How improved financial KPIs can enhance performance management for insurers

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The full impact of global accounting changes, centered around IFRS 17 for *Insurance Contracts* and IFRS 9 for *Financial Instruments*, along with new reporting regimes and enhanced capital standards, is now becoming clear for the insurance industry. While the effects can vary considerably across different regions and lines of business, all insurers—from life and health, to property and casualty (P&C), and reinsurance—will feel the impact on multiple aspects of their reported performance - especially product profitability, capital efficiency and shareholder returns.

The investment community will be affected too, particularly as they seek to understand insurers' ability to drive long-term value from their in-force business and their prospects for future growth and profitability. Overall, we expect these new accounting changes will deliver increased transparency and comparability of financial results across the insurance industry, though it will take some time for those benefits to materialize.

The first priority for insurers has been to achieve full compliance with these new standards by meeting the requirements for external (statutory and regulatory) reporting and developing capabilities to do so efficiently and sustainably. Increasingly, however, insurers are expanding their use of new and refined key performance indicators (KPIs) for internal management reporting purposes and to enhance their financial planning and analysis (FP&A) processes.

Past insurance accounting practices for insurance liabilities based on the predecessor standard (IFRS 4), were often driven by historic parameters plus actuals for the current period and were, therefore, backward-looking. In contrast, IFRS 17 combines past and current period results with modeled expected future cashflow information. The voluminous, granular and forward-looking data that insurers must now generate for external regulatory compliance purposes, can also be used to improve the relevance and accuracy of financial performance information (both actuals and forecasts) in internal management reports. The additional data can support better and faster decision making by the business through the use of sophisticated analytics and detailed drill-down reports.

In this article, we will:

01 Highlight the meaning and impact of new insurance accounting standards on different types of insurers, as well as investors and analysts.

02 Refer to the findings from EY's global benchmarking research into the use of IFRS 17 and IFRS 9 metrics on the 2023 and 2024 financial statements of a group of large insurers.

03 Recommend actions for insurers to take advantage of new and refined KPIs and related data management solutions to enhance internal management reporting and improve financial performance management.

What's changed and why it matters

IFRS 17 was the insurance industry's biggest accounting change in decades. Its impacts are playing out on multiple levels. The values of certain well-established financial metrics – such as return on equity (ROE) and combined ratios (CR), which are key measures of profitability for insurers – have been impacted by the application of IFRS 17. The underlying definitions and formulae to calculate these metrics have also changed. As a result, the market is still seeing variety in the reported metrics and, for some metrics, large differences from past periods. This variance should be viewed in context, taking into account both the planned accounting rule changes and unplanned market dynamics.

The relevance of certain pre-existing metrics may also change as insurers present solvency and other risk-weighted numbers alongside new and adjusted financial performance metrics. This combination should increase transparency and comparability and be more informative for investors. Previous reporting standards lacked a common framework and thus made peer-to-peer comparisons difficult, because insurers reported results based on different measurement principles, calculation models and disclosure practices.

IFRS 17 is prompting global convergence towards more comparable financial metrics and calculation methodologies, driven by a single financial reporting standard. Individual companies may face changes in their own financial performance definitions, values and presentation formats. The definitions of metrics and disclosures are more consistent across the insurance market with the introduction of IFRS 17 and IFRS 9 globally in 2023. In the US, the new US GAAP standard for some insurers (called LDTI) has introduced changes to the accounting for long-duration insurance contract liabilities that reflect some of the key aspects also included in IFRS 17.

New IFRS 17 metrics for profitability from new and existing business

Among the new IFRS 17 measures, the contractual service margin (CSM) as has garnered the most attention. Tracking the future expected profit on existing contracts, the CSM of business written in the current period is largely a lens for assessing insurers' ability to create value through the expected future profit of these contracts. The total 'stock' of CSM recorded on the balance sheet provides information on the expected (remaining) profitability of the in-force business, providing valuable insight to investors about future profit signatures.

IFRS 17 has introduced a prescribed and explicit measure of expected future profit from in-force insurance contracts into accounting for the first time. In the past, insurers often provided this information through alternative performance measures, such as the value of new business in their embedded value (EV) framework. In this sense, the CSM represents an improvement over previous accounting and actuarial models, which mixed different measures defined by companies, including insurance liabilities, future claims and benefits payments, implicit margins of prudence and deferred profits.

The new accounting standards also allow users to make a distinction between expected profits from insurance contracts (under IFRS 17), and returns from the investments backing the insurance liabilities (under IFRS 9). Because of options allowed by – and judgement applied under - IFRS 17, there remains some variety in how the CSM is determined and released into the P&L. Also, because the future profitability of investment contracts accounted for under IFRS 9 is not covered by the CSM, insurers need to also consider how best to factor in these expected future returns (eg. Future annual management charges on investment contracts).

Since the first reporting under IFRS 17 for the 2023 financial year, the CSM has moved to the heart of several revised KPIs and we expect more standardization to occur over time. The importance of CSM will be evident in performance metrics like:

- CSM (less loss component) of new contracts issued.
- Total CSM on the balance sheet.
- New business CSM as a % of NPV of future cash inflows from new contracts (a measure of the expected profitability of new contracts).
- Movements in CSM (i.e., mainly release of CSM into profit vs. addition of CSM from new business to indicate net growth).
- Equity plus CSM (after tax) as an expanded metric of shareholders' funds.
- Return on equity plus CSM (a measure of return).
- Financial leverage as a percentage of equity plus CSM.

Having published their first financial statements under IFRS 17 since early 2024, some insurers are finding that analysts' and investors' views of business performance have not substantively changed in the short term. However, these assessments are likely to change over time as stakeholders become more accustomed to the new metrics and begin to appreciate the value of the new information, as well as the increased transparency from the disclosure requirements of IFRS 17 and IFRS 9. For example, for life insurers applying the general measurement model of IFRS 17, the publicly disclosed split between the 'building blocks' (i.e., measurement components) of the insurance liability represents a fundamental improvement in the disclosed information provided in the financial statements.

In terms of sources of profit, future changes to the best estimate of cash flows are future payments that are generally not expected to come with much impact on the P&L due to the 'absorbing' effect from the CSM, though the effects from changes in financial variables (e.g., discount rates) together with returns from the investments could result in significant volatility in income. Also, profit or loss may be impacted by variances between actual and expected results in the current period or losses from onerous contracts. The risk adjustment component is expected (on average) to be released in the P&L as another source of future profit (other than CSM) but may be at risk due to the possible variability of insurance payments. The CSM is expected to be a relatively stable measure over time of future profit (as it is released to profit or loss over time).

New metrics for general insurance and P&C

Within general insurance (P&C), there is typically limited use of the general model in IFRS 17, and consequently, limited reporting of a CSM, due to the relatively short-term coverage period of the contracts issued. However, the newly published disclosures under IFRS 17 enables analysts to evaluate claim effects related to current period claims in isolation from the impacts of changes in estimates concerning prior years' claims.

New and updated metrics can be used to track the accuracy, reliability and predictability of those claim liabilities relative to prior years' claims by comparing the impact of revisions to estimates to the level of risk adjustment quantified. CSM will also apply to certain types of P&C contracts, particularly those of longer duration (eg. for some commercial real estate or marine business).

The benefits to investors and analysts

Increased transparency of financial statements and comparability of financial results will help analysts to better understand key performance variables of the business. The separation of underwriting and investment results, as well as additional disclosures under IFRS 17 (e.g., CSM release pattern, experience variances and applied discount rates) and IFRS 9 (e.g., impairment classifications and expected credit losses), will more clearly show the sources of earnings and losses. Ultimately, we expect IFRS 17 metrics and disclosures to become more widely used as the industry-standard performance measurement framework, both for external financial reporting and internal performance measurement purposes.

Although IFRS 17 introduces much more visibility on the sources of earnings, there is still more detailed additional information that some companies may want to share, even though it is not required for external disclosures. For example, in terms of the quantification of financial risk, the time value of options and guarantees is included in the best estimate of cash flows and not separately identifiable (like the risk adjustment for non-financial risk, which is disclosed explicitly). Filling that gap is something that companies may want to consider as market developments (e.g., interest rate movements and share price movements) can significantly impact the valuation of financial guarantees.

Insurers can also opt to build internal reporting frameworks using additional metrics that go beyond what is required by IFRS 17 for external reporting, as it provides a better and more complete and precise explanation of results. Even if they do not include such metrics in their external reporting, insurers could embed them in internal detailed analysis of results and KPIs to allow better explanation of movements in their results for future fine-tuning purposes.

Metrics to drive better understanding of the drivers of performance

Many insurers have made substantial compliance-driven investments by having to implement the new IFRS 17 and IFRS 9 standards in their financial reporting infrastructure. The greatest potential value from these efforts will be the improved comparability to their competitors and more granular financial performance insights now available for internal usage. It will be easier to break down financial results by distribution channel, product type, customer groups, region and other dimensions. Such insights can enable management to make better, faster and more confident decisions about future investments and capital allocations.

For now, relatively few insurers rely completely on IFRS 17 metrics for internal performance management, decision support or management remuneration. We are still in the early days of a long-term transition journey. Looking ahead, insurers will likely need to evolve their thinking regarding the integrated and fully embedded use – and not just the reporting – of these new and existing financial performance metrics.

Initial IFRS benchmarking research findings from EY

The global EY insurance team examined the IFRS 17 and IFRS 9 year-end 2023, half 2024 and full year 2024 financial statements from 45-50 international insurance groups. The reports of our findings can be accessed here.

The key insight is that IFRS 17-related KPIs are being reported more widely by insurers, and the application of a single accounting model globally allows comparison between the extent of future profitability, the margin on new business, the relative size of the adjustments for risk, and the variation between actual and expected results.

Breaking down the most common KPIs

Many of the most common KPIs have changed in meaningful ways under IFRS 17.

1. **Combined ratios (CR):** CR remains the main KPI for non-life business. However, with the adoption of IFRS 17, the definitions have been revised, and the reported values differ slightly. For instance, under IFRS 17, the claim portion in the CR is a discounted amount and therefore often lower than under IFRS 4. Similarly, non-directly attributable expenses are often lower than under IFRS 4.

   Net of reinsurance combined ratios are no longer based on net claims and earned premiums, as the notion of net earned premiums has disappeared. Instead, the ratio now typically applied is determined as the ratio of insurance service expense and insurance revenue, taking into account the effect of reinsurance.

2. **Return on equity (ROE):** ROE is in essence defined as "periodic return / amount invested." Both variables in that equation have been impacted by IFRS 17, meaning both return and equity may be higher or lower with IFRS 17. Much depends on the previous accounting under IFRS 4, which allowed for inconsistent account practices applied across insurance groups, and the approach used upon transition to IFRS 17. The interest rate environment at the date of measurement is another factor.

   The bottom line is that comparing ROE under IFRS 4 and IFRS 17 is very much dependent on the specific situation of an insurance group. The level of volatility in ROE may have increased for some insurers, as IFRS 17 is based on best estimates and market consistency with less possibility to implicitly "smoothen" these impacts over time. On the other hand, IFRS 17 includes several "built-in" possibilities for absorbing and spreading such impacts over time; for example, the CSM absorbs changes in estimates relating to future service or the disaggregation of insurance finance income and expense between P&L and other comprehensive income (OCI).

   Variations exist in how insurers determined their return on equity, for example, using IFRS profits vs adjusted (underlying or operating) earnings for the numerator and exclusion of unrealized amounts in OCI for the denominator.

   The use of adjusted IFRS equity (being IFRS equity plus the CSM) as an indication of the value of an enterprise is also gaining some traction.

3. **Operating profit and net profit before tax change**: Operating profit has long been used as a non-GAAP metric in external communication with investors and analysts. It will continue as a popular KPI with certain adjustments to reflect specific features of IFRS 17 measurement. Operating profit is often used to remove non-recurring results or the impact of short-term market volatility. In changing their definitions of operating profit based on IFRS 17, companies have a metric that is as similar and comparable as possible to what it was before switching to IFRS 17.

Recommended actions: How insurers can derive more value from their use of new financial KPIs

1. **Learn the new language:** Because the new KPIs will have a long-term impact and affect every part of the business, executives must invest time in better understanding these metrics and how they are calculated. The fact that the KPIs will continue to evolve adds to the urgency. The sooner executives grasp these concepts, the sooner they can utilize them for internal performance management and articulate a clear and consistent message to external stakeholders, including analysts and investors.
2. **Recognize what has stayed the same:** Many important KPIs are non-GAAP measures (i.e., alternative performance measures), e.g., claims paid, gross written premium, loss ratio, regulatory solvency ratio. These may not be (significantly) impacted by changes in the valuation method and are expected to remain important measures for assessing the financial health of the business. Furthermore, they can be combined with new KPIs to provide greater visibility into current performance and clearer insights into what lies ahead. When further developing the KPIs, insurers should also take into account the context of IFRS 18 *Presentation and Disclosure in Financial Statements*, the new IFRS accounting standard on presentation and disclosure in financial statements that becomes effective in 2027.
3. **Communicate proactively:** Insurers should take an "inside-out" perspective in engaging the investment community in presenting their financial results. Why? Because carriers have richer data and more sophisticated models than analysts and investors and can thus help them get a clear look into the heart of the business. Insurers should seize the opportunity to educate analysts and investors, who will also be challenged to understand the new KPIs, while also refining their own views of new metrics, particularly CSM, as an additional lens into value creation.
4. **Go beyond external reporting:** New KPIs can deliver value for all types of insurers, provided they are used for more than just the required external reporting. The combination of old and new KPIs will enable both granular analysis of historical performance and more precise projections of future performance, leading to more informed and confident decision making. Even better, these KPIs will be embedded in the performance remuneration framework for management in the form of a balanced scorecard.
5. **Unleash the data through visualization and self-service:** Increased visibility into the financial performance is useful not only to financial accounting and actuarial teams but also business managers and other decision makers (e.g., underwriters, capital and investment analysts) across the business. Senior finance leaders should provide self-service access to underlying KPI data and visualization tools and dashboards with drill down capabilities so users can explore the underlying data themselves to find the most impactful insights.
6. **Prepare to go deeper with AI:** Finance and actuarial teams must also be encouraged to further explore the available data, and AI-enabled tools can help them do just that. Financial variance analysis (and the reasons behind that variance) will be priorities for deeper AI-driven

analysis. The first step is to develop useful proof-of-concepts that can drive deeper analytics over time. Again, this type of analysis will be part of a long-term journey, but carriers that develop AI-driven analytical capabilities sooner will gain an advantage.

7. **Align the KPI framework to financial planning purposes**: Now that insurers have gained access to an enriched set of financial KPI metrics under IFRS 17 and IFRS 9, the next challenge will be to utilize the same standardized metrics and granular data for financial planning, budgeting and forecasting. Leading insurers have already started to develop FP&A tools that take full advantage of the valuable "new gold" hidden in their financial data stores. Some providers of finance, accounting and actuarial software are also working to address the need for more advanced enterprise performance management (EPM) tools. Some are offering new solutions that can be linked to the IFRS 17 subledger systems of insurers for a more automated source-to-report and plan-to-perform user experience. We would encourage insurers to explore these new tools and solutions and determine how to take full advantage of them. In doing so, they will be able to realize more of the promised benefits from the large-scale past investments in IFRS 17 and IFRS 9 implementations.

All in all, we believe the introduction of the new accounting standards IFRS 17 & IFRS 9 offers a great opportunity for insurers to not only enhance the comparability and transparency of their external financial performance reporting, based on a new set of globally consistent valuation methods, accounting rules and disclosures, but also to use the same underlying data for enhanced internal management reporting, both backward- as well as forward-looking. In that sense, the necessary embedding of these new standards in the financial reporting infrastructure and capabilities of insurers is hopefully only the beginning of a period of performance management adjustment, re-alignment and improvement for many years to come!

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