

IFRS 17 is already changing

International Financial Reporting Standard (IFRS) 17 was issued in May 2017. The industry quickly raised implementation concerns about the standard, including 126 issues submitted via the Transition Resource Group (TRG) public forum.

After extensive review, the International Accounting Standards Board (IASB) has proposed several amendments. They include, among others:

- Deferring the effective date by one year so that entities would be required to apply IFRS 17 for annual periods beginning on or after 1 January 2022 as well as extending the temporary IFRS 9 exemption to 2022.
- Allowing the deferral of insurance acquisition cash flows that relate to insurance contracts in groups yet to be issued.
- Requiring an entity that recognises losses on onerous insurance contracts at initial recognition to also recognise a gain on proportional reinsurance contracts held that were entered into at or before the onerous contracts were issued.

IASB staff are expected to publish an exposure draft of the proposed changes by the end of June 2019. This exposure draft will then be subject to a 90-day public consultation comment period.

A full summary of the proposed amendments is available online.¹

2018 IFRS 17 readiness survey results

Milliman published the results of our 2018 global IFRS 17 survey in February. This survey included over 115 insurers, with seven from South Africa. The survey considered insurers' general preparedness, the ability to use existing platforms and processes, the approach to topical technical aspects and the implications on the business of this new accounting standard.

Despite progress since the prior survey, it's clear there are many areas of development required and uncertainty to resolve. Information technology (IT) systems and process development challenges were a common issue cited. While many insurers are still undecided on key technical items, the survey does provide useful insight into insurers' expected methodologies. For example, for the risk margin, nearly half of respondents expect to use the cost of capital approach, most will likely use a confidence interval between either 70% and 80% or 90% and 99% and just under half will use a one-year time horizon.

A summary of Milliman's 2018 global IFRS 17 survey is available online.²

¹ See <http://www.milliman.com/insight/2019/Amendments-to-IFRS-17-from-April-2019-IASB-Meeting/>.

² See <http://uk.milliman.com/insight/2019/IFRS-17-preparedness-2018-survey-feedback/>.

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Cyber risk affecting insurers as claims and through direct attacks

The World Economic Forum's 2019 Global Risk Report ranks cyber risk as a top 10 risk and the majority of survey respondents expect the risk to increase in 2019.

Insurers are feeling the increasing impact of cyber risk through direct attacks on their systems and through major claims even as growing numbers of insurers are looking at this line as a source of premium growth.

Insurers have also looked at policy wording on lines where the frequency or severity of losses could be increased by cyberattacks as a new vector for existing risks. For example, business interruption cover historically has not explicitly excluded cyberattacks, but increasingly cyber risk cover is scoped out of basic cover and additional premiums are required for inclusive cover.

The reason is clear—losses can be significant and existing underwriting and risk assessments are out of date. For example:

In March hackers used ransomware to block the operations of Norsk Hydro, one of the largest global aluminium companies. Norsk Hydro was forced to shut down certain plants as well as switch some units to manual operations. Norsk Hydro estimated the financial impact at around USD 35 million to 40 million. The company has a cyber risk insurance policy in place with an undisclosed limit.

Milliman's Cyber Risk practice recently published an article.³ 'Could cyber risk be the next Big Short?', exploring the need for a new risk management paradigm.

More detail about Milliman's approach to cyber risk is available online at <http://www.milliman.com/cyber/>.

³ See <http://us.milliman.com/insight/2019/Could-cyber-risk-be-the-next-Big-Short/>.

Market conduct regulation

National Treasury published the draft Conduct of Financial Institutions Bill (CoFI Bill) in December 2018 and requested comments by 1 April 2019. The CoFI Bill is aimed at strengthening the regulation of how the financial services industry treats its customers.

Until the CoFI Bill comes into effect, market conduct is regulated under the Financial Advisory and Intermediary Services (FAIS) Act, Protection of Policyholder Rules (PPR) and other conduct standards.

It comes as a surprise to some that large parts of the Long-Term and Short-Term Insurance Acts are still in force (including giving force to PPR).

The recent and future changes in market conduct regulation will likely have a greater impact on products, distribution and business than the changes in prudential standards.

Licence conversion process

As part of the transitional arrangements to facilitate the implementation of the new Insurance Act, the Prudential Authority (PA) has adopted a phased approach to convert licences under the Long-Term Insurance Act and Short-Term Insurance Act to licences under the new Act. The conversion process has three phases spread over a two-year period:

- Phase 1 (1 July 2018 - 1 January 2019): Dormant insurers, microinsurers, cell captives.
- Phase 2 (1 January 2019 to 1 October 2019): Captive insurers, reinsurers, linked-only insurers.
- Phase 3 (1 October 2019 to 31 July 2020): All other insurers.

Until an insurer's licence is successfully converted, the insurer is able to continue to conduct insurance business under its existing registration. This includes any 'key person' appointed (e.g., Head of Actuarial Function) being automatically regarded as fit and proper until the licence conversion is concluded.

Insurers that have not yet had their licences converted are still subject to the governance, financial soundness and reporting requirements under the new Insurance Act.

Our article 'South Africa: Insurance licence conversion update' provides more detail and is available online.⁴

Insurance Group requirements

Insurers that are part of an insurance group were required to provide the PA with information on the structure of the group of companies by 1 September 2018.

Insurance groups are subject to specific group regulatory requirements under the new Insurance Act. They include:

- Prudential Standard FSG 1 – 3 (Framework for Financial Soundness of Insurance Groups)
- Prudential Standard GOG (Governance and Operational Standard for Insurance Groups)

Prudential Standard GOG includes the requirement for the controlling company of an insurance group to establish insurance group-level risk management, compliance, internal audit and actuarial functions.

For actuarial functions for large insurance groups with multiple solo insurers, it may make sense to appoint a head of actuarial function who brings knowledge and expertise specific to groups. On the other hand, many insurers that find themselves the most material entity within a group, and/or the only insurer within the group, are seeking ways to leverage off the existing solo insurer-level control functions.

Balance sheet and capital treatment of cryptocurrency

Are cryptocurrencies a financial asset, an intangible, or something else? This matters even more for demonstrating solvency and tax than it does for financial reporting.

At its March 2019 meeting, the IFRS Interpretations Committee discussed the application of IFRS standards to the holdings of cryptocurrencies. The committee tentatively decided not to add cryptocurrencies to its standard-setting agenda.⁵ The committee concluded that International Accounting Standard (IAS) 2 (Inventories) applies to cryptocurrencies when they are held for sale in the ordinary course of business, otherwise IAS 38 (Intangible Assets) should apply. This tentative decision is open to public comment until 15 May 2019.

Intangibles are regularly treated incorrectly when demonstrating solvency. Most intangibles should be recorded at zero. Only intangibles that can be separated and are traded in a market can be recognised at all. For better-known cryptocurrencies, one could at best recognise only 20% of the value as Own Funds.

Insurers should therefore carefully consider any investment in cryptocurrencies given their regulatory inefficiency, if not their high price volatility.

⁴ See <http://za.milliman.com/insight/Periodicals/za-insurance-update/South-Africa-Insurance-licence-conversion-update/>

⁵ <https://www.ifrs.org/news-and-events/updates/ifrs-updates/march-2019/>

How can Milliman help

If you would like to discuss any of the above or anything else with us, then please contact us.

Milliman can provide a range of services including:

- IFRS 17 implementation and advice
- Operational risk modelling
- Solo and Group Head of Actuarial Function
- Licence conversion and application assistance
- Capital optimisation



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