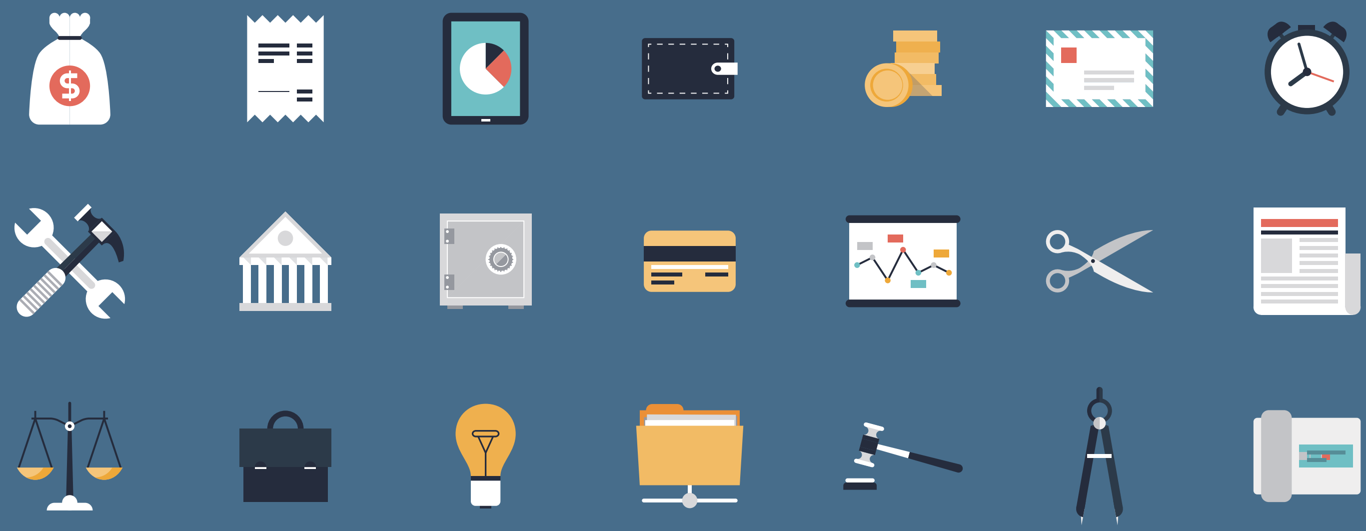
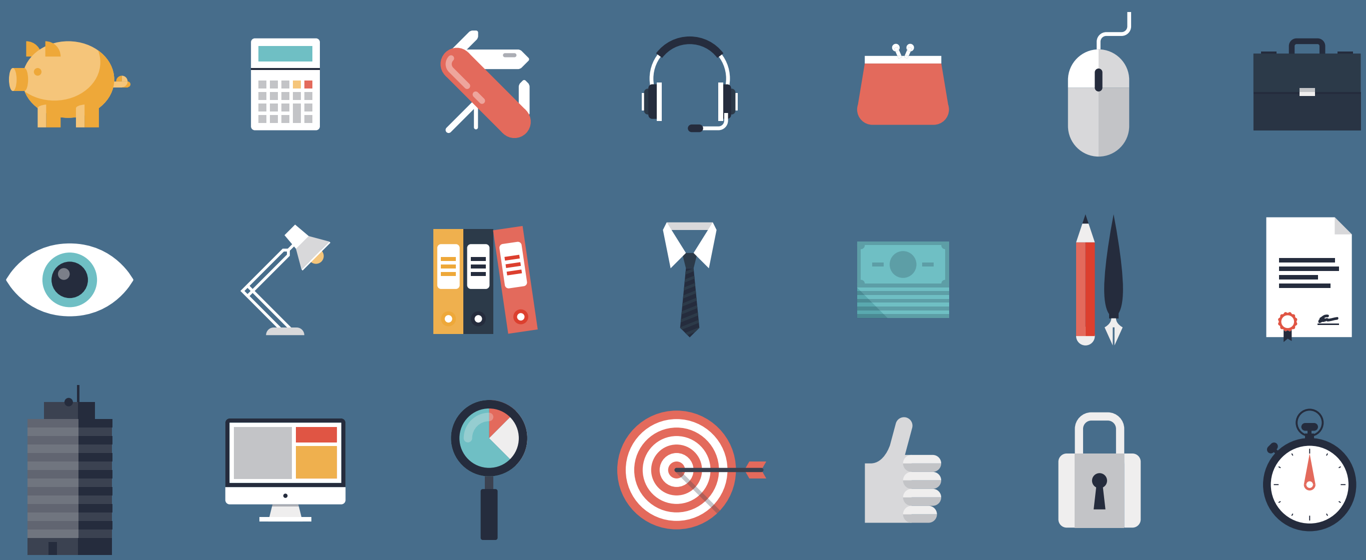


IFRS 17 for Non-Life Insurers:

A 360-Degree View of Implementation Challenges



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Foreword

Finalising the accounting standard for insurance contracts, IFRS 17, has been a decades-long project, but that milestone was finally reached in June this year. At this stage, insurers have no worries about what the standard will say, and an element of the uncertainty that has dogged implementation projects has been eliminated.

But implementation is not plain sailing from here. While insurers have been given extra time to comply (the most important of the recent amendments was a one-year delay to the effective date, to 1 January 2023), there are plenty of questions about how the standard can be interpreted; there are key decisions to be made about methodologies; and there are important implications for running the business that must be understood.

Much of the attention to date has been on the challenges facing the life insurance sector. There is no doubt that accounting for long-term contracts under IFRS 17 will be difficult and require significant investment. Nonetheless, implementing IFRS 17 in the non-life sector faces some similar, and some unique, challenges, too.

To help gain insight around IFRS 17 implementation for non-life insurers, in this report, sponsored by Moody's Analytics, *InsuranceERM* spoke to six insurers across different geographies during July and August 2020: Canada's SSQ Insurance and RBC Insurance; Dutch trade credit insurer Atradius; Australia's IAG and QBE; and Austria's VIG.

Consultants play an important role in IFRS 17 projects, particularly in establishing best practices across the industry. Sia Partners and Valani Global have kindly shared their observations.

We also sought perspectives from prudential insurance regulators including Canada's Office of the Superintendent of Financial Institutions, the Reserve Bank of New Zealand, the Monetary Authority of Singapore, and the Hong Kong Insurance Authority.

We are grateful to all the participants for their insightful comments.

Christopher Cundy,
Editor,
InsuranceERM

Cintia Cheong,
Senior Staff Writer,
InsuranceERM

This report attempts to capture a broad perspective from key stakeholders. This feedback gathered from non-life insurers, regulators, and consultants details the current state of IFRS 17 implementation and critical challenges.

At a high level, here are the challenges outlined by the non-life industry participants:

- Many insurers have formed an initial view of the standard; however, they expected these assumptions and policy choices would evolve over the implementation period
- Several participants noted that data requirements for IFRS 17 measurement continue to be a critical challenge
- Many insurers anticipate using the premium allocation approach (PAA) for most of their portfolios, but some property and casualty (P&C) insurers plan to use the general measurement model (GMM) for complex, long-duration contracts such as construction, creditor insurance, mortgage insurance, and surety, and for long-duration reinsurance arrangements
- Operational complexity was a continued challenge, both in terms of coordination across many different streams as well as efficient deployment of scarce resources
- A relative lack of non-life–specific capability in the IFRS 17 vendor solution space was also critical
- Finally, insurers noted they are starting to assess the impact of IFRS 17 on their internal key performance indicators (KPIs)

The responses received from regulators were also quite interesting and are broken down within the report along two broad categories: interactions of IFRS 17 with solvency and capital regimes, and the current state of implementation and the impact of Covid-19.

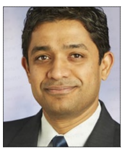
Regulators noted they are studying the impact of IFRS 17 on existing regulations, including:

- Consistency of assumptions between IFRS 17 and capital regimes
- Presentation and financial disclosure
- Helping the industry with the IFRS 17 transition
- Training of supervisory staff on IFRS 17 review requirements

Some of the supervisors also expressed concern around resourcing challenges facing insurers and their impact on meeting deadlines.

Finally, feedback from consultants covered a number of important topics including the impact of amendments included in the final version released in June. The consultants interviewed felt the changes related to recovery of losses for reinsurance contracts and the ability to allocate part of the acquisition costs to contract renewals would be especially beneficial to P&C insurers.

In summary, this is a 360-degree view of the current state of IFRS 17 implementation within the non-life insurance industry and its critical challenges. We hope you find the report valuable. We thank all the participants for their insights.



Srini Iyer,
Senior Director,
Moody's Analytics

Insurers' views on IFRS 17

Contributors:
Anthony Hams, Head of Group Provisioning, Atradius
Shiue Lin Pang, Director, IFRS 17 Team, RBC Insurance
Peter Grant, Group General Manager, Finance, IAG
Steffen Hoffmann, Head of IFRS 17 Staff Unit in Group Finance and Accounting, VIG
Rachel Poo, Head of Group Accounting Policy, QBE
Sarah Nadeau, Senior Corporate Actuarial Director and IFRS 17 Project Manager, SSQ Insurance

What is the current status of your IFRS 17 implementation?

Anthony Hams: Implementation is split into different projects. We have projects for data collection and provision, cash flow calculations, change management, and interpretation of IFRS 17 calculations. So far, different projects have been tested in isolation. At the moment, the first set of data has been delivered and the first set of cash flows have been produced for our main products.

Shiue Lin Pang: We are completing our testing on processes. We have a couple of outstanding accounting policy decisions that need to be wrapped up next year, but the majority of the work is completed.

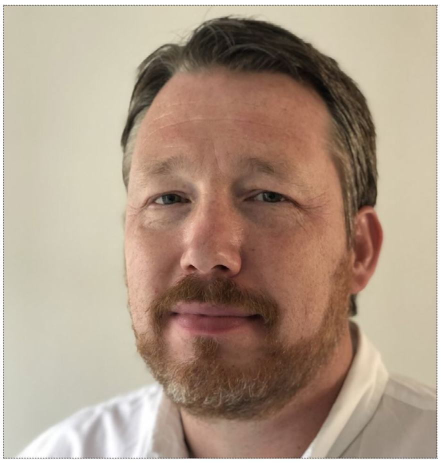
Sarah Nadeau: We have acquired a solution and are now in the development phase.

Peter Grant: We've gone through the impact assessment phase. We are currently in the solution and design phase, which effectively means we are developing our detailed technical policy decisions. We are starting to think about the systems and processes.

Rachel Poo: We've determined our accounting policies and key decisions, and now we are working through application methodology in key areas such as general model application and onerous contracts.

What challenges are you facing?

Sarah Nadeau: The IFRS 17 solution we have is still in development, as the solution is still evolving, but everybody has to deal with that situation.



Anthony Hams, Atradius

The fact the standard is principles-based is also a challenge because neither the industry nor the auditor has a firm position on every aspect of the standard. We still have to go forward to development stage not having a firm position on every aspect of the standard.

Another challenge involves reviewing our processes as it will impact many different departments of the company. We need to make sure all those departments are aligned.

Steffen Hoffmann: The main current challenge is having sufficient resources for running a lot of complex project tasks in parallel. This includes: an ongoing group-wide financial impact analysis; working on implementation and testing of use cases for the group-wide insurance subledger; facing data challenges, especially regarding actual cash flows; finalisation of IFRS 17 methodology; adaption of group-wide chart of account according to IFRS 17 and IFRS 9; development of a cost allocation for IFRS 17; evaluation of a new Target Operation Model under IFRS 17; definition of new KPIs, etc.

Coordination and efficient assignment of the available resources and the available expertise is also a main challenge.

Peter Grant: Securing certainty of funding and resourcing is a challenge. Another issue is maintaining the momentum and focus in a Covid-19 environment because there are so many conflicting urgent priorities now.

In our case, we have been implementing IFRS 17 as part of the broader finance transformation. We think it will create longer-term value for the CFO team, but that creates complexity.

Shiue Lin Pang: The biggest challenge has been dealing with old systems. We have acquired many different businesses over the years and kept all the systems on top of each other. It's a big effort to update them as systems don't talk to each other and data comes from different formats.

Challenges with the actuarial system is fitting it in a new end-to-end solution in a way that ensures data used in the model aligns with "actuals" data used in the new contractual service margin (CSM) calculation system. Lots more controls and reconciliations are required.

Rachel Poo: In our experience, the most significant challenges are around general model application and accounting for reinsurance contracts because IFRS 17 introduces new concepts and data requirements. We are also dealing with uncertainties around market interpretation and application. For example, there are ongoing discussions in the industry about practical application in certain areas, such as how to determine discount rates and what KPIs to use.

We are also waiting for clarity on the likely

Shiue Lin Pang, RBC Insurance

timing of integration of IFRS 17 with our regulatory and tax reporting requirements, so that we can factor these into our implementation plan. For example, how long and to what extent we need to maintain results under the current basis for regulatory reporting.

Anthony Hams: Data always forms part of the main challenges in any compliance project with a reporting component. Our efforts relate to defining precisely what is needed and comparing that with data available, considering as well the quality of it. We are also working on addressing data ownership questions and formalising improvement processes — in particular for data items that hitherto were not being used for reporting purposes. For our main product, credit insurance, this is relatively manageable as we already largely have centralised reserve calculation processes today.

We are also facing technical challenges with respect to data. Once we started producing all the cash flows needed, we quickly found out we are creating significantly more data than we are used to managing today. So, we had to innovate and start embracing modern technology to work with large amounts of data, including dealing with the security aspects related to this.

Other challenges are around the interpretation of the standard itself. Credit insurance and surety are niche products. We have been struggling a little bit with an interpretation of the standard for these products. We have come up with an interpretation that works for us, but at the same time complies with the letter and the spirit.

What contracts are likely to apply the General Measurement Model (GMM)?

Rachel Poo: We write lenders mortgage insurance (LMI), which has contract terms of up to 30 years. The general model is likely to apply to those contracts. Based on our PAA eligibility assessment, we expect our other multi-year contracts to be eligible for the PAA. Apart from LMI, we tested contracts with coverage periods of up to 10 years. What we found with our assessment is that PAA eligibility is not limited to contracts that are one year in coverage, it's taking us a bit further.

Sarah Nadeau: For our traditional P&C business (car, home, commercial), the contracts are to be treated under the PAA. We only offer contracts of one and two years of duration. For contracts lasting two years, we will determine eligibility for the PAA with the help of a simplified model that replicates the general model. That will allow us to justify or prove the eligibility of those contracts for the PAA.

Steffen Hoffmann: In our portfolio analysis, we identified that especially engineering and construction contracts could be likely to apply the GMM not taking materiality considerations into account. Also, some credit and payment protection insurance products or other products linked to lending have to be analysed in more detail.

Peter Grant: Our portfolio is relatively simple. On the direct [insurance] side, the vast majority of our contracts will sit comfortably within the PAA. We have a challenge with a number of long-dated proportional outwards reinsurance arrangements. Because they are long-dated, they are accounted for under the general model, which creates a bit of a disconnect between the measurement and our direct portfolio.

Shiue Lin Pang: Most (95%) of our non-life insurance business will be eligible for the PAA as these contracts last no more than one year. The only exception is creditor insurance, which we have negotiated contract wording such that the contract boundary is changed in order to automatically qualify for the PAA.

Anthony Hams: For credit insurance, most of our policies have a short term of 12 months or less. However, insured events (insolvencies, protracted defaults) can happen significantly later than the end of the policy term. My conclusion so far has been that we will not be able to apply the PAA by appealing to the simple rule of each coverage period being shorter than 12 months. Substantiating that GMM and PAA lead to materially the same results has also proven

Peter Grant, IAG

challenging for credit insurance.

For the other products we carry, e.g., surety, which have materially longer coverage periods, the option to apply PAA does not seem to be open to us.

We have a comprehensive reinsurance programme that covers all our products. So even if we are able to substantiate applying PAA for credit insurance on the direct side, we would still have to consider GMM on reinsurance held, for the same risks.

How do you determine PAA eligibility?

Steffen Hoffmann: We have drafted a methodology and an according process to determine PAA eligibility. This process will be tested and, if necessary, further developed during our upcoming runs. In general, we have condensed the PAA eligibility assessment into a number of process steps that highlight the qualitative and quantitative decision-making criteria.

Rachel Poo: We go through a few steps. We use our in-house PAA eligibility model to estimate the liability for remaining coverage (LRC) under the two measurement models (GMM and PAA) and we estimate those over the life of the contracts.

Then we do some scenario testing, applying a selection of reasonably expected scenarios to test a range of outcomes, but we are not required to consider extreme or remote scenarios. Lastly, we look at the differences between the LRC under the two models over the life of the contracts and determine whether they are material.

Anthony Hams: The standard says you can apply the PAA if the coverage period of each contract is less than a year. You can also use the PAA if you can substantiate there is not a material difference between the GMM and the PAA. For our main products, credit insurance, many contracts have a coverage period of less than a year, but there's a substantial part of the contracts that have a materially longer coverage period.

Even if you can isolate the components of the contracts with shorter durations, even if you apply the PAA, substantiating other parts is problematic for credit insurance because we are very sensitive to the state of the economic environment. So, if we believe more companies will go bankrupt, we expect future claims cash flows to increase.

How do you determine onerous contracts?

Shiue Lin Pang: From an IFRS 17 perspective, we are going with a seriatim determination approach. We use actuarial expectations of fulfilment cash flow at inception combined with acquisition expenses at a contract level to determine if it's onerous.

Sarah Nadeau: We are going to use our internal simplified model to assess groups of contracts that are onerous under the general model. If our model indicates a group of onerous contracts, we will recognise a loss in our P&L.

Anthony Hams: We strive to make a clean separation between predictive modelling of future cash flows and the IFRS 17 accounting calculation. We produce all cash flows based on actuarial and economic principles and store them in a database we intend to use also for other purposes, such as Solvency II and KPIs. So, in principle, no IFRS 17 accounting considerations enter this process. The IFRS 17 calculation process then simply concludes whether a contract is onerous or not, based on the cash flows stored in the database for that contract.

Rachel Poo: We are still working through the exact application methodology, but we are intending to leverage our planning process to identify the facts and circumstances that indicate onerous contracts. The combined ratio and loss ratio will very likely be important indicators.

We currently perform an equivalent onerous contracts test under the Australian Accounting Standards Board (AASB) called the liability adequacy test (LAT), which we intend to leverage for identifying onerous contracts for IFRS 17.

There are some differences between AASB 1023 and IFRS 17 requirements, which our proposed methodology will need to address. For example, IFRS 17 requires us to identify "groups of onerous contracts", which is potentially a more granular level than the level at which the current LAT needs to be performed. Also, under IFRS 17, onerous contracts are identified on a gross basis, with reinsurance considered separately. This is a slight change from the current LAT requirements, which takes reinsurance into account.

Steffen Hoffmann, VIG

How much reinsurance exposure do you currently have? Do you think IFRS 17 will prompt changes to your reinsurance purchasing? If so, how?

Sarah Nadeau: We don't anticipate any significant changes in P&C reinsurance.

Rachel Poo: Outwards reinsurance expense for the year ended 31 December 2019 was about USD 1.6bn. This included various types of reinsurance arrangements such as quota shares, excess of loss, and catastrophe treaties. It is unlikely that IFRS 17 will prompt changes to our reinsurance purchasing because we generally don't expect accounting changes to influence commercial decisions.

Anthony Hams: We tend to cede approximately 40% of risk assumed through proportional reinsurance. The scope of the cash flows, in terms of contract boundary, is different for reinsurance held. We need to consider the cash flows from all contracts that do not officially exist yet on the direct side, but are expected to be covered by the reinsurance held contract. We intend to do the same as we intend to do for the direct contracts. We will just predict all the cash flows that are needed, and we will follow the rules of the IFRS 17 accounting calculation.

There's another difficult part we are struggling with in the regulation: paragraph 66.c.ii allows you to offset movements from the CSM for direct business with that for reinsurance held. The paragraph is well intended, as it allows you to benefit in the P&L of the reinsurance that you have, but the actual implementation is very complex for us.

Peter Grant: I don't think so. The way we structure reinsurance is a commercial decision, a risk appetite.

We are very heavy users of reinsurance. We have 32.5% of the gross direct portfolio ceded under proportional reinsurance. Those are long-dated reinsurance contracts. Given they are derivatives of our direct portfolio, they ought to be accounted for on a consistent basis. The measurement of reinsurance contracts is adding significant complexity to the implementation process. That would be an area of IFRS 17 we are not particularly comfortable with.

Shiue Lin Pang: We do have a decent amount of reinsurance exposure because we have a lot of business and we buy reinsurance for risk mitigation purposes. IFRS 17 hasn't really impacted us too much in terms of how this offsets direct insurance. At the end of the day, we don't see too much change of reinsurance purchasing because of the risk mitigation perspective.

What KPIs are you looking to change as a result of IFRS 17?

Steffen Hoffmann: We've implemented our own KPI working group assembled by different experts (for example, investor relations, group controlling, group finance and accounting, etc.), which is observing the development in this area.

This includes various interviews with internal and external stakeholders to learn more about their expectations. Also benchmarking and observation on the market are important ongoing tasks. Our finding so far is there will be a future set of KPIs, which includes new KPIs and also some existing (but maybe with small differences).

At the moment we haven't defined our final new set of KPIs. Nevertheless, we can imagine that future metrics could, for example, be insurance revenue and growth of insurance revenues, insurance service result, combined ratio reflecting discounting and risk, cost ratio (especially overhead expenses), value of new life business, new business CSM, CSM in general and CSM development for life business, CSM at inception — but these KPIs are just examples out of a first "brainstorming".

Rachel Poo, QBE

Rachel Poo: This is still an evolving area. We are monitoring industry developments. We expect premium and underwriting profit measures will continue to be relevant, but it's not clear whether existing metrics will be modified or replaced entirely.

The insurance industry is extremely complex, and it has taken a long time for the metrics we have today to be understood by the market. It's really important to ensure the technical complexities of IFRS 17 don't result in reduced understandability of drivers of business performance or prevent a company from telling its story effectively.

Anthony Hams: This is still work in progress. IFRS 17 changes simple notions of "revenue" and replaces them with something significantly more complex, in particular in the case of the GMM. So, we are considering what the best approach is for managing the company. In addition, since we are creating a central database of expected and actual cash flows, we are considering KPIs based directly on this economic view, instead of the accounting view. I suspect we will end up with a hybrid approach.

What discussions have you had with your auditor? Do they agree with your methodologies/accounting choices?

Sarah Nadeau: We have submitted most of the accounting memos to the auditor. We have had conversations with them over the past 12 months. Of course, they are in a place where it's hard for them to provide a firm view on certain aspects of the standard. They are waiting [for industry development], as is everybody else. However, at this point, for our P&C issues, we have a common understanding of the standard and we don't foresee any fatal flaws regarding those topics.

Anthony Hams: We have not yet interacted with our new auditor on IFRS 17. We are still working within the credit insurance industry to try to come to aligned definitions; hence, we have not approached them yet on matters still under discussion.

Rachel Poo: We have engaged with our auditors throughout our project. They were involved in reviewing our impact assessment conclusions, accounting policies, and key technical decisions including our PAA eligibility conclusions, and they will also be involved in reviewing our proposed application methodologies, which will cover how we intend to apply those policies in practice.

So far, nothing has been highlighted to us as being inconsistent with current market interpretation, but we acknowledge that market practice may develop in a number of areas as other organisations progress their implementation of IFRS 17. We are closely monitoring market developments, as are our auditors. Forums around the world, including the Australian Transition Resource Group, have been really useful in bringing implementation questions to the table.

Shiue Lin Pang: So far, we haven't had any pushbacks from the auditors. Prior to engaging with our auditors, we had already engaged with several consultants and industry groups to test our accounting choices.

Most of the issues we've discussed with the auditors are not controversial, but we've only been focusing on transition choices, fair value methodologies, our CSM approaches, PAA eligibility and risk adjustments. There are minor issues that are a big deal in the Canadian industry, but we haven't had a chance to talk to the auditors about them yet (e.g., investment return services qualification).

Which approach are you taking for establishing the IFRS 17 discount rate?

Peter Grant: We are going adopt the top-down approach. We have had a pretty well-worn process, both in terms of discounting and the risk margin.

For a start, most of our portfolio is pretty short-tailed, so discounting particularly in a low interest rate environment is not an overly significant factor for us, and would be nowhere near as material as in a life insurance context.

Shiue Lin Pang: We are taking a top-down

Sarah Nadeau, SSQ Insurance

approach because as a bank, we do have more explicit market adjustments, but not at the level of liquidity premiums. The key considerations we take when setting the discount rate are sensitivity to interest rates as well as interpreting what drives liquidity characteristics to create different discount rates for different types of portfolios.

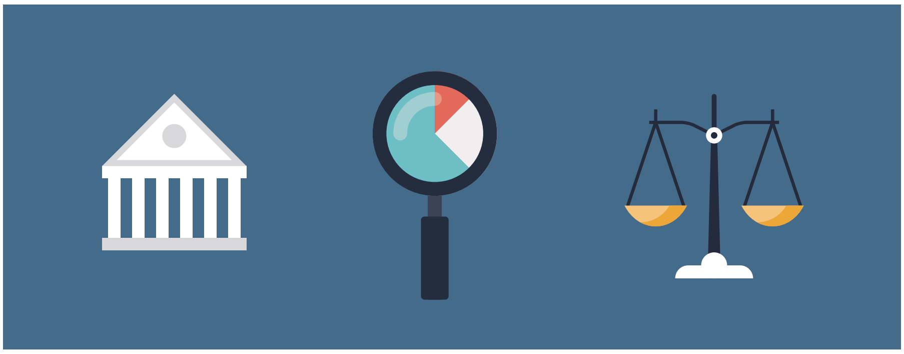
Anthony Hams: We have not made a final decision on discount rates. The duration of our main product not being that long, it is not a very material decision for us. To minimise operational complexity, we'd like to apply the same discount rates as we do for Solvency II, but we have to investigate whether that can be substantiated.

Sarah Nadeau: We've taken the top-down approach. We base it on our asset portfolio with liquidity adjustment. The main consideration was to use our own portfolio as a basis to limit the volatility of financial result. This is more of a long-term contract consideration than a PAA consideration, of course.

Rachel Poo: We intend to apply the bottom-up approach. For us, it's closer to the current practice under the Australian general insurance accounting standard (AASB 1023).

Under IFRS 17, the bottom-up approach means basically the risk-free rate plus a liquidity premium. One of the considerations is how to determine the liquidity premium and this is still subject to market consensus. There is still a lot of discussion around how an entity might determine that. The current thinking is that the basis used should only consider factors that are relevant to the liquidity characteristics of the insurance liability, so it is not expected to be influenced by market factors that may introduce volatility. ■

Regulators' views on IFRS 17



Insurance regulators and supervisors are primarily concerned with prudential and conduct issues, but they have an interest in what happens with accounting standards as they can affect how insurers manage their business.

However, in some jurisdictions, regulators are taking it more seriously, as the changes could affect their capital adequacy frameworks. So how do they view the standard, and how do they judge progress with implementation?

We spoke to several regulators including Canada's Office of the Superintendent of Financial Institutions (Osfi), the Reserve Bank of New Zealand (RBNZ), the Monetary Authority of Singapore (MAS) and the Hong Kong Insurance Authority (HKIA) for their views on IFRS 17.

Regulators' feedback

RBNZ has concerns about how existing regulations and standards will interact with IFRS 17.

"Our solvency standards are based on IFRS, and so will need to be modified to continue producing acceptable capital outcomes," says RBNZ.

"Also, changes in presentation of financial statements (e.g., the removal of premium measures) generate issues with respect to certain regulations and data returns."

Canada's Osfi says the key regulatory items affected by IFRS 17 are regulatory returns and capital calculations. To that end, Osfi is also finalising its plans to restart its consultations on both items.

The regulator says: "We continue to have the objective of supporting a robust implementation by maintaining an effective regulatory policy framework through the IFRS 17 transition and ensuring Osfi has the tools and training necessary to supervise and regulate institutions efficiently after the transition."

Singapore's MAS regularly reviews the financial statements of insurers. Together with MAS' risk-based capital returns, it says: "These documents aid us in our supervisory assessments of insurers' financial health.

"This will not change with IFRS 17 as the new standard improves financial reporting by providing information about the effects of insurance contracts on insurers' financial performance, and the nature and extent of risks that the insurers are exposed to."

The HKIA says the development of its risk-based capital regime (HKRBC) will take into account the accounting standard's requirements where appropriate. "For example, we adopt, broadly, the definition of the contract boundary from HKFRS 17 so as to ease insurers' burden for compilation of data," the HKIA says.

Covid-19 challenges

Covid-19 has not only affected insurers' operations and implementation of IFRS 17, but has also delayed regulators' planned activities.

In Canada, insurers are required to provide semi-annual updates on their IFRS 17 implementation project plans.

When Osfi last polled insurers, on 30 September 2019, it reported generally good progress with the transition to IFRS 17.

But because of the pandemic, Osfi has suspended this activity and as a result, "we do not have more recent assessment of industry readiness," according to a spokesperson from Osfi.

As the country takes steps to restore its economy, the regulator plans to gradually restart its policy development work, and the IFRS 17 progress-reporting requirement will resume beginning 30 September 2020.

In terms of challenges non-life insurers face, Osfi acknowledges firms are dealing with the amendments published in the final version of the standard, as well as adapting to a long-term Covid-19 scenario and implementing extended business continuity plans.

In Singapore, insurers are required to prepare financial statements in accordance with Singapore Financial Reporting Standards, prescribed by the Accounting Standards Council (ASC).

A MAS spokesperson says: "We understand that general insurers are in the midst of conducting impact assessments. There is room for the pace of these reviews and assessments to pick up, while taking into account current Covid-19 challenges faced by the sector.

"MAS is closely monitoring and engaging insurers on their IFRS 17 implementation progress, and works closely with ASC and the Institute of Singapore Chartered Accountants on this front."

The HKIA has conducted readiness surveys for the last two years. "The majority of general insurers targeted to perform a parallel or dry run for HKFRS 17 by 2021," it says.

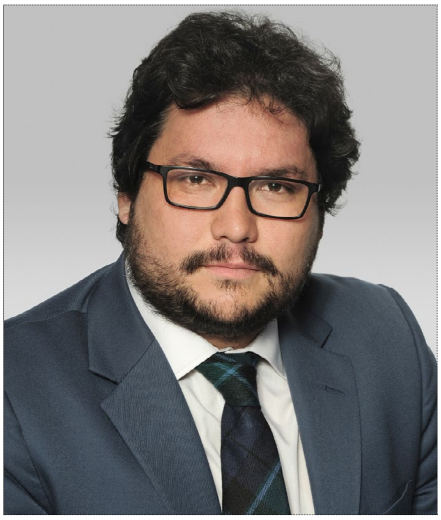
From the 2019 survey, the HKIA found some general insurers had performed their initial impact analysis, with half of them indicating the insurance contract liabilities based on HKFRS 17 are generally lower than or almost equal to those under HKFRS 4.

The challenges non-life insurers in Hong Kong face are mainly around the availability of IT and actuarial/accounting expertise. To support firms' implementation, the authority has collaborated with the Hong Kong Federation of Insurers, the industry's trade association, to identify consulting firms that offer solution packages for insurers.

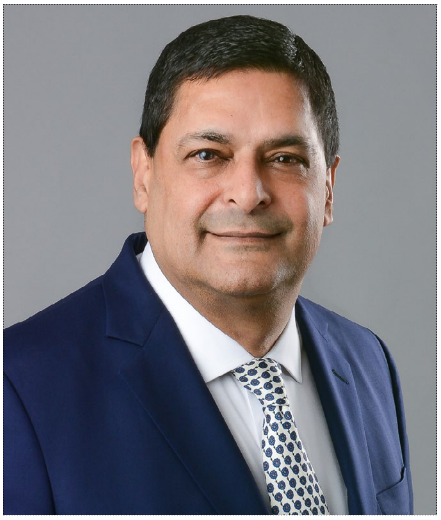
"With the use of readily available technology and packages, we hope this could address, to a certain extent, insurers' implementation concerns and resources constraints." ■

Consultants' views of IFRS 17

Santiago Fiallos, Senior Manager, Actuarial & Quantitative Services, at Sia Partners; and Nazir Valani, President and Co-Founder, Valani Global share their thoughts on IFRS 17 implementation at non-life insurers.



Santiago Fiallos, Sia Partners



Nazir Valani, Valani Global

What concerns and challenges have non-life insurers expressed with their IFRS 17 implementation?

Santiago Fiallos: A major challenge concerns data preparation and grouping. For example, under IFRS 17, contracts issued more than one year apart cannot be grouped together. This has very important consequences for non-life insurers as the classic reserving methods are based on claim incurred dates rather than contract inception dates.

Insurers need to find pragmatic approaches when deriving data at the required level and reuse as much as possible what is already in place to save precious time and resources for analysis.

The second major challenge is to choose the right approach when calculating the liability for remaining coverage (LRC). Non-life insurers might want to apply the PAA as extensively as possible since its implementation costs are reduced and is closer to the "unearned premiums" reserve in IFRS 4.

Some lines of business may, however, fail the eligibility test and non-life insurers would need to handle both GMM and PAA approaches and explain their revenue based on two different approaches.

Another challenge the industry is facing relates to the use of probable future cash flows and interest rates. IFRS 17 introduces present value calculations for both LRC and liability for incurred claims (LIC).

Whereas life insurers are familiar with this topic, the vast majority of non-life booked reserves do not allow for discounting effects. Regarding this topic, EU insurers have a comparative advantage as Solvency II introduced a "Best Estimate" approach based on discounted probable cash flows.

Nazir Valani: The concerns and challenges expressed can be grouped in three broad categories.

1. The standard itself: IFRS 17 is principles-based and offers limited guidance, which leads to some concern about whether this will be acceptable and how regulators will react. In particular, the new requirements related to discount rate(s) and risk adjustment are seen as challenges to some non-life insurers.

Furthermore, some non-life insurers express concerns about how to calculate and disclose the level of confidence related to the risk adjustment.

2. Preparation of financial statements: the standard will require the development of new long-term controls and audit requirements, which many insurers have not yet developed. Also, the new division of roles and responsibility is not yet clear in everyone's mind.

Finally, the implementation and execution of IFRS 17 will likely require new working dynamics involving teams across functions including actuarial, accounting and IT.

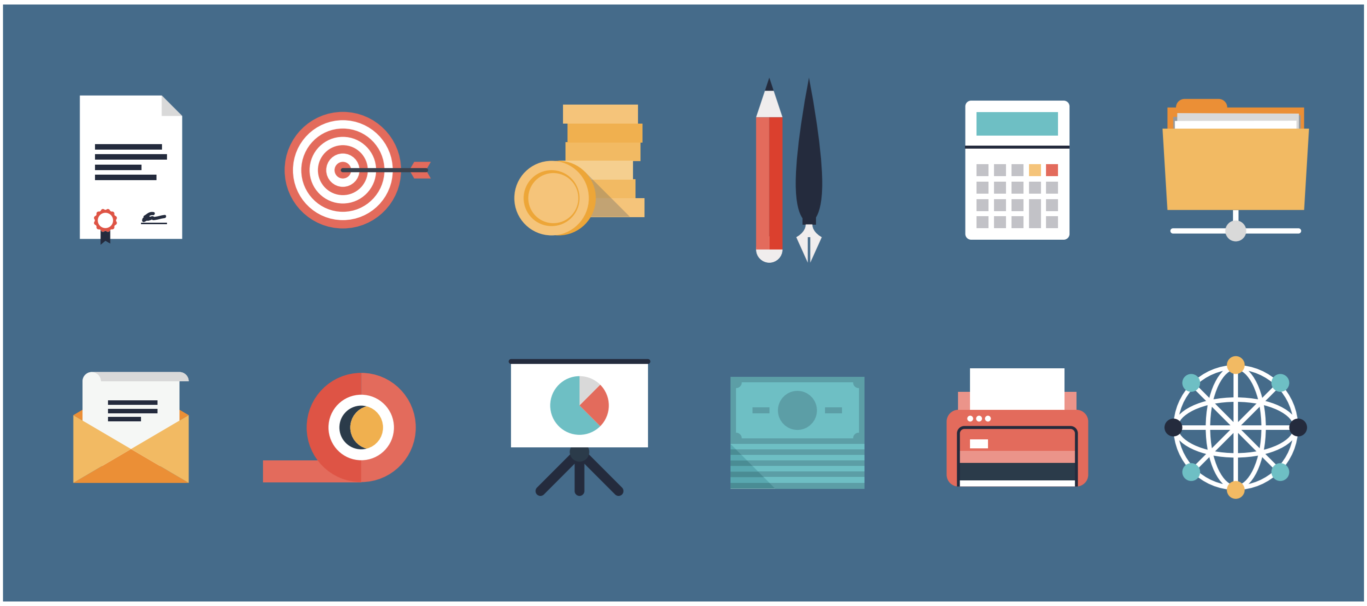
3. Data issues: these are often related to availability as well as the granularity held in IT systems. In many instances, data issues are exacerbated by the presence of legacy systems that make any change more complicated.

With regards to granularity, the standard requires data at the IFRS 17 group level, which may be more granular than how insurers currently maintain data.

How do you rate the non-life industry's progress with implementation? What major tasks are remaining, generally?

Santiago Fiallos: The non-life industry has made significant progress over the past 12 months. As usual for such projects, we see a great dispersion in the market on where insurers stand now in their projects.

Most insurers have now split their business into portfolios and groups of contracts as requested per IFRS 17 and they have chosen their calculation methods (GMM or PAA). Data preparation is underway, and several insurers



are expecting to complete dry runs on direct business at the end of 2020 using "real" data.

However, there is still a lot of work to be done before 2023. Reinsurance contracts held need special attention as they might need a different treatment than the direct business, regarding the valuation model, the contract boundaries and the timing of cash flows.

As the transition date gets closer, non-life insurers need to define new KPIs and identify possible levers to manage their financial communication under the new standard.

Nazir Valani: Progress seems to be related to the size of the insurer and whether or not it is part of an international group. Smaller insurers operating in a single country or region appear to still be near the start of the process, conducting analyses on data gaps and operating models.

We see more progress in larger, global insurers, with more development around accounting policy papers and some development work around the implementation of solutions. Some have completed much of the technical work.

The major tasks remaining are numerous. Those who elected to build their solution need to complete the development of their solution. This often means completing the testing of any extended proof of concept currently under way, building the remaining functionality, integrating it in their environment, and testing to ensure proper results. This remains a sizeable task. Those opting for vendor solutions have to evaluate their options, select a partner, and proceed to the implementation.

Insurers operating in Canada need more insight around Osfi's final non-life financial reporting requirements as well as the requirements for the Appointed Actuary's valuation report on policy liabilities. These could affect what they must do around the technology and data aspects of their project.

Those who are most advanced are still dealing with significant challenges such as including reinsurance in their modelling of LIC and LRC and deciding about the treatment of Risk Sharing Pools and Facility Association.

The IASB issued the final version of IFRS 17 in June 2020. Which changes do you think are most significant for non-life insurers? Which ones do you think are most disappointing for them?

Santiago Fiallos: The final version of the standard included two great pieces of news for non-life insurers: the recovery of losses for reinsurance contracts held and the ability to allocate part of the acquisition costs to contract renewals.

These two amendments are supposed to limit P&L volatility over time: an insurer can recognise now a reinsurance gain when an underlying group of contracts is onerous — irrespective of the reinsurance contract type — and a part of acquisition costs incurred can be deferred to be amortised by future contract renewals.

The one-year deferral of the effective date might be good news for most non-life insurers as they will have more time to finalise their projects, and better understand the new standards in terms of performance steering and financial communication. It is important, however, to have strong project management to avoid an excessive increase in the overall implementation costs.

Nazir Valani: The two changes considered to be the most important to non-life insurers were related to issues of reinsurance mismatch (i.e., the recognition of a gain on reinsurance related to onerous contracts) and the recoverability of acquisition cash flow.

There was lobbying for changes to the definition of recognition that would have simplified data and processes, and to some, the absence of change was considered a disappointment.

On the positive side, the delay of the effective date of the standard was considered a good outcome. ■