Understanding IFRS 17: What's Changed and Why It Matters

In January 2023, Canadian insurers adopted the International Financial Reporting Standard 17 (IFRS 17), as mandated by regulators. IFRS 17 is a new international accounting standard that the International Accounting Standards Board developed after extensive global consultation.

The new standard has implications for understanding the financials of the insurance sector and how that might influence public policy decisions. This document provides a high-level overview of IFRS 17's impact on property and casualty (P&C) insurance in Canada.

WHY were the changes made?

IFRS dictates what items get reported on an insurer's income statement, and how they are grouped. IFRS 17 made several changes from the previous standard, IFRS 4. The changes have several benefits:

Global Consistency:

IFRS 17 replaces a patchwork of accounting approaches and creates a single global standard, improving comparability of insurer reporting between countries. (Though, it should be noted, it brings challenges to other types of comparisons, like between insurers in the same country – more on this below.)

Transparency:

IFRS 17 requires clearer disclosures about cash flows, accounting assumptions (e.g., discount rate) and risks, helping analysts and investors better understand insurer performance.

Simplicity:

IFRS 17 consolidates numerous line items on an insurer's income statement, making the statement cleaner and simpler.

Clarity:

IFRS 17 moves some items from the underwriting (also known as insurance performance) side of the ledger to the investment side, better separating insurance performance from investment result.

WHAT has changed under IFRS 17?

The changes under IFRS 17 are intended primarily for investors and financial analysts. However, they have implications for P&C insurance industry analysts, policymakers and regulators.

Here are a few of the more pertinent impacts for P&C insurance:

Underwriting and measurement:

Incurred claims are no longer shown as a single line item. Instead, they're grouped with "**directly attributable expenses**," which are directly linked to servicing insurance contracts, such as broker commissions and loss adjustment expenses. Other expenses, such as overhead and IT, are reported separately. Previously, all expenditures were reported together and were separate from claims costs. Several implications stem from this change:

- It is now challenging to analyze trends in pure claims costs (e.g., the cost to fix cars or rebuild houses).
- Because IFRS 17 allows insurers some judgement in what they classify as **"directly attributable expenses," comparing insurers is now more difficult**.
- The metrics and formula that the Canadian P&C insurance industry historically used to measure underwriting performance, don't work under IFRS 17.

  (Loss ratio + Expense ratio = ~~Combined ratio (CR)~~)

- **As a result, the industry developed the comprehensive combined ratio (CCR) to replace CR.** The CCR does not precisely replicate CR, but it is the closest possible metric under the new accounting standard.

Investment and time value of money:

Under IFRS 17, the net investment result includes investment return (as under IFRS 4) but also a **new line item: insurance finance expenses**, which is how insurers factor in the time value of money by discounting their cash flows.

- Discount rates are based on interest rates and reflect the reality that a dollar today will be worth more in the future because money can be invested and grow.
- The "unwinding" of these discounts (reducing them over time) used to be included in underwriting result **– specifically, claims costs – but is now included in the investment result.**

HOW has IFRS 17 affected the interpretation of insurer performance?

Comparability over time

With the move from CR to CCR, underwriting performance is calculated slightly differently due to data availability, so **tracking long-term trends has become more difficult.** It will take several years to obtain accurate year-over-year comparisons under the new metric.

Comparability across insurers

Insurers have some flexibility in how they allocate directly attributable expenses and apply discount rates. As a result, **insurers may report similar activities differently, making comparing companies more challenging.**

Volatility in reported results

IFRS 17 has stricter rules around discount rates and enforces an allowance for uncertainty about future claims. These rules result in greater precision but mean that **the reported profit is subject to wider swings**, both up and down, from one period to the next.

- Also, while the results are more transparent, interpreting them **requires a deeper understanding of the underlying assumptions and accounting choices**.

Underwriting versus investment results

With the important caveat that the following statement is a generalization and will not always be the case – the reclassification of certain expenses from underwriting to investment means that **underwriting results are more likely to look better than under the previous accounting standard, and investment results are more likely to look worse.**

WHAT HAS IBC HELPED the P&C industry adapt to IFRS 17?

Develop key performance indicators (KPIs)
IBC developed KPIs (including CCR) that comply with IFRS 17 and could be widely adopted to help improve comparability and continuity.

Secure industry buy-in
MSA Research, Canada's leading analytical research firm for P&C insurance, agreed to adopt IBC's KPIs on its P&C and Life/Health analytical platform, further ensuring consistent measures across the industry.

Provide guidance and training
IBC presented at conferences and provincial regulator forums when the changes were made, to ensure stakeholders and regulators understand the impacts on the industry and the new metrics.

Ensure ongoing outreach
IBC continues to engage provincial and federal policymakers on the real-world effects of IFRS 17, so public policy decisions reflect the new accounting reality.

WHAT'S THE BOTTOM LINE?

IFRS 17 provides a clearer view of insurance profitability, but interpreting results requires caution and new ways of looking at the data. Policymakers need to adjust benchmarks and be aware of the limits of cross-company and historical comparisons.