Members' Update

The Assuris Members' Update provides articles and papers on key industry issues as well as share insights on regulatory news, global perspectives and Assuris updates.

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IFRS 17 Business Model Impacts

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IFRS 17 is a big change for the life insurance industry. The transition to IFRS 17 continues to monopolize many resources. This transition highly impacts an insurer's operations. It also affects how executives will manage the business.

Has the transition to IFRS 17 been an opportunity to re-think insurers' product offering, investment strategy and risk appetite? The Assuris industry consultation sheds light on the question.

Over the last few years, the insurance industry has shifted its focus towards less capital-intensive products such as participating policies, short-term contracts, and investment products. Life insurers' product offerings can be grouped into three categories:

1. Products with long-term protection (~retail insurance business)
2. Products with short-term protection (~group business)
3. Products without protection (~wealth business)

Sometimes, there is a thin line between offering and not offering an insurance product. Several aspects must be considered, such as client's needs, the price, the insurer's profits, and risk appetite. Finding the right balance requires a lot of work, and IFRS 17 will change insurers' balance sheet, earnings, and capital ratio, which could have an impact on product profitability.

Balance Sheet

At the industry level, we expect a decrease in equity due to changes to liability measurement. The increase in liabilities is mostly driven by lower discount rate and Contractual Service Margin (CSM), which represents the present value of future profit.

At transition, equity is expected to decrease at the industry level due to an increase in best estimate liability and the creation of CSM, which is a liability on the balance sheet. The IFRS 17 balance sheet shows a more conservative equity value because future profits are not immediately recognized. For products with long-term guarantees, the profit will be recognized when the service is provided over the life of the contract.

Assuming the same economics, companies should earn the same profits over the life of the contract. Therefore, lower equity under IFRS 17 implies higher equity growth expectations under IFRS 17 compared to IFRS 4 regime.

In other words, a change in liabilities' measurement does not change the economics of insurance. Total profits remain the same, but accounting affects the timing of earnings recognition. However, looking at the balance sheet, equity and earnings impact is not the whole story.

The insurer capital ratio is an important variable in the equation. The drop in equity at transition might be viewed negatively from a capital standpoint. However, the capital treatment of the CSM allows insurers to recognize these future profits immediately. The capital treatment of CSM has minimized the negative impact on insurers' capital ratio.

Corporate Owners' Dividend Expectations

Corporate owners provide capital in exchange for future dividend payments. The owners are focusing on their return on investment. The insurer's capacity to free up capital and pay dividends depends on earnings and capital ratio forecast.

What is the implication of IFRS 17 on insurers' capacity to release capital? We have broken down the insurers' sources of profits to understand the impact on each component. The last column indicates the IFRS 17 impact on insurers' capacity to free up capital. "Positive" means that IFRS 17 should be more favourable.

Earnings	IFRS 4	IFRS 17	Impact
New business gains	▸ Some future profits recognized at issue	▸ No future profits are recognized at issue	Negative
Release of reserve margins	▸ Known as PfADs (economic & insurance margins)	▸ Risk Adjustment (insurance margins)	Negative
Net investment return	▸ Assets return vs IFRS 4 discount rate	▸ Assets return vs IFRS 17 discount rate	Positive
CSM Release	N/A	▸ In force block CSM Run-off	Positive

The table above assumes no experience gains and losses related to actuarial assumptions.

In addition to earnings, the insurers' ability to release capital also depends on the relationship between available and required capital, which may further limit the ability to pay dividends. The capital regime under IFRS 17 was designed to achieve industry neutrality at transition.

Capital Release	IFRS 4	IFRS 17	Impact
Available capital	▸ IFRS 4 retained earnings	▸ IFRS 17 retained earnings	Negative
	▸ PfADs	▸ Risk Adjustment	Negative
	N/A	▸ CSM	Positive
Required capital	N/A	▸ Scalar reduction	Positive

The research indicates that insurers' capacity to free up capital should not deteriorate at the industry level under the new regime.

It is important to note that the implications of IFRS 17 differ for each insurer. The impacts at the industry level may or may not represents an insurer's situation. Many factors, such as business mix, investment strategy, and CSM growth, could impact an insurer's capacity to free up capital.

Volatility

Business owners usually prefer predictable results. Managing earnings and capital volatility is a critical task for the life insurance business. The new regime may or may not generate additional volatility, subject to how insurers will adapt to this new regime.

The insurer's block of business and investment strategies will affect the volatility of financial results, in particular, because financial guarantees are measured based on a market-consistent approach and the insurer's assets and liabilities are "de-linked" under IFRS 17. Under IFRS 4, liabilities were valued in reference to the value of the assets supporting those liabilities. This was known as the Canadian Asset Liability Method approach or CALM. Under IFRS 17, liabilities are valued based on the liquidity characteristics of insurance contracts without reference to the actual assets backing those liabilities.

Assets and Liability Management (ALM) practices and hedging will become even more important under IFRS 17. It is an area where we might see different approaches. Some insurers might be comfortable with the level of volatility, and others might prefer to reduce volatility. Modifications to investment strategies such as reduction in Non-Fixed Income (NFI) assets and surplus assets reclassification could be used to mitigate earnings volatility.

In Summary

Overall, our consultation indicates that IFRS 17 implications on insurers' business models should be minimal as it is defined as an evolutionary process rather than a revolution.

- Products with short-term guarantees and products that do not offer guaranteed protection are minimally impacted by IFRS 17.
- Even though the timing of earnings on life insurance products with long-term guarantees changes under IFRS 17, the implications are not significant enough to jeopardize the offering of these products.
- Business owners' dividend expectations and product profitability should not change significantly.
- The real volatility of financial results remains to be seen. In any case, insurers have the expertise and tools to adapt to this new reality.

The insurance industry has a lot to manage with the IFRS 17 transition compounded with the financial market volatility we have seen in 2022. Nobody has a crystal ball, and 2023 could be another bumpy year as companies navigate reporting under the new standard. Managing IFRS 17 earnings and capital volatility will again test insurers' capacity to adapt, but we at Assuris are confident that our industry will successfully rise to this latest challenge as it has so many times in past.

Steve McMahon FSA, FCIA is the Assistant Vice President, Industry Risk, at Assuris, and is responsible for analyzing the broad economic and emerging industry-wide risks. He is also responsible for developing Assuris' views on capital and actuarial policy issues. Steve is actively involved with in-depth analysis of solvency risks of our member life insurance companies.

Assuris – New Member

The Independent Order of Foresters joins Assuris as our newest member. This means that all Foresters Financial insurance product benefits are now protected by Assuris. The Independent Order of Foresters (IOF) is the first fraternal life insurer to become a member of Assuris.

Assuris is the not-for-profit organization that protects Canadian policyholders if their life insurance company fails. More details about Assuris' protection and its limits are available at **www.assuris.ca.**

Focused on Policyholder Protection

We are pleased to announce that Paul Petrelli, President & CEO, Assuris, was elected Vice Chair of the International Forum of Insurance Guarantee Schemes (IFIGS).

Assuris has always been an active member of IFIGS as one of the original founders of the organization. IFIGS is a unique networking forum, uniting leaders from guarantee schemes, in both life and non-life insurance, across the globe.

Guarantee schemes are an important contributor to the stability and soundness of the insurance industry. As some of Assuris' members not only operate in Canada but internationally, it is important to have an organization like this that will ensure open communication to better protect members' policyholders not only in Canada but globally.

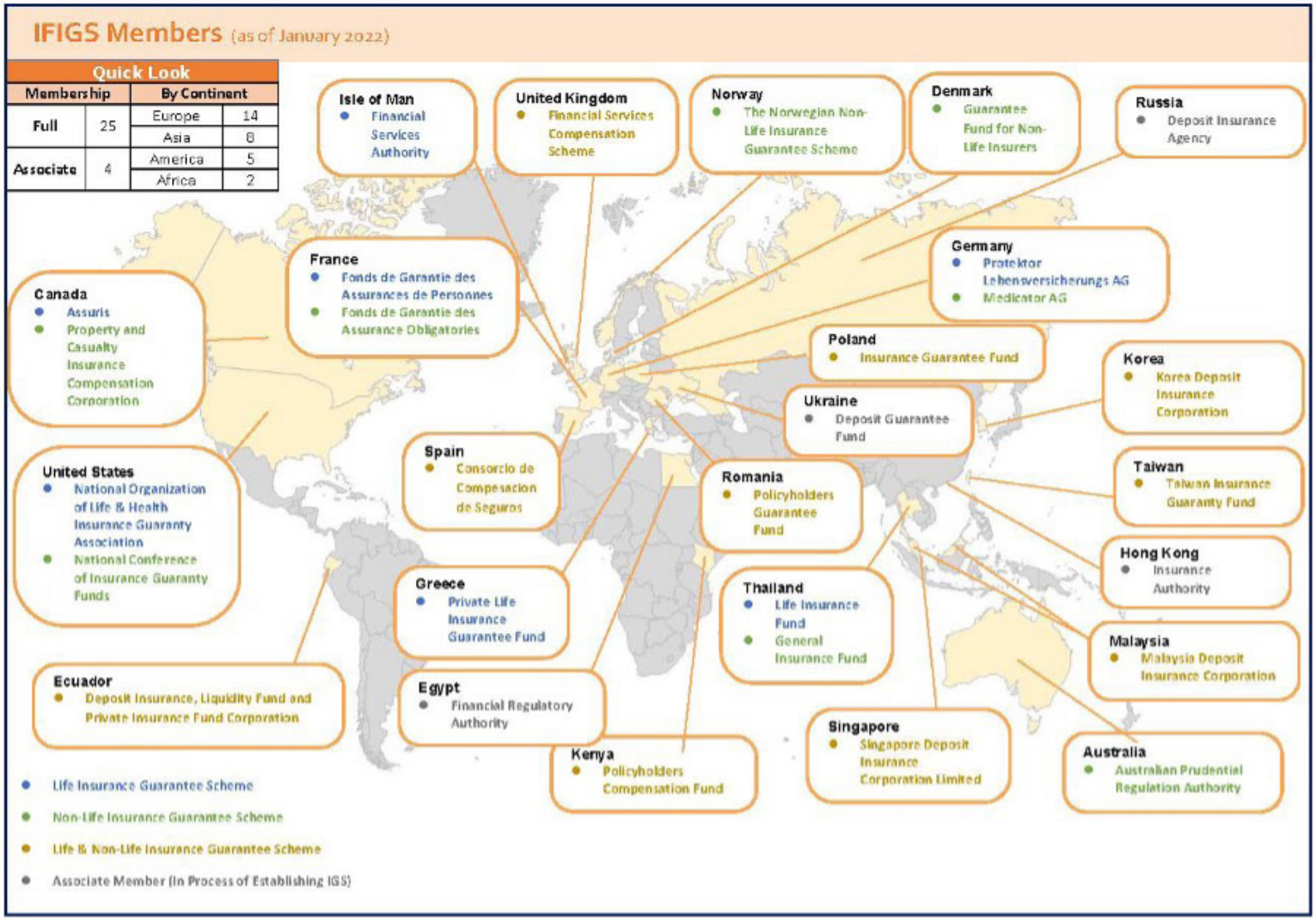
IFIGS Executive Committee

- Ms. Afiza Abdullah, Chair Perbadanan Insurans Deposit, Malaysia
- Mr. Paul Petrelli, First Vice Chair Assuris, Canada
- Mr. Chayong Yoon, Immediate Past Chair Korea Deposit Insurance Corporation, South Korea

Our objective is to establish relationships through the exchange of ideas and practices from the scope of policyholder protection and funding approaches to governance and risk management activities, including contingency plan testing and crisis simulation.

IFIGS also strives to collaborate with various stakeholders, including the International Association of Insurance Supervisors (IAIS) and the Financial Stability Board (FSB). Most recently, IFIGS collaborated with World Bank to host a webinar with the theme of "Navigating the Way Forward for the Last-resort Protection to Policyholders."

Founded in 2013, IFIGS currently has 26 members and 4 associate members.



Expertise and Experience – Our Board of Directors

Ruvimbo Francois-Kumaza
Corporate Governance Specialist

The Assuris Board of Directors is comprised of independent directors with decades of experience in fields such as, actuarial, accounting, law, government and life insurance. Our directors are chosen for their experience in business and their technical expertise which are vital to the life insurance industry and the management of failures.

Each of our directors embodies Assuris' values and are committed to our mission to protect Canadian policyholders if their life insurance company fails.

Results	Respect	Partnership	Integrity

Supporting Good Governance

Our Board maintains the highest standards of Fiduciary Responsibility and Duty of Care. They are responsible for the stewardship of the Corporation, and they do this through an appropriate balance of the three 'sights'- foresight, oversight, and hindsight.

As the industry continues to evolve, it is vital for our Board of Directors to focus on maintaining their expertise on industry issues and emerging risks. Directors take continuing education courses and regulator education sessions with industry experts to maintain the highest level of competence as board members. Assuris encourages directors to advance their knowledge and develop the necessary skills to enhance their contribution on the Board.

Assuris' mission is to protect Canadian policyholders. As such, it is important that Canadian policyholders see themselves represented on our Board. Like many organizations, we are challenged in achieving an appropriate and diverse representation on our Board. But we are committed to making diversity a priority and having a multiplicity of perspectives in the boardroom. We have already achieved a 50% gender balance and 30% Quebec representation, and this year we have set an objective to have 20% of the slate of candidates, being considered for election to the Board, be Black, Indigenous, People of Colour (BIPOC) to work towards achieving our goal.

Priorities of the Board

While the Board is always focused on fulfilling its mission, there are two priorities that are top of mind this year. Assuris:

- must be resolution ready to respond quickly if a life insurance company fails. A successful and quick resolution will protect the policyholders and minimize the cost to the industry;

- wants to strengthen relationships with its stakeholders. We firmly believe that strong relationships today are critical to effectively dealing with any troubled insurer. We do not want the first time that policyholders and financial advisors are hearing about Assuris, to be when a problem arises.

Ruvimbo Francois-Kumaza M.A. is the Corporate Governance Specialist at Assuris and is responsible for maintaining and implementing corporate governance practices and guidelines. She is also responsible for managing the logistics for Assuris' Board and committee meetings.

Assuris Board Members

Denis Berthiaume
Former SVP & COO, Desjardins

Alain Brunet
Former SVP & President of Insurance National Bank of Canada

Brenda Eprile
Former ED & Chief Accountant, Ontario Securities Commission

Monika Federau
Former Chief Strategy Officer, Intact Financial

Marie-Josée Martin
Former President and CEO for Blue Cross Life Insurance Company of Canada

Tricia O'Malley
Former Chair, Canadian Accounting Standards Board

Paul Petrelli
President & CEO, Assuris

Janis Sarra
Professor of Law, UBC Peter A. Allard School of Law

Frank Swedlove (Chair)
Former President & CEO, CLHIA

Mark Zelmer
Former Deputy Superintendent, OSFI

Assuris – Follow-us on Social Media

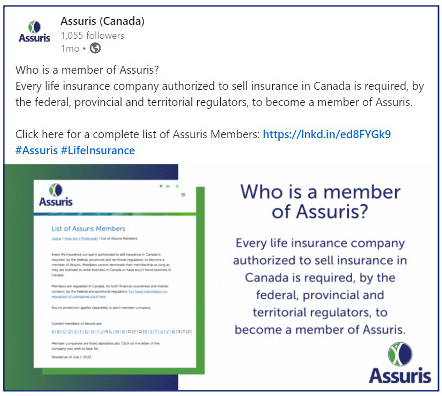
Assuris' role is to protect Canadian policyholders in the unlikely event that a life insurance company fails. Established in 1990, we are an independent not-for-profit compensation organization, backed by the financial strength of the entire Canadian life insurance industry.

Every life insurance company authorized to sell insurance policies in Canada is required, by the federal, provincial, and territorial regulators, to become a member of Assuris. Assuris is designated by the federal Minister of Finance under the Insurance Companies Act of Canada and specified in the Quebec Règlement d'application de la Loi sur les assurances.

If you have life insurance from a member company, you already have Assuris protection!

Find out more about Assuris – Follow us on LinkedIn, Twitter and Facebook

Here are some top posts you may have missed!



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