IFRS 17 – What you should be doing now

March 2017

Introduction

The International Accounting Standards Board (IASB) is finalising a new reporting standard that will be applicable to all insurance contracts.

The forthcoming standard, which aims to increase reporting comparability within the industry will represent a significant change to insurers both in terms of the financial result and the finance and actuarial operating model including people, systems and processes.

Evolvement over time

June 2013
Second exposure draft released

October 2013
End of comment letter period

2015
Amendments released

November 2016
Board discussions of outstanding issues

2017
Final standard issued

2017 - 2020
Preparation / implementation

2021
Go live

Technical & historical overview

Key Issues for consideration and the Contractual Service Margin

In order to calculate the Contractual Service Margin (CSM), the Fulfilment Cash Flows (FCF) are used. The components of the FCF are shown below:

Contractual Service Margin
A measure of unearned profit

Fulfilment Cash Flows (FCF):

- Unbiased, probability–weighted measure of the net future cash inflows and outflows
- Time value of money
- Risk Adjustment

Calculation and subsequent adjustment of the CSM will require significant changes to data, processes and systems.

Other key technical considerations:

Transition arrangements
Companies will need to apply retrospectively and restate previous years' results under IFRS 17

Level of aggregation
Contracts will be grouped depending on whether they are profitable or are/expected to become onerous

Impact of changes in discount rates – presentation in Profit or Loss (P&L) and Other Comprehensive Income (OCI) – policy choices will have to be made

Participating contracts and short term contracts
These will be measured using different approaches to the general 'building block' approach

The technical requirements will have significant financial impact. Data, systems and processes will require effective transformation.

Insight on some of the technical requirements

Level of aggregation

If a contract is profitable on day one, the recognition of this profit is postponed through the setting up of a Contractual Service Margin (CSM). If a contract is loss making on day one (ie onerous), the loss has to be recognised immediately in Profit or Loss.

If companies were allowed to group profitable and loss making contracts together, this would be beneficial to the company as the losses would be offset by profits on other contracts, therefore would effectively not be recognised immediately.

During the Standard deliberations, there were concerns that IFRS 17 would require companies to perform the calculation at a very granular level. This would be operationally complex and may not be consistent with how the business is written.

In the latest discussions, the International Accounting Standards Board (IASB) clarified that companies could aggregate policies within a single issue year, but not across years. Companies will also be required to separate policies into the following groups:

- those that are profitable at outset and are unlikely to become onerous
- those that are profitable at outset and may become onerous
- those that are onerous at outset.

These requirements are somewhat more relaxed than originally feared, but will still require significant work and judgement to determine which category to allocate products.

Transition

IFRS 17 should to be applied retrospectively to all contracts in force at the date of transition, using reasonable and supportable information but without hindsight to estimate the effect on the opening balance sheet. Historic databases may not be sufficiently granular, complete or accurate on key data points like discount rates, pre-contract cash flows and changes in estimates affecting the CSM. However, any modifications or the use of fair value approaches must be justified as the only practicable alternatives to full retrospection.

Further challenges arise from the policy options available under IFRS 17. They relate to scoping of certain guarantees and fixed fee service contracts, presentation of the impact of changes in discount rates between OCI and Profit or Loss, treatment of changes in the fair value of options and guarantees under the variable fee approach where risk mitigation strategies are employed and the designation of investments.

Therefore insures should exercise caution not to undermine by their transitional arguments the reliability of judgements, systems, data and processes which will later underpin reporting on new business post transition. Disclosures on these blocks of in-force and new business have to be made separately post transition, therefore any decisions will have a lasting effect on reporting performance, managing capital and steering product development.

Modifications to the general model

Modifications to the standard 'building blocks' approach are allowed in certain circumstances. The implications of these modifications include the treatment of participating contracts and the Premium Allocation Approach.

Treatment of participating contracts

The treatment of participating contracts is an area that has attracted significant debate. In the UK, this would include with-profits and unit linked contracts.

Under the previously proposed requirements, companies felt this would introduce significant volatility into the IFRS results. As a result, the concept of the variable fee approach was developed.

Under this approach, companies are able to offset changes in the entity's share of economic experience against the contractual service margin where formal risk mitigation strategies are employed. This has helped to alleviate the concerns of companies writing significant volumes of this type of business.

Premium Allocation Approach (PAA)

General insurers will also face implementation challenges and may not be able to ride solely on using the Solvency II implementation work around claims liabilities valuation.

The PAA approach is permitted but not mandated, meaning that insurers will still need to demonstrate that they achieve a good approximation of the building block approach for their products (eg multi-year contracts with non-adjustable premiums and engineering or construction covers may pose a particular challenge). Policy choices have to be made around acquisition expenses and accretion of interest/discounting for contract periods less than 12 months.

The application of the PAA approach in parallel with the specific model for reinsurance contracts held may lead to operational complications too. If an insurer chooses to disaggregate insurance finance income and expense between OCI and Profit or Loss, the requirement to use historic discount rates at contract inception rather than the date when the first claim was reported may require changes in the data collection and analysis routines.

Our step by step approach

We will be your partner for your implementation journey and can assist you in a full scale end-to-end implementation or with aspects of your program. We offer a pragmatic solution to achieve synergies with Solvency II and other completed projects.

An efficient implementation project will require seamless collaboration between finance and actuarial teams. The complexity of transition will demand a much wider range of skills and an agile and multi-disciplinary approach, involving IT specialists, data analysts and experienced project managers.

To be successful in an environment of competing priorities and strain on resources, insurers will have to:

- plan and deliver the IFRS 17 transition in a holistic manner
- secure executive sponsorship by communicating early the implications reaching beyond financial reporting
- mobilise project teams early
- implement rigorous project management routines.

Training

Develop and deliver training for your staff and Board:
- Interactive training and series of workshop
- Understanding of new KPI and impact on disclosures

Impact assessment

Perform gap analyses and assess the impact of policy choices on transition on:
- Financial statements and management information
- Accounting and actuarial processes
- Business processes and operations
- Skills, resources, systems and data

Programme planning and management

Develop and manage the programme for transition:
- Track against a clear roadmap and stay on budget
- Incorporate lessons learnt from Solvency II, models and data
- Build on and improve existing processes
- Develop a 'blue print' to integrate core systems
- Engage in a timely way with you and your auditors on key judgements
- Suggest workarounds to resolve gaps and limitations

Modelling and systems requirements

Support you to develop and justify significant estimates and related models in the areas of key judgement:
- Analysis of product profit profiles and level of aggregation
- Approach for CSM calculation on transition and subsequent data capture
- Methodology for determining the discount rate (explore synergies with Solvency II)
- Methodology for calibrating the risk adjustment

Move to business as usual

Deliver your project to budget and transition to 'business as usual':
- Track progress closely through to project closure, debrief and share lessons with your wider team
- Design, test and implement the business as usual processes and controls
- Provide assurance and post implementation assistance
- Design a plan for continuous improvement in IT, data and modelling

We keep it simple and practical

IFRS 17 implementation will disrupt established operating models. A clear vision about the 'end state' and alignment with business steering is crucial for your success. We provide a simple and practical solution for a maximum return of your project investment.

We follow lessons learnt from Solvency II implementation…

Break 'silos' between teams	Address complex technical issues timely	Document and re-design controls 'as you go along'	Allow enough time to prepare and explain reconciliations	Budget prudently; have a Plan B for contingencies	Train delivery teams and engage executives early

…to guide you through your key decisions on:

Modifications to the building block approach	Systems implementation	Measuring performance	Financial reporting & disclosure	Actuarial & finance modernisation
Will your products qualify? Is it beneficial to use the modifications? Can your systems support multiple approaches?	Which Solvency II systems improvements can you leverage? Can you save cost and time if you integrate IFRS 17 in other planned upgrades?	Will your current monitoring KPIs be fit for purpose under IFRS 17? What else do you w ant to measure and track?	Can you align key reconciliations to how you manage the business? What is your 'story' to the investors? Can you produce it timely at low cost?	How do your teams collaborate? How do you share know ledge and allocate tasks to skills? How do you avoid duplication of effort?

…before you invest in detailed solutions around:

Data sources	Assumptions	Models	Results	General Ledger	MI
• Transitional data • Policyholder cohorts • Assets • Pre-contract cash flow s	• Records for multiple bases (Solvency II, IFRS 17, for some groups: US GAAP / UK GAAP)	• FCF (leverage SII) • Discount rate • Options & guarantees • RA (use VaR?) • CSM 'add-on'	• Disclosure pro-formas • 'Bridging' results under different bases (build on exiting SFCR reporting routines)	• Updated chart of accounts • Data storage for CSM • More granular reconciliations • OCI/ P&L analysis	• Focus on w hat maters most for the Board • Utilise ORSA and existing risk monitoring or scenario / stress testing routines

A sample of our experience

IFRS conversion and improvement in controls for a Reinsurer	We delivered an IFRS conversion for the UK subsidiaries of a major reinsurer. The project involved the resolution of material prior period errors, rectification of data quality issues and errors in the configuration of monitoring reports. In addition to various technical accounting challenges, we managed a complex group of stakeholders involving the external auditors, consultants on a Finance Transformation program and the Head Office Finance team of the parent company.
Implementation of significant reduction in close times for UK listed insurer reporting capital results	We were engaged to design the Target Operating Model (TOM) for the Solvency II capital process covering financial and actuarial elements. A deep dive was performed on the capital aggregation processes resulting in significant working day savings being driven out through the implementation. The design allowed the insurer to deliver on both market and solvency reporting deadlines.
Rationalisation of finance and actuarial processes and models in the UK listed insurer	We developed the TOM for a large domestic listed insurer. The initial part of the project involved an assessment of ultimate needs against the "as-is" position, including all aspects of the finance and actuarial TOM. Workstream packages were developed to deliver the tactical and strategic phases of the project. We led on three of the detailed workstreams setting out the planning activity to deliver the TOM.
Improvement in controls for UK listed insurer	We reviewed the controls around a capital model for a listed insurer. This included identifying risks in the process, controls mitigating these risks and looking at the design, operation and evidencing of these controls. We identified a number of areas for improvement both in the control environment and also in the efficiency of the processes.
Integration of two finance divisions for listed insurer with significant resulting cost savings	We delivered an integration project combining the finance functions of two leading UK insurers. The integration work covered the actuarial aspects of the integration of the Chief Actuarial Team and the broader Finance function. Key focuses included the design of the TOM for the technical finance teams, devising an offshoring programme for the business, assessment of duplication of tasks and simplification of the processes. These actions resulted in a significant reduction in business costs.

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International Tax Review European Tax Awards
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