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Changes to accounting standards offer transformational opportunities for insurers, with extended time to implement

Big changes are coming to how the insurance industry recognises and reports out financial performance. But the effects won't be felt just in the accounting department.

IFRS 17, *Insurance Contracts*, and its U.S. companion, accounting standard ASU 2018-12, *Targeted Improvements to the Accounting for Long-Duration Contracts*, are intended to add clarity for investors in the wake of events and financial improprieties such as those that occurred during the global financial crisis of 2008. The new rules promulgated by the accounting standard-setters — the Financial Accounting Standards Board (FASB) in the United States and its international counterpart, the International Accounting Standards Board (IASB) — are aimed specifically at revenue accounting, as well as insurance liabilities and assets. Complying with these standards, however, will not be solely an accounting and finance project; rather, it will be a companywide effort requiring a significant level of transformation and investment in new technology, processes, skill sets and data governance.

These new standards will serve the dual purpose of:

- Aligning principles-based insurance financial reporting around the world by eliminating disparities among financial reporting standards in the United States and other countries (ASU 2018-12)
- Making the insurance accounting standards consistent and ensuring a uniform measurement and presentation approach for all insurance contracts (IFRS 17)

For insurance industry leaders, the realignment provides an opportunity to rethink their operating models and improve the way they develop, position and price life and annuity products, as well as the way they support those products in the marketplace.

More broadly, these changes are significant because, while most companies in other industries have already made their revenue recognition consistent with new risk-based global thinking, the insurance industry, due to its complexity and high level of regulation, has not yet been through that crucible nor reaped the related transformational improvements.

Deferrals to Help Address Higher Costs, Shifting Responsibilities

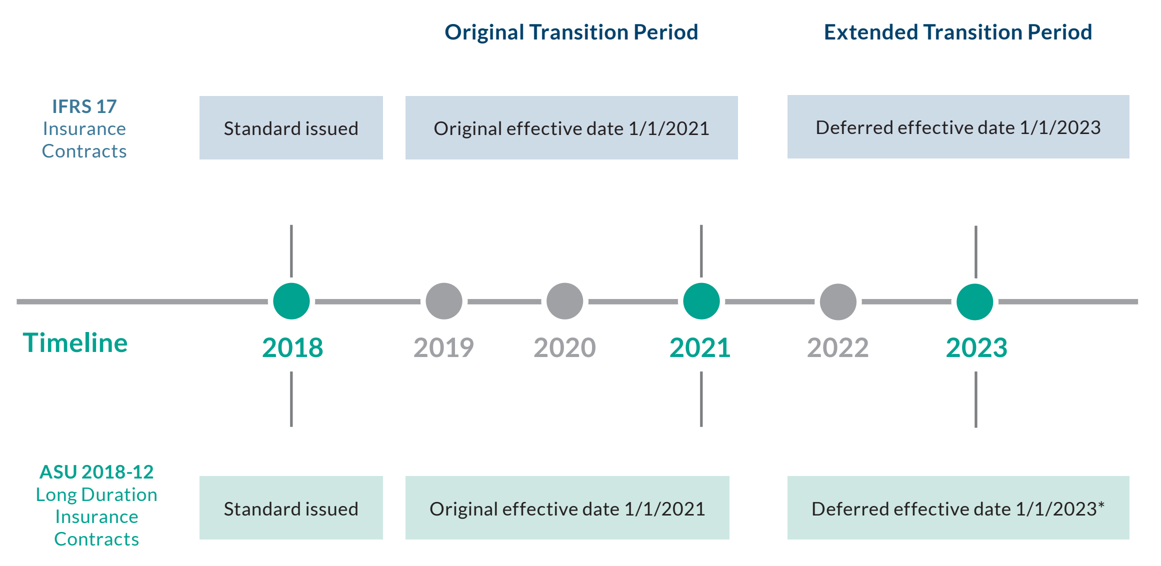
Reporting under these new standards will be much more technical and complex than it has been under the current standard. IFRS 17 introduces new definitions and actuarial components that require skill sets and knowledge beyond the scope of the typical accounting department. As the target operating models of finance and actuarial departments evolve, a shift of financial reporting responsibilities away from accountants and toward actuaries is possible.

While these changes are considerable, the biggest pain point appears to be the implementation effort itself, which can run into hundreds of millions of dollars for large multinational insurers. Although that cost decreases along with the size and complexity of the organisation, the effort is still significant, as is the cost of maintaining the new financial reporting process going forward.

For these and other reasons, insurers have been given more time to make the transition. In June 2020, the IASB issued *Amendments to IFRS 17*, the standard-setter's response to industry concerns regarding implementation effort and complexity. Among other changes, the amendments defer implementation for public companies to 1 January, 2023 (a year later for privately held companies), simplify balance sheet presentation and descope certain credit-related insurance products. FASB announced the effective date deferral in November 2020.

The standard-setters have recognised the challenges and have simplified their new standards by de-scoping certain products, which should help insurers focus resources on core products and services, rather than spending time, money and effort to adopt the new standards for ancillary products such as credit card insurance or student loans.

IFRS 17 and ASU 2018-12 — Timeline Perspective



*ASU 2018-12 — For public companies, effective for fiscal years, and interim periods within those fiscal years, beginning after 15 December, 2022. For all other entities, effective for fiscal years beginning after 15 December, 2023, and interim periods within fiscal years beginning after 15 December, 2023. Early adoption is permitted.

More Time Means More Opportunity to Transform Key Business Functions

Given the size of the required investment to implement these accounting standards, both in time and money, many insurers are taking advantage of the deferred compliance dates to transform foundational aspects of their organisation. This is particularly true for large, complex insurers, which now have more time to comb through their business processes and make the changes they need to achieve.

To provide some perspective on the magnitude of potential change involved and why broader transformation efforts should be considered, the new standards introduce new principles along with new definitions. Most notably, as we mentioned earlier, ownership and responsibilities for certain financial reporting that traditionally have sat with controllers and/or financial reporting teams may transition to actuarial departments.

Why is this the case? The new standards introduce numerous actuarial-related components that require a vastly different skill set and knowledge, as well as actuarial expertise, which accounting and financial reporting teams typically lack. As an example, under IFRS 17, the financial reporting outcomes are going to be far more technical and cash-flow-modelling-based compared with reporting requirements under the current IFRS 4.

The accompanying graphic below illustrates just a few of the accounting/valuation and process/data impacts of these two standards.

Business Impact of IFRS 17 and ASU 2018-12

It is important to recognise that any time an organisation is required to take a deep dive into fundamental processes is also an ideal time for broader refreshment or redesign. This means, among other actions, investing in technology,

IFRS 17 and ASU 2018-12 — Business Impact

Accounting and Valuation

IFRS 17

- Contracts classification and grouping
- Contractual service margin
- Risk adjustment
- Premium allocation approach versus variable fees approach
- Expense definitions
- Attribution and allocations

ASU 2018-12

- Liability for future policy benefits (FPBs)
- Measurement of market-risk benefits
- Simplification of deferred acquisition cost (DAC) amortisation

Process and Data

- Data architecture and granularity*
- Data quality*
- Accounting systems and modelling*
- G/L systems
- Reporting tools (disclosures)
- Record-to-report*
- Financial analysis
- Control framework*
- Audit
- Capital management
- Dividend capacity
- Governance and ownership (RACI)*
- Personnel qualifications*
- Product management *
  - Current profitability analysis
  - Future pricing scenarios

* Commonality among standards

assessing data governance and quality, and rethinking roles and responsibilities to enhance core processes and related activities, even those as basic as reconciliations.

It should be noted that while an approach focused on broader transformation is considered a leading practice, not every insurance company is doing it this way. But certainly, to the extent that an organisation is able, it should strive to take full advantage of this gift of mandated change — along with more time from the standard-setters — to assess processes throughout the enterprise.

In Closing

IFRS 17 and ASU 2018-12 are introducing major changes to insurers that are not limited to their accounting and finance departments. These new standards present an excellent opportunity to transform multiple areas of the business, including but not limited to introducing new technologies and tools to enhance processes and enable the organisation to better leverage data. And now that insurers have been granted extra time to achieve compliance, they should consider where they can transform foundational aspects of their business and position their organisations to face their future confidently.

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