



Prudential Communication 2 of 2021

Insurance Act 18 of 2017

Flavour-of-the-year topic communication to insurers

Objective of this Prudential Communication

This communication provides information on the Prudential Authority's flavour-of-the-year topic for insurers for the 2021 calendar year, including the approach that will be followed by the Prudential Authority with regard to the topic, that is, the implementation of International Financial Reporting Standard 17.

1. Application

1.1 This Prudential Communication is applicable to all licensed insurers.

2. Purpose

2.1. The purpose of this Prudential Communication is to:

- a. provide information on the flavour-of-the-year topic for insurers for the 2021 calendar year.

3. Introduction

3.1. Annually, the Prudential Authority (PA) considers whether any current developments affecting regulated institutions at an industry level are of such significance that additional focus from a supervisory perspective would be required. The topic(s), selected through the PA's governance processes, are communicated to regulated institutions at the beginning of the year and are referred to as 'flavour-of-the-year' topics.

3.2. The PA has determined that for the 2021 calendar year, the flavour-of-the-year topic will be the implementation by insurers of International Financial Reporting Standard 17: *Insurance Contracts* (IFRS 17 or the standard).

4. International Financial Reporting Standard 17: Insurance Contracts¹

4.1. Background

The International Accounting Standards Board (IASB) issued IFRS 17 on 18 May 2017. The standard was subsequently amended in June 2020. IFRS 17 replaces the existing standard, namely IFRS 4: *Insurance Contracts* (IFRS 4). IFRS 4 was introduced in 2004 as an interim standard and allowed for insurers to use different accounting policies to measure similar insurance

¹ <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-17-insurance-contracts/>

contracts. By contrast, IFRS 17 provides consistent principles for accounting of insurance contracts and aims to remove the existing inconsistencies which will enable users of financial statements to meaningfully compare insurers' financial position and performance. The standard will impact all insurers, although the extent of such impact may differ depending on existing models, accounting policies and data availability.

IFRS 17 undoubtedly represents the most significant change to insurance accounting requirements in over 20 years. It requires an entity to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows. IFRS 17 will affect the profit emergence of a company as profit is not realised at the inception of the contract but released over time as the service is provided. It is applicable to insurance contracts (including reinsurance contracts) issued, reinsurance contracts held and investment contracts with discretionary participation features. IFRS 17 allows for a degree of optionality in the application of principles and could therefore still result in varying outcomes for the insurer, depending on the policy choice adopted. It is important that such choices and resulting outcomes are well understood by the PA.

It should be noted that although the regulatory solvency requirement does not base the calculation of required capital on the accounting values as determined by the International Financial Reporting Standards, the adoption of IFRS 17 is a major change for insurers and entails significant operational and system changes. For listed insurers, it will also impact the results released to the market. It is therefore necessary for the PA to closely monitor the implementation of IFRS 17 to ensure that any potential challenges and risks to the insurance industry are identified and adequately addressed in order to safeguard and maintain the safety and soundness of affected institutions.

The flavour-of-the-year topic for 2021 is part of a range of IFRS 17 engagements that the PA has embarked on with the insurance industry leading up to the effective date of the standard, that is, for financial periods beginning on or after 1 January 2023.

4.2. Engagement approach

4.2.1 Insurers supervised by the Financial Conglomerate Supervision Department of the PA

The chairperson of the relevant audit committee or the capital and risk management committee (or equivalent) of the institution (insurer and/or insurance group)² will be required to make a presentation to the PA during the PA's planned supervisory meetings with the board of directors (board). The presentation should focus on the steps that have been or will be taken by the institution to ensure readiness and compliance with the IFRS 17 requirements by the effective date of the standard. At a minimum, the presentation should cover the focus areas listed in paragraph 4.3 and should be no longer than 30 minutes. The PA may consider to communicate the outcome of these engagements to the industry at an aggregated industry level.

² One presentation may be provided to cover all affected entities within the group.

4.2.2 Insurers supervised by the Banking, Insurance and FMI Supervision Department of the PA

A survey will be issued to insurers during the first quarter of 2021. The PA will analyse the responses to the surveys which will inform additional supervisory interventions, where necessary. The outcome of the responses may also be communicated to the industry at an aggregated industry level.

4.3. Areas of focus for meetings with the board or to be included as part of the survey

4.3.1. Project management and governance

- a. Board strategy (including the strategy at a group level) with regard to the new standard.
- b. Board involvement, including training of board members.
- c. Project management, including project governance processes, milestones and timelines.
- d. Key risks/challenges identified relating to the adoption of IFRS 17 and how these are being addressed.
- e. The involvement of consultants, including internal and external audit.
- f. IFRS 17 implementation by operations outside of South Africa (if applicable).

4.3.2. IFRS 17 technical requirements

- a. Key differences between the institution's existing application of IFRS 4 and the expected application of IFRS 17.
- b. Changes required to systems and processes to incorporate the IFRS 17 requirements, including the associated cost impact thereof.
- c. Preliminary quantitative impact assessment for financial reporting purposes and with regard to the regulatory solvency requirement on 'Day 1' adoption of IFRS 17.
- d. Disclosure considerations.

4.3.3. Other aspects

- a. Any potential strategy considerations, such as the impact on product offerings arising from the implementation of IFRS 17.
- b. Degree of integration among various divisions such as Finance, Risk, Actuarial and Information Technology.
- c. Resource availability (e.g. staff with the adequate skills) and training of staff.
- d. Investor and/or other stakeholder awareness, where applicable.

5. The impact of new technologies on regulated financial institutions

In reference to the topic of 'new technologies' that was suspended as a flavour-of-the-year topic in 2020, kindly note that this topic will no longer be a flavour-of-the-year topic for insurers in 2021; however, the PA will, in the first quarter of 2021, issue a survey to all insurers on the topic to gather information on insurers' approach to 'new technologies'. Once the survey is complete, the PA will communicate should there be a need for further input from insurers on this topic.

6. Acknowledgement of receipt

A written acknowledgement of receipt of this communication, signed by both the Chief Executive Officer of the insurer and the insurer's external auditors, should be submitted at the earliest convenience to the PA Frontline team responsible for the supervision of the insurer. Should you have any queries in this regard, please contact the relevant PA Frontline team.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Kuben Naidoo', written in a cursive style.

Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

Date: 12 March 2021