The Road to IFRS17: A Top-Down Approach

The first comprehensive and truly international IFRS accounting standard for insurance contracts.

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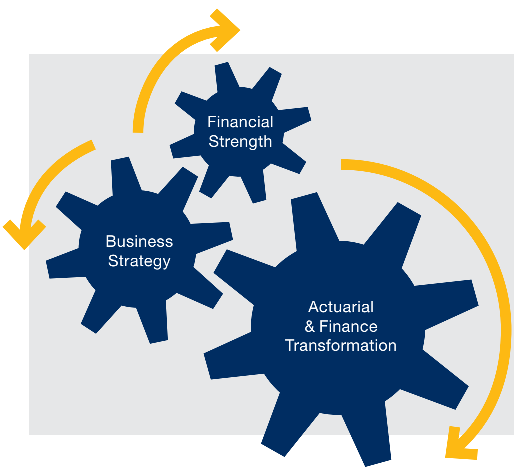
After 20 years of discussion and debate, and almost 5,000 days since IFRS4, the new IFRS17 accounting standard has emerged as a fundamental change in how insurance companies calculate and disclose information relating to insurance contracts. This will give users of financial statements a whole new perspective on the way in which insurance and reinsurance companies generate profits and create value.

Current areas of focus amongst insurers are predominantly of a technical nature, including:

- Implementation challenges (system changes, new data requirements and resource needs)
- Back-book transition (Contractual Service Margin calculation and data requirements regarding this)
- Stakeholder understanding of accounting standards and required developments

While these are important, we believe that the consideration of business impacts of IFRS17 should drive the subsequent implementation of the accounting standards and process design decisions, rather than the other way around. Accordingly, beyond the raft of technical considerations, there are some ***key strategic questions*** that Boards should be asking of their Executives.



- **How can the new accounting standard showcase the financial strength of the company?**
- **What will be the impacts on the business strategy and product mix?**
- **How can we leverage IFRS17 implementation to accelerate actuarial & finance transformation?**

By focusing on the key strategic questions allows organisations to jump-start any required or desirable changes to the business strategy. Effectively, these changes then drive the underlying implementation of the accounting standards.

This ensures buy-in from senior stakeholders at the outset, resulting in more of a "pull" by the business to drive the development, in addition to the "push" of the regulations.

Link to key strategic areas

A top-down approach to IFRS17 implementation ensures that development decisions are taken with the strategic business outcomes in mind.

Every development decision in the context of IFRS17 implementation should be able to contribute to one or more of the three key strategic questions asked by the Board, and help to evidence the way in which the business creates value.

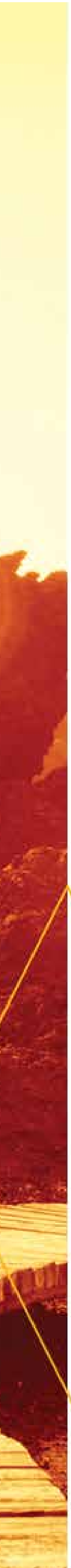
Financial Strength	How does IFRS17 show that the company has a strong and profitable product offering which generates real value for the business?
Business Strategy	Does IFRS17 make some products more attractive to sell than others? Can upfront consideration of IFRS17 impacts result in a competitive advantage when looking for potential acquisition targets, or the disposal of legacy products?
Actuarial & Finance Transformation	Can the implementation project present opportunities to streamline processes and gain significant efficiencies, possibly building on developments made during Solvency II?

Key business implications

The strategic questions can be more easily answered if the Board has an understanding of the underlying business implications of IFRS17, including:

- The extent to which short term profits may be delayed due to changes in how profits emerge, depending on the product and/or reinsurance treaties in place
- Possible changes to current and deferred tax
- Necessary changes to KPIs, and subsequent implications for the dividend strategy
- Any additional alterations to the dividend strategy, in order to take account of the longer term profit profile
- Possible changes in earnings volatility for certain products
- A review of the product mix, and refocusing on product design, pricing and reinsurance treaty terms in light of increased data granularity and the need to differentiate between profitable and unprofitable contracts
- Updates to investment policies and the asset liability management strategies, if aligned to IFRS accounting
- Reviews of risk strategies and risk limits, due to changes in opening equity and emergence of new IFRS metrics
- IFRS17 implementation costs, and how to increase efficiency in return for development spend
- Greater interdependency and operational alignment between traditional actuarial and financial functions, including any subsequent changes to decision making processes, governance structures and company culture.

Smart decisions. Lasting value.



What can proactive companies be doing right now?

Business Strategy

- Consider potential strategic decisions on product mix and/or reinsurance, including acquisition or disposal of business lines or revisions to treaties
- Identify any Solvency II processes and systems which can be leveraged for IFRS17 purposes
- Design new target operating model for finance and actuarial
- Determine IT and systems strategy, build vs buy
- Make plans and understand the costs of implementation, as well as any ongoing compliance requirements
- Articulate process improvements and effectiveness as part of the implementation plan

Communications & Culture

- Begin internally socialising the implications and upskill in the required areas
- Communicate early, both internally and externally to shareholders and analysts, about the expected impacts on financial statements and profit profiles

Finance

- Assess the required updates to accounting policies and manuals
- Assess current processes, systems and data availability
- Enhance data quality and storage, given the retrospective transition requirements
- Engage taxation authorities to discuss potential tax impacts and any transition implications

Actuarial

- Assess the recent Solvency II implementation programme and review the lessons learnt in order to identify potential areas where the implementation of IFRS17 may pose specific challenges
- Analyse the impact on profit emergence for significant legacy products and update methodology guidance for the underlying assumptions
- Begin designing the calculation engine for the contractual service margin
- Perform impact analysis on volatility and profit profiles
- Perform reviews of product and pricing strategy and reinsurance

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Summary

While the industry has focused on the potential high costs of implementation of IFRS17, we believe there is additional value to be gained through a holistic strategic implementation approach, in order to take advantage of improving processes, systems, governance and collaboration between finance and actuarial teams. The benefits of this approach are summarised below:

Outperformance For The Strongest Companies

- Increased consistency amongst insurers and with other industries will better aid investor and analyst understanding, benefiting stronger performers and those who are early to market on discussing IFRS17 transition impacts. For global insurers, IFRS17 should facilitate the aggregation of financial statements, and aid comparability across jurisdictions
- The competitive advantage should improve for those firms who best understand impact on profit emergence from different products and are able to adjust their strategy accordingly

Improved Business Strategy Development

- Companies will more accurately be able to identify sources of profit and loss within their operations, allowing them to optimise the product structure and pricing
- There could be potential to reduce cost of capital in the longer term, for those who are best able to amend their business strategy and respond to changes
- Greater comparability of results across the sector could facilitate merger and acquisition activity, encourage greater competition for investment capital and help enhance the trust of investors
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Accelerated Actuarial Transformation

- IFRS17 will require enhanced cross-functional collaboration and skill sharing between Actuarial and Finance functions, in order to produce good quality financial statements and investor messaging and communications
- Companies who are most adept at leveraging the significant overhaul of their data for IFRS17 purposes will improve the efficiency and effectiveness of their data systems for wider purposes than just reporting
- IFRS17 will require enhanced governance and controls around finance and actuarial systems, and data, with the opportunity to enhance the reconciliation process with fewer errors, a more efficient back office process and a single source of the truth

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Crowe was rated a leader in the ALM Intelligence Strategic Risk Management Consulting Providers report (March 2019).