

31 August 2020

Dear CEO

IFRS17 - Results of Phase 2 “Financial Impact Assessment”

In December 2018, SAMA rolled out its IFRS17 road map comprising four phases. The Phase 1, titled “Gap Analysis” was completed in 2019. The Phase 2, titled ‘Financial Impact Assessment’, of SAMA IFRS17 roadmap has now been completed successfully. SAMA issued instructions for this phase on 10 November 2019 titled ‘IFRS17 Phase 2 Financial Impact Assessment’, with submissions originally due on 31 March 2020. Due to COVID19-related circumstances, this was extended till 30 April 2020.

For this Phase, each company was required to submit the following documents:

- Financial Impact Assessment (“FIA”) Report, along with a duly-filled SAMA FIA template
- Operational Impact Assessment (“OIA”) Report
- Certificates of Review by the Chief Financial Officer and the Appointed Actuary

We carried out a detailed review of each company’s submission. For this purpose, we used over two-hundred criteria for assessing the above submissions. In addition, we carried out an independent testing of the FIA results for a sample of insurance companies.

The purpose of this letter is to share the overall results of the above exercise, along with our assessment of those results, with the Company’s management. The Appendix 2 to this letter compares your Company’s results, along with our assessment of your results, with the overall sector. The letter also sets SAMA’s future expectations of the Company’s management in various areas related to the implementation of IFRS17.

It is therefore important that this letter be discussed with the Board of Directors, members of senior management, appointed actuary and the Company’s IFRS17 implementation team. Where the Company utilizes services of an external consultant for IFRS17 implementation, it is expected that the letter will also be discussed in detail with the consultant.

This letter consists of the following sections:

- Part ‘A’ – Financial Impact Assessment (pages 2 – 18)
 - A1. Summary of FIA results¹ submitted by insurance companies (pages 2 – 12)
 - A2. SAMA’s assessment of FIA reports (pages 13 – 18)
- Part ‘B’ – Operational Impact Assessment (pages 19 – 24)
 - B1. Summary of OIA reports submitted by insurance companies (pages 19 – 21)
 - B2. SAMA’s assessment of OIA reports (pages 21 – 24)
- Part ‘C’ - Outcome of reviews performed by CFO and Appointed Actuary (pages 25 – 26)
- Appendix 1 (Abbreviations & Criteria used), Appendix 2 (Company-specific results)

¹Caveat: The results shown in Part A1 were produced by insurance companies after applying a number of simplifications and significant judgements. In addition, the data used, methodology applied and estimates generated in this exercise have not been audited. Our own review has identified a number of shortcomings in several areas. It is therefore expected that the true results under IFRS17 will be different, possibly materially, from those produced above. This could be due to a variety of reasons, including refinement of significant judgements in view of the evolving best practice, adoption of full approaches replacing simplifications, validation performed by the external auditors. Moreover, it is possible for the individual company results to be materially different from the aggregate market results – refer Appendix 2. Additionally, we have removed data for a few companies from the graphs in Part A1, due to either non-comparability with other companies, the company not following SAMA’s instructions or the results being deemed not reliable.



Part A – Financial Impact Assessment

A1. Results of Financial Impact Assessment (FIA)

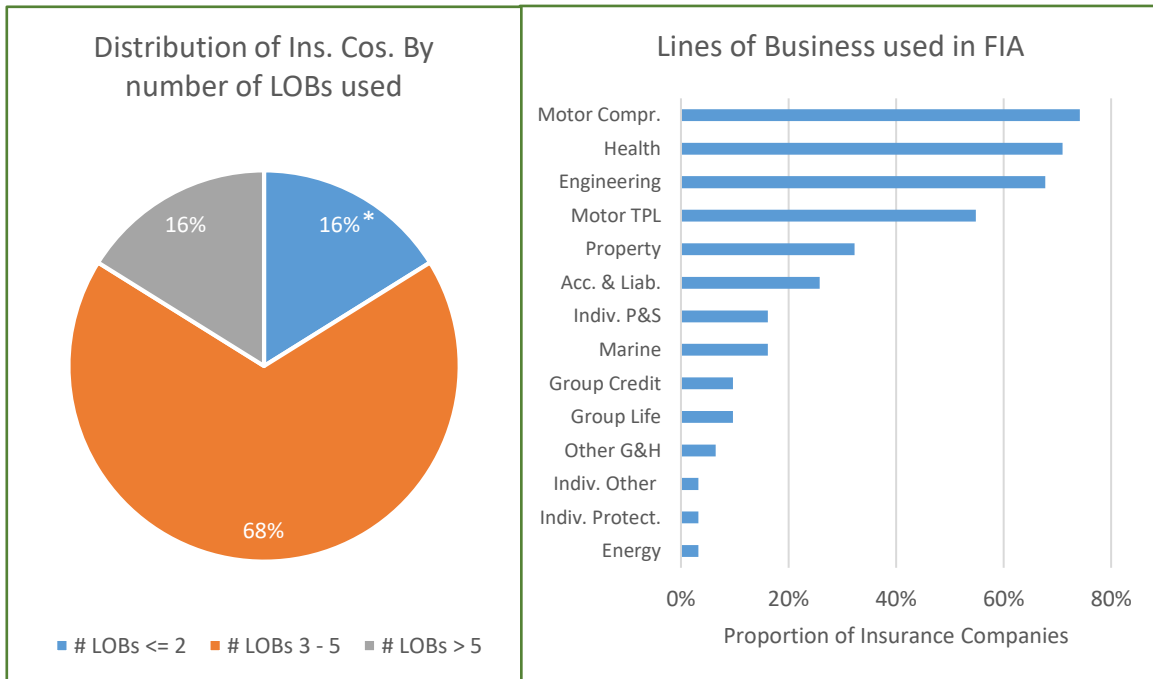
a) Lines of Business and Measurement Methods considered

According to the instruction issued by SAMA for this Phase, each company was required to select those lines of business (LOBs), which in aggregate reflect at least 75% of the business by premium volume for underwriting year 2018.

The IFRS17 stipulates use of ‘General Measurement Model’ as the default method. A simplified method, namely ‘Premium Allocated Approach’ can be used subject to meeting certain conditions. Separately, where the business underwritten has direct participating features (e.g., unit-linked protection & savings policies), the Standard requires application of ‘Variable Fee Approach’ for that segment of business.

Each of the above methods can have a significant bearing on the Company, either financially or operationally, or both. For the purpose of FIA, SAMA therefore required that the Company select those lines, which would enable it to test all measurement methods relevant for the Company.

Many companies selected LOBs for FIA such that they met only the minimum requirements stated above. Others went beyond the minimum and sought to assess the impact of IFRS17 on almost the entire book. The first graph below shows the distribution of the market by the number of LOBs used by insurance companies in their FIA. The second graph shows the most-commonly used LOBs.



*includes two mono-line insurance companies

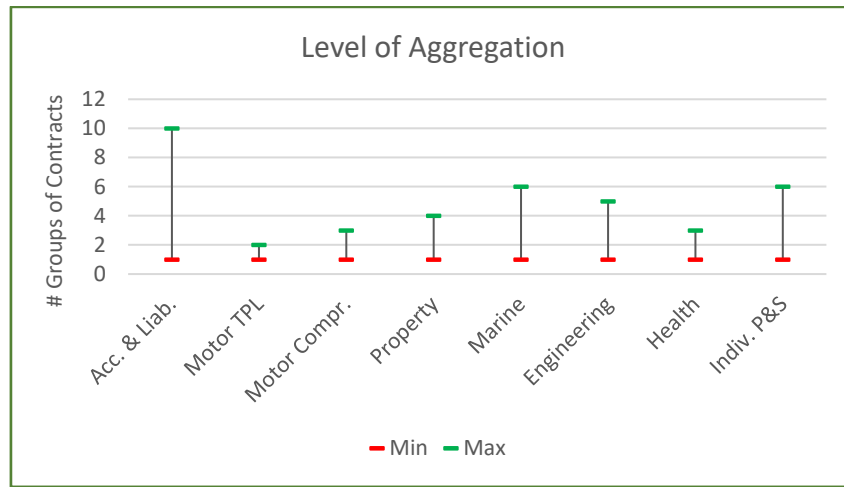


A majority of insurance companies considered between three and five LOBs for their FIA exercise. Motor Comprehensive was the most commonly used LOB, followed by Health, with Premium Allocation Approach being used in general for both LOBs. This was followed by Engineering, where General Measurement Model was used in general.

SAMA expects that management will consider the learnings from the FIA exercise when deciding on the appropriate method to use for each LOB.

b) *Level of Aggregation*

The IFRS17 principles require each insurance company to define the level of aggregation appropriate for its business using several criteria. In this regard, the graph below shows the range of the number of 'groups of contracts' used by insurance companies for each line of business.

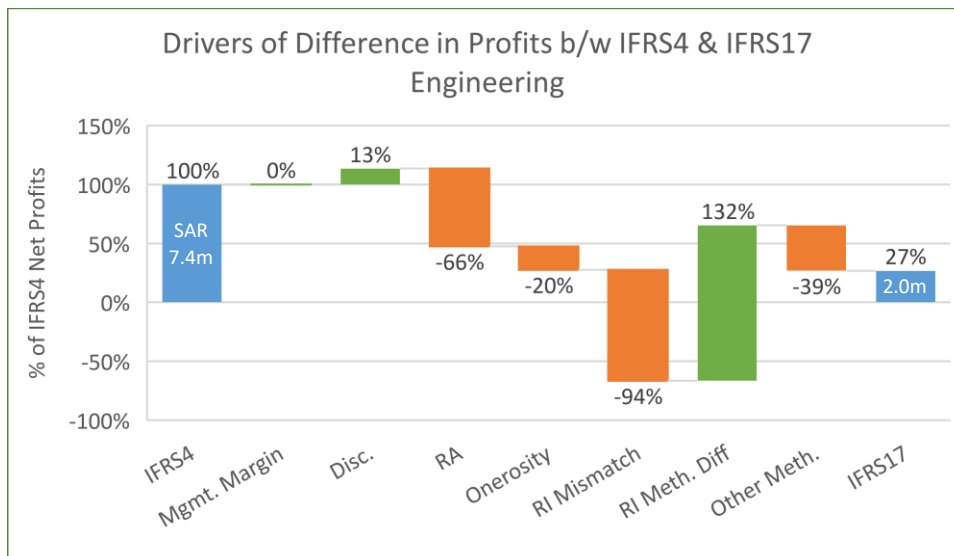
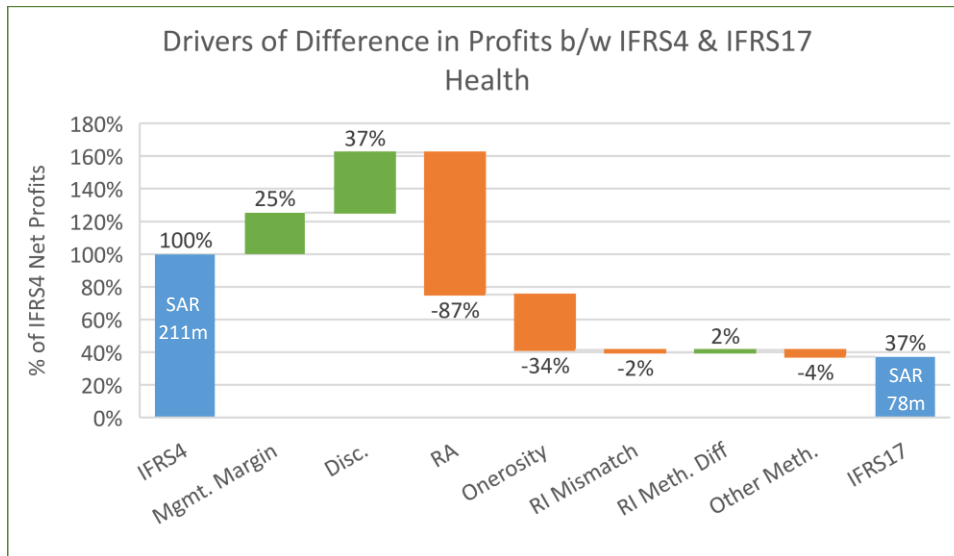
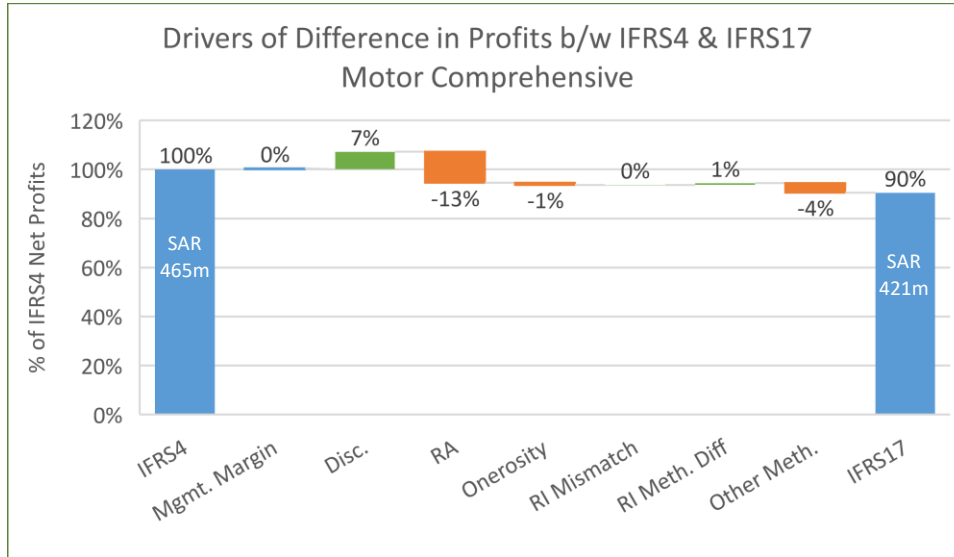


As indicated by the minimum number seen above, a number of insurance companies defined 'group of contracts' at the LOB-level only, more so as a simplification for the FIA exercise. On the other hand, many insurance companies made the extra effort to identify sub-segments within each LOB, either based on the profitability of sub-segments or on the basis of differences in the nature of risks covered under each sub-segment following the IFRS17 principle of 'similar risks and managed together'.

c) *Drivers of Difference in Profits between IFRS4 and IFRS17*

Non-Life & Health

The graphs below show the difference in IFRS4 and IFRS17 net profit in the first year for a sample of LOBs based on the results of the FIA exercise. The drivers of those differences are identified in each graph.



Note: The above graphs are based on the aggregate results of all insurance companies using these LOBs in their FIA.



It can be seen above that many drivers are in play, causing the first year profits under IFRS17 to be lower than IFRS4 profits and deferring those profits to later years. In addition, the individual as well as aggregate impact of drivers varies materially from one line of business to the other.

The Motor Comprehensive LOB appears to have a limited impact on the first year profits, mainly due to its relatively more profitable nature than other lines. On the other hand, Health and Engineering LOBs have large reductions in profits, driven by a combination of factors.

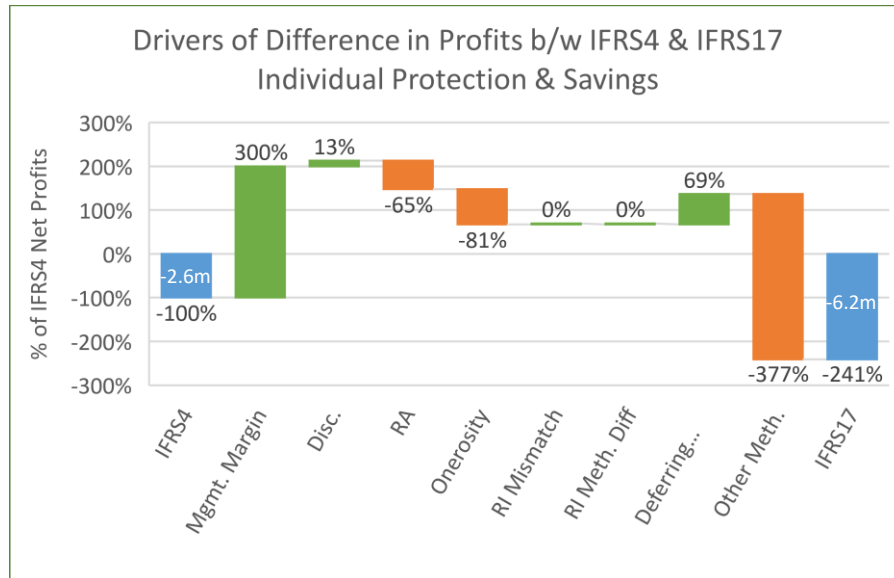
For Health LOB, the impact of each driver is amplified due to its lower profit base compared to Motor Comprehensive. The 'risk adjustment' has the biggest impact as it is based on large claim reserves corresponding to the biggest LOB. Recognition of 'onerous contracts' earlier than under IFRS4 has the second largest impact on IFRS17 profits, which also highlights the profitability challenges under this LOB. The positive impact of 'discounting' offsets the reduction in profits, but only partly due to the short tail nature of health claims liabilities. Removal of management margin from claims liabilities also has a material positive impact, as this discretionary item gets replaced by the compulsory 'risk adjustment' factor, bringing greater consistency in the strength of claim reserves across the sector.

For Engineering LOB, due to a high proportion of business ceded to reinsurers, methodology differences between the gross and the reinsured part have the biggest impact caused by the application of different measurement models for each. The negative impact of reinsurance mismatch was mainly due to one company not following the latest guidance from the International Accounting Standards Board² and SAMA on the treatment of reinsurer's profits in cases where the underlying contracts were deemed onerous. Despite its long term nature and hence greater volatility, impacts of 'discounting' and 'risk adjustment' on the net profits for Engineering are lower than for Health, due to the high cession rate under Engineering leading to a low net of reinsurance impact.

Individual Protection and Savings

The data for Individual Protection and Savings LOB was sparse, and wide range of results were observed among the few companies writing this LOB. Therefore, many components in the waterfall graph below are heavily influenced by individual companies. Also, given that overall this LOB was loss-making in the first year, the graph below compares the overall loss (instead of profit) under IFRS4 and IFRS17, along with the drivers of change between the two.

² Starting in 2018, the Saudi Organization of Certified Public Accountants ("SOCPA") adopted IFRS, issued by International Accounting Standards Board, for implementation by all insurance companies operating in Saudi Arabia as endorsed by SOCPA.



Note: The above graph is based on the aggregate results of all insurance companies using this LOB in their FIA.

The release of management margin currently embedded in IFRS4 reserves had the biggest favorable impact. This was followed by the favorable impact of ‘deferral of acquisition expenses’, though only one company allowed for it. While its lack of consideration by other life insurance companies is understandable given that the IFRS17 guidance on this topic was not finalized until June 2020, the final guidance can have a material impact on the first year profits of life insurance companies.

On the other hand, the biggest reduction in profits was caused by ‘Other Methodology Difference’, mainly due to recognizing profits under IFRS17 slower than under IFRS4. The recognition of onerous contracts and addition of risk adjustment (in place of discretionary management margin) also appear to have material impacts on the results.

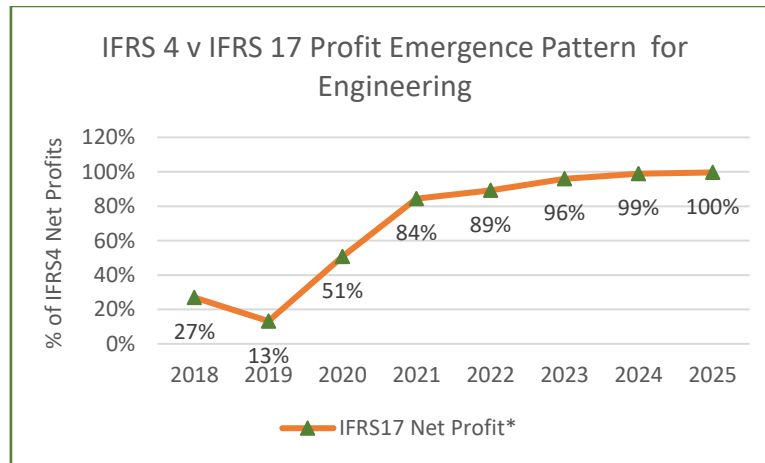
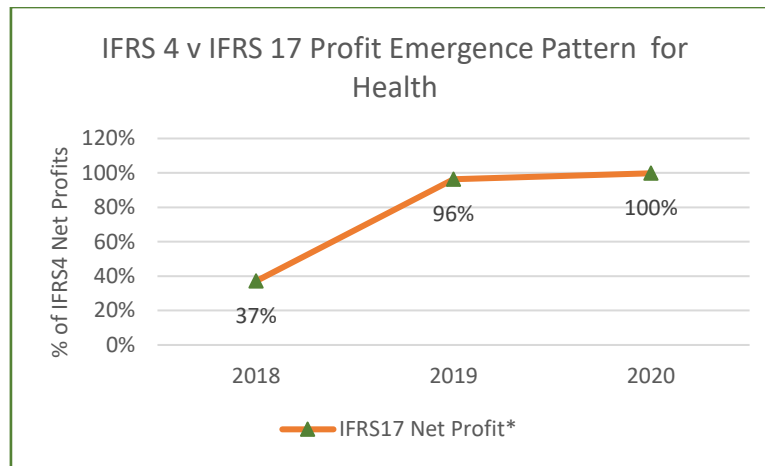
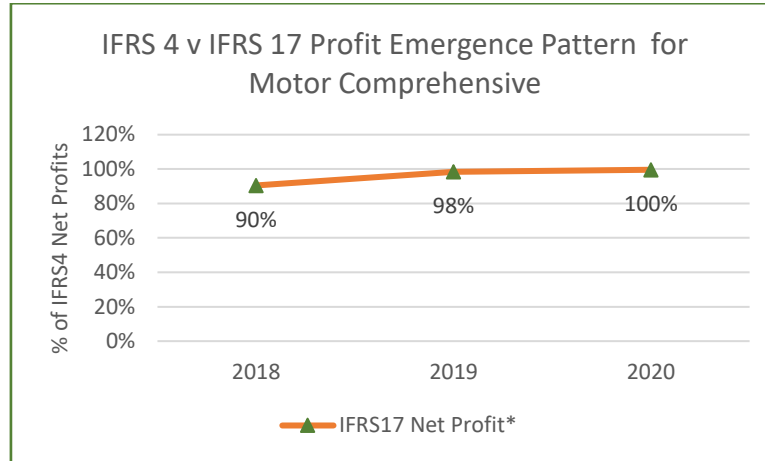
It was also interesting to note that the overall net impact of discounting was positive for some companies but negative for other companies since, unlike for non-life & health, premium cash flows are materially affected by discounting for Individual Protection and Savings business.

d) Profit Emergence Pattern – IFRS4 v IFRS17

Non-Life & Health

While the total profits over the lifetime of insurance contracts are expected to be the same under IFRS4 and IFRS17, it was observed that profits under IFRS17 emerge slower than under IFRS4 due to the factors appearing in the waterfall graphs seen in the previous section.

The graphs below show the difference in profit emergence pattern between IFRS4 and IFRS17 for a sample of LOBs.



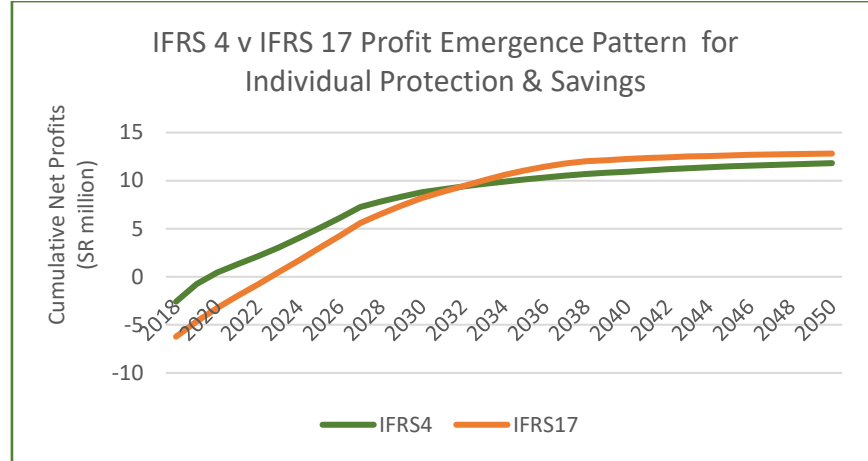
* Sum of Cumulative Net Profits of all insurance companies using the above LOBs in their FIA

It can be seen above that, despite having significantly different impacts in the first year, the cumulative profits for both Motor and Health LOBs catch up soon with the IFRS4 profits, which is consistent with their short-term nature. The delay is most prominent for Engineering where profits do not reach the IFRS4-level until after several years.



Protection and Savings - Individual

The graph below shows the difference in profit emergence pattern between IFRS4 and IFRS17 for Individual Protection & Savings business.



Note: The above graph is based on the aggregate results of all insurance companies using this LOB in their FIA.

It can be observed that, similar to that seen for non-life & health business, the profits under IFRS17 emerge slower than under IFRS4. The trend however appears to have reversed in later years. Moreover, cumulative profits under IFRS4 and IFRS17 do not appear to converge. For explanations of the above anomalies, we approached the relevant insurance companies. In one instance, we learnt that two different assumptions were used for investment returns under IFRS4 and IFRS17. In other instances, explanations provided lacked clarity. We believe these anomalies need a closer look by management going forward.

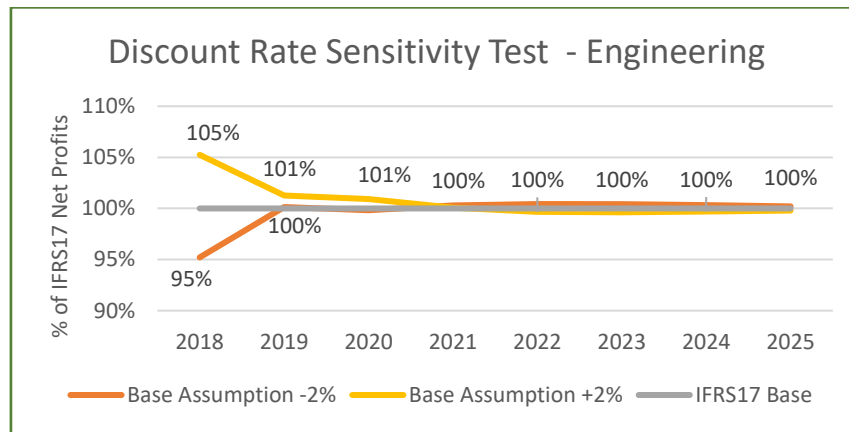
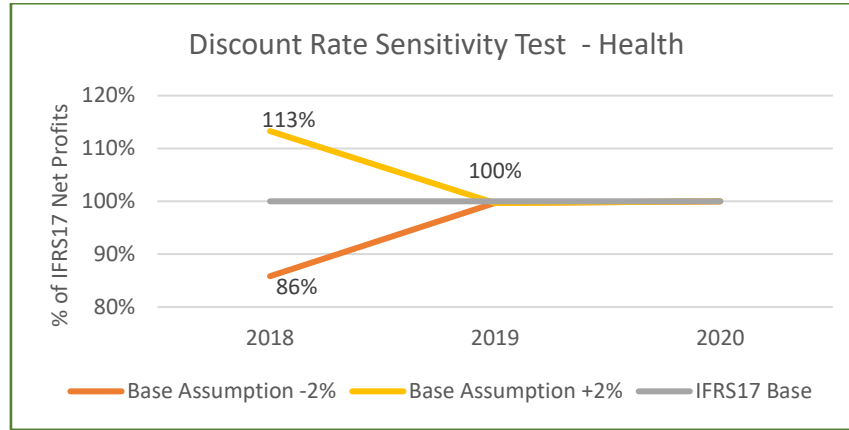
e) *Results of Sensitivity Testing*

The results under IFRS17 are dependent on a number of new assumptions not required under IFRS4. It is important that management understands the sensitivity of results to those assumptions. Therefore, as part of the FIA exercise, SAMA required that, in addition to the Base scenario, results should also be derived using alternative sets of assumptions.

Three types of sensitivity tests were required to be performed, covering i) discount rate, ii) risk adjustment, and iii) proportion of onerous contracts within a LOB.

i) Discount Rate Sensitivity Test

This sensitivity test required producing results using two alternative discount rates, i.e, 'Base Discount Rate + 2%' and 'Base Discount Rate – 2%', subject to a minimum of 0%. The graphs below show the change in cumulative profit using the above assumptions compared to the profit under the Base assumption for Health and Engineering LOBs as examples.

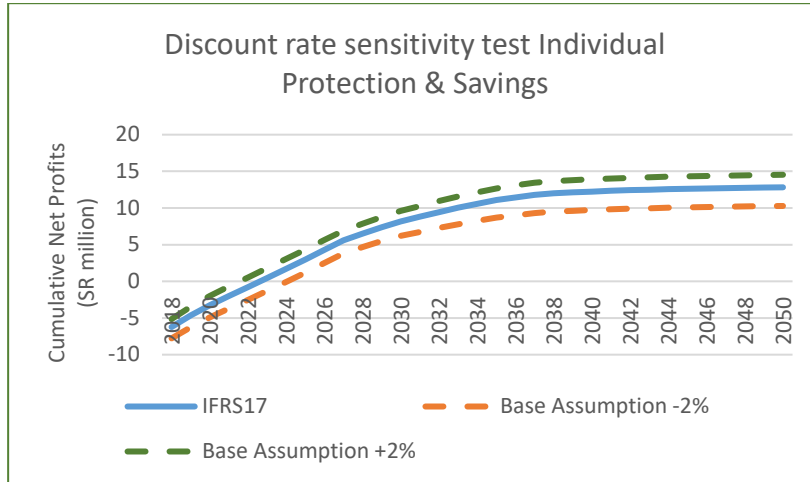


Note: The above graphs are based on the (unweighted) average impact across all insurance companies.

It can be seen above that, during early years, profits under both LOBs are materially sensitive to the choice of the discount rate assumption. Moreover, despite its long-term nature, the sensitivity of profits to the discount rate seems lower under Engineering than under Health, which appears counter-intuitive. Upon a closer look, it was noticed that this anomaly was created due to the profitable and loss-making Engineering businesses moving in opposite directions in the above graph, and hence offsetting each other to reduce the overall impact of the change in discount rate.

Individual Protection & Savings

The graph below shows the results of sensitivity testing for Individual Protection and Savings class.



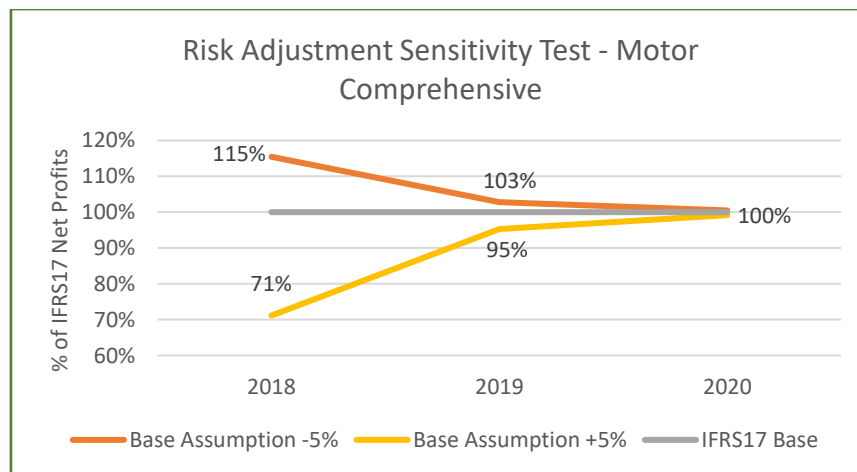
Note: The above graph is based on the aggregate results of all insurance companies using this LOB in their FIA.

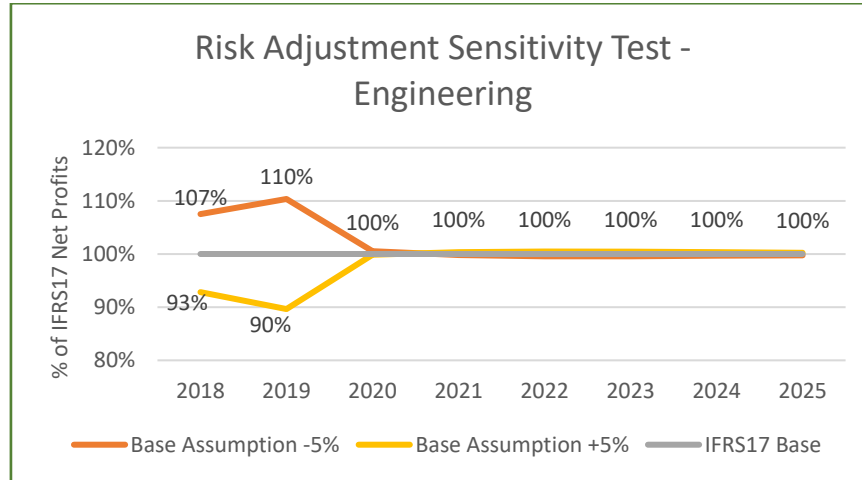
It can be seen that the net profits are materially sensitive to the choice of discount rate.

SAMA expects that management will ensure provision of reliable and timely information to the Appointed Actuary in order to assist him in selecting an appropriate discount rate under IFRS17, and controls will be put in place to ensure there is adequate review and challenge around the discount rate selected by the Appointed Actuary.

ii) Risk Adjustment Sensitivity Test

This sensitivity test required producing results using two alternative risk adjustment loadings, i.e, 'Base Risk Adjustment + 5%' and 'Base Risk Adjustment - 5%', subject to a minimum of 0%. The graphs below show the change in cumulative profit using the above alternative assumptions compared to the profit under the Base assumption for Motor Comprehensive and Engineering LOBs as examples.





Note: The above graphs are based on the (unweighted) average impact across all insurance companies.

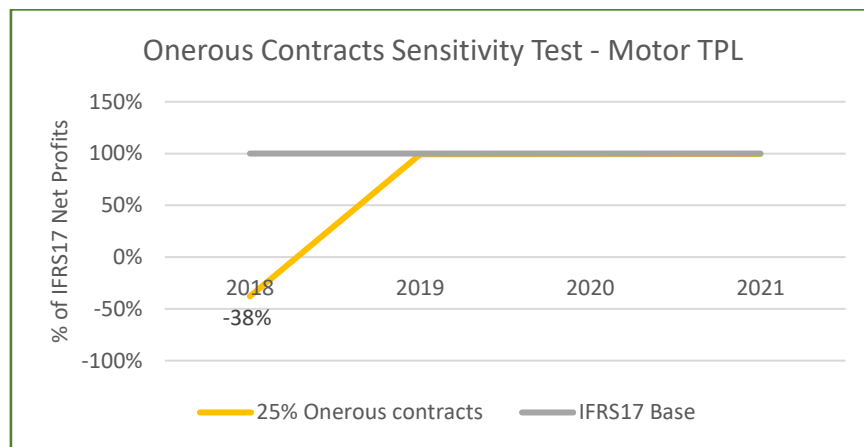
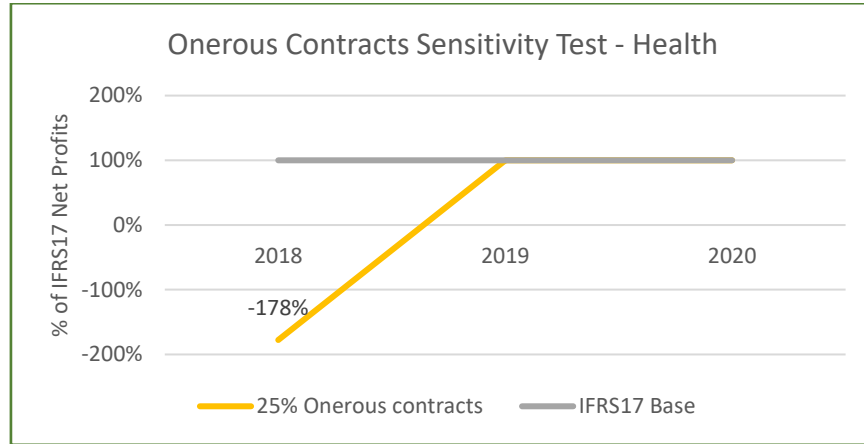
It can be seen above that initial profits under both LOBs are materially sensitive to the choice of the risk adjustment assumption. Moreover, despite its long-term nature, the sensitivity of profits to the risk adjustment seems lower under Engineering than under Motor Comprehensive, which appears counter-intuitive. Upon a closer look, similar to that observed for the discount rate sensitivity, it was noticed that this anomaly was created due to the profitable and loss-making Engineering businesses moving in opposite directions in the above graph, and hence offsetting each other to reduce the overall impact of the change in risk adjustment.

SAMA expects that each appointed actuary will select the methodology for risk adjustment considering the professional best practices as well as the risk appetite of the Company and with due input from management.

iii) Onerous Contracts Sensitivity Test

Determination of onerous contracts is an important area of judgment under IFRS17, where an insurance company is required to establish the level of granularity at which onerosity of contracts shall be determined and the assumptions (e.g., loss ratio, expense ratio, discount rate, risk adjustment, claims payment pattern, etc.) used for the selected level of granularity. This sensitivity test required producing results using one alternative scenario, where 25% of the LOB was deemed to be onerous.

The graphs below show the change in cumulative profit using the above alternative assumption compared to the profit under the Base scenario for Health and Motor Compulsory LOBs as examples.



Note: The above graphs are based on the weighted-average impact across all insurance companies, where weights used are the Net Profits for each company.

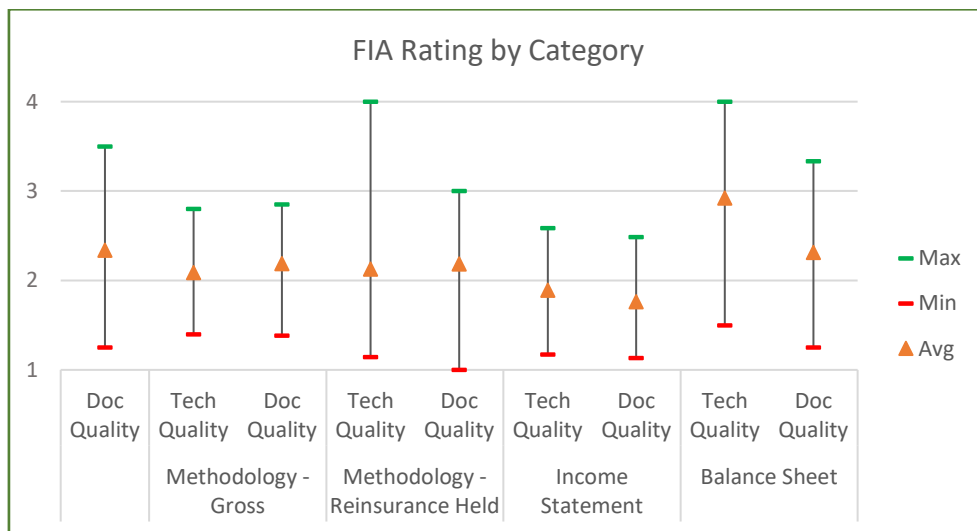
It can be seen above that the initial profits are materially reduced due to the losses on 25% of the LOB being recognised earlier than the profits on the remaining 75% of the LOB.

SAMA expects that management will pay special attention to this area during the next phase (i.e., "Design of Implementation Plan") and a sound methodology consistent with IFRS17 principles will be adopted, and a transparent process will be put in place to identify onerous contracts with clear assignment of responsibilities.

A.2. SAMA’s Assessment of FIA reports

Each FIA report was assessed for *Technical Quality* and *Documentation Quality* on a scale of 1 to 4 against a range of well-defined assessment criteria, with 1 being the lowest and 4 being the highest score. The assessment was performed considering the following five key areas of each FIA report, namely, *Data*, *Methodology (Gross)*, *Methodology (Reinsurance held)*, *Income Statement* and *Balance Sheet*. In terms of the number of assessment criteria under each of the above five areas, Income Statement had the maximum number of assessment criteria, followed by Methodology (Gross).

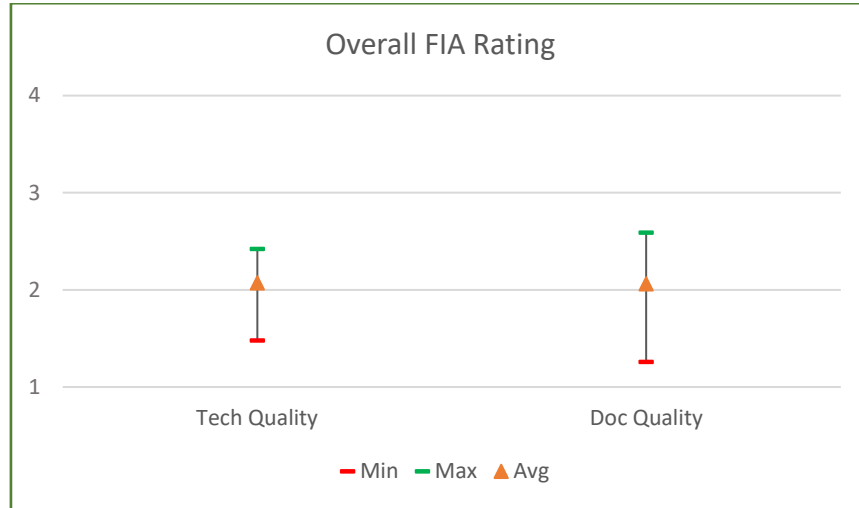
The graph below shows our overall assessment of the insurance companies in each of the above areas.



It can be seen above that the lowest average scores pertained to the Income Statement area, which dealt with the changes in revenues and expenses under the new Standard, and explanations and justifications provided around those changes. The ‘Methodology for Reinsurance Held’ was an area with the largest variation in results where some insurance companies scored very low and a few scored very high.

On the other hand, the quality of output pertaining to the Balance Sheet area, where the difference in profits between the two standards was disaggregated into its components (i.e., discounting, risk adjustment, impact of onerosity, etc.), was relatively better.

The rating for each FIA report was calculated as the average of ratings in the above five areas, weighted by the number of assessment criteria in each area. The graph below shows the average score of all FIA reports, along with the range of scores achieved by the insurance companies.



It can be observed that the average score for Technical Quality and Documentation Quality each barely managed to stay above the lowest scoring band. Aggregate scores for a number of companies fell well below the average score, whereas even companies with relatively better quality reports could not cross into the highest scoring band (i.e., above 3).

While we note that the average score in this Phase has improved compared to Phase 1 (“Gap Analysis”), we express our dissatisfaction with the low average score achieved by the sector, and the limited improvement seen compared to the previous phase. This raises serious questions about the level of understanding of IFRS17 within insurance companies, the quality of internal review and challenge where work was performed by external consultants, and the overall project oversight by the Board of Directors and senior management. The importance of high technical rigor and strong oversight cannot be overemphasized given the significant impact IFRS17 can have on the profit emergence pattern, as seen in Part A1 above.

Below we have identified the key observations from our review of FIA reports, along with SAMA’s expectations in respect of those observations.

a) Significant judgements and alternatives

Under its principle-based approach, IFRS17 requires management of each insurance company to make certain key methodology decisions and policy choices, and each of these decisions and choices can materially affect the company, either financially or operationally or both. It is therefore vital that management makes these decisions from an informed position.

To facilitate management in its decision-making, as part of its instructions for the FIA exercise, SAMA had stipulated that each FIA report shall clearly state all significant judgements used, together with the alternative judgements available to management. Examples of these significant judgements include grouping of contracts, methodology for risk adjustment, top-down v bottom up approach for discounting, immediate recognition v deferral of acquisition cost, etc. Likewise, where simplifications were used, those were required to be clearly marked in the FIA report, along with a description of the full approach applicable under IFRS17. Examples of simplifications include use of a flat discount rate, no diversification in risk adjustment calculation, onerosity calculation similar to that under IFRS4, etc.

While some reports clearly identified the significant judgements and simplifications used along with their alternatives, and thus scored high in this area, many reports contained poor or inadequate documentation in this regard.

Given the critical nature of these decisions for the design of IFRS17 solution by the Company, SAMA expects that management will spend adequate time and effort to fully understand the options available to it and the implications of each option. Management is also encouraged to seek input of the external auditors early in this process in order to avoid any late surprises.

b) Quality and Depth of Methodology Documentation

A large majority of FIA reports did not meet the general criterion of 'sufficient explanation for a knowledgeable third-party to fully understand the approach used and, if required, reproduce the results following that approach'. Since the majority of FIA reports were produced by external consultants, it was essential that the methodology documentation was clear and elaborate in order to make the report useful to the Company, in particular to its Finance and Actuarial functions. In the absence of such documentation, we have doubts whether the relevant functions of the company fully understand the work performed and will be able to take ownership of that work in the next phases.

SAMA expects that management will ensure adequate interaction between its external consultants and the key functions at the Company, enabling the latter to take ownership of methodologies and their implementation going forward. It is also expected that the quality of documentation will improve in the next phases of SAMA IFRS17 road-map.

c) Mapping between IFRS4 and IFRS17 Income Statement

Compared to IFRS4, the Income Statement under IFRS17 involves various new calculations under new headings (e.g., insurance service revenue, insurance service expense, net expense from reinsurance contracts, liability for remaining coverage, etc.). It was expected that the FIA exercise would assist the Company in understanding this transition from IFRS4 to IFRS17. Unfortunately, the majority of reports did not contain details of the mapping between the line items of IFRS4 and IFRS17 Income Statements.

SAMA expects that management will ensure sufficient understanding of the mapping between IFRS4 and IFRS17 income statement at all levels within the Company, in particular by the Board of Directors and senior management, preparing them in time to fully interpret and comprehend the business performance in IFRS17 financial reporting era.

d) Level of Aggregation and Onerosity

For the grouping of insurance contracts, IFRS17 follows the principle of 'similar risks and managed together' and 'profitable v onerous (v unlikely to be onerous)'. This is a fundamental assessment and a company's decision on the granularity of the grouping of contracts is likely to affect its financial results, their presentation and disclosure, as well as the IT System solutions supporting those results.

The majority of FIA reports lacked details on how the above principles were adhered to, and in many cases, business was segmented by 'line of business; only without adequate justification, thus getting a low score in our assessment. On the other hand, a few companies split their books

into significantly more granular segments than those used under IFRS4 reserving exercise, as shown in the graph in Part A1(b) above.

SAMA expects that management will ensure that all IFRS17 principles are adhered to in both letter and spirit, and the focus is on adopting not just the simplest solution but the one which is optimal for the Company in managing its business and is closely aligned with the market best practice.

e) Insurance Finance Income and Expense

This is a new concept introduced in IFRS17 Income Statement, which directly affects the reported profits. Hence, it was expected that each FIA report would elaborate in detail the approach used in this regard. On the contrary, the majority of FIA reports did not contain any explanation of the numbers derived, the difference in approaches depending on the measurement model used, or the difference in calculations when using spot curves v forward rates. In a few cases, insurance finance income and investment income were deemed equal, thus oversimplifying the calculations.

SAMA expects that management will ensure that all new features of IFRS17 are well understood within the Company, and relevant individuals within the Company have complete ownership of each new feature.

f) Other Key Observations from SAMA's review of FIA reports

- Expense Allocation
 - The majority of FIA reports lacked clarity on the approach used to allocate expenses at a *group of contracts* level, and on the differentiation between *Directly Attributable expenses* and *Other expenses*.
 - While total expenses under IFRS17 and IFRS4 are unlikely to be affected at the company-level, variations are possible at the 'group of contracts' level depending upon the allocation philosophy. In the FIA exercise, we observed that some companies allocated lower expenses at the group of contracts level than under IFRS4, while others allocated higher expenses than under IFRS4.
- Risk Adjustment
 - For risk adjustment calculation, the majority of FIA reports resorted to using simplifications (e.g., use of flat percentages, no diversification, no determination of confidence intervals, etc.). Given the complexity and sophistication of this new feature under IFRS17, the impact of implementing a full approach is therefore yet to be fully understood by many insurance companies.
 - When releasing the risk adjustment in subsequent years, the majority of FIA reports lacked clarity on whether the release was split between Insurance Service Result and Insurance Finance Income & Expense, or considered entirely under Insurance Service Result only, which is a policy choice to be made by each insurance company.
- Discount Rate
 - A few companies made the effort to deploy a Top-Down or Bottom-Up approach, which earned them favorable scores compared to those using a flat discount rate assumption.



- Among the companies using a Bottom-Up approach for discount rate, a few did not either make any adjustment for the illiquidity premium or made a flat adjustment as a simplification.
- Net Expense from Reinsurance Contracts
 - Many companies did not allow for the counterparty-default risk. Where this allowance was made, it was usually based on simplifications, instead of considering the default probability and loss-given-default for each individual reinsurer.
 - For onerous contracts, the majority of insurance companies did not make corresponding adjustment in the reinsurance contractual service margin (“CSM”).
 - Assumptions used for projecting the reinsurance cash flows were inadequately documented, making it difficult to follow the calculations.
- Consideration of Probability-weighted Mean
 - IFRS17 requires that the estimate of future cash flows shall be based on the probability-weighted mean of the full range of possible outcomes. There was limited evidence that this requirement was considered, as the majority used a deterministic approach when projecting the future cash flows. In addition, very few companies made an adjustment for the expected default in premium payments.
- Contractual Service Margin (CSM)
 - Some reports lacked clarity on the measure considered for releasing the CSM from one year to the other.
- Treatment of Manafeth
 - For companies participating in the Manafeth pool, the majority of FIA reports carried no description of the proposed approach for Manafeth business. While this business segment may have been excluded as the 75% threshold was already met, it is expected that the treatment of Manafeth under IFRS17 will undergo a significant change compared to its treatment in the current financials, in turn giving rise to additional data and methodology requirements. Similar considerations may apply for Haj & Umrah insurance, Inherent Defects Insurance and other pooling/ coinsurance arrangements.

g) Additional Observations from SAMA’s Independent Testing of FIA results

We selected a sample of insurance companies for independent testing of the FIA results, and input data was requested from those companies. Once received, the input data was passed through SAMA’s in-house IFRS17 Tool.

A number of differences were identified between the FIA results provided by the Company and those produced using our Tool. These differences were classified into three categories, namely, ‘insignificant’, ‘minor’ and ‘major’.

Where major differences were observed, we further investigated a sample of those areas by seeking detailed results from the relevant insurance companies. Below are the key findings based on those investigations.

- Insurance Finance Income & Expense
 - There was lack of transparency around the use of spot curves and forward rates.



- Instead of calculating the unwinding of discount, one company showed release of reserves and CSM under this head.
- Treatment of Loss Component
 - Instead of doing a full calculation to determine the loss component (i.e., allowing for discounting and risk adjustment), some companies resorted to an IFRS4-type calculation using Premium Deficiency Reserve as the basis for determining the loss component.
 - In many cases, the loss component-related adjustment to Insurance Revenue, required under para 49 of IFRS17 standard, was not made.
 - Similarly, for the reinsurance held part, adjustments to CSM required under para 66A and 66B of IFRS17 were not made by many insurance companies.
- Risk Adjustment
 - There was one case where closing risk adjustment did not match with the opening risk adjustment of the next year.
- Contractual Service Margin
 - In one case, differences were observed in the amount of CSM calculated by the company and that calculated by us using the company data. Upon further investigated, it was noted that the company had ignored the first year cash flows when determining the initial CSM.
- Other issues
 - For some companies, detailed results provided did not add up to the summary results appearing in the FIA template, casting doubts over the accuracy of calculations and adequacy of controls on the flow of information before it was shared with SAMA.
 - In one case, Insurance Revenue under Premium Allocation Approach was shown net of acquisition expenses, instead of netting-off through Insurance Service Expense. While this did not affect the overall profit, both Insurance Revenue and Insurance Service Expense were misrepresented.
 - In another case, the input assumptions provided for the calculations of risk adjustment did not match with the assumptions actually used by the company, which became evident only once we obtained the detailed results of FIA calculation.
 - In one case, we managed to match the insurance finance expense for the first year, but differences emerged in the second year, raising concerns regarding the approach used to unwind the discounting effect.

The results of our independent testing have raised doubts in various areas of calculations performed by the insurance companies. Much of this appears to be driven by an inadequate understanding of IFRS17 principles or differences in interpretation of IFRS principles. We foresee the external auditors playing an important role in ensuring appropriate interpretation and accurate calculations under IFRS17.

SAMA expects that management will ensure the external auditors of the Company have the necessary knowledge and expertise of IFRS17 in order to analyze the results in sufficient detail so that the Audit Committee can get the required assurance around the Company's IFRS17 financial statements.

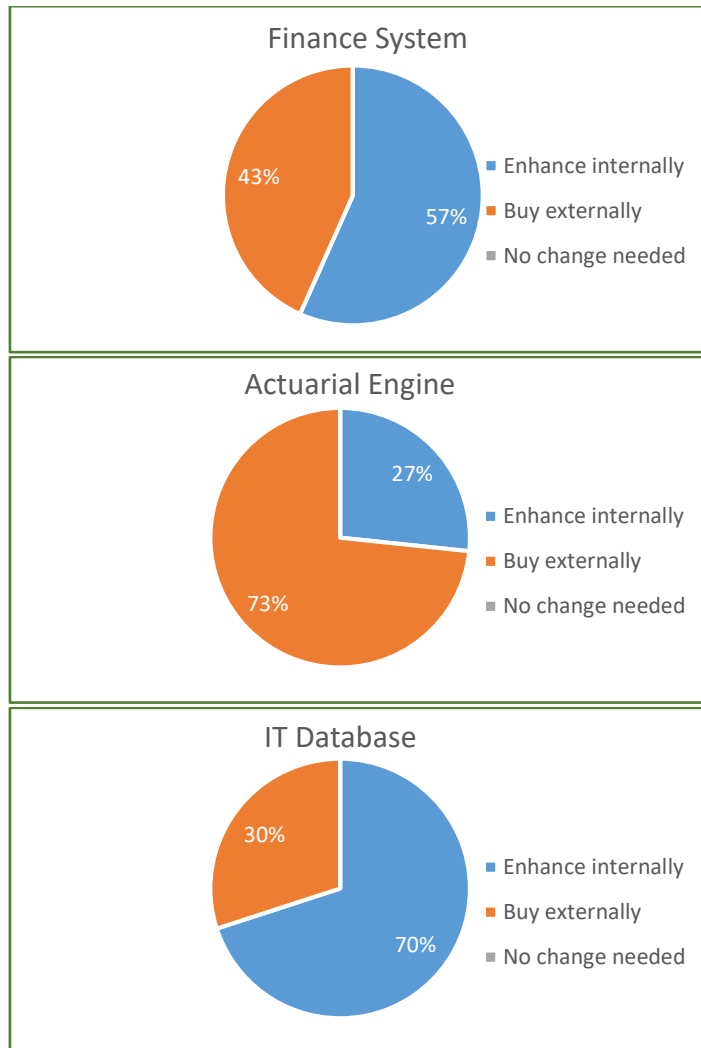
Part B – Operational Impact Assessment

B.1. Summary of OIA results

Each OIA report was required to cover, as a minimum, the operational impact of IFRS17 in areas of Data, IT Systems & Software, Process and People. The following two sections summarize the findings of insurance companies in respect of their existing systems and resources vis-à-vis the requirements of IFRS17.

a) System Enhancements

The graphs below reflect the current thinking among insurance companies in respect of upgrades to their Finance, Actuarial and IT systems.



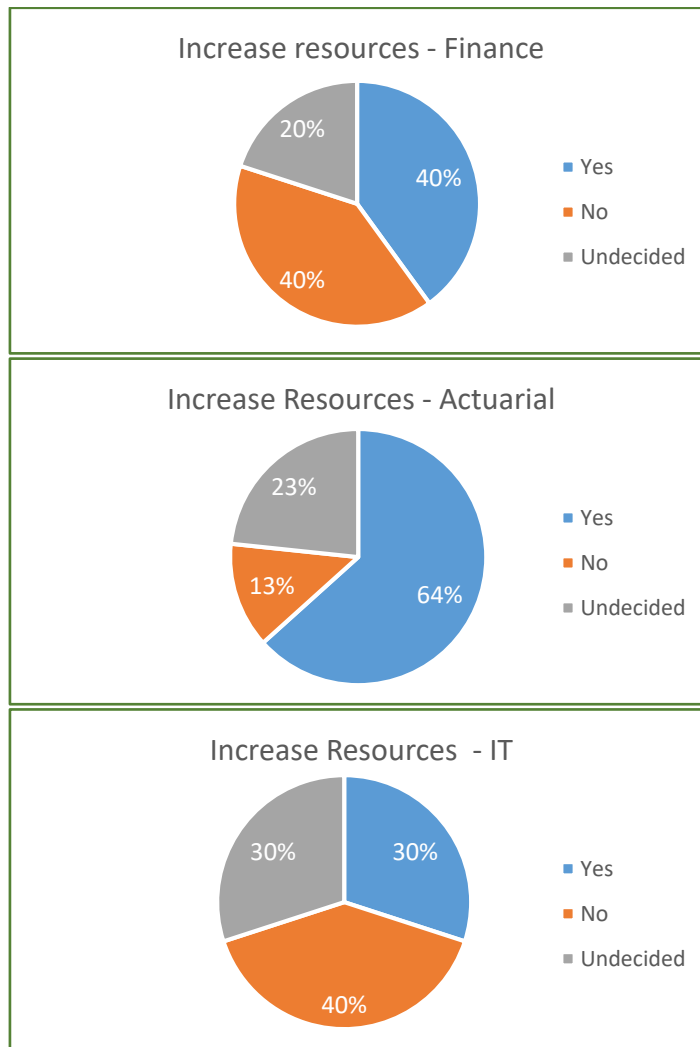


No company assessed that its existing systems could cater to the requirements of IFRS17. For Finance and IT systems, larger proportion of companies plan to enhance their existing systems compared to those who intend to buy external modules as an 'add-on' or as a 'full replacement'. In contrast, a large majority of insurance companies intend to buy external Actuarial engine in support of their Finance system. Where served by an external appointed actuary, a number of insurance companies are pondering over the extent of reliance they can place on the appointed actuary's systems.

SAMA expects that management will develop an in-depth understanding of the system requirements of IFRS17 and will make informed decision regarding system enhancement, either internally or through external purchase. While buying externally, management shall seek to fully understand the limitations of the vendor models and ensure that plans are in place to complement the gaps of the vendor models internally.

b) *Resourcing Needs*

The graphs below reflect the current thinking among insurance companies in respect of supplementing their existing Finance, Actuarial and IT teams.





The majority of insurance companies recognize the importance of actuarial input in producing IFRS17 financial statement and, where the company is served by an external appointed actuary, the need for an in-house actuarial team for day-to-day support to the Finance team. This is consistent with SAMA’s strategy where, under the recently published Actuarial Work Rules, all insurance companies are required to establish an in-house actuarial function and recruit a qualified actuary. Similarly, a significant proportion of insurance companies has identified the need to strengthen the Finance and IT teams, though more in Finance than in IT. Moreover, a number of insurance companies are still in the process of assessing their resourcing needs.

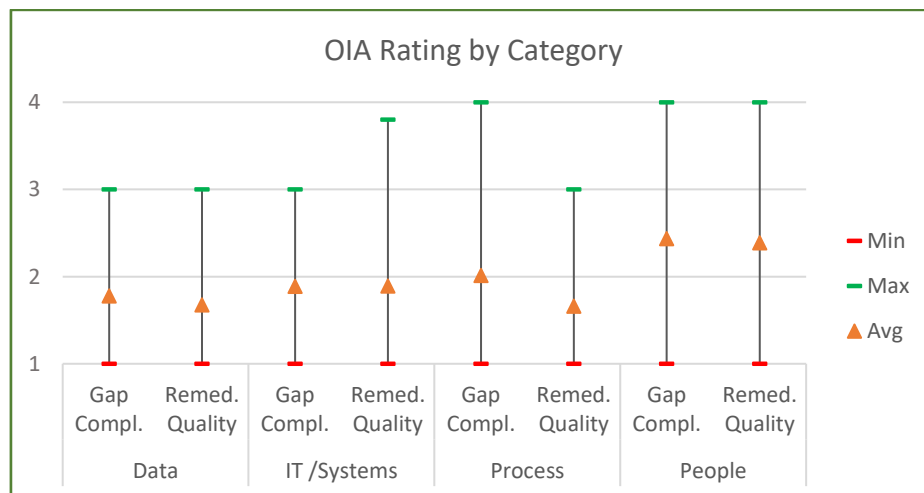
SAMA expects management to ensure adequate and skilled resources are available to each function for effective and smooth implementation of IFRS17. Given the steep learning curve involved, it is expected that planned recruitments and/or trainings will be carried out in a timely manner.

B.2. SAMA’s Assessment of OIA Reports

Each OIA report was assessed for ‘Comprehensiveness of Gaps Identified’ and ‘Quality and Completeness of Proposed Remediation’. This assessment was broken down into four areas, namely, Data, IT & Systems, Process, and People. In terms of the number of assessment criteria under each of the above four areas, Data, IT & Systems, and Process had similar number of assessment criteria, whereas People had the least number of assessment criteria.

Similar to our assessment of FIA reports, scores of 1 to 4 were assigned against each assessment criterion, with 1 being the lowest and 4 being the highest score.

The graph below shows our assessment of the insurance sector in each of the above four areas, along with the range of scores achieved by the insurance companies.

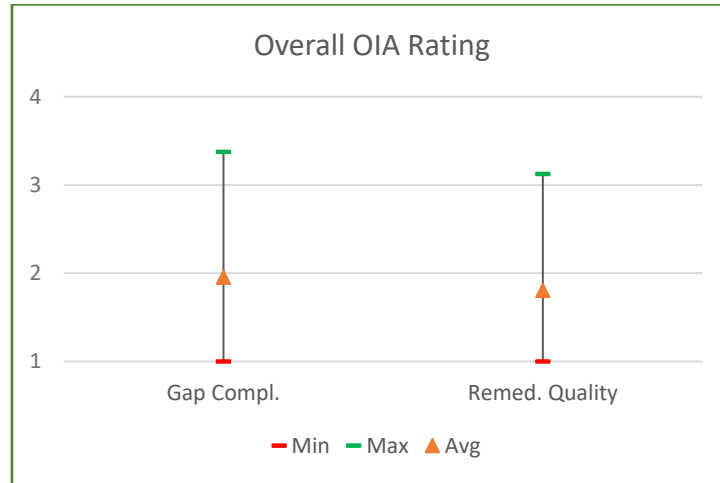


It can be observed from the above that the gaps and remediation relating to *Data* scored poorly on average. On the other hand, gaps and remediation relating to *People* scored the



highest on average. Wide ranges seen in all areas above highlight large variations in the quality of OIA reports across the sector.

The scores for the above four areas were then aggregated, weighted by the number of assessment criteria in each area, to produce the overall score for each OIA report. The graph below shows our overall assessment of OIA reports, along with the range of scores achieved by the insurance companies.



It can be seen above that the average score for ‘Comprehensiveness of Gaps Identified’ almost managed to reach the middle band, whereas the score for ‘Quality and Completeness of Remediation’ fell well within the lowest scoring band, both indicating towards a low quality of OIA reports on average.

It is commonly believed across the insurance sector that, irrespective of the impact on a company’s financial statement, the operational impact of IFRS17 will be material for each insurance company. Therefore, given the importance of operational readiness for IFRS17, SAMA expresses its concern over the low OIA score achieved by the insurance sector in aggregate.

SAMA expects that each of the four areas (Data, IT & Systems, Process and People) will get due attention from management during the next phase (i.e., Design of Implementation Plan) of IFRS17 implementation journey.

Below are the key observations from our review of OIA reports.

a) Generic v Company-tailored Reports

Those OIA reports that demonstrated adequate understanding of existing processes and resources and where the proposed remediation was tailored to a company’s specific circumstances, received higher scores than those proposing generic ‘one size fits all’ solutions. We also took note of the degree of similarity between OIA reports for a few companies, thus raising questions whether the external consultants involved spent enough time and effort in understanding each company’s specific operational infrastructure and enhancements required for each.



SAMA expects that management will seek to fully understand the challenges posed by IFRS17 to its current operational infrastructure in order to decide on the optimal remediation for the Company.

b) Use of Insights from FIA Exercise

Those OIA reports that drew upon the learnings from the FIA exercise scored higher than the reports that largely appeared to be a reproduction of Phase 1 Gap Analysis reports. For example, where challenges relating to data and methodology faced during the course of FIA exercise were appropriately reflected in the OIA report, we considered those favorably in our scoring.

SAMA expects that management will ensure the learnings from Phase 2 are shared with all relevant functions of the Company and insights developed from this Phase are fully utilized during the next phase (“Design of Implementation Plan”).

c) Treatment of Alternative Significant Judgements & Simplifications

A number of FIA reports contained significant judgements and simplifications (refer to Part A2a above). The SAMA instructions for Phase 2 required that, in all such cases, the OIA report should state the operational impact if another alternative judgement is used, or if full approach is used, instead of a simplification. We noted that some OIA reports had specific sections to deal with the above, which were considered favorably in our scoring; however, many OIA reports lacked the necessary details in respect of the above.

SAMA expects that management will seek to understand both the financial and operational impacts of alternative significant judgements and of replacing simplifications with full approaches and will make decisions regarding the design of IFRS17 implementation plan from an informed position.

d) Other Observations

- Data
 - A number of reports did not clearly identify the additional data requirements for underwriting, claims, actuarial and/or finance functions. In particular, barely any report commented on whether any changes would be required to the data captured in Claims system.
 - As regards the external data requirements, the majority of OIA reports failed to state the need to identify the data source for obtaining the probability of default and loss-given-default in respect of each reinsurer.
- IT & System
 - Where gaps and remediation of IT systems did not include an end-to-end flow diagram, those reports scored relatively low in this area.
- Process
 - For onerosity, the majority of reports failed to highlight the importance of having a transparent and well-organized process, with clarity of roles and responsibilities for actuaries and underwriters, in order to ensure that the required information is gathered in a reliable and smooth manner.



- Resourcing
 - Many reports contained details regarding the current capacity of each function, along with the proposed number of new head-count, as well as the capabilities of individuals within those functions and their training needs. Such reports scored relatively high in our assessment. On the other hand, the OIA reports that contained assessment and recommendations at the overall company level only, with no differentiation between individual functions, scored relatively low in our assessment. Some reports included training plans differentiated by each function; such reports were considered favorably in our assessment.
- Going beyond the minimum
 - Some OIA reports contained gaps and remediation over and above the minimum requirements, and hence were considered favorably in our scoring. For example, some reports included the current v proposed Chart of Accounts in detail.
- Product-specific considerations
 - Where gaps were identified separately for each product written by the company and remediation proposed was specific to a product, relatively high scores were assigned to such reports compared to those where no product-specific considerations were made.
- Classification of gaps and remediation
 - Where a report not just identified the gaps and proposed remediation, but also classified those remedial measures by their importance and amount of effort required, such reports were considered favorably in our scoring.

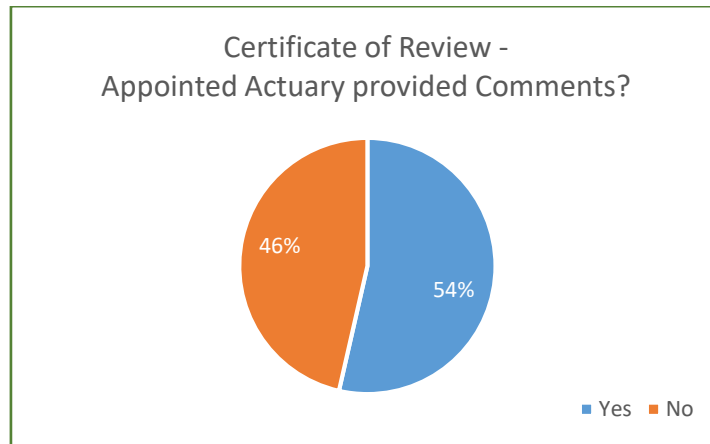


Part C - Certificate of Review by CFO & Appointed Actuary

Where an insurance company used services of an external consultant, SAMA required that the CFO and the Appointed Actuary should submit a *Certificate of Review* each, encompassing the FIA and OIA reports and the FIA results' template. The purpose was two-fold:

- Firstly, to provide an opportunity to the above key roles to express their opinions in areas where they may have differences with the Company's external consultants, and
- Secondly, to ensure that the CFO and Appointed Actuary are fully aware of the outcome of the FIA & OIA exercises and are able to take ownership of their respective areas when moving to the next phase.

The graphs below show the distribution of insurance companies depending on whether Appointed Actuary and/or CFO expressed their opinions through the above certificate, drew attention towards the shortcomings of the proposed approach and/or suggested improvements to the proposed approach.



While the majority of appointed actuaries expressed their opinions on the proposed methodology and assumptions and remedial actions, it was disappointing to note that no CFO identified shortcomings or suggested improvements in the work produced by the external consultants. While it is possible that in some cases, differences of opinion were resolved before finalizing the reports, we express our apprehension that in many cases, this could be due to the CFO lacking adequate



understanding of IFRS17 or not getting sufficiently involved in discussions around the methodology and assumptions.

SAMA expects that management will hold discussions with the CFO and the Appointed Actuary in order to,

- a) make informed design decisions in areas where there are differences of opinion between the Appointed Actuary and external consultants, and*
- b) ensure that methodology and assumptions have full input from both the CFO and the Appointed Actuary.*



Appendix 1 – Abbreviations & Criteria Used

Abbreviations applicable for all graphs

#	Line of Business	Name used for Chart titles	Abbreviation Used
1	Accident & Liability	Accident & Liability	Acc. & Liab.
2	Motor Compulsory	Motor TPL	Motor TPL
3	Motor Compulsory + Others	Motor Comprehensive	Motor Compr.
4	Property	Property	Property
5	Marine	Marine	Marine
6	Aviation	Aviation	Aviation
7	Energy	Energy	Energy
8	Engineering	Engineering	Engineering
9	Health Insurance (both compulsory and non-compulsory)	Health	Health
10	Other General & Health Insurance	Other General & Health	Other G&H
11	Group Life	Group Life	Group Life
12	Group Credit Life	Group Credit Life	Group Credit
13	Group - Other	Group - Other	Group Other
14	Individual - Protection	Individual Protection	Indiv. Protect.
15	Individual - Protection & Savings	Individual Protection & Savings	Indiv. P&S
16	Individual - Other	Individual - Other	Indiv. Other

Abbreviations applicable for graphs in Part A1 (“Drivers of Difference in Profits”)

#	Item	Abbreviation
1	IFRS4 Net Assets	IFRS4
2	Impact of removing Management Margin to move to a Best Estimate basis	Mgmt. Margin
3	Impact of Discounting	Disc.
4	Impact of Risk Adjustment	RA
5	Impact of Onerous Contracts	Onerosity
6	Impact of Reinsurance Mismatch	RI Mismatch
7	Impact of difference in valuation methodology Gross and Reinsurance Held	RI Meth. Diff
8	Other Methodology differences	Other Meth.
9	IFRS17 Net Assets	IFRS17

Abbreviations applicable for graphs for FIA and OIA ratings in Part A2 and Part B2

#	Item	Abbreviation
1	Technical Quality	Tech Quality
2	Documentation Quality	Doc Quality
3	Gap Completion	Gap Compl.
4	Remediation Quality	Remed Quality



Criteria used for System and Resource Requirements (ref: Part B1 of Dear CEO letter)

System Changes

Finance system includes Accounting, Investments, Business planning, but at a minimum, Accounting system was considered.

‘Enhance internally’ implies that an insurance company does not intend to buy a new system, in full or in part; this excludes scenarios where a company intends to buy an add-on to the existing system

‘Buy externally’ implies complete replacement as well as part-addition by buying a component to be added to the existing system.

Resource Increase

Where the report states that overall resources may need to be increased but does not specify the functions or departments, this was put in the category ‘Undecided’

Comments by Appointed Actuary/CFO (ref: Part C of Dear CEO letter)

This assesses whether the Appointed Actuary and CFO differed with the consultants or provided comments on the report. Where an Appointed Actuary or a CFO has stated that they fully agree with the consultants, it was treated as 'No' observation.



Appendix 2 – Company-specific Results

- Attached (to be sent in a separate email)