NINE ESSENTIALS FOR THE IMPLEMENTATION OF IFRS 17

The impact on the implementation of **IFRS 17** is considered mayor and complex. There are several reasons why this new insurance accounting standard, which replaces IFRS 4, presents significant challenges for companies, particularly insurers. Here are 9 key factors contributing to its complexity:

1. Fundamental Change in Insurance Accounting

IFRS 17 fundamentally changes how insurance contracts are measured and reported in financial statements. Unlike IFRS 4, which allowed a variety of accounting practices for insurance contracts depending on local regulations, IFRS 17 introduces a consistent approach across countries and companies. This uniformity increases complexity because many insurers need to shift from their legacy accounting practices to comply with the new standard.

2. New Measurement Models

IFRS 17 requires insurers to apply different measurement models depending on the nature of the insurance contract:

General Measurement Model (GMM): Also called the Building Block Approach (BBA), this is the default model for most insurance contracts. It involves calculating the present value of future cash flows, adjusting for risk, and recognizing contractual service margins (CSM).

Premium Allocation Approach (PAA): A simplified model used for short-duration contracts, such as non-life insurance.

Variable Fee Approach (VFA): Applicable to contracts where the policyholder shares in the returns on underlying items, such as unit-linked or participating contracts.

3. Data & System Requirements

IFRS 17 significantly increases the data demands on insurers. The standard requires granular data at contract level, requiring sophisticated actuarial models and financial reporting systems. Insurers need to capture more detailed data on cash flows, discount rates, and risk adjustments, often in real-time. Many companies need to upgrade or overhaul their existing systems, which involves significant investment in IT infrastructure and process automation.

4. Contractual Service Margin (CSM)

One of the key innovations of IFRS 17 is the recognition of the Contractual Service Margin (CSM). CSM represents the unearned profit of insurance contracts and is released over time as the insurer provides services. Calculating and maintaining the CSM requires sophisticated tracking and adjustment over the life of each contract, adding complexity to financial statements and requiring adjustments whenever there are changes in estimates or assumptions.

5. Discounting & Risk Adjustments

IFRS 17 requires the use of discount rates to present the present value of future insurance liabilities and an explicit risk adjustment for the uncertainty in the timing and amount of cash flows. Determining appropriate discount rates, updating them regularly, and ensuring consistent risk adjustments across products can be challenging.

6. Disclosures & Reporting Requirements

The standard mandates detailed disclosure requirements, which are more extensive than under IFRS 4. Insurers are now required to provide reconciliations of the opening and closing balances of insurance contract liabilities, the components of insurance revenue, and more detailed explanations about the profitability of their contracts and future financial performance. This involves significant reporting infrastructure changes and more collaboration between actuarial and finance teams.

7. Operational Challenges

Implementing IFRS 17 involves multidisciplinary efforts from actuaries, finance teams, IT departments, and management. Collaboration between these groups is crucial but can be difficult due to differing objectives and expertise. The transformation may involve changes in processes, controls, governance frameworks, and risk management, which require coordination across departments and geographies, particularly for multinational insurers.

8. Training Expertise

Since IFRS 17 introduces a new framework, companies must invest in training staff to understand and apply the standard. Actuaries, accountants, auditors, and management must all be versed in the technical aspects of IFRS 17, adding to the cost and time of implementation.

9. Transition Process

Transitioning from IFRS 4 to IFRS 17 is complex because companies need to apply the new standard retrospectively to existing contracts. This involves recalculating liabilities and profit emergence for actual business, as if IFRS 17 had been in place when these contracts were initially recognized. The retrospective application can be particularly challenging when the historical data required is incomplete or no longer available.

Conclusion

The complexity of IFRS 17 stems from its significant departure from previous insurance accounting standards, introducing new measurement models, data requirements, and financial reporting obligations. The changes are extensive, impacting actuarial processes, IT systems, finance, and reporting, and require collaboration across different functions within organizations. Moreover, the need for substantial investments in systems, expertise, and training adds to the complexity and cost of implementing IFRS 17.