IRLA blog #004
25/10/18
Graham Oswald - Director, PwC

IFRS17 : Important considerations for the legacy market

- *There are significant financial and operational impacts of IFRS17 on legacy market participants*
- *Legacy market players need to invest time now to assess the scale of this impact*

As IFRS17 comes sharper into focus for the insurance industry as a whole, it is becoming ever-clearer that the legacy insurance market will not escape its grasp. Potential changes to the way that profit from past and future transactions can be recognised on transition and in the future mean that it is critical that these changes are fully understood by legacy market participants in order to plan for the financial and operational impacts on your business.

What is changing?

It's no secret that the measurement of all insurance liabilities will change to a risk-adjusted discounted basis and that the current common practice of holding additional margins will no longer be allowed. This means that profit will emerge differently over time between current IFRS and IFRS17.

Of particular additional importance to the legacy market is that acquired or retrospectively reinsured portfolios of fully expired (run-off) contracts will have a new coverage period, equal to the settlement period of the liabilities, and the embedded profit from transactions will be released over this settlement period. This is in contrast to the current environment where profit may often be recognised on the transaction date.

Furthermore, this reassessment is retrospective, so on transition to the new standard, an acquirer's balance sheet will be restated to reflect this treatment for all unsettled historical transactions. It is worth noting that the topic of exactly how historical transactions should be treated on transition is an issue raised in the October 2018 IASB meeting.

Continued...

What does this mean in practice for acquirers and sellers

So what does this mean for the legacy market? The key takeaway is that under long-term reinsurance agreements and Part VII transfers, the ultimate profit will not change but IFRS17 could change the way that profit from transactions emerges over time, which could impact the perceptions of investors, dividend pay-out patterns, the KPIs that are used to value transactions and potentially even deal pricing for some insurers.

IFRS17 will also transform the presentation of your consolidated group financial statements on transition and in the future, and the entity financial statements to the extent that IFRS is used as the accounting basis in entity accounts. It will also lead to a balance sheet impact on transition so it is important to understand how historical transactions of business currently in the settlement period will be accounted for in the new world.

The move to IFRS17 can also impact the tax position of companies, especially where IFRS is used as the tax base (in the UK, this is the case if the financial statements are on IFRS). Transition could cause one-off profits or losses for tax purposes, and the ongoing profit profile may change for tax purposes. Even where companies do not use IFRS as the tax base, there may be deferred tax impacts to consider.

In addition to these headline impacts:

- Enhanced disclosure requirements will increase the transparency of reserve adequacy, expected profitability and quality of earnings, which could change the landscape of the deal market because buyers will have access to more information.
- Changes to financial statement presentation will drive new key performance indicators and MI requirements across the industry, for example deal metrics.
- All insurers operating in an IFRS17 world will require additional data and a more complex measurement model under IFRS17, introducing greater levels of system complexity and cost, with corresponding impacts upon finance and actuarial processes.

So what should you do now?

It remains to be seen whether IFRS17 will impact deal pricing but regardless of this, it is important for all run-off acquirers and disposers to understand the financial impact of IFRS17 on transition and on the accounting for future transactions. Further consideration of the key judgments available, plus the impact on data, systems, and processes will help companies assess the scale of the change and enable them to plan accordingly.

More PwC blogs can be found at https://pwc-spark.com/docs/DOC-921764

T: +44 (0) 203 362 4233
E: secretariat@irla-international.com