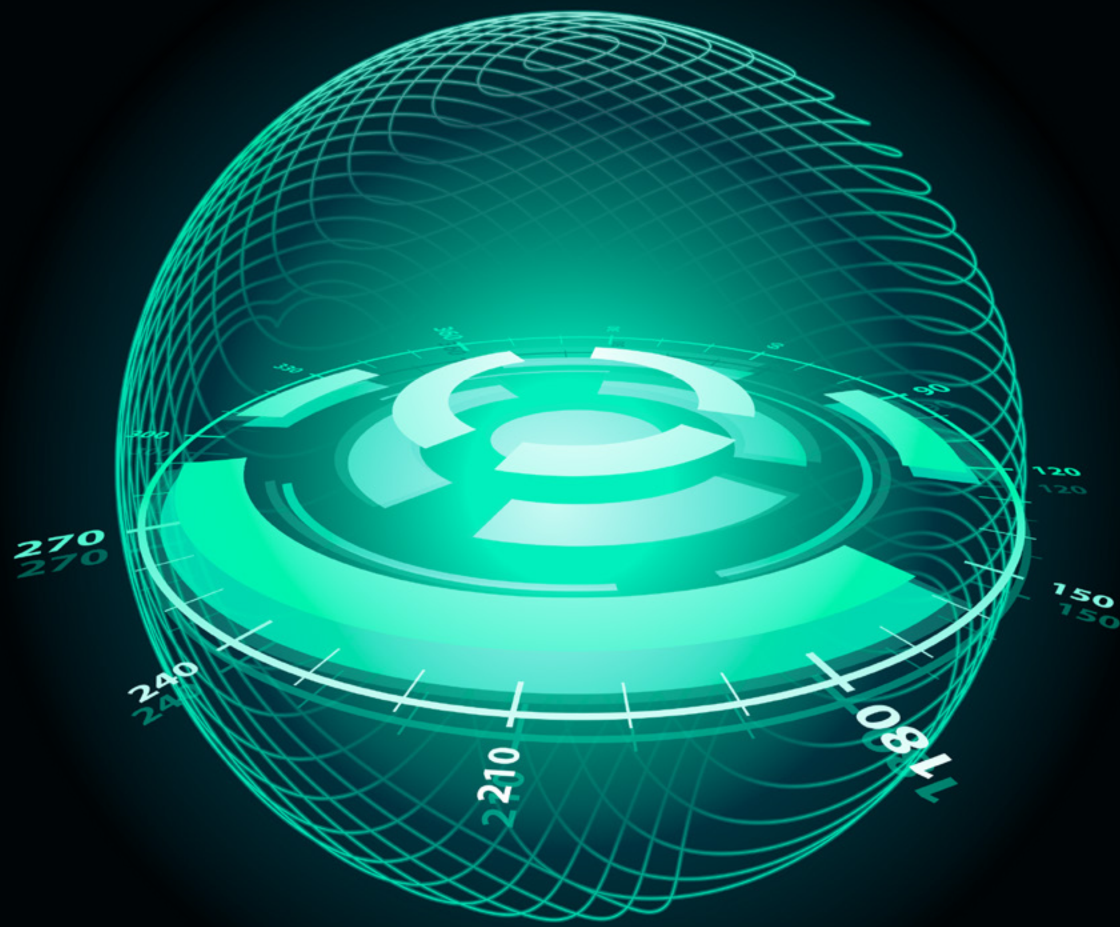
ARTICLE 2

IFRS 17: Performance Measurement and Management



South African Insurance Outlook 2021 | Navigating the insurance landscape

IFRS 17: Performance Measurement and Management

In our introductory article, "Understanding a more complete IFRS 17 picture", we outlined a simplified operating model of an insurer. This showed a capability within an insurer that enables an insurer to define, measure and manage its performance against its strategic objectives. The IFRS 17 implications for insurers were discussed and five key next steps were presented. In this follow-on article we will focus on where insights gained from IFRS 17 metrics will impact on an insurer's performance measurement and management capability.

The requirements of IFRS 17 translates into more consistent, granular income statement reporting for insurance contracts, which results from more detailed data being used in the financial reporting process. Consequently, we can expect that IFRS metrics reported for insurance contracts can provide deeper insights into the performance of these contracts. Both internal and external stakeholders will be able to use these new IFRS metrics to assess the performance of the insurer, both in line with their strategy, and relative to other insurers. Because of this, it is important for insurers to revisit the performance metrics that they currently use. They need to examine how the new information that IFRS 17 introduces can be used to replace some of these metrics, and also create new ones that can give additional insight into the performance of the business.

Why is this relevant now?

There are, of course, many choices of relevant IFRS 17-derived performance metrics which could be designed and used. There are two key reasons for implementing performance measurement metrics now:

1. **Building the IFRS 17 performance story**
   Insurers are generating their transition results to produce an opening IFRS 17 financial position. For many insurers, this opening position will fundamentally affect the emergence and disclosure of insurance contract IFRS profits. By investigating and agreeing a set of performance measures now, insurers will be able to understand the implications of transition decisions on the level and profile of this profit emergence. This understanding will ensure that appropriate management decisions are made to optimise IFRS performance in the first years of operating under IFRS 17.

2. **Putting the systems and structures in place**
   Outside of the financial reporting capability, which gives rise to the presentations and disclosures required under IFRS 17, further business insights will not automatically emerge from an IFRS 17 implementation. The potential for additional insights will only arise after deliberate investigation and design of an insurer's IFRS 17 data and modelling architecture.

Data flows and reporting systems are being designed, built and tested now. Insurers need to be aware of the granularity needed or the additional IFRS 17 performance metrics that are required, once IFRS 17 has been implemented. This will include deciding what information will flow out of the IFSR 17 subledger solution and what information will be sourced from other elements of the solution. Data visualisation, dashboarding and automation tools are key elements to achieve this.

The output requirements, actuarial models and the subledger should no longer be viewed as those required for minimum regulatory reporting compliance. Rather, these systems will be a valuable source of management information for generating analytics and insight on insurance contract performance.

Addressing the requirements now, as part of the insurer's transition strategy and IFRS 17 build, will ensure key business information can be sourced from core financial reporting systems. For example, if the product development team needs IFRS performance by product segment, but a portfolio spans more than one product segment, an approach to track and calculate IFRS metrics at a more granular level will be required.

Three Key Performance Focus Areas

Insurers are looking to focus on three key areas within their performance strategy: growth, financial resilience and value generation. The impact of IFRS 17 for each of these are discussed below. The impact that these areas will have on the insurer's performance measurement and management capability need to be assessed.

Growth

The CSM and the Risk Adjustment have a large impact on the emergence of insurers' IFRS profits. Performance measures that give insight as to the source of earning growth, the drivers of that growth through time and its sustainability will ensure that management act on insights that will improve their competitive position.

These insights need to be informed by information at a higher level of granularity or cumulative results rather than reported results. For example, product development and pricing teams may analyse trends in profitability by product and year sold, or adjust for loss component timing effects. The analysis of data will also depend on the business requirements; there may be a need to produce results at a distribution channel rather than portfolio level. This needs to be built into the IFRS 17 reporting solution. Beyond this, adjustments might be made to standardise results to compare products or to market benchmarks.

Financial Resilience

IFRS 17 will give a more meaningful insurance service result when compared to IFRS 4, as under IFRS 17 insurance revenue is more closely aligned to insurance service expenses. As insurers transition to IFRS 17, the resulting insurance profit metrics will become more comparable across the industry. Key metrics such as the loss ratio, expense ratio and combined ratio will be much more meaningful to analysts and shareholders than would have been under IFRS 4 particularly for longer duration contracts often found in life insurers.

We believe that IFRS 17 might change the use of the current Analysis of (IFRS) Surplus (AoS) that is performed by many life insurance companies. The IFRS 17 Analysis of Change (AoC) of actuarial liabilities provides many of the same insights. This is through a combination of the insurance result, changes in the CSM estimates and experience variances related to future service. However, IFRS 17 disclosures do not require a detailed source of earning analysis, and to get this from the AoC will mean that granularity of step changes of the AoC needs to be designed into the IFRS 17 reporting solution.

The presentation and disclosures under IFRS 17 will be a source of additional information for the users of financial statements. With the disclosure of both actual and expected finance results, asset/liability mismatches will be much more apparent. Decisions on performance measurement should be made in light of any changes that are made to any revised balance sheet management approach under IFRS 17.

Finally, reinsurance is separately measured and reported under IFRS 17. Reporting on financial performance of reinsurance decisions will need insurers to enhance their reinsurance reporting dashboards.

R Value Generation

Insurers will need to decide on measures which signal the ability to pay dividends. For example, a metric such as the ratio of the actual CSM amortisation to expected CSM amortisation will help management communicate their ability to achieve forecasted profit recognition. Insurers will need to decide on the role that solvency, IFRS and embedded value metrics play in assessing performance of their insurance book. Embedded value is a particularly key topic, and one which needs careful consideration. Insurers will need to decide whether to produce embedded value figures off an old or new basis and whether additional information will be needed to supplement the current embedded value disclosures.

Conclusion

Reporting under the new IFRS 17 framework gives insurers the opportunity to revise their performance measurement and management capability. We see successful insurers using business insights that are derived from new IFRS 17 metrics, such as those outlined above, to drive better performance out of their product sets. Finance teams need to start conversations with key business stakeholders now. This will ensure that they are informed about IFRS 17 performance measurement opportunities, and that the IFRS 17 project team builds the functionality needed to sustainably and reliably report on new metrics.

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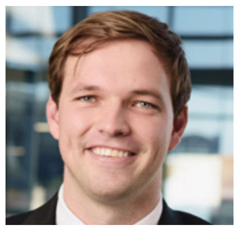

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