ORACLE Financial Services

THE WATCHLIST

Trending Now: Insurance Contract Financial Transparency Moves Into the Spotlight

Insurance companies and other institutions that issue insurance contracts find themselves on the threshold of a new era of financial transparency as they prepare to implement new accounting standards. These requirements – which affect insurers and financial institutions in the United States and around the globe – will fundamentally change the way insurers manage, measure, and report business results.

Implementing the new accounting standards will require significant focus and resources. Organizations that plan carefully will realize an important upside, however. The data infrastructure and analytical capabilities needed to support the new standards will position financial institutions to achieve greater alignment between finance, risk, and actuarial disciplines. Just as important, they will enable insurers to more actively and accurately incorporate risk into their decision-making and gain actionable business and profitability insights that drive business growth.

Developments and Opportunities to Address Now

1

All Eyes are on IFRS 17. In May 2017, the International Accounting Standards Board (IASB) unveiled the long-anticipated IFRS 17 standard. Today insurers and other affected financial firms adhering to IFRS standards are working to size up their obligations and options as the January 1, 2022, implementation date looms on the horizon. IFRS 17 – coming after IFRS 9 (which focuses on financial instruments and the asset side of the balance sheet) – looks to bring new levels of transparency to insurance contracts and investment contracts with discretionary participation features (which fall on the liability side of the balance sheet).

IFRS 17 seeks to bring new levels of transparency by requiring all companies that issue insurance contracts to account for them in a way that provides:

- "current estimates at each reporting date of the obligation created by the insurance contracts, reflecting up-to-date information about cash flows arising from insurance contracts, and the timing and risk associated with those cash flows.
- information about (i) the sources of profit or losses through underwriting activity and investing premiums from customers; and (ii) the extent and nature of risks arising from insurance contracts."[1]

1 "Why Change Insurance Contracts Accounting?," IFRS, January 2017. https://www.ifrs.org/-/media/project/insurance-contracts/current-stage/educational-materials/why-change-insurance-contracts-accounting.pdf

As part of the quest for greater transparency, IFRS 17 also requires a company "to recognize profits as it delivers insurance services (rather than when it receives premiums) and to provide information about insurance contract profits the company expects to recognize in the future."[2]

The new standard is expected to fundamentally change the accounting process for all entities issuing insurance contracts. And, these organizations will need to adopt both IFRS 9 and 17 – adding to the challenges ahead. Many insurance products combine characteristics of both financial instruments and service contracts, and others generate cash flows that vary over a long period of time – creating a highly complex accounting paradigm.

2

The Financial Accounting Standards Board (FASB) elevates insurance contract transparency in the United States. In August 2018, the FASB issued Accounting Standards Update (ASU) No. 2018-12, Financial Services – Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts (known as Long Duration Targeted Improvement standard or LDTI). The standard requires an overhaul of published financial statements, aiming to make both income statements and balance sheets more comparable within the industry, and achieve the much-needed transparency and clarity for all stakeholders. LDTI addresses improvements to the timeliness of measuring liability for future policy benefits for specified long duration contracts and makes changes to deferred acquisition costs accounting, cash flow assumptions, recognition of instrument specific credit risk assumptions, and disclosure requirements. The new standards will deliver:[3]

- A more current measure of the insurance liability for traditional and limited-payment contract liabilities, providing a more current view of an insurance company's expected future cash flows. Insurers will be required to review and update cash flow assumptions for measuring the liability for future policy benefits annually. In addition, they will have to update discount rate assumptions used to measure liability for future policyholder benefits quarterly
- A more uniform and current market-based measure of market-based options or guarantees. Specifically, insurers will have to measure a new category of market risk benefits at fair value
- A consistent recognition and measurement model applied to contract features with similar risks and economics
- Simplified amortization of deferred acquisition costs that provides a clearer amortization pattern
- Enhanced disclosures about insurance liabilities and deferred acquisition costs that provide information that is useful in investor analysis. These will include disclosures of disaggregated tabular roll forward of the beginning-to-ending balances, reconciliation from the disclosures to the financial statements, as well as measurement assumptions, changes in those assumptions, and crediting rate guarantees

For public companies following a calendar year, the new standards will go into effect in 2021. For non-public calendar-year companies, the changes will be effective in 2022.

While the new standards will not fundamentally transform accounting processes for organizations issuing insurance contracts in the United States, they will require greater insight into data and the IT infrastructure to support expanded transparency and analysis.

2 "IFRS 17 Fact Sheet," IFRS, 2017. https://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-factsheet.pdf

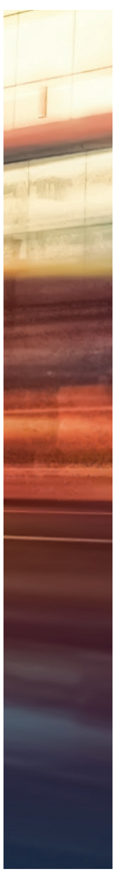
3 "Understanding Costs and Benefits: Accounting Standards Update No. 2018-12
Targeted Improvements to the Accounting for Long-Duration Contracts Issued by Insurance Companies," FASB, August 2018. https://www.fasb.org/cs/ContentServer?c=Document_C&cid=1176171062203&d=&pagename=FASB%2FDocument_C%2FDocumentPage&utm_source=Media&utm_campaign=8fbc8770f4-EMAIL_CAMPAIGN_2018_08_14_10_31&utm_medium=email&utm_term=0_d21da5f9e0-8fbc8770f4-98611745&mc_cid=8fbc8770f4&mc_eid=c21e3346c3

3

Conversation continues about possible future North America adoption of IFRS. While the United States is not expected to adopt IFRS standards in the foreseeable future, discussion continues around greater alignment. For example, "… in a public statement issued in January 2017, the outgoing SEC Chair expressed support for the development of high-quality, globally accepted accounting standards, and suggested that the SEC support further efforts by the FASB and IASB to converge their accounting standards to enhance the quality and comparability of financial reporting. Separately, the SEC is still discussing the possibility of allowing domestic issuers to voluntarily submit IFRS financial information, without reconciliation, in addition to their US GAAP financial statements."[4] Organizations making investments in their data foundation and analytical applications are wise to play the long game and create an infrastructure that can meet broad-based and long-term needs and requirements.

4

Look beyond compliance and seek broader business benefits. While time is running short to comply with the new requirements, creating and implementing a successful compliance strategy should not be the only end game for insurance organizations. With an undertaking and investment this formidable and costly, they should consider the long-term upside of gaining better control over and insight into finance, risk, and actuarial data – and factor it into their path forward. The foundation created by standardizing and aggregating data, and expanded analytical capabilities, can help to support and accelerate other institution initiatives. For example, it can help firms to cultivate a transparent risk management culture, as well as promote pervasive intelligence across departments. Combined, these capabilities present a solid foundation for improved performance.



Preparing a Strong Foundation

As insurers and financial institutions develop plans to migrate to applicable new standards, it is important that they assess their data infrastructure as well as analytical, modeling, data governance, and reporting capabilities. Preparation is a rigorous process, requiring firms to adopt new models for determining contract value estimates, risk adjustment, contractual service margin (CSM), portfolio optimization and more. They must also be prepared to provide greater documentation on their financial and risk models and how they're applied.

What components should be included in a complete solution designed to ensure accounting standard compliance while supporting and advancing alignment and transparency between finance, risk, and actuarial that can drive top- and bottom-line growth? Consider the following checklist:

- A unified data platform and repository for risk and finance data
- End-to-end management of complex computations and accounting, as well as financial and management reporting
- Transparent, rules-driven identification of distinct investment and risk components, contract boundaries, and the identification of directly attributable costs
- Pre-built business event rules and methodologies for calculations such as contract value estimates, service margins, risk adjustment, CSM, and more
- Analytical capabilities that enable portfolio optimization by factoring mortality, lapses, acquisitions, costs, future cash flows, credit risk, and more

4 "Key Development on in IFRS in the US," https://www.pwc.com/us/en/cfodirect/issues/ifrs-adoption-convergence.html

- Native capability for modeling that can be a shared utility across risk and finance areas – which is particularly important as IFRS 17 does not provide full guidance on how risk margin, discounts, and adjustments should be calculated
- Predefined reporting templates
- Ability to support both IFRS 9 and 17, as all institutions must implement both, as well as LDTI standards and the flexibility to accommodate new requirements

IFRS 17 and new LDTI insurance contract reporting requirements will play an important role in driving greater alignment between risk and finance across insurers and other financial institutions. The standards, and the data infrastructure needed to support them, will position these organizations to more actively and accurately incorporate risk into their decision-making, and benefit from more extensive data-centric business and profitability insights. In addition, a comprehensive data and analytical application infrastructure positions firms to cultivate a transparent risk management culture, as well as promote pervasive intelligence across departments. Combined, these capabilities present a solid foundation for improved performance.

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