While the majority of insurers included a single confidence level, there were instances of insurers providing a confidence level range or providing different confidence levels for different measurement models or portfolios. Some insurers included the risk adjustment as a significant judgement or estimate, however many did not.

Coverage units: the level of detail provided by insurers regarding coverage units also varied significantly across the population. Some insurers provided disclosure of the coverage unit consideration for each type of product, and other insurers provided limited disclosure. It was also not always clear across insurers whether the coverage units are discounted or not. Coverage units were included as a significant judgement or estimate for some insurers, but not all.

The significant variance in the level of detail and specificity regarding IFRS 17 accounting policies and significant judgements was also observed as part of the KPMG International survey, indicating that this is not only a local trend. While a level of disparity in disclosures will always exist between insurers based on the size, complexity and materiality of each individual entity, it is expected that the market will find greater alignment in disclosures moving forward.

Presentation

Statement of financial position: as required by IFRS 17, all portfolios in a net asset position at reporting date are shown within the (re)insurance contract assets caption on the balance sheet, and all portfolios in a net liability position are shown within the (re)insurance contract liabilities caption on the balance sheet. For entities applying the PAA, the clear majority of gross portfolios are in a net liability position, with reinsurance portfolios in a net asset position at year-end. The only outliers to this are cell insurers that recognise the 'in substance reinsurance' arrangement with the cell owner at a significant liability value. For entities applying GMM or VFA, the split between whether the portfolios are in a net liability or net asset position at year-end is more balanced, with many insurers including balances in all four balance sheet captions at year-end.

Reinsurance expense: twelve insurers opted to disclose the reinsurance expense as a single net line on the face of the income statement. The other 7 insurers disclosed the gross up of reinsurance expenses and reinsurance income on the face of the income statement.

Disclosure aggregation: paragraph 96 of IFRS 17 requires insurers to consider the level of aggregation for which information is disclosed. Six of the insurers that only applied the PAA included the insurance contract opening to closing reconciliations at an entity level (i.e. one reconciliation for all gross business and one reconciliation for all reinsurance business). However, some of these insurers included other information relating to certain insurance financial statement captions at a more disaggregated level (i.e. within the insurance revenue or insurance service expense notes). The remaining 7 insurers that applied only the PAA disaggregated the reconciliations into between two or three bases, such as a split between personal and commercial; property, motor and other; and CAT and other reinsurance. For the insurers that applied multiple measurement models, the reconciliations were split between measurement models, with a few insurers also showing separate reconciliations based on the type of business written.

Expected CSM release: the majority of insurers included the buckets within 1 year, 2-5 years, 6-10 years and 10+ years to indicate the expected release of the CSM. The population is split equally between those that disclosed an interest element within the CSM maturity analysis, and those that did not.

Premium debtors from intermediaries: four insurers disclosed premium receivables from intermediaries as IFRS 9 financial assets, and 7 insurers disclosed these as part of the LRC under IFRS 17. For the remaining 8 insurers, the accounting policy choice was not clear within the financial statements.

Claims development: two of the non-life and 4 of the life insurers did not disclose claims development tables in line with the exemption set out under paragraph 130 of IFRS 17. For those insurers that disclosed claims development tables, the detail of these tables varied significantly.

KPIs: there is limited disclosure included in the financial statements regarding KPIs. Some insurers started to include some IFRS 17 aspects such as insurance revenue and CSM into the commentary, but this remains limited. Commentary within various reports still refers to IFRS 4 terminology such as gross written premiums and earned premiums.

Significant time and effort have gone into the initial sets of IFRS 17 compliant financial statements. While the initial population of IFRS 17 results available for analysis is small, it is a good base upon which to develop further analyses, as more insurers release their first set of results. As the dust settles on IFRS 17 transition and we move into an IFRS 17 business as usual world, insurers will have the ability to take a step back to consider their significant judgements, estimates and assumptions, how these are disclosed, and the interaction between the accounting policies and the risk management disclosure, ensuring that the financial statements tell a complete story to the user.

With all the knowledge and experience gained during the first year of reporting, insurers will likely consider refinements to IFRS 17 decisions, calculations and disclosures. The approach to dealing with these potential refinements is considered in the article 'Hindsight is 20/23: How to navigate 2024 with improved vision'.