

INTERNAL MEMORANDUM



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REGISTRAR: SHORT- AND LONG-TERM INSURANCE, AND MEDICAL AIDS FUNDS

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SUBJECT: INTERNATIONAL FINANCIAL REPORTING STANDARD (IFRS) 17 *INSURANCE CONTRACTS* - FINANCIAL REPORTING BY THE INSURANCE AND MEDICAL AIDS FUNDS INDUSTRY – POSITION PAPER.

PURPOSE

This paper seeks to provide some background information on how International Financial Reporting Standard (IFRS) 17- *Insurance contracts* change the way in which insurance companies and medical aid funds prepare their common purpose financial statements. The paper will further explore the various regulatory options available to NAMFISA to adopt as the regulatory reporting approach. Challenges faced by both the insurance and medical aid funds industries will be provided for each of the approaches available to NAMFISA. Finally, a recommendation will be made on the most cost efficient and practical regulatory reporting approach to be adopted by NAMFISA.

BACKGROUND INFORMATION

The international accounting standards board (IASB) issued IFRS 17 in May 2017 to supersede IFRS 4 (the previous insurance financial reporting framework) with significant changes to the way in which insurers and medical aid funds (entities which issue insurance contracts) recognise, measure, present and disclose insurance contracts.

The following are some of the key changes and supervisory implications introduced by IFRS 17:

1. **Scoping:** IFRS 17 widens the scope of entities which may use this reporting framework to present its financial statements. The previous reporting was explicit and only compelled “**insurers**” to use IFRS 4 to prepare and present common purpose IFRS financial statements. This meant that entities that were not registered as “insurers” could not report in terms of IFRS 4. The widening of the scope means that entities which are not necessarily registered as insurers may apply IFRS 17 accounting principles¹.
2. **Profit measurement (deferral):** The current framework allows for entities to record premiums collected and consequently profits in the year in which the underlying insurance contracts are written. The dominant change introduced by IFRS 17 is that at contract inception, the profits inherent in the contract is deferred in the “contractual service margin” and only released to profit and loss as the underlying insurance services are rendered to the policyholders. Gross written premiums (GWP) for insurers and contributions in the medical aid funds industry will fall away under IFRS 17. **The measurement of profit under IFRS 17 introduces a great degree of volatility in the profitability of entities from one reporting period to the next (losses on onerous contracts are immediately recognized in the income statement – this will result in significant reduction in industry wide profits at implementation date).**
3. **Aggregation:** The current reporting framework does not have explicit requirements on the level of aggregation. IFRS 17 requires insurance contracts that are of similar risks and are managed together to be aggregated in cohorts and for reporting to be driven by these cohorts. No supervisory implications introduced by the aggregation rules imposed by IFRS 17.

¹ No significant supervisory implications flow as a result of this change other than that entities not under NAMFISA's regulatory net may apply IFRS 17 accounting principles for IFRS reporting.

4. Different measurement models: The previous reporting framework only provided for one basis of recognition, measurement, presentation and disclosure of all insurance contracts. IFRS 17 makes provision for three (3) measurement models:

4.1 **General Measurement Model (GMM)**: This is the default measurement model and is based on four building blocks (present value of fulfilment cash flows, risk adjustment, contractual service margin and the time value of money are the building blocks measured at contract inception).

4.2 **Variable Fee Approach (VFA)**: This is a variation of the GMM and will in principle be applied for contracts with investment features where the performance is linked to the performance of underlying items (investment assets)

4.3 **Premium Allocation Approach (PAA)**: Simplified approach to be applied to insurance contracts with a coverage period of one year or less. The PAA may be applied in other circumstances, provided the liability for remaining coverage is not materially different from what it would have been if the GMM was used as a basis of measurement.

The supervisory implication is that the regulatory return in an IFRS 17 reporting environment will be onerous as it will require an extensive overhaul to cater for all the variations of measurement models. There is a possibility that one insurer with a complex product range may use all three measurement models and aggregate these to derive the entity level financial results and position. Furthermore, consolidation of industry data may prove to be complex in that two insurers may elect to two different measurement models on the exact same product class, e.g., engineering or liability has a possibility of being either accounted for under the GMM or the PAA.

5. Income statement implications: IFRS 17 compels entities to split insurance service result (underwriting activities) from the financial results and to present these two distinct components separately. Supervisory implications are that the **current key performance indicators (KPI) such as the claims ratio, expenses ratio, and combined ratio may not be useful and a new set of KPI's may need to be developed for IFRS 17 reporting.**
6. Statement of financial position implications: all assets and liabilities attributable to insurance contracts are lumped together and reported as a single line item called "insurance contract assets". The implication is that items such as premium debtors (key number for credit risk assessment) may fall away under IFRS 17 measurement. Similarly,

only one line item will be reported for liabilities attributable to insurance contracts. The transparency of the various items of assets and liabilities falls away under IFRS 17.

7. Different implementation dates: IFRS 17 is effective for annual periods beginning on or after 1 January 2023. Insurance companies in Namibia have different financial year ends and or reporting dates and this invariably means that not all insurance companies will adopt IFRS 17 at the same time. The table below summarizes the year ends of insurers in Namibia and shows possible adoption dates:

Year Ends	Number of Entities	IFRS 17 adoption date
28 February	2	1 March 2023
31 March	3	1 April 2023
30 June	11	1 July 2023
31 August	2	1 September 2023
31 December	20 (includes medical aid funds)	1 January 2023

All eight (8) registered medical aid funds have 31 December year ends and as such the issue of different implementation dates is not as pervasive in the medical aid funds industry. The different year ends and implementation dates reflected in the table above invariably mean that there is a period during which different insurers will use different reporting frameworks to satisfy and or comply with the stringent requirements under IFRS 17. It is thus not plausible for NAMFISA to implement an IFRS 17 reporting template until all the entities in insurance and medical aid funds has implemented IFRS 17.

READINESS ASSESSMENT

As part of the IFRS 17 implementation project, NAMFISA conducted a readiness and preparedness survey to determine where the industry was in terms of the level of preparedness and the applicability of IFRS 17 given the various product offerings by the insurers and medical aid funds. The primary insurance market consists of 14 insurers in the long-term insurance (LTI) industry, 14 in the short-term insurance (STI) industry and 8 registered medical aid funds (MAF).

Applicability of IFRS 17: the aforementioned survey confirmed that two entities issues contracts or products that will potentially not be scoped in and measured in terms of IFRS 17. These two entities will use IFRS 9 – Financial Instruments to measure and account for their contracts as these are pure financial risk transfer agreements. One life insurer and one short-term insurer are anticipated to use IFRS 9 as its primary reporting framework. All medical aid funds confirmed that IFRS 17 is applicable to them and will migrate to IFRS 17. The supervisory implication is that even under IFRS 17 reporting, provision has to be made for insurers who would use reporting frameworks other than IFRS 17 to present their common purpose financial statements.

Preparedness assessment: The following percentage readiness and or preparedness was observed across the three sub-sectors impacted by IFRS 17: LTI (57%), STI (57%) and MAF (71%). The table below summarizes the key themes and the results from the study:

<u>Key theme</u>	<u>LTI</u>	<u>STI</u>	<u>MAF</u>
<u>Preparedness</u>	<u>57% (8 out of 14)</u>	<u>57% (8 out of 14)</u>	<u>71% (5 out of 7²)</u>
<u>Budgetary provisions</u>	<u>64% approved budget for IFRS 17</u>	<u>79% some form of budget for IFRS 17</u>	<u>79% some form of budget for IFRS 17</u>
<u>Board involvement and prominence</u>	<u>High priority by 100%</u>	<u>High priority by 86%</u>	<u>High priority by 86%</u>
<u>Resources</u>	<u>May require actuarial skills</u>	<u>May require actuarial skills</u>	<u>May require actuarial skills</u>
<u>Reporting</u>	<u>Predominantly still use IFRS 4 to track and report on performance internally (only one fully IFRS 17)</u>	<u>Predominantly still use IFRS 4 to track and report on performance internally (only one fully IFRS 17)</u>	<u>Will continue to use IFRS 4 to track and report internally</u>

² One registered medical aid fund did not complete the readiness and preparedness assessment, hence the total of seven medical aid funds.

The most important takeaway from the aforementioned survey was that the majority of entities will still continue to use IFRS 4 (current status) as a basis for measuring, tracking and reporting financial performance. From this result, it can thus be inferred that the majority of entities will still be able to produce the regulatory returns as currently required by NAMFISA.

OPTIONS FOR REGULATORY REPORTING:

This section of the memorandum sets out the various options available to NAMFISA to design its regulatory reporting requirements and sets out the advantages and disadvantages of the various options:

Option 1: Continue with the current IFRS 4 reporting as per the NAMFISA chart of accounts. Under this approach, the regulatory requirements will remain as is and insurers and medical aid funds will be required to continue reporting on the same basis for regulatory purposes.

Advantages:

- The current KPI's developed for the industry will remain and be used for regulatory purposes and a substantial number of entities confirmed that IFRS 4 reporting and the current KPI's will be used for internal reporting purposes. This is more so given that KPI's in an IFRS 17 environment are still to be developed and tested.
- With the status quo remaining, the risks brought about by the disruption of switching over and aligning the regulatory reporting to IFRS 17 are minimized.
- Will not require alignment of FIMA Chapter 2 and 7 Standards based on IFRS 4 to IFRS 17 set to be affected by the change.

Disadvantages:

- Reconciliation of IFRS 4 data submitted for regulatory purposes to the IFRS 17 data for audited annual financial reporting purposes will prove to be difficult. The measurement basis of the two sets has vast differences and NAMFISA may not be in a position to satisfy itself on the validity, accuracy and completeness of quarterly statutory data submitted to the audited annual financial statements under IFRS 17.
- This approach may result in NAMFISA losing assurance provided by the external auditors as it is likely that the auditors will only provide assurance on the IFRS 17 financial statements and not on the regulatory financial statements.

- This may exponentially increase the cost of regulation and compliance. Firstly, entities who has or are in the process of completely changing their systems and ICT infrastructure to produce IFRS 17 data may be required to maintain two systems and produce two sets of financial reporting which comes at a significant operational cost. Secondly, NAMFISA may require audit assurance on the regulatory financial information which is outside of the scope of a normal audit and may result in additional fee charges by the auditors.
- Lack of comparability of performance and size of the local insurance and medical aid funds market to peer markets in other countries who will migrate to IFRS 17 due to varying KPIs.

Option 2: Hybrid reporting for regulatory purposes. Under this option, it is recommended for NAMFISA to amend its chart of accounts to align with IFRS 17 and impose additional information that is not produced or required under IFRS 17.

Advantages:

- Entities who have opted to change their financial reporting systems and ICT infrastructure to produce IFRS 17 financial information will be able to some degree leverage between IFRS and regulatory reporting requirements.
- NAMFISA may under this model impose for entities to report on financial and non-financial information not required under IFRS 17 and still use the current KPI's and early warning indicators to prudentially supervise the industry with minimal disruptions.
- NAMFISA will be in a position to perform reconciliations of the quarterly statutory returns to the audited annual financial statements and test the validity, accuracy and completeness of information filed by the insurers and medical aid funds on a quarterly basis to the audited annual financial statements. This option allows NAMFISA to retain independent assurance on the regulatory financial data submitted.

Disadvantages:

- The model may present practicality challenges for entities who would have reconfigured their systems and ICT infrastructure to only produce information required under IFRS 17 to produce the additional regulatory information requirements.
- May result in some degree of double systems and reporting which will increase the cost of regulation and compliance for the industry.
- Will require alignment of some of the FIMA Chapter 2 and 7 Standards to IFRS 17 – *no immediate impact as FIMA is not operational yet.*

Option 3: Align regulatory reporting requirements to IFRS 17.

Advantages:

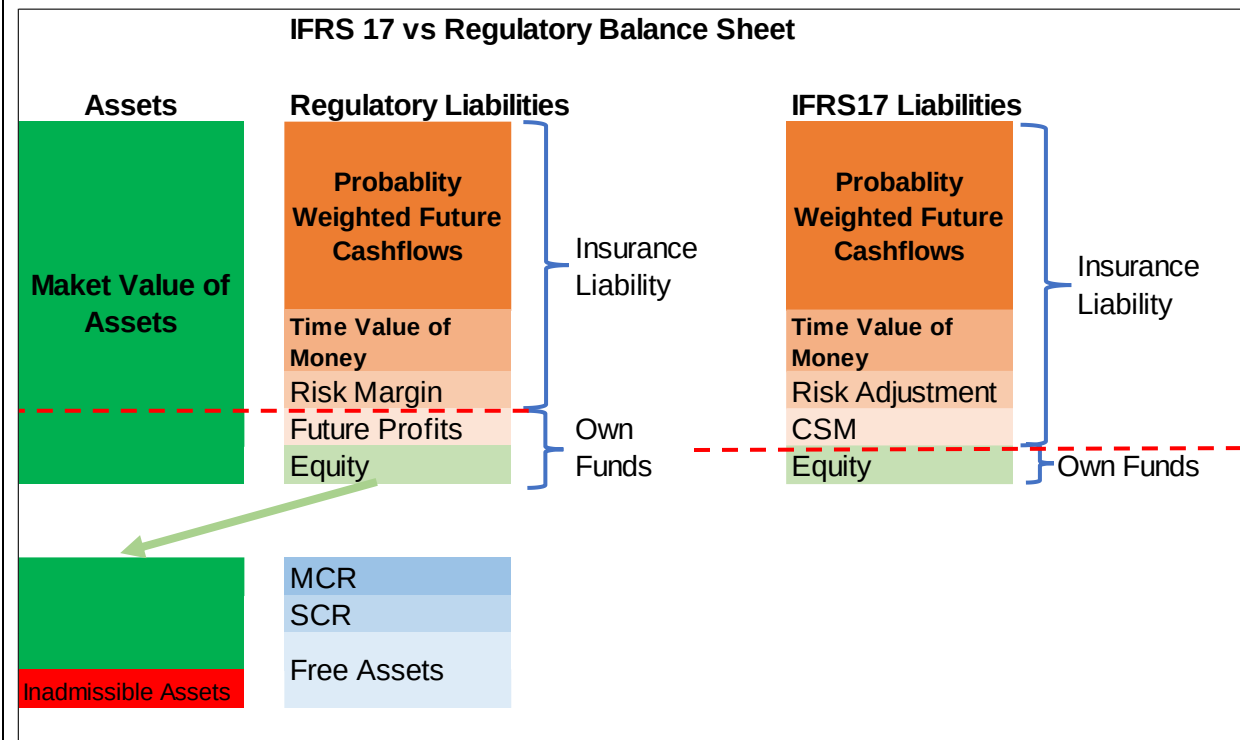
- Insurers and medical aid funds will be in a position to completely leverage off financial information prepared for IFRS reporting purposes and use the same information for satisfying regulatory requirements without any modifications to the underlying data.
- There will be no differences between the financial information prepared for IFRS reporting and regulatory purposes. NAMFISA will retain full assurance over the validity, accuracy and completeness and will be in a position to validate quarterly information to the audited annual financial statements with ease.

Disadvantages:

- Some entities may not be ready in terms of resources, systems, infrastructure to deploy IFRS 17 reporting requirements. (IFRS 17 requires accounting and finance departments to have an elevated degree of actuarial skills).
- NAMFISA and industry does not have IFRS 17 data to assess quantitative impact of the implementation of IFRS 17. Decisions made will most likely not be data driven and may not be sound decisions from a prudential supervision standpoint.
- NAMFISA and industry are not in a position to develop meaningful KPI's under full IFRS 17 reporting. There is a risk that the lack of meaningful KPI's and early warning indicators will hinder effective prudential supervision of insurers and medical aid funds (due to lack of historic IFRS 17 data given effective date of 1 January 2023 – experience needs to be built up over time).
- Crucial information (volume of business written, GWP, claims statistics, premium debtors, to mention a few) will fall away as these are not required by IFRS 17 financial statements. May impede the ability of boards to exercise proper governance over the affairs of the insurers and medical aid funds. This will further hinder effective prudential supervision and oversight of the industry.
- There is a risk that entities whose product offerings fall outside the scope of IFRS 17 may produce financial information for regulatory purposes which is not aligned to the rest of the industry – posing challenges to have a consolidated view of the information.
- Heavy reliance placed by insurers in the Namibian market on their South African counterparts for systems support and actuarial expertise. This goes against the policy

position of localization of core systems and may in the medium to long term hinder the effective prudential supervision of insurers.

Option 4: Regulatory reporting templates mapped to or aligned to NAMFISA requirements and prudential standards.



The approach of adopting a regulatory balance sheet afford the supervisory authority some leverage in that the best estimate of liabilities (probability weighted future cash flows) will yield similar results with some minor differences owing to contract boundary under IFRS 17 and the possibility of different discount rates used or prescribed by regulatory reporting whilst IFRS 17 allows the entity some discretion in determining the appropriate discount rates.

Advantages:

- This model allows for NAMFISA to develop a regulatory income statement and balance sheet tailored for regulatory purposes. There is an opportunity for NAMFISA to align the data requirements to our prudential standards.
- Future changes to financial reporting requirements imposed by the IASB will not exert strain on NAMFISA to align regulatory reporting to mirror IFRS reporting requirements.
- Application of financial soundness requirements for insurers and medical aid funds will not be impacted by the introduction of new financial reporting requirements.

- This allows for uniformity of data requirements across the sector and facilitate a smooth consolidation process to determine aggregate industry results and financial position.

Disadvantages:

- This exercise may require NAMFISA to develop three different reporting templates for each of the sub-sectors (LTI, STI, MAF) owing to the salient different features and manner in which risk-based capital requirements are determined. The operational efficiencies that would be available under IFRS 17 of deploying one return that is adaptable by all three sub-sectors is foregone.
- This approach may result in NAMFISA losing assurance provided by the external auditors as it is likely that the auditors will only provide assurance on the IFRS 17 financial statements and not on the regulatory financial statements specifically developed to facilitate the prudential supervision of insurance and medical aid funds.
- This may exponentially increase the cost of regulation and compliance. Firstly, entities who have or are in the process of completely changing their systems and ICT infrastructure to produce IFRS 17 data may be required to maintain two systems and produce two sets of financial reporting which comes at a significant operational cost. Secondly, NAMFISA may require audit assurance on regulatory financial information which is outside of the scope of a normal audit and may result in additional fee charges by the auditors.

Recommendation(s)

1. In view of the above, in the interim the IMAF Division recommends that the insurers and medical aid funds continue to fulfill their NAMFISA reporting obligations in accordance with the current ERS one chart of accounts Statutory Return, which is based on the IFRS 4 accounting standard. This position is to be maintained at least for the calendar year **1 January 2024 through 31 December 2024** while the IFRS 17 requirements are incorporated and tested.
2. Given the advantages and disadvantages of the options explored in the preceding section of this paper, the IMAF Division recommends option 2 (a hybrid model incapsulating IFRS 17 reporting and requesting for additional information for prudential supervision purposes) to be adopted.

Deployment of the IFRS 17 aligned return to be rolled out effective for all regulatory reporting commencing on 1 January 2025.

3. For NAMFISA levies to be based on GWP (insurance sector) and on gross contributions (medical aid funds) for the foreseeable future – these metrics will be required on the regulatory returns and as such no changes to be afforded to the current levy returns. The basis of the levy (GWP and gross contributions) to be separately audited and included in the AFS for independent assurance on validity, accuracy and completeness.