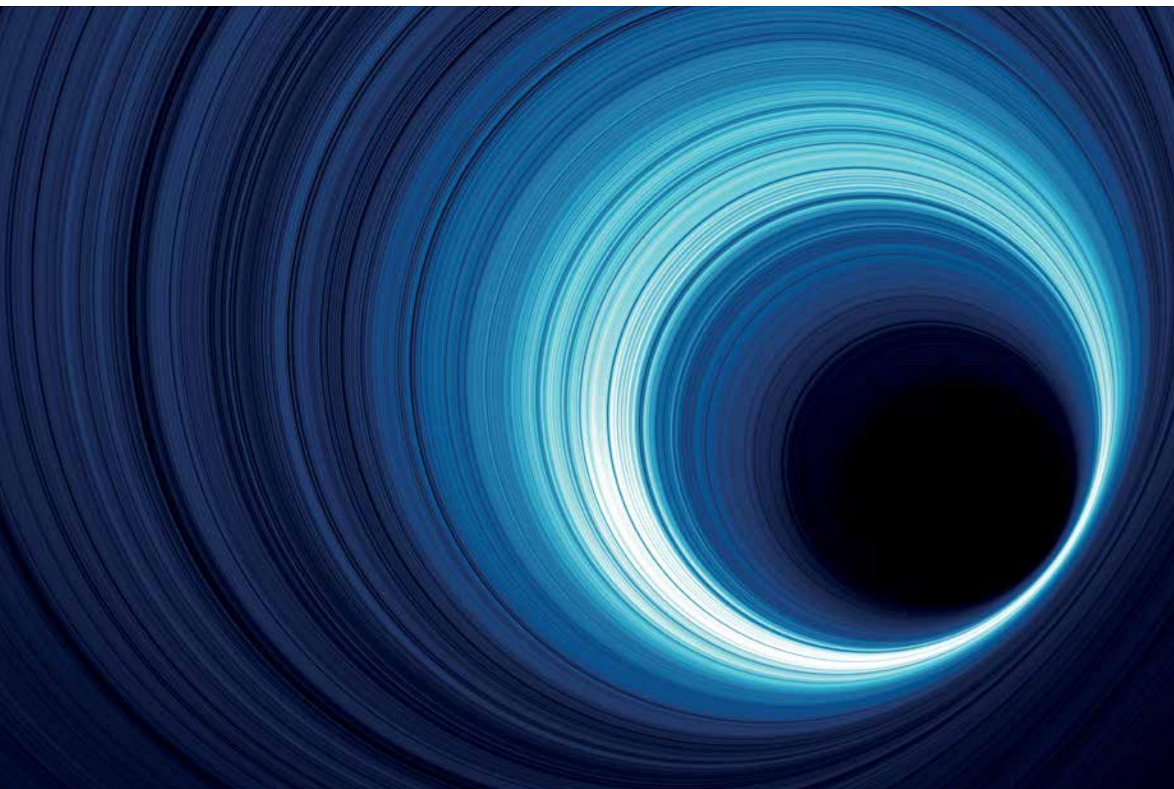
IFRS 9/17 in turbulent times

How to make use of the one year postponement without significant cost increase



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Introduction

Over the past two years, most Insurers have gone through an IFRS 17 Impact Assessment and have project plans in place for implementation, while there are still some that have not started yet. As with all large implementation projects, the devil is in the details. Many challenges have been discovered, alternative scenarios discussed, several IT solutions considered and process, data and operating models analyzed. One of the biggest concerns we heard over the last 12 months was how to address the multiple challenges and historical issues, within the tough implementation timeline – issues like heterogeneous reporting warehouses and “Access data bases”, manual data transfers, handovers or hundreds of excel sheets.

Given the intensive time pressure to develop new accounting frameworks that need greater granularity and more interaction between finance and actuarial systems, many insurers have had to accept the reality of workarounds whilst re-organizing their IT-landscapes.

With the IASB offering one more year to implement IFRS 9 and IFRS 17, it opens the opportunity to rethink the current roadmap, consider more effective ways to implement, and spend a little more time mitigating the risk of failure to deliver.

One more year might raise the appetite for expanding the scope of the project significantly, spending more money, bringing in new people with new ideas questioning the decisions made, or cause those who have been working on the new topics on top of their day jobs for over 2 years, to burn out.

Insurance Companies are on the whole aware of these challenges, and are taking them into consideration when reshaping and adapting their IFRS 9 and 17 programs. Most are discussing how to avoid another full year of escalating costs.

The purpose of this White Paper is to add PwC’s point of view to this discussion by giving an overview of what could be changed to maximize the value of the extra year without spending significantly more money.

Doing it smarter does not mean necessarily making it more expensive.

1. The facts about IFRS 17

What is certain for now is that the standard will become effective on January 1st 2022, while there are still calls from some stakeholders for further delay.

1.1. IFRS 17 – a moving target

The IFRS 17 implementation journey started when the IASB issued IFRS 17 on May 18th 2017. However in the past months we have seen the IASB, subject to due process, delay the implementation of both IFRS 17 and IFRS 9 for insurers until January 1st 2022.

Over the last two years, insurance and reinsurance companies filing under IFRS 4 have been intensely working to understand IFRS 17 and its impact. Staff working for the IASB have held numerous webcasts, podcasts and produced detailed examples to assist insurers with understanding the key concepts in the standard. The IFRS 17 Transition Working Group (TRG) has held meetings each quarter to answer over 80 questions so far from industry, supervisory bodies and other stakeholders.

PwC is publishing technical papers whenever decisions are taken by IASB and EFRAG referring to the standard.

Not all concerns are expected to lead to changes in the standard and the extent of change is uncertain.

For the current concerns raised and also for potential future concerns, the IASB has set relatively high hurdles for considering any change in the standard at all. Useful information is key for the IASB, therefore any amendment should avoid:

- Reducing the relevance and faithful representation of information in the financial statements of entities that issue insurance contracts;
- Causing reduced comparability or introducing internal inconsistency in IFRS standards, including within IFRS 17; or
- Increasing complexity for users of financial statements, thus reducing understandability.

In addition, the amendments should not unduly disrupt implementation already under way or risk undue delay in the effective date of IFRS 17.

Some adjustments might even lead to less complex and more flexible implementation and reduce risks in the projects. Most parts of the standards will remain unchanged.

There is no reason to pause and wait for each decision to be taken!

EFRAG continuously monitors the developments of the IASB meetings and recently announced that it wants to take a more proactive role in the pre-ED phase of proposed changes to IFRS 17 by the IASB. The work carried out by the EFRAG will be used as an input for both the development of EFRAG's endorsement advice and for responding to the IASB's due process.

The available time with the effective date 2021 was a huge challenge, so the postponement by one year gives the Insurers more time for implementation. Since for many insurers the implementation of IFRS 9/17 is part of running finance transformation projects, the postponement helps tremendously to create the basis for the implementation of IFRS 9/17 and to use it as the opportunity to modernise and optimise the finance function, which goes further than compliance only.

1.2. The chances of having one more year

During the last months, the IASB staff have considered many options on how much additional time is needed by the industry to implement IFRS 17. Some insurance companies fearing escalating costs and did not want any delay; others wanted one, two or three+ years. However almost all would agree that the additional time helps reduce project risks and allows time to focus on topics that will not change.

One more year offers the opportunity…

- to better align with other transformation projects (such as e.g. S4/Hana Implementation, Fast Closing due to SII, Reporting alignment or Finance Automation)
- to fix historical challenges around feeder systems and address the lack of knowledgeable resources
- to shape the system architecture roadmap to ensure that various IT, finance and actuarial enhancements are delivered in a timely manner to support one another rather than create more workarounds
- to get a deeper understanding of the financial consequences of system and accounting, choices from future profit emergence based on decisions for transition, stakeholders' communication and interdependency with IFRS 9
- to analyze and implement (possible) amendments to the standard to gain wider appreciation and understanding of how to reduce dependency on key individuals through the creation of specialist centers of excellence

1.3. The risks of having one more year

The one extra year offers a wide range of chances to run projects in a smarter way but there are also risks to be considered. These risks might raise costs and are mainly people related – but they can be managed proactively.

1.3.1. Don't lose momentum and your people

At most insurance companies, IFRS 17 project teams are running their project tasks in addition to their daily jobs. Using the year to take a break from implementation seems to be a poor project management choice. While it might allow teams to take stock of what they have achieved, giving a break or taking your foot off the gas, could reduce momentum gained and the motivation of teams.

However, with the extra year, project teams are now looking at another year of long hours, more dry-runs and more requests of "what would it look if we did …". Expanding the extreme workload of these key indivi-duals by another year will cause significant issues for the overall project success.

That's why it is critical to spend some time over the next months and proactively address these people related issues:

1. People get burnt out working solely on one topic – especially on top of other commitments – they will become less proactive and effective over the longer term.
   - Listen carefully – take the typical "heavy workload" complaints seriously
   - Set up 1:1 coaching workshops for key players to investigate tasks which can be delegated, maybe from their daily business
   - Identify project tasks that can be better supported by PMO (e.g. documentation, preparation of workshops etc.)
   - Investigate "line substitution" options to free up resources for the project by bringing in new people for the project period. Fresh graduates and students can make a difference.
2. Project team members might be replaced which raises the workload due to handovers and training to get familiar with the program, its mission and the content developed so far.
   - Smart onboarding of new staff through welcome packages, and explaining the scope, design criteria and decision process can acclimatize staff and reduce the time to get up to speed.
3. New project team members might come in with new ideas and challenge decisions already taken. This might lead to many discussions around why decisions were taken, leading to reopening the scope and might put deliverables already approved at risk.
   - Clearly captured records of scope and decisions taken with a written sign-off and approval can help to avoid re-inventing the wheel for those parts of the program which stay stable.
4. Market demand for experts is increasing as following industry players look to acquire those with deep knowledge and practical experiences gained during the impact assessment and design phases.
   - Think about a retention bonus based on the project success, contributions and achieving milestones.

Despite all these actions, ensuring the continued engagement of the project team is an ongoing risk for any project – but it can be reduced by acting proactively.

1.3.2. Get prepared for new ways of collaboration

Over the last five years, finance functions have been redesigned to ensure closer collaboration amongst the actuaries, risk management and performance management.

However, while they might all sit in one location,

- risk management still focuses on (solvency) capital requirements
- actuaries are left to explain why the P&L has taken a hit from changes in reserving, like a small change in IBNR or a "modelling change"
- performance management is then left to explain how it all fits together.

Under IFRS 17, actuarial calculations get more complex and the closing process depends even more on data deliverables to and from the actuaries. IFRS 17 demands re-thinking around the operating model to better integrate Actuaries, Accountants, Risk Management and Controlling.

The Operating Model for IFRS 9/17 has to reflect the strong collaboration required between Actuaries, Risk Management, Finance/Accounting (incl. Asset Accounting) and Controlling. Data Management and IT Architecture have to enable a smooth and effective collaboration ideally supported by Workflow Capabilities providing a certain level of automation, including completeness and quality checks (also relevant for ICS) as well as proper "hand overs".

With time pressure most operating model considerations focused on how to have processes up and running by 2021 by leveraging existing processes and capabilities (often related to Solvency II).

The extra year gives time to open the discussion of the future role of the finance and actuarial functions and what the CFO is expecting them to do. The risk is – depend on ambition level of both functions – to raise the appetite of both to invest in future capabilities to underpin their importance for steering the business and instead of better collaboration both sides start to compete against each other to get more budget.

With one more year, the pro's and con's of the different options can be analyzed carefully according to the future vision of the Business Steering Functions.

The extra 12 months also offer on top of this the opportunity to map the Operating Model options against future IT Capabilities, workflows and processes and vice versa. Current skill gaps don't need to be taken as a key constraint in order to build what makes most sense for the long run – there is enough time given now for training and recruiting.

2. Time to align IFRS 9 and 17 initiatives

Given the overwhelming impact of IFRS 17, the focus of the insurers' implementation projects was often on the liability side while IFRS 9 implications on the asset side were not as much on the radar. The postponement allows insurers to look at the most relevant IFRS 9 driven topics again to work on robust solutions.

These IFRS 9 driven topics revolve around the system solutions for IFRS 9, granularity and sourcing of new data required and transition. The advantage of the postponement is the additional time gained to upgrade old systems and customize for the IFRS 9 requirements.

The transition to IFRS 9 requires significant adjustments and decisions, which now have to be revisited from a content and timing perspective:

- If an insurer changes its inventory method as a result of implementing the impairment rules: How is the transition into a lot accounting world done from an accounting and systems perspective?
- How is the comparative period in 2021 impacted (note that the IASB is addressing the IFRS 17 requirement to prepare comparative information as part of the topics for potential amendments of the Standard)?
- Will insurers perform an IFRS 9 parallel run for 2021?

There are no right or wrong answers to these questions; it is mainly a matter of management decision for which the postponement allows to deepen the basis.

Another big topic is the future shape of the IFRS 9 data model and concept, with focus on enabling an integrated planning and simulation solution for IFRS 9 and 17. This would allow insurers to perform a whole "new" IFRS planning forecast with effective date 2022.

The postponement of the effective dates of IFRS 9/17 provides in addition the opportunity for insurers to align their Income Statement stories for how the assets and liabilities behave.

The importance of aligning accounting options (Fair Value Options/OCI in both IFRS 9 and 17) for a useful story line and financial statement management as well as ongoing scope discussions (e.g. on Policy Loans and IAS 39 products out of scope IFRS 4 or deposits under reinsurance treaties), are strong arguments to think about how to align both projects to ensure proper attention to these topics.

Alignment could and should be realized via assigning selected Program or Operational Steering Committee members to both programs, or defining a sub-committee on IFRS 9/17 alignment which meets on a regular basis. In addition, if not already in place, insurers should consider introducing new work streams with a focus on financial statement management. (Please refer to chapter 4.3 "Time to shape meaningful principles for steering"). The implementation of new accounting standards is only a success story if result management and expectation management is better than before – otherwise insurers have large costs for just fulfilling a regulatory request.

Financial statement management should work in close alignment with IFRS 17 actuarial and accounting analysis and IFRS 9 results on financial statements. Insurers may wish to make use of the Business Model Review in light of the measurement model landscape under IFRS 17 to optimize their performance, equity, CSM or other (new) key measures. For example, when insurers have initially agreed to only have one business model, but in reality holds groups of insurance contracts in all IFRS 17 measurement models, accounting mismatches arise from an overall financial statement perspective. A review of whether the business model may be determined at a lower level may help reduce accounting mismatches.

Some further topics frequently discussed in the context of IFRS 9 and IFRS 17 are related to the alignment of methodologies, process and IT workstreams: e.g.

- **Policy loans:** Whether policy loans fall under IFRS 9 or under IFRS 17 is subject to analysis due to their close relationship with the underlying insurance contract. Many insurers are currently treating them under the assumption that policy loans are assumed to be outside their own project and, instead, are in scope of the other program. The postponement provides time to develop clear criteria applying the principles in IFRS 17, to perform a detailed analysis of contractual agreements and to plan for consequences such as developing data interfaces for accounting purposes. The assessment whether to treat policy loans under IFRS 9 or IFRS 17 must be taken soon.
- **Non-insurance products:** Alignment might be needed, whether to handle IAS39-non-insurance products as of today under the scope of IFRS 9 implementation project. Alternatively, those pure investments contracts also could be under the scope of IFRS 17 implementation project scope due to the communication needed with actuarial department. In this case, the relevant implementation task communication is needed from IFRS 9 project (e.g. how to perform SPPI test etc.).

In addition there is now more time to better align the comparative periods for IFRS 9 and IFRS 17. IFRS 17 has a transition date one year prior to the effective date of the standard while IFRS 9 does not require, but allows to restate prior periods presented in the financial statements in which the Standards are first applied. Hence, where insurers have not planned for a parallel run under IFRS 9 or had to consider work-arounds in order to avoid disruptions on running IFRS 9 implementation, the postponement allows to reconsider potential parallel run scenarios.

3. Time to solve historical issues

When designing the future IFRS 9/17 Business- and IT-Architecture it is a must to deliver processes that are auditable, traceable, reliable and accurate. Existing closing timetables will be stretched and without significant changes in Processes, Data Management and Systems, IFRS statements will be delayed.

Insurers would reluctantly admit that most of their historical issues have been created over many years and from pressures to keep spending less money during the low interest rate environment.

With Solvency II and other measures, many new requests were resolved by workarounds and manual data enrichments to meet compliance and reporting requirements. These workarounds and data "manipulations", manual adjustments and data transfers created many data- and system-breaks across the organization including isolated data bases with limited documentation and auditability.

Here are some ideas of what you could do with the extra year of time.

3.1. The trouble with transition

Everyone is talking about transition. Most CFOs have already been to their finance functions and demanded initial estimates of the opening CSMs and shareholder equity at transition. The standard requires all existing contracts to be measured under IFRS 17 using the full retrospective approach (FRA) but permits two modifications in case of impracticability: modified retrospective approach (MRA) and fair value approach (FVA). Currently, most insurers are still struggling to produce more than high-level CSM estimates mainly due to limited model functionality and other competing demands.

In this section we explore some more interesting challenges in applying FRA.

FRA means measuring the fulfilment cash flows and residual CSM at transition date starting at inception of each group of insurance contracts. The CSM is then re-measured at each subsequent reporting period until the transition date allowing for changes in future services, de-recognitions, interest accretion and amortized in line with the service provided. While this is a sensible requirement, it requires two critical assumptions of existing financial systems:

1. Existing financial systems can produce IFRS 17 components required from inception to transition
2. Data and processes are designed that already work at the level of granularity needed for IFRS 17

Software providers will often say that their new IFRS 17 systems are capable of measuring IFRS 17 balances for historical reporting periods.

This is true, for the most part. The challenge is often that the today's models might not fit with what was actually done in the past.

Techniques have evolved with market and modelling experience. E.g. economical measurement of financial options and guarantees (FOGs) stem from the realization of certain interest rate guarantees could be in-the-money. Dynamic lapse assumptions stem from better data collection methods around when policyholders are cancelling their contracts and how they evaluate the value of their options.

Our experience suggests that biometrical and surrender assumptions could be prepared from historical documentation for several years, nevertheless this might be not cost efficient. Economic scenarios and inflation rates are not so challenging. Expense loadings offer some challenges with cost models evolving many times over the years and not being designed to allocate to the IFRS 17 level of granularity.

A real challenge will be the required data. Actuarial model points could be recreated (perhaps in new formats) but might struggle with contract definitions, contract boundaries, and overcoming non-distinct investment components. Contract de-recognition also creates a challenge in measuring the amounts adjusting the CSM and amortized with the remaining contracts in the unit of account. Does the administration system maintain historical records of payments made? Does it capture the non-distinct pieces? Do the historical systems properly capture the complete insurance contract liabilities that include components such as IBNR and premium deposits accurately at the claim date? In Embedded Value (EV) calculations and other economic reporting basis, insurance companies have some views on these often in aggregate but not at the granularity of the unit of account.

Another challenge is addressing historical model developments. For example, should insurers build their IFRS 17 tool that incorporates dynamic lapses, even though it was only introduced a few years ago? What if certain functionality requires data that was not captured historically? Do you build a separate tool that accommodates the data from the past? Or do build a single one that can do both, knowing that it could hamper performance?

In the case data availability does not allow insurers to apply the FRA: we suggest you to check data availability to use the MRA for the most recent years to avoid for all years the application of the FV approach: applying the FV approach you could have a larger OCI at transition, but low results from portfolio business in the next years after initial application of IFRS 17.

3.2. Time to shape the reports according to stakeholder's expectation

Insurers can distinguish themselves according to the quality of their CSM calculation. An effective finance function balances information granularity, assures smart closing and provides for reconcilable KPIs in a multi-GAAP environment. Insurers need to speak with their stakeholders, involve their equity and debt investors and identify their areas of focus. How will they change their approach to analyzing insurers and reinsurers, what will they base their investment decision on?

Two crucial areas in this respect:

- A good transition story on what is the new historical value of the existing business and how it will be translated through the P&L
- Ensuring the new disclosures requirements can be successfully leveraged to tell the story of the insurer's business, performance and long-term prospects.

Putting the operational challenge of transition aside, as described in chapter 3.1, "The trouble with transition", insurers need to be careful in setting the opening CSM. If measured aggressively (high), pressure on policyholder participation and dividends may increase. If measured too conservatively, analyst's expectation on future profitability of the insurer's business may not be met. Developing a balanced and solid story around the **opening CSM**, which aligns to the future story around new sales, will be time consuming and involve analyzing a number of scenarios.

Secondly, insurers should increase their focus on story lining their **disclosures**. A minimum compliance approach, which often has been the focus until now and still may be the primary objective of many insurers, may now be short of readers' expectations, given the additional time. Consistent with the minimum compliance approach that most insurers have, the design of new external reporting for IFRS 17 were limited to implementing minimum requirements. Insurers might now realize that they are unlikely able to present themselves in the best possible light by overserving these minimum requirements. Moreover, the extra year could provide enough time for voluntary additional effort to enhance the information to shareholders.

In addition, shaping the IFRS 17 (and IFRS 9) story has an operational impact. Some insurers are in an advanced stage of developing their Chart of Accounts (CoA) and are well progressing in their methodical requirements and policies for IFRS 17. A number of working assumption on data availability and granularity often need to be made to establish a compliant CoA-basis for the IT implementation of the general ledgers in the ongoing implementation projects.

In many cases insurers follow a bottom-up and top-down approach simultaneously, i.e. the development of financial information requirements is significantly driven by actuarial project activities (bottom-up) and simultaneously approached on a systematic basis from the financial reporting end (top-down). Linking the two is challenging and is hard to develop beyond a minimum compliance objective. Having said that, a change in disclosure tables may become even more burdensome to implement though the process landscape including CoA, data requirements, reporting granularity and reporting process. Insurers should therefore seek to define their key performance indicators and steering measures as early as possible to avoid burdensome change requests late in the process.

Using the extra year to spend more time on disclosures, storytelling and KPI's for performance management looks like a good time investment.

3.3. Time to fix Data challenges

The implementation of a new accounting standard or new regulatory requirements usually comes along with a significant impact on finance or risk data.

Most insurers have had to deal with these data challenges in the past, when modernizing their Finance IT, implementing Solvency II or Swiss Solvency Test or just improving their performance management and controlling by embedding new Key Performance Indicators to enrich the Balance sheet view from a risk and economic perspective.

With the one year extension the opportunity is given to make use of the lessons learnt from former initiatives because the same data management issues are re-emerging in their IFRS 17 programs.

Some of the lessons learnt from previous finance and risk data projects are:

- Proper data management is only as good as its underlying functional and technical IT-architecture. While large data management projects in the past were typically part of overly ambitious finance transformation programs, only very few had a true vision of an integrated functional and technical architecture and end-to-end processes. Most initiatives missed a clear and realistic target picture from the very beginning of a project as a common goal for all stakeholders and work streams to address the many detailed issues that are associated with data management.
- Data governance in general receives too little emphasis and is addressed too late in the projects. A lack of proper assignment of ownership and future responsibilities for new finance or risk data typically leads to lower data quality and unnecessary workarounds in data chains. Managing data governance properly has been a particular challenge for comprehensive change programs that involve processing data from different finance departments. The implementation of Solvency II, for instance, required collecting and processing actuarial, accounting, investment, and risk data. Aligning data responsibilities for these different types of data and overcoming a certain 'silo thinking' of involved department have been huge challenges for insurers and is still creating quarterly struggles for several of them.

- Further, to ensure compliance with new regulation, projects are often linked with ambitious goals to generate business benefit. For data management such benefits are typically expected from centralizing finance and risk data in a shared data warehouse, standardizing interfaces or generating common data models. While these are truly beneficial for any company, sufficient resources for design, development, testing, and deployment are ever available to realize such benefits.
- Another lesson learnt relates to changes to data granularity a new regulatory rule might require. Assessments of such changes typically start with looking at available data. New regulatory requirements usually mean additional new disclosures or some other forms of reporting requesting additional data. These new reports should be the starting point of such assessments. Breaking down the input required for new disclosures and drilling down to the actual source systems is the recommended way to identify the required data granularity. But still, many projects start with available data and "work their way up" to disclosures, usually leading to missing pieces of data that must be generated elsewhere.

Large transformation projects with complex changes to finance or risk data typically require a huge amount of time to perform comprehensive testing and validation. This is particularly true if multiple data sources and processing system (e.g. various accounting sub-ledgers, general ledger and consolidation) are involved. The true effort to test integrated data elements is often underestimated. Sophisticated tools for automated testing can alleviate such resource constraints; however, they are usually not included in initial project planning, but only come into play when resource problems start materializing.

12 months on top will help to balance the workload for testing and validation and to plan for scarce resources to focus on Data Management in a smarter way.

4. Comply in a smarter way – don't boil the ocean

Most companies are trying to avoid a significant increase of implementation cost. Their focus is on using the additional time to implement IFRS 9/17 in a better and smarter way without spending significantly more money.

Their ambition is to implement efficient future processes and achieve some added value here and there without initiating a huge transformation.

There are many small enhancements helping Insurers to comply with IFRS 9/17 in a smart way.

4.1. Financial Statements – Avoid the "Big R"s and "Little R"s

One of the worst nightmares for a CFO is being told of a material mistake in the financial statement and that a restatement is required (the "Big R"). Alternatively, an error is discovered that is not material in isolation or in any prior period financial statements, but accumulates over time to a material amount (the "Little R"). In this case, the company needs to disclose the correction in the footnotes.

A restatement from an actuarial modelling error under IFRS 4 is more operationally manageable, mainly due to the mostly prospective reserving approaches used to measure the insurance contracts. The error needs to be assessed by re-measuring the actuarial balances at the start of the period, or sometime the prior period, based on data from that reporting period.

IFRS 17 introduces a number of challenges for owners of financial statements in needing to track and measure historically calculated balances including the CSM, onerous contract liability, and OCI option.

An error in the actuarial system, such as using incorrect lapse assumption, now requires changes in the Balance Sheet (Fulfilment Cash Flows, CSM) and Comprehensive Income Statement (Insurance Contract Revenue, Acquisition Costs, Loss Component and OCI). While some of these are also prospective in nature and need current period data, others need to be re-built from prior periods. The CSM, for example, needs to be re-constructed from the time the error occurred allowing for amortization and changes in future services, following a retrospective measurement approach. Both Big and Little "Rs" will require this attention. The requirement for annual cohorts exacerbates the separate disclosures around onerous contract liabilities.

The final twist is that IFRS 17 is a market-consistent measurement currently leading to discount rates lower than under many reporting approaches under IFRS 4. Lower discount rates typically adds to the volatility and increase the size of errors in financial systems. An immaterial error today might have been larger when markets or interest rates where depressed. Many investors point to the volatility in Embedded Value measurements as an example of this.

With increased implications of a restatement, it might be worth investing some of the extra one year to do more validation of the actuarial systems to increase the stability and reliability of these models.

What should insurers do

- Most insurers have already started to either build the new IFRS 17 actuarial models, or as a minimum update existing models to be ready for the new functionality. It is important to continue to build these systems even if the guidance is evolving. This ensures that the basics of the calculations can be tested in a timely manner. Model functionality will be updated either from revised interpretations of the Standard or from the need to improve the timeliness of the models.
- For the model validation, a clear governance process for model design and specifications needs to be established. Separate testing teams should be identified early and ring-fenced. Companies should start designing test plans that demonstrate coverage of new and existing functionality and ensure effective and efficient auditable evidence.
- Don't forget transition. Transition is meant to be a one-off exercise to determine the opening CSM. Errors in actuarial models will almost always impact the transition numbers. Only the fair value offers some rest-bite. Under the FRA, the corrected actuarial model might need to be run for numerous historical reporting periods to recalculate the transition numbers.

4.2. Spending more time on Unit of Account Definition can be beneficial

IFRS 17 requires the measurement of the insurance liabilities at the level of groups of insurance contracts (GIC), which corresponds to the so-called unit of account (UoA) – the accounting level of valuation in context of IFRS 17 Measurement.

Generally, the UoA is to be understood in the context of the "portfolios", which per definition is a set of contracts, having similar risk-structure and managed together.

These portfolios should be separated by profitability groups (onerous, profitable, likely not onerous) and additionally into one-year cohorts.

It has not been easy for the reserving department to fit the definition of UoA/ GIC into their current measurement approaches. The discussions held on this fundamental topic are not finished yet.

Some alignment is required for the interaction between the reporting and the UoA granularity to meet actuarial and finance needs. With P&L line items, such as the insurance contract revenue needing both actuarial and finance items, the way the data is provided will matter.

Having a one year delay will give insurers time to consider how to solve the UoA challenge.

Here are some of those UoA challenges to consider:

- Aggregation is at many levels: Definitions of portfolios, sub portfolios, GIC's, primary and ceded business, life/ health/non-life.
- Changes in the policy terms, contract boundaries and coverage boundaries of riders can have significant implications on the UoA and affect the measurement and postings.
- Allocation to the UoA is subjective and can significantly influence the profit recognition (including risk adjustment, policy-based premiums, expenses, claims). Well understood allocation keys are needed to ensure transparency and consistency with the messaging to external market on profitability and pricing strategies.
- Treatment of policies that offer multiple currency options or contracts with similar risk but in different currencies, being part of the same unit of account. Measuring and handling this effect, e.g. FX rate changes, can be challenging and as such needs to be carefully considered.

Finally, there is the strategic question of whether it is worth applying a tighter definition of the UoA than the standard requires. Operationally it is more challenging but measurement on a more granular basis, for example, allows profitability to be tracked by customers and brokers. In the longer term, real-time data from image recognition of claims could be used to supplement the reporting processes and get faster more accurate results. Having more granular analysis might better align IFRS 17 income with the actual cash generated from each policy.

The level of sophistication seems to be unlimited! Now is the chance to define the right level of granularity reflecting mandatory requirements and company specific ambition level without time pressure.

4.3. Time to shape meaningful principles for steering

From a business steering perspective for listed companies the IFRS reporting framework is the key reporting metric to communicate to investors and stakeholders.

With Solvency II and IFRS 17 both having a principle-based approach to measure insurance contract rights and obligations (the use of best estimate assumptions and market consistent views), there is a clear advantage to align both views for the steering of the business. With consistency comes reduced burden of reconciliation and ensures that business steering metrics aligned with "GAAP", regulation and internal metrics.

In the next paragraphs we share our Point of View on business steering and result performance management.

4.3.1. Re-thinking economic valuation rather than risk steering

Three key topics should be given further consideration in the extended implementation time granted:

1. Selection of appropriate valuation techniques used from a steering point of view: Under IFRS 17 the consideration of uncertainty underlying the projections can – but not must – follow the same approach as are known and used from the stochastic Solvency II models which use risk-neutral valuation techniques.
2. Known differences on the use of less liquid market and investment data between IFRS 17 (which consider IFRS 13) and Solvency II could be a reason for systematic differences in discount rates, economic scenarios for options and guarantees and the measurement of the underlying items. Conversely IFRS 17 is, to some extent, more flexible than regulatory requirements allowing for certain entity-specific judgement and accounting options for discount rates and OCI options. This creates challenges for benchmarking results with peers, but might help improve internal planning and controlling by mitigating accounting mismatches between investments and insurance liabilities.
3. While under the regulatory view, the sufficiency of eligible own funds to cover the solvency capital requirements in total is in scope, the development of profitability on individual group of contract level is a new key item for business steering under the IFRS 17 framework. In the established IFRS/US-GAAP accounting framework those items in general are only be considered on a aggregated level, for example when thinking at the high level of aggregation where EGMs and EGPs are calculated based on derived profitability pattern on the level where the business is managed. From a business steering perspective the crucial point is not what the level is where all the calculations are done but rather the validity/reliability of potential allocation techniques to bring down the outcome to the required level of group of contract, because on this level the valuation and measurement is performed.

There is no doubt that the approaches taken need to be aligned with formal IFRS 17 standard requirements, esp. on definition of group of insurance contracts including the still open item of potential consideration of annual cohorts and on what are the remaining constraints for consideration of mutualization, definition of underlying items and CSM roll-forward. Nevertheless, there is also no doubt that an artificial granularity level that would ignore complex interactions between premium tariffs or how profitability is managed would not be helpful. Finally, a too artificial approach regarding the level of granularity would not be the basis for meaningful business steering. Here the company needs to find the right way to test and validate potential approaches.

A key question would always be how to handle these challenges in the current projects, while there are still a lot of uncertainties w.r.t potential changes in the standard (especially for the German direct participating business applicable for VFA).

The clear answer is not to stop but to develop and test reasonable and systematic approaches under consideration of key cornerstones, which appear consistent with general IFRS principles and also can be accepted as meaningful principles from a business steering view. For example, one of those cornerstones could be the understanding that mutualization impacts a stand-alone preliminary onerous tariff generation at a maximum in a way that lead to the fact that losses from onerous contracts can be avoided but it is difficult to derive a storyline why such a tariff generation might still generate positive CSM releases in the future.

4.3.2. Defining new key performance indicators reflecting a volatile environment

Besides dealing with the valuation, defining a stable and meaningful set of key performance indicators (KPI) under IFRS 9/17 is also of importance and should be prioritized regardless of the outstanding topics addressed to IASB from a business steering perspective.

We strongly recommend to define a set of leading key performance indicators KPI under IFRS 9/17 and to perform assessment whether the planned IFRS 17 accounting and valuation approaches lead to reliable outcomes use that can be explained to stakeholders based on those key ratios. When this is done the next task is to define an approach on how to split-up and drill-down the leading indicators to a more granular level for a further detailed analysis and to integrate them as consistently as possible in the established steering framework, which typically considers the generic perspectives like profitability, liquidity, leverage, coverage, value and risk. A sound concept that supports managment of the business will in return be very helpful in order to take accounting approaches towards the company's auditor.

4.3.3. Shaping multiple GAAP-reporting streams within one group

International insurance groups who have business in different markets are facing additional complexity in steering to address the local needs.

For those Insurance groups, it is important to define their IFRS 17 approach in a way that reflects local business characteristics without creating an over complexity for group steering and reporting purposes.

Different approaches and calibrations underlying the derivation of risk adjustment are one example for a complexity driver. A wide range of different solutions are expected to be implemented at local peers in the market but level consistency within the group is a precondition to achieve a higher level of centralization in preparation of IFRS financial statements.

Another more market specific example might be the approaches for the German Life insurance business and product specific questions of what is the best solution for the underlying item and for definition of coverage units. If the underlying item is based on the expected gross surplus according to German GAAP and the more local GAAP refers to the definition of coverage units, the more the forecast and estimation process under local GAAP gets in the IFRS 17 project scope. Otherwise, a more centralized forecast and estimation approach will get higher importance for the local German subsidiary. In any case, during an accounting implementation project the focus should especially be on forecast and planning processes under IFRS 17.

During the additional year to implement IFRS 17, these topics should be prioritized and dealt with in the upcoming month.

4.4. Actuarial Model integration and how to apply a new coat of paint to the old actuarial models

Most companies have already decided that it is not cost effective to build a new actuarial model for IFRS 17. Insurance companies are already managing various actuarial systems across jurisdictions, product lines and reporting basis: IFRS, internal profitability, regulatory reporting and capital management. While these models overlap, there are fundamental differences driven by the needs of each one: some models measure insurance contracts on an individual contract basis, others uses streamlined data to measure options and guarantees and reflect holistic management action rules. As such, no single model is readily usable for IFRS 17 in all cases.

With the extra year given, there is the temptation to rethink the software choice. However, most insurers still believe that adjusting risk based reporting models is the best solution, partly as they have best-estimate liability calculations and partly that they are built using somewhat more "modern" technology.

So, then, what should you do with the extra time given by the IASB?

When we talk with the actuarial functions, it is clear that there is no stopping or pausing on the build. Most companies are already building the new functionality. Prototypes/sandboxes already produce simplified results using limited product lines and provide key insights on how to efficiently implement IFRS 17 across the organization. Other insurers are investing heavily to address legacy problems and to align existing models and reduce un-modelled business.

Clearly a significant proportion of the time is needed enhance the functionality in the actuarial models for IFRS 17. But, it is worth remembering that IFSR 17 requires significantly more Balance Sheet and Income Statement disclosures. The "Analysis of Change" from Embedded Value and the Variation Analysis of Solvency II are not sufficient to cover the disclosure requirements of the Insurance Contract Revenue, OCI options and Balance Sheet. This means that actuarial functions will need to manage more data, do more runs and carefully control the assumptions on each run.

Using scripting languages like PowerShell, Python, Jscript or VBScript can provide customized solutions. But other simpler tools can also solve these problems. Robotic Process Automation (RPA) solutions (UIPath, Automation Anywhere, Guidewire and Blue Prism) allow you to automate the process of setting-up of assumptions across multiple departments and limit the case of the same information copied and pasted between different formats. RPA or scripts can also help manage the data produced from actuarial models (such as Prophet and MoSes) and automatically populate the ledger interfaces. Other tools like FIS DCS, PowerShell or Python libraries dedicated for data processing allow efficient translation of the policyholder data into the new model points needed for production. Similarly, visualization of the results can be accelerated using Real Time Reporting like Tableau, Inetsoft or Mitrefinch.

Another solution that we identified in the market is replacement of current cash flow projection software. Most cash flow projection tools used by Insurers were designed in the nineties of the former century. Nowadays there are more modern, cheaper and faster software solutions available in the market.

Choosing one of these solutions can quickly improve a production process. More importantly, they can significantly reduce run time during a development and testing phase. With the dry-run phase likely to last 18 months, insurers will be re-running actuarial models many thousands of times. Being able to leverage process management software during this phase can ensure that scarce actuarial and finance resources are focused on analyzing what the numbers mean and not simply cutting and pasting between Excel files!

4.5. Smart CoA – The prerequisite for efficient accounting processes

IFRS 17 requires important financial accounting changes. Insurers need to fit their entire book of business into new measurement models to create and apply complex posting rules over many contract types and product lifecycle events. Finance needs a new IFRS 17 Chart of Accounts (CoA) to base extensive new disclosures on, delivering IFRS 17 accounting quickly within the 'working day timetables' which are typically more accelerated than other regulatory insurance reporting such as Solvency II.

This new IFRS 9/17 CoA will be the link between new measurement models and posting logics in book of business/IFRS 17 data repository and general ledger/ presentation/disclosures. So designing a "Smart IFRS 9/17 CoA" is an essential basis and of major significance for implementing both compliant and efficient new IFRS 9/17 accounting processes.

We recommend using the extra year to anticipate possible future amendments to IFRS 17 by designing two or more versions of CoA, reflecting on one hand the 'as is' standard, and on the other hand the possible to-be standard.

To be clear: you will have only one new IFRS CoA – incl. all amendments by IFRS 9 and IFRS 17!

By the way, one remark on presentation of premium receivables: The IASB is not expected to change its cash flow based principle, and as such premium cash flows will be included in the carrying amount of the group of insurance contracts. Insurers will need the additional time to properly address the operational consequences and develop new interfaces between their related cash and debit systems and actuarial systems. Moving away from premium recognition on debit position contribution to a cash received needs a redesign of the accrual/ debit position. Of course latter alternative requires another CoA structure than first one.

Even if further changes do not require separate presentation/measurement of premium receivables and claims payables, we strongly recommend using the time gained by the one year postponement to pay particular attention and resources to CoA design.

4.6. Proper Data Management – the spider in the net (consistent data taxonomy, directory, data cleansing)

With IFRS 17 implementation programs already underway or just starting insurers are well-advised to reaffirm they have all 'traditional' data management issues under control. The one year on top insurers received for the IFRS 17 implementation should enable them to reassess and, if necessary, revise current approaches to the new requirements.

In contrast to Solvency II, the need to provide more granular data is a challenge for both actuarial as well as accounting departments. The new measurement of insurance contracts requires in many cases a complete re-assessment of sourcing and preparation of input data for actuarial modeling. The increase of accounting data comes with more detailed presentation requirements resulting in more granular chart of accounts, changes to posting logics and closing process.

With increasingly granular data running through actuarial modeling tools and accounting systems a proper validation, approval, and sign-off process is essential to ensure data integrity. Experience from Solvency II have revealed that aligning different providers for finance and risk data can be a complicated challenge. Thus, insurers have to overcome "silo thinking" to ensure that actuaries and accountants are aligned on data ownership.

Such tasks include establishing automated data integration that incorporates proper validation, in particular at interfaces where data is handed over from actuaries to accounting. Currently, actuarial data preparation for Solvency II cash flow modeling often still heavily rely on the use of spreadsheets feeding input data to modeling tools.

The need for an integrated data management approach for IFRS 17 also comes into play when actuarial output data, in particular best estimate cash flows, need to be aligned to actuals (e.g. premiums received, claims and expense paid) that are usually delivered through accounting systems in a different granularity. At this stage, several insurers are evaluating the idea of central IFRS 17 data storage. Such a "single point of truth" can avoid multiple and potentially redundant data storage, overlapping transformations and data quality steps, and having to deal with several inconsistent data repositories for reporting. At the same time, there is a long-term aspect insurers need to consider: with Solvency II already in place and IFRS 17 implementations underway, a phase of "finance and risk data consolidation" is likely to follow. Therefore, current ideas of creating a central data repository for IFRS 17 should already incorporate sufficient flexibility to expand its future scope to a central data platform across all finance and risk data.

4.7. Time to make it cheaper and faster

IFRS 17 is not just a new accounting standard for the Finance Function– the required changes will affect almost every stakeholder and functional area, and many systems and processes. Many insurers have a focus on becoming minimum compliant to the standard due to the stretch of implementation. However one year delay could provide the opportunity to incorporate Robotics Process Automation (RPA) or Artificial Intelligence in the different Finance and Risk reporting processes. As the future after IFRS 17 implementation will demand from Finance and Risk better information, faster delivered and at lower costs this could be the window of opportunity to start working on these objectives.

Current implementation programs show that meeting current reporting deadlines under IFRS 17 will be a stretch due to higher complexity in the process and system landscape. Also dependencies on availability of data will have a negative impact on timeliness e.g. in case underlying items are investment related, companies can't start measuring the CSM under VFA until all the closing asset data is prepared.

That means in order to meet the reporting deadlines or to speed up the process, a redesign of the closing process is required. Focus should be on removing unnecessary waste like rework, checking, reformatting, unnecessary controls and of course manual handlings should be reduced to the minimum. Manual handlings are common in the reporting process and include activities like double data entry, copying and pasting data between systems, reconciling and cross –reference data between systems often done by employees in excel. As the amount of data will significantly increase and there is no time to waste RPA could be a solution to consider in order to increase quality and speed of the closing and reporting process. The one year on top could give many insurers the opportunity to start or to further implement RPA in the Finance and Risk domain and to build the required capability in house.

As mentioned above, the current focus of many insurers is to comply and to be able to report under the new standards. The challenge of how to unlock the power of data for Finance and Risk under the new standards is often considered out-of-scope. However under pressure to be more strategic, efficient, and collaborative, the role of the CFO is changing and this shift is all about bringing data analytics to the forefront. With the current IFRS 17 implementation scope the risk arises that too much time in future is spend on data reporting, whilst the complexity of IFRS 17 demands for greater insight in e.g. how to manage volatility, sustainability of profits, where to grow and invest, timing of dividend payout etc. Also the the 'Analysis of Change' during closing will need a lot of time and tie up scarce resources.

As many insurance companies are developing a more mature data foundation the one year on top provides the opportunity to implement or to make better use of existing tools that deliver analytical power and enable a more efficient analysis. Tools can enable a real-time or near real-time reporting, support self-service (with drag and drop manipulation), data exploration, sensitivity analysis, visualization and modeling. All with very little help or resourcing from finance.

With better data, put to better use, finance and actuarial functions will have an opportunity to cut across organizational and data boundaries to look at opportunities and risks in new ways. Highly developed information analytics will become the key determinant of competitive differentiation in future!

5. How to move on

An impact assessment of the postponed IFRS 17 effective date is a mandatory task for any implementation program irrespective of the current status.

Ongoing projects, in particular those with severe problems with the previous effective date (01.01.2021) could benefit from taking a brief time out to reassess their current set-up e.g. projects could mandate a "task force" to assess current scope, budget and timeline. This task force should present results to management/sponsors should no later than Q1/ 2019 to accommodate for an additional one or two months to implement potential changes to the program

The Standard's postponement impacts various criteria. These should be re-assessed:

- **Standard interpretation:**
  - More time could be assigned to business analysis and understanding key metrics
  - Deliberations of IFRS 17 TRG are still ongoing that might result in further changes to the standard
  - Track recommendations/interpretations from stakeholders (e.g. EFRAG, IAIS)
- **Guiding principles:**
  - Any program has – or should have – guiding principles for planning and budgeting (e.g. re-use of existing processes as much as possible, "compliance-only" focus with limited additional business benefit) – should you adjust these guiding principles in light of the extra year?
- **Budget:**
  - Does the extra year for implementation allow sticking to the current budget?
  - Most current project roles are staffed until 2021 (usually until first closing) while adjustments for external roles are typically easier, extending internal resources might require additional regulatory and HR procedures
  - Budget constraints might need hard choices on which roles to extend
  - Most programs have planned a "support year" after 2021 – this might be scratched or at least shortened
- **Timing:**
  - How does the extra year impact the timing of the current scope – instead of simply extending all tasks to incorporate one more year, there should be a prioritization of topics and an identification of "non-deferral/deferral candidates" i.e. of topics that must be pursued with the same high focus (e.g. transition, closing process) and of topics that can be deferred (e.g. internal reporting, integration tests)
  - Time planned for integration tests as well as validation activities is typically too short and should be prolonged with the postponement
  - Consider an "earlier adoption" if implementation can be finalized ahead of schedule
- **Process optimization:**
  - Current design of future IFRS 17 processes with the objective to achieve "compliance only" might be revised to optimize future Business as usual operations (e.g. identification of quick wins or tactical changes to achieve better alignment with Solvency II or local GAAP processes)
- **Governance/Management alignment:**
  - Potential revision of the projects current governance structure on management level: Are the boards/ committees sufficient to enable adequate management information and to foster effective decision making? Is their meeting frequency appropriate?
  - Which improvements can be made in aligning with management (based on experience so far)?
  - Potential changes to project organization → appoint new leads; expert roles; "sort out" sub performers

- **IFRS 9 compatibility:**
  - Both implementations (IFRS 9 and 17) are separately planned and executed
  - Overlapping topics or necessary alignments are insufficient
  - Additional time should be allocated to align both standards' implementation, testing and roll-out approaches

Many (large) insurers use the IFRS 17 implementation to implement standard or proprietary solutions for IFRS 17 calculations and sub-ledger accounting. Typically the solutions are intended to support all subsidiaries ("Group solution" or "One System Approach"). In parallel to the re-assessment of scope, time, and budget, it might also be the right time to evaluation the status of the technology solutions.

A validation of the following criteria could be helpful to make adjustments and to improve the future operability of the tool:

- accessibility
- performance
- security
- governance
- business benefits
- flexibility

There is no "one and only" roadmap for IFRS 17 independent of the deferral but we see market trends around all mentioned criteria. The insurers that started later on the finance journey may benefit from the early adopters and the broader variety of software vendors on offer.

Closing remark

Even though the IASB has not finalized its views on the proposed changes, we believe the worst thing to do is to pause and wait until each item is concluded. Everyone knows that there is a lot to do to have auditable financial statements ready from January 2022.

The prerequisites to avoid additional heavy workload for CFO departments and IT under the new IFRS 9/17 regime are:

- a company-specific definition of methodologies and designs addressing business needs, mandatory requirements and future benefits (e.g. actuarial calculations, CoA, UoA etc)
- Proper data management and solid data quality at source
- Clear responsibilities and well defined Target Operating model
- Efficient processes and handovers by avoiding complex workarounds
- People engagement and encouragement

It is not about enlarging the scope of the project but taking the additional time given to do it in a smarter way. Some decisions taken under time pressure might be only reconfirmed, others might be challenged and new concepts and ideas might sharpen the design decisions or open the door for a smarter shape.

The one year on top helps to avoid the “quick and dirty” solution we all have seen so often in the past in the context of regulation.

And maybe here and there, lives become easier when historical issues can be fixed or long lasting solutions have the chance to evolve.

If you are interested in more information:

- register for one of our events for peer to peer discussion: www.pwc.ch/ifrs17-event
- or contact one of our experts.

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