

11 July 2021

Dear CEO

### **SAMA IFRS 17 Implementation Road Map - Findings from Phase 3 submissions**

The International Financial Reporting Standard No. 17 (IFRS 17) is due to go live from 1<sup>st</sup> January 2023. The Standard will replace the existing financial reporting standard, namely, IFRS 4. The Standard is expected to enhance the transparency of financial statements of insurance companies. It is also expected to increase the comparability of financial statements from different jurisdictions.

In order to ensure the Saudi insurance sector transitions to the new Standard in an orderly manner, SAMA issued an implementation road-map in December 2018, which comprised four phases, namely, i) gap analysis, ii) financial impact assessment, iii) implementation plan and iv) implementation and dry runs.

The first two phases were completed in years 2019 and 2020 respectively. After each phase, SAMA reviewed the submissions received and issued feedback to the sector in the form of a 'Dear CEO letter', along with specific feedback in the form of individual company letters. The purpose was to raise awareness of evolving market best practices for the consideration of Company management as they progress with their IFRS implementation journey.

For the third phase "Implementation Plan", SAMA issued detailed instructions on 29<sup>th</sup> October 2020, with submissions due on 31<sup>st</sup> March 2021, which was later extended to 15<sup>th</sup> April 2021.

This letter contains SAMA's overall feedback based on our review of the submissions received. The letter also sets out our expectations going forward in various areas covered in this letter. The Company management shall discuss this letter with its Board of Directors, Executive Committee, Appointed Actuary, Company's IFRS17 implementation team, its external auditors, and (where applicable) with its external consultants.

Separately, SAMA will share individual company benchmarks with management, showing the Company's relative position compared to the sector in various design areas. It is expected that management will use those benchmark comparisons to revisit or fine-tune its design decisions, as appropriate.

This letter discusses the design of IFRS 17 implementation plan in the following sections:

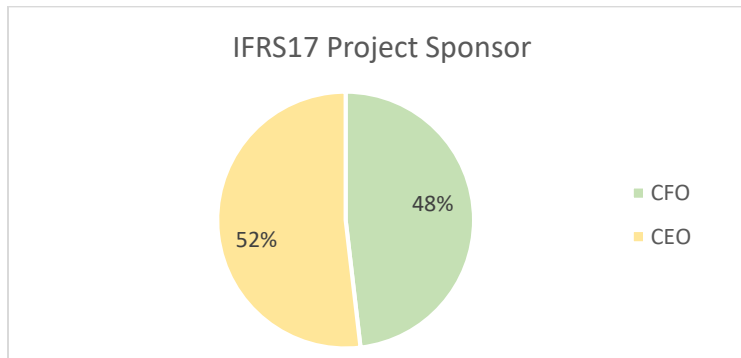
- A) Governance & Controls Framework, pages 2 – 6
- B) Operational Design, pages 7 - 11
- C) Technical and Financial Design, pages 12 – 27
- D) Audit Review and Assurance Plan, pages 28 - 29
- E) Budget for Implementation, page 30
- F) Conclusion, page 31



**A) GOVERNANCE & CONTROLS FRAMEWORK**

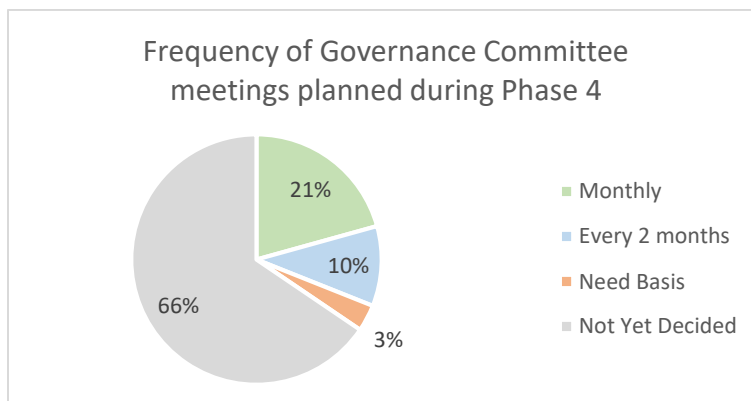
Project Sponsorship and Monitoring

A successful implementation of IFRS 17 requires attention and ownership from senior management. The graph below shows the distribution of the ownership of IFRS 17 implementation project at insurance companies.



In line with SAMA’s expectations, top executives own and drive the IFRS 17 implementation at insurance companies. SAMA expects the extent of involvement of senior executives and Board of Directors to increase significantly as the sector enters into Phase 4. SAMA expects this involvement to be evidenced through meeting participations, training sessions, review and challenge of the key design decisions, etc. SAMA expects management to ensure participation of wider functions too in this journey, so that the entire Company gets ready to embrace this change. SAMA also expects management to put in place a plan to take the investor community on board.

During the next phase, as an insurance company goes through the process of implementing its IFRS 17 plan, an effective monitoring will be key to ensuring it meets all target dates as stated in the implementation plan, and any changes to the implementation plan, if deemed necessary, are made on a timely basis and after appropriate review and approval. The graph below shows the monitoring plan of insurance companies for the next phase.



We express our concern that the majority of insurance companies lack clarity over their monitoring plan for the next phase. SAMA expects management to have in place a mechanism for regular (preferably monthly) and effective monitoring of its progress with implementing the

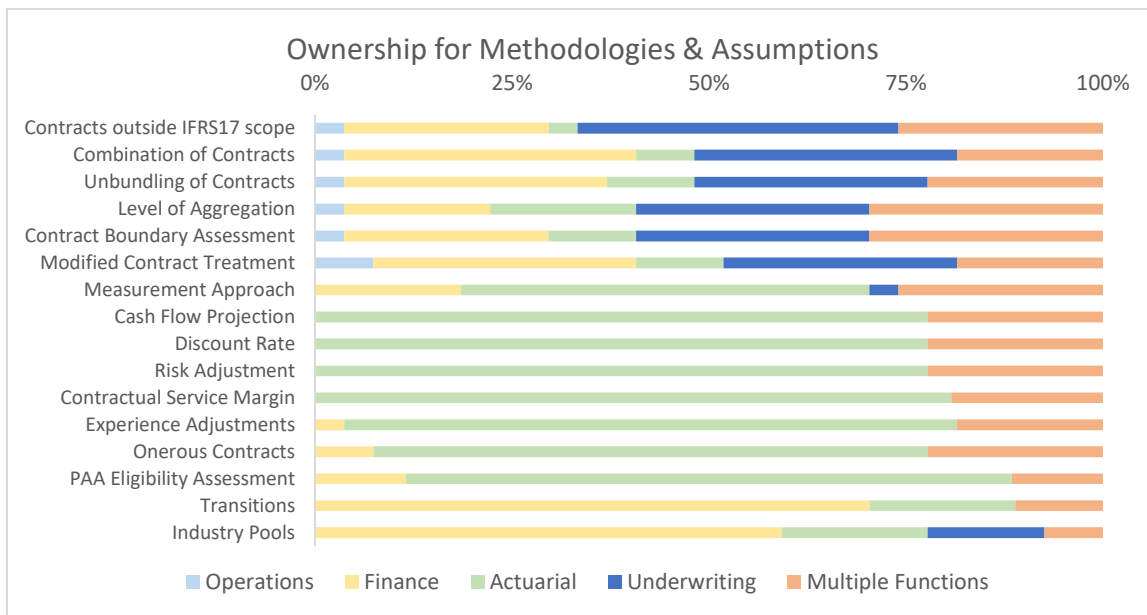


processes, systems, methodologies, accounting policies, training and recruitment. It is also expected that proceedings of governance committee meetings will be recorded and made available to SAMA upon request, as well as escalations will be made in a timely manner.

Governance around Key Design Decisions

*Responsibilities for Methodologies and Assumptions*

For an effective execution of the IFRS 17 implementation plan, it is imperative that all key functions are fully aware of their roles and responsibilities, and those responsibilities are assigned taking into account the competencies of the individuals and nature of the topics. The graph below shows the ownership of important design methodologies and assumptions by various functions at insurance companies.



Across the sector, responsibilities for key methodologies and assumptions are distributed mainly among finance, actuarial and underwriting functions. We note several ‘technical areas’ where finance function appears to have a high proportion of ownership relative to actuarial or underwriting function, for example, combination and unbundling of contracts, level of aggregation, measurement approach, and industry pools. Moreover, for identifying onerous contracts, while the majority of insurance companies have assigned the ownership to their actuarial function, it is expected that the underwriting function will contribute materially towards this area.

Additionally, we note that a material proportion of companies has assigned ownership to multiple functions jointly, though we believe assigning ownership to one function provides more clarity. In case of joint ownership, ensuring sufficient clarity on roles and responsibilities for each participating function would be important.

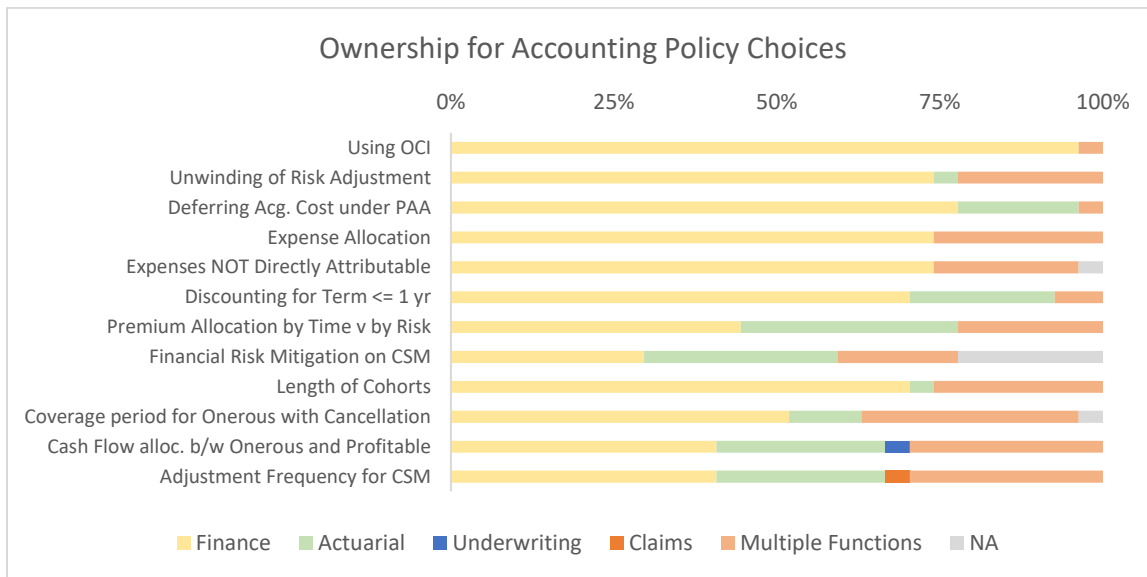
SAMA expects management to ensure appropriate alignment between the core competency of a function and the complexity of the topic when assigning the ownership of the methodology and



assumptions relating to that topic. Where joint ownerships have been assigned, SAMA expects management to ensure each participant fully understands his responsibility and the hierarchy of decision-making is clear for all participants. SAMA also expects management to put in place an effective process for obtaining contributions from the relevant functions in aid of the owner functions. SAMA also expects management to lay down an effective process for review, challenge and approval of the methodologies and assumptions proposed by the owner functions.

*Responsibilities for Accounting Policy Choices*

IFRS 17 permits an insurance company to choose an accounting policy it deems appropriate for its business model, provided appropriate justification for that selection can be provided. These choices can have a material impact on the design of IFRS 17 implementation plan as well as on the IFRS 17 financial statement of the company. The graph below shows the distribution of responsibilities across the sector for making those accounting policy choices.



The majority of insurance companies have assigned responsibilities for the above policy selection to their finance function. Among those, assigning the accounting policy for the *length of cohorts* is of particular note, since the choice of the length of cohorts can have a material bearing on the calculations performed by a company’s appointed actuary. The actuarial function too has a sizeable share of ownership in some areas, e.g. discounting of cash flows for contracts with a term of one year or less. A number of companies have assigned joint responsibilities for these selections.

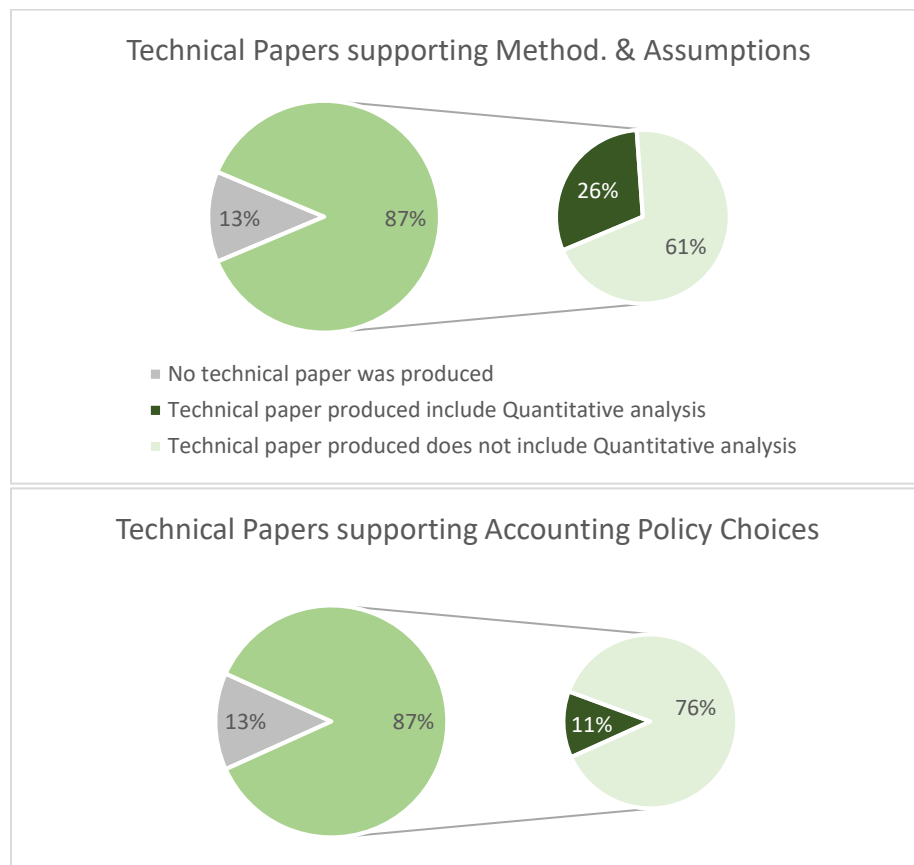
SAMA expects management to think through the implications and appropriateness of the selected accounting policies, leveraging of the market benchmarks, and where necessary, revisiting the current selection. Where joint ownerships have been assigned, SAMA expects management to ensure each participant fully understands his responsibility and the hierarchy of decision-making is clear for all participants. SAMA also expects management to put in place an effective process for obtaining contributions from the relevant functions in aid of the owner functions. SAMA also



expects management to lay down an effective process for review, challenge and approval of the methodologies and assumptions proposed by the owner functions.

#### *Technical Analysis Supporting Key Design Decisions*

As part of its instructions for Phase 3, SAMA had encouraged all insurance companies to prepare detailed technical papers in all key decision areas, listing all options available and citing *pros and cons* of those options, and documenting rationale for the selected option. Where possible, it was recommended to quantify the impact of each option, so that management can make informed policy decisions. The graph below shows the distribution of companies as regards production of those technical papers and, where technical papers were produced, quantification of the impact of each option.



While technical papers were produced for the majority of key decision areas, it is noted with concern that only a small proportion of those technical papers contained quantitative analysis. This increases the risk of key design decisions being arrived at without fully understanding their consequences (or of their alternatives).

SAMA expects management to continue to explore and understand the impact of alternative methodologies and accounting policy decisions during the upcoming dry-run exercises, and where deemed necessary, amend current design decisions.



### Materiality

IFRS 17 is a principles-based standard that gives choices to management in several key design areas. It is expected that management will execute its decision-making with reference to a well-defined philosophy. The concept of 'materiality' is at the core of this philosophy, and it can significantly influence the overall design of IFRS 17 implementation plan.

We note that insurance companies have defined their materiality considerations in a variety of ways, including *extent of influence on decision-making, audit materiality, by nature and complexity of each topic, etc.*

SAMA expects management to exercise due care and have clear objectives when defining its 'materiality' framework so that it is sufficiently robust and meets the expectations of all stakeholders.

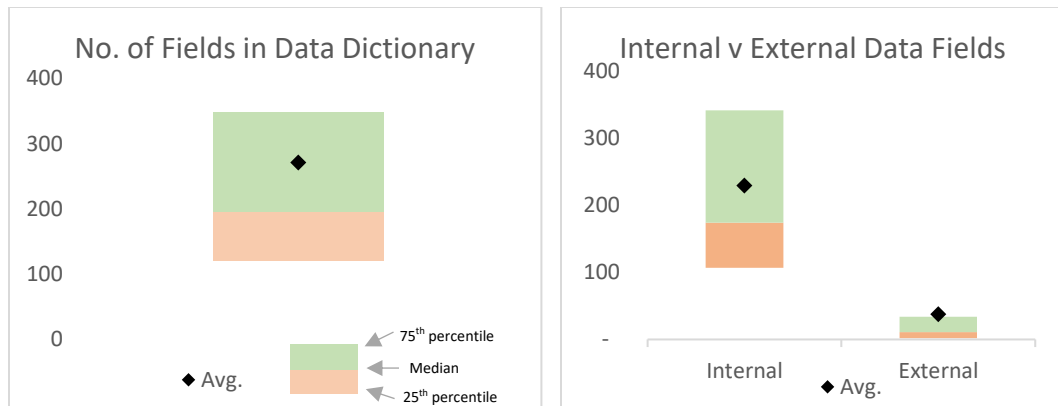


**B) OPERATIONAL**

Data Dictionary

*Completeness of Data Dictionary*

For a comprehensive implementation plan, it is imperative that all required data fields are identified at the design stage, so that the system and process requirements can be aligned. The graphs below show the mean, median and inter-quartile range in regards to the data dictionaries designed by insurance companies.

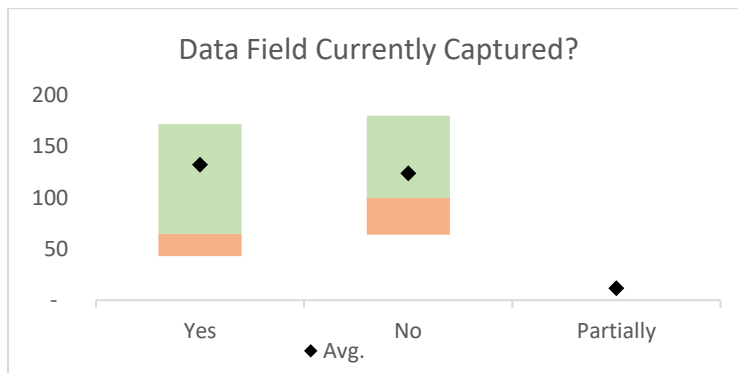


A wide variation can be seen among insurance companies in terms of the total number of fields identified, with the mean well above the median, indicating a positively skewed distribution. As regards the data inputs required from external sources, the very low first quartile compared to the average seen above indicates some companies may not have fully understood the external data requirements.

SAMA expects management to ensure producing a comprehensive data dictionary, dealing with all aspects of IFRS 17 income statement and disclosures, paying special attention to the external data requirements along with identifying the sources of external data.

*Availability of Data*

The graph below shows the magnitude of new data fields required to be captured for IFRS 17 implementation.



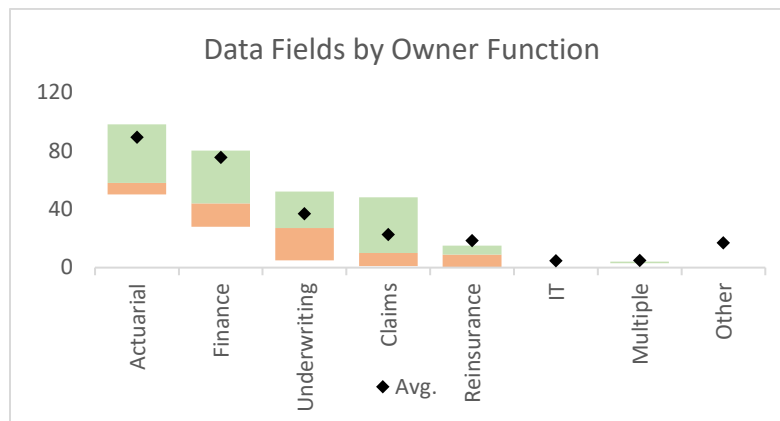


It is important to note that, on average, of the total data fields required, nearly half of the data fields are not currently captured by insurance companies, indicating the enormity of efforts required. Yet again, the wide variation seen among insurance companies in identifying the number of new data fields indicates that some companies need to pay greater attention to this critical area.

SAMA expects that management will ensure application of great diligence in identifying all data items required for IFRS 17 implementation, particularly new and external data fields along with identifying the external data sources.

### *Ownership of Data*

The graph below shows the distribution of data dictionary fields by owner function.



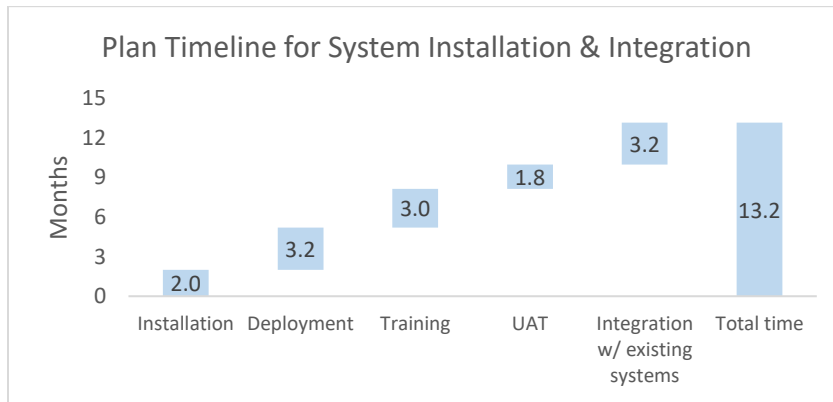
Many functions within each insurance company have been assigned the responsibility for creation and maintenance of data dictionary, with actuarial, finance, underwriting and claims functions having the dominant role.

SAMA expects management to ensure robust data validation processes are in place within each function and responsibilities for data collection and maintenance are clearly defined for personnel within each function.

### System and Software

#### *Timelines for Installation and Integration*

The graph below shows the planned duration for each step involved in system installation and its integration with existing systems.

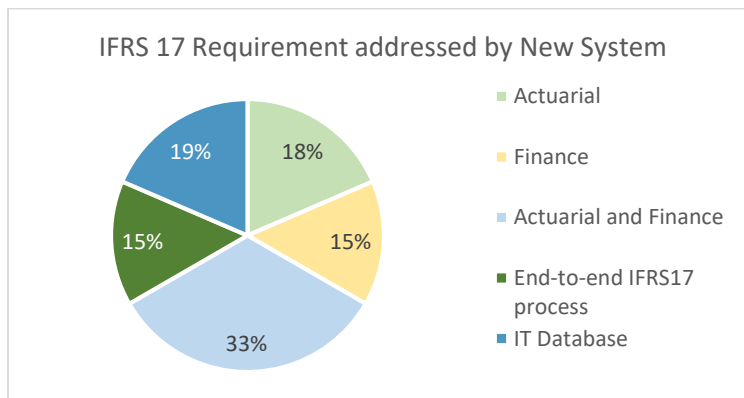


It is obvious from the above that if some activities are not carried out in parallel, the overall task can cross over into the year 2022, which would be in conflict with SAMA’s IFRS 17 implementation road map.

SAMA expects management to ensure system installation, testing, training and integration activities are carried out in parallel, to the extent possible, and all steps are completed before the dry-run exercise planned by SAMA in Q4 2021.

*Objective of New System & Software*

The graph below shows the distribution of intended objectives behind new system and software being acquired by insurance companies.



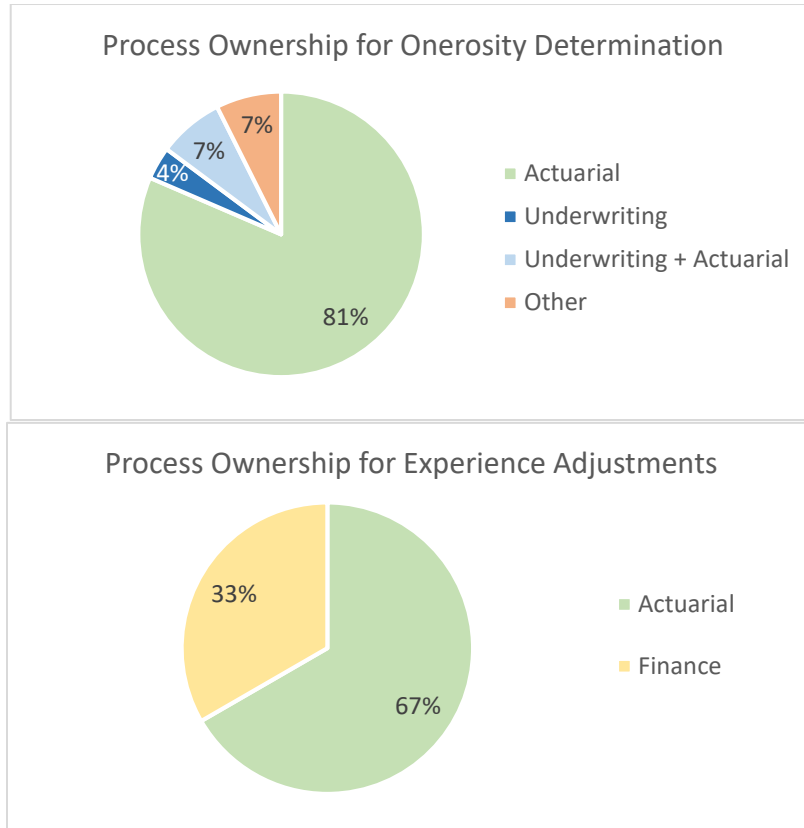
While one third of insurance companies made purchase decisions encompassing requirements of both actuarial and finance functions, over one third of insurance companies had a relatively narrow objective of addressing the requirements of either finance or actuarial function. A small proportion reported buying a comprehensive end-to-end solution. A number of insurance companies considered IFRS 17 implementation as an opportunity to upgrade their IT systems. We also noted that, in some cases, insurance companies stated different purposes for the same system, raising concerns regarding management’s understanding of the capabilities of the system before making the purchase decision.



SAMA expects management to ensure strong coordination with system and software providers so that any gaps in understanding of software capabilities are identified early in the process and, if required, remedial actions are taken on a timely basis.

Processes

The two graphs below show the distribution of responsibilities for running the processes of onerosity determination and of making experience adjustments.



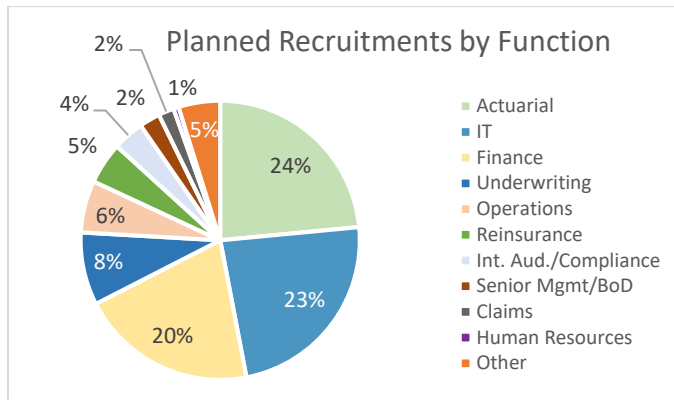
While the majority of insurance companies have assigned responsibility for the above processes to their appointed actuary and actuarial function, many companies have also made finance or underwriting functions responsible for the above processes, which is probably driven by differences between companies in their understanding of the requirements for each process.

SAMA expects management to ensure taking full account of the nature and complexity of each process when assigning ownerships for processes. Management is also expected to ensure availability of adequate support to the owner function by all relevant functions.

Training and recruitment

*Recruitment*

The graph below shows the distribution of the total number of new hiring planned by insurance companies to meet their IFRS 17 requirements.

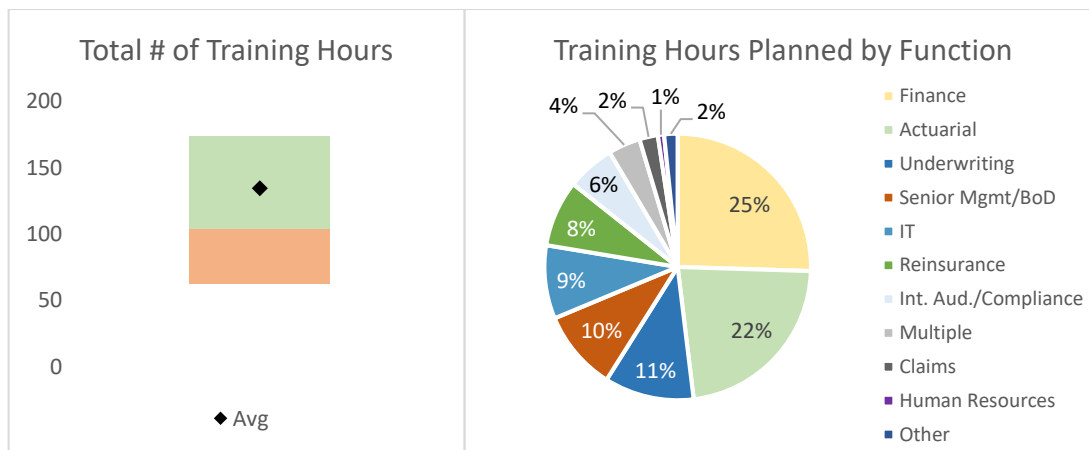


While the majority of recruitments are targeted at actuarial, finance and IT professionals, there are noticeable opportunities in other functions too.

SAMA expects management to ensure timely recruitment of individuals with right capabilities. Given the worldwide demand of individuals with IFRS 17 knowledge and experience, finding individuals with adequate IFRS 17 knowledge and experience may be challenging, and insurance companies will likely be required to bridge this gap by imparting adequate training to all new recruits, thus helping them to climb up the steep learning curve.

### Training

The graph below shows the distribution of the training hours planned by insurance companies for upskilling their employees and management in IFRS 17.



While the bulk of training is aimed at the finance, actuarial and underwriting functions, wider functions are also included in the training plan, though with a lower share. We note that around one-tenth of the total training hours are dedicated for senior management and the Board of Directors.

SAMA expects management to ensure imparting of adequate and timely training aligned with the role of each function in IFRS 17, with special emphasis on training for senior management and the Board of Directors with the objective of preparing them for informed decision-making during Phase 4 and ultimately in the go-live state.



**C) Technical and Financial**

Level of Aggregation

Choosing an appropriate level of business segmentation for calculation and reporting under IFRS 17 is one of the most critical decisions that significantly influence the design, implementation and usefulness of IFRS 17. The two graphs below show the mean, median and inter-quartile range of the number of groups of contracts for each line of business, both for direct and reinsurance held businesses. The number of groups of contracts shown below are before splitting further for profitable v onerous contracts and annual v quarterly cohorts.



There are noticeable variations among insurance companies in the way a particular line of business is intended to be segmented into groups of contracts, for both direct business and reinsurance held, with this difference more noticeable for protection & savings business. The positively skewed distributions seen above indicate that, while a large number of companies are aiming for relatively less granular segmentation, probably for ease of implementation and for avoiding complexity of reporting, there are companies that are seeking significantly more granular segmentation of the business written by them.

SAMA expects management to pay due attention to this critical design decision, and focus not only on the simplest route but also consider the utility of the adopted route in providing business



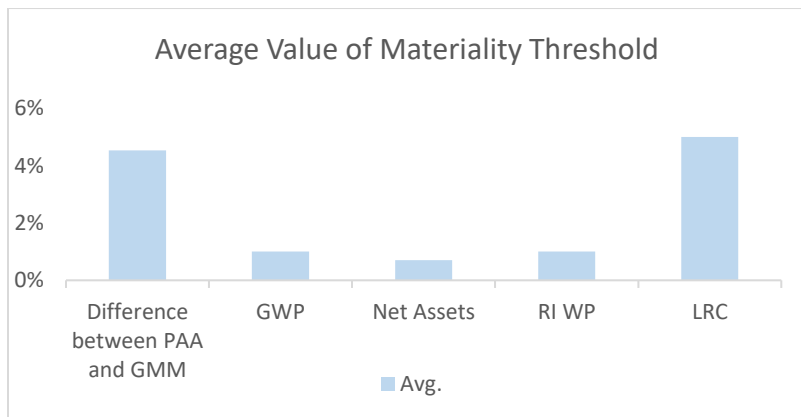
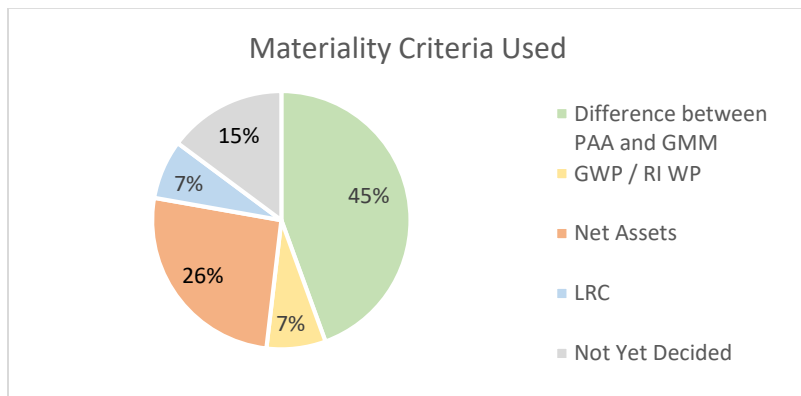
insights and in informing strategic decision-making. SAMA will also work closely with the insurance sector and assess the need for harmonization in this area.

Eligibility Assessment for Premium Allocation Approach

In order to replace the default calculation method, viz. ‘general measurement model (GMM)’ with the simplified ‘premium allocation approach (PAA)’, IFRS 17 requires an insurance company to meet a number of requirements.

One of the requirements to qualify for the simplified method is to demonstrate that results under the GMM and PAA methods are similar and any differences are within the materiality threshold set by the insurance company.

The graphs below shows the types of the materiality criterion used by insurance companies to determine their eligibility for PAA and the average value under each criterion.

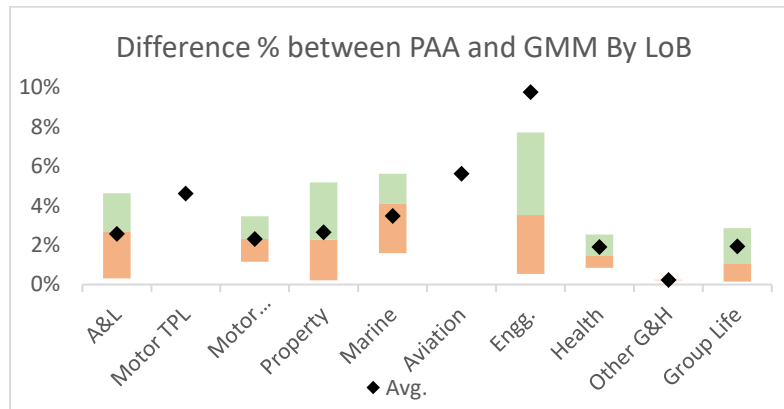


While a large number of companies have used the direct criterion of ‘the difference between results under GMM and PAA’, a number of companies have used indirect criteria based on *net assets* or ‘gross/ reinsurance written premium’. While the threshold percentage values under those indirect criteria may appear low in the above graph relative to the direct criteria, the underlying large base of the indirect criteria will likely produce very high materiality thresholds, possibly rendering the threshold ineffective.



Selecting an appropriate materiality criteria and the corresponding threshold is an area of significant judgement that is likely to have a material impact not only on the design of IFRS 17 implementation plan but also on the insights available to management for informed decision-making in the go-live state.

The graph below shows the range of the PAA-eligibility test results produced by insurance companies for comparison with the materiality thresholds shown above.

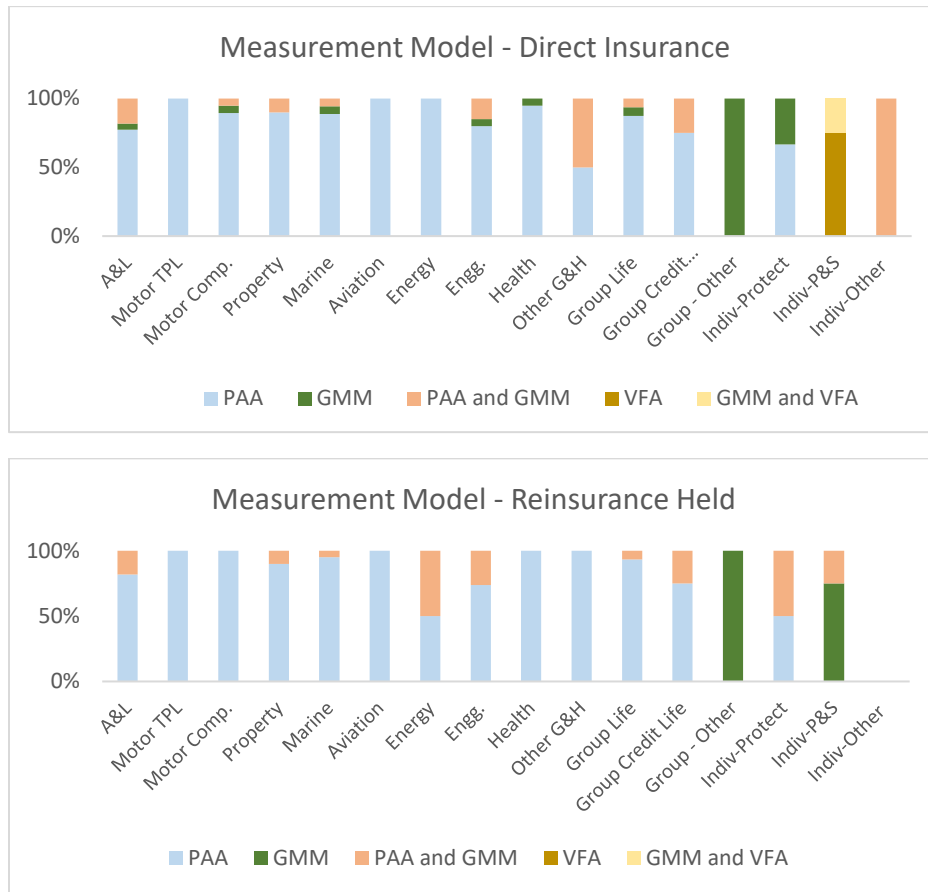


Engineering insurance, which also covers long-term construction projects, shows the biggest differences, and hence requires appropriate professional judgment and compliance with each company's own materiality thresholds in order to pass the test. Inherent Defects insurance, a new line of business for insurers in Saudi Arabia, may not have been tested yet, and needs careful consideration given the long-term nature of those policies.

If management decides to consider the PAA option, SAMA expects it to ensure developing full understanding of the 'pros and cons' of using the simplified approach and applying due professional care in selecting an appropriate materiality criterion and the corresponding threshold. It is also expected that a lower materiality threshold than that used for audit purposes will be applied, keeping in view the different objectives of the two exercises.

#### Measurement Model

The default GMM approach is considered more insightful for management and investors than the simplified PAA model, since unlike the latter, GMM provides an upfront view of future profitability/loss (i.e., value creation/erosion). On the other hand, it is perceived as more complex to run than the PAA model. The choice of an appropriate measurement model is therefore an important decision for management. The graphs below show the measurement models selected by insurance companies for direct and reinsurance held portfolios.



While some insurers have opted for GMM or a blend of GMM and PAA, the majority has opted for PAA, which is of particular note for long term Engineering and Inherent Defects Insurance classes. We also note that under Other General & Health class, there is a significant share of blended approach for direct business, possibly due to some special risks classified under this line of business.

For reinsurance held, a similar extent of preference for PAA is observed. We understand that a large number of companies reinsure their one-year term policies on a proportional risk-attaching basis, so that the treaty term spans two years, thus requiring assessment of PAA eligibility for all such treaties.

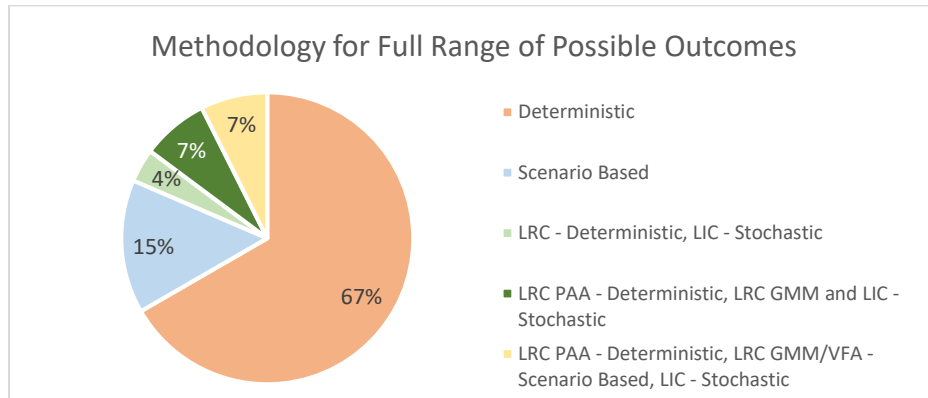
Going forward, SAMA will engage with insurance companies to understand the rationale for the selected model and to discuss the results of PAA eligibility assessment in detail.

SAMA expects management to ensure its decision on the measurement model selection is supported by sound professional argument, takes account of future business growth and corresponding needs, and serves to provide adequate insight to management and investors on business performance.



Allowance for full range of possible outcomes

Under IFRS 17, the projection of cash flows requires consideration of all possible outcomes, and not the expected average outcome only. The graph below shows various approaches being adopted in this regard.

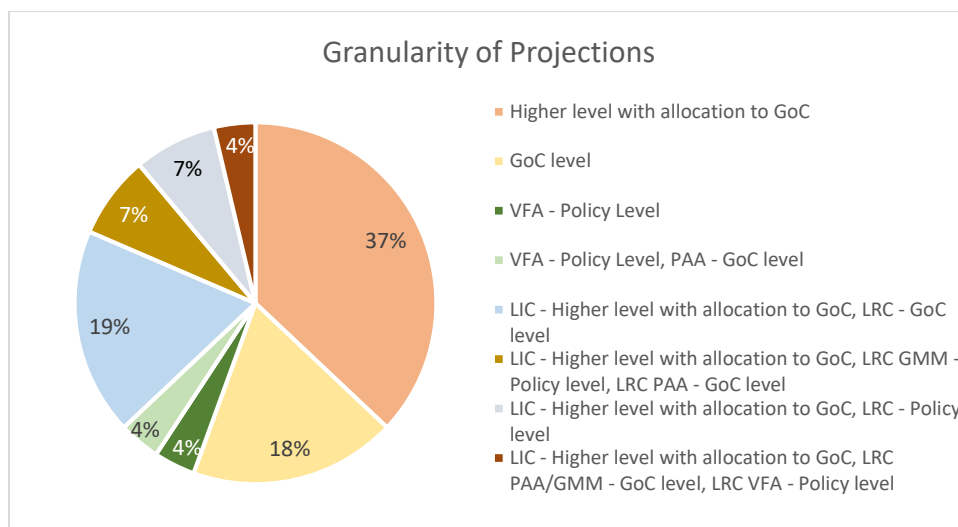


The majority of insurance companies have opted for a deterministic approach, which lacks the ability to reflect the variability of outcomes.

SAMA expects management to ensure full compliance with IFRS 17 principles, and where a simplification is used, availability of sound rationale for that simplification. Also, it is expected that the consideration for all possible outcomes will have relevance to the pricing basis and changes in facts and circumstances that may have happened subsequently.

Granularity of projection for Fulfilment Cash Flows (FCF)

The graph below shows the range of approaches adopted by insurance companies as regards the granularity of projecting the fulfilment cash flows.



A wide array of approaches has been adopted, with policy level projections being common where the company uses Variable Fee Approach (VFA) method, generally applicable for unit-linked life



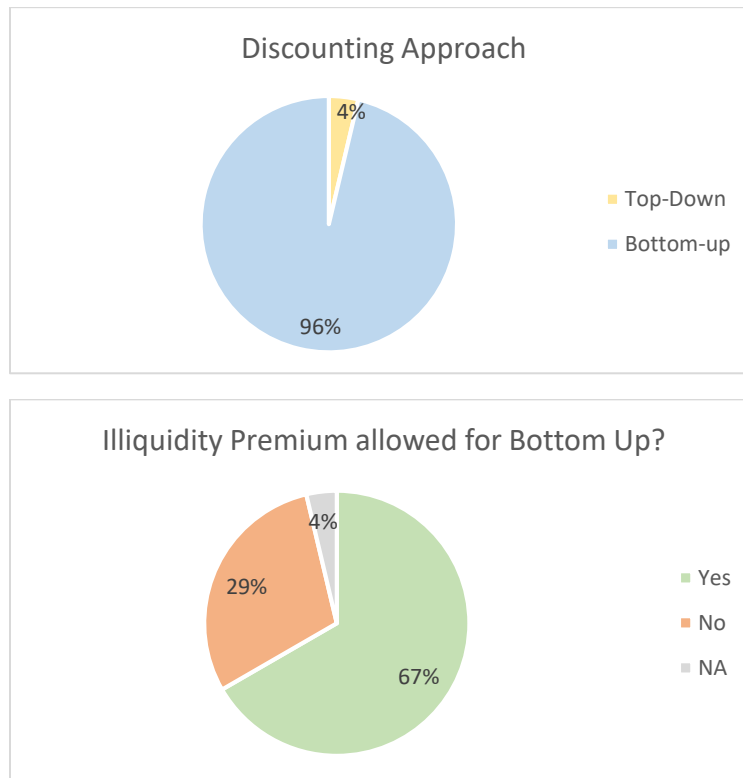
business. A number of companies have sought to differentiate their projections based on whether projections are in respect of the liability for remaining coverage (LRC) or liability for incurred claims (LIC), or whether those are under the PAA or GMM model.

SAMA expects management to ensure, where projection is not at the group of contracts (GoC) level, the selected allocation approach is sound, stable from one period to the other, and is not at risk of manipulation.

### Discounting

Unlike the current accounting standard, IFRS 17 requires insurance companies to discount cash flows using an appropriate discount rate, derived using one of the two possible approaches, viz., bottom up or top down. When adopting the bottom up approach, an insurer is allowed to take credit for the illiquidity of liability cash flows, and adjust the discount rate upwards.

The graph below shows the distribution of the two approaches as opted by insurance companies, and for the bottom approach, whether allowance is made for illiquidity.



An overwhelming majority has adopted the bottom up approach for discounting. Of those, a small but noticeable proportion does not intend to take credit for illiquidity premium.

SAMA expects management to ensure full understanding of the implications of its design decisions. Moreover, to harmonize the selection of yield curves and illiquidity premiums, SAMA will work with the sector and assess the need for issuing additional guidance on those selections.

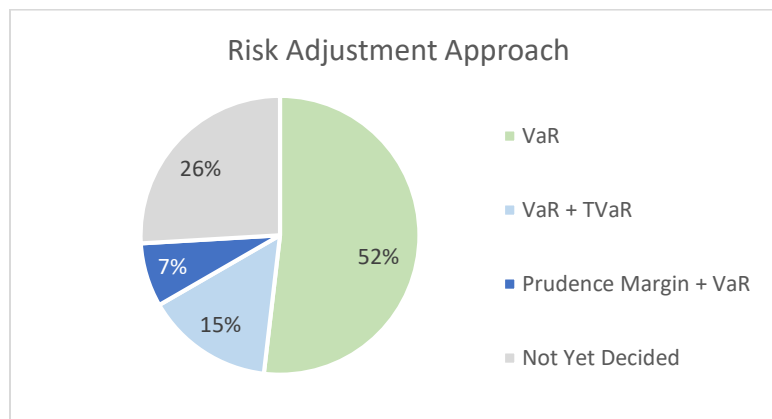


### Risk Adjustment

Introducing a new concept, IFRS 17 requires insurance companies to estimate the uncertainty around the amount and timing of the cash flows and reflect it as part of its liabilities. This replaces the judgmental prudence margin held in technical reserves by many insurance companies under the current reporting standard, thus enhancing the comparability of financial statements under the new standard. The calculation must be aligned with each insurance company's own risk appetite, expressed in terms of confidence interval, which is more of a management decision than a technical one.

### *Modelling Approach*

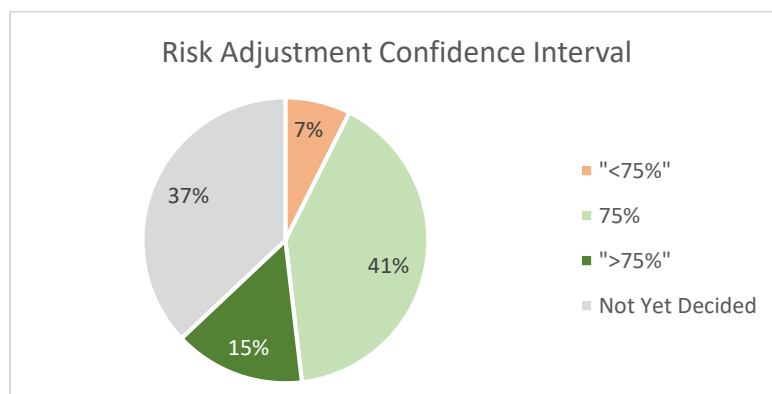
The graph below shows various modelling approaches adopted by insurance companies for estimation of the risk adjustment.



*Value at risk* (VaR) and *Tail Value at risk* (TVaR), two of the standard approaches in actuarial science, are being used by the majority. Some of those insurance companies that write long-time life insurance business are using *prudence margin* approach. We note with concern that a sizable proportion of insurance companies has not decided on the selected approach yet.

### *Confidence Interval*

The graph below shows the distribution of confidence intervals selected by insurance companies.

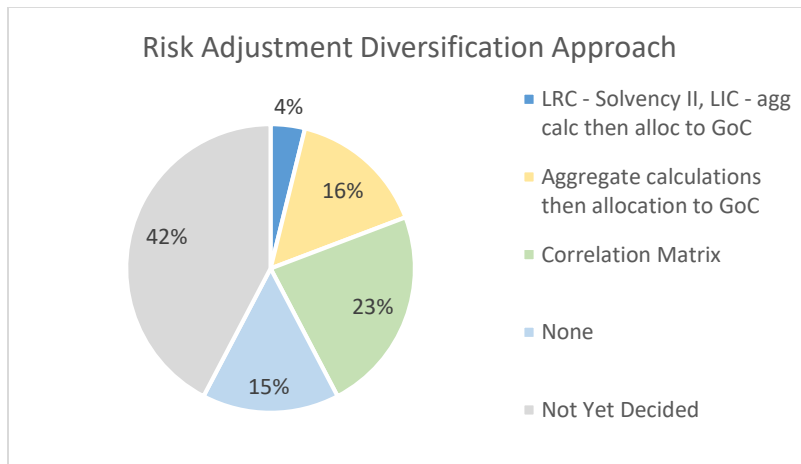




Among those insurance companies which have decided on their approach in this area, the majority has selected the 75% confidence interval. We note with concern that a sizable proportion of insurance companies are yet to arrive at a decision in this regard. Also, companies targeting a specific confidence interval would need to demonstrate alignment of their selection with their own risk appetite.

*Correlation and Diversification*

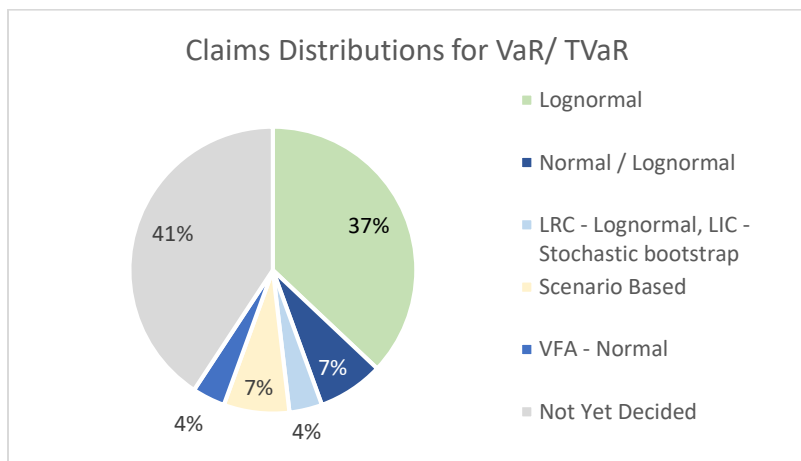
The actuarial literature implies that while there is probability of some risks occurring at the same time (correlation), not all risks occur at the same time (diversification). The graph below shows the correlation and diversification approaches selected by insurance companies.



A variety of approaches has been selected to estimate the correlation/diversification effects. Some have referred to Solvency II correlation matrices using a bottom up approach, while some others have selected a top down approach of aggregate calculation and then allocation. Some insurance companies have decided to ignore any credit for diversification, which would require justification, while a large proportion of insurance companies are yet to decide in this regard.

*Statistical Distributions*

The graph below shows different claims distributions used for the risk adjustment calculations.



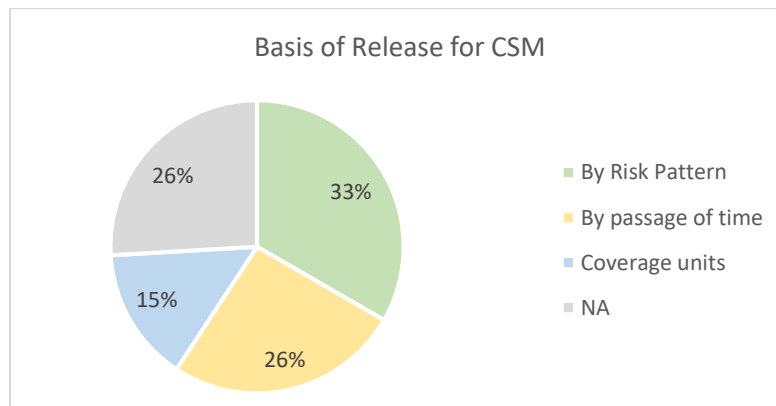


The lognormal distribution is the most commonly used claims distribution. Some insurance companies have varied their approaches between LRC and LIC calculations.

It is obvious from the above that a range of approaches is being adopted in the sector to estimate the risk adjustment. The estimate requires input from both management and the actuarial function. SAMA expects the estimation approach to be refined over time as the actuarial profession grows in sophistication in the Kingdom. SAMA also expects management to provide active input and steer to ensure alignment between the selected confidence interval and the Company's risk appetite. As regards the companies that are yet to complete work in this regard, SAMA notes that this was against its expectations and it will follow up with those companies.

#### Contractual Service Margin (CSM)

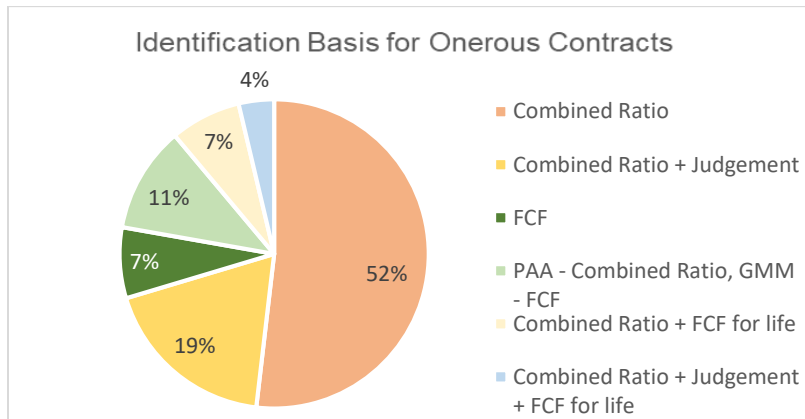
The contractual service margin reflects the profit embedded in insurance contracts, estimated at the time of issuing a contract and released over the lifetime of the contract.



The release by risk pattern is the most commonly adopted approach, expected to be applicable for contracts where risk is not linear (e.g., engineering construction contracts, extended warranty contracts, etc.). A number of life insurance companies have adopted 'coverage units' as the basis for release of CSM.

#### Identifying Onerous Contracts

An insurance company is required to identify at the time of issuance (and in subsequent periods), whether a group of contracts is loss-making, and if so, treat it separately from profit-making groups of contracts. The graph below shows the range of identification approaches being adopted by insurance companies.

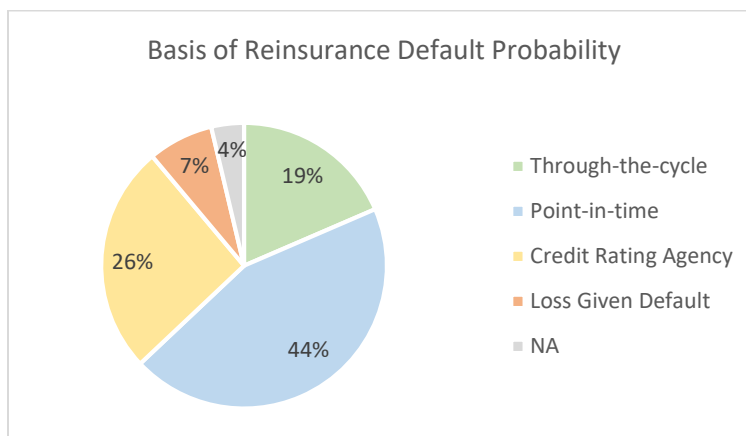


The majority of insurance companies appear to have chosen a simplified route and intend to use ‘combined ratio’ as the basis, with no allowance for volatility of claims. Some companies, predominantly life insurers, plan to use the full approach of using fulfilment cash flows (FCF).

SAMA expects management to ensure adoption of sound and transparent methodology and process for the identification and treatment of onerous contracts, so that both management and investors can obtain intended insights from this new way of reporting under IFRS 17.

#### Allowance for Reinsurer Default

An insurance company is required to make an explicit allowance for the probability of its reinsurers defaulting on fulfilling their obligations, due to either financial difficulties or disputes. The graph below shows the distribution of approaches being adopted by insurance companies for estimating the likelihood of this default.



The two dominant approaches being adopted are *through-the-cycle* (also used by many rating agencies) and *point-in-time*. Each approach has its ‘pros and cons’. For example, the *through-the-cycle* approach is likely to be more stable but may also smooth results and credit rating changes, potentially delaying response to changes in a reinsurer’s circumstances. On the other hand, the *point-in-time* approach may provide the most accurate estimate of future default probabilities but is also prone to frequent changes. Many insurance companies provided responses on their

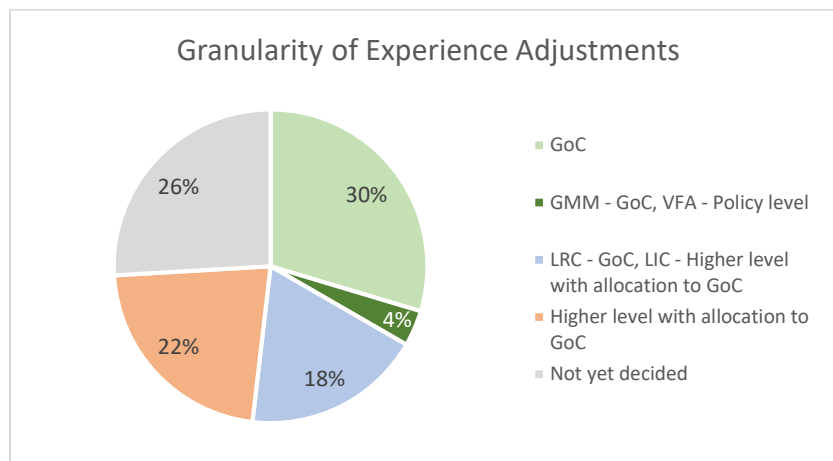


selected approach that showed their lack of understanding of the subject (e.g., loss given default, credit rating agency, etc.).

SAMA expects management to ensure development of full understanding of various options available to it and selection of an approach aligned with its assessment and selection of reinsurers.

### Experience Adjustments

After setting its initial expectations regarding the extent of profit (or loss) from issuing a group of insurance contracts, an insurance company should adjust its results and future expectations based on the emerging experience. A key design decision in this regard is whether to measure those experience adjustments at a granular group of contracts level or at an aggregated level and then allocate to groups of contracts. The graph below shows the distribution of approaches intended to be adopted by insurance companies in this regard.

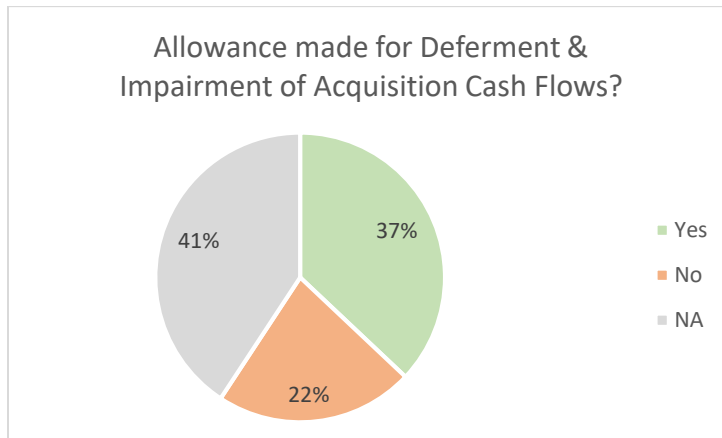


A large proportion of insurance companies intend to perform experience adjustment at the granular group of contracts level. A sizable proportion, on the other hand, intends to perform these adjustments at an aggregate level, which may have the advantage of less volatile results but also runs the risk of obscuring the true performance of each group of contracts.

For making appropriate adjustments to reflect the emerging experience, SAMA expects management to ensure selection of a methodology that not only meets the IFRS 17 principles but also serves the objective of providing adequate and timely insights on business performance to management.

### Deferment and Impairment of Acquisition Cost

IFRS17 requires an insurance company to defer the initial acquisition cost to renewal years, unless it chooses to incur that cost immediately when using the simplified PAA model. While the practice of deferring the initial acquisition cost to renewal years is not unfamiliar for life insurance accounting, this is a new concept for short-term non-life and health insurance business. When adopting this deferral approach, an insurance company must make an allowance for impairments due to the possibility of contracts not renewing. The graph below shows the considerations made by insurance companies in this regard.



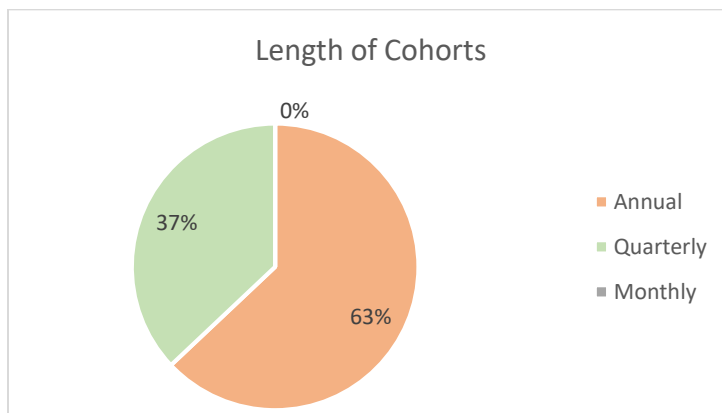
While a large proportion of insurance companies have not considered this area, possibly due to incurring all acquisition expenses upfront, some insurance companies appear to have not finalized their methodology or they have not fully understood the requirement in this regard.

SAMA expects management to make careful consideration for an appropriate accounting policy and ensure selection of a methodology that complies with the IFRS 17 requirement regarding the deferment and impairment of acquisition cash flows, and which is in line with their business model and distribution strategy.

Accounting Policy Choices

*Length of Cohorts*

For the purpose of selection of assumptions and projection of cash flows, an insurance company is required to decide on the length of the period during which all contracts issued are treated as belonging to the same cohort. The graph below shows the distribution of the lengths of cohorts chosen by insurance companies.



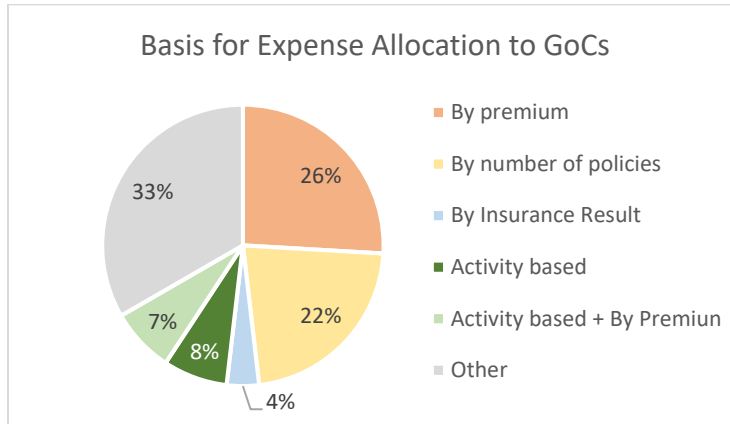
The majority of insurance companies selected cohorts of annual length, which has the implication of possibly making quarterly changes to the initial discount rate applied to a cohort under certain circumstances, thus adding a layer of complexity to the calculations. On the other hand, annual cohorts may be closer to the way business is managed by some insurance companies and hence easier to interpret the results.



SAMA expects management to ensure selection of the length of cohorts is done with full understanding of the 'pros and cons' of each option available.

*Basis of Allocation of Expenses to Groups of Contracts (GoCs)*

Each insurance company is required to allocate its indirect expenses to groups of contracts by following a transparent and justifiable allocation methodology.

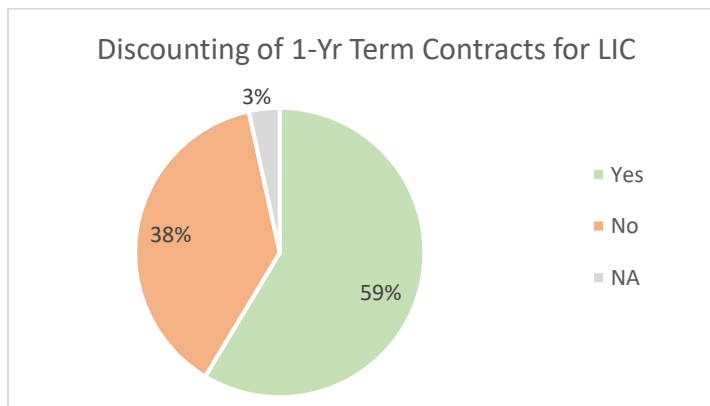


The majority of insurance companies appear to have taken a simplified approach for allocation of indirect expenses using either premium or policy count as the basis for allocation, which may not fully reflect the time and effort spent on a particular group of contracts. Only a small proportion appears to adopt the detailed activity-based calculation route.

SAMA expects management to ensure sufficient rigor is applied in arriving at assumptions for expense allocation, and the selected assumptions appropriately reflect the actual incidence of cost.

*Discounting for Contracts of Term One Year or Less*

While discounting of cash flows is the default approach under IFRS 17, an insurance company is permitted to ignore discounting, provided it can demonstrate that claims are expected to be settled within one year of being incurred. The graph below shows the policy choices made by insurance companies in this regard.





While the majority has opted for the default approach, a sizable proportion of insurance companies do not intend to take credit for discounting of claims cash flows, a decision likely to be driven by objectives of simplicity and materiality. Since it is rare for all claims pertaining to a line of business to settle within one year, however short the tail of the line of business may be, the decision to not discount is likely to be open to challenge.

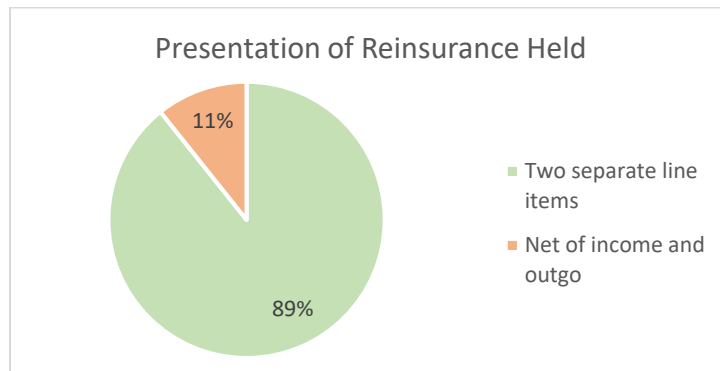
SAMA expects management to ensure sufficient evidence exists to meet the IFRS 17 condition for not applying discounting.

### Presentation & Disclosures

Our review shows significant variations in the design of financial statements (presentation and disclosures) included in the Phase 3 reports. During the course of the next phase, SAMA will work with the sector to achieve uniformity of presentation and disclosures made by insurance companies.

#### *Presentation of Reinsurance Results*

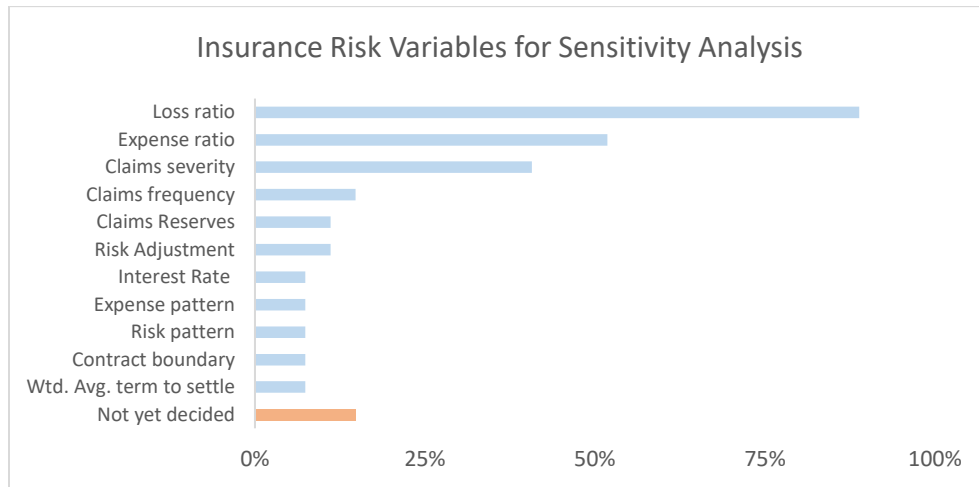
IFRS 17 allows an insurance company to decide on whether to present the results of reinsurance held separately as income and outgo, or to present combined as net of income and outgo. The graph below shows the distribution of the two approaches adopted by insurance companies.



The majority of insurance companies intend to show reinsurance income and outgo separately, which is considered more insightful than the approach adopted by the minority of insurance companies.

#### *Risk Framework*

An extensive array of new disclosures are required to be included as part of IFRS 17 financial statements, which has a direct bearing on the data dictionary and types of calculations performed. The graph below shows the range of variables considered by insurance companies for the purpose of determining and disclosing sensitivity of results to the insurance risk, which is one of the many disclosures required.



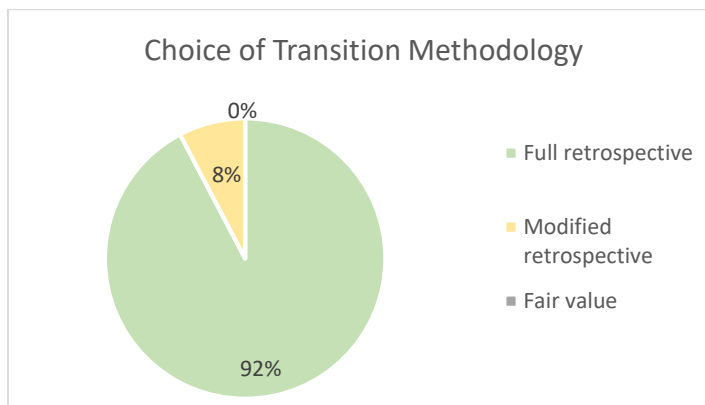
Loss ratio is the most commonly used variable, followed by expense ratio. A small but noticeable proportion of insurance companies have sought to include many more variables in their sensitivity framework.

SAMA expects management to ensure design of disclosures serve to be meaningful and insightful for use in strategic decision-making.

### Transition

While IFRS 17 is due to go live from 1<sup>st</sup> January 2023, the transition period starts a year earlier, i.e., from 1<sup>st</sup> January 2022. An insurance company must fulfill all reporting requirements at the transition date, essentially treating each group of insurance contracts in force at the transition date as if IFRS 17 had always applied to those groups of contracts. The default approach is 'full retrospective', which can be replaced with alternative approaches, viz., modified retrospective or fair value approach in case if an entity cannot meet the full requirements.

The graph below shows the distribution of different transition approaches intended to be adopted by insurance companies.



The majority of insurance companies plan to adopt the full retrospective approach, which is not surprising given the dominance of short-term non-life and health business in the Kingdom. For



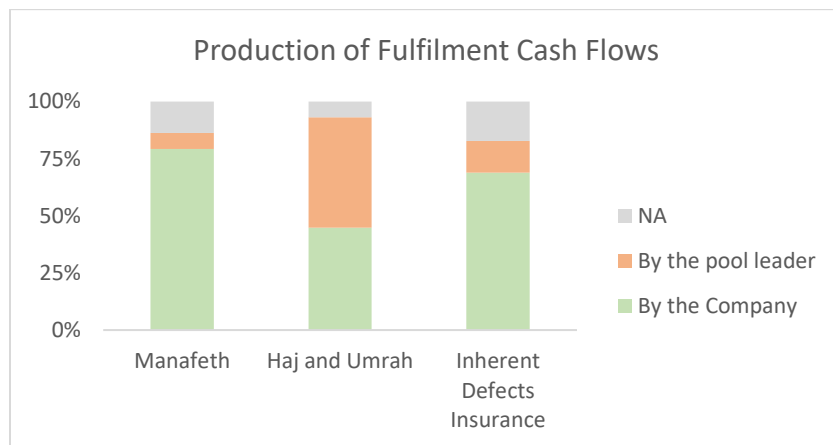
the long-term life insurance products, availability of historical policy data as well as of historical yield curves may pose some challenge. Under non-life insurance, engineering line of business may face similar challenges.

SAMA expects management to ensure complete readiness to produce transition results in a timely and reliable manner, with full appreciation of data challenges posed, and adequate planning to deal with those challenges.

### Insurance Pools

Where an insurance company participates in one of the industry pools, availability of information as per the insurance company's own design requirements, and not of the pool leader, may be a challenge. It is therefore important for insurance companies to identify their data requirements in respect of their pool participations and agree those with the pool leader.

The graph below shows the extent of reliance by insurance companies on the pool leader for various industry pools.



With the recent transfer of Manafeth under Najm's management, insurance companies appear confident in producing the fulfilment cash flows on their own. This is in contrast to Haj & Umrah cover, where a sizable proportion of the sector appears to rely on the pool leader, which even exceeds that for the latest industry pool for Inherent Defect insurance.

SAMA expects management to ensure provision of sufficient information in respect of industry pools for all IFRS 17 calculations, and where reliance is placed on the pool leader for some calculations, establishing adequate procedures to validate those calculations.



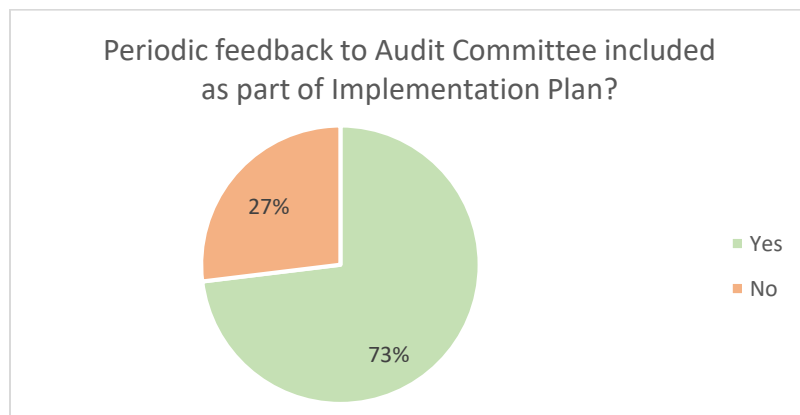
## D) AUDIT REVIEW & ASSURANCE PLAN

In January 2020, the six largest global accounting firms (viz. PwC, EY, Deloitte, KPMG, Grant Thornton, and BDO) issued guidelines<sup>1</sup> for management on implementing IFRS 17, including measures to minimize the audit risk. Below are some relevant excerpts from that guidance:

- Page 16, first paragraph reads, *“It is critical that external auditors are involved throughout an entity’s journey to implementation of IFRS 17 so that audit risks associated with the transition to the new standard can be addressed on a timely basis. External auditors should be engaged at an early stage in challenging the key accounting and technical discussions and judgments being made by management. It is likely that new data, systems, processes and controls will all need to be subject to audit.”*
- Page 16, paragraph 3.2 reads, *“As management works through its implementation plan, it should seek auditor’s review of the key areas of judgement (including accounting policy choices), valuation models, changes to the control environment, implementation of new systems and processes, and completeness and accuracy of disclosures as early as possible to avoid surprises during the audit and potential rework”.*

In line with the above guidance, as part of its Phase 3 instructions, SAMA stipulated for management to obtain feedback from its external auditors on its IFRS 17 implementation plan before finalizing and submitting it to SAMA. This requirement was deferred ‘temporarily’ until SAMA issues further guidance in this regard.

In the same spirit, SAMA required all insurance companies to develop a complete and clear path to keep its audit committee and external auditors fully engaged during the implementation process, i.e., Phase 4. The graph below shows the proportion of insurance companies that complied with the requirement.



<sup>1</sup> [gx-GPPC-IFRS-17-implementation-guide.pdf \(deloitte.com\)](#)  
[gppc-ifs-17-companion.pdf \(pwc.com\)](#)



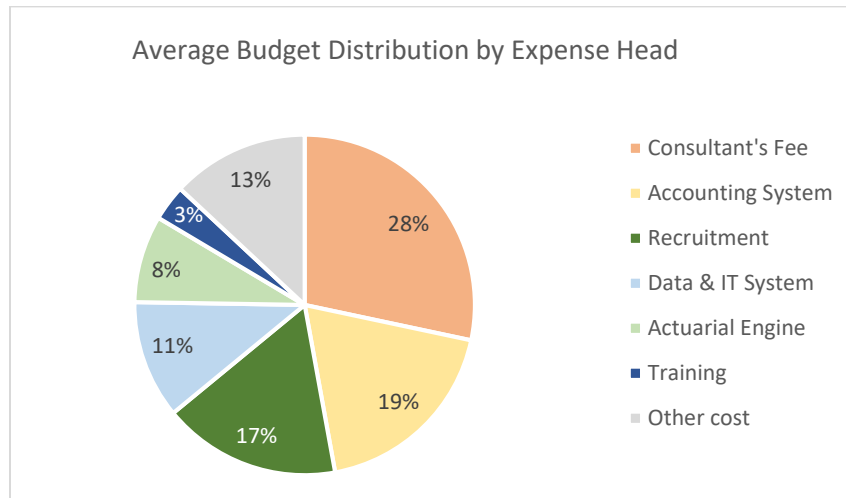
We note that a sizable proportion of insurance companies are yet to comply with the requirement.

SAMA expects management to ensure effective and regular monitoring by and feedback to the audit committee as the Company makes progress on its implementation journey. Likewise, SAMA expects management to engage with its external auditors in an effective and regular manner in order to minimize the audit risk.



## E) BUDGET FOR IMPLEMENTATION

It is important to recognize that however good an implementation plan may be, it is unlikely to produce the desired results if not backed by an adequate budget. The graph below shows the average distribution of implementation budgets into various expense heads.



Consultants' fee has the biggest share in the overall budget, followed by the cost of replacing or upgrading the accounting system, which is then followed by the cost of injecting new talent into mainly the finance, actuarial and IT functions of insurance companies. On the other hand, there is a very small budget for training, which exposes insurance companies to the risk of inadequately trained in-house teams taking over from the consultants for *business-as-usual* purposes.

SAMA expects management to ensure effective knowledge transfer from its consultants to the employees and management of the Company. During the course of the next phase, SAMA will engage with the IFRS 17 team as well as management of each insurance company in order to assess the extent and pace of this knowledge transfer.

## F) **CONCLUSION**

The Saudi insurance sector, so far, has made significant progress in its journey to implement IFRS 17. It is however important to recognize that we are now entering the final and most critical phase. During the next phase, it is therefore vital for management to closely monitor all aspects of IFRS 17 implementation at the Company.

Based on our review of the Phase 3 reports, as highlighted in this letter, we draw attention of the Board of Directors and executive management towards the following areas:

- A number of companies have inadequate plans to monitor their implementation progress during the next phase. It is unlikely that any company has a 'perfect' implementation plan in place at this stage. Effective and regular monitoring is essential for a company to take timely corrective actions based on learnings from the upcoming dry-run exercises and evolving best practices.
- 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.
- 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 companies deviate from SAMA's expectations and need to be re-aligned in consultation with software vendors.
- 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. Also, for adequate knowledge transfer, it would be essential for internal teams to work side by side with external consultants during the next phase.
- 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.
- 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 day to day business and in shaping business strategies.
- Timely inclusion of external auditors in the journey to implement IFRS 17 will be important. SAMA will issue further guidance in this regard in the near future.

For the next phase, SAMA has designed an adequate monitoring plan, including obtaining periodic progress reports and performing site visits. Going forward, SAMA expects the Board of Directors and executive management to ensure full compliance with SAMA's monitoring requirements.

SAMA is currently working with the industry Working Group to issue instructions for the next phase. In the meantime, all insurance companies should start implementing their design without any delay.