Session 5A – IFRS 17 and its operational challenges

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IFRS 17 and its operational challenges

Session 5A on 6th July (16:25-17:00)

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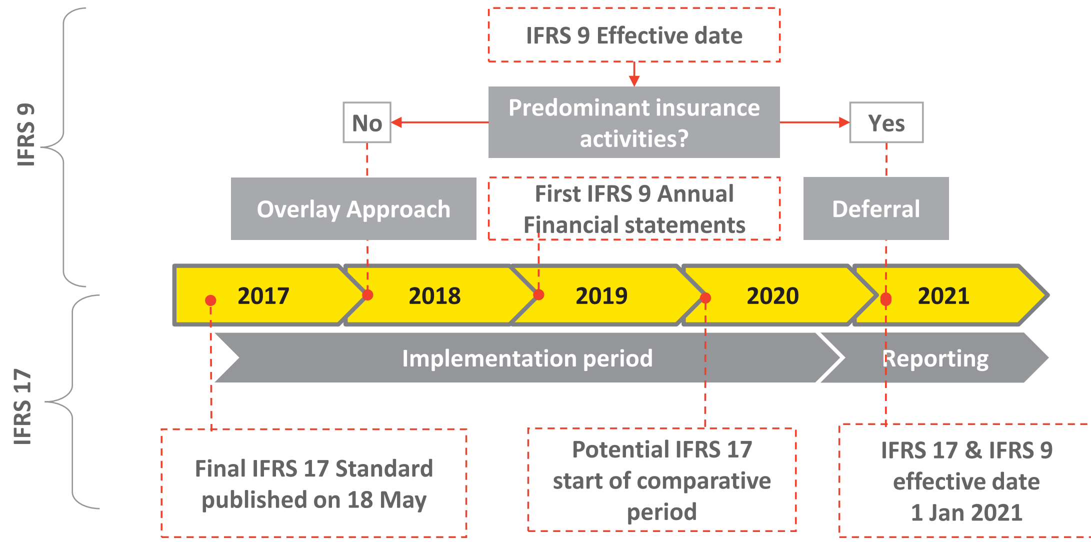
SOCIETY OF ACTUARIES

Overview & selected key challenges

SOCIETY OF ACTUARIES

COMBINED TIMELINE: IFRS 9 & IFRS 17



WHY IFRS CHANGING MATTERS

Current regime

- Mix of different local Generally accepted accounting principles (GAAPs)
- Limited comparability between insurers and inconsistency with other industries
- Limited use for steering the business and understanding sources of profit
- Some key metrics based on IFRS (e.g., RoE and pay-out ratios) but … significant use of secondary metrics

Forthcoming regime

- Consistent across geographies
- Current assumptions each reporting period
- Impact likely be most significant for life insurance
- Exposure approach to recognition of profit and revenue – as insurance or investment services are provided
- Significant changes in disclosures
- Greater insight into sources of profit within the business (e.g., underwriting, expenses, investment return)

Key steps in transition

- Operational implementation
  - Efficient implementation
  - Compliance vs catalyst for change
- Accounting decisions
  - Implementation choices
  - Design principles
  - Trade-off between operational simplicity and optimization
- Implications for messaging
- Strategic decisions

MEASUREMENT MODELS

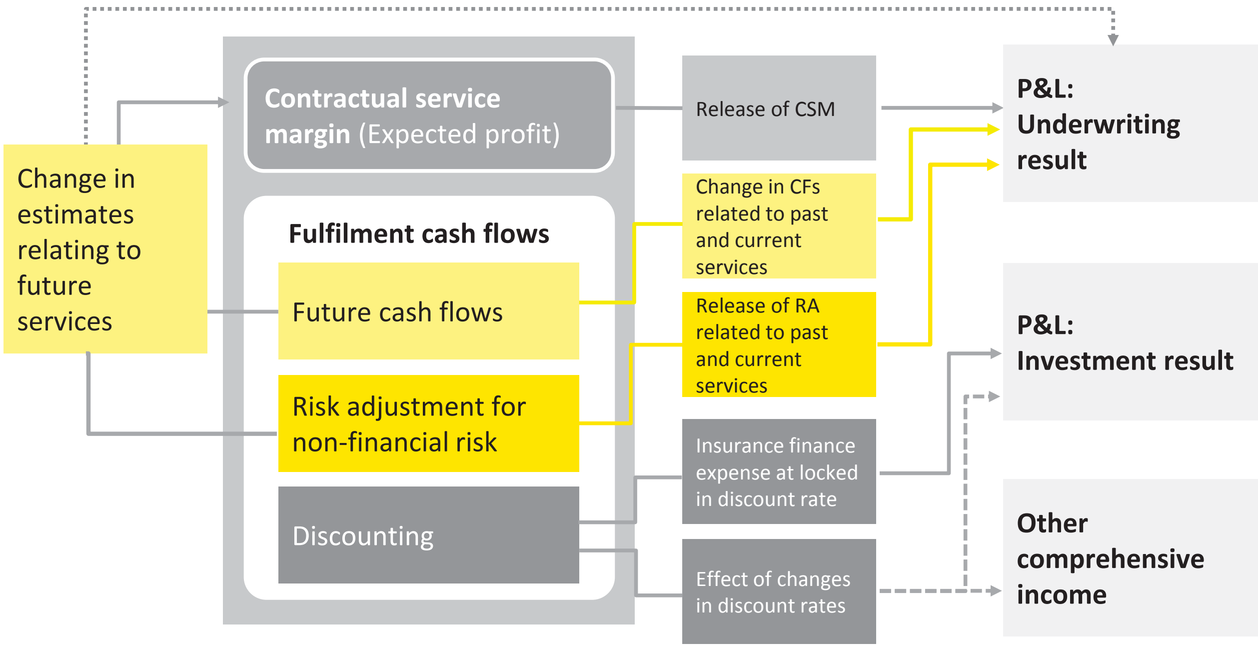
	Key features	Product examples
General model (GM)	▶ Default model in IFRS 17 ▶ Probability weighted discounted cash flows ▶ Market-based valuation of options and guarantees ▶ Contractual service margin ("CSM"): to spread recognition of profit and impact of changes ▶ Risk adjustment	▶ Annuities ▶ Protection ▶ Long-duration non-life business
Variable fee approach (VFA)	▶ Based on the building block approach, but with additional features for direct participating contracts ▶ Market volatility passes through CSM vs Statement of Comprehensive Income (P&L/OCI) for GM	▶ With-profit business ▶ Unit-linked business
Premium allocation approach (PAA)	▶ Optional approach for short duration contracts (pre-claims liability) ▶ GM used to determine remaining exposure	▶ Short-duration contract (mostly non-life insurance)

FUNDAMENTAL PRINCIPLES

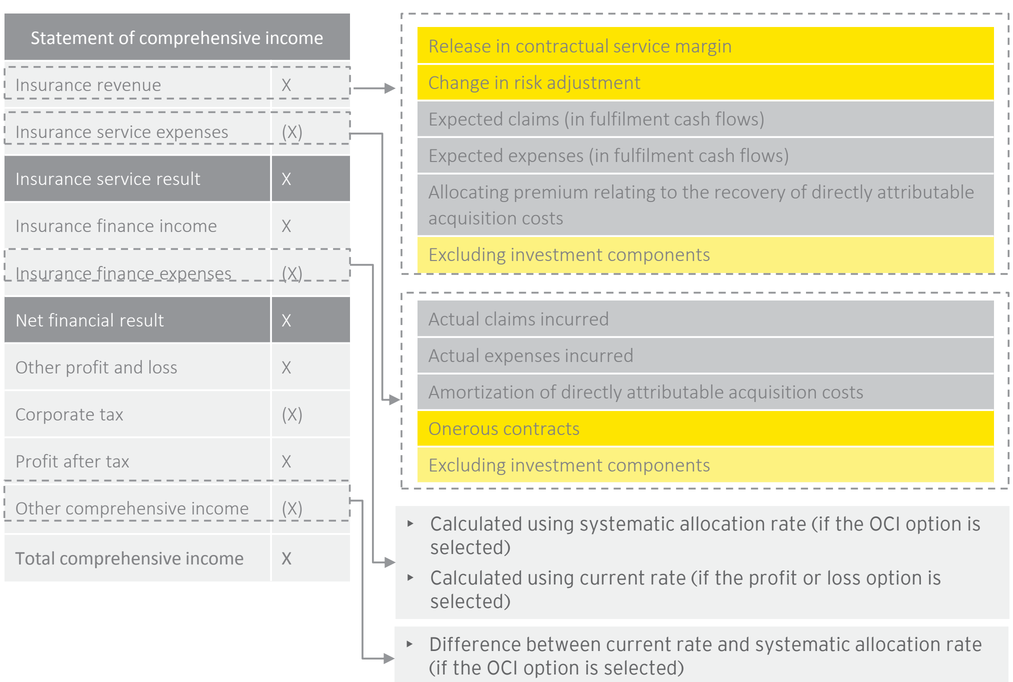
General model

Contractual service margin	The unearned profit that the entity recognizes as it provides services. (Unlocked for impact of changes to future cash flows and risk adjustment and spread over period of the contract)
Risk adjustment for non-financial risk	The compensation that an entity requires for bearing the uncertainties about the amount and timing of the cash flows that arise as the entity fulfills the insurance contract
Time value of money	Discount rate that reflects the characteristics of the liabilities
Expected future cash flows	An explicit, unbiased and probability-weighted estimate of future net cash flows that will arise as the entity fulfils the insurance obligations

FUNDAMENTAL PRINCIPLES



PRESENTATION

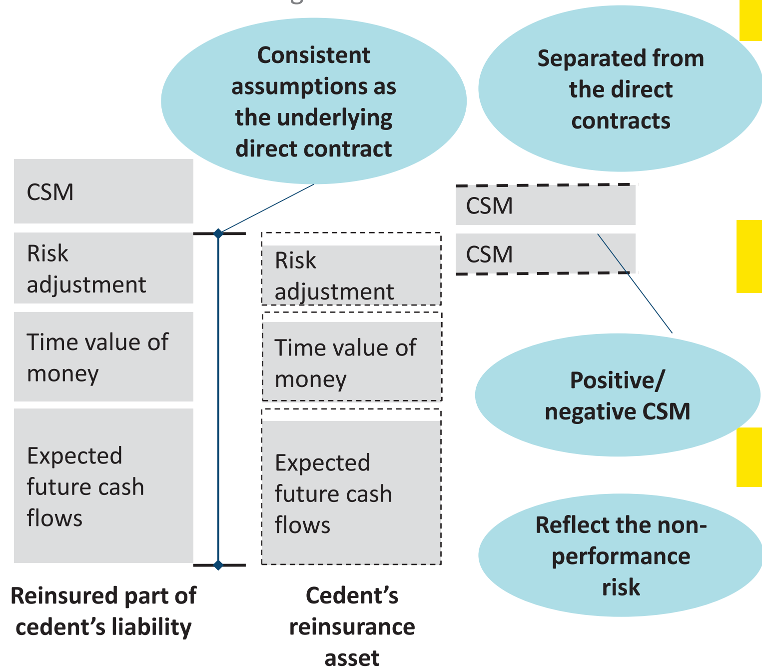


DISCLOSURE

Including the quantitative aspects, illustration of the reconciliation of the insurance liability carrying amounts	Liabilities for remaining coverage		Liabilities for incurred claims	Total
	Excluding onerous contracts component	Onerous contracts component		
Insurance contract liabilities 20X0	161,938	15,859	1,021	178,818
Insurance revenue	(9,856)			(9,856)
Insurance service expenses	-	-	-	-
Claims incurred in the period	-	-	7,985	7,985
Onerous contracts losses and (reversals)	-	(623)	-	(623)
Insurance acquisition costs expensed	1,259	-	-	1,259
Investment components	(6,465)	-	6,465	0
Insurance service result	(15,062)	(623)	14,450	(1,235)
Insurance finance expenses	8,393	860	55	9,308
Total changes in the statement of comprehensive income	(6,669)	237	14,505	8,073
Cash flows				
Premiums received	33,570			33,570
Claims, benefits and other expenses paid			(14,336)	(14,336)
Insurance acquisition cash flows	(401)			(401)
Total cash flows	33,169	-	(14,336)	18,833
Insurance contract liabilities 20X1	188,438	16,096	1,190	205,724

REINSURANCE

Reinsurance measurement under IFRS 17 from a cedant's view under the general model



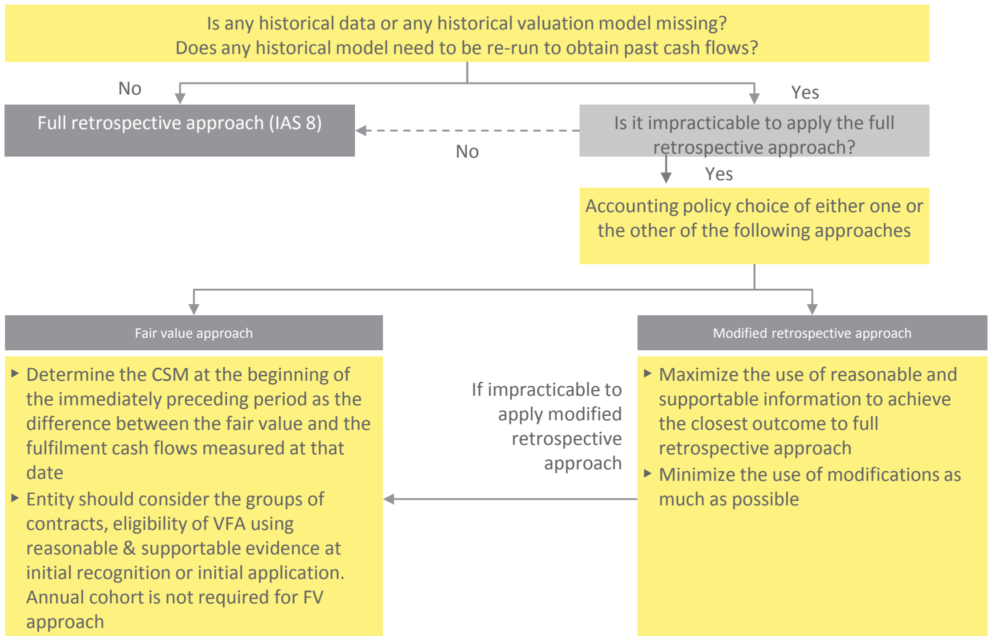
01 Any net cost or net gain of reinsurance held should be recognized as a CSM except there is net cost on the coverage relates to event that occurred before the purchase of the reinsurance.

02 Entity may present the income or expenses from reinsurance held as a single amount or may present separately the amounts recovered and premiums paid.

03 Entity should consider the modelling requirements of:
(i) reinsurer's non-performance risk
(ii) the symmetric P&L treatment between reinsurance & direct contracts.

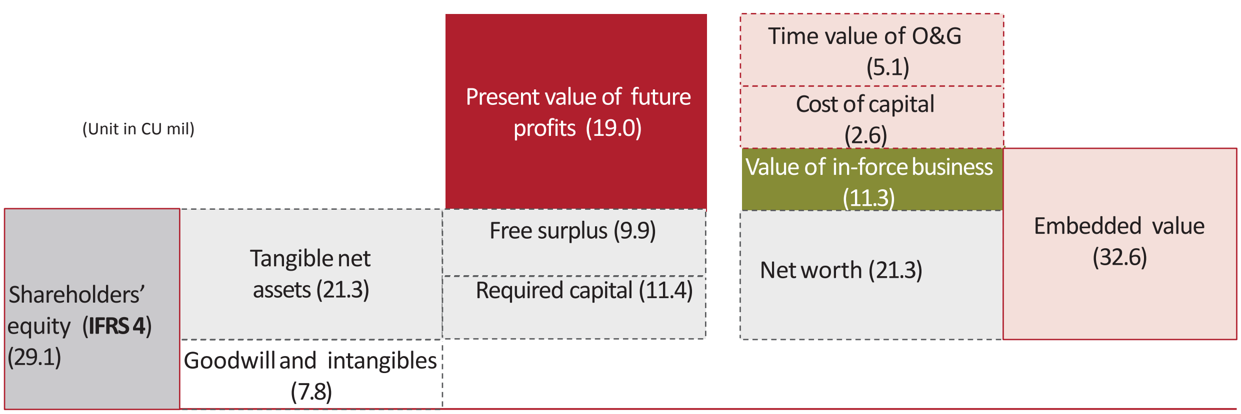
TRANSITION

Assessment chart to determine the transition approach to be applied



REDUCED NEED FOR NON-GAAP INFORMATION

Embedded Value Reporting



Source: modified from *Effects Analysis* issued May 2017 by IFRS Foundation [page 45]

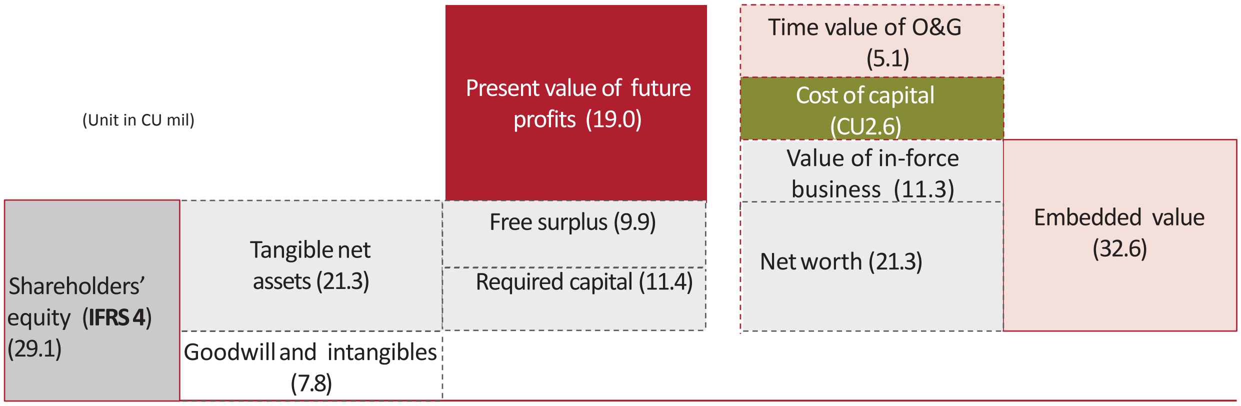
My personal view:

1. Value of in-force is the net present value of margin released from the policy and claim liabilities after deducting cost of capital.

2. The value of in-force corresponds broadly to the contractual service margin, explicitly determined when applying IFRS 17.

REDUCED NEED FOR NON-GAAP INFORMATION

Embedded Value Reporting



Source: modified from *Effects Analysis* issued May 2017 by IFRS Foundation [page 45]

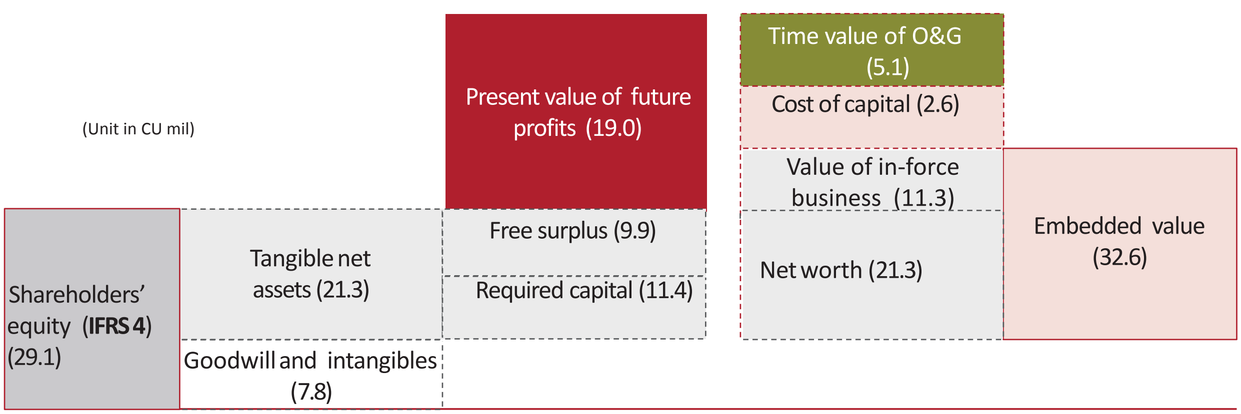
<u>My personal view:</u>

3. The "cost of capital" for non-financial risks corresponds to the "risk adjustment", explicitly determined when applying IFRS 17.

4. Even if cost of capital approach is chosen for computation of risk adjustment, the standard requires the confidence level to be disclosed in the financial statement.

REDUCED NEED FOR NON-GAAP INFORMATION

Embedded Value Reporting



Source: modified from *Effects Analysis* issued May 2017 by IFRS Foundation [page 45]

<u>My personal view:</u>

5. The "Time value of O&G" is required under IFRS 17.

6. Embedded value reporting may differ from the measurement required by IFRS 17 in other respects, including the discount rate and manner of reflecting risk and the treatment of embedded guarantees and financial options.

Numerical example

>Initial measurement
>Subsequent measurement (pre 2021)

SOCIETY OF ACTUARIES

NUMERICAL EXAMPLE

A non-participating product

A non-par product (insurance contract)

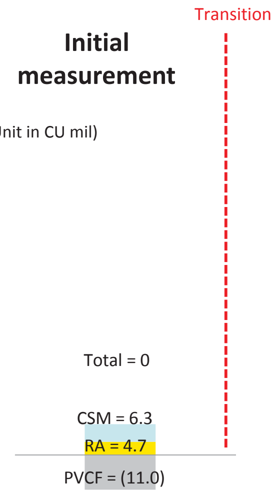
- 10-year limited pay, whole life coverage
- Policies were issued in 2005, non-onerous
- Sum assured payable upon death and permanent disablement, no reinsurance cession
- Cash surrender value payable upon surrender
- IFRS 17 valuation: General Model (a.k.a. building block approach)
- Transition method: Retrospective approach (with simplification)

NUMERICAL EXAMPLE

1 Initial Measurement: in 2005

Initial measurement

(Unit in CU mil)



Valuation date	2005
Non-economic assumptions	2005
Discount rates	2005

1

	Approach
PVCF	PV of estimates of future cash flows ("CF")
RA	Risk Adjustment using cost of capital ("CoC") approach
CSM	Contractual Service Margin = Negative of the sum of PVCF and RA; = - Min (PVCF+RA,0)

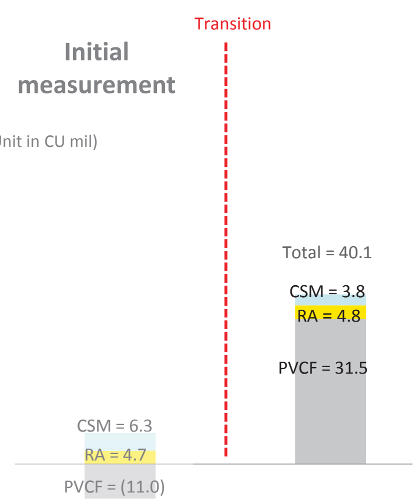
- Building block approach: PVCF, RA and CSM (components are shown on the left)
- PVCF + RA is also known as Fulfilment Cash Flows
- Assumption as of 2005 is applied

NUMERICAL EXAMPLE

2 Subsequent measurement: in 2020

Initial measurement | **Subsequent measurement**

(Unit in CU mil)



Valuation date	2005	2020
Non-economic assumptions	2005	2005
Discount rates	2005	2005

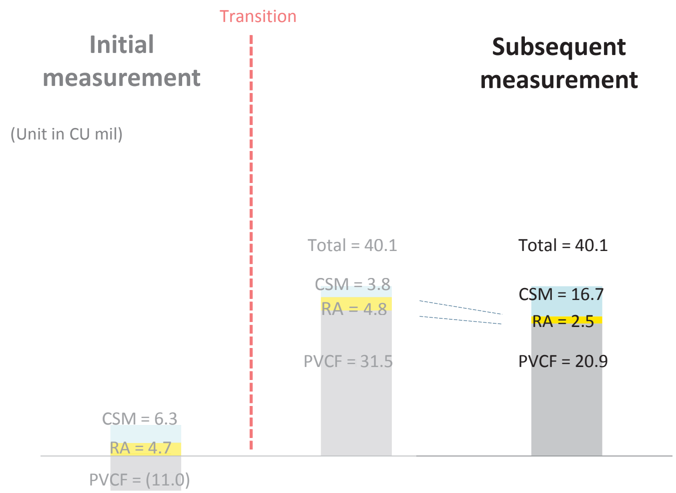
2

- Re-calculate each building block component in 2020

NUMERICAL EXAMPLE

3

Subsequent measurement: unlocking of CSM



Valuation date	2005	2020	2020
Non-economic assumptions	2005	2005	2020
Discount rates	2005	2005	2005

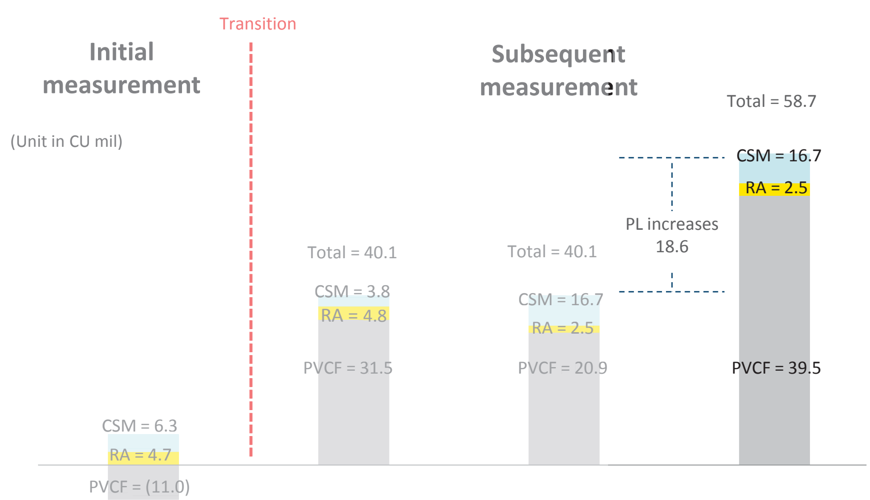
3

- IFRS17 requirement: estimate should be current so 2020 non-economic assumptions are used
- Mortality improvement leads to lower future claims
- 2005 discount rate should be used

NUMERICAL EXAMPLE

4

Subsequent measurement: change of discount rates



Valuation date	2005	2020	2020	2020
Non-economic assumptions	2005	2005	2020	2020
Discount rates	2005	2005	2005	2020

4

- 2020 discount rate is updated
- IFRS17 requirement: allows insurers to reflect the impact of change in discount rate in either P&L or Other Comprehensive Income

Q&A

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