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# IFRS 17

## Special report 2019

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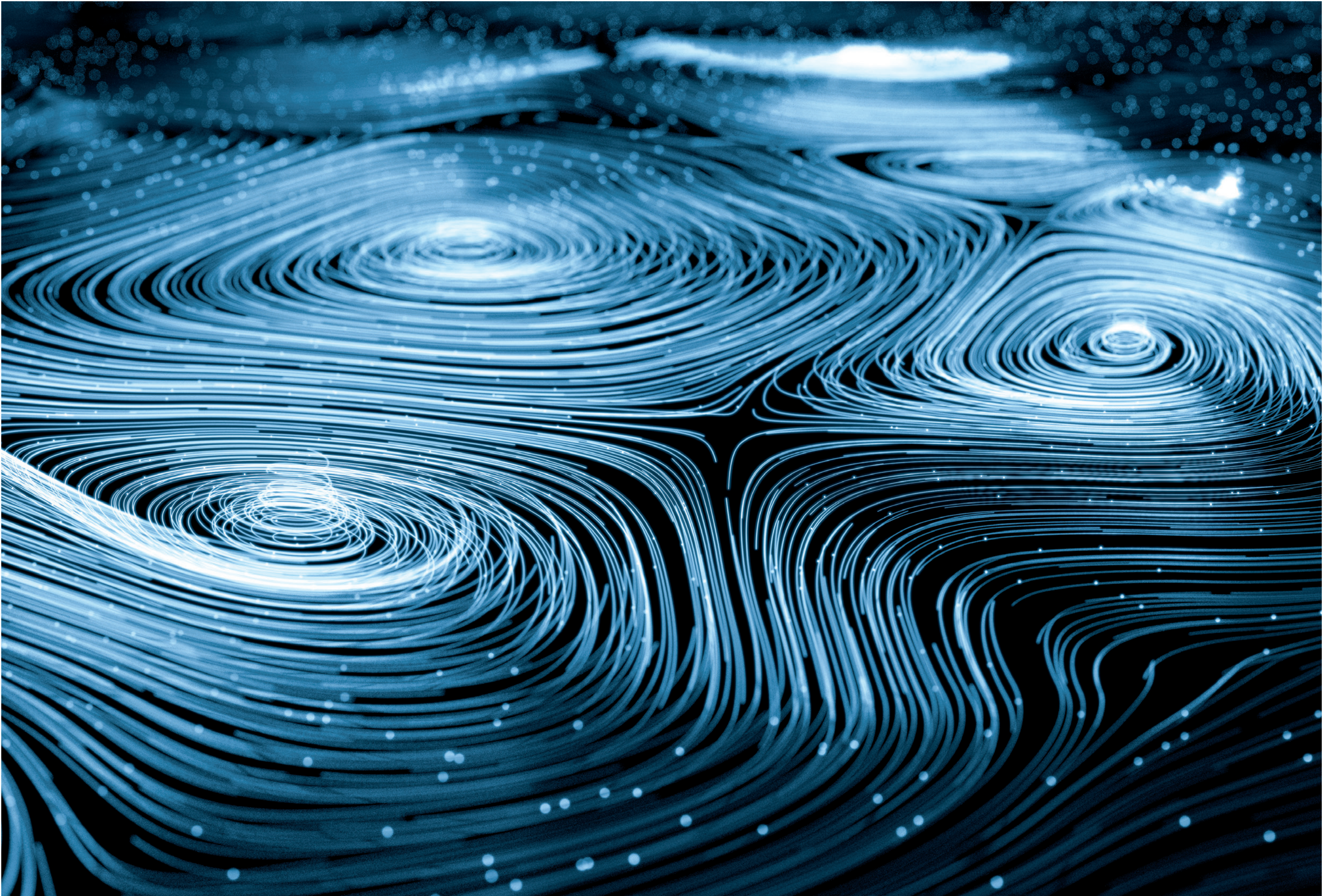

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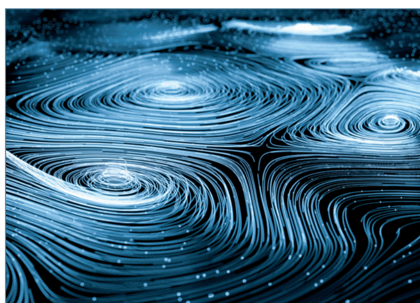

# Keeping the foot on the pedal despite deadline deferral

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The insurance industry has long been vocal about the need for a two-year extension to the International Accounting Standards Board's (IASB's) proposed 2021 implementation date for International Financial Reporting Standard (IFRS) 17 – the accounting standard for valuing the liability side of insurers' balance sheets that replaces IFRS 4. Eventually, IASB met them halfway, opting for a 12-month extension – a decision that hasn't been greeted with universal approval from the sector.

What has been less talked about is IASB's move at the same time to delay IFRS 9 – which looks at the valuation of financial instruments – for insurers until 2021. In other words, the industry will be able to co-ordinate the implementation of both the asset and liability accounting reform in the same year, a move that William Gibbons, asset-liability management specialist at PwC, says is a major boon to be drawn from IASB's November announcements.

"The continuing alignment of implementation dates for IFRS 17 and IFRS 9 is a positive because it means insurers don't have to introduce IFRS 9 one year and then IFRS 17 the next. Insurers can assess the asset and liability implications together.

"It might have been hard for IASB to give an additional year for IFRS 9, as insurance will be the only significant sector the delay applies to. So the delays of both IFRS 17 and IFRS 9 make sense for insurers."

The insurance sector is the only part of the financial markets to be given a reprieve from IFRS 9, which is pretty much mandatory from January 1, 2019, so does this exemption contradict the IFRS's mission statement to bring "transparency", "accountability" and "efficiency" to global financial markets?

"No", is the general answer from those asked by *Risk.net* and, while IASB has come under a lot of criticism over IFRS 17, the move to co-ordinate its implementation with IFRS 9 appears well thought-out and should benefit the industry.

But there are still complaints. IASB has recognised 25 areas of dispute as part of an ongoing dialogue with the European Insurance CFO Forum and time is running out to resolve these. But, even without this clarity, insurers need to continue with their implementation programmes, and consultants warn of the need to heed the lessons learnt from Solvency II implementation.

One such consultant has some blunt words for insurance risk managers when it comes to IFRS 17 – it's big and complex, so make use of the lessons from the previous project of that type: Solvency II.

"The accounting standard was published 20 months ago and, while not all companies started their IFRS 17 programmes quickly, they are all up and running now. But we would suggest insurers don't use this one-year extension as a means to slow down, and instead use the time wisely to improve the implementation process.

"There's always the temptation with a deferral to slow down implementation but that ultimately costs more. There's lots of evidence of that from Solvency II where the industry downed tools at certain points and total costs started rising. Has the industry learnt those lessons? We will soon see."

Aaron Woolner
Contributing editor, *Risk.net*

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Major changes are expected under the new IFRS 17 regime – insurance companies must make efforts to comprehend and communicate the full impact of changes to profit emergence under different scenarios, and its sensitivity to different methodology choices, writes Steven Morrison, senior director, research, at Moody's Analytics

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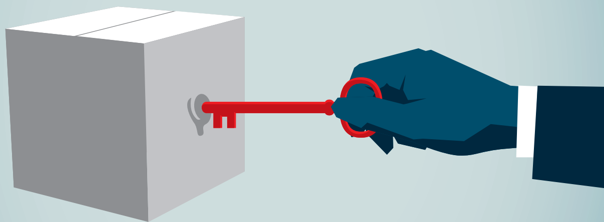

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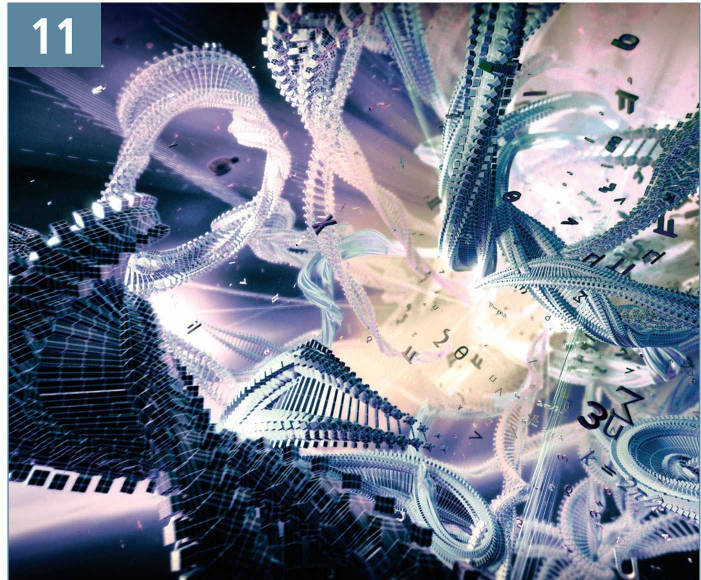

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Insurers call for IFRS 17 changes

Insurers have gained an extra 12 months to implement their IFRS 17 programmes, but the industry is calling for further changes to the standard as well as more time. Aaron Woolner reports

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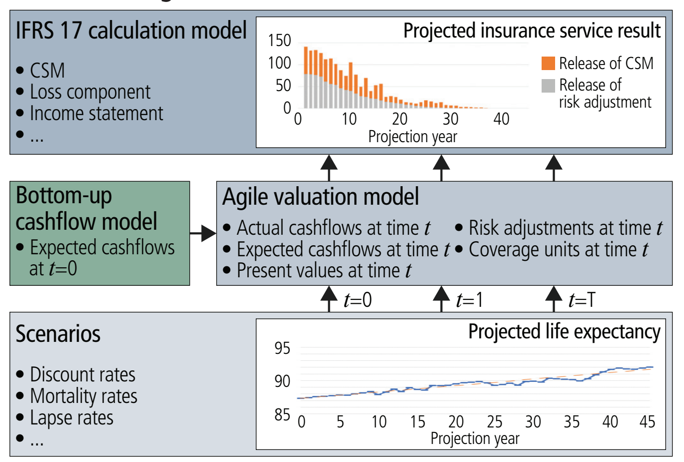
# Profit emergence under IFRS 17

Major changes are expected under the new IFRS 17 regime – insurance companies must make efforts to comprehend and communicate the full impact of changes to profit emergence under different scenarios, and its sensitivity to different methodology choices, writes Steven Morrison, senior director, research, at Moody's Analytics

Many insurance companies are currently focused on implementing systems to support calculation and reporting of IFRS 17 financial statements. However, the introduction of IFRS 17 ultimately requires insurance companies to be able to perform more than point-in-time calculation and reporting. Insurers also want to project these statements in the future under different scenarios. Such a projection capability serves at least two important purposes:

- To better understand the timing and volatility of profit emergence, which could change significantly relative to existing reporting. This could have a major impact on many areas, including the payment of dividends, tax and remuneration. This information is important not just for insurance companies' management but also their investors, who will want to understand the effect of IFRS 17 on profits, and any resulting impact on management strategy.
- To understand the impact of methodology decisions not prescribed by the standard. For example: transition methodology, level of contract grouping, choice of coverage units and risk adjustment methodology. These decisions impact on the timing of profit emerging under different scenarios.

1 Profit emergence under IFRS 17




Under IFRS 17, the new contractual service margin (CSM) plays an important role in profit emergence, ensuring profit is not realised at contract inception but released over time as services are provided. It also partially absorbs the impact of changes in certain assumptions on fulfilment cashflows. However, this does not mean profits are entirely predictable or stable. Indeed, under certain scenarios they could be highly volatile. In particular, when assumption changes are sufficiently extreme, the CSM is eliminated, the contract group becomes onerous and further variability is recognised immediately in profit and loss (P&L) – until a CSM is re-established.

To fully understand profit emergence, companies should consider the effects of different scenarios. In particular, it can be useful to consider other scenarios in addition to best-estimate forecasts. Companies may find it useful to understand which scenarios result in a contract group becoming onerous, and how this changes depending on methodology decisions.

Such scenarios could be hand-picked – typically, to reflect a narrative – or generated using a stochastic scenario generator. In choosing the type and number of scenarios to investigate, companies will face a trade-off between the amount of information provided and the complexity of implementation. Projection under many stochastic scenarios can provide detailed information but may not be feasible using existing actuarial cashflow models. Where these do not support efficient IFRS 17 projections, 'agile' or 'proxy' models may provide an alternative approach.

Companies also need to consider the impact of changes in financial assumptions on assets measured under IFRS 9. The interaction between these two standards can be complex, with resulting net profit depending on the classification of assets and liabilities. For example, the impact of financial risk on participating contracts varies depending on whether they qualify for measurement under the variable fee approach (VFA) or the general measurement model. Furthermore, under the VFA, the impact of financial risk varies depending on whether risk mitigation techniques are recognised.

Even for non-participating contracts, financial risk impacts both assets and liabilities through the effect of discounting. Companies can choose to recognise the effect of changing discount rates immediately through P&L or other comprehensive income. Similarly, the effect of changing interest rates on assets depends on their classification under IFRS 9. Companies will need to consider classification and the choices available under both standards to ensure these are aligned and accounting mismatches are avoided where possible. Projections under different scenarios can be used to investigate these options. ■

## To learn more

Explore Moody's Analytics' research papers, articles, white papers and videos on profit emergence under IFRS 17 at the Thought Leadership Center
www.moodysanalytics.com/ifrs17-thought-leadership

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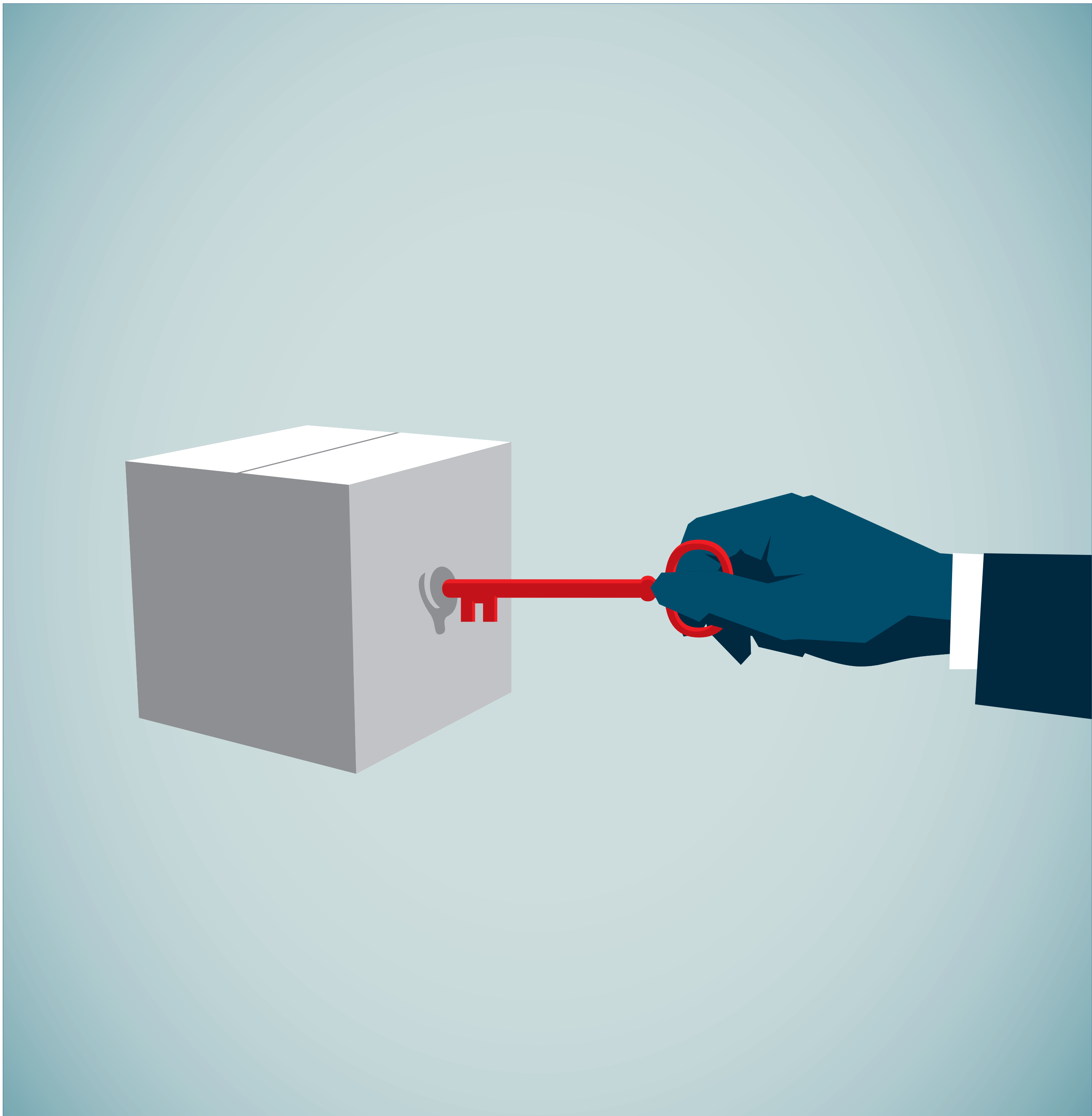
# Discounts rated

## Accounting and discount rates clash

While Solvency II 'boxes in' insurer discount rates, IFRS 17 sets them free – but the regulators aren't happy. Aaron Woolner reports



In many ways, the changes applied to the Solvency II discount rate – which is the basis of valuing all cashflows – symbolise the insurance regulatory standard's transformation from its principles-based origins to the rigid rules-based standard that came into force on January 1, 2016. First came the extrapolation method for calculating long-dated cashflows in liquid markets, followed by the volatility and matching adjustment, resulting in a discount rate that – according to one leading consultant – leaves insurers 'boxed in' when it comes to valuing their liabilities.

### Solvency II versus IFRS 17

The approach applied by the European Insurance and Occupational Pensions Authority (Eiopa) is so prescriptive, the regulator publishes a monthly set of interest rate structures to be applied to all insurers. These figures are based on the bond and swap rates of around 60 countries worldwide – including Liechtenstein, Taiwan and Colombia – according to the 130-page report published by Eiopa in January 2018 on the technical standards to be applied for determining interest rate structures.[1]

The difference between Eiopa and the International Accounting Standards Board's (IASB's) thinking on this results in substantial practical differences between the standards, according to Anthony Coughlan, director at PwC's UK insurance practice. He highlights a number of points of divergence, such as the Solvency II volatility adjustment, which is not permissible under IFRS 17, and the approach to extrapolating the risk-free rate from a number of currencies. And it doesn't stop there.

"For annuity products – primarily in the UK and Spain – the Solvency II matching adjustment is a similar concept to an IFRS 17 top-down discount rate, but it would require revisions. The end result would be a significant difference between a Solvency II- and IFRS 17-compliant discount rate."

Another key difference between Solvency II and IFRS 17 is that the latter specifically allows expected cashflows from the product itself. Therefore, for a firm selling an asset-based policy, such as a unit-linked product, the discount rate chosen under IFRS 17 would reflect the expected return on assets. But, for a product such as term insurance, the determinants of the discount rate would be metrics such as durations, currency and the liquidity of the assets supporting the product.

### Preventing figure massaging

Several people *Risk.net* spoke to reported that the net result of such a major disparity in the approach to the discount rate in Solvency II and IFRS 17 meant it could be possible for insurers to use the greater IFRS discount rate flexibility to massage their IFRS 17 figures.

"The opportunity to calibrate this in a different way is real," says one. "But how many insurance companies in Europe will do that remains to be seen. There will be a discussion between those insurers and their auditors about whether a discount rate set under the prescriptive rules of Solvency II can also be valid for IFRS 17 and, if it is, whether the shareholders will actually like it."

"IFRS 17's principles on determining the applicable discount rate and risk adjustment may have exceeded the appropriate level of allowing for entity-specific inputs and consequently may give rise to significantly different and potentially incomparable results"

Regulators appear to be aware of this point. Eiopa, for example, sent a letter in November outlining its response to IASB's decision to extend the implementation date. Despite welcoming the "paradigm shift" in accounting regulation that it said IFRS 17 represents, it went on to raise concerns over the differences in discount rates.

The letter goes on to state: "IFRS 17's principles on determining the applicable discount rate and risk adjustment may have exceeded the appropriate level of allowing for entity-specific inputs and consequently may give rise to significantly different and potentially incomparable results."

### Setting the discount rate

This received a scathing response from Andrew Carpenter, IFRS policy specialist at the Association of British Insurers. He said that, while the IFRS 17 discount may result in different end numbers for different companies, that is because it is intended to inform investors, not regulators or policyholders. Moves by groups such as Eiopa to influence this are therefore a clear case of going beyond their mandate.

"There have been calls from regulators for more prescription in setting the discount rate: both the European Securities and Markets Authority and Eiopa have raised this issue, among others, but we feel this is an example of regulators overreaching their responsibilities. Capital markets have their own dynamic," says Carpenter.

Capital markets are also global and, according to sources familiar with IASB's thinking, the body was conscious that it has a large number of member countries, and that the needs of all – not just European – members needed to be considered when setting out the discount rate, particularly given the market-driven nature of all other standards. That is the critical issue.

According to the IFRS website, it serves as a standard-setter for more than 150 economies globally – in places as diverse as Timor-Leste, Gambia and Iran – and, as such, has met a very diverse range of needs.

Crucially, of the 150 states IFRS says it provides accounting standards in, one exception is the US – the world's largest insurance market. Meanwhile, Japanese insurers – the second largest market – have the option of using IFRS 17 or a Japanese version of Generally Accepted Accounting Principles (GAAP).

In fact, the US Financial Accounting Standards Board is also overhauling its approach to accounting for insurance liabilities to roughly the same timeline as IFRS 17, meaning European insurers with US subsidiaries will have to overhaul two sets of [differing] accounting regimes at the same time.

### Euro-centricity

However, William Gibbons, insurance asset-liability management specialist at PwC, is sanguine about the impact of these processes occurring at around the same time. US GAAP is different to IFRS already, and after the next round of changes it will be different in yet another way.

"In the context of European insurers, the reality is there is a difference today between US GAAP and IFRS GAAP, and there will just be difference between them in the future. Insurers were hoping for a global standard but, sadly, won't get that and instead it's effectively more of a European standard. A number of Asian countries, including important markets like China, Korea and Hong Kong have already said they will adopt some form of IFRS 17 – but what exactly and when is not clear." ■

[1] *Eiopa,* Technical documentation of the methodology to derive Eiopa's risk-free interest rate term structures, *January 2018, https://bit.ly/2sBqGwg*

# IFRS 17 implementation

## Preparation strategies ahead of 2022

With the IFRS 17 deadline fast approaching, firms have little time to adapt to a massive increase in data volumes, as well as perform calculations and generate reports. A panel of industry leaders discusses the main challenges to implementation and how processes are being adapted accordingly, how technological solutions can aid firms looking to change the way they measure financial performance, and the likelihood of the industry meeting the January 2022 implementation deadline

Stefan De Lombaert
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Solution Consulting, Emea
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**What is IFRS 17 and how would the proposed deferral of its deadline impact implementation?**

**Stefan De Lombaert, SAS:** IFRS 17 is scheduled to be applied on or after January 1, 2022. It will have implications on financial disclosures and profound operational impacts on all aspects of the organisation.

The industry faces tough challenges in understanding the operational impacts on data, systems and processes:

- Data management, storage, data quality and archiving
- Systems architecture
- Actuarial and accounting processes that will support the future reporting process.

Insurers will soon need to implement significant technical and practical changes to appropriately respond to these challenges.

SAS believes the most efficient way to approach this will be via an integrated operating model and technology platform for actuarial and finance, enabling insurers to work as a unified team with a single seamless calculation and reporting system.

**What IFRS 17 implementation challenges are firms currently facing?**

**Yannick Cortese, Moody's Analytics:** The main challenges fall into six categories: data granularity, modelling, disclosure, transition, technology and timeline.

IFRS 17 requires more granular data, given that cashflows are required to be split into 'units of accounts', and cashflow variations must be segmented by type. It introduces new calculation elements such as the contractual service margin (CSM), with several methodologies according to contract type and risk adjustment. With the new standard being principles-based, companies will need to translate the principles into detailed interpretive models. The current reporting environments and reports will also need to be changed to fulfil the new disclosure requirements.

Calculating the remaining profits on the existing portfolio using one of the three possible methods – full retrospective, modified retrospective, fair value – will pose significant transitional effort. The technical challenge mainly relates to the huge increase in data volumes required and the time needed to perform calculations and generate reports. The two-year timeline to project completion is tight, leaving no provision for a break.

**Sufyan Khan, Oracle:** IFRS 17 replaces IFRS 4 – the previous standard. Though the timeline has been extended, the road ahead does not undermine the challenges insurers face.

Some of the key challenges are as follows:

- Data – The amount of data required under IFRS 17 is immense and is required from all functions, covering current and historical information such as policy data, premium information, reference data or investment data. A holistic approach needs to be taken to address the data management issues at a more enterprise level to reach a target operating model.
- Measurement – To compute CSM, metrics such as best-estimate cashflows, risk adjustments and discounting – including allocations – need to be put in place to measure results and large volumes of data, including granularity and the complexity of calculations.
- Reporting – Day-one reporting for measurement standards is a key challenge under IFRS 17. Since data is fragmented, automation is lacking and, in the absence of an integrated data model, the reporting process can be time-consuming, prone to human error and not cost-efficient. Once CSM, fulfilment cashflows and other metrics have been calculated, they need to be reported within the financial statement, including movement analysis. In addition, the frequency of internal and external reporting should not be underestimated. Insurers also need the flexibility to audit results to the data's point of origin.
- Postings – Results of CSM under different measurement approaches, including best-estimate cashflows and adjustment, need to be translated into general ledger (GL) postings, which should seamlessly translate into financial statements.
- Process automation – For the process to be successful, it is important to automate the end-to-end process as much as possible. The entire way from data capture to data quality checks and from management of cohorts to calculation of CSM and CSM release – including GL postings and report generation – should be part of an automated process/workflow.

**Ulrich Gröbel, IFB:** IFB looks predominantly at the implementation challenges, based on project experience with insurers from the European and North American markets.

One of the challenges is the interpretation of the principles-based standard and the company-specific adoption of valuation methods for the group-specific business portfolio with its core and niche products. Based on early impact assessments for the company-specific business portfolios, decisions are needed on measurement models to provide solid ground for designing functional requirements.

Another challenge is to generate the increasing amount of data required and to significantly increase the quality and lineage of that data to ensure proper valuation results. Depending on the option chosen for transition, this might require additional effort to retrieve historical data for far-reaching business periods. Ideally, IFRS requirements are used to define a data architecture to serve integrated finance and risk requirements, such as Solvency II, to prepare for future developments of regulatory standards.

IFRS 17 affects almost the entire business IT system landscape of insurance companies, which has often been developed over time with little integration. A future-oriented business and IT system architecture lays the foundation for a complex project environment, where architectural decisions are needed early on to enable the required progress in IFRS 17 transformation. There is no one-size-fits-all target architecture. It needs to be designed based on middle- and long-term objectives for business transformation, such as a single or multiple Generally Accepted Accounting Principles (GAAP) solution, finance and risk integration, or a centralised-versus-decentralised approach. In addition, it requires close collaboration of various group functions and interaction with local subsidiaries.

This contributes to a complex project environment with a large number of different participants that need a joined-up and transparent approach to integrate functional and technical requirements. Significant budgets are required just to adhere to regulatory standards. Tangible benefits beyond regulatory compliance can be achieved by aligning the target operating model, target architecture and target IT system landscape to additional future-oriented business objectives. Such benefits might focus on quality, cost, business insights, and planning and simulation capabilities.

**Stefan De Lombaert:** IFRS 17 will have several impacts on insurance groups, causing uncertainty around the following:

- Which technological solution to employ to best meet the standard. In this regard, firms have two options:
  - Build out the new capabilities by extending actuarial tools or GLs, or both.
  - Introduce an end-to-end solution comprising a process orchestration tool, a strong data management platform, a CSM calculator, a sub-ledger and a set of disclosures.

- Where to find staff to successfully implement the new standard, considering that:
  - Implementation teams require the full-time attention of a multidisciplinary internal team, assistance of external subject matter experts and personnel from its technology provider.
  - Companies moving faster will have access to better resources, while slow deciders will face difficulties in ensuring the necessary resources.

- How to marry the finance requirements with the performance deep-dive analysis, the planning and budgeting needs, and the what-if requirements before and after transition:
  - A recent survey found that 84% of insurers expect much more than complete compliance from their IFRS 17 projects, including:
    - A review of planning and budgeting needs.
    - Testing various options during transition.
    - The ability to analyse profitability on a highly detailed level.

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**What are businesses required to do to change their processes to meet IFRS 17?**

**Yannick Cortese:** First, accountants and actuaries will need to sit down together. Their collaborative efforts are of critical importance in meeting calculation and reporting execution timelines of five to seven weeks from the closing date. Second, firms must get on top of data accuracy and quality to avoid process inefficiencies. Third, IFRS 17 is designed to bring more transparency and comparability – therefore chief financial officers (CFOs) will need to set up reliable internal audit and control processes. And fourth, CFOs will need to put robust processes in place to better forecast and control future financials, given that insurance companies now need to assess assets and liabilities at market value. Loss components will need to be incorporated into the profit and loss (P&L) during the current reporting period without any deferral, which means financial results will tend to be more volatile.

**Sufyan Khan:** Based on feedback from clients, changes are being made by businesses in the following areas:

- Clients are increasingly adopting technology platforms and innovative systems to transform their business and finance processes. With the huge volumes being processed, deployment over big data platforms is imperative.
- Many insurers are adopting a control framework over financial reporting along with strong capabilities around auditing to meet the minimum requirements as per the standard while mitigating risk during the reporting process.
- To avoid manual intervention and have a better governance framework in place, many insurers are adopting process automation to automate workflows within their business processes.
- Training and development of skill sets within the workforce are key to explaining the key accounting changes and how this would impact key performance indicators (KPIs) and successful delivery of the standard.

**Stefan De Lombaert:** The new standard will require, at the very least, IT, actuarial and finance departments to work much more closely together, eliminate manual procedures, store data at a very detailed level and undertake the process in a much shorter time than they are used to.

- Actuaries will have to run models more often, redefining modelling granularity.
- Finance will have to become acquainted with a new chart of accounts, and work with both a GL and a sub-ledger.
- Everybody will have to take a fair share of responsibility in a more complex process.

**Ulrich Gröbel:** It is not sufficient to simply redesign existing processes. New aspects are needed under IFRS 17, and processes require a more intense collaboration of various functions within insurance groups. The standard enforces a deeper interaction between actuaries and accountants, and closer co-operation on preparation work from related functions within the business units. This includes preparing data for various 'estimates' and 'actuals', and within reporting functions such as accounting and actuary – both on a legal-entity level

as well as group-wise. This is because IFRS 17 vastly increases calculation and measurement efforts within the sub-ledger compared with non market value-oriented or time value of money-oriented local GAAP.

Although IFB has been practising this type of co-operation by adapting the Solvency II requirements, different requirements are involved, such as for designing portfolios or preparing cashflow information. Co-operation will be more intense for the evaluation of portfolios that affect the attractiveness of business segments.

A common understanding of modelling assumptions and insurers' interpretations of standard principles will enable control over measurement results to be reported under IFRS 17. Insurers that design a target solution for future co-operation that is based not only on current understanding of responsibilities but on future needs will gain an advantage in harvesting a better quality of results and ongoing analysis and interpretation.

The focus of process design should be not only on how to generate valuations but also on how to interpret and analyse them. From benchmarking studies we know that most of the manual effort driving capacity within group functions is caused by insufficient support of this type of analysis – such as reconciliation work, change reason analysis, comparison between different GAAP and so on.

**How likely is it that the industry will meet the January 2022 implementation deadline?**

**Sufyan Khan:** The tentative extension of the deadline by the International Accounting Standards Board (IASB) has given insurers some breathing space. At the same time, it has given insurers the opportunity to implement IFRS 17 as a strategic approach instead of taking a tactical view. The industry needs to take this as an opportunity to avoid the mistakes made during Solvency II, and adopt a view to extracting long-term benefits from IFRS 17 implementation. According to the most recent Deloitte survey, around 35% of insurers expect to spend around €50 million on IFRS 17, with large insurers anticipating around €100 million.

**Yannick Cortese:** This will vary according to the degree of preparation and choice of approach. Developing an internal solution might put deadlines at risk and impose high long-term maintenance costs. Investing in a configurable solution from an experienced vendor will accelerate development and provide structure for internal efforts.

**Ulrich Gröbel:** Some of IFB's current projects with international insurance groups started in the second half of 2017, and some started later in 2018. Considering the IFRS 17 compliance deadline being extended by one year – an additional extension might be granted by the European Financial Reporting Advisory Group at the end of 2019 – IFB believes insurers will remain under pressure to complete IFRS 17 compliance projects in terms of time, budget and quality.

For those that started early, the deadline extension allows room for dry runs with real data within the renewed system and process landscape. This will help align portfolio segmentation choices and measurement methods to company-specific interpretation of IFRS 17 standard and to improve reporting figure quality. This phase is to take place in the second half of 2020 and early 2021. Companies that have already set up a project environment and selected an IT tool to support IFRS 17-specific valuation have the chance to describe functional requirements based on the options the target architecture and landscape offers in relation to the scope of functionalities of the chosen IT tool. It will still be a challenge to meet the extended timeline.

**Is consensus emerging from the industry on interpreting the principles-based approach?**

**Stefan De Lombaert:** The Transition Resource Group (TRG) within IASB is closing the gap between this principles-based approach and the remaining divergences in the industry. The big four auditors play an important role; unless they are in accord, it will be difficult to achieve rapid consensus between insurance companies active in different markets.

The proposed deferral from 2021 is subject to public consultation, which is expected in 2019. IASB has been discussing potential amendments to IFRS 17 in December 2018.

Over the coming months, SAS will monitor the extent of any proposed amendments to the standard and make changes to its solution, though no major changes are expected.

**Yannick Cortese:** The TRG has acknowledged there are still 21 issues that require a resolution. Risk adjustment and reinsurance are particular areas of concern. Professional services firms are making efforts to provide interpretations and solutions that at least provide best practices to insurance companies, even if not a single method of applying those principles. Certainly, there is a strong desire within the industry to establish a consensus.

**Sufyan Khan:** There has been much more clarity from IASB on the premium allocation approach (PAA) and variable fee approach (VFA) in recent months. Insurers definitely see a benefit in the standard, which has taken 20 years. The fact it is principles-based brings it in line with IFRS 9, which – along with IFRS 17 – insurers need to be live by January 2022.

Ulrich Gröbel
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**How advanced are the technological solutions helping firms change the way they measure financial performance?**

**Ulrich Gröbel:** Various software providers offer IT solutions to support IFRS 17 requirements of valuation and sub-ledger accounting. Solutions differ in terms of the technical maturity of systems architecture; the range of functionality, such as for valuation, accounting, analysis, simulation, forecasting and planning; the scope of valuation support, such as single versus multi-GAAP, multicurrency, and so on; and the level of performance, such as memory and data handling.

The maturity and quality of standard content data models is also a differentiating factor. All aspects are usually validated within a proof-of-concept phase, based on selected typical requirements from a group and/or legal entity perspective. Yet the scope and quality of functionality provided need to suit the mid- and long-term architectural objectives and current state of the system landscape to select the most appropriate tools for the insurance group. Since none of the tools have been used in a live working environment, and the functionality will improve with future releases, it is helpful to learn from practical implementation experience in related working environments, such as IFRS 9.

The experience and capacity of existing implementation consultants also helps minimise risk in achieving project milestones and deliverables.

**Yannick Cortese:** There are multiple target operating models that have been developed. Firms must select the one that best fits their current IT architecture and provides the required functionalities. Performance will be a challenge – a few vendors provide software-as-a-service solutions that will enable firms to increase their IT process performance significantly within given timeframes.

**Stefan De Lombaert:** SAS considers this a major game-changer, only achievable with an integrated operating model and technology platform for actuarial and finance.

There are two approaches to this, both of which we support. A company can decide to run a second calculation at a level below the contract group or can allocate down the CSM from contract group level to a more granular level. Going forward, all analytical techniques can consequently be used to deep-dive into all (combinations of) dimensions available.

**Sufyan Khan:** Many insurers have been burdened with multiple legacy systems – either for historical reasons or because of a merger or acquisition. The next challenge is aligning the data across multiple silos. It is important to have an integrated data model covering both actuarial and finance systems to ensure not just the teams but the technology – as well as the data – is aligned. From an IFRS 17 perspective, the same set of results under the different measurement approaches can be viewed by both actuarial and finance teams, ensuring both the teams are looking at the same number with full lineage. The other fact that needs to be considered is how the results can flow seamlessly into the accounting hub as postings.

**What is the impact of the calculation and disclosure requirements?**

**Yannick Cortese:** Processes must be developed to enable the collection – or creation – of data at the required level of granularity. For valuation methods requiring a CSM calculation, a new calculation engine will be critical, and this might not be easy or even possible with existing tools. For many insurers, the necessary roll-forward, analysis and explanation of IFRS 17 liabilities will introduce significant processing overhead. The new standard introduces the risk of accounting mismatches, which can make financial management more difficult in the future.

Disclosure under IFRS 17 is more extensive, which means producing the reports will be more time-consuming. Sometimes consolidation can become more complex, and existing consolidation systems will need revision. Accounting systems will also need significant development with the introduction of a revised chart of accounts.

**Sufyan Khan:** Following discussions with clients, Oracle sees significant challenges for insurers in two main areas. One is on the calculation of CSM and CSM release along with unlocking the coverage units. The other is the representation of financial statements, including representation of revenue and expenses. Insurers would like to see a clear link between the assets held and the benefits payable to the respective policyholders. This is where data and data lineage become fundamental. The objective is not just to link the associated policies and portfolios with the investments, but also to have the flexibility to analyse the results of the different measurement approaches, as well as to compare movement analysis across multiple timeframes, including projection analysis.

**Stefan De Lombaert:** The most important impact is that many extra data items are generated – CSM, loss components, risk adjustments and present values of cashflows, plus all their movements from contract inception to contract derecognition. All of these items need to make it to accounts to be stored, analysed and disclosed.

However, since the changes introduced by IFRS 17 are so important and fundamental, it is anticipated that multiple what-if questions will need to be answered: the impact of a PAA versus a building-block approach (BBA), other comprehensive income (OCI) or P&L amortisation schemes, increase/decrease of reinsurance, more internal or external reinsurance, the impact of an increase in lapses, and so on.

**What is the capacity in the industry to disclose deeper insurance and financial risks arising from the business that insurers write?**

**Yannick Cortese:** IFRS 17 makes some allowance for the risks borne, including risk adjustment, which is defined to provide necessary compensation for accepting non-financial risks. However, it could be argued that, fundamentally, IFRS 17 is not a metric designed to take account of risks.

Many insurers already produce alternative significant disclosures about their risks under capital reporting metrics. Solvency II requires insurers to produce publicly available annual solvency and financial condition reports, which disclose the risk profile in some depth.

**Sufyan Khan:** There is an internal and external impact. For internal assessment, IFRS 17 would require adjustment to performance management and KPIs. For external reporting, IFRS 17 would have a significant impact on net assets/equity resulting in capital volatility which would be visible in the first year when results are reported by insurers. Also, the impact would be on first-year profits, which are anticipated to be lower and would have to be disclosed to the board and shareholders. These results would need to be audited and validated to portfolio and policy level with full data lineage before they are finally disclosed.

**What will be the impact of P&L volatility on IFRS 17?**

**Sufyan Khan:** Under IFRS 17, insurance firms will see an impact on their net assets or equities. One of the main reasons for this is the significant increase in the value of the insurance liabilities under IFRS 17. However, as per the third survey run by Deloitte, around 53% of insurers expected profit volatility to be lower as per the new standard. The other half expected the profits to emerge slowly. Nevertheless, earning volatility, including capital volatility, is a matter of significant concern. In the first year, insurers expect profits to be lower after the implementation of the standard compared with the previous year. One of the main reasons is that, as per the standard, any new business losses are realised upfront while any gains are deferred. The other related impact is the tax implications associated with earnings.

**Yannick Cortese:** Volatility is likely to increase once IFRS 17 is implemented. More volatility can be expected on the assets side because assets will be assessed based on their fair value. Accounting policy choices – such as P&L or OCI – will impact how fair-value variations impact P&L and balance sheet.

Liabilities will also be subjected to increased volatility for many reasons, including the unit of account granularity, which does not allow the same mutualisation; the rule to incorporate loss components in the P&L without any possibility of deferral; the choice of coverage units that will impact the level of volatility; changes to economic assumptions, such as discount curves and/or liquidity premia; changes to non-economic assumptions; and differences between expected and actuals and reinsurance modelling through the BBA and excluding the VFA.

CFOs will need insight into volatility sources and related impacts so they can anticipate outcomes. Since the timeframe will always be short, they will require automated and high-performing solutions with stochastic scenarios. ■

>> The panellists were speaking in a personal capacity. The views expressed by the panel do not necessarily reflect or represent the views of their respective institutions.

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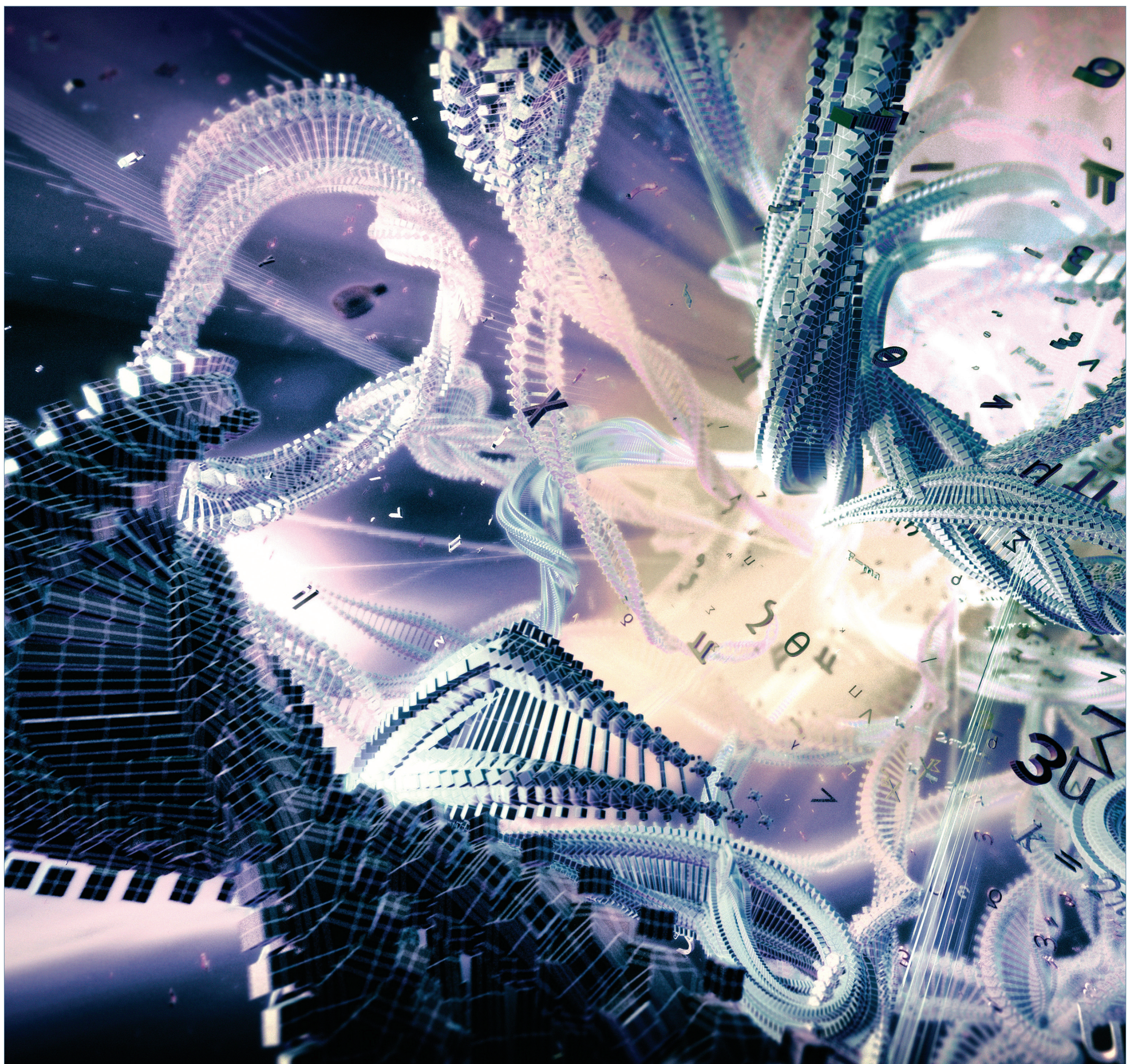
# Questionable standards

## Insurers call for IFRS 17 changes

Insurers have gained an additional 12 months to implement their IFRS 17 programmes, but the industry is calling for further changes to the standard as well as more time. Aaron Woolner reports



The news on November 15 that the International Accounting Standards Board (IASB) intends to delay the implementation of IFRS 17 to 2022 saw the standard-setter meet the insurance industry's request for a two-year extension halfway.

But, whether one year or two, IFRS 17 is merely delayed – not cancelled – and this adjournment, according to Francesco Nagari, who leads Deloitte's global Insurance IFRS practice, will not impact the strategic focus of European insurers. These firms had spent the previous few years investing heavily in terms of people, data and systems to meet Solvency II, which came into force in 2016. According to Nagari, insurers are looking to repurpose these efforts as much as possible to meet impending accounting standards.

"European insurers already have to comply with the stringent Solvency II regime, and we know for sure that our European clients all have a strategic goal in mind – that is, the integration of Solvency II and IFRS requirements in terms of implementation work. This is of the utmost importance in terms of how they will manage these requirements across data and people and systems."

### Prudential and accounting approaches

The good news according to Nagari is that Solvency II's use of mark-to-market pricing means the difference between the prudential and the accounting standards will only be found on the liability side of the balance sheet. Even here, there are a number of areas where it is possible to reconcile the two approaches, with the stringency of the existing Solvency II standards meaning IFRS 17 should result in lower liability figures than for their prudential requirements.

"Solvency II takes a different perspective altogether from IFRS. It says that insurers should be calculating a balance sheet in the event they are going to go bust, and what Solvency II regulators want to know is how much insurers are going to have to pay for someone else to take that liability off their balance sheet," he says.

By contrast, IFRS 17 intends to provide a more consistent global accounting model for insurers, aimed at enabling investors to better compare different firms issuing different types of insurance contracts in a more meaningful way. But even if Nagari is correct that large-scale European insurers – with the potential exception of some of the UK bulk-purchase annuity sector – will see lower liabilities under IFRS 17 than Solvency II, not everyone is happy.

This was made very clear in a letter from the European Insurance CFO Forum to IASB on December 6, signed by the group's chair Matthew Rider, chief finance officer at Dutch firm Aegon. The letter highlighted a number of concerns resulting from IFRS 17 field testing earlier in 2018, conducted by the European Financial Reporting Advisory Group (Efrag).

"As we have consistently stated, we believe that it is very important to assess the outstanding issues identified by members of the CFO Forum in the Efrag testing exercise. This exercise – by a significant number of major insurers – along with ongoing implementation projects, has provided substantial new evidence for the significant issues, their impact and the associated cost and complexity."

> "Our European clients all have a strategic goal in mind – that is, the integration of Solvency II and IFRS requirements in terms of implementation work. This is of the utmost importance in terms of how they will manage these requirements across data and people and systems"
> Francesco Nagari, Deloitte

### A lack of clarity

The outstanding issues outlined by the survey are almost innumerable. According to Ferdia Byrne, insurance partner at KPMG, the CFO Forum survey raised 12 key areas, which were further broken down into 25 separate issues by IASB. While not all of these 25 apply to every insurer globally, Byrne says the collective lack of clarity on what IFRS 17 will look like makes this the fundamental issue with regard to insurers meeting its requirements.

"The biggest obstacle to IFRS 17 implementation is that there are still technical issues with the standards and there has been a lack of clarity from IASB in response," he says. From an operational perspective, insurers need to understand what changes are being made to the standard as soon as possible, so that the final technical decisions can be made to push forward with integration."

### The importance of flexibility

Byrne says the most important of the 25 areas identified by IASB relates to the proposed methodology of how to restate previously earned profits that may appear a liability under IFRS 17. There are two main structures: the full retrospective approach – which requires a complete dataset – or the prescriptive modified retrospective approach. Meeting the full retrospective approach may present clear issues regarding data availability, and therefore a number of insurers will be forced to use the modified approach, which may not be appropriate to all firms.

Byrne says the insurance industry instead wants a compromise based on the available data rather than a prescriptive list. He concedes this may not be a perfect – nor a fully retrospective – solution, but one that could be an improvement on the modified retrospective approach, particularly from an operational perspective.

"How this issue transpires will drive a lot of the work in the next couple of years, and it's a big area where we would hope IASB will show some flexibility to help the industry do the best possible job in transitions," Byrne says. His views on the importance of the continued ambiguity over IFRS 17 and the main barrier to its implementation were backed by Andrew Carpenter, an IFRS policy expert at the Association of British Insurers. He said the results of the recent Efrag IFRS 17 field tests simply meant that changes had to be made to the standard.

"IFRS 17 throws up operational challenges – which are unnecessary on a cost-benefit basis – and it also includes issues over performance reporting, which don't do justice to the finances of our members' businesses," says Carpenter.

"In our view, IASB's decision to opt for a one-year extension precludes it actively looking at the technical issues that remain. IASB hasn't so far been active in its response directly and this unwillingness to engage with the industry is disappointing." ■

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