20 January 2025

Insurance and Pensions Supervision

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Dear Chief Executive Officer,
Dear Chief Financial Officer,
Dear Compliance Officer,

IFRS 17 | Good practices, Lessons Learnt & Next Steps

You are receiving this letter as the Chief Executive Officer, Chief Financial Officer and/or Compliance Officer of an authorised (Re)Insurance Undertaking supervised by the Malta Financial Services Authority (herein referred to as "MFSA" or "the Authority").

Background

In January 2023, IFRS 17 – Insurance Contracts became the new International Financial Reporting Standard ("IFRS") for insurance contracts, replacing the previous interim standard IFRS 4. With its introduction in 2004, IFRS 4 was intended to limit changes to existing insurance accounting practices. Conversely, IFRS 17 ("new accounting standard") is a comprehensive standard that aims to provide a consistent and transparent approach to insurance contract accounting as well as reduce methodological differences.

As the implementation date for IFRS 17 drew closer, the MFSA undertook an exercise to assess the level of readiness among (Re)Insurance Undertakings. In this regard, in January 2020, the Insurance and Pensions Supervision Function within the MFSA ("IPS") conducted a thematic review titled *'(Re)Insurers' preparedness in relation to IFRS 17 – Insurance Contracts'*. This review aimed to collect relevant and focused information to gauge the progress made in (Re)Insurers' implementation of IFRS 17 as at that date. This thematic review also included a financial impact assessment to evaluate the effect on the underlying financial results. The responses received from (Re)Insurers assisted the Authority in understanding the prevailing levels of readiness in implementing IFRS 17 whilst also obtaining a preliminary understanding of the financial impact on (Re)Insurers.

Subsequently, in October 2022, IPS issued a market update survey titled *'Is Your Business Ready for IFRS 17 - Insurance Contracts?'* as a means of obtaining an update from (Re)Insurance Undertakings with respect to their readiness towards the implementation of IFRS 17 and any challenges thereto.

During 2023, IFRS 17 Implementation remained a key agenda item in all Supervisory Meetings and Compliance Inspections of insurance and re (Re)Insurance Undertakings. Furthermore, in April 2024, the MFSA was in receipt of the Audited Financial Statements ("AFSs") encompassing first-year audits reported under IFRS 17. In fact, 64% of the (Re)Insurance Undertakings authorised by the MFSA reported their AFS under IFRS 17 for the first time. The remainder reported under Legal Notice 299 of 2023 - Accountancy Profession (General Accounting Principles in Respect of Certain Eligible Entities Related to the Business of Insurance) Regulations.

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Scope and Methodology

Following the receipt of the AFSs in 2024, the MFSA continued its engagement particularly through Supervisory Meetings and Compliance Inspections. The aim of such Supervisory Interactions was to achieve further insight into the implementation of IFRS 17 and its related financial reporting; the experience of the first-year audits under IFRS 17; and the impact of the implementation on other business operational areas. Through such interactions, the MFSA is now in a better position to highlight good practices, lessons learnt, and areas for improvement.

Good Practices, Lessons Learnt and Next Steps

Good Practices

Through our market engagement, the Authority has identified several best practices that, in our view, have played a key role in the successful transition to IFRS 17. These practices include, but are not limited to, the following:

I. *Early Start to the Implementation of IFRS 17 – Insurance Contracts*

IFRS 17 was issued on 18 May 2017 and is applicable for annual periods beginning on or after 1 January 2023. Notwithstanding the long period of time from the issuance to the effective date, the Authority positively notes that a number of (Re)Insurance Undertakings acknowledged the magnitude of the new accounting standard and were proactive in initiating work towards the implementation of IFRS 17.

II. *Establishment of Working Groups and Steering Committees*

The successful implementation of IFRS 17 demanded close collaboration between finance, actuarial, and IT teams to ensure the seamless integration of new processes and systems. (Re)Insurance Undertakings have implemented a measure involving the establishment of Working Groups and Steering Committees focused on the implementation of IFRS 17. In this regard, IFRS 17 Working Groups were set up to ensure that different functions were collaborating, while Steering Committees were established to monitor the progress of the adoption of IFRS 17.

III. *Engagement of Third-Party Consultants*

The implementation of IFRS 17 has transformed insurance accounting practices. Consequently, the appointment of third-party consultants to offer financial, actuarial, and IT expertise to (Re)Insurance Undertakings implementing IFRS 17 was a common practice in the insurance market. These services enhanced the technical knowledge within the (Re)Insurance Undertakings and improved consistency across the insurance market.

IV. *Training*

(Re)Insurance Undertakings invested in training on IFRS 17 to both employees within the Finance and Actuarial Functions, as well as to their Board of Directors and Audit Committee Members. Nonetheless, on-the-job training played an integral part in the implementation of IFRS 17. The knowledge exchanged through collaboration across various functions, the formation of Working Groups and Steering Committees, and the involvement of consultants played a crucial role in the effective implementation of IFRS 17.

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V. Performance of Parallel Runs

To ensure a smooth transition from IFRS 4 to IFRS 17, most (Re)Insurance Undertakings performed parallel runs. This comprised of the preparation and presentation of two sets of Management Accounts, one in accordance with IFRS 4 and one in accordance with IFRS 17. To bridge the gap between the two sets of Management Accounts, (Re)Insurance Undertakings also prepared waterfall charts which visualised the walkthrough from one accounting standard to the other.

From Supervisory Interactions, it became apparent that having a set of Management Accounts prepared in accordance with IFRS 4 was crucial for effective decision-making purposes. However, simultaneously having a set of Management Accounts prepared in accordance with IFRS 17 for comparison purposes was deemed advantageous. This practice served as a good opportunity for Executive Management to grow accustomed to and understand the financial results presented under IFRS 17.

VI. Regular Communication with Board of Directors and Audit Committee Members

A common practice observed during our Supervisory Interactions was the regular engagement, often weekly, between the various teams working on the IFRS 17 implementation and the Board of Directors and Audit Committee Members, in addition to the standard Board and Audit Committee meetings. This served as a platform for the different functions to provide Executive Management with timely updates in respect of the implementation of IFRS 17.

Such regular communication also served as an opportunity for the Board of Directors and Audit Committee Members to familiarise themselves with the new format of the Management Accounts under IFRS 17, particularly the Profit & Loss Account. This also allowed them to monitor the progress made; be informed of any identified challenges; and ensure that adequate resources were available for a successful IFRS 17 implementation process. This frequent communication assisted the Board of Directors and the Audit Committee Members in providing effective oversight and decision-making support.

Lessons Learnt

In the course of our interactions with the market, the Authority has identified several valuable lessons that, in our view, could play a crucial role in ensuring a successful transition to IFRS 17. These lessons include, but are not limited to, the following:

I. Integration of Data from the Different Business Units

Throughout the Supervisory Interactions, data emerged as a recurring theme. In this regard, it was observed that data from different business units, particularly from the Actuarial and Accounting Functions, was often being treated in silos. Consequentially, separating such data may have impinged on data consistency and completeness, as well as acted as a deterrent to collaboration between the Actuarial and Accounting Functions. Furthermore, it may have led to increased manual input which may have ultimately impacted data accuracy and work efficiency.

Also linked to data was the system implementation process. In this respect, it was noted that the implementation process revealed areas for ongoing enhancement in data management practices. For example, in instances where data was being provided from one team to the other, the team on the receiving end strived to understand the data being provided to ensure that it was sensible and reasonable. Additionally, in such cases, data integration within the system may have needed to be tweaked for a smoother process. Furthermore, a centralised system would have been beneficial for both parties to ensure that data was available and accessible when required. (Re)Insurance Undertakings should ultimately ensure that there is an element of ownership in the data captured within their systems.

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II. Data Quality

The transition to the new IFRS 17 standard has revealed the necessity for (Re)Insurance Undertakings to collect and manage granular data. In this respect, it was observed that most (Re)Insurance Undertakings did not hold data in its required form to enable the preparation of IFRS 17 figures. Furthermore, it was noted that numerous data sources were being used in an attempt to produce the necessary figures. Such an approach may have given rise to issues in data quality, where data from different sources would result in variations between such sources. This could have ultimately led to the production of incorrect financial information, for example if the data being inputted in the data engines was not accurate. (Re)Insurance Undertakings should consider introducing reconciliations for data inputs as well as reasonableness and validation checks for data outputs. These measures would ensure the limitation of discrepancies and act as a means of ensuring the integrity of the data within the system.

III. Documentation

An insight emerging from this exercise was the extensive time and effort required to prepare and, where necessary, update the documentation in relation to IFRS 17. In this regard, certain technical and methodology papers were still in draft format, and the finance procedures manual was still not updated to reflect new processes and procedures brought about by IFRS 17. (Re)Insurance Undertakings acknowledged this gap and are working towards ensuring that their documentation is formalised so that it may act as a reference to the preparers of financial information in subsequent reporting periods.

IV. Earlier Engagement with External Auditors

A frequently discussed matter was the involvement of the external auditors throughout the changeover as well as subsequently. Several (Re)Insurance Undertakings engaged with their external auditors earlier and more frequently than in prior years due to the extensive additional audit procedures emanating from the first-time adoption of IFRS 17. In addition to the standard interim and annual external audits, the first-year audit of the Financial Statements in accordance with IFRS 17 entailed further work to be performed, including a one-off audit of the opening balances and a review of the IFRS 17 technical papers.

By including the external auditors at an early stage, where possible, discussions pertaining to significant matters may have been undertaken earlier, enabling the audit process to run smoother as complexities would have been considered towards the start of the audit cycle.

V. The Impact of IFRS 17 on Underwriting Strategies

Finally, a common factor emerging from the exercise was the influence that this new accounting standard is having on business underwriting decision-making. It appears that the selection of the measurement approach and assessment of onerous contracts could potentially dampen (Re)Insurers' appetite for entering into new business which falls outside of their chosen measurement approach(es). Therefore, it may be opportune for (Re)Insurance Undertakings to review their current systems and procedures to cater for any potential additional measurement approaches.

Next Steps

Based on our interactions with the market, the Authority has identified several actions that should be taken into account during the continued adoption of IFRS 17. These actions include, but are not limited to, the following:

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I. Data Enhancement and Refinement

Based on experiences gained during the first year of implementation, (Re)Insurance Undertakings recognise the critical importance of data and its granularity in the end-to-end process of producing financial reports. (Re)Insurers also understand that the output data must be clear, comprehensible, and easy to interpret. Therefore, in the second year of implementation, (Re)Insurance Undertakings should prioritise and focus on gaining a thorough understanding of all data outputs. Gaining this comprehensive understanding is crucial for improving and refining the quality of their data.

II. Documentation of New Processes and Procedures

In the initial year, (Re)Insurance Undertakings focused on adopting the necessary changes in the accounting processes resulting from the new accounting standard. In the subsequent year, (Re)Insurers should focus on the formalisation and documentation of such processes and procedures. These are critical for ensuring business continuity and compliance, consistency, and accuracy in the financial reporting process. Furthermore, having all procedures documented enables better risk management, ensures audit readiness, supports decision-making and helps streamline operations.

III. System Automation and Internal Controls

Automating the IFRS 17 accounting process with minimal manual input involves leveraging technology to streamline data collection, processing, and reporting. Automating the data requirements emanating from IFRS 17 can save time, reduce errors, and ensure compliance. Therefore, the inputting of data in a centralised data warehouse where all relevant data can be stored and accessed in real-time would be beneficial to (Re)Insurers as it would reduce the need for manual data entry. Furthermore, (Re)Insurance Undertakings should now reflect on the quality and effectiveness of controls to critically inform how to improve the accuracy, efficiency and implementation of internal controls and reconciliations.

IV. Key Performance Indicators under IFRS 17

From various Supervisory Interactions held, it was noted that in view of the new accounting standard, (Re)Insurance Undertakings have adopted different approaches to the preparation and presentation of their Key Performance Indicators ("KPIs"). The Authority noted that some (Re)Insurers are still utilising KPIs emanating from IFRS 4 figures and favourably noted that other (Re)Insurers have extended their KPIs to incorporate metrics using the new accounting standard. Whilst the Authority acknowledges that some traditional KPIs, such as Gross Premiums Written, may remain relevant for measurement and decision-making purposes, (Re)Insurers are encouraged to consider additional KPIs emanating from the financial statement line items under IFRS 17.

V. Internal Audits

The Authority acknowledges that the new accounting standard has brought about drastic changes in accounting procedures and internal controls. It is expected that (Re)Insurers' internal audit plans include the assessment of the key aspects of this new accounting standard to ensure full compliance and effective implementation.

VI. Auditor's Letter to Management pertaining to IFRS Audit

The first IFRS 17 audits uncovered control weaknesses and areas requiring improvement. Therefore, it is the Directors' and Audit Committee's responsibility to ensure that such audit observations have already been addressed, or at least shall be addressed in the short-term. The (Re)Insurance Undertakings should strive to have less observations pertaining to IFRS 17 implementation in the forthcoming audit management letters.

VII. Control over IFRS 17 Software System Solutions

With the introduction of IFRS 17, the majority of (Re)Insurance Undertakings have resorted to third-party service providers for services, including actuarial and accounting software system solutions. Although this may be beneficial for (Re)Insurers to widen their resources and professional expertise, it could also lead to the risk of becoming overly reliant on a third-party service provider.

(Re)Insurers should seek to prioritise less dependency on third-party service providers by taking ownership of data outputs. Furthermore, (Re)Insurers should produce a plan for ongoing maintenance of the new systems.

Way Forward

The Authority acknowledges that (Re)Insurers are currently assessing the effectiveness of the first year of implementation of IFRS 17. Looking ahead, continuous compliance monitoring is crucial. Since IFRS 17 implementation is still relatively new, (Re)Insurers must remain alert to any future updates or changes to the standard and ensure that they remain adhering to the requirements of the accounting standard. Additionally, any feedback from external auditors and consultants during the audit process that may necessitate adjustments to the company's systems or processes must be acted upon.

Whilst the first year of IFRS 17 implementation involved substantial adjustments to accounting systems, processes, and disclosures, the second-year audit should focus primarily on verifying that these processes are functioning effectively, and that the (Re)Insurance Undertakings continue to meet the new standard's requirements consistently.

In conclusion, the Authority expects (Re)Insurance Undertakings to review and take note of the content of this letter and identify any areas for further improvement. Should you require any clarification on the above, please do not hesitate to contact the Authority's IPS Function on ipsu@mfsa.mt.

Yours Sincerely,

Malta Financial Services Authority

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