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MFRS 17: A catalyst for finance transformation

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Insurers (including takaful operators) are having their hands full implementing the new Malaysian Financial Reporting Standards (MFRS) 17 Insurance Contracts which will come into force on Jan 1, 2023.

MFRS 17 sets out the principles for the recognition, measurement, presentation and disclosures of insurance contracts while improving comparability and transparency. It fundamentally changes the way in which insurers measure and account for insurance contracts.

The reporting requirements of MFRS 17 profoundly impact many functions within an organisation, including data requirements, systems, processes, actuarial modelling and finance reporting processes. The industry is grappling with the lack of a strategic approach to MFRS 17 implementation that can improve and transform ineffective and inefficient systems and business processes.

What makes implementing MFRS 17 complex? Insurers need to collate, clean and store voluminous granular data from core insurance, actuarial and cash systems. For many insurers, the difficulties are compounded by siloed legacy systems because products with different features have been maintained in different systems, and there is limited integration activity arising from multiple past mergers and acquisitions. These systems often do not talk to each other, resulting in quick fix workarounds and manual reconciliations.

Every month, finance teams typically spend considerable time and resources to perform reconciliations between the subsidiary ledgers from core insurance systems and the general ledger for premiums, claims, receivables, payables or even bank reconciliations.

Many insurers have made incremental changes by introducing new infrastructure and processes to handle different types of reporting, ranging from statutory, group, regulatory, risk-based capital (or solvency) framework and tax reporting. But because of the need to comply with the multiple reporting requirements on time, enhancing business insights has become less of a priority — a significant opportunity cost.

In the past, insurers have resolved some of these issues by building data warehouses to combine the disparate data from different sources, or building IT platforms for all the systems to interface directly with each other. However, MFRS 17 needs more than just a quick fix, prompting a transformational approach for insurers to overhaul not just their technology and processes, but ingrained behaviours and ways of working that have defined the insurance industry.

Greater dependence between finance and actuarial functions with MFRS 17

Since the implementation of the risk-based capital framework in Malaysia in 2009, insurers have progressively redesigned their finance function over the years to ensure closer collaboration among the actuaries and accountants. Even so:

- actuaries still focus on the capital requirements and are left to explain why the profit or loss has taken a hit from the changes in reserving, for instance, changes in incurred but not reported (IBNR) claims, modelling changes or assumption changes; and
- accountants are then left to explain how it all fits together, especially the impact to underwriting results and investment results.

MFRS 17 will significantly change how business performance is reported and measured, creating even greater dependence between finance and actuarial functions. With the implementation of MFRS 17, actuarial calculations get more complex, and the financial closing process will depend on even more data deliverables to and from the actuaries. MFRS 17 demands rethinking around the operating structure that coordinates finance and actuarial data. This will be crucial, not only to support MFRS 17 statutory reporting but also to meet group, regulatory, risk-based capital (or solvency) and tax reporting on a timely basis.

Building transformational finance capabilities

Imagine the opportunities that will open up for insurers who use MFRS 17 data at the policy or contract level. Such data can be collated from the core insurance, actuarial and cash systems to create one suite of analytics that drive business insights focusing on the customer relationship, their experience and needs. With vast amounts of granular data, the finance function can identify profitable or onerous products or lines of business and provide timely and actionable insights to the business development, sales and marketing and underwriting teams.

Presently, interactions with policyholders are mainly confined to the occasional necessities of renewals and claims. Various benefits can be realised if data transformation is pursued with innovations catering to changing lifestyles.

For example, through data collected via usage of fitness watches by policyholders, life insurers can understand the health status of their policyholders and create better customer engagement with tailored benefits and rewards. Telematics devices installed in the vehicles of policyholders allow general insurers to collect data to monitor driving behaviour, speed patterns, distance travelled and the driving environment. Premium discounts can be offered to policyholders to incentivise safe driving behaviour. Certain insurers have also introduced pay-as-you-drive cover to their policyholders, especially with working from home becoming the new norm, reducing the need for driving.

Tax should be part of the transformation journey

For insurers, the tax aspects of MFRS 17 are likely the furthest thing from their minds. However, tax liabilities have an impact on cash flows, which need to be a key consideration.

It is also important to take into account the relationship between MFRS 17 and MFRS 9 Financial Instruments, as many insurers will be adopting these standards concurrently. MFRS 17 changes the valuation of liabilities, whereas MFRS 9 impacts the valuation of assets. As insurers tend to match the recognition of the assets with the liabilities to avoid fluctuations and accounting mismatches, any decision made on one may influence the other.

Taxation of insurance companies is complex, and the tax rules provide different bases for taxing life insurers, general insurers, family takaful operators and general takaful operators. Insurers (and takaful operators) are governed by specific tax rules that do not strictly follow the accounts, and broadly require a realisation basis. Investment income is one example of a situation where tracking is required, as it is taxed on a realisation basis, particularly for equity instruments measured at fair value through other comprehensive income under MFRS 9, where the gain and loss will not be presented in the income statement.

Another example is the replacement of earned premiums with insurance revenue under MFRS 17. A simplified approach can be opted for short-term insurance contracts (one year or less) where the insurance revenue is not expected to differ significantly compared with the current earned premiums model. However, for long-term insurance contracts, MFRS 17 requires profits (contractual service margin) to be released over the lifetime of contracts, and this will result in divergence with the tax treatment of taxing earned premiums for general insurers. This would mean having to maintain a separate set of accounts just for tax purposes.

Systems and processes would need to be in place to allow tax information to be easily extracted from the financial reporting system to comply with tax requirements.

The focus now should be on the need for a data system that can help generate the right data for various reporting needs, including tax reporting purposes. With the scale of changes to systems, data and processes, more than ever now, tax needs to have a seat at the table to contribute to decisions on the organisation's transformation journey to sufficiently cater for tax requirements.

This means companies will need to think differently about their culture and how it aligns with their purpose, including finetuning their tax technology strategy to ensure that tax information can easily be extracted to fulfil reporting and compliance requirements. With business decisions increasingly made based on data, tax has evolved beyond its role as a support function, becoming a strategic partner to the business.

Upskilling needs to be part of the equation for any transformation programme to be successful. In addition to the digital skills required to meet the needs of the business, an upskilling programme should cover the development of soft skills such as resilience and critical thinking, which are key to harnessing value in data for better business decisions.

A clear business case to transform the finance function

In summary, MFRS 17 should be looked at as more than a mere compliance requirement. Insurers should take the opportunity to retool their data and systems strategy, not only to ease the transition but also to deliver significant commercial benefits.

The journey to upskill their people through initiatives promoting learning and digital capability building should not be delayed. With the right vision and planning, this finance transformation can drive innovation and differentiation across the entire business while ensuring compliance with statutory, group, regulatory and tax requirements.

In short, any transformation in line with MFRS 17 will need to go hand-in-hand with cultural change to ensure that the organisation and its people are fit to meet the needs of the future. E

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