

Accounting Considerations for Insurers

What you need to know (May 2020)

What are some issues to consider?

1. The COVID-19 pandemic affects insurance companies in many ways. From an accounting perspective, an insurer's assets and liabilities may be affected by:
 - (a) the market volatility on its investment portfolios; and
 - (b) the changes to cash flow estimates relating to the insurance contracts that it issues and reinsurance contracts that it holds.
2. In addition, an insurer may need to disclose more information to help users understand how COVID-19 affects the insurer's financial position and performance, and future cash flows.
3. An insurer may want to consider the questions below when preparing its financial statements. COVID-19 is currently an evolving situation that results in an increased level of uncertainty. Therefore, the judgment, estimates and assumptions used in preparing financial statements will change over time as the financial impact on an insurer becomes clearer.

Should I consider impairment on my investment portfolios under IAS 39?

4. Most insurers, but not all, have elected to defer applying IFRS 9 *Financial Instruments* using the temporary exemption¹ in IFRS 4 *Insurance Contracts*. Therefore, insurers that continue to apply IAS 39 *Financial Instruments: Recognition and Measurement* will need to assess whether there is any

¹ Available to qualifying insurers whose activities are predominantly connected with insurance.

impairment on investments that are not classified as financial assets at fair value through profit or loss. ([IAS 39.58](#))

5. Under IAS 39, expected losses as a result of future events, no matter how likely, are not recognized. ([IAS 39.59](#)) This is different from IFRS 9 in that, under IFRS 9, impairment losses are recognized, even if the loss has not yet been incurred.²
6. To determine whether an investment is impaired in light of the volatile markets, an insurer should assess at the end of each reporting period if:
 - (a) there is objective evidence of impairment as a result of one or more events (a “loss event”) that occurred after initial recognition; and
 - (b) that loss event has an impact on the estimated future cash flows that can be reliably estimated.([IAS 39.59](#))
7. Objective evidence of impairment includes observable data about loss events. Indicators of loss events include: ([IAS 39.59](#))
 - (a) significant financial difficulty of the issuer; or
 - (b) it becoming probable that the borrower will enter bankruptcy or other financial reorganization.
8. A downgrade of an entity’s credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. Examples of other factors to consider may include information about:
 - (a) the debtor’s or issuer’s liquidity, solvency, and business and financial risk exposures; and
 - (b) national and local economic trends and conditions. ([IAS 39.60](#))
9. For an equity investment classified as available for sale, an impairment loss is recognized if there has been a significant or prolonged decline in the fair value of the investment below its cost. ([IAS 39.61](#)) An insurer may initially conclude in its interim financial statements that there is not a significant or prolonged decline in the fair value of its investments. However, if COVID-19’s impact on the markets persists over time, this conclusion could change in future reporting periods.
10. In some cases, the observable data required to estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. For example, an insurer determines a borrower is in financial difficulty and there is limited historical data relating to similar borrowers. In such cases, an insurer uses its experienced judgment to estimate the amount of any impairment loss. ([IAS 39.62](#))

² For insurers that apply IFRS 9, refer to the International Accounting Standards Board’s educational document, “[IFRS 9 and COVID-19 – accounting for expected credit losses](#).”

11. It is possible that, after the reporting date but before the financial statements are issued, indicators of impairment become more evident. To determine what events need to be accounted for and disclosed after the reporting period, refer to the COVID-19 Resource titled "[Events after the Reporting Period.](#)"

What factors should I consider in the measurement of my insurance liabilities?

12. IFRS 4 allows insurers to use a wide variety of accounting practices for insurance contracts, reflecting national accounting requirements. As a result, insurers will need to consider COVID-19's impact based on the accounting policies applied under IFRS 4.
13. IFRS 4 includes a few additional requirements, one of which is performing the liability adequacy test. This test requires an insurer to assess whether its insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. ([IFRS 4.15](#))
14. In assessing how COVID-19 might affect the measurement of insurance liabilities given the potential change to policy patterns such as claims development or premiums collection, an insurer might consider:
- (a) the effect on reported claims and incurred but not reported claims;
 - (b) revisions to demographic assumptions (e.g., mortality) and market assumptions (e.g., decline in interest rates) resulting from the current environment; and
 - (c) any changes to assumptions about the timing of premium cash flows and expected future claims.

Should I consider impairment on my reinsurance assets?

15. If an insurer (cedant) has reinsured risks from its insurance contracts, it should also consider whether there is impairment to a recognized reinsurance asset. A reinsurance asset is impaired if:
- (a) as a result of an event, there is objective evidence that the cedant may not receive all amounts due to it under the terms of the contract; and
 - (b) that event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer. ([IFRS 4.20](#))

What other items should I consider?

16. Insurers should consider additional disclosures relating to COVID-19. For example, insurers should explain how the risks from insurance contracts are being managed and the assumptions used in the measurement of insurance liabilities, including sensitivities in the assumptions. ([IFRS 4.38-39A](#))
17. Other disclosures such as credit, liquidity and market risks should be considered as well, both in the context of investment portfolios and insurance liabilities.
18. Given COVID-19 is an evolving situation, further disclosures may be required to help users understand the key assumptions that an insurer makes about the future, and its major sources of estimation uncertainty, if not already required by other IFRS® Standards. ([IAS 1.125](#))

19. The Office of the Superintendent of Financial Institutions (OSFI) announced a series of regulatory adjustments to support the financial and operational resilience of federally regulated banks, insurers and private pension plans. These adjustments relate to a number of regulatory capital, liquidity and reporting requirements, including suspending the semi-annual progress reporting on the implementation of new accounting standards, notably, IFRS 17 *Insurance Contracts*. An insurer should consider how COVID-19 could affect its capital disclosures.

Has the IFRS® Discussion Group talked about this topic?

20. The Group has discussed impairment considerations under IAS 39. The discussion listed below may be helpful as you think how COVID-19 could affect the accounting for your investment portfolios:

Meeting Date	Topic	Meeting Report
October 18, 2012	Meaning of “Significant or Prolonged” Decline in Fair Value	View Document

What other resources are available?

21. Do you need more information? The following publications may provide more insights:

KPMG, “[What are the specific accounting implications for insurers?](#)” March 31, 2020.

EY, “[Applying IFRS, Accounting considerations of the coronavirus outbreak,](#)” Updated March 2020.

Deloitte, “[The impact of COVID-19 on the L&H insurance industry in Canada,](#)” April 2020.

PwC, “[In depth, A look at current financial reporting issues, Accounting implications of the effects of coronavirus,](#)” April 1, 2020.

OSFI, “[COVID-19 Measures – FAQs for Federally Regulated Insurers.](#)”

Extracts from relevant IFRS® Standards

Standard	Guidance
IFRS 4	<p>15 An insurer shall assess at the end of each reporting period whether its recognised insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities (less related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32) is inadequate in the light of the estimated future cash flows, the entire deficiency shall be recognised in profit or loss.</p>
	<p>20 If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment loss in profit or loss. A reinsurance asset is impaired if, and only if:</p> <ul style="list-style-type: none"> (a) there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive all amounts due to it under the terms of the contract; and (b) that event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.
	<p>38 An insurer shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from insurance contracts.</p>
	<p>39 To comply with paragraph 38, an insurer shall disclose:</p> <ul style="list-style-type: none"> (a) its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks. (b) [deleted] (c) information about <i>insurance risk</i> (both before and after risk mitigation by reinsurance), including information about: <ul style="list-style-type: none"> (i) sensitivity to insurance risk (see paragraph 39A). (ii) concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (eg type of insured event, geographical area, or currency). (iii) actual claims compared with previous estimates (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year.

Standard	Guidance
	<p>(d) information about credit risk, liquidity risk and market risk that paragraphs 31–42 of IFRS 7 would require if the insurance contracts were within the scope of IFRS 7. However:</p> <p>(i) an insurer need not provide the maturity analyses required by paragraph 39(a) and (b) of IFRS 7 if it discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. This may take the form of an analysis, by estimated timing, of the amounts recognised in the statement of financial position.</p> <p>(ii) if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirement in paragraph 40(a) of IFRS 7. Such an insurer shall also provide the disclosures required by paragraph 41 of IFRS 7.</p> <p>(e) information about exposures to market risk arising from embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.</p> <p>39A To comply with paragraph 39(c)(i), an insurer shall disclose either (a) or (b) as follows:</p> <p>(a) a sensitivity analysis that shows how profit or loss and equity would have been affected if changes in the relevant risk variable that were reasonably possible at the end of the reporting period had occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used. However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 41 of IFRS 7.</p> <p>(b) qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.</p>
IAS 1	<p>125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:</p> <p>(a) their nature, and</p> <p>(b) their carrying amount as at the end of the reporting period.</p>

Standard	Guidance
IAS 39	<p data-bbox="358 300 1425 499">58 An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 63 (for financial assets carried at amortised cost), paragraph 66 (for financial assets carried at cost) or paragraph 67 (for available-for-sale financial assets) to determine the amount of any impairment loss.</p> <p data-bbox="358 531 1425 905">59 A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognised. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following loss events:</p> <ul style="list-style-type: none"> <li data-bbox="451 936 1117 968">(a) significant financial difficulty of the issuer or obligor; <li data-bbox="451 993 1403 1056">(b) a breach of contract, such as a default or delinquency in interest or principal payments; <li data-bbox="451 1081 1398 1182">(c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider; <li data-bbox="451 1207 1317 1270">(d) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation; <li data-bbox="451 1295 1365 1358">(e) the disappearance of an active market for that financial asset because of financial difficulties; or <li data-bbox="451 1383 1425 1526">(f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including: <ul style="list-style-type: none"> <li data-bbox="509 1551 1425 1694">(i) adverse changes in the payment status of borrowers in the group (eg an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or <li data-bbox="509 1719 1425 1850">(ii) national or local economic conditions that correlate with defaults on the assets in the group (eg an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to

Standard	Guidance
	<p style="text-align: center;">oil producers, or adverse changes in industry conditions that affect the borrowers in the group).</p> <p>60 The disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment (for example, a decline in the fair value of an investment in a debt instrument that results from an increase in the risk-free interest rate).</p> <p>61 In addition to the types of events in paragraph 59, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.</p> <p>62 In some cases the observable data required to estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. For example, this may be the case when a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. In such cases, an entity uses its experienced judgement to estimate the amount of any impairment loss. Similarly an entity uses its experienced judgement to adjust observable data for a group of financial assets to reflect current circumstances (see paragraph AG89). The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.</p>