Moody's Analytics

Whitepaper

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Sharing the load

The implementation of the new International Financial Reporting Standard (IFRS) 17 is likely to disrupt the global insurance industry, driving discussion around the financial reporting implications and the challenges of managing new data flows and developing new assumptions. However, it would also be fair to say that behind all the debate lies a level of uncertainty: how can the standard be correctly interpreted and applied to various types of insurance or reinsurance contracts? A large part of the uncertainty is caused by the need for accountants and actuaries to start working more closely together. While the standard is written by the accounting profession, implemented under corporate finance control and subject to the review and approval of auditors, its implementation will depend on actuarial input – both in identifying or generating input data and in designing and operating key portions of the overall solutions. The need for cross-departmental collaboration is no startling revelation – it was clear from the beginning that a key objective of IFRS 17 was to disassemble the opaque nature of actuarial reserves, and the resulting changes in those liabilities presented in traditional insurance income statements. The new framework reveals the underlying nature of long-term insurance contracts, ensuring that revenue earned and reported changes in accounting estimates align with modern accounting methodologies.

Solutions come to the fore

While the fundamental changes in presentation are pervasive, and the standard is still not widely understood, insurers and their advisors quickly grasped that they would need additional solutions to support this reporting framework. For larger organisations, it became apparent that they would be reliant on technology. Big budgets were committed, steering committees formed and advisors hired – and the gnashing of teeth commenced. Surprisingly, there has not been much discussion about the challenges of producing the required actuarial calculation components and efficiently integrating them in a tightly managed – and reliably executed – financial reporting cycle. The level of systems integration required, and the number and diversity of data elements passing between systems, is immense, and entirely different from before. Given this complexity, it is also surprising to note the lack of attention given to the role of the company actuary in producing, reviewing, reporting and signing an opinion on the actuarial contributions and their presentation in financials.

A new approach to actuarial input

Traditionally, company actuaries would run their models in actuarial platforms, ending up with the total required liability figures for the entity as a whole, as of the reporting date. Minimal breakdown would be provided. Typically, this could be easily handled by a memo of transmittal and manual entry into the general ledger. Here are some ways that it changed under IFRS 17:

1. Three separate components of contract liabilities must be calculated and tracked: the present value of estimated future cash flows, the risk adjustment and the contractual service margin
2. The contractual service margin is calculated at contract group level and rolled forward from the previous reported balance
3. Thousands of groups may be required, each with separate locked-in assumptions and last reported balances
4. The actuarial calculations must be based on both the starting in-force portfolio and the ending one, and must also take the movements in that portfolio into account
5. Mandated disclosures and internal analysis will demand six or more recalculations of cash flows and their present values.

Comprehensive and complex actuarial calculations on multiple data files will enable the insurer to present the actuarial components of ending liabilities at the group level, the underlying analysis of the change in those liabilities and estimates of the expected insurance service costs (benefits and expenses). This will then drive revenue entries in the statement of financial performance. The results of all of the above calculations must be transferred and stored in a sub-ledger to drive the posting entries needed to inform the final statement assembly. This must pass accounting standards for governance, control and auditability. The final presentation requires the signing actuary's review to confirm fair and accurate reporting of the actuary's work. We must acknowledge that these new calculations and the underlying processes and systems are a joint actuarial and accounting responsibility. A new standard of practice will be essential to define actuarial professional responsibilities and joint professional guidance on communication between actuary and auditor. Hopefully, actuaries and accounting professionals will find ways to work together and meet these new challenges.

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