KPMG

The PSAK 117 post implementation series: Business planning under PSAK 117 and PSAK 109

Executive summary

Life and non-life insurers are now required to enhance their business plans to incorporate PSAK 117 and PSAK 109. This can be accomplished by making a projection of the balance sheet and income statement over the designated timeframe, followed by a comprehensive analysis of the results. In addition, insurers must update their current key performance indicators (KPIs), engage in discussions regarding the outcomes, and obtain a consensus from their stakeholders. Re-calculations may be necessary, and documentation will need to be revised, especially if there are changes in assumptions.

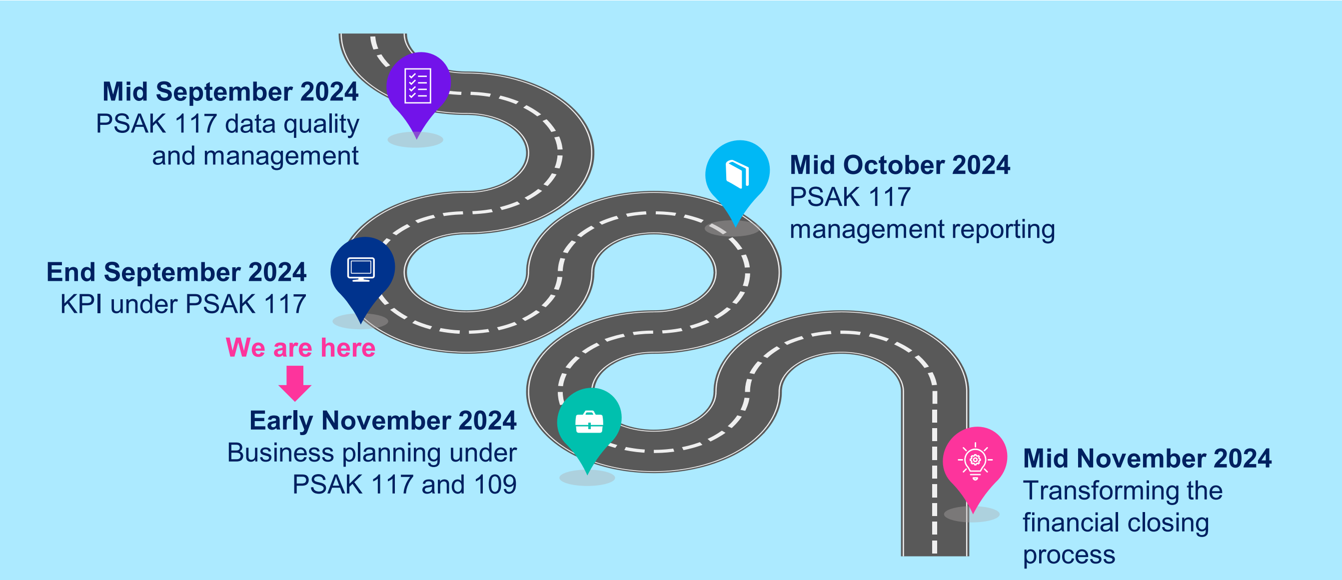
Additional assessments beyond the development of the business plan are also required, including:

- An assessment of marketing strategies, particularly for onerous products
- An evaluation of the profitability of various lines of business and distribution channels
- An assessment to ensure that insurers meet the minimum risk-based capital threshold established by the OJK (Otoritas Jasa Keuangan)
- An analysis of the sensitivity testing results. This is essential for guiding pricing decisions
- An assessment of risk adjustments for each product to ensure that risk mitigation measures adequately reduce the company's exposure
- An evaluation of whether the level of non-attributable expenses aligns with the insurer's expectations

This publication, part four of our five-part series titled “PSAK 117 Post Implementation,” builds upon insights from the previous three publications, which stressed the importance of enhancing data quality, updating KPIs under PSAK 117, and implementing rigorous management reporting to provide a comprehensive overview of an insurer's performance.

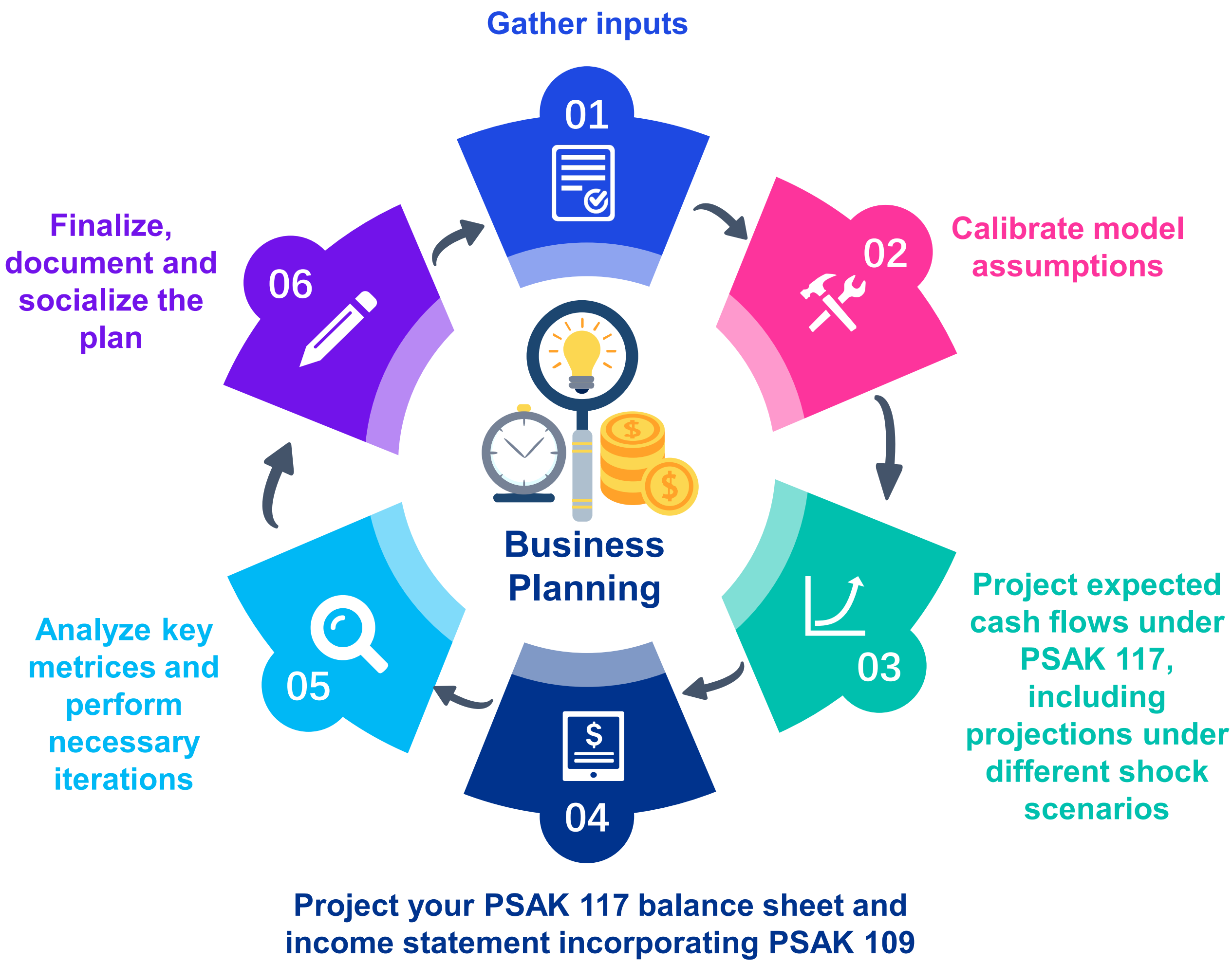
Release of the "PSAK 117 post implementation" series

We have released four publications to date. We trust that you have started your preparations for the anticipated adoption of PSAK 117 in January 2025, including enhancing your data quality, key performance indicators (KPIs) and management reporting. Our final publication is scheduled for release in mid-November. We hope that you are looking forward to this upcoming addition. We encourage you to follow our social media channels to access all of our "PSAK 117 Post Implementation" articles.



Business planning under PSAK 117 and PSAK 109

Below is a guideline outlining how insurance companies can enhance their business plans so that they are in compliance with PSAK 117 and PSAK 109.



Gather inputs

Insurers must clearly define the scope and horizon of their business plans, including the timeframe (such as five years) and the specific products to be incorporated into the projections. Additionally, insurers need to gather the necessary inputs to project cash flows so that they are in compliance with PSAK 117. Some of the inputs include:

- Projected sales volume for in-force and new business
- Projected budgeted acquisitions and other overhead expenses, including the split between attributable and non-attributable expenses
- Projected product mix, channel mix, new business (NB) mix, if necessary.
- Assumptions required to project the fulfilment of cash flows such as claims ratios, expense ratios, risk adjustments, non-distinct investment components ("NDIC"), loss recovery percentages, etc.
- Discount rates including illiquidity premiums

Calibrate model assumptions

After gathering the necessary inputs, insurers will need to identify the key risks and scenarios to be tested as part of the scenario testing process. The following sensitivities may be considered:

Life Insurers

- Attributable expenses may be X% higher or lower than the best estimated assumptions.
- Acquisition expenses may be X% higher or lower than the best estimated assumptions.
- Maintenance expenses may be X% higher or lower than the best estimated assumptions.
- Sales volume may be X% higher or lower than the best estimated assumptions.
- Investment returns may be X% higher or lower than the best estimated assumptions.
- Business mix may be X% higher or lower than the best estimated assumptions.

Non-life Insurers

- The ultimate loss ratio may be X% higher or lower than the best estimated assumptions.
- The ultimate premium may be X% higher or lower than the best estimated assumptions.
- Underwriting expenses may be X% higher or lower than the best estimated assumptions.

This will enable insurers to evaluate the potential impact of the risks they are facing.

Project expected cash flows under PSAK 117, including projections under different shock scenarios

Project PSAK 117 fulfillment cash flows by insurance contract groups for both new business and in-force contracts, with any reinsurance contracts held measured separately from the insurance contracts as required by PSAK 117. Insurers should also consider the impact on projected cash flows under the selected shock scenarios. Additionally, insurers should consider aligning the granularity of the projection results with management reporting requirements.

Project PSAK 117 balance sheets and income statements incorporating PSAK 109

Projected expected cash flows will be input into the CSM solutions to generate future projections under the chosen time frame and to develop their projected balance sheets and income statements. PSAK 109 should also be considered so insurers will need to incorporate their expected credit loss (ECL) into their projected balance sheets and income statements.

Analyze key metrices and perform necessary iterations

After completing projections for the balance sheet and income statement, insurers should perform the following additional activities:

- Recalculate projected expected cash flows and sensitivity cash flows to determine if any assumptions need to be adjusted.
- Engage in discussions with stakeholders to reach a consensus on the results.
- Update the key performance indicators (KPIs).
- Analyze the impact of the Contractual Service Margin (CSM) and the roll-forward of the present value of fulfillment cash flows, as well as insurance finance income or expense (IFIE), under various shock scenarios.

**It is important to note that iterations may be necessary to achieve results that align with expectations.*
***For further information regarding key performance indicators under PSAK 117, please refer to our previous publication (Key Performance Indicator (KPI) under PSAK 117).*

Finalize, document and socialize the plan

Once the results have been finalized, insurers should document and socialize their business plan, which should include the following:

- Balance sheets and income statements for each contract group, along with the aggregated results.
- Projected insurance contract provisions for key lines of business and the main movement drivers.
- Updated key performance indicators (KPIs).
- Documentation of the methodology and assumptions that were used.

Key considerations

In addition to producing the quantitative aspects of the business plan, other key aspects critical to the financial health of the insurance company should also be considered:

- **Assess the profitability of each product and revise marketing strategies**
  Insurers should evaluate the profitability of each product and revise their marketing strategies as necessary. PSAK 117 introduced the concept of onerous contracts, which will be important for management. Insurers will need to determine whether re-pricing is necessary. For profitable contracts, it is essential to analyze which lines of business and distribution channels yield higher profitability. Additionally, insurers may need to amend their marketing strategies to remain competitive. A comprehensive business plan will also assist insurers in establishing sales goals for new products.

- **Assess capital adequacy requirements and solvency based on the projected balance sheets**
  Insurers must comply with the minimum risk-based capital thresholds set by the OJK (Otoritas Jasa Keuangan). Therefore, insurers may need to revisit their risk management frameworks, including their investment strategies, to allocate assets by their risk appetite. Furthermore, asset-liability management (ALM) should be updated using PSAK 117.

- **Assess the results of sensitivity testing for insights into business strategies**
  Regular sensitivity testing may provide valuable insights for insurers. It is useful in developing pricing strategies for various products by determining an insurer's sensitivity to risks such as mortality and investment returns. Sensitivity testing also plays a critical role in managing individual risk being used in asset-liability management (ALM), and ensuring that the insurer maintains adequate reserves. Additionally, this information can support an insurer's risk management framework when defining their risk appetite.

- **Assess the risk adjustment for each product**
  Insurers should evaluate the risk associated with each product, identify the key risks to which the company is exposed, and implement risk mitigation measures to reduce such exposure.

- **Assess the total amount of non-attributable expenses**
  Insurers should examine whether the total amount of non-attributable expenses for different lines of business align with their expectations, as any overrun or underrun will affect the profit and loss statement directly.

Next steps

As we approach 2025, insurers should start looking into how to enhance their current business plans to incorporate PSAK 117 and PSAK 109. Engaging stakeholders early in the process will provide insightful input and help mitigate any unforeseen challenges. Furthermore, insurers should begin refining their marketing, investment strategies and risk management frameworks to ensure a timely and effective response to the outcomes of their updated business plans.

How KPMG can help

KPMG firms have dedicated teams who work with a broad range of clients across life and non-life insurers. KPMG also has local and global experts with strong technical and market experience at the forefront of PSAK 117 who can assist you on this journey.

KPMG teams can help you to:

- Assist in documenting key data, methodologies, and assumptions, along with projecting the balance sheet and income statement based on PSAK 117 and PSAK 109.
- Assist in identifying the key drivers of the changes in the balance sheet and income statement after the implementation of PSAK 117 and PSAK 109.
- Assist in developing pricing strategies, particularly for onerous contracts.
- Assist in establishing a risk management framework that includes investment strategies, especially regarding asset allocation.
- Assist in updating asset-liability management (ALM) based on PSAK 117.
- Assist in developing bespoke financial projection models to project cash flows, balance sheets, and profit and loss statements under PSAK 117 and PSAK 109 basis.

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