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LDTI VS IFRS 17 Simpler, But Not Simple

For long-duration insurance contracts, IFRS 17 and LDTI is challenging for several reasons. It can be an even bigger challenge for companies with a global footprint who will need to comply with both standards, at the same time. To help in your journey to accelerate implementation, we have outlined critical areas to consider when assessing your plan for IFRS 17 and LDTI.

AREA OF DIFFERENCE	IFRS 17	LDTI
Scope	Impacts all entities, insurance or noninsurance companies, that issue insurance contracts.	Specific reporting and accounting guidelines are applicable to insurance companies.
Non-financial risk adjustment	Explicit risk adjustment to address the uncertainty of timing and amount of cash flows that arise from non-financial risk.	Provision for risk of adverse deviation applicable to traditional long-duration contracts but not for short-term contracts.
Distribution of risk	Entities must determine whether the cash flows of a group of insurance contracts affect the cash flows of another group of insurance contracts. This effect, which is called 'mutualisation' of contracts, is used to measure fulfilment cash flows.	There is no concept of 'mutualisation' included in LDTI.
Agregation of Contracts	Insurance contracts must be divided into the following groups: • Onerous (loss making) contracts • Non-onerous contracts • Contracts that may become onerous subsequently These groups are further divided into subgroups containing contracts issued within one year of each other.	Insurance contracts must be grouped according to the entity's mode of acquiring, measuring the profitability, and servicing of insurance contracts. There is currently no requirement for year-wise grouping, but it is mandatory to ascertain the existence of premium deficiency, if any.

Methodology	Three potential methods for calculating the risk adjustments: • Cost of capital • Value at Risk 'VaR' • Margins for Adverse Deviation	Two requirements specified for DAC amortization: 1. A constant-level basis that approximates straight-line amortization on an individual contract basis 2. Contracts shall be grouped consistent with the grouping used in estimating the liability for future policy benefits (or any other related balance) for the corresponding contracts
Treatment of loss-making contracts	Recognition at inception: Primary insurance contract: The net loss position is recognized immediately in profit or loss at inception and if it arises subsequently for a group Reinsurance contract held: The net loss is not recognized immediately in profit or loss but is deferred.	Requires accrual of the probable loss amount when there is a premium deficiency relating to insurance contracts.
Acquisition costs	Acquisition costs can be treated as expense in the year in which it was incurred instead of amortizing such costs.	Acquisition costs must be deferred and amortized.
Revenue recognition	Premiums are recognized in proportion to the period of the contract. If the insurance contract is for more than one year, the entity will have to assess whether discounting of cash flow is required.	Same approach is followed for recognizing premiums; however, discounting is not used for short duration insurance contracts.
Calculations	Introduces the concept of a risk adjustment for non-financial risk. Risk adjustment must satisfy certain conditions, the method for its calculation is not prescribed and is the choice of the insurance company. Risk adjustment calculated at contract group level.	Net premium model is used to measure the liability for future policyholder benefits. Net premium ratio is calculated at contract inception by dividing the present value of the total policyholder benefits and expenses. The net premium ratio remains a constant percentage of the grow premium for the duration of the contract.
Presentation and Disclosures	Requires disclosure of qualitative and quantitative information about: • Amounts recognized in financial statements from insurance contracts • significant judgements, and changes in those judgements • detailed reconciliations of opening and closing balances • nature and extent of the risks from contracts in scope	Finance teams will need to provide a complete audit trail to substantiate and explain movements at a granular level and any balance volatility resulting from the changes and unlocking of assumptions.

Data Harmonization	Integration and harmonization of diverse data (such as actuarial and accounting, etc.) must be ensured in order to achieve confidence in the accuracy of the required calculations and disclosures.
Implementation	Strong governance and robust planning (Actuarial, Finance, IT, HR, legal) required to manage the interdependencies with the e2e process impact – data origination through reporting – will cause multifaceted transformation.
Operations	Multiple workflows need to be addressed – transition processes, point-in-time valuations, roll-forwards and disclosures, unlocking processes. Increased workload on finance because of the additional and challenging new disclosure requirements.
Governance	Established model governances and assumption development processes are now required.

MAKING IT SIMPLER

Considering the timeline for implementation, along with the extent of changes needed and resource constraints–insurers planning for short-term solutions to enable only the required LDTI reporting; in the long-term may not be a wise choice.

Some organizations are looking to broaden and modernize minimum compliance efforts to develop an efficient future-state operating model. While achieving full modernization prior to the effective date of January 2022 is likely to be unfeasible for many, those working to kick-start smart investments should:

1. Conduct a gap analysis to evaluate current framework capability
2. Balance the cost and timeline implications to realize maximum value across accounting
3. Identify regulatory overlaps that apply to your organization
4. Apply the lessons learned from current in-flight accounting changes
5. Focus on the data overlap and systems implications to maximize operational efficiencies

ORACLE'S SOLUTION

With its extensive experience in the financial services industry, Oracle delivers a solution to address these challenges and make certain insurers can comply with the complex requirements comprehensively, on time with improved business modelling capabilities. For LDTI and IFRS 17, Oracle provides a framework for data ingestion from source systems, business rules for portfolio setup and disaggretation, rate and risk adjustments, performing calculations, attribution and reporting, and sub-ledger accounting. Oracle helps to implement the new standard with coordination across Actuarial, Risk, Finance, IT and business functions to ensure a well-defined approach that encompasses the entire lifecycle of the project.

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