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IFRS 9, a year later

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IFRS 9 has now been in use by insurance companies for the last year. What does it address and what are its impacts?

International Financial Reporting Standard (IFRS) 9 “Financial Instruments” has applied to insurance companies concerned since 2023. It can be broken down into three main points: a new classification of financial assets, a new impairment model for these assets, and changes in hedge accounting. In particular, the standard impacts the recognition of equities and investment funds. Changes in market values are taken to profit or loss or to the balance sheet, at the insurer’s discretion for equities, and directly to profit or loss for investment funds. P&L thus becomes more volatile.

This treatment deviates significantly from French GAAP, under which profit or loss is made up of more predictable components, excluding provisions: dividend/coupon payments and unrealised capital gains or losses. Under IFRS, P&L can no longer be managed by selling equities and funds. As a result, overall, insurance companies have tended to reduce their share of investments in assets impacting P&L in a bid to limit their volatility: funds and equities depending on the option chosen by the insurer. We expect this trend to gather pace in 2024.

How did insurance companies prepare for IFRS 9?

In 2022, in preparation for the implementation of IFRS 9, insurance companies already had to determine the option they preferred for the recognition of equities: in P&L (impact on result) or in OCI (Other Comprehensive Income, impact on shareholder equity). We guided insurers in this strategic choice by conducting studies that highlighted the pros and cons of both options and the impacts they would have on their strategic allocation.

What concrete impacts have you identified in the definition of strategic allocation?

Without altering their strategic allocation, insurance companies see their P&L become less predictable, making financial communication more complicated. In general, they aim to limit P&L volatility, which is something we incorporate in our research. This may call for a decrease in the strategic equity allocation (depending on the choice of accounting treatment made) and/or fund allocation. At the same time, insurers have been inclined to shore up their investments in bonds, given that their accounting recognition under IFRS is similar to French GAAP, while also offering a more attractive return thanks to the rise in interest rates.

What changes are there in terms of tactical allocation?

We have to be much more responsive and dynamic on that front, in order to successfully manage P&L under IFRS. IFRS 9 introduced the real-time recognition of changes in the value of certain assets under profit or loss. As a result, portfolio managers have a shorter time frame for investing in these asset classes, on a par with that of non-insurance-oriented investment strategies. Movements in these assets are thus more frequent, with higher rotation.

This is a real paradigm shift, one that makes tactical allocation all the more relevant for insurers concerned. Asset management firms have had to adapt their investment processes and information systems alike in order to incorporate more inputs. At Ostrum AM, we have a proprietary tool that is regularly updated to take new accounting developments on board. With this type of system, we can address both national and international financial reporting standards. French GAAP still apply, after all. Portfolio management decisions also need to account for impacts associated with provisions and generation of historic capital gains/losses.

Are changes differentiated depending on the accounting treatment option chosen?

Yes, there are some subtle differences. For example, the treatment option chosen for equities changes the investment process: prioritising investments in high-yield securities for the OCI option versus investments in lower-volatility equities for the P&L option. So we have to be able to offer both approaches. Another example: there is a mismatch under IFRS between the treatment of equities recognised on the insurer's balance sheet and any hedging of these instruments directly taken to profit or loss.

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