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IFRS 17: AN OVERVIEW OF THE CHALLENGES AND OPPORTUNITIES

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Introduction

In May 2017, the International Accounting Standards Board (IASB) issued IFRS 17 Insurance Contracts, with an initial mandatory effective date of 1 January 2021, after nearly 2 decades of discussions. IFRS 17 replaces IFRS 4 Insurance Contracts, the interim standard issued by the IASB in 2004. Since IFRS 4 was put together in a compact timeframe, just ahead of the European Union's adoption of IFRS, it was aimed for minimum rather than complete harmonisation. During the years of development, the project was known as "IFRS 4 Phase II".

In light of these developments, Trust Re is pleased to publish this short article, which highlights the key challenges and opportunities for organisations adopting IFRS 17. The proactive and regular sharing of perspectives is an integral part of our bid to provide our business partners with value-added services.

Preliminary 'Delay'

On 14 November 2018, IASB agreed to start the process to defer the mandatory effective date of IFRS 17 by one year i.e. 1 January 2022, which means that the expiry date of the temporary exemption from IFRS 9, Financial Instruments in IFRS 4 to allow entities to continue applying the temporary exemptions from IFRS 9, is 1 January 2022.

What is the change?

IFRS 17 demands a face-lift of financial statements of insurers. This is not the only impact, IFRS 17 is much more than an accounting change for insurers. IFRS 17 entails significant work from insurers to update their operations including new (or upgrade) technology, redesign processes and update controls.

IFRS 17 will bring about significant financial and operational challenges that will affect all parts of the organisation and the way that business is managed, the level of organisation and the granularity of data capturing. Wherever you work in your organisation, you will need to understand IFRS 17. More complex measurement models will mean finance and actuarial processes may need to change fundamentally. This could lead to additional data requirements and greater levels of system complexity. More collaboration, understanding and knowledge sharing between functions will be needed.

The IFRS 17 journey will be defined by key decisions about the choice of the measurement models, risk adjustment and discounting options.

Synopsis of IFRS 17

IFRS 17 Insurance Contracts establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows. [IFRS 17.1]

IFRS 17 requires a company to report as insurance revenue the amount charged for insurance coverage when it is earned, rather than when the company receives premiums.

IFRS 17 requires issuers of the insurance contracts to report them in the statement of financial position as the total of:

(a) the fulfilment cash flows – the current estimates of amounts that the company expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and

(b) the contractual service margin – the expected profit for providing insurance coverage.

The expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided. IFRS 17 requires the company to distinguish between groups of contracts expected to be profit making and groups of contracts expected to be loss making. Where a contract is expected to be loss-making, the expected loss is recognised in profit or loss immediately.

The amounts of the fulfilment cash flows recognised in the statement of financial position are required to be updated at each date, using current estimates of the amount, timing and uncertainty of cash flows and of discount rates.

The company:

(a) accounts for changes to estimates of future cash flows from one reporting date to another either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it; and

(b) chooses where to present the effects of some changes in discount rates—either in profit or loss or in other comprehensive income.

Changes in insurance obligations due to changes in the economic environment (such as changes in interest rates) will be reflected in an insurer's financial statements in a timely way. IFRS 17 will therefore provide current updated information about the effect of insurance contracts on a company's financial position and risk exposure, as well as transparent reporting of changes in insurance obligations.

The premium allocation approach (PAA) is a simplified approach that is available to measure some short-term insurance contracts. The measurement requirements are modified for reinsurance contracts held and insurance contracts with direct participation features.

IFRS 17 also requires disclosures to enable users of financial statements to understand the amounts recognised in the company's balance sheet and statement of comprehensive income, and to assess the risks the company faces from issuing insurance contracts.

How different is IFRS 17 from IFRS 4?

The impact of IFRS 17's adoption will vary significantly from company to company, depending on previous accounting policies and practices. There are three ways in which IFRS 17 differs from IFRS 4:

1) Comparability

Under IFRS 4, companies could carry on using a variety of accounting treatments for insurance contracts depending on the local standards and the type of products. As a result, the financial statements (results) of the insurers were not comparable even within a single jurisdiction. IFRS 17 aims to ensure insurers across all IFRS jurisdictions apply consistent accounting for all insurance contracts, regardless of product and the terms of the contracts.

2) Transparency

IFRS 17 achieves this by:

- Enhanced disclosure and greater transparency by combining current measurement of future cash flows with the recognition of profit over the period that services are provided under the contract.
- Insurance service results are presented separately from insurance finance income or expense.
- Investment components are excluded from insurance revenue and insurance service expenses.
- Entities can choose to disaggregate insurance finance income or expense between profit or loss and other comprehensive income (OCI).

3) Consistency and stability

IFRS 17 will provide insights into insurers' business models and exposures as it supports efficient risk management. IFRS 17 has the potential to strengthen financial stability of the insurance markets. IFRS 17's market-consistent and risk sensitive measurement for insurance obligations reflects on economic reality.

Embrace the change and next steps

IFRS 17's business impacts and requirements need to be understood and a formal impact assessment around the systems, data and processes should be done and communicated to internal and external stakeholders. Given the scale of this change, investors and other stakeholders should understand the likely impact as early as possible.

IFRS 17 implementation approach should be proactively budgeted. Insurers should target to 'dry run' one year ahead of the proposed implementation in order to be ready with the comparative information. However it is important to note that some impacts of IFRS 17 cannot yet be determined and implementation plans need to be flexible to accommodate any further improvements and/or changes.

References:

1. KPMG publication – IFRS 17 Insurance Contracts 'First Impressions'
2. EY publication – Impacts of IFRS 17 insurance contracts accounting standard 'consideration for data, systems and processes'
3. Deloitte publication – IFRS 17 Insurance Contracts 'Technical summary of IFRS 17'
4. IFRS Foundation – IASB agendas
5. IFRS Foundation - Standards Effects Analysis
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7. Institute of Chartered Accountants of England and Wales (ICAEW) & Institute of Chartered Accountants of Pakistan (ICAP) websites

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