Sri Lanka Insurance Report

Issue 3
April 2020

Contents

Foreword

Suren Rajakarier
Partner,
Head of Audit and Insurance
KPMG in Sri Lanka

> **"The impact of COVID-19 will affect the short as well as the long-term financial outlook of insurers. The pandemic will not only reduce global growth but have an impact on equity and debt instrument pricing and also reduce insurable exposures due to negative impact on businesses."**

The numerous advancements that took place within the insurance industry during 2019 contributed towards the establishment of a more competitive, coherent, regulated and transparent environment for insurers operating in the country, showcasing a clear path towards growth given the low penetration levels of both general and life insurance businesses showing positive trends within the country. However, traditional insurance mainly provides for the financial impact of risk. Taking a look at the risks that came into light in 2019 and early 2020, it is evident that there will be more considerations given to the list of impacts related to risk.

Overall insurance sector grew its total asset base by 11.5% YoY in September 2019 with life insurers dominating the higher proportion of overall industry assets. Insurers continued to invest majority of their funds in government securities due to the lower risk involved and regulatory requirements, that contributed to a higher growth in asset base. Gross written premiums (GWPs) of the sector reflected a 9.2% growth in the first nine months of 2019 a decrease in comparison with the 13.2% growth of the corresponding period of 2018. The adverse weather conditions coupled with the Easter Bombings that occurred in 2019 led to a steep increase in claims incurred by general insurers.

IFRS17 has been making a buzz across the globe and has grasped the attention of insurers in Sri Lanka too. Latest development in terms of IFRS17 is the IASB's decision to push the effective date further to 01st January 2023. This is expected to overcome many of the complications faced by insurers pertaining to implementation of the standards, availability of systems and drawbacks of the existing standard by introducing more refined accounting methodologies such as the General Measurement Model, which provides a comprehensive and cohesive approach to identify insurance contract liabilities.

The impact of COVID-19 will affect the short and long-term financial outlooks of insurers. The pandemic will not only reduce global growth but have an impact on equity and debt instrument pricing and also reduce insurable exposures due to negative impact on businesses. The industry must be prepared for large financial losses arising from bond and equity markets and loss events. Loss events could arise across a range of products like health, travel, event cancellation, business interruption, employer's liability, income protection, key personnel or even minimum guarantees. This is an unprecedented phenomenon that continues to evolve and insurers should preserve their capital position for the long haul balancing it with protecting the insureds, even by limiting dividends and other distributions..

The gig economy, a product of our ongoing digital disruption era, is one of the biggest trends to affect the workforce in the last decade as it really took off in the global recession period between 2008 and 2009. Having said that, this was the sector most affected due to lockdown of cities resulting from COVID 19. There is a market opportunity for insurers in this sector if they're innovative to capture the hearts and minds of the gig economy workers.

We expect insurers to continue growth amongst these challenges whilst pursuing new developments in the global arena. Use of Insurtech to introduce innovative insurance products to the general public is expected to be one major development that the insurers will focus on, going forward. High mobile penetration would offer products for low- and middle-income segments at relatively low costs. Furthermore, focus on developing the micro insurance segment will support future growth.

01 A PESTEL Review of the Decade

A rundown of the decade through the eyes of Sri Lanka's insurance sector

The past decade has brought about many challenges to the insurance industry covering many angles. The sector has had its share of downturn but continued to show its promising results throughout the decade. During the past years, the Sri Lankan insurance industry saw many players entering and exiting the business that were caused by numerous factors.

Introduction of new products, changes to regulatory framework, involvement of latest technology, changes of the ruling party of the government and stock market listings of insurers were some of the key highlights that took place during the past decade. We run through the decade, section by section evaluating the factors of Politics, Economics, Social, Technology, Environment and Legal, and how they shaped Sri Lanka's insurance industry.

Political factors that shaped the industry

The year 2010 started off as a year of promise as Sri Lanka experienced a full year of peace overcoming a 30 year civil war. The leadership of HE Mahinda Rajapakse, the president back then, paved a way for rehabilitation and resettlement schemes, and also established infrastructure facilities across the country with large-scale development programs, both at macro and micro levels. This started a boom in the Sri Lankan economy from a 3.5% growth in GDP to a significant 8% growth in 2010, which in turn nurtured the insurance industry potential.

The Insurance Board of Sri Lanka, on behalf of the insurance industry made a valuable contribution with numerous submissions to amend the Value Added Tax (Amendment) Act, No. 9 of 2011. The act was amended as services being receipts from re-insurance by any local insurance company by way of commission or compensation in an insurance business (with effect from 1st January 2011) to be exempt from Value Added Tax.

The National Insurance Trust Fund (NITF) that covers all government servants through the Agrahara Medical Insurance scheme also provides reinsurance cover to primary insurers. The government released Gazette notification No. 1791/4 of 31st December 2012, stating that all primary insurers are required to cede 30% of their total liability arising out of every general reinsurance to NITF.

The government declared the 1st of September of each year as "National Insurance Day" from 2017 onwards, marking a key milestone for the country's insurance industry recognizing the contributions made by the insurers.

The year 2010 started a boom in the Sri Lankan economy from a 3.5% growth in GDP to a significant 8% growth in 2010, which in turn nurtured the insurance industry potential.

Interconnection of economic parameters and performance indicators of the insurance industry

The post war growth in GWP for both long term and general insurance sectors started to grow significantly. The growth depicted in 2010 was a result of improved business confidence after the restoration of peace, new business opportunities emerging from the North and East of the country, growth in GDP during 2010, and the global bounce back from the economic recession.

The decade began with promising signs of significant improvement in the life insurance sector driven by growth in new businesses in 2010 as a result of the booming business confidence post war, coupling with the introduction of new life insurance products such as investment linked products and a range of retirement products to the market.

The insurance industry strengthened with two additional players as the Board granted licenses to Orient Insurance Ltd a 100% fully owned subsidiary of a foreign insurance company and Arpico Insurance Ltd to carry on general insurance business and long term insurance business respectively. Accordingly, the number of registered insurers increased from 20 to 22 from 2010 to 2011.

Amidst the Eurozone crisis; an aftermath of the global financial crisis, and the continuity of adverse weather conditions in the country, the overall Gross Written Premium grew by 11.03%, consisting of General Insurance growing by 14.67% and Long Term Insurance growing by 6.56%. The growth in the insurance sector was also a reflection of the continued growth in the country's GDP, a rate of 6.4% in 2012.

In the following year, motor insurance was negatively affected by reductions in the registration of new motor vehicles and price competition among the insurance companies. Growth in the motor insurance sector has considerably decreased compared to double digit growth recorded in 2012.

Sri Lanka's GDP continued on its increasing trend with a growth rate of 7.4% in 2014 compared to 7.2% recorded in 2013 which was mainly attributed to the substantial increases in the GDP of the industrial and services sectors.

This resulted in a steady growth rate of the insurance industry's gross written premium for the year. 2015 saw the implementation of technological tools to improve processes in the insurance industry that contributed to increased performance of the long term insurance sector.

The use of technology paved a way for improved operational processes to assure quality service to customers, introduction of innovative life insurance products to cater to changing needs of customers and improved customer awareness on insurance. The segregation of composite insurers had to be completed by 2015. This caused a dip in the growth of assets of long term and general insurance businesses.

2016 was a challenging year for general insurers as despite the steady increase in premiums year on year with intense competition prevailing in the general insurance market. The industry brought out introduction of innovative general insurance products, implementing Enterprise Risk Management strategies, focusing on risk selection and pricing while tapping into a new market for general insurers.

The decade witnessed a few significant mergers and acquisitions in the industry that shaped its course. Asian Alliance General Insurance Limited was acquired by Fairfax Asia Limited in year 2015 and was renamed as Fairfirst Insurance Limited. AIA General Insurance Lanka Limited and Janashakthi General Insurance Limited have been amalgamated in 2016 and renamed Janashakthi General Insurance Ltd
.

A key highlight of 2018 was when Janashakthi General Insurance Ltd. was acquired by Allianz Insurance Lanka Ltd. in year 2018 and amalgamated with effect from 28th September 2018 and renamed Allianz Insurance Lanka Ltd. The acquisition made Allianz Insurance Lanka Ltd one of the leaders in terms of market share.

Pressure points from social aspects of the insurance industry

2010 displayed a growth in life insurance penetration compared to 2009. The post war era brought light to a booming economy in Sri Lanka with positive growth in GDP. This impacted positively on the insurance industry and resulted in the penetration of life insurance business as a percentage of the total population increasing to 10.9% (2009:10.4%) while the penetration as a percentage of total labor force increasing to 27.7% (2009:26.4%).

The growth momentum in the long term insurance business somewhat declined in 2011 but was gradually increasing in absolute terms in 2012, mainly due to the increase in insurance awareness levels through comprehensive awareness raising programs and creative marketing campaigns conducted by insurers.

Introduction of "Life Insurance Awareness Month" in September 2015, helped to educate and create greater awareness across the country on the importance of long term insurance among the general public which in turn contributed to the growth in the long term insurance market.

The robust growth showcased in the private sector contribution in the healthcare sector and the increasing trend of the ageing population has created more space for health insurance products to be penetrate the market in the recent past.

Technology: the right move to unlock global expertise

The recent years have shown many technological developments taking place in the insurance industry. Sri Lankan insurers have been engaged with insure-tech to reap its benefits by deploying different tools in different aspects of the lifecycle of insurance including development of innovative products, distribution lines and comprehensive customer experience.

The industry's synergistic opportunities were apparent when some of the insurers and insurance brokers collaborated with telecommunication providers to broaden the landscape of insurance service while increasing the accessibility to consumers. With the technological innovations insurers tend to use multi-distribution channels specially exploring ways to develop newer distribution channels in the online space.

InsureMe.lk is Sri Lanka's first digital Insurance Comparison web platform, and first internet based broker, was launched in February 2019. This was a key milestone for Sri Lanka's insurance industry, paving a way towards digital transition.

Gathering information for insurance products via the internet has been supported by the popularity of social media, thus creating opportunities for insurers especially in marketing. The vast amounts of information management has enforced new laws and regulations on data protection and cyber security.

The growth momentum in the long term insurance business somewhat declined in 2011 but was gradually increasing in absolute terms in 2012

The heightening concerns of the environment

In 2016 Sri Lanka's GDP grew at a slower pace compared to 2015. The services sector made the highest contribution to GDP followed by industries, taxes less subsidies and agriculture respectively. The agriculture sector took a hit reporting a decrease of 4.2% in 2016. This was mainly caused by the adverse weather conditions prevalent throughout the year.

The adverse weather conditions increased the amount of claims to be paid out by insurers. The increasing trend in claims had a negative impact on the profitability of general insurers.

The continuing hazards caused by adverse weather conditions forced the Sri Lankan economy on a downward trend with GDP growth rate declining from 4.5% (2016) to 3.1% in year 2017.

General insurers including the National Insurance Trust Fund faced challenges due to natural disasters including heavy monsoon rains that triggered flood and landslides in certain districts in the island.

The Easter Bombings that shocked the country in April 2019 was yet another hit to the insurance industry, causing significant damage to property while increasing the claims to be paid by insurers.

The criticality of law and order

A key highlight from the legal aspect of the insurance industry occurred in 2011, where amendments were introduced to the RII Act including the requirement for composite insurance companies to segregate into two separate entities of life and non-life by 2015 and for insurance companies listed in a Stock Exchange to be approved by the Securities and Exchange Commission of Sri Lanka (SEC) by 2016.

In terms of the entities operating in the insurance industry, Volanka Insurance Services (Pvt) Ltd. was prohibited from functioning as an insurance broker with effect from 1st January 2012 since the company failed to comply with Section 80 (2) of the Act prior to 31st December 2011.

The Implementation of the Risk Based Capital (RBC) model was an immense challenge faced by the industry in 2012. Transitioning from a Rules Based Capital Regime to a Risk Based Capital (RBC) model was one of the important regulatory measures that the IBSL engaged in, during the year under review.

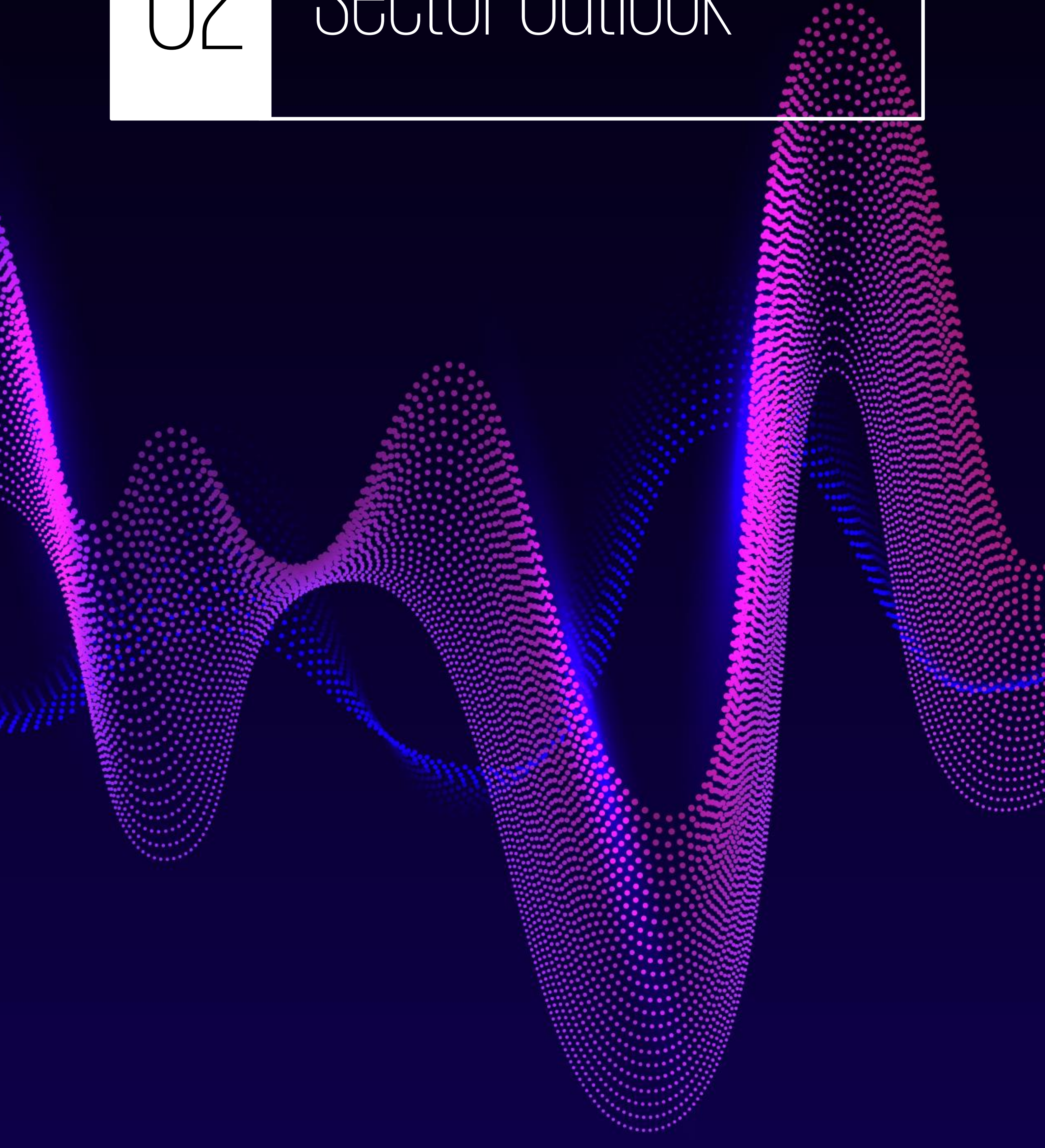
The profits recorded by life insurance sector was significantly high in 2017. This was caused by some long-term insurance companies making one off surplus transfers which emerged as a result of changing the valuation method of policy holder liabilities, to comply with regulations of the IRCSL..

The continuing trends of embracing new technology will be the key to overcome challenges put forward by industry forces.
The customer will have her bargaining power increased in the coming years and insurers will have to find flexibility to deal with unique customer needs.

Sri Lanka is currently not a mature industry with few investments in Insure-Tech. The general public's increasing awareness of insurance products will dictate that insurers establish innovative and cost effective policies with proper utilization of insure-tech. The industry has potential to grow and the past has shown that the industry can recover from economic downturn.

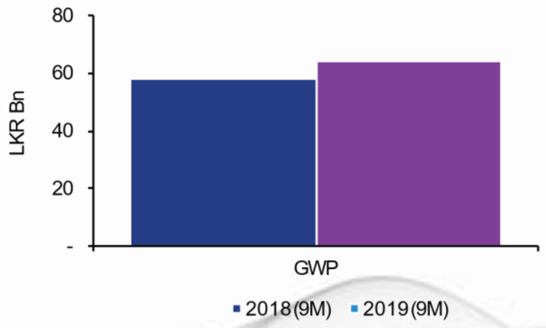
The continuing trends of embracing new technology will be the key to overcome challenges

02 Sector Outlook



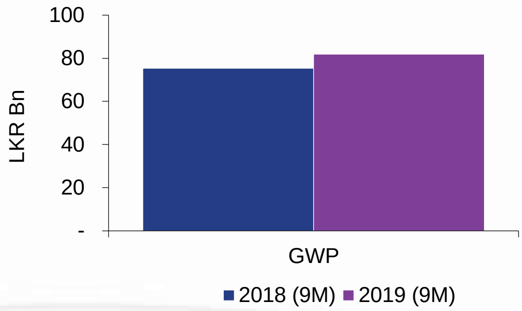
Gross written premiums (GWP)

Gross Written Premiums – Life Insurance



Source: IRCSL – Industry Performance Q3 - 2019

Gross Written Premiums – General Insurance



Source: IRCSL – Industry Performance Q3 - 2019

Total Gross Written Premium (GWP) of the insurance sector for the nine months ending in September 2019 was recorded at LKR 145.7 Bn, out of which contributions of LKR 63.9 Bn was from Life Insurers and LKR 81.8 Bn was from General Insurers. General insurance accounted for a higher GWP in absolute terms with a major contribution from mandatory motor insurance schemes.

The GWP of the Life Insurance sector grew at a rate of 9.8% year on year in the first nine months of 2019, a decrease from 12.1% in the corresponding period in 2018. GWP of General Insurers grew by 8.6% showcasing a contraction from previous year's 13.9%.

Despite the industry growth rate, Softlogic Life Insurance PLC grew its premiums by a significant 26% for the nine months ended in September 2019.

In terms of GWP, life insurance sector growth was slightly higher than that of general insurance reflecting favorable conditions for long term insurance products.

Considering the sub sectors of general insurance, a sharp spike was shown in Fire and Health insurance. The two subsectors, for the period of nine months ended in September 2019, showed growth rates of 24.9% and 22.3% respectively.

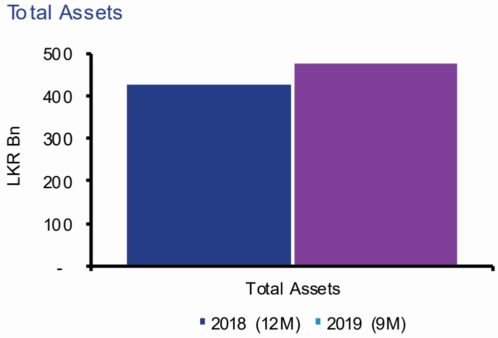
The increasing government expenditure on infrastructure projects and real estate and construction projects in 2019, brought in the demand for fire insurance policies.

The growth in health insurance premiums increased due to more awareness on the ageing population and the high life expectancy trends leading to increased health costs. Premiums from Motor insurance, a key contributor to the GWP of the general insurance sector grew at a mere 3.1% year on year as new tax regulations imposed on vehicles and the decline of personal vehicle imports in the first nine months of the as stated in CBSL reports, negatively affected the overall general insurance sector.

Despite the economic and political downturn in 2019, the life insurance sector sustained its growth by improving operational processes to assure quality service, re-engineering existing products in a highly competitive environment.

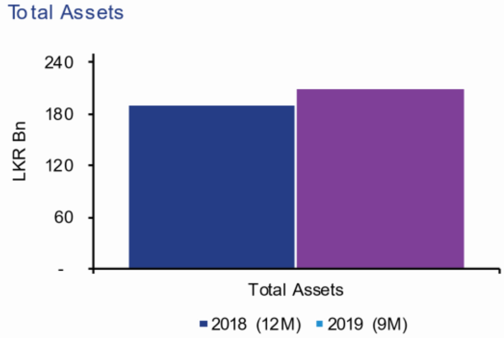
Assets

Life Insurance



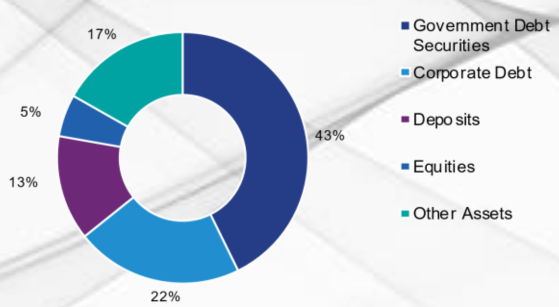
Source: IRCSL – Industry Performance Q3 - 2019

General Insurance



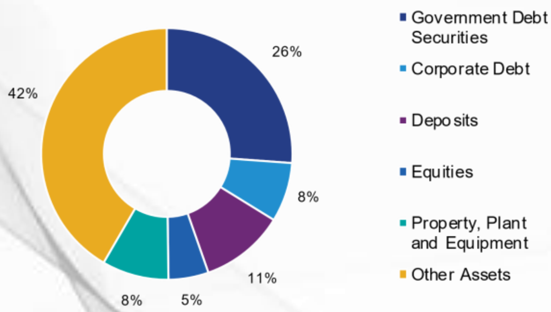
Source: IRCSL – Industry Performance Q3 - 2019

Concentration of Assets – Life Insurance



Source: IRCSL – Industry Performance Q3 - 2019

Concentration of Assets – General Insurance



Source: IRCSL – Industry Performance Q3 - 2019

Total assets of life insurance companies totaled at LKR 480 Bn as of 30th September 2019, displaying a growth rate of 11.8% in the first 9 months of the year.

This was a significantly increased growth rate compared to the 6.5% recorded in the corresponding period of 2018.

An accelerated growth in assets was noted in Q3 2019 despite the increased vulnerabilities in the economy including political set backs and other global and local economic factors.

Similar to last year, government debt securities contributed to a higher composition of the total investment portfolio due to the regulatory requirements, lower risk involved and long tenure of instruments.

A mere increase of 2% year on year in deposits was observed due to the fluctuating interest rates.

Total assets of the general insurance sector as of the end of September 2019 amounted to LKR 210 Bn. The assets grew at a rate of 10.8% during the first nine months of 2019, an increase compared to the dip of 0.62% in the corresponding period of 2018.

Similar to Life Insurance sector, higher composition of the asset portfolio was invested in government debt securities due to similar regulatory and risk factors.

Investments in Equities decreased to LKR 10.8 Bn from LKR 12.3 Bn in September 2018 as a result of performance fluctuations of listed companies throughout 2019 and a general dip in the stock market as depicted by the declining trend of the all Share Price Index (ASPI) of the Colombo Stock Exchange that continued its declining trend from 2018 on to the first nine months of 2019.

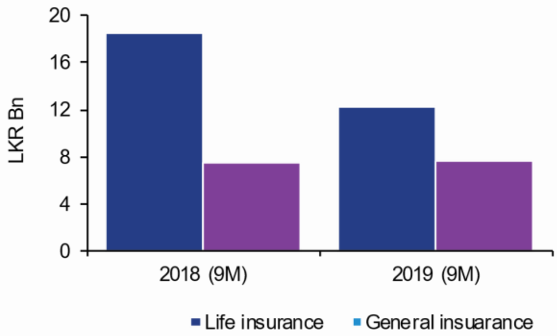
Profitability - 9M 2019

The overall insurance sector reported a significant year on year decline of 23.8% in profit before tax amounting of LKR 19.9 Bn compared to LKR 26.1Bn reported in the nine months ended in September 2018.

The life insurance sector reported a profit of LKR 12.2 Bn in September 2019, 34.2% decline from LKR 18.5 Bn in September 2018. The higher tax liabilities of life insurers coupled with currency depreciation had its impact on the PBT of Life Insurers.

Non-Life insurers grew profits by a mere 1.7% year on year totaling up to LKR 7.7 Bn. The rupee appreciated against the dollar by a mere 1.2% in the nine month period not adequately to hinder the increasing claims for general insurers in terms of motor claims for imported spare parts. LKR 25.8 Bn were paid as total claims for motor insurance.

Profit Before Tax



Source: IRCSL – Industry Performance Q3 - 2019

Claims incurred

Overall claims incurred by the insurance sector as at 30th September 2019 was LKR 72.8 Bn, depicting a significant increase of 13.2% in comparison with the claims incurred in the corresponding period of the previous year.

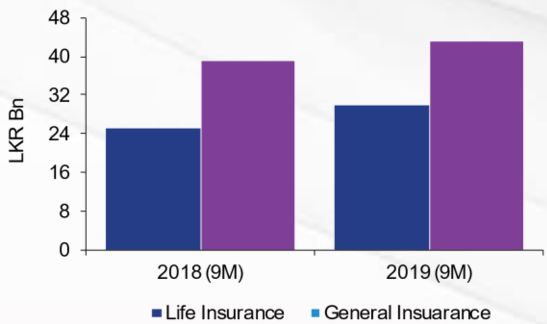
The total claims of life insurers for the nine months ended in September 2019 grew by an extensive 18.4% totaling to LKR 29.8 Bn compared to LKR 25.2 Bn in the corresponding period of 2018.

General insurance claims incurred during the year to September 2019 displayed a moderate increase which amounted to LKR 43 Bn compared to LKR 39.1 Bn in the first nine months of 2018.

Motor insurance maintained its position as the largest sub sector of claims over the nine month period which amounted to LKR 25.8 Bn.

Second highest claims were recorded in the health insurance sector amounting to LKR 11.2 Bn. Claims incurred for fire amounted to LKR 6.8 Bn an increase from LKR 5.2 Bn as reported in September 2018.

Claims Incurred 9M 2019



Source: IRCSL – Industry Performance Q3 - 2019

03 Disrupting Global Insurance

The workforce is changing in Sri Lanka

CAN INSURANCE KEEP UP IN THE GIG ECONOMY ERA?

The gig economy, a product of our ongoing digital disruption era, is one of the biggest trends to affect the workforce in the last decade as it really took off in the global recession period between 2008 and 2009.

It refers to temporary short-term jobs, and the freelancers and independent contractors who are performing those jobs, which are transforming the traditional economy and the way companies hire, train, reward and manage employees. However, it must not be seen only as an opportunity for employment purposes but also as a new growing market.

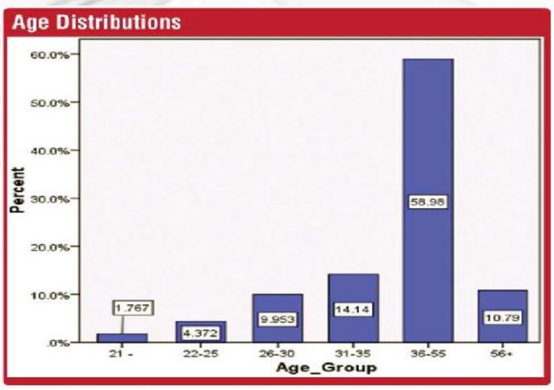
Getting a real measure of this global phenomenon is not easy especially when some may underestimate its true size by considering only gig work as a primary source of income.

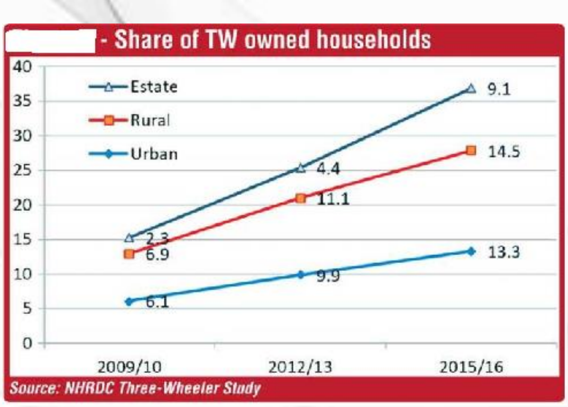
In the US, more than 35 percent of the workforce seems to be participating in the gig economy, and that number is expected to jump to 43 percent by 2020.

In Europe, the size of the gig economy as a secondary source of income is growing, specifically in Austria and Italy.

In some countries like China, India, Indonesia and Brazil, the share could be even higher, considering that gig work, for many, is the primary source of income.

In Sri Lanka, Three wheel drivers and an estimated Uber driver population may put the share at around 15-20% of the workforce, keeping in mind the significant growth depicted below 6, with nearly 60% of the them being between the ages 36-55.





Three wheeler, PickMe and Uber drivers leading the gig revolution in Sri Lanka, without any other significant informal sector.

These new freelancers have several motivations: they are looking for more flexible alternatives to traditional ‘9 to 5’ jobs; they are supplementing their primary income; they are pursuing their areas of interest; and in some cases they are looking for a transition to retirement.

In fact, it is a false myth that only millennials love to gig!

TECHNOLOGY AND THE GIG ECONOMY

Technology, for sure, has played an important role for this new business and employment model. The current cutting-edge digital online platforms, along with the proliferation of mobile applications, have paved the way for the gig economy by enabling an instantaneous matching of supply and demand, bringing together service providers with people needing those services.

Fundamentally, there are two main kinds of gig digital platforms: the labor based ones, which enable workers to provide activities, completing tasks like driving a car (e.g. Uber, PickMe), delivering parcels and food (e.g. UberEATS), assembling flat-pack furniture (e.g. TaskRabbit an American online and mobile marketplace that matches freelance labor with local demand, allowing consumers to find immediate help with everyday tasks, including cleaning, moving, delivery and handyman work, Hodabass.lk) and the asset based ones which allow people to rent or sell their unused assets (e.g. Airbnb, eBay).

These platforms have evolved and have enabled over time the transformation of the gig economy from a C2C market, with individuals offering/demanding products from each other like on eBay founded back in 1995, into a B2C market with new models exploiting underused assets or skills.

The gig economy is also a B2B market, highlighting transactions between different sectors and the need for new insurance products.

THE GIG ECONOMY INSURANCE GAP

Because the gig economy is a new, flexible, and short-term model of work, it does not provide the benefits and the protections that come with traditional full-time employment, such as life and health insurance, unemployment insurance, paid vacation or days off and minimum wage protection.

Gig workers (and consumers), as they are not covered by their employers' insurance, may be exposed to greater risks than traditional employees.

Furthermore, they may not even be fully aware of all the risks they are exposed to, as gig work does not fall neatly into commercial or personal insurance.

In fact, personal insurance will not cover accidents that arise, for example, from transporting passengers with your car for commercial use; and the coverage, which some ride-sharing platforms do provide, is not robust enough and might still expose employees to liability.

Therefore, the gig economy has created a significant insurance and protection gap for these kinds of workers.

That's why this represents a great opportunity for the insurance industry: there is a new lucrative opportunity to provide tailored insurance policies for gig workers, as this new model of work demands new ways of thinking about insurance, with products that are flexible and able to be customized to particular needs.

IS THERE SPACE FOR TRADITIONAL INSURERS IN THE GIG ECONOMY?

Traditional carriers face challenges like policy pricing which is dependent upon years of historical loss information, legacy systems and complex organizational structures that are not easy to adapt.

On the other side, gig workers need speed, frictionless transactions and are looking for new, very flexible, short-term coverage; and they may not be willing to pay annual insurance premiums for the time they are not working.

Insure-tech entrants with their easy, digital, on-demand policies, are currently better tapped into this segment of the market. They have leveraged their state-of-the-art platform based on artificial intelligence algorithms that bypass the traditional underwriting processes and the outdated legacy systems in order to price the risk through flexible pay-as-you-go or monthly subscription models, based on the behaviors and needs of the workers.

However, large insurers, wishing to expand in this space, could also quickly adapt or collaborate with new start-ups in order to seize this new market opportunity, as the insurance gap is wide, considering the vast number of individuals operating within the gig economy.

There are many opportunities for local joint ventures and partnerships between incumbent insurers and potential insure-techs in the sector who can often represent the easiest and fastest way for traditional carriers to embrace these micro, scalable, on demand products.

THE BOTTOM LINE

Although we don't know exactly what the workforce of the future will look like—and there are concerns, particularly regarding the legal status of gig workers in many jurisdictions around the world, and the possibility that gig workers could be subject to labor regulations—however all signs indicate that the gig economy will continue to grow and that insurance will keep transforming.

The next giant leap should be when health insurance, retirement plans and benefits like stock options and grants become "portable" and non-exclusive to traditional employment, opening the doors to the gig market.

This might, in some cases, already be beginning to happen among major players like Airbnb and Uber and some larger global insurers are moving forward by trying to attract a broader section of society including non-salaried segments with simple, monthly and flexible insurance plans.

Article By:

Suren Rajakarier
Partner - Head of Audit
KPMG in Sri Lanka

Suren is the Head of Audit of KPMG in Sri Lanka and the FS Insurance head. He counts over 30 years of audit experience, having served multi-nationals and local companies in a wide range of industries in multiple service lines.

Suren leads the Insurance Accounting Change in Sri Lanka & Maldives for IFRS 17 and Chairs the Insurance accounting group at the Chartered Institute to advice on the impact of IFRS 17 .

Suren is the Chairman of the ACCA member network panel in Sri Lanka. He is a Member of the Statutory Accounting Standards Committee and the Chairman of the Statutory Auditing Standards committee set up under the Sri Lanka Accounting & Auditing Standards Act No 15 of 1995..

Insure-Tech

Competitive Advantage, Market Share, Innovation and Sustainability are known to be the key factors that distinguish "industry leaders" from the "industry followers" across multiple business sectors. These factors took a turning point when technology started to compete with traditional human capabilities.

The evolution of the internet has created many innovative platforms since the latter part of the 20th century until today. Today, we come across terms such as; "Blockchain", "Internet of Things", "Drone Technology", "Virtual Reality" and "Augmented Reality".

The insurance industry is known to be an industry with a heavy usage of data processing on a daily basis. The early adoption of technology in the insurance industry was mainly in the avenue of computerizing such tasks that turned out to be mundane which only required minimal knowledge for manual completion.

With the continuous evolution of financial cycles, business cycles and customer taste, insurance companies had to acquire new technology consistently to stay in par with competition

Blockchain in insurance

"Information Management" is a term that has currently been replaced by "Blockchain", a type of tech that uses cryptography to manage vast amounts of data in real time.

The insurers that have already tapped into Blockchain use it as a tool to streamline client and employee onboarding process to improve the services provided. This helps insurers to issue insurance certificates efficiently while detecting fraud in real time.

The surfacing of Blockchain has had a major impact on the financial services industry in terms of managing and validating the amount of transactions that occur frequently.

Blockchain has enabled integration of police reports with external databases thereby detecting fraudulent patterns specific to each identity. Furthermore, the tech provides a permanent audit trail to each transaction to evaluate suspicious claims.

The manual intervention of the "Know Your Customer" process is starting to get detached from day to day operations of Insurers as Blockchain has provided a platform for customers to access relevant databases to update information at their own discretion. The platform provides state of the art cyber security measures to encrypt customer data.

Blockchain has enabled integration of police reports with external databases thereby detecting fraudulent patterns specific to each identity

Insurance in Internet of Things (IoT)

The integration of countless numbers of physical devices that collect and share data via the Internet could simply constitute the Internet of Things (IoT).

The global availability of wireless networks can turn any device into an integral of IoT.

The IoT adds value to a device with digital intelligence that enables real time data exchange without human intervention thereby merging digital with the physical elements.

Connected Health is a concept that has been applied by many insurers where devices connected via IoT monitors the health
conditions of a human to recommend policies based on the data retrieved. U.S. based insurer John Hancock's Vitality
Program allows people suffering from diabetes to use the Apple Watch to track their fitness activities and earn a discount on the following year's premium if they meet certain pre-set goals.

A similar concept is used in motor insurance named "Connected Car". IoT has enabled insurers to implement a Usage Based Insurance scheme to insure vehicles where the policy is determined by the vehicle type, time period, mileage and other behavioral factors.

The usage of smart devices have helped insurers to obtain data on customer behavior and assess the domestic environment.

Insurers utilize the obtained data to provide customized housing insurance policies.

A number of insurance companies are establishing relationships with tech-providers in the smart-home industry and acquiring technology solutions to create innovative smart-home solutions.

Insurance with extended reality

Extended Reality has its two components; Virtual Reality (VR) and Augmented Reality (AR). VR is a simulated experience that is similar or even completely different to reality.

The elements in VR do not physically exist but they have been made to appear so by software.

AR provides an experience with elements that reside in the real world but they are enhanced by the integration of software.

VR and AR are mainly used in the insurance industry in the lines of Support Processes and Customer Interactions.

Global insurers have been using extended reality in terms of claims management to evaluate property damage.

The usage of smart devices have helped insurers to obtain data on customer behavior and assess the domestic environment.

Drone insurance

The increasing use of drones across many industries have created a new market
that has been identified by global insurers. Many insurers have initiated the process of providing insurance covers for drones.

The industry is aware of such an emerging market where few insurers have moved into it with first mover advantage.

Apart from the market presence, insurers have started to use drones to improve operational efficiencies.

Remote inspection of claim sites that have been affected by natural disasters are being assessed with the use of drones.

Operational excellence in insurance (KPMG - ACORD Research)

"KPMG Global teamed up with ACORD to conduct a research on the insurance industry's operational excellence.

The research was conducted under two main pillars; the current state and the future state.

The major findings of the research reflected the current perception of insurers in terms of technology and the implementation.

Looking at the future, many insurers have already planned to focus on particular areas of which technology can be the turning point if adopted in time"

Current state

Insurers indicate they are behind the curve with regard to gains in operational efficiency, with a lack of process standards and strategic vision mentioned as key inhibitors.

The survey found that most carriers are currently focusing on process redesign, implementation of lower cost sales and servicing channels, and legacy systems repair or replacement initiatives.

Furthermore the research had the following key indicators to which insurers were directing their prime focus;

KEY INDICATORS

13% on Transformative operational automation via intelligent automation; RPA through cognitive, IA reduces labor cost.

12% on Alternative sourcing, partnerships and outsourcing and 4% on any other improvement.

21% on Legacy System fixes, new co-strategies and efficient data transformation.

Culture – **26%** on basic process efficiency and process standardization, process redesign and end to end value chain improvement throughout customer lifecycle.

24% on Lower cost channels, self-service and automation of traditional channels.

Future state

The respondents ranked the following elements of the value chain as most critical for operational efficiency gains:

55% - Claims, 51% - Policy Servicing, 45%- Underwriting and 39% - Distribution.

On the other hand, the majority of respondents ranked HR (74 percent) and finance (57 percent) as the lowest-priority areas of focus.

The prioritization of value chain components was one area in the study where significant differences emerged depending on the location of the insurer.

A Future aligned with technology

With technology becoming obsolete at lightning speed, industries not only need to adopt new technology but also need to foresee when existing technology will be made redundant.

The investment in latest technology needs to be feasible both financially and non-financially.

Obtaining the latest technology may not be the smartest move if the rate of obsolescence is high.

A sustainable approach needs to be used in order to stay competitive in the long run.

Article By:

Priyanka Jayatilake
Partner - Head of Advisory
KPMG in Sri Lanka

Priyanka is a Partner of KPMG in Sri Lanka & Maldives and is the Head of Advisory & Technology practices of the firm. He is also the Managing Director of KPMG Technology Solutions (Pvt.) Ltd. He leads a team of over 600 professionals and associates across Technology, Management Consulting, Risk Consulting and Transactions & Restructuring Practices. Priyanka counts over 32 years of experience in Technology, Audit and Advisory spheres. Priyanka has been instrumental in setting up some of the functional divisions of KPMG such as Technology Solutions, IT Audit & Advisory, Outsourcing, HR Solutions and Executive Search.

04 A Comprehensive Solution for Risk

Insurance; the sole solution for the emerging risks

Risk mitigation strategies will take different stances depending on business context, impact and likelihood, time constraints, systematic and unsystematic risks, a list that keeps on continuing. A common factor in the aforementioned is the financial impact to businesses.

Insurance is a common mitigation strategy for encountering so called risks with a financial impact.

The development of Insure-Tech has enabled traditional insurers to cater to different entities with unique risk appetite.

Insure-Tech aids traditional insurers to adopt latest technology to improve efficiency, build better pricing models, anticipate demand and fraud, and build customized and innovative products tailored to the specifications required by organizations or individuals

The ability to provide for constantly changing paradigm of risk, will continue to create new markets for insurers if identified proactively. In this section, we turn our focus towards the Top 10 Emerging Risks for the third quarter of 2019 by Gartner Research, and how insurers need to position themselves to create opportunities.

01 CLIMATE CHANGE LIABILITY

An outburst topic in all spectrums today is Global Warming. The crisis on climate change has affected economies across the globe with raising concerns in politics, technology, law & order and social matters. The predictability of consequences that arise in response of the climate crisis is significantly low and therefore insurers may lack the research and tools to justify the risk assessment models.

The repercussions of the climate crisis, to an extent, will be irreversible hence insurers need to raise awareness of extreme weather events and how they can damage private and public property. Assessment on prudent land use, strong building structure and the use of renewable energy could be the insurance industry's contribution towards the fight against global warming.

Sri Lanka is yet to make its considerable contribution towards the fight against the climate crisis, whereas insurers could turn its focus towards providing covers for solar energy and other sustainable methods of operating.

02 DATED POLICIES AND PROCEDURES

Organizations set policies to govern how they operate. Similarly, governments set policies to control how a country is operated. These policies need to consistently be updated as there is risk of them being outdated and there can be severe consequences as a result of it.

Dated policies and procedures in an organization could lead to a wide range of consequences from missing out on an opportunity of attracting young talent to paying high amount of fines for non-compliance.

Compliance across industries has had significant impact on governance in relation to environment, fraud, labor regulations etc. The adoption of high quality compliance measures by entities is a result of the standards set by governing bodies.

insurers could cater to risks arising from compliance and companies could go ahead with increasing compliance measures.

03 GLOBAL CURRENCY INSTABILITY

Currency exchange rate fluctuation has continued to increase throughout the decade and it is predicted that it will continue to do so. The impacts of high exchange rate
fluctuation has its chain reaction on global economies.

As a result of this chain reaction, international business operations will take a significant hit from the amount of transactions made in foreign currency.

Currency hedging is provided by financial institutions to mitigate for risk that arises from exchange rates.

Blockchain has been adopted by global insurers for the analysis of large amounts of data in real time with the use of cryptography. Similarly, the analysis of exchange rates through blockchain could be an opener for insurers to cater to currency risk.

In the Sri Lankan market, Blockchain is yet to make a significant impact, but the market is open for insurers to use the technology to be utilized for new products especially for entities that engage in foreign currency.

04 RISK RESPONSE PERCEPTION

The third party perception of a particular risk response would reflect on how the response for the risk has affected the stakeholders. A negative perception could imply that the particular risk mitigation strategy did not address the risk comprehensively.

Insurers could play their part as the financial risk mitigation strategy, but some consequences that arise from risk do not only consider financial repercussions. Insurers need to widen their scope to focus on how they can cater to non-financial factors.

05 INDUSTRIAL RECESSION

Amidst the global economic crisis, manufacturing output has continued its declining trend into the latter part of 2019. According to leading economic forecasters, the
newly developing coronavirus could cost the global economy more than USD 1 Tn in lost output if it turns into a pandemic as a result of declines in discretionary consumption and travel and tourism, with some knock-on financial market effects and weaker investment.

The reduction in manufacturing out could also be a result of the decreasing demand of capital goods globally.

From the cost perspective, manufactures may have to focus on a demand driven supply rather than a pushing products to the market. A flexible supply chain and automation of processes could be a temporary solution for the crisis at stake. Insurers need to innovate their products to reflect a focus on securing investments on automation and other manufacturing equipment.

This may seem as a risky market for insurers to operate in, but on a separate note, it may help the overall manufacturing industry to recover and thereby create a turnaround for the economy.

06 US/CHINA TRADE TALKS

The US/China trade war, an important talking point related to the Trump administration has continued to intensify while having its weight carried especially by many importers and exporters. With the intense tug of war on the tariffs to be levied on, many companies have had their amounts of receivables increasing with the question of if these amounts could be recovered or not.

Unsettling times like these could create a space for insurers to operate in. Insurers could provide facilities for entities that have been affected by the trade war in terms of recovering the amounts that are pending.

Such services could be from short term to medium term given the assumption that the two governments come to an agreement in the near future. Insurers need not commit to this open space for a long term, but since there is an untapped demand of companies seeking to mitigate the risk arising from the trade war, capitalizing on this could be a value addition for the insurance industry.

07 DATA LOCALIZATION

The increasing amounts of data in digital platforms has pressured governments to enforce up to date regulations on data protection. Many of the regulations at stake are pressurizing entities to store data in servers within the geographic boundaries of the respective countries and not in servers located in foreign countries.

Entities that operate beyond geographical boundaries may have to set up server facilities in countries they operate. Insurers could tap into this upcoming market with a customized product to cater to the specific needs required to establish servers in different locations.

Hence, the above factors will further create a backdrop for insurers to underwrite policies for cyber related issues that could arise. Insurers in Sri Lanka need to collaborate with government agencies to gain greater understanding on cyber risk and thereby provide covers in the lines of cyber.

08 STRATEGIC ASSUMPTIONS

An entity's strategic plan derives how the entity will take the necessary steps to achieve its goals in the medium to long term. Traditionally, strategic planning is a long term view coupled with a number of assumptions to establish the necessary steps that need to be taken.

In highly dynamic business environment, a medium to long term plan may not seem as the best option. The plan requires to be flexible to adapt to different dynamics of he environment. The assumptions considered may tend to be outdated prior to the execution of the strategy thus having a negative impact on the overall corporate strategy.

Insurers will not have a control over the corporate strategies of entities but they will need to assess the company's strategy to ensure any externalities are reflected in the insurance premium.

09 LAGGING DIGITALIZATION

Digitalization is turning towards being the norm of global economies. Entities are focusing on digitalization to gain economies of scale, design new products, cater to new markets and gain an edge over the competition.

Amidst the transition to a digitally enabled era, there are countless amounts of companies that are yet to embrace the digital journey.

The risk of such negligence could lead to organizations falling behind the competition and may lose its position in the market. Insurers may have to pay attention to companies that fall into this group, especially if they provide insurance coverage to these companies.

On the other hand, insurers should seek to identify companies that are willing to embrace technology to transform themselves to be digitally enabled.

Customized insurance products that cater to mitigate risk that arise from process automations, cloud technologies and real time analytic tools could serve the interest of organizations that look to engage in a digital journey.

10 DIGITAL MISCONCEPTION

Throughout the decade, entities have continued to pursue strategies that would make themselves absorb the latest technologies available. While pursuing such strategies, in some instances, companies have lost focus on their core business. Hence, a misconception on digitalization has arisen in across spectrums.

As of September 2019, Digital Misconception tops the list of emerging risks. Decision makers need to understand the fact that in changing times, business models need to adapt to changing demand. Trying to stick with the original business model could make a company vulnerable to many unknown risks.

Insurers need to first identify the required technologies to deliver the end product that is required by the customer.

Furthermore, insurers need to get a deeper understanding on the customer to identify the areas that are lagging.

Insurers can be the value addition that provides expertise on which technologies could be adopted and provide a cover as per the relevant risks.

CONCLUSION

The list mentioned above could be an opportunity for insurers worldwide. In Sri Lanka's context, insurance has dominated only in the lines of Life Insurance and General Insurance that covers healthcare, motor, disaster and fire protection.

The Sri Lankan insurance industry may not be mature enough to cater to all of the above mentioned risks but it will worthwhile to identify which of the above will have a greater impact on the local economy and then cater to them with adequate measures.

Article By:

Jagath Perera
Partner
Internal Audit Risk &
Compliance Services &
Forensic Services
KPMG in Sri Lanka

Jagath leads KPMG's Internal Audit and Risk Consultancy Services and the Forensic Services practice in Sri Lanka; a multidisciplinary team of professionals who advice clients on forensic investigation, strategic planning, Internal audit services, cost optimization, financial management, decision support, supply chain management , regulatory compliance. He has over 25 years of experience in Sri Lanka, Maldives and in practice for numerous global and regional projects.

05 Stay Ahead or Get Left Behind

Stay ahead or get left behind

For the users of financial information, IFRS17 will create a whole new perspective on insurers' financial statements. The new standard brings greater comparability and transparency about the profitability of new and in-force business and gives users more insight on an insurer's financial health than ever before.

Accordingly, implementation of IFRS17 has clear benefits-particularly in the lines of increased transparency and greater comparability regarding insurers' financial capacity and performance

However, there are key questions that not only insurers but the wider audience is keen on over the new standard's implementation.

We look towards some of the common queries that have arisen amidst the transition period of implementing IFRS17.

HOW TO IDENTIFY AN INSURANCE CONTRACT?

An insurance contract is "a contract under which one party; the issuer – accepts "significant insurance risk" from another party; the policyholder."

If a "specified uncertain future event; the insured event – adversely affects the policyholder", then the policyholder has a right to obtain compensation from the issuer under the contract.

Generally, insurance contracts create a bundle of rights and obligations that work together to generate a package of cash flows. Some types of insurance contracts only provide insurance coverage; e.g. - most short term non-life contracts.

However, may types of insurance contracts; e.g. – unit link and other participating contracts contain one or more components that would be in the scope of another standard if the entity accounted for them separately.

For example, some insurance contracts contain: Investment components: e.g. - pure deposits, such as financial instruments whereby an entity receives a specified sum and undertakes to repay that sum with interest.

Goods or service components: e.g. - non-insurance services, such as pension administration, risk management services, asset management or custody services; and Embedded derivatives: e.g. - financial derivatives, such as interest rate options or options liked to an equity index.

Investment components and goods and services components have to be separated from an insurance contract if they are distinct. An entity is prohibited from applying IFRS15 or IFRS9 to components of an insurance contract when separation is not required.

For instance, some entities currently separate policy loans from the Insurance contract to which they relate. If separation is not required because a component is not distinct, then separation is prohibited under IFRS17.

AT WHAT LEVEL SHOULD I AGGREGATE?

The aggregation of contracts into groups is required on initial recognition for all contracts in the scope of IFRS17. The grouping of individual contracts under IFRS17 is performed in a manner of such that it offsets the profitable contracts against onerous ones, having regard to how insurers manage and evaluate the performance of their business. The groups are established on initial recognition and are not reassessed subsequently.

In determining the level of aggregation, an entity identifies portfolios of insurance contracts.

An entity divides each portfolio into a minimum of: a group of contracts that are onerous on initial recognition, if there are any a group of contracts that, on initial recognition, have no significant possibility of becoming onerous subsequently, if there are any; and a group of any remaining contracts in the portfolio.

The objective is to identify contracts that fit into these groups at an individual contract level. This can be achieved by assessing a set of contracts if the entity can conclude, using reasonable and supportable information, that the contracts in the set will all be in the same group. An entity cannot include contracts issued more than one year apart in the same group.

Therefore, each portfolio will be disaggregated into annual cohorts or cohorts consisting of periods of less than one year. However, exceptions apply in certain circumstances on transition.

HOW TO CALCULATE THE CONTRACTUAL SERVICE MARGIN (CSM)?

The CSM represents the unearned profit that the entity will recognize as it provides services in the future for the insurance contracts categorized as groups.

On initial recognition of a profitable group of insurance contracts, the CSM is the equal and opposite amount of the net inflow that arises from the sum of the following: the fulfilment cash flows; the de-recognition of any asset or liability recognized for insurance acquisition cash flows; and any cash flows arising from contracts in the group at that date, An entity calculates a CSM for each group of insurance contracts.

Generally, at each reporting date the carrying amount of a group of insurance contracts is re-measured by: updating the fulfilment cash flows using current assumptions; and updating the CSM to reflect changes in fulfilment cash flows related to future service, a financing effect and the profit earned as insurance services are provided in the period.

The updated CSM represents the profit that has not yet been recognized in the profit or loss statement because it relates to future service to be provided.

For contracts without direct participation features, interest is accreted on the carrying amount of the CSM during the reporting period using the discount rate applied on initial recognition to reflect the time value of money.

At each reporting date, the CSM reflects the profit in the group of insurance contracts that has not yet been recognized in profit or loss, because it relates to future service to be provided. Therefore, the CSM is adjusted in each reporting period for an amount recognized in profit or loss to reflect the services provided under the group of insurance contracts in that period.

This amount is determined by: identifying the coverage units in the group; allocating the CSM at the reporting date (before recognizing any release to profit or loss to reflect the services provided) equally to coverage units provided in the current period and expected to be provided in the future; and recognizing in profit or loss the amount allocated to coverage units provided in the period.

The CSM represents the unearned profit that the entity will recognize as it provides services in the future for the insurance contracts categorized as groups

WILL MY DISCOUNT RATE CHANGE?

Discounting adjusts the estimates of expected future cash flows to reflect the time value of money and the financial risks associated with the cash flows (to the extent that the financial risks are not already included in the cash flow estimates).

The discount rates applied to the estimates of expected future cash flows: reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts; are consistent with observable current market prices; and exclude the effects of factors that affect observable market prices used in determining the discount rate, but do not affect the future cash flows of the insurance contract.

Cash flows that vary based on the return on underlying items are discounted or adjusted to reflect that variability, regardless of whether: the variability arises from contractual terms or discretion of the issuer; or the entity holds the underlying items.

When some cash flows vary based on the return on underlying items and some do not, an entity can either: divide the cash flows and apply the relevant discount rates for each stream of cash flows; or apply discount rates appropriate for the estimated cash flows as a whole – for example, using stochastic modelling techniques or risk-neutral measurement techniques.

FRS 17 does not prescribe a single estimation technique to derive discount rates. However, the standard does specify that a 'top-down' or 'bottom-up' approach may be used. In theory, for insurance contracts with cash flows that do not vary based on the performance of the underlying items, both approaches should result in the same discount rate, although differences may arise in practice.

The effect of, and changes in, the time value of money arising from the passage of time and the effect of financial risk are presented as insurance finance income or expense within the statement of financial performance (with certain exceptions for direct participating contracts).

IFRS 17 requires insurers to discount their insurance contracts using a current interest rate and the effect of changes in that interest rate can be reported in profit or loss. Thus, the income and expenses reported in profit or loss, as a result of changes in current interest rates, are expected to offset, at least to some extent, the volatility in profit or loss that may arise from financial assets accounted for at fair value through profit or loss.

As a result of changes introduced by IFRS 17 and IFRS 9, some companies may decide to reassess how they carry out their asset and liability management.

This is because the measurement of financial assets and insurance contract liabilities may change in applying IFRS 9 and IFRS 17.

It is expected that the combination of IFRS 9 and IFRS 17 will provide clearer information about the effects of a company's asset and liability management.

IFRS 17 does not prescribe a single estimation technique to derive discount rates. However, the standard does specify that a 'top-down' or 'bottom-up' approach may be used.

HOW WILL THE RISK ADJUSTMENT BE CALCULATED?

The risk adjustment conveys information to users of financial statements on the amounts the entity charged for bearing the uncertainty over the amount and timing of cash flows arising from non-financial risk. It measures the compensation that the entity would require to make it indifferent between: fulfilling a liability that has a range of possible outcomes arising from nonfinancial risk; and fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contract.

The risk adjustment for non-financial risk considers risks arising from an insurance contract other than financial risk. This includes insurance risk and other nonfinancial risks such as lapse and expense risk. Risks that do not arise from the insurance contract for instance, general operational risk – are not included.

The risk adjustment for non-financial risk reflects: the degree of diversification benefit that the entity includes when determining the compensation that it requires for bearing that risk; and the entity's degree of risk aversion, reflected by both favorable and unfavorable outcomes.

The objective of the risk adjustment for non-financial risk is to reflect the entity's perception of the economic burden of the non-financial risk that it bears. Therefore, the entity specifies a level of aggregation for determining the risk adjustment for non-financial risk that is consistent with its perception of its non-financial risk burden.

IFRS 17 does not prescribe methods for determining the risk adjustment for non-financial risk. Therefore, management's judgement is necessary to determine an appropriate risk adjustment technique to be used.

WHICH OF THE ACQUISITION COSTS ARE INCLUDED?

Insurance acquisition cash flows fall within the boundary of an insurance contract. They arise from selling, underwriting and starting a group of insurance contracts.

These cash flows need to be directly attributable to a portfolio of insurance contracts to which the group belongs. Cash flows that are not directly attributable to the groups or individual insurance contracts within the portfolio are included.

Insurance acquisition cash flows: can arise internally; e.g. - in the sales department or externally via agents include not only the incremental costs of originating insurance contracts, but also other direct costs and a proportion of the indirect costs that are incurred in originating insurance contracts and include cash flows related to both successful and unsuccessful acquisition efforts.

An entity recognizes as an asset or liability in any insurance acquisition cash flow relating to a group of insurance contracts that it pays or receives before the group is recognized.

These assets and liabilities are derecognized when the group of insurance contracts to which the cash flows are allocated is recognized, as part of determining the CSM on initial recognition.

The objective of the risk adjustment for non-financial risk is to reflect the entity's perception of the economic burden of the non-financial risk

WILL MY REINSURANCE CONTRACTS HELD BE IMPACTED?

A 'reinsurance contract' is a type of insurance contract that is issued by an entity(the reinsurer) to compensate another entity (the cedant) for claims arising from insurance contract(s) issued by the cedant.

IFRS 17 has provided modifications to the general measurement model that are applied to reinsurance contracts held.

The cedant accounts for a group of reinsurance contracts held separately from the underlying contract(s) that it relates to because the cedant does not normally have a right to reduce the amounts that it owes to the underlying policyholder(s). The cedant's contractual obligations to the underlying policyholder(s) are not extinguished because the underlying contract(s) is reinsured.

The cedant measures and accounts for groups of reinsurance contracts that it holds using the recognition and measurement requirements for issued insurance contracts, modified to reflect the following facts:
Reinsurance contracts held are generally assets, rather than liabilities. They are separate from the underlying insurance contracts; however, they correspond with them.

For reinsurance contracts held, the cedant pays a premium to a reinsurer and receives a reimbursement from the reinsurer if it pays valid claims arising from the underlying contracts. Generally, insurers do not make profits from reinsurance contracts held. Rather, they generally pay a margin to the reinsurer as an implicit part of the premium. The cedant has a net cost or a net gain on purchasing the reinsurance – i.e. a CSM hat can be positive or negative.

TRANSITION?

IFRS 17 is applied for annual reporting periods beginning on or after 1 January 2021. Earlier application is permitted for entities that apply IFRS 9 and IFRS 15 on or before the date of initial application of IFRS 17.

The transition requirements define the date of initial application as the start of the annual reporting period in which an entity first applies IFRS 17. IFRS 17 is applied retrospectively unless this is impracticable.

DO I NEED TO EXPAND MY DISCLOSURES?

The general disclosure objective is for an entity to disclose information that, together with information presented in the primary financial statements, provides a basis for users to assess the effects that insurance contracts have on its financial position, financial performance and cash flows. IFRS 17 contains specific disclosure requirements that focus on information about: amounts recognized in the financial statements; significant judgements and changes in those judgements; and the nature and extent of risks that arise from insurance contracts.

Although entities currently provide some disclosures similar to those required by IFRS 17, many current disclosures; e.g. - reconciliations of changes in insurance liabilities –are typically made only at a very high level, with little or no disaggregation, and the new requirements may represent a significant change in disclosures. Entities will have to consider what level of disaggregation is appropriate in order to achieve the general disclosure objective.

The conclusions reached may result in a significant difference in the level of detail currently disclosed by entities, which might require revisions to systems and processes to accommodate the new level of disaggregation.

The objective of the risk adjustment for non-financial risk is to reflect the entity's perception of the economic burden of the non-financial risk

OVERALL IMPACT AND KEY CONSIDERATIONS?

NEW PERSPECTIVES FOR ANALYSTS AND USERS

IFRS 17 will change the way analysts interpret and compare companies. Global comparability and increased transparency will give users more insight into an insurer's financial health.

NEW ROUTINES

Identifying and accounting for onerous contracts and presenting an explicit margin for non-financial risk will gain a new prominence for both life and non-life insurers. Accounting for reinsurance ceded will enter new territory.

GREATER VOLATILITY IN FINANCIAL RESULTS AND EQUITY

The effect of using current market discount rates will vary, but it is likely to be significant in many cases, resulting in greater volatility in financial results and equity. Economic mismatches between assets and liabilities will become more visible insurers may wish to revisit the design of their products and their investment allocation.

COMMUNICATION CHALLENGES

New presentation and disclosure requirements will change the way performance is communicated. Entities will need to design new KPIs and educate internal and external users.

KEY FINANCIAL METRICS WILL CHANGE

Premium volumes will no longer drive the 'top line' as investment components and cash received are no longer considered to be revenue. The new measurement model may result in profits being released over significantly different patterns for some contracts.

NEW DATA, SYSTEMS AND PROCESS AND CONTROL DEMANDS

The need for new data, and updated systems and processes will be challenging given the long time horizon over which many insurers operate and the legacy systems that many still use. Entities will also have to develop controls around any system and process changes and develop or upgrade existing controls for business as usual after transition.

NON-LIFE SECTOR IMPACTS

Non-life insurers will need to navigate the criteria to qualify for the PAA in order to retain familiar accounting models. However, the discounting of the liability for incurred claims may be a significant change from current practice.

SOME IMPACTS CANNOT YET BE DETERMINED

IFRS 17 may trigger a second wave of activity by local tax authorities and prudential regulators. Implementation plans need to be flexible to accommodate these second order effects.

OVERALL IMPACT AND KEY CONSIDERATIONS?

CLEARER PICTURE OF PERFORMANCE

The impact that financial risks have on an insurer's results will be presented separately from insurance performance, providing a clearer picture of profit drivers.

SCARCE RESOURCES UNDER PRESSURE

The human talent required to operationalize IFRS 17's requirements and translate theory into practice is significant.

LIFE SECTOR IMPACTS

The use of current discount rates and the end of 'locked-in' assumptions will almost certainly lead to significant accounting changes for many life insurers. The burden and profitability of minimum interest guarantees will become more transparent.

OPPORTUNITIES FOR STREAMLINING AND GREATER EFFICIENCY

Change brings opportunity. Insurers that have already started to analyze the standard see opportunities to streamline through greater use of shared service centers and centralization.

NON-LIFE SECTOR IMPACTS

Non-life insurers will need to navigate the criteria to qualify for the PAA in order to retain familiar accounting models. However, the discounting of the liability for incurred claims may be a significant change from current practice.

SOME IMPACTS CANNOT YET BE DETERMINED

IFRS 17 may trigger a second wave of activity by local tax authorities and prudential regulators. Implementation plans need to be flexible to accommodate these second order effects.

Article By:

Raditha Alahakoon
Partner – Accounting Advisory Division
KPMG in Sri Lanka

Raditha counts over 10 years of experience in audit assignment both in Sri Lanka and in the Maldives. He is an Associate Member of the Institute of Chartered Accountants of Sri Lanka (ACA) and holds a BSc. (Special) degree in Financial Management, from University of Sri Jayewardenepura.

ACKNOWLEDGEMENTS

The following KPMG staff have made significant contribution towards the development of this publication.

Sashi Dharmadasa
Director

Kasun Gunawardhana
Assistant Manager
Corporate Finance;
Deal Advisory

Maheshini Senanayake
Manager
Markets

Azlan Sourjah
Senior Executive
Markets

Anuresha Jayamanna
Executive
Markets

Follow KPMG Sri Lanka on

About KPMG

KPMG Global

KPMG is one of the world's top global networks of professional services firms. We provide, audit, tax and advisory services with quality, integrity and excellence as fundamental pillars that have marked our work over our more than 140 years of history.

Global Revenue

28,960 million USD

9,090	19,870
Financial sector services	Rest of services

Revenue figures 2017/2018

153 Countries

985+ Offices

207,050 Professionals

KPMG Sri Lanka

KPMG is one of the largest professional services firms in Sri Lanka and is also the oldest Chartered Accountancy firm in the country spanning over a century since inception in 1897.

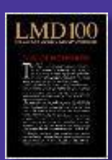
6 Offices
Including one in Maldives

Over 1,400 Professionals
Our clients value the breadth of skills and experience KPMG professionals bring to every client engagement

Audited 45% of Listed Entities in Sri Lanka
As indicated in the LMD Auditors League 2016.

842	178	272
Professionals in **Audit**	Professionals in **Tax**	Professionals in **Advisory**

Recognition | KPMG in Sri Lanka



First in the Auditors League in Sri Lanka

LMD 100 - 2017

Recognized for Professionalism and Integrity

LMD Most Respected 2017

Best Deal Advisory Firm in Sri Lanka

Global Banking and Finance Review 2015

Best Advisory Firm in Sri Lanka

The International Finance Magazine 2016

Sri Lanka Tax Firm of the Year

Asia Tax Awards 2017

Highlighting the significance of KPMG's impact in the marketplace, KPMG in Sri Lanka received a number of accolades including being the 'Best Deal Advisory Firm in Sri Lanka' by The Global Banking and Finance Review for its outstanding achievements in Deal Advisory, being ranked among the 'Most Respected' entities in the country for 2016 and being ranked first in the 2015/2016 Auditors League as indicated in the LMD 100. Recently the firm also won the Tax Firm of the Year at the Asia Tax Awards 2017.

KPMG Service Offerings

Audit

High quality, independent financial statement audits are essential to maintaining investor confidence.

Our audit professionals are committed to the public interest. They seek to challenge assumptions and unlock valuable insights based on a thorough understanding of an organization's business and industry, and innovative audit methodologies and approaches.

Understanding the financial performance of any business must be placed in the context of strategic priorities, risk appetites and competitive positioning. Our technology-enabled audit approach applies extensive data analytics to provide the necessary evidence confirming that critical controls and disclosures uphold the highest level of integrity.

- Audits of financial statements
- Audit-related services
- Audit data & analytics
- Accounting Advisory

Management Consulting

Our high capability teams offer deep industry and technical knowledge, and market-leading tools to deliver solutions across every business and industrial sector.

Our consultants assist clients to make better decisions that may reduce costs, enhance organizational effectiveness and develop appropriate technology strategies.

- People & Change
- Customer & Analytics
- Financial Management
- Operations
- Strategy & Economic Advisory
- IT Advisory
- Supply Chain

Risk Consulting

Our risk consulting practice combines the knowledge and expertise of over 50 partners, directors and professionals. We help organizations transform risk and compliance efforts into competitive advantage by applying a risk lens to corporate strategy. This improves risk intelligence and decision making, protects financial and reputational assets, and enhances business value.

- Forensic
- Business Process Management
- Accounting Advisory Services
- Internal Audit & Risk Compliance

Deal Advisory

Our experienced investment professionals skilfully assess how opportunities to buy, sell, partner, fund or fix a company can add and preserve value. Our teams combine a global mind-set and local experience with deep sector knowledge and superior analytic tools to support clients. From assisting to plan and implement strategic change to measurably increasing portfolio value, we deliver tangible results.

- Valuations
- Debt Advisory
- Transaction Solutions
- Mergers & Acquisitions
- Corporate Restructuring
- Real Estate Advisory

Tax

A business's approach to tax is increasingly subject to public scrutiny and is now a major reputation driver. From company set-up to cross-border and transfer pricing solutions, we work with a wide range of national and multi-national organizations to deliver effective tax solutions. Our tax professionals combine international experience with local knowledge to provide leading edge commercial tax strategies tailored to specific client needs.

- Inbound & indirect taxes
- Mergers, acquisitions and restructuring
- International tax services
- Transfer pricing
- Tax management consulting
- Global mobility services
- Automatic exchange of information

KPMG Leadership - Insurance

Reyaz Mihular

Managing Partner

Audit

Suren Rajakarier
Partner, Head of Audit, Insurance and People, Learning and Development

Yohan Perera
Partner, Audit
Chief Operating Officer

Thamali Rodrigo
Partner, Audit

Tax

Shamila Jayasekara
Partner, Head of Tax & Regulatory

Suresh Perera
Principal - Tax & Regulatory, Deputy Head of Markets

Advisory

Priyanka Jayatilake
Partner, Head of Advisory

Shiluka Goonewardene
Principal - Head of Deal Advisory, Deputy Head of Markets

Jagath Perera
Partner, Internal Audit Risk & Compliance Services & Forensic Services

Dulitha Perera
Partner, Internal Audit, Risk Consulting

Markets

Ranjani Joseph

Partner – Deputy Head of Audit, Head of Banking Services and Markets

Contact us

Reyaz Mihular
Managing Partner
T: +94 11 5426500
E: reyazmihular@kpmg.com

Ranjani Joseph
Partner – Audit, Head of Banking Services, Head of Markets
T: +94 11 5426302
E: ranjanijoseph@kpmg.com

Shiluka Goonewardene
Principal - Head of Deal Advisory, Deputy Head of Markets
T: +94 11 5426271
E: sgoonewardene@kpmg.com

Suresh Perera
Principal - Tax & Regulatory, Deputy Head of Markets
T: +94 11 5426502
E: sperera@kpmg.com

www.home.kpmg/lk

KPMG Sri Lanka

@kpmgsl