BEST'S COMMENTARY

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Frequently Asked Questions: IFRS 17

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IFRS 17 is an international financial reporting standard (IFRS) issued by the International Accounting Standards Board (IASB) for insurance contracts. The standard changes insurance contract accounting quite substantially for IFRS reporters. It is applied in jurisdictions that have adopted IFRS and will not apply to US-based (re)insurers, which will continue to report under US Generally Accepted Accounting Principles (GAAP).

However, subsidiaries and branches of insurance groups, including those of US-based insurance groups in jurisdictions where an insurance entity is required to file IFRS accounts locally, will have to apply the standard in those filings. The EU, UK, and certain other jurisdictions, including those in the Middle East, require only that listed companies report under IFRS, with local GAAP remaining an option for unlisted entities. In Japan and Switzerland, reporting under IFRS is optional.

The standard is intended to bring insurance accounting more in line with that of other sectors and to provide more uniformity to insurance accounting across territories. Disclosure and transparency are likely to improve under IFRS 17, but the standard will also add considerable complexity.

In general, comparability within the IFRS 17 universe will be enhanced. However, comparability of Key Performance Indicators (KPIs) across accounting standards—for example, with US GAAP reporters—will continue to require interpretation.

Best's Capital Adequacy Ratio (BCAR) is unchanged for IFRS 17 reporters to maintain comparability and continuity for all insurance companies. The following frequently asked questions provide initial insights and considerations for AM Best's treatment of IFRS 17 data, as some markets transition to the new standard.

AM Best's rating methodology, criteria, and processes are not specific to the variety of accounting standards currently used across different jurisdictions, and IFRS 17 should be viewed similarly.

General

Is the introduction of IFRS 17 expected to impact AM Best's ratings?

The introduction of IFRS 17, in and of itself, is not expected to have a direct impact on ratings, as AM Best focuses on (re)insurers' underlying economics for its analysis. Nevertheless, new insights can emerge over time and behavioral changes due to the new standard have the potential to affect ratings.

What is the effective date for the IFRS 17 accounting standard, and does it differ across territories?

Although IFRS 17 became effective for financial periods commencing on or after January 1, 2023, in jurisdictions adopting the standard from the outset, implementation dates vary by territory (i.e., as of 2024, 2025, 2026). Non-IFRS territories (notably, the US) will not be

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2023-174

adopting the standard. Some jurisdictions are converting their local GAAPs for insurance contracts to IFRS 17, albeit to different degrees.

How consistent will reporting by company and jurisdiction under IFRS 17 be, and how transparent will disclosures be?

For IFRS 17 audited year-end financial accounts, all companies will have an extensive set of financial disclosures built into the reporting requirements of the standard. Nevertheless, AM Best expects the level of voluntary additional/supplementary disclosure (for example, via the notes to the accounts and investor reporting) to vary by type of company and market. Furthermore, standardization of industry KPIs is unlikely to emerge for two or three years, as industry decisions and stakeholder consensus on such disclosures evolve.

As is the case with other accounting standards, certain accounting policy choices are available to IFRS 17 reporters—for example, the use of other comprehensive income (OCI) to account for the effects of discount rate changes and the deferral or otherwise of acquisition costs. These should be visible in accounting policy notes. Discount rates are likely to vary by insurer, but full-year results should also contain sensitivity analyses. Disclosure is also required to explain how risk adjustments are set.

What is the difference between the PAA, GMM and VFA approaches under IFRS 17?

IFRS 17 enables three different measurement models for reporting purposes: the Premium Allocation Approach (PAA), General Measurement Model (GMM) and Variable Fee Approach (VFA). GMM requires a split of the insurance contract liability into a present value of future cash flows (PVFCF) and a risk adjustment, with the remaining amount being the Contractual Service Margin (CSM). The PAA requires only that incurred claims be split into a PVFCF and a risk adjustment. The VFA is a variant of the GMM, under which the investment result normally goes to the CSM instead of being credited directly to equity. The VFA is applied to certain participating policies. In general, the PAA is used for most non-life business, while most long-term life business is reported under the GMM or the VFA.

How does IFRS 17 impact the financial reporting, including shareholders' equity, of non-life vs. life insurers?

IFRS 17 presents a range of movements by insurer in equity and profit over transition. Movements on transition to IFRS 17 are far more pronounced in the life insurance segment. The range of outcomes depends on many factors, including the relationship between the pace of profit recognition under IFRS 4 and that under IFRS 17. Changes to the treatment of capital in participating funds often act to reduce shareholders' equity on transition, though this depends on previous practice and is not uniformly the case. For non-life insurers, the impact is considerably narrower, with most non-life insurers likely to report marginally higher shareholders' equity. To some extent, for large composite insurers, the reduction in shareholders' equity for life contracts will be partly mitigated by an increase for non-life contracts.

Does AM Best expect IFRS 17 financial statements and reporting to make disclosures across insurance companies/segments more uniform?

AM Best expects the standard to bring more uniformity and transparency to insurance accounting across territories, as well as more complexity. When IFRS 4 was introduced, it grandfathered practice previously in force. Widely varying practices under local GAAP disclosures were therefore used in IFRS 4 reporting.

A uniform presentation of margins in the form of the risk adjustment under IFRS 17, prior-year development (past service under IFRS 17), loss-making contracts (onerous contracts under IFRS 17), and an estimate of deferred profit for long-term business are some of the disclosures AM Best regards as helpful, with the last item being particularly relevant for the life segment.

How will AM Best's financial and credit reports for insurers change in response to IFRS 17 reporting?
AM Best's credit and financial report templates have been updated to accommodate the changes in reporting/disclosure under IFRS 17. This includes changes to the income statement and balance sheet, as well as other key financial indicators disclosed in AM Best reports.

Credit and financial reports will continue to include financial data for up to five years. As a result, there will be a combination of IFRS 17 and prior reporting. Reference should be made to the column headers when distinguishing between IFRS 17 and non-IFRS 17 reporting.

Will there be any changes to the data collected or the format of credit or financial reports for insurers that do not report under IFRS 17?
There will be no changes for non-IFRS 17 reporters. AM Best will retain and maintain existing data formats used for ratings purposes for insurers that do not report under IFRS 17, and will similarly retain and maintain existing credit reports and financial reports.

Methodology

Is AM Best updating its Credit Ratings Methodology (BCRM) to accommodate IFRS 17 reporting?
The BCRM and associated criteria already accommodate various financial reporting standards used around the world, and the implementation of IFRS 17 will be no different. Some changes have been incorporated for clarification.

Does a move to IFRS 17 change AM Best's building block (balance sheet strength, operating performance, business profile, and enterprise risk management) approach to ratings?
The building block approach will not change as a result of the IFRS 17 reporting standard. AM Best's ratings methodology, criteria, and process already accommodate a variety of different financial reporting standards around the world and the implementation of IFRS 17 is no different in this respect.

When will AM Best begin using IFRS 17 reporting as the basis of its ratings analysis?
AM Best will commence using IFRS 17 financial results for rated entities as and when the standard becomes the basis of the companies' financial reporting and disclosure. Interim reporting will often be used to update consideration of full year-end reporting.

For many companies adopting IFRS 17, the first full-year results reported under IFRS 17 will be those ending December 31, 2023. However, this varies by market, depending on implementation timelines and on a company's financial year-end. For example, a New Zealand insurer with a September 30 fiscal year-end is expected to report only its first full year of IFRS 17 results for the fiscal year ended September 30, 2024.

Is an insurer's IFRS 17 preparedness and compliance with reporting requirements a rating consideration for AM Best?
Yes, a rated company's compliance with regulation, including mandatory IFRS 17 reporting requirements, is a rating consideration. A company's failure to comply with such requirements could lead to license restrictions or other regulatory implications, which could have a bearing on AM Best's rating assessment. In particular, inadequate preparedness or non-compliance with IFRS 17 reporting requirements may negatively impact AM Best's assessment of a company's enterprise risk management.

AM Best also will assess management's preparedness with regard to the understanding and use of IFRS 17 reporting.

How will AM Best consider onerous contract provisions in credit ratings?
Onerous contract provisions are part of the IFRS 17 insurance contract liability. In general, the more granular level at which onerous contracts are assessed under IFRS 17 compared to many other accounting standards is a positive factor for reserve adequacy—one of the qualitative components of balance sheet strength.

In the absence of financial statement reporting of premium volumes (gross and net) under IFRS 17, how will AM Best assess an insurer's size, scale and portfolio diversification when evaluating a company's business profile?
Although companies are not required to report written premiums, gross written premiums are likely to be available in the notes to financial statements or other accompanying material. However, the focus will be on insurance services revenue as the main indicator of an insurer's size, diversification, and exposure to pricing risk.

Key Performance Indicators (KPIs)

How consistent are underlying assumptions for IFRS 17 reporting?
Assumptions will be set by management, in agreement with auditors, and will generally reflect an insurer's circumstances. However, as with other accounting standards, variations will occur. Transparency and the clarity of underlying assumptions, along with disclosures regarding sensitivities, are critical to ensuring these assumptions can be viewed in a fair and consistent manner.

What changes to KPIs does AM Best expect under IFRS 17 reporting?
Existing key financial metrics will mostly continue to be used under IFRS 17. However, there are new measures reported under IFRS 17. Both the changes to the data input into existing KPIs and the new measures will impact comparability with existing calculations, and interpretation will be required. AM Best will capture a wide range of KPIs under IFRS 17. KPIs reported by the industry will likely take some time to solidify as best practices emerge. AM Best expects KPI reporting in the IFRS 17 universe to become more consistent and comparable across the industry as consensus is reached on the use and value of various financial and non-financial measures.

How will AM Best use combined ratios calculated from IFRS 17 data in assessing non-life underwriting performance?
AM Best expects to evaluate net/net and net/gross combined ratios calculated for IFRS 17 reporters. IFRS 17 ratios should be more comparable across the IFRS 17 universe, at least when comparing similar ratios such as the net/net, than was previously the case. This is partly because normal variations between lines of business should be diminished due to discounting. However, combined ratios will remain subject to interpretation for individual insurers. Comparisons across accounting standards will require careful interpretation. Indeed, the need for interpretation will grow when comparing combined ratios that use IFRS 17 data with those from other accounting standards, including US GAAP. Operating ratios are also considered by AM Best and, over time, may receive greater weight in the rating analysis.

What performance metrics will be most relevant for life insurers reporting under IFRS 17?
AM Best will continue to use traditional metrics such as return on equity (RoE) and life revenue margins to assess the performance of life insurers. Life revenue margins may become more relevant than was previously the case given the newly matched nature of revenue and expenses. Additionally,

AM Best expects that RoEs will become more meaningful and receive more attention, to some degree at the expense of estimated returns on new business. As reported earnings measures become more transparent and meaningful under IFRS 17, particularly in the life segment, their relevance will be enhanced, though cash flows will also remain important.

CSM-related measures will be welcome new additions to the KPI roster. For example, CSM new business profitability and the growth of CSM over reporting periods will be considered. AM Best expects that, over time, life segment KPIs derived from financial reporting will become more relevant to AM Best's analysis under IFRS 17 than previously. This will, to some degree, be at the expense of regulatory and embedded value type reporting.

What leverage ratios will AM Best use when considering debt leverage, and will equity include CSM?
In AM Best's methodology and criteria procedure, leverage is a key consideration in a company's balance sheet strength assessment but is not directly linked to the issuer credit rating. A view on leverage is made in conjunction with other balance sheet factors, serviceability of debt, and exposure relative to peers.

AM Best will continue to use its standard definition of financial leverage in its analysis and in published credit reports. However, for IFRS 17 reporters, AM Best will also take into consideration financial leverage including the CSM. As previously, coverage ratios, the amount and timing of cash flows, their variability and relationship to debt maturities, and how capital markets view debt levels will be considered and will play an important role in the ratings evaluation.

Will AM Best evaluate a company's reserve discounting approach under IFRS 17?
Reserve adequacy is an important consideration for AM Best when determining a (re)insurer's credit rating, regardless of the accounting standard. For IFRS 17 reporters, the company's reserving approach, reserve adequacy, risk adjustment, and discount basis/assumptions are likely to be key considerations, overall and by line of business basis. AM Best expects that IFRS 17 will enhance transparency of reserve strength in published reporting.

How will AM Best consider economic changes and resulting movements in discount rates/performance metrics over time when evaluating an insurer's balance sheet strength and operating performance?
The more economic nature of IFRS 17 will in general diminish accounting mismatches compared with prior reporting, and enhance transparency relative to economic changes. The sensitivity of a company's balance sheet strength and operating performance to future economic movements is an important consideration in determining an insurer's credit rating. The sensitivity of key measures, such as capital adequacy, liquidity, loss ratios, combined ratios and investment fair value gains/losses is all considered in AM Best's analysis. This will remain the case under IFRS 17 reporting.

How will AM Best compare performance metrics of IFRS 17 and non-IFRS 17 reporting insurers?
Comparisons across accounting standards will require careful interpretation, and differences from other accounting standards are likely to increase under IFRS 17. AM Best will use internal benchmarking analyses and tools to compare insurers using different accounting standards. This will be a challenge initially, but greater detail and acceptance of KPI metrics will evolve over time, along with comparative views against other accounting standards. AM Best will seek to capture a variety of financial metrics so that comparisons can be made against relevant peer groups.

BCAR

Does AM Best expect BCAR scores for rated companies to move significantly as a result of adopting IFRS 17 reporting?

BCAR depicts the quantitative relationship between an insurer's balance sheet strength and the key financial risks that could impact such strength. BCAR scores consider the underlying economics of an insurer, and these factors do not change due to the introduction of IFRS 17. BCAR score movements should therefore be limited on transition in most instances.

Is the BCAR changing to accommodate IFRS 17 reporting?

The BCAR considers an insurer's underlying economics. The BCAR is used for evaluating capital adequacy from insurer financial statements under many reporting standards, including the varying accounting practices under IFRS 4. The BCAR's basis and the factors used (including in the global, Canadian property/casualty, and Canadian life/health variants) have therefore not been changed in response to IFRS 17 reporting.

However, the BCAR's data interface has been updated to accommodate the derivation of inputs from IFRS 17 data. For example, the non-life reserve page of the BCAR has been updated to transparently reverse reported claims discounting and risk margins for all insurers, including for IFRS 17 reporters, before applying the BCAR's (unchanged) discount and capital charge factors. In AM Best's balance sheet strength assessment, reserve adequacy remains an additional factor outside the BCAR.

Is the CSM arising from life business viewed as economic capital by AM Best under IFRS 17?

Under various reporting standards, AM Best currently adjusts reported equity when assessing available capital for the BCAR, to allow for the net economic value due to long-term business (NEVLtB) in the life segment. This approach is expected to continue under IFRS 17. The equity credit granted in BCAR would not normally exceed 50% of the measure representing this economic value.

Under IFRS 17, the life segment CSM and risk adjustment will form the basis of the NEVLtB. AM Best will consider the source and profile of CSM amortization and the volatility of the CSM balance, with the possibility that equity credit might in well-defined cases vary from 50%, though we envisage it will be in the 40%-65% range. The haircut reflects volatility of the economic value in this component, including sensitivity to assumption changes, and fungibility constraints.

Will AM Best give equity credit for non-life CSM?

Consistent with existing practice, AM Best does not typically expect to adjust for economic value due to long-term business in the non-life segment. As is current practice, there may be exceptions for products and country-specific cases.

For IFRS 17 reporters, what will AM Best use as a measure of premiums in its BCAR calculation?

For IFRS 17 reporters, AM Best expects to use net insurance services revenue to derive a measure of premium/pricing risk in the BCAR calculation. The present value of cash inflows on contracts initially recognized in the year will also be used for life segment business not measured under the PAA.

IFRS 17 financial statements will see a shift from reporting gross written premium/net written premium to insurance services revenue. Will AM Best still require written premium volumes to be disclosed for its analysis?

AM Best will not normally require disclosure of gross written premium/net written premium for IFRS 17 reporters. However, disclosure of insurance services revenue by line of business and net insurance services revenue will be required for the AM Best rating analysis and to support the determination of pricing risk in BCAR.

How will AM Best treat IFRS 17 deferred acquisition costs, which are amortized against future new business (IFRS 17 DAC) versus in-force DAC?
The treatment of in-force DAC will not change. IFRS 17 DAC is a new asset and will be deducted from available capital.

Insurance debtors and creditors are expected to form a part of insurance contract liabilities on the balance sheet of insurers under IFRS 17. Will AM Best require additional disclosure to determine these component balances?
Insurance debtors and creditors represent future cash flows and are included in the PVFCF component of insurance contract liabilities/assets under IFRS 17. AM Best will continue to use net (of reinsurance) liabilities for incurred claims that do not include insurance debtors and creditors as inputs for reserve risk in the BCAR.

These balances will be obtained either from voluntary public disclosure or via the Supplemental Rating Questionnaire (SRQ).

How will AM Best treat long-term non-life insurance contracts (those exceeding 12 months) under IFRS 17 reporting?
AM Best's treatment of long-duration, non-life insurance policies and the greater potential for mis-pricing risk remains unchanged. As such, the long-duration component (exceeding 12 months) of the IFRS 17 liability for remaining coverage and incurred claims will typically attract additional underwriting risk charges in BCAR.

How will AM Best treat country-specific product features in BCAR, such as the long-term, non-life business in South Korea or the life business in New Zealand?
The AM Best rating process affords flexibility to ensure economic treatment of specific insurance contracts and product features. The long-term contracts referenced have typically been, and are expected to remain, examples of that flexibility. AM Best's current view is that IFRS 17 disclosure will enhance transparency of the performance of these contracts.

Will "Liability for Remaining Coverage""(LRC) under IFRS 17 be used as a replacement for "Unearned Premium Reserves" (UPR) under IFRS 4 in the BCAR?
In general, the LRC serves the same purpose in IFRS 17 accounts as the UPR did. It is therefore the starting point for BCAR inputs where the UPR was previously used. However, the LRC is stated net of all DAC and after taking into account relevant net (of debtors) insurance creditors. Adjustments may therefore be made for these items as necessary.

Supplementary Rating Questionnaire (SRQ) and Disclosure

Will the SRQ prepared by insurers as part of the AM Best's interactive rating process change in response to IFRS 17?
Yes. For IFRS 17 reporting companies, some new fields/data requirements have been added to the SRQ template. These new fields center around additional breakdowns and financial disclosures necessary to complete the BCAR for rated entities. Examples include insurance debtor/creditor breakdowns and in-force DAC. Insurance service revenue and IFRS 17 present value of new business premium (PVNBP) measures will be requested where net and gross written premium was previously supplied on the forms. The amount of discount and risk margin for non-life incurred claims will be required for all insurers, including IFRS 17 reporters.

Will insurers rated by AM Best be required to provide additional disclosures beyond what is presented in audited IFRS 17 accounts?

Yes, there will be additional IFRS 17 disclosures required as part of AM Best's SRQ template. In addition, further financial and non-financial disclosures may be requested by AM Best as needed.

Will rated entities be required to prepare financial forecasts/projections based on IFRS 17 for AM Best's rating purposes?

Yes, for rated entities where the prevailing financial reporting standard is IFRS 17, AM Best would typically expect financial forecasts/projections to be prepared on a consistent basis.

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