IFRS 17 Implementation: A Solution Approach for Insurers

Abstract

The International Accounting Standards Board's (IASB) International Financial Reporting Standard 17 (IFRS 17) for insurance contracts takes effect from January 1, 2021. With little time to prepare, insurance companies must quickly get their act together to understand the implementation challenges and develop a project plan for implementation. The new standard impacts not only the profits, equity, insurance obligations, and financial reporting of the insurers but also the actuarial models and IT architecture. This is because of the changes suggested in the standard around consistent accounting treatment of insurance contracts, measurement of insurance contracts, and disclosure requirements.

An ideal solution approach to addressing IFRS 17 requirements would be to use an agile implementation methodology for enhanced flexibility and communication between cross functional teams. In addition, automating the process of grouping contracts, deploying analytics to determine onerous contracts, and building a strong database for granular reporting can help insurers drive timely compliance.

IFRS 17 Contract Accounting and Measurement Requirements

IFRS 17 requires companies to report insurance contracts on the balance sheet as a total of the fulfilment cash flows (using current estimates of the amount, timing, and uncertainty of cash flows and discount rates) and contractual service margin (CSM) at each reporting date. It also requires them to distinguish between groups of contracts expected to make profits and groups of onerous contracts. The expected profit for providing insurance coverage is recognized in the profit or loss (P&L) statement over time. Once the company determines that losses are expected from onerous contracts, the losses are accounted for in the P&L statement. In addition, IFRS 17 requires insurers' to disclose additional information to enable the users to understand the risks that company faces from issuing insurance contracts. So what are the IFRS 17 implementation challenges and possible solutions for insurers?

IFRS 17 Implementation Challenges

Insurers face two major implementation challenges in addition to incurring implementation costs.

1) **Short run up to implementation:** Given that the new standard is to be implemented on or before January 1, 2021, now is the time for insurers to start with an impact analysis and prepare a project plan for the next three years. The project plan should consider aspects such as gap analysis, budgeted costs, IT architecture changes, resource planning, data collection, data mapping, data conversion, and storage issues.

2) **Data gathering and analysis:** IFRS 17 will have a major impact on the way data is collected, stored, and analyzed. Currently, under IFRS 4, insurers store data according to the insurance product groups for measurement purposes. IFRS 17 requires insurers to analyze the data with sufficient granularity to identify and consistently segregate the groups of contracts right at inception. This helps determine and accrete interest on CSM, and store information on inception dates and the coverage period of the group of contracts, historical cash flows, discount rates, and risk adjustments for each group of contracts. This level of granularity will have a major impact on actuarial modelling and financial reporting systems, as well as supporting data requirements.

Agile is the Way Forward

A structured implementation approach can help insurers drive a smooth and timely implementation of IFRS 17.

Methodology: Considering the complexity involved, the agile methodology is best suited for project implementation rather than the traditional waterfall approach. The implementation project will likely span three years and involve changes in the accounting systems, actuarial models, and IT systems along with multiple milestones. An agile methodology enables insurers to be flexible and interactive across different phases of implementation to better overcome the implementation challenges. Agile also reduces the risk of developing wrong solutions and speeds up delivery.

Technical requirements: The existing insurance database might not be equipped to meet IFRS 17 requirements due to the complex calculations and reporting requirements of its building blocks, as well as the need to maintain discounting rates and historical data. This means insurers will need to change the data architecture to include the requirements of IFRS 17. The database management systems must be capable of maintaining a high level of granularity, grouping, calculation, and data reporting requirements. The database should also be flexible and efficient to support the reporting changes as well as integrate necessary automation to reduce overall costs involved. Each insurance contract is to be tested at inception to check if it is onerous or not, and accordingly grouped for measurement. Artificial intelligence (AI) and robotics can play a major role here. They can help analyze each contract for accurate grouping and measurement to determine if it is onerous or not, and also efficiently handle the huge volume of data.

Resource planning: Implementing IFRS 17 requires experts from different functions to work together. The actuarial function and risk management teams need to work with the financial reporting function to ensure that complex calculations required for CSM and Solvency II are processed accurately and in a timely manner. Resource planning must be carried out at the initial stages to include the experts from various functions who need to work together. Experts from different teams such as actuarial, finance, IT, and learning and development need to come together to understand the changes required and plan the implementation strategy. These experts will first need to undergo training to understand the expectations and requirements of IFRS 17. They will also need to perform a gap analysis to identify the changes required in the existing processes and systems, while collaborating to finalize the implementation plan. With the agile methodology, the technical and functional teams can easily come together to implement the plan through enhanced and goal-oriented collaboration.

Benefits Outweigh Costs with IFRS 17

Implementation of IFRS 17 requires changing the existing financial systems of insurers and gathering new information, which in turn, requires significant investments in terms of time, money, and effort. However, once implemented, IFRS 17 addresses a number of inadequacies in IFRS 4 and existing insurance accounting practices such as inconsistent accounting policies across insurers, usage of inappropriate discount rates and older estimates of the contracts, as well as risk adjustments in insurance contracts that are not explicit. In addition, it addresses challenges such as non-recognition of onerous insurance contracts in a timely manner and inadequate comparability of financial information.

The result: IFRS 17 will put insurers on a firmer footing to drive long term growth.

References

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