INSURANCE – GENERAL

Gaining a perspective on IFRS17 implementation

The Badri Management Consultancy's Mr Hatim Maskawala spoke to us about some major changes and direct impacts of the new IFRS17 standard.

By Osama Noor

The performance of insurers in the UAE this year is significant as the industry adopts IFRS17. The implementation of IFRS17 was considered in Badri Management Consultancy's analysis of 26 insurers in its report UAE Listed Insurance Companies Performance Analysis H12023.

One of the purposes of IFRS17 is to bring more transparency and comparability across industries, said Badri Management Consultancy managing director Hatim Maskawala.

"The principles that we see in IFRS17 are similar to other accounting standards; and also include what was missing in IFRS4. The financial statements are moving away from being based on historic cost to being centred on future expectations.

"From a pure insurance industry perspective, IFRS17 brings transparency around some of the elements of reserving. The company must reserve on a best estimate basis and add explicit risk adjustment," he said.

UAE under IFRS17

Insurance revenue for the 26 UAE listed insurers surged by 15% to AED14bn ($3.8bn) in 1H2023 versus AED12bn in 1H2022.

"Formerly, the focus was on GWP as a source of pride and industry rivalry in the UAE insurance sector; however, this metric is no longer disclosed (under IFRS17)," said the report. Insurance revenue resembles gross earned premium but incorporates expected credit losses (ECL). The insurance industry in UAE is experiencing a rise in credit risk; Badri anticipates mounting industry pressure due to heightened ECL impact.

The top five insurers observed a rise in insurance revenue from AED7bn to AED9bn, an 18% increase. Meanwhile, the remaining insurers saw a modest growth of 10% as revenue reached AED7bn to AED9bn.

Insurance service results for the 26 analysed insurers declined by 27% to AED570m in 1H2023 from AED784m in 1H2022, with the top five providers witnessing a 4% dip to AED598m from AED626m; the remaining registering 118% drop to a negative AED27m from AED158m. These results, akin to IFRS4's underwriting profits (post expenses), have witnessed a decrease, said the report.

Another benefit of IFRS17 (or IFRS9) is the focus on cashflow and receiving money, said Mr Maskawala.

"Previously, bad/doubtful debts were hidden in admin expenses. Now, companies must show the revenue net of ECL. This will lead to improvements in credit policies that companies implement," he said.

He believes the new standard will lead to an improvement in longer term.

"Previously, companies were keeping premium deficiency reserve but this could be a line of business level and allowed cross subsidisation between various contracts in one line. Now, companies must separate

profitable and loss-making contracts and recognise the losses immediately. My view is that this, along with removal of GWP, will lead to an improvement in underwriting practices," he said.

Structure of profit

Profit before tax for the 26 listed insurers in 1H2023 reached AED993m against AED935m in 1H2022, a 6% increase. The top five providers in terms of profitability observed a surge of 20% where profit reached AED820m from AED721m in 1H2022. The remaining companies encountered a decline of 38% as profit reached AED132m against AED214m.

Net finance income under IFRS17 encompasses the interest income acquired from the contractual service margin (CSM) and the interest expense generated by the unwinding of the discount rate applied to insurance liabilities. This relates to the recent decision the Central Bank of the UAE (CBUAE) has taken to stop insurers from granting a 50% discount on motor rates.

"Given the withdrawal of this circular and improvements in pricing that we have witnessed since the beginning of the year, the outlook for the second half remains positive," the report said.

Thirteen out of the 26 listed insurers recorded net insurance financial deficit and six out of these 13 were able to generate profit. On the other hand, none of the companies recorded losses on their investment income.

The way profits are earned in longer-term policies is now well-defined and clarifies which are the loss-making segments in the portfolio, said Mr Maskawala.

"However, it is making a few comparisons difficult. For example, how much receivables a company has is not visible in the current disclosures and this is an important factor given the impact of credit risk in the region. Similarly, admin expenses are now shown as part of insurance expenses; therefore, we cannot compute the traditional metric of expense ratios for companies. Previously, this allowed benchmarking between companies on how efficiently they are operating," he said.

Assets, capital and liabilities

CBUAE mandates companies to reveal their solvency status to ensure that it is not falling below the stipulated 100% threshold to ensure that insurers can honour their financial commitments.

"Solvency standings among companies are progressively facing greater strain. Out of the 24 that disclosed their solvency, five firms do not meet the solvency criteria," the report said.

The report said that there are three solvency measures applicable to companies in the UAE: solvency capital requirement, minimum capital requirement and minimum guarantee fund.

Asset mix compares the proportion of invested assets and non-invested assets. The prescribed range for invested assets to total assets as per the CBUAE is greater than 70%. The 40-70% zone is of caution and companies falling in critical range of below 40% are under red zone.

IFRS17 comparison

The profit transition ratio compares the 1H2022 profit as reported last year under IFRS4 with the profits shown as 1H2022 as per the IFRS17 financials published this quarter. At a total level, the impact is only 5% where the profits for these 26 companies last year totalled AED893m and increased to AED935m under IFRS17, the report said.

Despite most companies' successful adoption of IFRS17, the transition has not been devoid of challenges, said Badri in the report.

"We anticipate that the quality of published financials will enhance as companies refine both their data and operational processes," said the report.

Raising the bar

The relationship between the loss component and insurance revenue is crucial for determining the overall profitability and financial performance of an insurer. By analysing the ratio of the loss component to insurance revenue, stakeholders can assess the efficiency of the company's underwriting activities and the adequacy of premium pricing in covering expected losses.

The report said that an integral aspect is that the reconciliation of account receivables/payables along with the associated credit risk implications, has already affected certain companies, therefore, it is expected that more firms to make provisions for write-offs due to this factor.

One important area that has improved a lot under the IFRS17 implementation is the quality of the data that companies have, said Mr Maskawala.

"An example is in receivables. Previously, companies were keeping records by counterparty and there were many reconciliation issues as well. IFRS17 has forced companies to keep records at a policy level and this has forced companies to clean up. Another example is on the reinsurance side. Many companies did not have proper data and they are forced to record reinsurance cash flows by contract. Many have not completed the data clean-up process but everyone is headed in the right direction," he said.

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