AUTORITÉ DES MARCHÉS FINANCIERS

Notice relating to the application of the *Guideline on Capital Adequacy Requirements – Property and Casualty Insurance 2023 (the "Guideline")*

First Published December 1, 2022; revised January 26, March 16, April 27, May 11 and December 14, 2023.

On July 21, 2022, the Autorité des marchés financiers (the "AMF") published the final version of the Guideline, which took effect on January 1, 2023, in its Bulletin. Since its release, the AMF has noticed that some Guideline items could present difficulties in interpretation or application.

This notice sets out clarifications and adjustments to enable insurers to calculate the MCT in accordance with the AMF's expectations.

Clarifications and adjustments

1. Insurance risk – Calculating unexpired coverage for insurance contracts issued
Publication date: December 1, 2022
Effective date: January 1, 2023

Insurance contracts concerned

The formulas for calculating the unexpired coverage for insurance contracts issued, described in section 3.3.2 of the Guideline, appear to leave room for interpretation in determining whether all insurance contracts issued and recognized in accordance with paragraphs 25 to 28 of the IFRS 17 standard are included in the calculation.

Clarification by the AMF

The AMF hereby confirms that only contracts recognized in accordance with sections (a) or (b) of paragraph 25 of IFRS 17 must be included in the calculation of unexpired coverage for insurance contracts issued. Accordingly, premiums receivable (under the premium allocation approach) or future cash flows (under the general measurement model) for onerous contracts recognized in accordance with section (c) of paragraph 25 must not be included in this calculation.

Please note that this clarification applies only to section 3.3.2 of the Guideline. All contracts recognized in accordance with IFRS 17 must be taken into account for the requirements described in the other sections of the Guideline.

2. **Insurance risk – Calculating unexpired coverage for reinsurance contracts issued**
   Publication date: January 26, 2023
   Effective date: January 1, 2023

Cash flows recognized

The AMF notes that the formulas for calculating the unexpired coverage for reinsurance contracts issued, described in section 3.3.2 of the Guideline, do not specify the cash flows to be recognized.

Clarification by the AMF

The cash flows to be recognized for the calculation of the unexpired coverage for reinsurance contracts issued are the cash flows from all underlying insurance contracts that are within the contract boundary, including underlying insurance contracts that have not yet been issued. Accordingly, future cash flows (under the general measurement model) or premiums receivable, whether outstanding or not yet due, including installment premiums (under the premium allocation approach) for underlying insurance contracts, must be included in this calculation.

3. Insurance risk – Risk mitigation and risk transfer mechanisms - reinsurance
Publication date: March 16, 2023
Effective date: January 1, 2023

Captive fronting arrangements

The AMF notes that captive fronting arrangements may not be accounted for applying the requirements of IFRS 17.

A captive fronting arrangement means any insurance contract entered into with a policyholder and subsequently reinsured in whole by the insurer to an entity within the same group as the policyholder. This type of arrangement is subject to the risk mitigation and risk transfer mechanisms for unregistered reinsurance under section 3.4 of the Guideline. These mechanisms are based on accounting using the IFRS 17 accounting presentation framework.

Accordingly, when completing the MCT form, insurers must report on the unregistered reinsurance exhibit (page 40.11 of the form) all reinsurance arrangements held with unregistered insurers, including captive fronting arrangements.

4. Insurance risk – Calculation of the unexpired coverage for insurance contracts issued
Publication date: April 27, 2023
Effective date: January 1, 2023

Unamortized insurance acquisition cash flows

Representatives of P&C insurers have contacted the AMF to obtain clarification on the concept of unamortized insurance acquisition cash flows, which is defined in footnote 18 and used in calculating the margin for unexpired coverage for insurance contracts issued, determined using either the general measurement method (GMM) or the premium allocation approach (PAA), in section 3.3.2.1 of the Guideline.

Clarification by the AMF

The AMF clarifies that, unless insurance acquisition cash flows are recognized as expenses by applying paragraph 59(a) of IFRS 17, the balance of unamortized insurance acquisition cash flows at the end of a reporting period must be determined using one of the following methods.

If using the GMM:

- taking the insurance acquisition cash flows allocated to the group of contracts for the purpose of calculating the contractual service margin (CSM) or the loss component at the date of initial recognition, and
- subtracting the portion of the insurance acquisition cash flows that was amortized under paragraph B125 of IFRS 17.

If using the PAA:

- taking the insurance acquisition cash flows paid at initial recognition of the group of contracts,
- adding any amount arising from the derecognition of an asset for insurance acquisition cash flows applying paragraph 28C of IFRS 17,
- adding the cumulative amount of insurance acquisition cash flows paid since the date of initial recognition, and
- subtracting the portion of insurance acquisition cash flows that was amortized under paragraph B125 of IFRS 17.

The balance of unamortized insurance acquisition cash flows cannot be negative.

5. Insurance risk – Calculation of the unexpired coverage and premiums associated with unexpired coverage for reinsurance contracts held
Publication date: April 27, 2023
Effective date: January 1, 2023

Unamortized reinsurance commission

Representatives of P&C insurers have informed the AMF that they noted differences between the definition of unamortized reinsurance commission provided in section 3.3.2.2 and the one in footnote 37, in section 3.4.2.1 of the Guideline.

Clarification by the AMF

By this notice, the AMF clarifies that the definition of unamortized reinsurance commission to be used for the calculations of the unexpired coverage and premiums associated with unexpired coverage for reinsurance contracts held is the definition provided in section 3.3.2.2 of the Guideline. Footnote 37 in section 3.4.2.1 of the Guideline is to be disregarded.

6. Insurance risk – Calculation of the unexpired coverage for insurance contracts issued

Publication date: May 11, 2023
Effective date: January 1, 2023

Insurance acquisition cash flows

In September 2018, the Transition Resource Group for IFRS 17 of the International Accounting Standards Board (IASB) published an interpretation relating to insurance acquisition cash flows[1]. In certain cases, this interpretation excludes from insurance acquisition cash flows the reinsurance commissions paid by the reinsurer to the cedant. The AMF observes that this interpretation could impact the calculation of the unexpired coverage for insurance contracts issued, determined using either the general measurement method (GMM) or the premium allocation approach (PAA), in section 3.3.2.1 of the Guideline. In order to ensure that the MCT applies consistently and in accordance with IFRS 17, the AMF provides the following clarification.

Clarification by the AMF

The unexpired coverage for groups of insurance contracts issued must be determined using one of the following methods.

Groups of insurance contracts issued measured using the GMM

Unexpired coverage for insurance contracts issued (using GMM)
= Estimate of future cash flows for insurance contracts issued (excluding premium, reinsurance commissions and acquisition expenses cash flows), adjusted for the time value of money

The reinsurance commissions to be excluded from the calculation are those not meeting the definition of insurance acquisition cash flows set out in Appendix A of IFRS 17.

Groups of insurance contracts issued measured using the PAA

Unexpired coverage for insurance contracts issued (using PAA)
= {LRC, excluding the loss component + unamortized insurance acquisition cash flows + unamortized reinsurance commissions + premiums to be received} x expected loss ratio (ELR) + costs

The reinsurance commissions to be excluded from the calculation are those not meeting the definition of insurance acquisition cash flows set out in Appendix A of IFRS 17.

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[1] Paragraph 27 of the paper of the Transition Resource Group for IFRS 17 of the International Accounting Standards Board (IASB): https://www.ifrs.org/content/dam/ifrs/meetings/2018/september/trg-insurance/ap03.pdf

7. Insurance risk – Calculating unexpired coverage for reinsurance contracts held
Publication date: December 14, 2023
Effective date: January 1, 2023

Cash flows to be recognized

The Autorité des marchés financiers (the "AMF") has received comments seeking clarifications on the cash flows to be considered in determining the unexpired coverage for reinsurance contracts held, described in section 3.3.2.2 of the Guideline. In response to these comments, and to ensure that the MCT is applied consistently and in accordance with IFRS 17, the AMF is providing the following clarification.

Clarification by the AMF

The unexpired coverage for groups of insurance contracts held must be determined using one or the other of the following methods. By way of clarification, the AMF is adding the following elements (underlined):

Groups of reinsurance contracts held measured using the GMM

Unexpired coverage for reinsurance contracts held (using the GMM)	=	(Estimate of future cash flows for reinsurance contracts held (excluding premium and reinsurance commission cash flows that are due)[2] + estimate of future cash flows from future reinsurance contracts held), adjusted for the time value of money[3]

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[2] Premiums and reinsurance commission cash flows on risk attaching proportional reinsurance contracts held are considered due and therefore are zero.

[3] See paragraphs 33 to 36 of IFRS 17.

Groups of reinsurance contracts held measured using the PAA

Unexpired coverage for reinsurance contracts held (using the PAA)	=	{(ARC excluding the loss recovery component + unamortized reinsurance commission[4]) + premiums to be paid[5] for reinsurance contracts held + expected premiums payable for future reinsurance contracts held} x ELR[6] - (expected premiums payable[7] for reinsurance contracts held net of associated reinsurance commissions receivable[8] + expected premiums payable for future reinsurance contracts held net of associated expected reinsurance commissions receivable)

4 The reinsurance commission is the ceding commission (or a portion of the ceding commission) paid by the reinsurer to the ceding insurer, which is not contingent on claims of the underlying contracts and generally includes a total provision for broker/agent commissions, insurance premium taxes and other acquisition and servicing expenses.

5 Whether outstanding or not yet due.

6 The ELR for the unexpired coverage for reinsurance contracts held (using the PAA) in section 3.3.2.2 is the ELR for the ceded calculations that relates to the portion of such contracts that covers the unexpired portion of the underlying insurance contracts issued. It can therefore differ from the ELR in section 3.3.2.1 for calculating the unexpired coverage for insurance contracts issued (using the PAA).

7 Not yet due. Expected premiums payable and associated reinsurance commissions receivable on risk attaching proportional reinsurance contracts held are considered due; therefore, the amount of expected premiums payable for these contracts is zero.

8 Not yet due. Expected premiums payable and associated reinsurance commissions receivable on risk attaching proportional reinsurance contracts held are considered due; therefore, the amount of expected premiums payable for these contracts is zero.

If you have any questions, please contact Zinsou Ruffin Adja (ZinsouRuffin.Adja@lautorite.qc.ca).

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