

8 March 2023

Dear CEO

SAMA IFRS 17 Implementation Road Map - Findings from Phase 4 submissions

This is the final letter in the series of market feedbacks SAMA has issued over the last several years in preparation for implementing IFRS 17 in the Saudi insurance sector. It comprises the following sections:

- A) Executive Summary (pages 1 – 2)
- B) Background of IFRS 17 and IFRS 9 (page 3)
- C) Highlights of the Implementation Journey (page 4 – 6)
- D) Re-cap of Previous Phases 1, 2 and 3 (pages 7 – 10)
- E) Key Findings from Phase 4 (pages 11 – 23)
- F) Next Steps for Insurance Companies and SAMA (pages 24 – 28)

SAMA expects this letter to be widely circulated within the insurance company, in particular among the members of the Board of Directors and the Audit Committee, and discussions are held at all levels, both strategic and operational, in order to maximize the benefits from the important observations and messages included in this document.

A) Executive Summary

After a long and arduous preparation journey for the adoption of the International Financial Reporting Standard No. 17 (IFRS 17) that began in 2018, the insurance sector in Saudi Arabia has successfully adopted the Standard with effect from 01 January 2023. This is regarded as one of the biggest financial reporting improvements in the Saudi insurance industry. Simultaneously, the insurance sector has also adopted the International Financial Reporting Standard No. 9 (IFRS 9). Given the challenges being faced by other jurisdictions, including some significantly more mature than Saudi Arabia, this is a significant achievement for the Saudi insurance sector and sets the scene for the future rapid and professional development of this sector in line with the expectations of Vision 2030.

Courtesy of the early preparations started by the Saudi insurance sector and multiple Dry Run exercises conducted, of which at least one involved the Company's external auditors, there is sufficient confidence in the insurance sector's ability to produce Financial Statement in the go-live state in a reliable manner. At the same time, it is imperative that the senior management pays immediate attention to and addresses the observations raised by the Company's external auditors in the form of Management Letter points, and in some cases, through Audit Qualifications.

SAMA had set up a robust review, challenge and feedback process during the entire journey, which served to lift the level of professionalism in the Saudi insurance sector and a new *bar* has been set. The sector is expected to treat the new *bar* set by SAMA as '*business as usual*',

and SAMA will continue to encourage and strive for greater professional sophistication in the insurance sector.

The Saudi IFRS 17 Working Group, facilitated by and operating under the guidance of SAMA, proved to be a very useful forum to promote professional dialogue and deliberations regarding key challenges faced by the insurance sector during its implementation journey. Through this consultative approach, the Working Group produced very useful outputs for the sector, including Uniform Financial Reporting Templates, Recommendations in 91 most-challenging areas of IFRS 17, Expense Attribution template, IAS 8 Disclosure template, standard instructions for Special Purpose Audit of Dry Run exercise, etc. SAMA will continue to promote the culture of professional discussions and deliberations and seek active cooperation from all professionals in its efforts. At the same time, the senior management and the Board of Directors is expected to encourage the Finance and Actuarial functions to fully leverage those outputs from the Working Group.

In order to produce a technically sound Financial Statement, management is expected to closely follow the emerging *market best practices*, in particular those relating to Risk Adjustment and its diversification, Expense Attribution, Level of Aggregation, Onerosity Calculation, Provision for Doubtful debts, and seek to benefit from benchmarking information shared by SAMA at various points during this journey, including those included in this letter (Section E).

From an operational perspective, in order to produce Financial Statement in an efficient, reliable and timely manner, it is essential that management prioritizes addressing challenges relating to hiring and retaining resources with appropriate actuarial and accounting expertise, integration of IFRS 17 engine with its core system, and implementing validation checks on the results produced by the IFRS 17 engine of the Company.

For year 2023, next steps and priorities for the senior management and Board of Directors shall include adequate preparation for the first quarterly reporting under IFRS 17, automating the production of Financial Statement, implementing validation checks on the results produced by the Company's IFRS 17 engine, ensuring clarity of roles for the Finance and Actuarial teams, developing and updating Key Performance Indicators (KPIs) for the business and its functions, and communicating with the investor community effectively.

On its part, SAMA plans to issue new actuarial reserving instructions and update its review, validation and benchmarking processes to conform to IFRS 17. Moreover, we plan to update, as appropriate and where deemed necessary, the current SAMA rules, regulations, regulatory reporting forms, Risk-based Supervision Framework, and solvency calculations in order to align with IFRS 17. While making the above improvements, we will continue to have dialogue and deliberations with the insurance sector in the same manner as adopted during the course of the IFRS 17 journey.

Finally, SAMA would like to thank the entire insurance sector, particularly the members of Saudi IFRS 17 Working Group and the members of insurance companies' IFRS 17 teams, for their contribution towards the success of this project. SAMA would also like to express its gratitude to the senior management and Board of Directors of insurance companies for the support and leadership provided to their respective IFRS 17 teams during this journey.

**B) Background of IFRS 17 and IFRS 9**

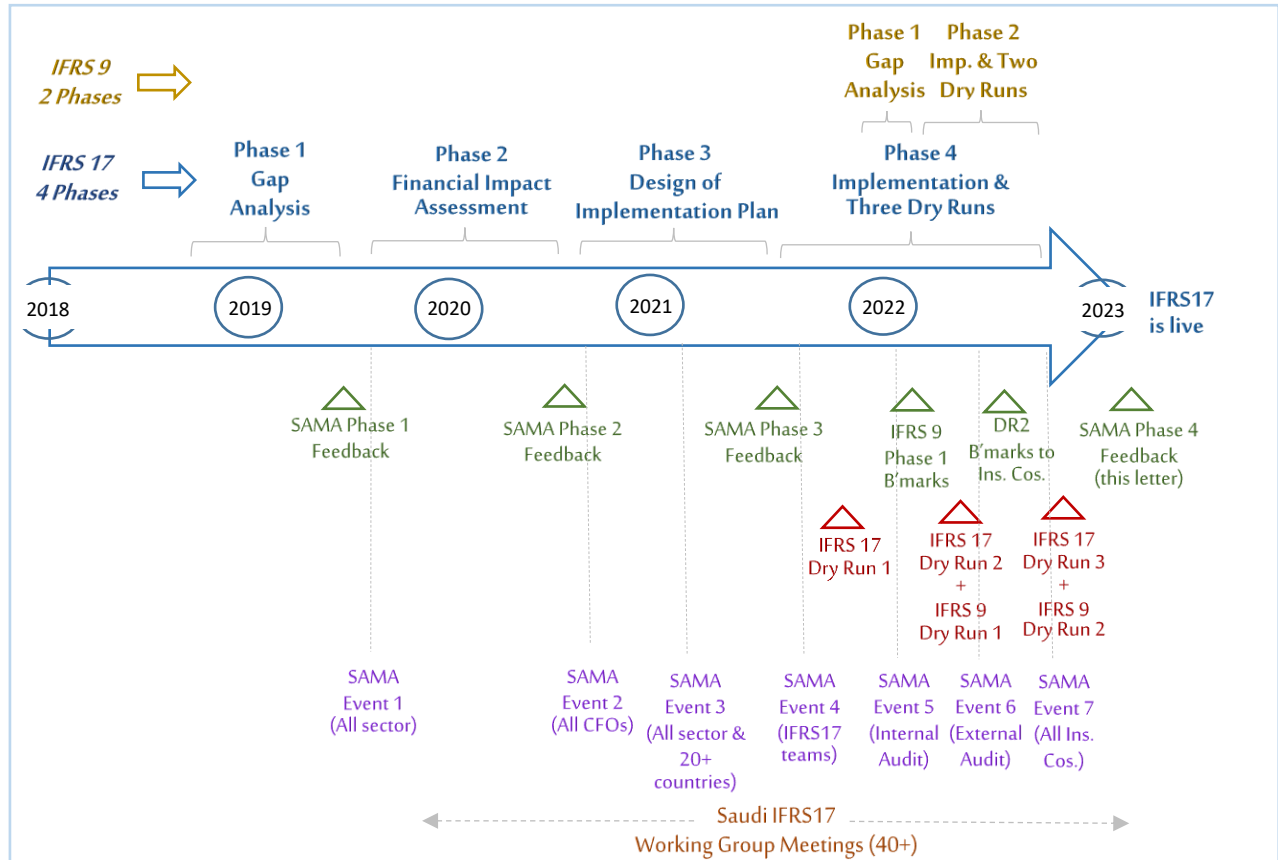
- Work on IFRS 17 started way back in early 2000s and it took the International Accounting Standards Board (IASB) more than fifteen years of preparation and long deliberations at the global insurance industry level before it issued the Standard in May 2017. The Standard replaces IFRS 4 “Insurance Contracts” issued in 2004. Immediately after its issuance, the Standard underwent close scrutiny by insurance companies, and after a series of discussions, major amendments were made to it in June 2020. The original effective date of IFRS 17 was meant to be 1st January 2021, which in March 2020, was deferred to 1st January 2023 in view of the implementation challenges associated with the highly complex nature of the Standard.
- While this Standard is expected to improve the transparency of reporting by insurers, it is also aimed at achieving greater synchronization between the financial reports of insurance companies and those of other financial sectors (e.g., by using terms ‘insurance service revenue’ instead of ‘premium’), thus assisting the investor community in informed decision-making. Moreover, due to its worldwide adoption, it will be far easier to compare financial statements of insurance companies operating in different jurisdictions.
- Additionally, the IASB issued the International Financial Reporting Standard No. 9 (IFRS 9) “Financial Instruments” in July 2014, replacing the International Accounting Standard No. 39 (IAS 39) “Financial Instruments” issued in 2003. While the effective date of IFRS 9 for other financial institutions, including the banking sector, was set to be 1st January 2018, insurance companies were allowed to adopt IFRS 9 together with IFRS 17, i.e., effective 1st January 2023.



C) Timeline and Highlights of the Implementation Journey (2018 – 2022)

- Given the complex nature of the Standard, SAMA anticipated the challenges that lied ahead for the insurance sector early in the process. Therefore, while there were discussions still going on at the global level and there were uncertainties as to the final form and effective date of the Standard, SAMA rolled out an implementation road map in December 2018, comprising the following four phases:
 - Phase I – Gap Analysis
 - Phase II – Financial (and Operational) Impact Assessment
 - Phase III – Design of Implementation Plan
 - Phase IV – Implementation and Dry Runs
- Commensurate with the relatively small impact of IFRS 9 on the insurance sector, in February 2022, a ‘Two Phase’ implementation road map was rolled out, viz., i) Gap Analysis, and ii) Implementation and Dry Runs.
- A project team was formed at SAMA, tasked with ensuring the road map was diligently followed by the insurance sector. All insurance companies were asked to form similar internal project teams, with due leadership support and effective governance process in place. Below are the timelines followed for each phase of the above road map by the insurance sector, along with the key milestones reached in this journey.

Implementation Journey



- The highlights of the journey include the following:
 - Timely and Comprehensive SAMA Instructions for each Phase, including
 - Detailed circulars with clear timelines
 - Templates for reporting of results under each phase
 - Template for progress monitoring for senior management and SAMA
 - Minimum gap between two consecutive phases to maintain continuity
 - Regular, Value-adding feedback from SAMA to insurance companies, comprising
 - Market feedback in the form of 'DEAR CEO' letter after each phase
 - Individual company benchmarks, showing comparison with other insurance companies
 - Robust review and challenge by SAMA, including
 - Review of submissions of insurance companies after each phase
 - Review of quarterly updates after Phase 1
 - Reproduction of results of Phase 2 for a sample of insurance companies
 - Review of monthly progress reports after Phase 3
 - On-site interviews of IFRS 17 project team and senior management and members of the Board of Directors of insurance companies
 - Individual company meetings to discuss the results of Dry Run exercises
 - Individual external auditor meetings, including their actuarial experts, to provide feedback on the quality of the audit work performed on the Dry Run 2 results
 - SAMA being highly responsive to the Sector's needs and requests, evidenced by
 - Deferral of SAMA Phase 2 deadlines due to COVID-related disruptions
 - Giving management discretion over the audit of the Dry Run 3 result due to concerns expressed by insurance companies regarding the fee charged by external auditors for the audit of Dry Run 2
 - Deferral of deadlines for Dry Run 3 upon the request of Insurance Executive committee
 - Formation of Saudi IFRS 17 Working Group, with 40+ meetings in just over three years, comprising experts from actuarial, finance, and external audit fields, as well as IFRS 17 software vendors, numbering 20 in total, which led to
 - Promoting a culture of dialogue, professional deliberations and technical sophistication within the insurance sector
 - Issuance of Uniform Financial Reporting Templates (URTs) that were tested during Dry Run 2 and Dry Run 3 so that those can be adopted in the go-live state
 - Issuance of detailed guidance on Expense Attribution under IFRS 17



- Issuance of recommendations (91 in total) in respect of issues and challenges faced by insurance companies when performing Dry Run exercises
- Risk Mitigation efforts by SAMA
 - Intense dialogue and liaison with the audit profession and SOCPA, ensuring adequate and timely engagement of external auditors during Dry Run exercise(s) to reduce the risk of audit qualification in the go-live state
 - Getting internal auditors involved in Dry Run 1 to perform governance and controls testing in all key areas
- SAMA Market Events for Knowledge Transfer, and Effective Communication
 - Seven events were organized by SAMA during this journey, where SAMA presented its latest observations and expectations going forward;
 - In addition, panel discussions were held with panelists during the above events, representing a range of expertise operating in the sector, who shared their experiences and learnings from IFRS 17 implementation for the benefit of the participants.
 - In one of those events, which was open for participation for anyone interested in IFRS 17, around 400 professionals from 20+ countries attended the event, which was a testament to the worldwide interest in the successful IFRS 17 journey in Saudi Arabia.



D) Re-cap of SAMA Findings and Expectations from Phases 1, 2 and 3

Below are some of the key messages from each of the last three phases that SAMA had shared with the insurance sector in the form of 'DEAR CEO' letters.

- Phase 1 – Gap Analysis (*refer DEAR CEO letter dated 11 June 2019*)
 - Majority of Gap Analysis reports submitted to SAMA fell short of SAMA's expectations in terms of quality and depth of technical assessment.
 - A number of reports contained generic statements on the assessment of gaps, and there appeared to be limited effort to tailor the assessment made to the Company's own business model.
 - One of the weakest areas of the report was identification of significant judgments, expected to be made by the Company in several areas when complying with IFRS 17. Given the importance and influence of these judgements on the outcome of the overall compliance with IFRS 17, it is critical that all significant judgements are properly documented, management is fully aware of these significant judgements along with their impact, enabling it to make informed decisions on the options available.
 - The readiness of the Board of Directors for IFRS 17 scored significantly low in our assessment. Without adequate understanding and involvement by the Board of Directors, there is likely to be increased uncertainty about successful completion of the project by the Company.
 - Majority of companies have yet to perform an assessment of the cost involved in executing the next three phases. To avoid late surprises, SAMA encourages companies to set aside appropriate amounts for the next phases and continue to fine-tune those as progress is made through the next phases.
 - While heavy reliance was placed on external consultants for the Gap Analysis phase, companies intend to make greater use of internal resources for the subsequent phases, which is in line with SAMA's expectations. This however will only be possible if adequate knowledge transfer takes place, and it is expected that management will pay special attention towards this aspect when discussing the terms of the next phases with its external consultants.
- Phase 2 – Financial (and Operational) Impact Assessment (*refer DEAR CEO letter dated 31 August 2020*)
 - *Significant Judgements* - 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 IFRS 17 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.

- *Methodology* - 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 IFRS 17 road map.
- *Discounting* - 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 IFRS 17, and controls will be put in place to ensure there is adequate review and challenge around the discount rate selected by the Appointed Actuary.
- *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.
- *Onerosity Determination* - 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 IFRS 17 principles will be adopted, and a transparent process will be put in place to identify onerous contracts with clear assignment of responsibilities.
- *Mapping between IFRS 4 and IFRS 17 Income Statement* - SAMA expects that management will ensure sufficient understanding of the mapping between IFRS4 and IFRS 17 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 IFRS 17 financial reporting era.
- *IFRS 17 System* - SAMA expects that management will develop an in-depth understanding of the system requirements of IFRS 17 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.
- *Resourcing* - SAMA expects management to ensure adequate and skilled resources are available to each function for effective and smooth implementation of IFRS 17. Given the steep learning curve involved, it is expected that planned recruitments and/or trainings will be carried out in a timely manner.

- *External Audit* - SAMA expects that management will ensure the external auditors of the Company have the necessary knowledge and expertise of IFRS 17 in order to analyze the results in sufficient detail so that the Audit Committee can get the required assurance around the Company's IFRS 17 financial statements.
- *Overarching messages*
 - SAMA expects that management will ensure that all IFRS 17 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.
 - SAMA expects that management will ensure that all new features of IFRS 17 are well understood within the Company, and relevant individuals within the Company have complete ownership of each new feature.
- Phase 3 – Design of Implementation Plan (*refer DEAR CEO letter dated 11 July 2021*)
 - *Governance and Monitoring by Senior Management and BoD* - Despite significant efforts to date, it is unlikely that any insurance company has a 'perfect' implementation plan in place at this stage. Effective and regular monitoring is therefore essential for an insurance company to take timely corrective actions based on learnings from the upcoming dry run exercises and evolving best practices. SAMA has observed that a number of companies have inadequate plans to monitor their implementation progress during the next phase. Additionally, it is essential that a regular feedback loop involving the Board of Directors is in place.
 - *Informed Decision-making* - IFRS 17 requires management to make decisions in key design areas. To aid management in this decision-making, SAMA encouraged insurance companies to produce technical papers, showing various options available and the impact of each option. However, only a small proportion of technical papers produced by insurance companies contained quantitative impact assessment, exposing them to the risk of making un-informed choices.
 - *Wide Variations among Insurance Companies* - There are several key methodology and policy decisions that can materially influence the IFRS 17 implementation plan as well as the extent of insightful knowledge available to management in the go-live state. Wide variations in some of those areas (e.g., level of aggregation, length of cohorts, basis for onerosity determination, etc.) suggest the need for further careful thinking by insurance companies in those areas.
 - *Balance between Simple and Useful* - Where IFRS 17 gives choices to insurance companies, the chosen route should not be driven by 'simplicity' considerations

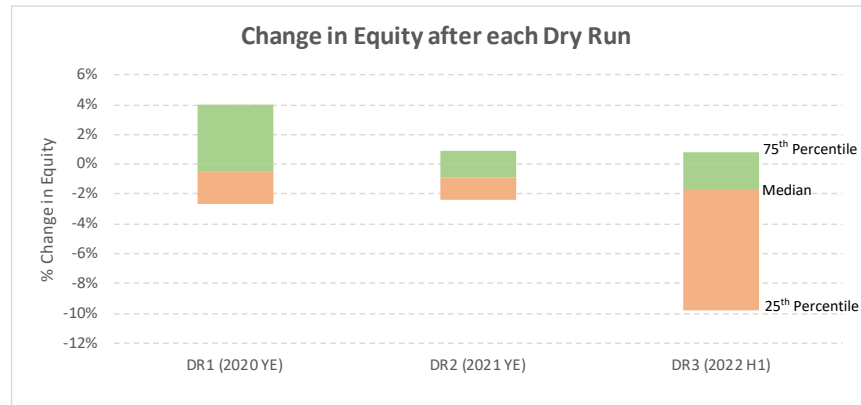
only; instead, management is expected to consider all 'pros and cons' of it, including its usefulness in managing the day to day business and in shaping the business strategies.

- *Assigned Roles v Capabilities* - Assigning roles and responsibilities aligned with the core capabilities of individuals and functions will be important in ensuring the reliability, accuracy and appropriateness of results. Some companies appear to deviate from general market practices and, hence, may need to revisit their existing assignment of roles and responsibilities.
- *Data Availability* - Nearly half of the overall data fields, required under IFRS 17, are currently not captured by insurance companies. Significant efforts by insurance companies will be required to plug this gap.
- *IFRS 17 Engine Adoption and System Integration* - Getting the new IFRS 17 systems up and running on a timely basis will be critical for the overall preparations. Current implementation timelines for many insurance companies deviate from SAMA's expectations and need to be re-aligned.
- *Resourcing and Training* - Provision of adequate resources and training to employees and senior management is considered essential. We note limited training budget for many companies, which exposes companies to the risk of inadequately trained internal teams. Moreover, for adequate knowledge transfer, it would be essential for internal teams to work side by side with external consultants during the next phase.
- *Knowledge Transfer and Ownership of Outputs* - Majority of the IFRS 17 preparation work has so far been carried out by the external consultants. For business-as-usual, this is not a sustainable model. During the next phase, the Board of Directors is expected to ensure sufficient ownership at all levels of the Company.
- *Investor Communication* - The Board of Directors is also expected to oversee setting up of a plan for communication with the investor community, educating them about the upcoming changes and the likely impact of transition to IFRS 17.

E) Key Findings from Phase 4

E1) Change in Equity

- The graph below shows the extent of change in the shareholders' equity of insurance companies after each of the three Dry Run exercises.



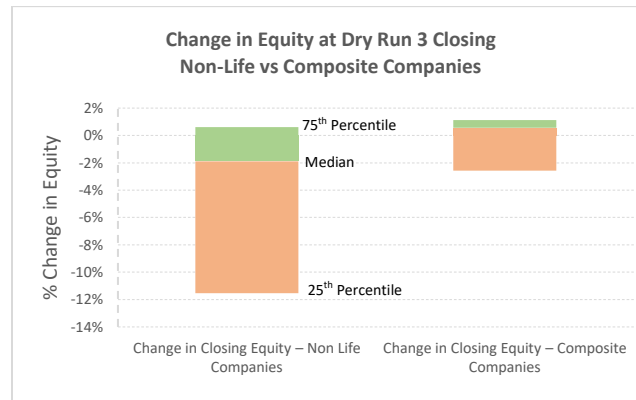
Based on our discussions with insurance companies, we note that the results of Dry Run 1 lacked reliability for a large number of insurance companies. Despite this, it provided a good learning opportunity for insurance companies.

In Dry Run 2 (audited), improvements were made by insurance companies in respect of both data and methodology. While there was a relatively narrow range of results in this Dry Run, the range of results widened significantly in Dry Run 3. This widening can be attributed largely to insurance companies responding to the observations and, in some cases, qualifications of their external auditors in Dry Run 2, as well as refinements made to various methodologies in consideration of the recommendations of the IFRS 17 Working Group, review and challenge by SAMA, and benchmark comparisons shared by SAMA with insurance companies.

In Dry Run 3, significantly more companies had a negative impact on equity than those that had a positive impact due to transition to IFRS 17 and IFRS 9. Moreover, based on our review of Dry Run 3 results and discussions held with a selection of insurance companies, we expect both data and methodology to undergo further refinements, in addition to addressing the remaining audit observations, in order to increase the reliability and stability of IFRS 17 Financial Statements.

- Composite v Non-Life only companies*

The graph below shows a comparison of the change in shareholders' equity between non-life insurance companies and composite insurance companies operating in the Saudi insurance sector.

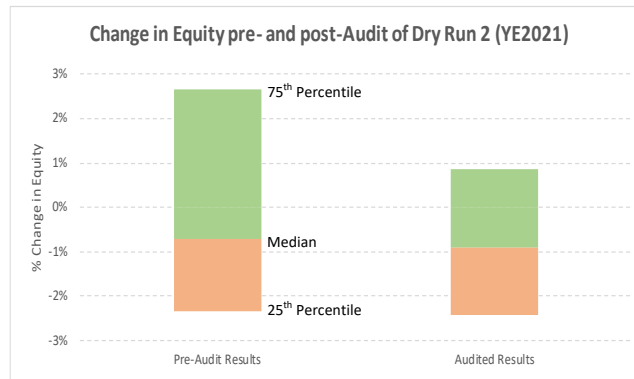


- Non-life companies had a materially adverse impact on equity than composite insurance companies. This can possibly be attributed in part to a high onerosity factor and a higher risk adjustment factor for non-life companies than for composite companies, in view of the intense competition for Motor and Health lines of business and the historical high volatility of those two lines.

E2) Audit of Dry Runs

- *Audit of Dry Run 2*
 - *Difference between audited and unaudited results*

The graph below compares the change in shareholders' equity between pre- and post-audit results of Dry Run 2.

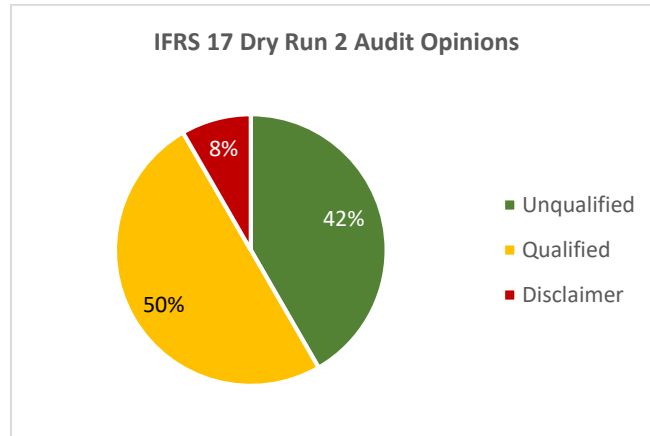


Compared to the pre-audit position, the range of results narrowed down significantly after the results were audited, with the reduction mainly observed for those companies that had initially estimated a positive impact on equity. This significant movement can possibly be attributed to two major reasons: corrections in response to initial audit observations before the audit opinion was finalized, and adjustments made by insurance companies after submission of unaudited results to SAMA, as many gaps were observed during our meetings held with insurance companies to discuss the unaudited results.



- *Distribution of audit opinions*

The graph below shows the distribution of the types of audit opinion received by insurance companies after the audit of Dry Run 2 results.



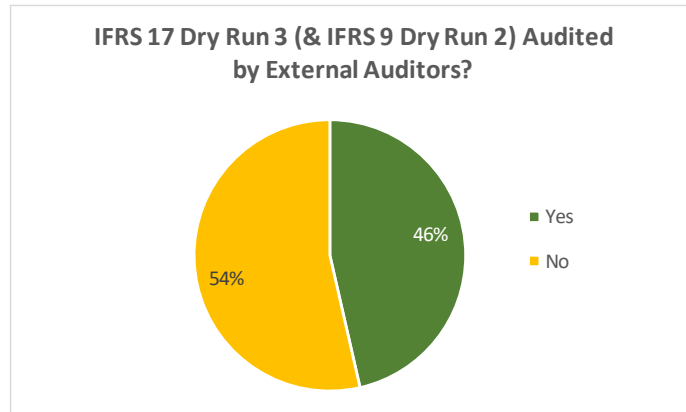
More than half of all insurance companies received a qualified opinion or a disclaimer. The findings of auditors were broadly in line with SAMA's observations based on our review, challenge and discussion of the Dry Run 2 results with insurance companies.

The qualifications, disclaimers and management letter points served as early warnings to the senior management, drew their attention towards the key issues and areas of uncertainty, and provided them with the opportunity to address those in time before the Standard went live.

The audit exercise is also expected to reduce the risk of potential surprises for management, policyholders and investors in the go-live state. The exercise also helped the external auditors in preparing their teams for the go-live state.

- *Audit of Dry Run 3*

- Based on the concerns of the insurance companies related to the cost of audit, SAMA gave management of insurance companies discretion on whether to get the results of Dry Run 3 audited. The Audit Committee was required to justify its position to SAMA where it decided against the audit of Dry Run 3 results. The graph below shows the proportion of insurance companies seeking audit opinion on Dry Run 3 results.



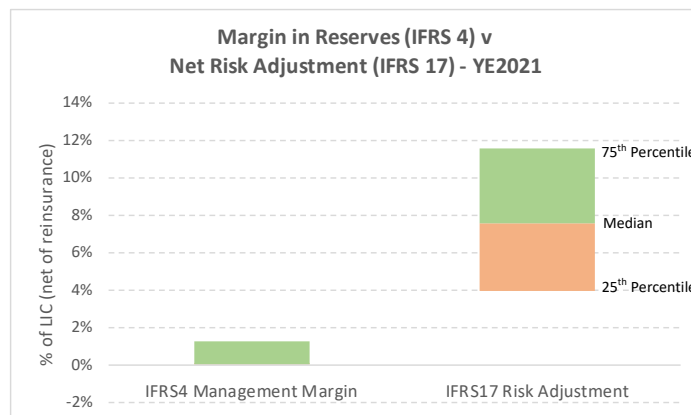
- We noted with concern that the proportion of insurance companies opting for audit in Dry Run 3 was less than the proportion of insurance companies that received a qualified opinion or a disclaimer in Dry Run 2. We expect the Audit Committee and senior management of those companies to ensure that appropriate measures are taken and strong governance is in place in order to validate that all audit observations are addressed in a timely manner.

E3) Key benchmarks

○ *Risk Adjustment*

- *Management Margin in Reserves v Risk Adjustment*

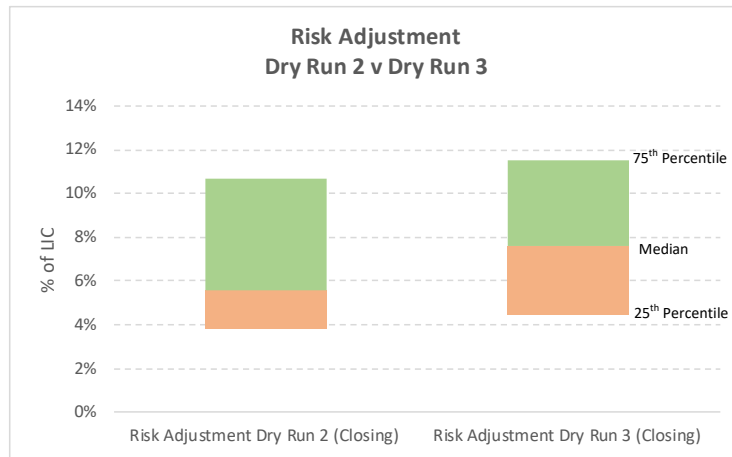
Unlike IFRS 4, where company management had the discretion to decide on whether and how much margin to add to the Appointed Actuary’s recommended reserves, IFRS 17 requires all insurance companies to add risk adjustment to its liabilities, such that the confidence level around the insurance liabilities booked in financial statements is in line with each company’s own risk appetite. The graph below compares the margin in IFRS 4 reserves added by management with the risk adjustment added, net of reinsurance.



It can be seen above that the addition of risk adjustment caused a material increase in liabilities, since under IFRS 4 many insurance companies had opted to put 'nil' margin on top of the Appointed Actuary's recommended reserves. This may be partly offset by release of prudence margins in actuarial reserves.

- *Risk Adjustment – Dry Run 2 v Dry Run 3*

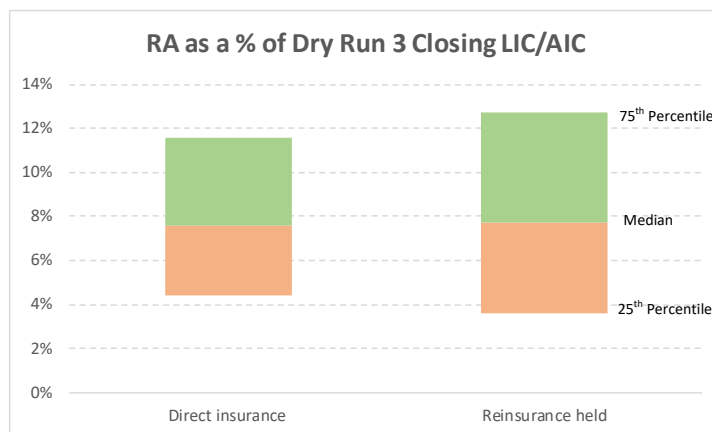
The graph below compares the risk adjustment at the end of Dry Run 2 and Dry Run 3.



A small upward shift is noted in the level of risk adjustment between the two Dry Run exercises, possibly due to refinement of risk adjustment methodologies.

- *Risk Adjustment - Direct v Reinsurance Held*

The graph below compares the consistency (or lack of it) of risk adjustment estimates between direct insurance and reinsurance held.



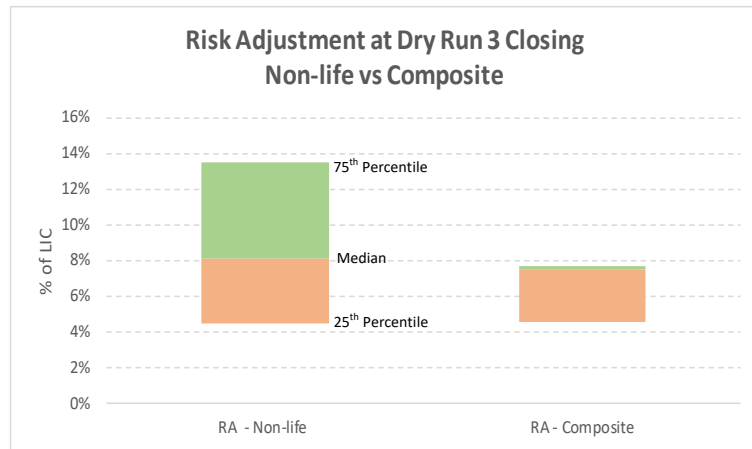
A wider range of risk adjustment can be observed for reinsurance held than for direct business.



Using a higher risk adjustment assumption for reinsurance held than for direct business will be advantageous for an insurance company immediately, but more costly in the longer run as it is released over time. Management is expected to ensure there is sufficient diligence and challenge within the Company around all key assumptions.

- *Risk Adjustment - Composite v Non-Life companies*

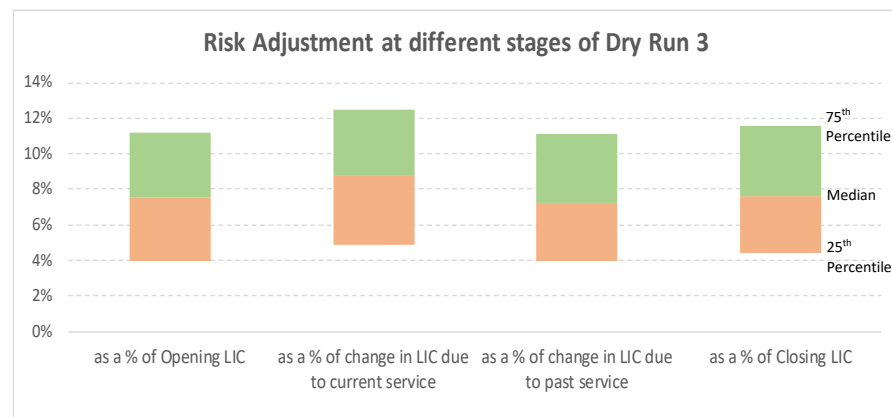
The graph below compares the risk adjustment estimates between non-life companies and composite companies.



The risk adjustment estimates are noticeably higher for non-life companies than for composite companies. This is likely due to the high volatility experienced by Motor and Health lines of business in recent years.

- *Stability of Risk Adjustment Estimates During a Given Period*

As part of its validation and controls, management is expected to assess whether risk adjustment estimates remain stable throughout the year. The graph below shows risk adjustment, as a percentage of the relevant bases, at the beginning, during and end of Dry Run 3.

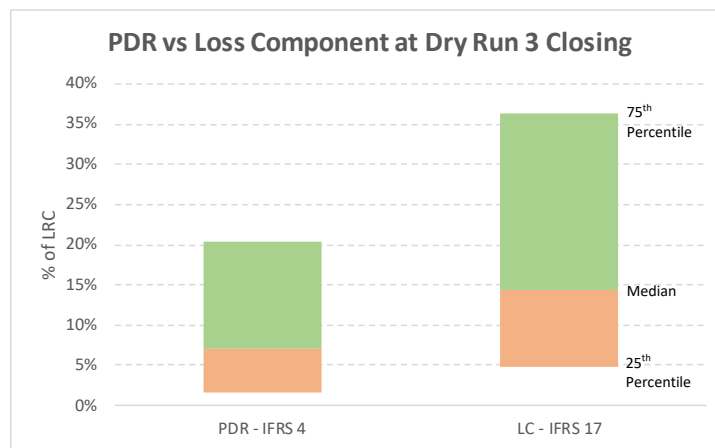


While the beginning and closing risk adjustments appear similar in the above graph, variations can be observed in risk adjustment estimates during the year. Based on our discussions with insurance companies, we understand some to this variation is due to inaccurate allocation to individual groups of contracts and portfolios.

○ *Loss Component & Loss Recovery Component*

▪ *Loss Component v Premium Deficiency Reserves*

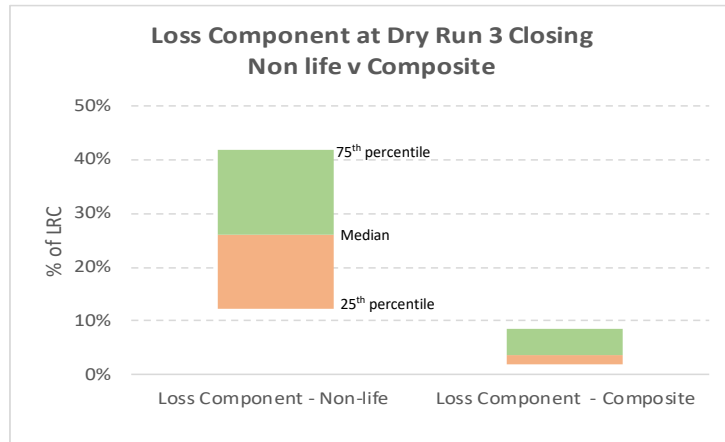
IFRS 17 requires onerous determination at a more granular level than permitted under IFRS 4, thus restricting a company's ability, unlike under IFRS 4, to offset loss-making groups of contract with profitable groups of contract. Moreover, an insurance company is required to add risk adjustment to its onerous calculations, unlike under IFRS 4. The graph below compares the closing loss component in Dry Run 3 with the corresponding premium deficiency reserves at Q2 2022.



Due to the above reasons, the loss component appears materially higher than the premium deficiency reserves held by insurance companies.

▪ *Loss Component - Non-Life v Composite*

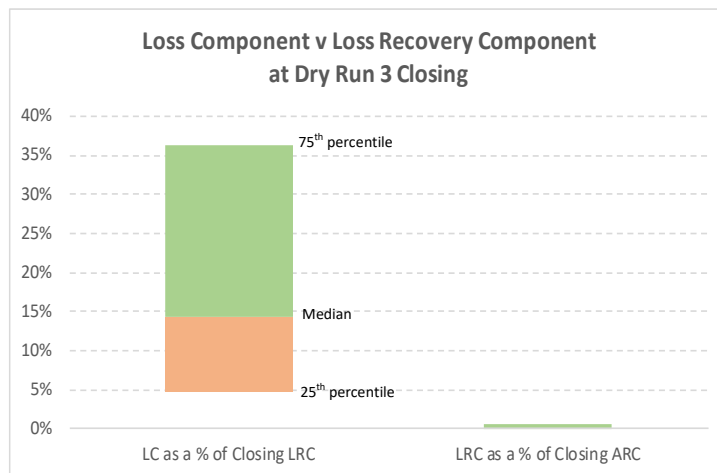
The graph below compares the loss component in Dry Run 3 between non-life companies and composite companies.



The loss component for non-life companies was significantly higher than for composite companies, mainly due to the intense, and at times, unhealthy competition among companies underwriting Motor and Health business. On the other hand, the individual life book of composite insurance companies had either a small or no loss component.

- *Loss Component v Loss Recovery Component*

Where an insurance company holds loss component in respect of groups of contract, IFRS 17 permits passing a part of this loss to the reinsurer as a loss recovery component. The graph below shows the loss component and loss recovery component, as a percentage of their respective bases, in Dry Run 3.



We noted limited use of the loss recovery component feature of IFRS 17 by insurance companies, mainly due to the loss component generally arising from Motor and Health lines of business that are usually protected by Excess of Loss treaties and where more sophisticated estimation approaches and assumptions are required than those applicable for

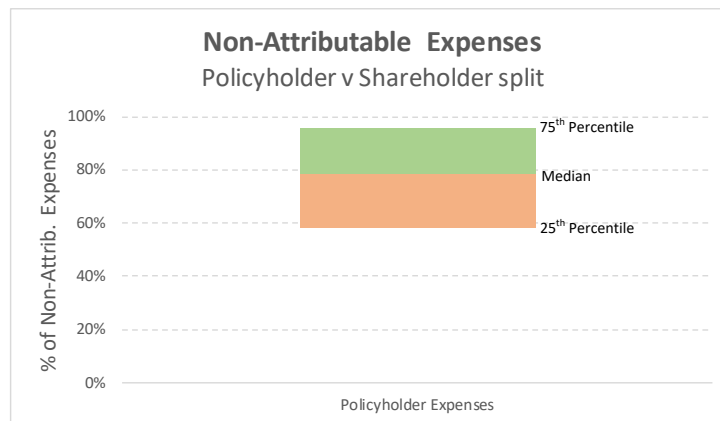
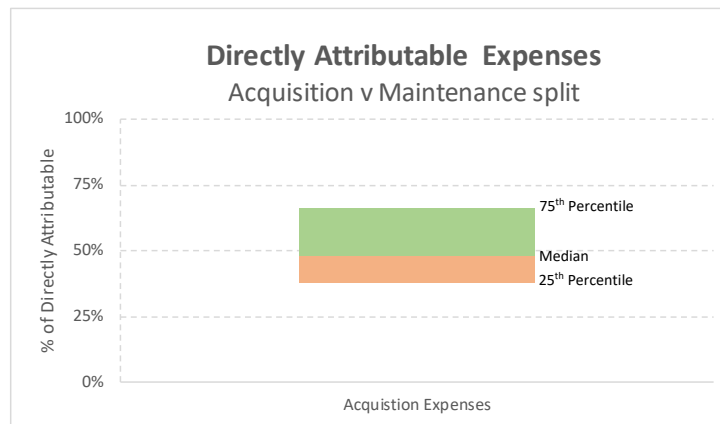
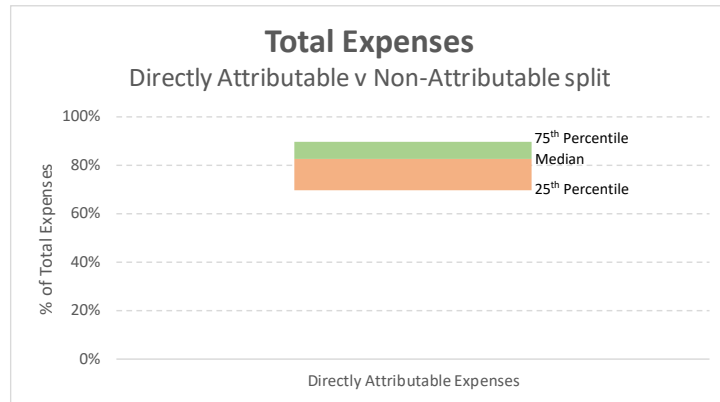
proportional treaties. We expect the actuarial methodology deployed in this area to evolve in the future.

○ *Measurement Models*

- Majority of insurance companies have opted to use the simplified Premium Allocation Approach (PAA) over General Measurement Model (GMM). For segments of business with policy terms longer than one year (e.g., EAR/CAR, Medical Malpractice, Extend Warranty insurance, etc.), companies performed PAA-eligibility testing before adopting the PAA route.
- We have noted that in a number of cases, the results of the PAA-eligibility test were measured against the materiality used for financial statement. This may not be deemed strictly in line with the principles of IFRS 17, as raised by some external auditors in Dry Run 2.
- Moreover, many companies did not perform PAA-eligibility test for ten-year long Inherent Defect Insurance policies, under the argument of immaterial business volumes. The general market perception is that the PAA route may not be valid for this line of business given its long term nature. Therefore, as the volume grows under this line of business, companies may need to consider adopting the GMM route.
- Therefore, it is expected that insurance companies will continue to evaluate the suitability of the measurement model keeping in view their evolving business profile and the IFRS 17 principles.

○ *Expense Attribution*

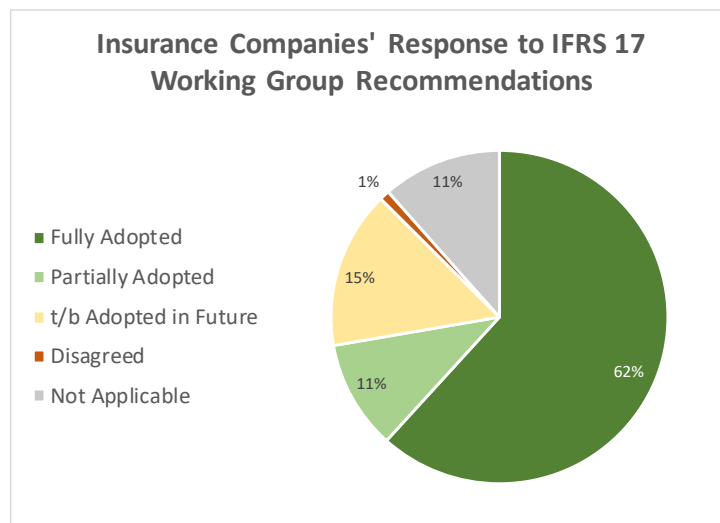
- Based on the results of the first two Dry Runs, SAMA identified expense attribution as an area where significantly varying practices were followed by insurance companies, leading to materially different results despite writing similar business. This was particularly true for determining whether a group of contracts was onerous or not.
- The IFRS 17 Working Group deliberated at length on this subject, and finally issued detailed recommendations for distribution of total expenses into directly attributable and non-attributable, further splitting directly attributable expenses into acquisition and maintenance, and non-attributable expenses into policyholders' and shareholders' expenses. The three graphs below show the results of the calculation by insurance companies in Dry Run 3 following those recommendations.



- Compared to the wide range observed in respect of the directly attributable expenses in previous Dry Runs, the range of results narrowed down significantly in Dry Run 3. This is a positive outcome, since it is expected to increase comparability of results among insurance companies. SAMA may issue further instructions in this regard in order to increase comparability and consistency in the sector.
- The ranges for acquisition v maintenance expenses and policyholder v shareholder expenses are also expected to narrow down over time as the

market best practices emerge. Management is expected to remain abreast with the emerging market best practices, and where the Company's approach deviates materially from those practices, have a sound argument to support the Company's approach.

- *Adherence to Working Group's recommendations*
 - Based on SAMA's review and discussion of the first two Dry Run results with insurance companies, a number of areas were identified where market practices varied or where there was significant uncertainty as regards the best practice since no clear guidance was available from the Standard. The issues, 91 in total for Dry Run 3 and increasing since then, were discussed at a series of Working Group meetings and recommendations were issued for the consideration of insurance companies in Dry Run 3. The graph below shows the extent of adoption of those recommendations by insurance companies.



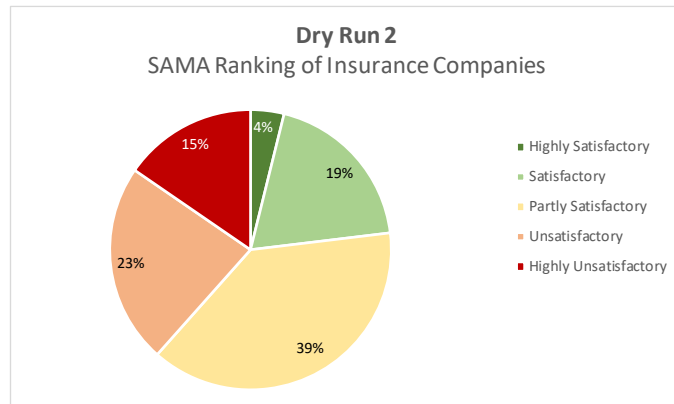
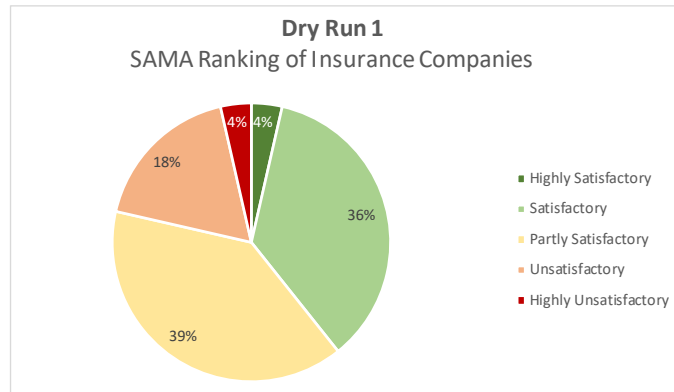
- Based on the feedback received from insurance companies, it can be stated that the above recommendations proved immensely helpful for the sector, as is also evident from the overwhelming adoption and planned adoption. Moreover, in the small number of cases where an insurance company disagreed with a recommendation, our discussions revealed that in the majority of those cases it was down to incorrect understanding of the recommendation or error in filling the relevant template.

E4) Findings from SAMA Review and Monitoring

- *Discussion of Dry Run Results with Insurance Companies*
 - After each Dry Run exercise, SAMA held meetings with individual insurance companies to discuss the results produced and to



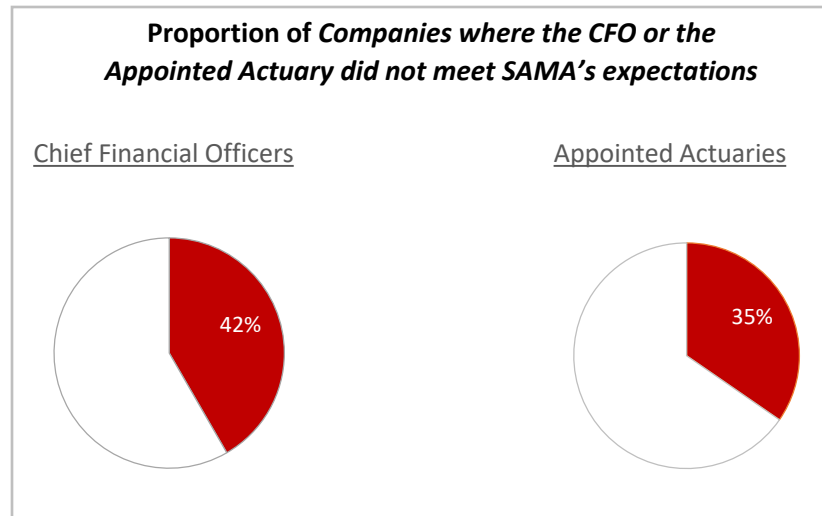
understand the issues and challenges being faced by individual companies and the sector as a whole. During these meetings, each company was assessed considering the reliability of the results presented and the ability of the company's team to demonstrate understanding and ownership of those results. The two graphs below show the summary of SAMA's assessment of insurance companies in each Dry Run.



- In both Dry Runs, a large number of companies fell well short of SAMA's expectations. Despite improvements by insurance companies between Dry Run 1 and Dry Run 2, the proportion of companies not meeting SAMA's expectations went up in Dry Run 2, as SAMA raised its bar given the fast approaching go-live date. Moreover, the use of Uniform Financial Reporting templates enhanced SAMA's ability to perform a more objective assessment.
- In Dry Run 3, SAMA focused on a selection of insurance companies, where it had specific concerns, and meetings were held with those companies. SAMA will continue to follow up with those companies as appropriate.

○ *Monitoring of Key Personnel Involvement*

- In order to establish an effective, reliable and durable IFRS 17 reporting framework, it is essential that both the CFO and the Appointed Actuary of the Company play leading roles. Hence, during the course of our interaction with insurance companies, we also assessed the role played by each of the above two professionals, and in many cases, one or both fell short of SAMA's expectations. The graph below shows the proportion of each that fell short of SAMA's expectations.



- SAMA will continue to monitor the role of the above individuals in implementing IFRS 17 and IFRS 9. At the same time, it urges all CFOs and Appointed Actuaries to work jointly towards producing a robust IFRS 17 and IFRS 9 reporting framework within the insurance company. Moreover, it is expected that the two will act as role models for the Company IFRS 17 team members and will assist in developing subject-matter experts within the Company.

F) Next Steps

- Next Steps and Issues to be addressed by Insurance Companies
 - Preparation for Q1 2023 financial reporting on IFRS 17 and IFRS 9 basis
 - In addition to the usual work involved in preparing a quarterly financial statement, this would require preparation of Balance Sheet as at year-end 2022 on IFRS 17 basis as well as the Comparatives for Q1 2022.
 - It is imperative that management defines a precise delivery schedule with clear milestones as a priority and agrees it with its external auditors.
 - It is also important that all management letter points and qualifications (if any) from the audit of Dry Run(s) are addressed before finalizing the Q1 2023 financial statements.
 - Alignment of key methodologies with '*market best practice*'
 - Based on the learnings from the three Dry Run exercises, discussion of those results at the Working Group meetings, and courtesy of SAMA feedback and benchmarking results shared with insurance companies, significant refinements and broad harmonization has been achieved among insurance companies in various key methodology areas. These include expense attribution, provision for doubtful debts, level of aggregation, granularity of onerosity calculations, diversification of risk adjustment, etc., and further refinements are expected during the course of 2023.
 - The senior management and Board of Directors are expected to ensure the methodologies used by the insurance company remain aligned with the market best practice, unless any deviation can be justified, and latest market developments (e.g., in the form of recommendations issued by the Working Group, etc.) are closely followed.
 - Consistency of Reporting and Disclosures by insurance companies
 - Transparency of reporting being one of the key objectives of IFRS 17, it is imperative that all insurance companies disclose useful information consistently and in an easy-to-understand manner.
 - Building on to the Uniform Financial Reporting templates produced by the Saudi IFRS 17 Working Group, minimum Disclosures are expected to be developed at the industry level during 2023. It is important that the Company remains abreast of the development work in this regard in

order to implement any necessary changes to the Company's systems and processes in a timely manner.

- Automation and System integration
 - Many companies struggled to produce information, sourced from their IFRS 17 engine, at the level of granularity required by the Uniform Financial Reporting templates, thus requiring manual intervention; this at times led to errors and omissions.
 - Moreover, many companies are still in the process of completing integration between their core system and the IFRS 17 engine. Without achieving full integration, the stability and reliability of results will remain exposed to significant risk.
 - The senior management and Board of Directors are expected to pay special attention to this critical operational aspect in order to have a sustainable eco-system for the production of Financial Statements and associated Disclosures in a timely and reliable manner.
- Implementing Validation Checks
 - Our discussions with insurance companies after Dry Run exercises revealed that many companies relied excessively on their IFRS 17 engine, and results produced were not subjected to adequate validations. As a result, at places, the results produced defied logic and, at other places, there was limited understanding of the drivers behind those results.
 - In order to establish a sound financial reporting system, it is essential for both Finance and Actuarial teams to develop and implement comprehensive validation checks on the results produced by the IFRS 17 engine. This will be especially important during the early days of IFRS 17 as insurance companies get accustomed to the new look and new jargon of financial reporting.
- Solvency Impact of Transition to IFRS 17 and IFRS 9
 - The results of Dry Run exercises revealed that many insurance companies would experience a reduction in equity upon transition to the new Standards. For some companies, this impact is seen to be significant, and can cause a material weakening of the solvency position of those companies.
 - The Board and senior management must ensure that the Company remains solvent at all times, plans are made and measures are taken in a timely manner to deal with any downward pressure on the solvency position of the Company.

- Resourcing and Responsibilities
 - Going forward, in the IFRS 17 reporting era, it is commonly believed that both Finance and Actuarial functions will have to work closely on a day-to-day basis. During the course of Dry Run exercises, we found insurance companies with a strong in-house Actuarial function to be generally better prepared than those without. In this regard, attention is drawn to the Actuarial Work Rules 2020, issued by SAMA, which required each insurance company to hire a fully qualified actuary by early 2022.
 - Moreover, while the CFO has the overall responsibility for the financial statements, given the need for increased actuarial input, the Working Group felt it necessary to issue guidance on the distribution of ownership between the CFO and the Appointed Actuary of the Company as regards the various line items in the Uniform Financial Reporting templates. The above guidance is expected to enable smooth and seamless working relationship between Finance and Actuarial functions.
 - The senior management and Board of Directors are expected to ensure adequate actuarial and accounting resources are hired in a timely manner. Moreover, management is expected to consider establishing internal policies in order to align with the Working Group's recommendations regarding the distribution of responsibilities between Finance and Actuarial functions of the Company.
- Aligning existing and developing new Key Performance Indicators (KPIs)
 - In order to ensure quick and complete absorption of the transition to IFRS 17 by all functions of the Company, it is essential for management to consider re-aligning the current KPIs and developing new ones in line with the new financial reporting format. Some of these may include:
 - i. Volume and impact of onerous contracts underwritten by the Sales/Underwriting team,
 - ii. Insurance Service Revenue produced by the Sales/Underwriting team,
 - iii. Insurance (and Reinsurance Held) Service Results produced v those projected in the Business Plan (which would also need to be restated)
 - iv. Revision to the definition of Combined Ratio
 - The senior management and Board of Directors are expected to prioritize developing and aligning KPIs in line with the new reporting formats so that there is no communication gap between various functions of the Company.

- Investor Communication
 - The Working Group has prepared a standard Disclosure, required under IAS 8, for insurance companies to use in their year-end 2022 Financial Statement, which provides insight on the financial impact of transition to IFRS 17 and IFRS 9.
 - It would be important that the senior management and Board of Directors supplement the above Disclosure with direct communication with current and prospective investors so that any uncertainty in the stock market is avoided and investment decisions are taken with confidence.
- Next Steps for SAMA
 - Actuarial Reserving under IFRS 17 and its Review
 - Update and issue SAMA instructions for actuarial reserving, with the first report due in respect of year-end 2022 in early 2023; the reporting deadline shall be decided considering the schedule of financial reporting for 2023, to be announced by the Capital Market Authority (CMA)
 - Update the internal SAMA processes for review, validation and benchmarking of individual company submissions
 - SAMA Regulatory Reporting Forms
 - Add new forms to the regulatory reporting requirement, covering Uniform Financial Reporting templates at portfolio and group of contracts levels
 - Adjust the existing reporting forms to avoid any overlap with the new forms being added
 - Roll out a plan so that the reporting requirements based on IFRS 4 can be phased out over time
 - Risk Based Supervision (RBS) Framework
 - Add new data fields for companies and new KPIs for SAMA based on the new Standard
 - Roll out a plan to phase out over time those data fields that are based on IFRS 4 and not considered relevant anymore and/or overlap with the new Standard



- SAMA Rules and Regulations
 - Update the current rules and regulations as appropriate to align with IFRS 17 and IFRS 9
- Solvency Calculations
 - Consider changes deemed necessary to the current solvency calculations while considering in parallel the results of the annual actuarial analysis in respect of solvency and capital of the Company
- Continue to Facilitate and Encourage Professional Discussion and Dialogue
 - Organize meetings of the Saudi IFRS 17 Working Group at an appropriate frequency and discuss issues and observations based on the financial statements of the initial quarters of 2023
 - If deemed necessary, hold market events to disseminate key messages to wider audience

Finally, SAMA would like to thank the entire insurance sector, particularly the members of Saudi IFRS 17 Working Group and the members of insurance companies' IFRS 17 teams, for their contribution towards the success of this project. SAMA would also like to express its gratitude to the senior management and Board of Directors of insurance companies for the support and leadership provided to their respective IFRS 17 teams during this journey.

Distribution

Chief Executive Officers

Appointed Actuaries

Members of Company IFRS 17 Teams

Members of Saudi IFRS 17 Working Group