

By Ron Hersmis, Cornelis Slagmolen and Arjan Schoemaker

IFRS 4 PHASE II SURVEY: CURRENT STATUS AND ANTICIPATED CHALLENGES AT DUTCH AND BELGIAN INSURERS



In a combined effort, the Dutch & Belgian Deloitte practice has conducted a survey on IFRS 4 Phase II expectations, preparations and anticipated challenges within insurance companies. The results of this survey include the view of 15 insurance groups from Belgium and the Netherlands on topics such as: status of the implementation, data requirements, impact on financial & reporting systems and the alignment of Solvency II and IFRS 4 Phase II. In this article we focus on a broader mix of disciplines (a.o. Actuarial, Finance, IT) involved in the IFRS 4 Phase II preparations and implementation. Below we will present the most noteworthy results and vision on how to deal with challenges lying ahead of us.

Current status of the IFRS 4 Phase II implementation

The majority of Dutch insurers indicate to start creating awareness around IFRS 4 Phase II in the upcoming months or later, whereas Belgian insurers have already begun to create awareness through training. Although the standards are not yet completely finalised, most concepts are already known and not subject to change. Consequently, a lot of preparatory work could commence now, for instance gathering of 'historic' data that is required for IFRS 4 Phase II or develop first insights by performing example calculations for most affected product categories. > see chart 1

Besides awareness training, most insurers have begun or plan to begin assessing the possible leverage with work done in Solvency II and reviewing availability and quality of data. As project teams still need to be established, most insurers have not estimated the budget or FTEs required. When new standards are finalised, it is expected that almost all insurers will swiftly start building a project team and required budgets and FTEs will be defined.

Creating awareness

As IFRS 4 Phase II will also have impact on other departments of the organization than Risk and Finance, it is wise to create awareness at other departments that will be involved in the implementation of IFRS 4 Phase II (e.g. IT- and data architects and business and product managers). It is understandable that insurers currently are more focused on the Solvency II implementation. To that extent it helps that the implementation of IFRS 4 Phase II is delayed and gives insurers more time to be well-prepared.

Creating awareness is not limited to organizing workshops and training. Awareness is also understanding which business processes have to be adjusted to the new reporting standard. For example, for determining a technical provision a valuation of

future cash flows is needed. This implies a strong interaction between the risk/modelling function and the financial function. Besides that the implementation of IFRS 4 Phase II affects the primary process as well. From different involved functions understanding of the concept of the contractual service margin (CSM) is expected, which is needed for revenue recognition. Actuaries are considered to be specialists in quantifying the provisions for insured obligations, using cash flow projection models. As IFRS 4 Phase II affects not only the actuarial department, it is obvious that creating awareness is a multi-disciplinary endeavor where actuaries will have an important role to play.

Challenging aspects of IFRS 4 Phase II

According to the insurers surveyed, the most challenging part is expected to be the disclosures. These will require more detail compared to current IFRS requirements, and the ability to produce all numbers will require a large effort. Moreover, the presentation of the P&L will change fundamentally and therefore the structure of the financial administration needs to change as well. Starting in a timely fashion and assessing which disclosures would be possible and which not, given the current systems and data availability, could save insurers from last-minute surprises. > see chart 2

Presenting and explaining insurance revenue and costs under the new definition is also seen as a significant challenge by more than 50% of the insurers. As the basic building block approach is not subject to any further change, one could begin by developing examples by which insurance revenues and costs under IFRS 4 Phase II are calculated for all product categories. In such a way, insurers would be better able to implement the final standards when they become available, especially for more complex products.

Another element that is regarded a big challenge is the effective date of the standard. Uncertainty remains

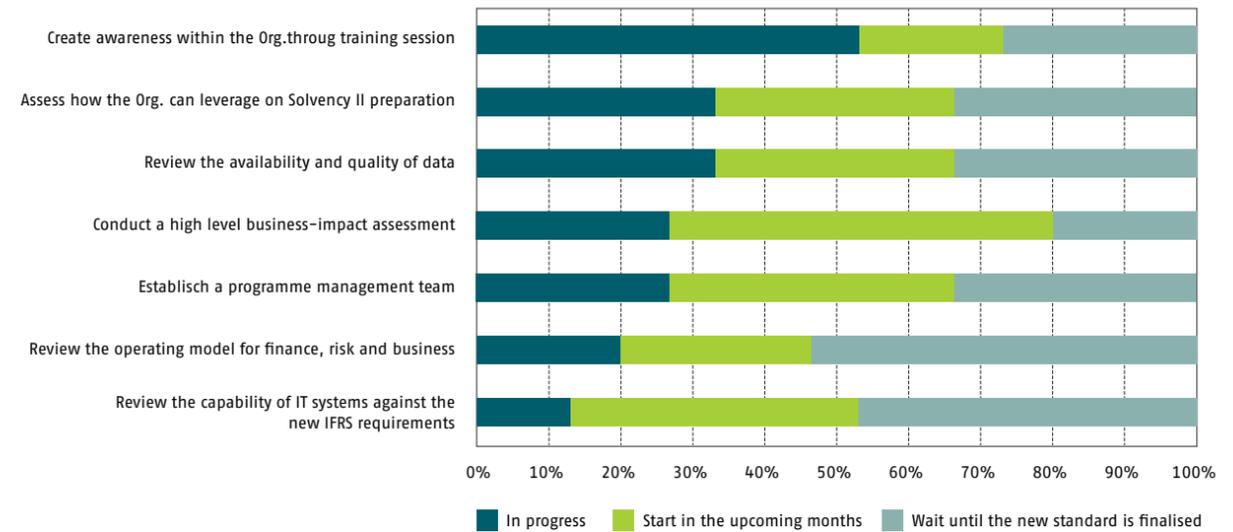


Chart 1: What is the current status of the following elements of your IFRS 4 (Phase II) implementation?

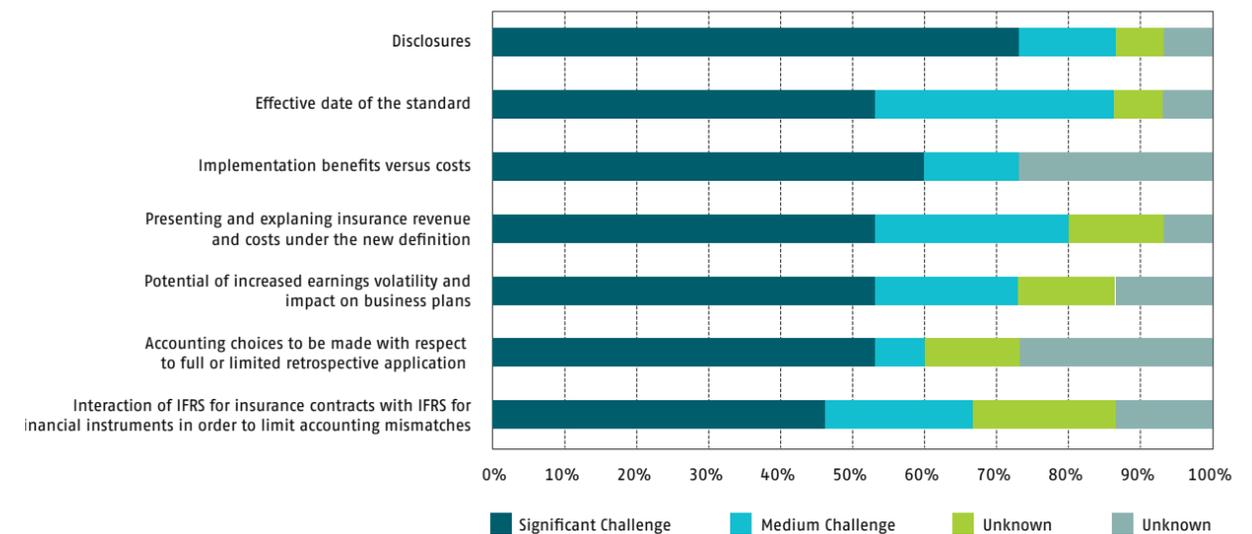


Chart 2: How do you rate the challenging aspects of the following IFRS 4 (Phase II) elements?

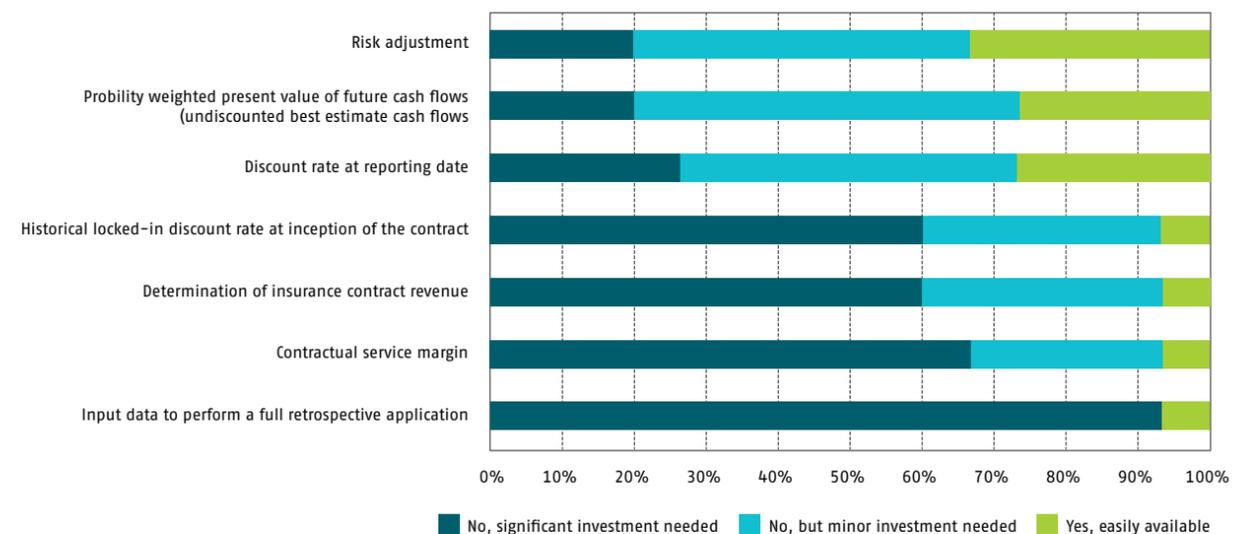


Chart 3: Are the additional data dimensions available to address the data requirements for each of the following elements that are specific to IFRS 4 (Phase II) elements?

around the release date of the final standards and, more importantly, also around the exact effective date. This last date is particularly important, as it will indicate the exact amount of time that will be available for the implementation, which is in itself an important input variable to determine the required budget and FTEs. The survey results also make clear that, with the implementation of Solvency II fresh in mind, many insurers are concerned as to the implementation benefits versus the costs. However, where Solvency II has been used as the paradigm to build new infrastructure, insurers should have a proper starting point (i.e. Infrastructure, Change capacity) for IFRS 4 Phase II.

Additional data requirements

There is consensus on what will be the biggest challenge concerning data. Dutch and Belgian insurers agree that the most critical part will be extracting data that enables insurers to obtain retrospective information. It would require major effort in order to be able to extract information on, for example, the historical locked-in discount rate at inception for certain portfolio subsets.

A slight advantage with respect to retrospective data requirements could be that the OCI solution is no longer mandatory (according to the latest redeliberations). Insurers could make accounting decisions (i.e. result on interest through P&L instead of OCI for some portfolios) which will mean an easing of retrospective data requirements. Investigating all accounting decisions that could affect data requirements before starting up projects around data for IFRS 4 Phase II is therefore of vital importance. > see chart 3

Impact on systems & data

Based on the survey results, it is clear that a significant systems upgrade is needed throughout the entire

reporting chain. As adaptation of systems affected is expected to take a significant amount of time, one should start as early as possible by assessing what needs to be done to become IFRS 4 Phase II ready. A possible starting point could be to investigate which data is actually required and in which system (or systems) the data is, or should be, maintained.
> see chart 4

Conclusion

Most Dutch insurers stated that they plan to start creating awareness around IFRS 4 Phase II in the upcoming months. As a lot of the more technical and challenging issues require a high degree of actuarial knowledge there will be an important role for actuaries in explaining and training other disciplines within the organization (i.e. Finance and IT).

Being able to disclose on the required level of detail and, at the same time, being able to explain all results are seen as the most challenging aspects. Also system and data requirements will require significant attention before and during implementation. Using simple product examples based on current information in the exposure draft and redeliberations, insurers could already gain insight into the specific data requirements to obtain the risk adjustment, contractual service margin and determination of insurance contract revenue under IFRS 4 Phase II. In such a way insurers will be well prepared for what is coming. ◀◀

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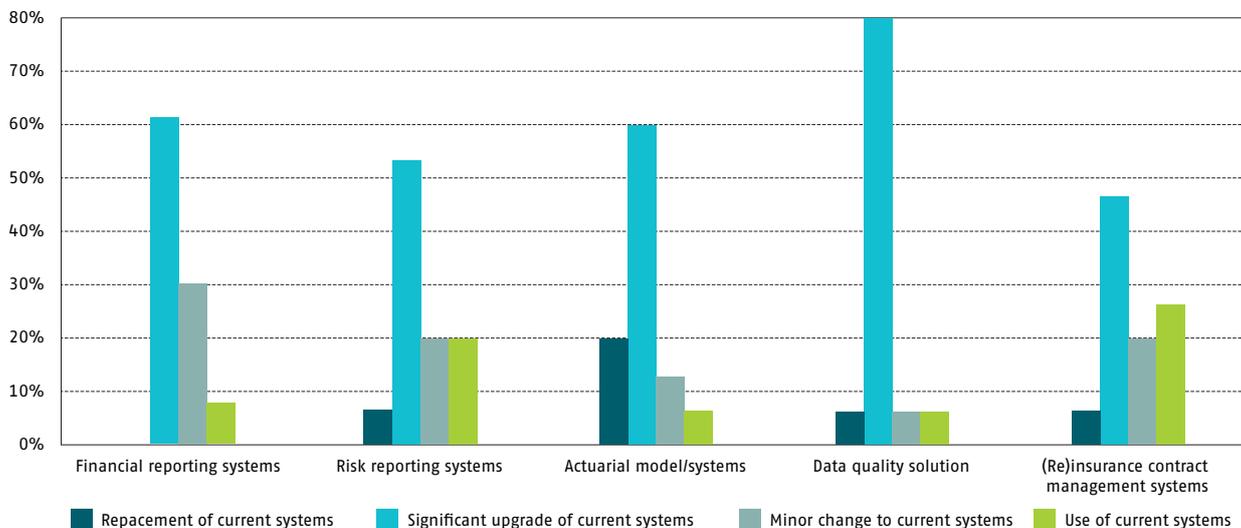


Chart 4: To what extent will the new requirements impact each of the following systems so that reporting deadlines can still be met?