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IFRS 17 from Indian Health Insurance Perspective

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Sources:

- IFRS 17 standard
- Internal Milliman sources
- Articles from IFoA website

Contents

- **IFRS 17 Overview**
- **Insurance Products in Indian Market**
- **Expected Liability Valuation Methodology under IFRS 17**
- **Other Considerations**

IFRS 17 Overview

Scope of IFRS 17

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- Applies to:
  - Insurance and reinsurance contracts issued
  - Reinsurance contracts held,
  - Investment contracts with discretionary participation features
- Does not apply to:
  - Warranties or residual value guarantees provided by manufacturer, retailer
  - Employer provided benefits
  - Contingent payments on non-financial items
  - Financial guarantee contracts
  - Policyholder accounting other than reinsurance ceded
- Optionally applies to fixed fee service contracts (or can apply IFRS 15 – Revenue)

IFRS 17- Contract Boundary

- Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity **can compel the policyholder to pay the premiums or has a substantive obligation** to provide the policyholder with services.

IFRS 17- Contract Boundary

Para 34 of the standard:

A substantive obligation to provide services ends when:

- The entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or
- Both of the following criteria are satisfied:
  - The entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and
  - The pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.

Para B61 to 65 for further reference

Level of Aggregation – Yearly Cohorts

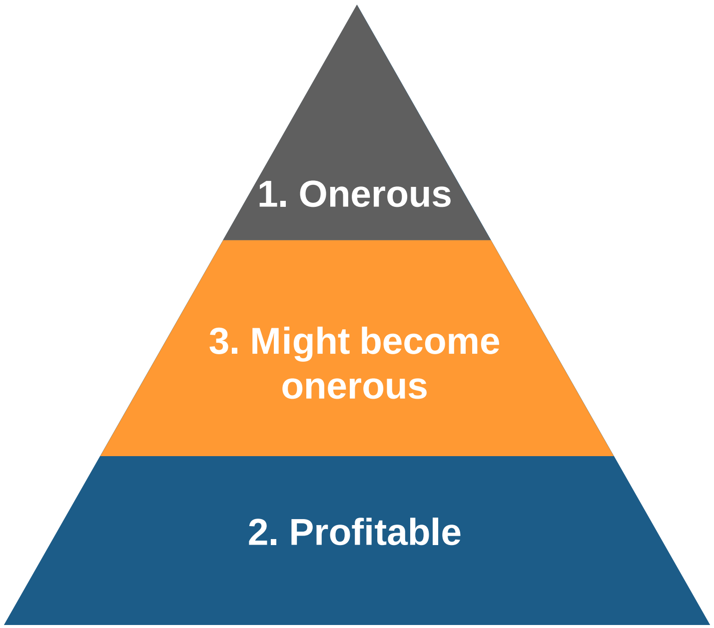
Contracts that are subject to similar risks and managed together.

- Consistent with internal reporting.
- Exemption for Regulatory Pricing.

Contracts issued more than 1 year apart cannot be in same group.

Level of Aggregation – Minimum Grouping

3 groups minimum for each issue year within a portfolio:



Exception
A legal or regulatory restriction on entity's ability to reprice the product.

Can include in same group

Key issue
Assessing significant possibility of becoming onerous

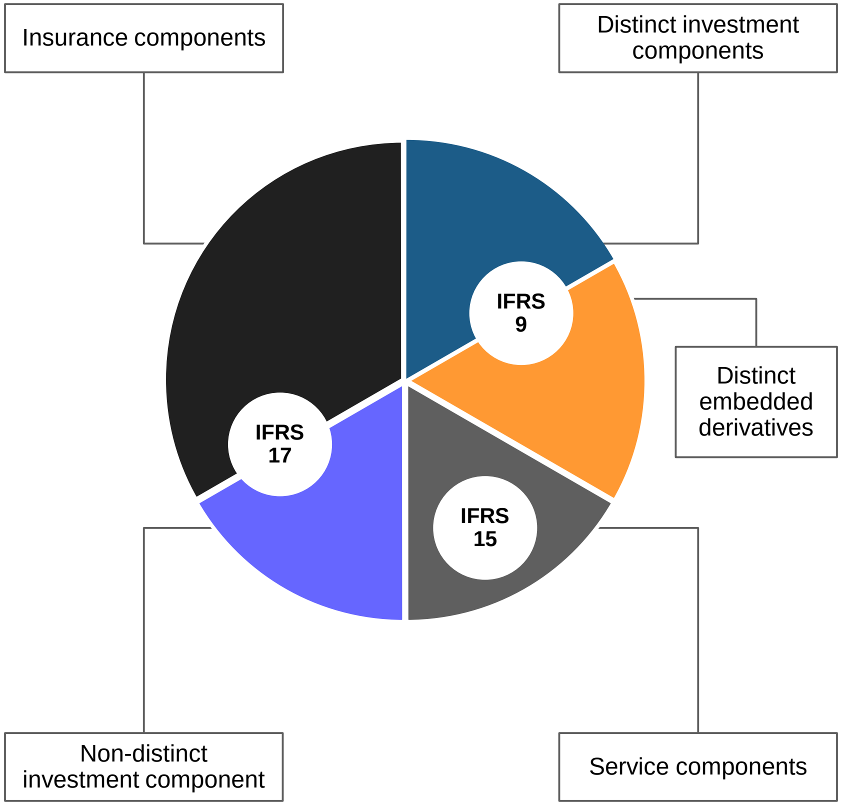
Groups of contracts are the unit of measurement used in IFRS 17

Profitable Contracts: Unearned Profit to be recognized as liability and is released as insurance services are provided

Onerous Contracts: Loss to recognized immediately in P/L

Bifurcation – Service components

“an entity shall separate from the host insurance contract any promise to transfer distinct goods or non-insurance services to a policyholder, applying paragraph 7 of IFRS 15. The entity shall account for such promises applying IFRS 15.“ (Para 12 of IFRS 12 of IFRS 17 standard)



Introduction – Measurement Approaches

There are three measurement approaches in IFRS 17, depending on the type of insurance contracts:

GENERAL MODEL
(aka Building Block Approach or BBA)

Default valuation approach

VARIABLE FEE APPROACH
(VFA)

Approach for contracts with direct participation features

PREMIUM ALLOCATION APPROACH
(PAA)

Simplified approach for short duration contracts (coverage period up to one year)

Comparison of Methods

<table>
<tr><th></th><th>Current Methodology</th><th>PAA(Provided eligibility criteria is met)*</th><th>GMM</th></tr>
<tr><td rowspan="4">Liability for Remaining Coverage (LRC)
Unexpired Risks</td><td rowspan="4">Unearned Premium Reserve(UPR)
Premium Deficiency Reserve (PDR)
Unexpired Risk Reserve(URR) = UPR+PDR</td><td rowspan="4">Akin to Premium less acquisition Costs(Unearned)</td><td>Contractual Service Margin</td></tr>
<tr><td>Risk Adjustment</td></tr>
<tr><td>Discounting</td></tr>
<tr><td>Best Estimate of Fulfillment Cash flows</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td rowspan="3">Liability For Incurred Claims(LFIC)
Expired Risks</td><td rowspan="3">IBNR
IBNER
Cat Reserve etc.
(Undiscounted)</td><td>Risk Adjustment</td><td>Risk Adjustment</td></tr>
<tr><td>Discounting</td><td>Discounting</td></tr>
<tr><td>Best Estimate of Fulfillment Cash flows</td><td>Best Estimate of Fulfillment Cash flows</td></tr>
</table>

*Can chose not to discount the LFIC if tail of claims is less than a year

Transition to IFRS 17

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- IAS8 classifies adoption of a new accounting standard as a change in accounting policy and requires a retrospective approach to determine the correct financial position for the earliest prior period presented:
  - Retrospective application means adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.
- The following opening adjustments need to be made:
  - Measurement of all insurance liabilities as sum of BE, RA and CSM.
  - Adjustment of the retained earnings.
  - Adjustment of the accumulated OCI, by including the difference on the fulfillment cash flows between current discount rates and initial discount rates.
  - Derecognition of DAC and intangible assets from previous business combinations that do not meet the definition of an intangible asset (VOBA).
  - Recognition any assets or liabilities from business combinations not previously recognized.

Transition – three approaches

Full Retrospective Approach

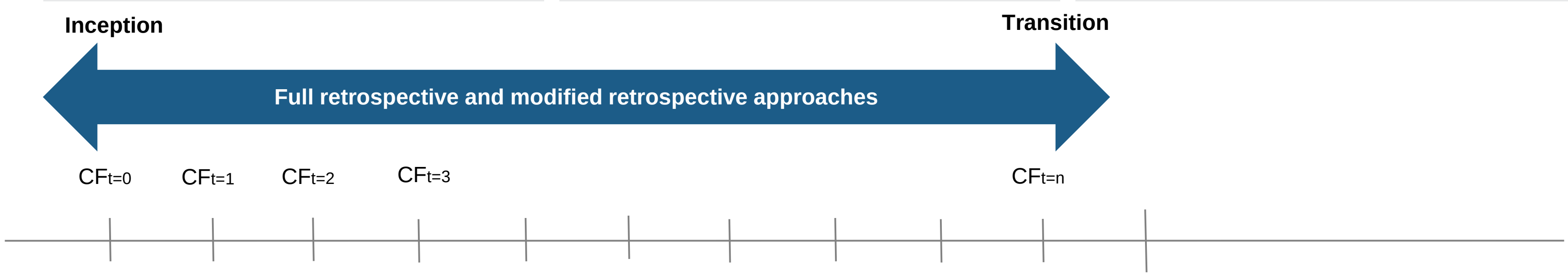
- Required where not 'impracticable'.
- Requires day 1 data and assumptions and full history to date of transition.
- If impracticable, choose between modified retrospective and fair value approach.

Modified Retrospective Approach

- Retrospective with simplifications to address data gaps.
- Simplifications can be applied on a piecemeal basis.

Fair Value Approach

- Comparison of fulfilment value to IFRS 13 fair value.
- Could result in limited CSM and hence future profits.
- Determination of fair value of insurance contract is unclear.



Insurance Products in Indian Market

Broad Classification of Products

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Short Term Hospitalization Covers	Travel	Personal Accident	More than 1 year Hospitalization cover	Group Products: Employer-Employee, Others
Term 1 year	Mostly Term less than 1 year	Term 1 year	Term >1 year	Term 1 year
Mostly Non-Onerous	Non onerous	Non Onerous	Non Onerous	Mostly Onerous
Product with guaranteed renewability and rate for age bands	No premium guarantee	No Premium guarantee	Premium is guaranteed for more than 1 year	No Premium guarantee

Regulation

- As per the current regulations, the premium rate for a new products can not be altered for experience till 3 years.

Does this have an effect on Contract Boundary?

"The entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and"

Pricing

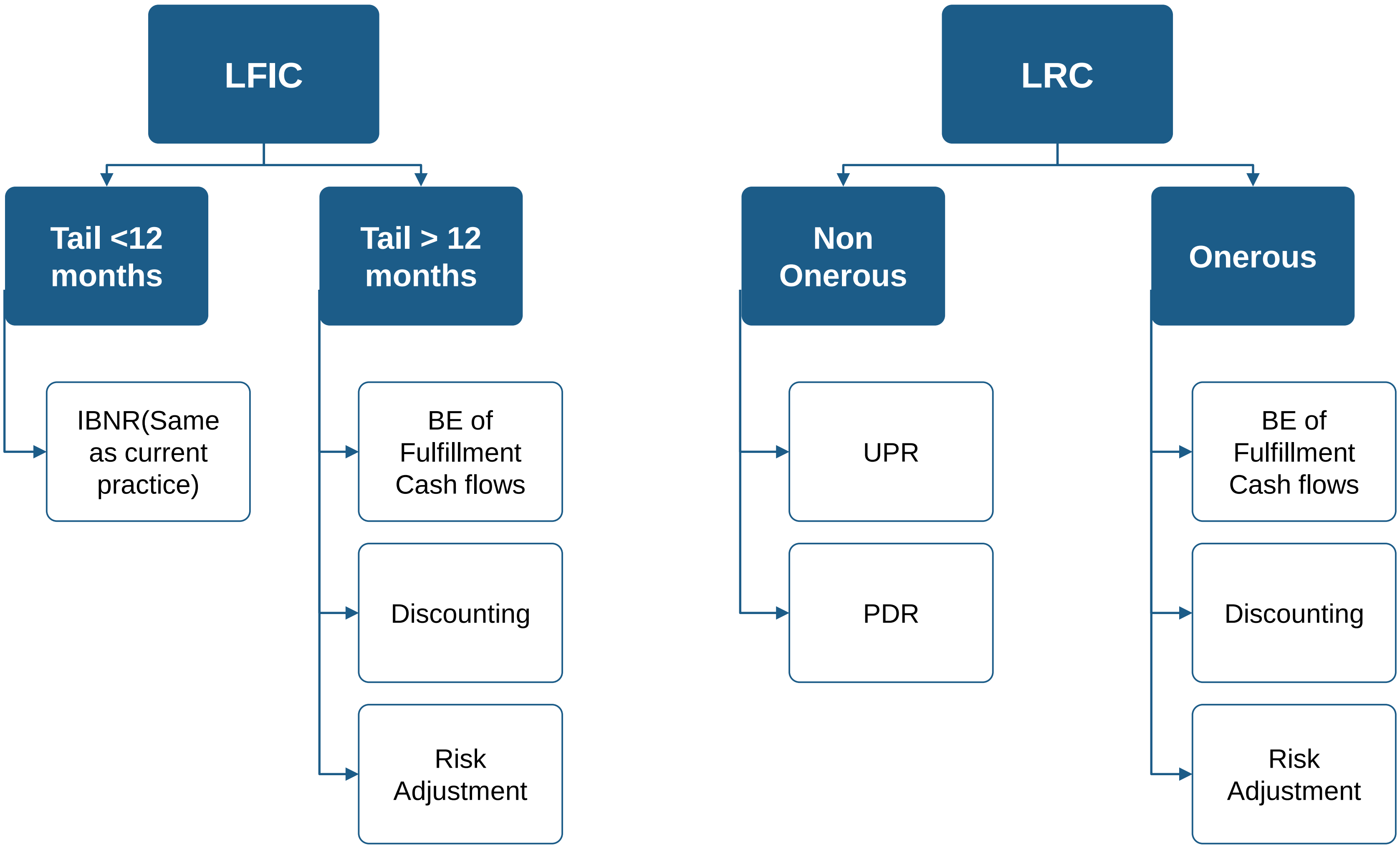
- The current practice for Pricing includes pricing w.r.t. coming 3 to 4 years with assessment of Lapse Rates, Waiting periods etc. in coming 3 to 4 years

Does this have an effect on Contract Boundary?

“The pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.”

Expected Methodology

PAA Model – Initial measurement



For non-onerous contracts, the subsequent measurement of LRC has to be mapped from the opening value of the liability.

PAA Eligibility Criteria

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- Is the Coverage at inception less than 1 year?
- Does the entity reasonably expects the LRC under PAA would not differ materially from GMM?
- What is the Contract Boundary and when the insurer has practical ability to reassess the risk?

Need to define ‘Coverage Period’, ‘reasonably expects’ and ‘differ materially’.

Expected Methodology

	Short Term Hospitalization Covers	Travel	Personal Accident	More than 1 year Hospitalization Cover	Group Products: Employer-Employee, Others
Experience Considerations while Pricing	Considers for 3 to 5 year	As per term	Considers 3 to 5 years	As per the Term	Experience Based
Contract Boundary	?	As per the term	?	As per the term	Term 1 year
Onerous	No	No	No	No	Mostly
Expected Methodology	PAA or GMM, PAA Eligibility Test required	PAA	PAA or GMM, PAA Eligibility Test required	GMM	GMM for Onerous and PAA for Non Onerous, PAA eligibility Test for Onerous

As the regulation restricts any price change for a new product for 3 years, potentially, the contract boundary for a new product is 3 years.

Is PAA an alternative?

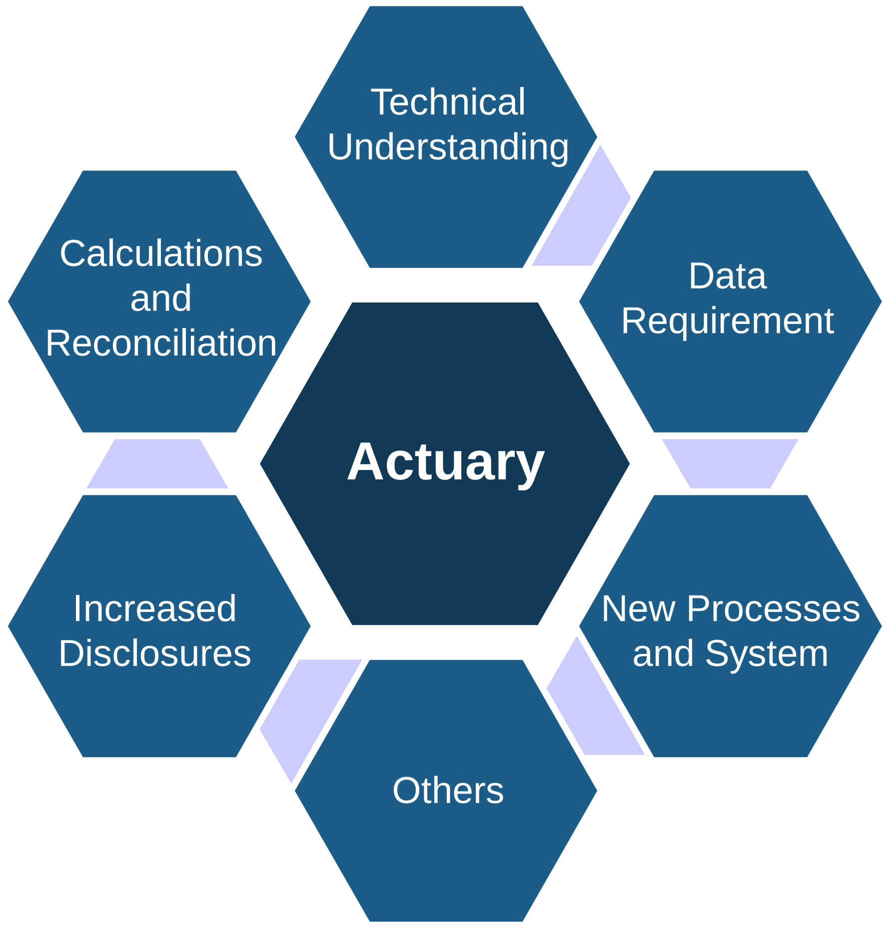
- Need to regularly demonstrate that the results are not materially different from GMM to auditors.
- Feasibility of implementing and maintaining two models.
- Explanation may be required for key stakeholder – Board, Investors, Rating Agencies.

Other Considerations

Important Considerations

- Non Insurance Component: Wellness Benefits etc.
- Cash flows Projection and Discounting.
- Risk Adjustments.
- Reinsurance and Co insurance.
- Retrospective Reporting.
- Change in Disclosures.
- Presentation in Financial Statements.

Transition Management-Actuarial Perspective



Principal based standard and not prescriptory, Actuaries have a major role to play

Thank You