9th Capacity Building Seminar in General Insurance
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IFRS 17: Issues and challenges

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Agenda

- Getting the numbers right
  - Model selection
  - Level of aggregation
  - Calculating components of GMM and PAA
  - Reinsurance and its implications
- Getting numbers on time
  - Actuarial modelling process may need to be industrialized
- Understanding and communicating results

Measurement Models available under IFRS 17

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Selecting the right model is fundamental – and may not be straightforward

General Measurement Model (Building Block Approach)

Approach applicable to all contracts

Premium Allocation Approach

Optional simplification, principally for short-duration contracts (one year or less)

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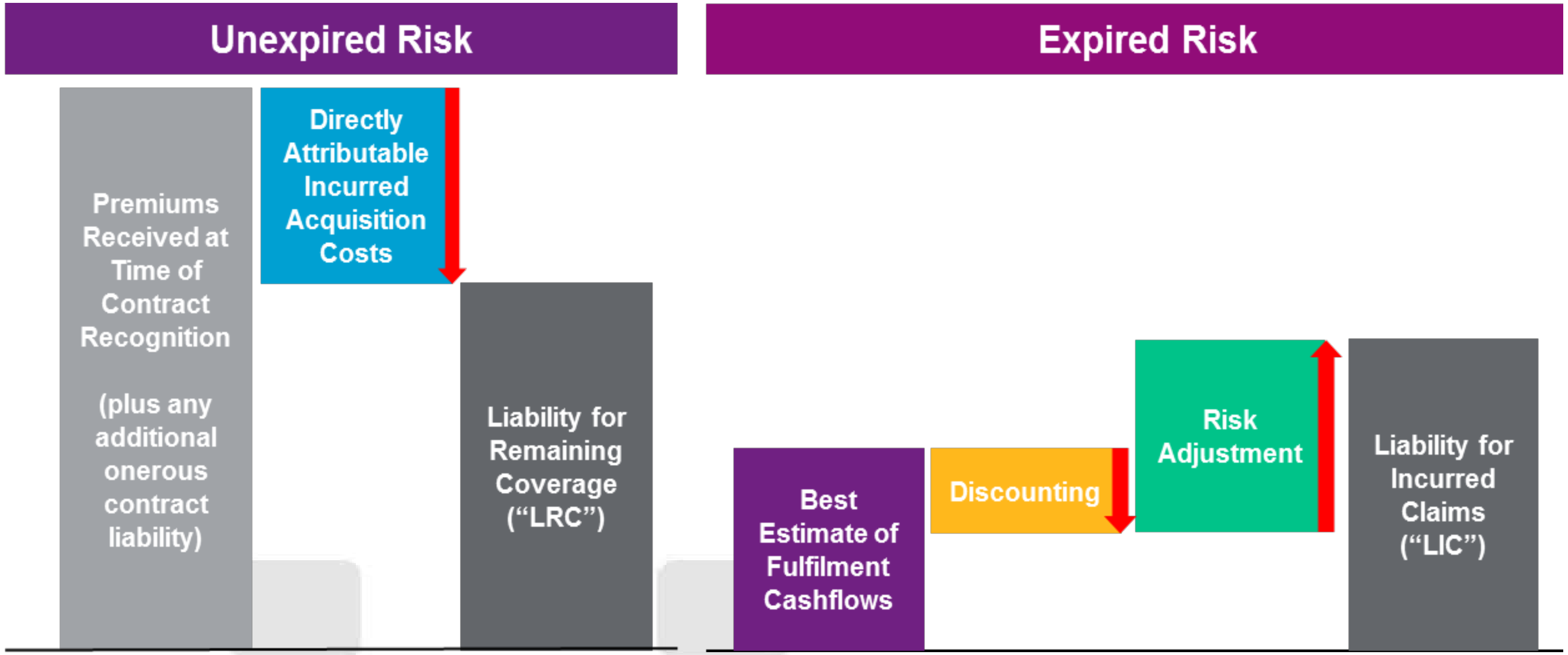
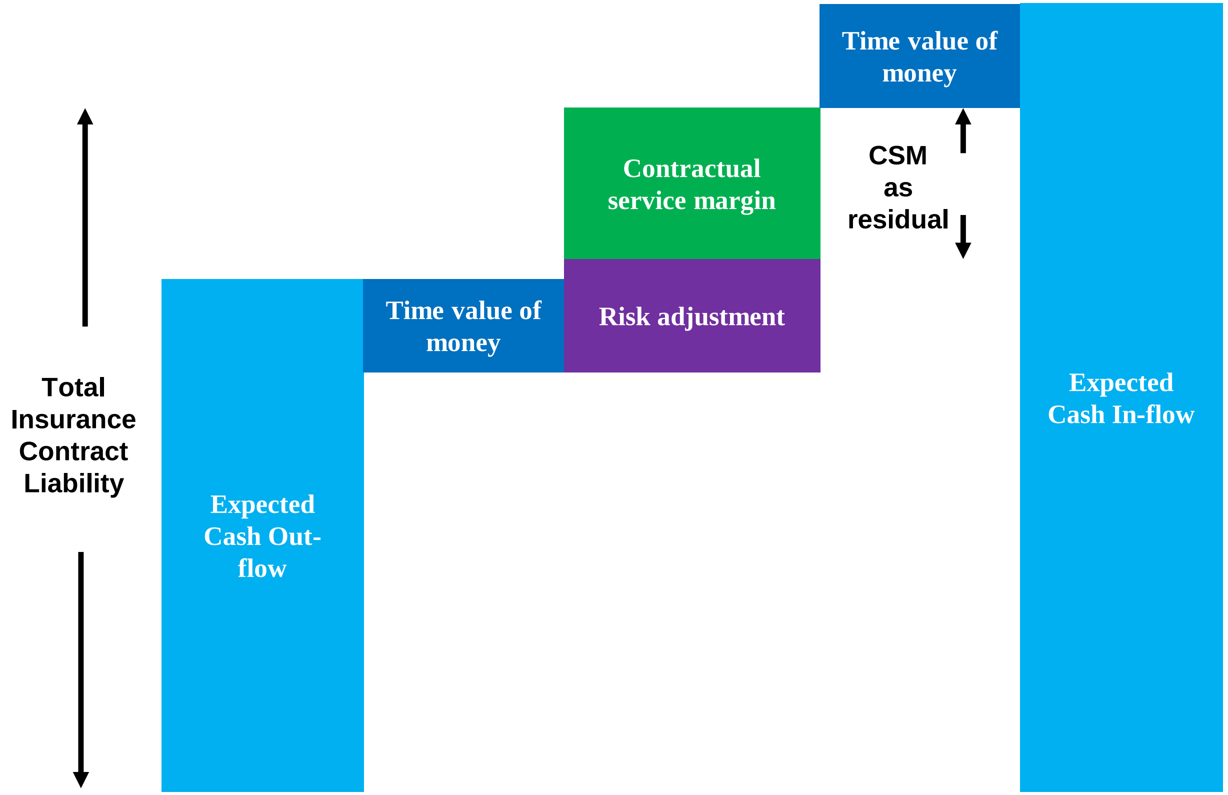
Note:
IFRS 17 does not differentiate between Life contracts and P&C contracts, but rather between approaches

Premium Allocation Approach (PAA)



General Measurement Model (GMM)

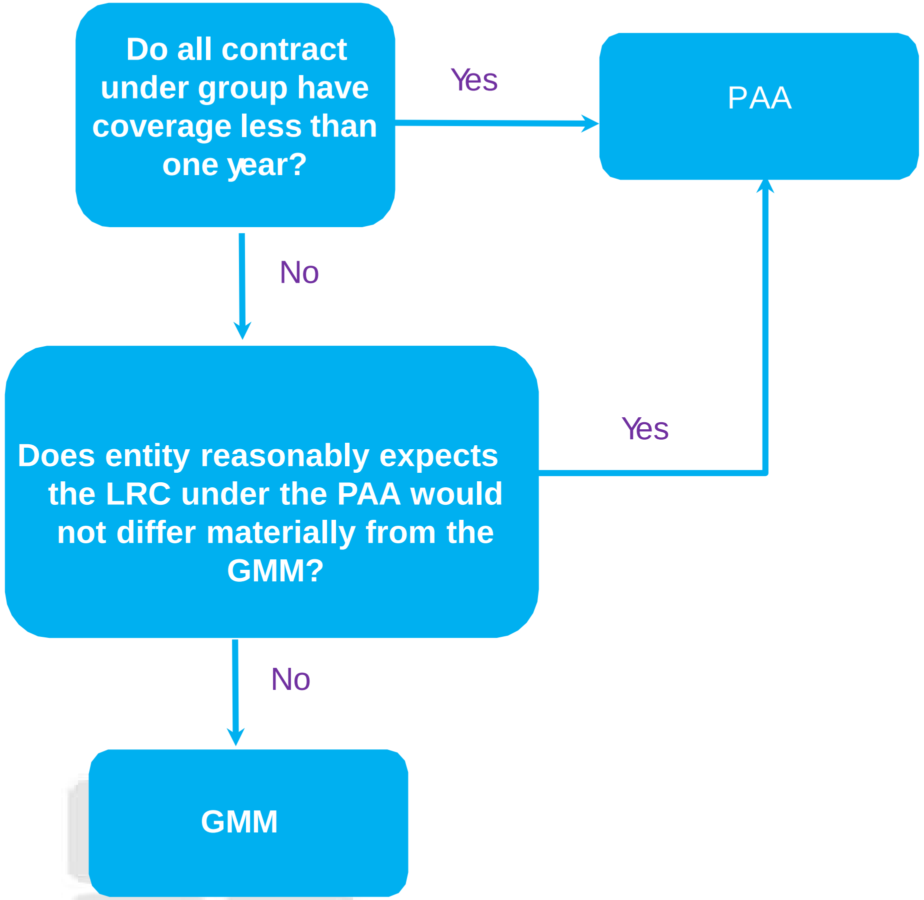


Relevance for P&C insurers?

- Most may seek to apply simplified premium allocation approach
- GMM will be difficult to entirely avoid for most General Insurance Company
- For onerous contracts (and the onerous contract test), most components will still be needed

PAA eligibility test

- Need to define what ‘reasonably expects’ and ‘differs materially’ means for the reporting entity.
- May require modelling of future stresses/scenarios to demonstrate immateriality in a range of outcomes.



Level of aggregation is key to future measurement

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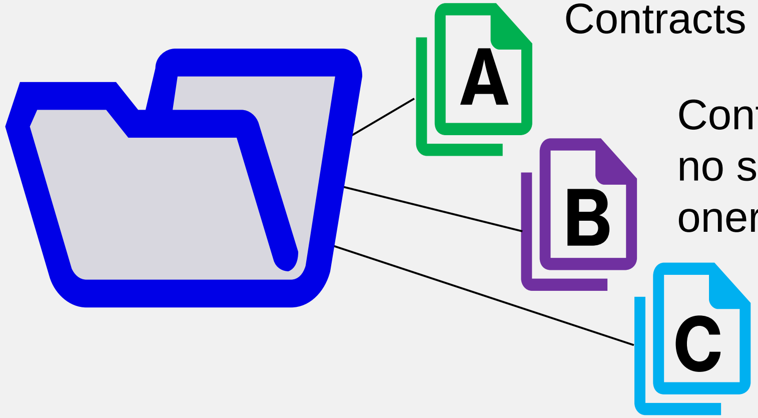
1 **Contracts initially to be split into “portfolios”, comprising contracts that are subject to similar risks and managed together.**

2 **Each portfolio is then divided into three groups. These groups, once established, are units for subsequent measurement and are not subsequently re-assessed**



Contracts that are onerous at initial recognition

Contracts that at initial recognition have no significant possibility of becoming onerous subsequently

The remaining contracts in the portfolio

3 **Contracts in each group need to be sub-divided into annual cohorts**

What is an onerous contract?

An insurance contract is **onerous** at the date of initial recognition if the fulfillment cash flows, any previously recognized acquisition cash flows and any cash flows at the date of initial recognition are a **net outflow**

In practice, for a contract or set of contracts to be onerous at initial recognition is likely to be the result of an intentional pricing strategy, and therefore relatively infrequent.

IFRS 17.BC135

Assessment made **using existing information** provided by entity's internal reporting system. Not required to not gather additional information in order to make assessment.

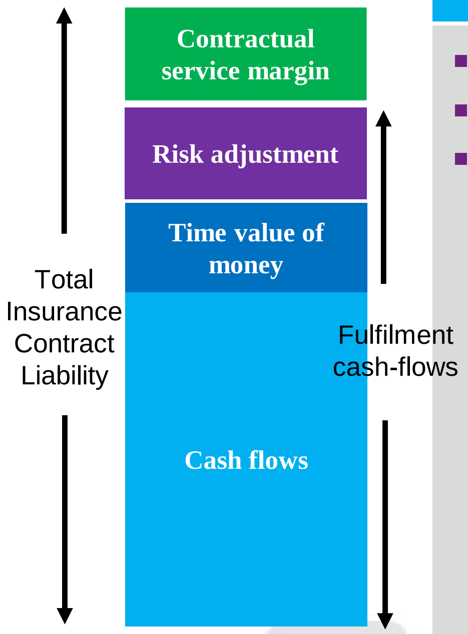
For contracts measured under PAA, an entity shall **assume that no contracts** in the portfolio **are onerous** at initial recognition**, unless facts and circumstances** indicate otherwise**.**

The assessment of whether a contract is onerous is made on a **gross basis** – i.e. without consideration of the effect of reinsurance

Reinsurance contracts held cannot themselves be onerous

This may result in a mismatch where an loss on a contract written is offset by a gain on reinsurance

Measurement of fulfilment cash flows



Cash Flows	Included	Excluded
▪ Explicit and unbiased ▪ Entity perspective ▪ Within contract boundary, i.e. including all cash flows relating to existing business, excluding future business	▪ Premiums ▪ Claims net of recoveries ▪ Attributable acquisition cash flows ▪ Claims handling costs ▪ Policy admin and maintenance costs ▪ Premium taxes ▪ Allocation of overheads*	▪ Investment returns ▪ Amounts under reinsurance contracts held ▪ Future insurance contracts (e.g. not within contract boundary) ▪ Costs not directly attributable to portfolio (e.g. product development and training) ▪ Wastage ▪ Income taxes

Fulfilment cash flows: measured on a current basis

Contract boundaries

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
- In which the entity has a **substantive obligation** to provide the policyholder with services.

A substantive obligation to provide services ends when:
the entity has the **practical ability** to reassess the risks and, as a result, **can set a price or level of benefits that fully reflects those risks; or**

Determining the discount rate

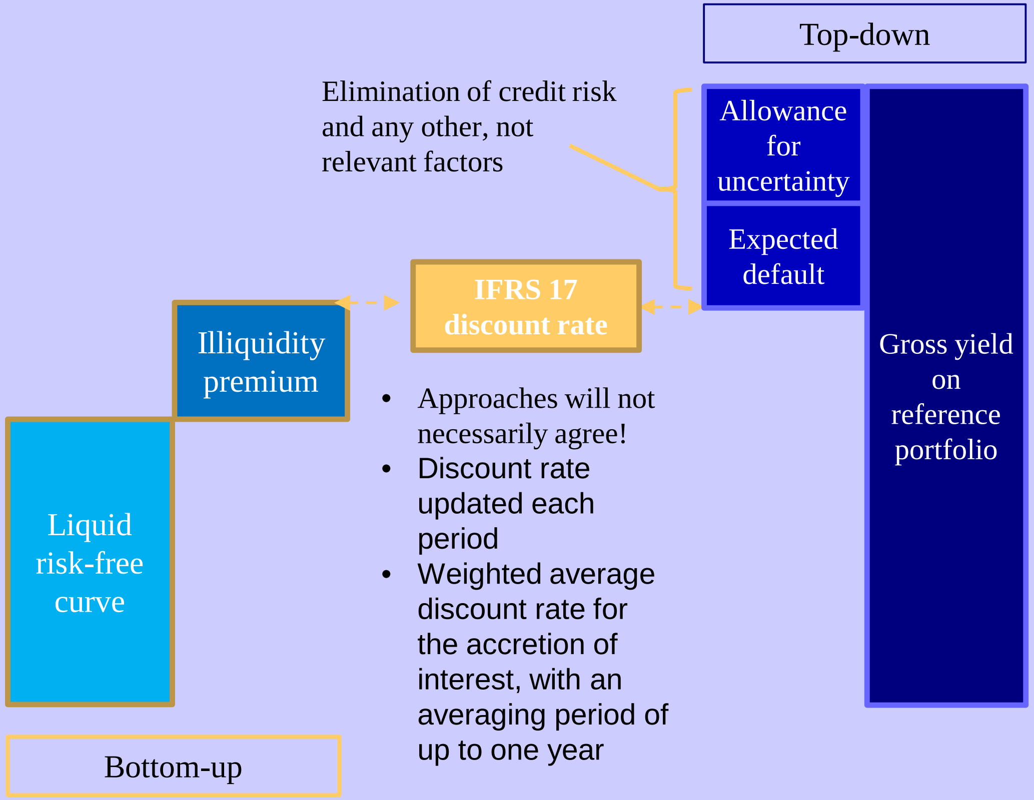
- Estimates of future cash flows are adjusted to reflect (§32)

- *the time value of money and the financial risks related to those cash flows, to the extent that the financial risks are not included in the estimates of cash flows*

4 main requirements

1. Reflect time value of money, characteristics of the cash flow (timing, amount)
2. Reflect the characteristics of the underlying insurance contract (liquidity)
3. Be consistent with market practice
4. Exclude effects that impact market prices, but which have no impact on future cash flow

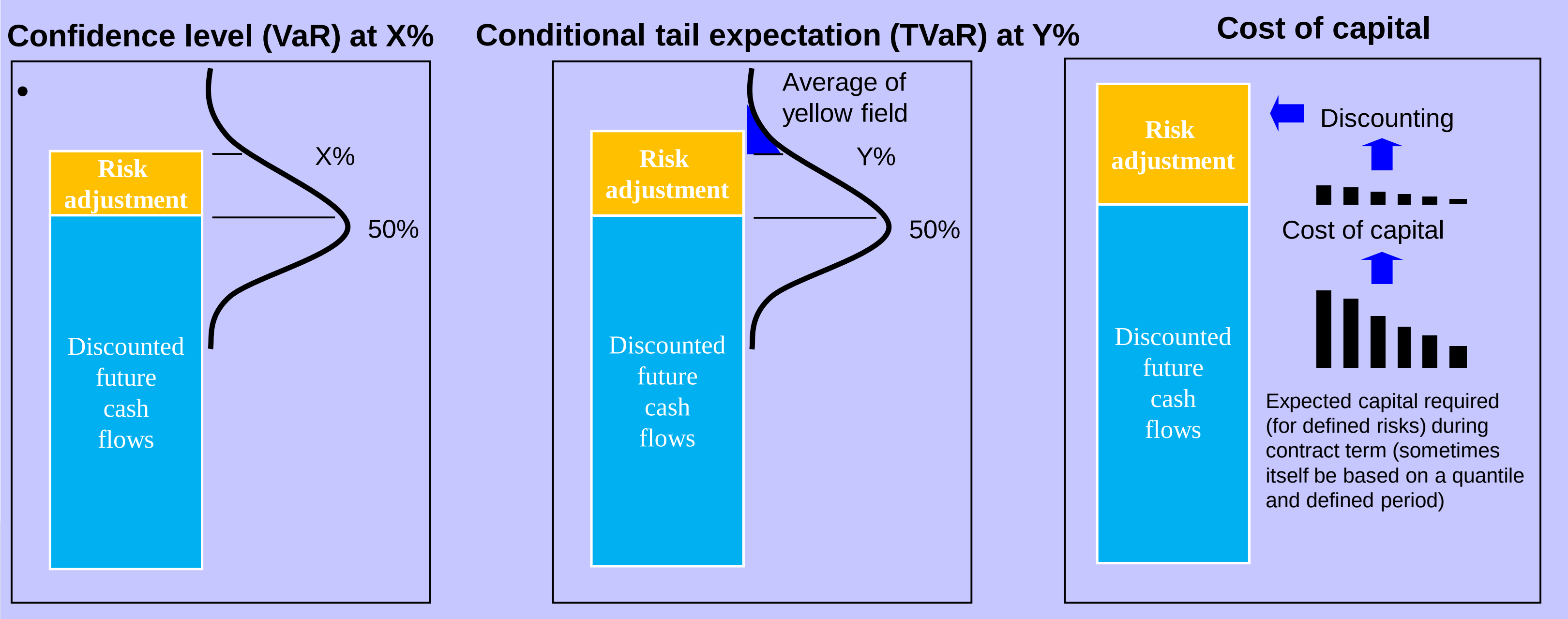
2 possible approaches



- Approaches will not necessarily agree!
- Discount rate updated each period
- Weighted average discount rate for the accretion of interest, with an averaging period of up to one year

Risk adjustment – Choice of technique is <u>not prescribed</u>

- Risk adjustment reflects the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk
- Compensation to make entity indifferent between:
  - range of possible outcomes arising from non-financial risk; and
  - fixed cash flows with the same expected present value
- Can allow for diversification benefits



CSM roll-forward could be complex

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CSM Progression – General Measurement Model

CSM at start of period

\+ CSM for new contracts

\+ Interest at locked in rate

+/- Changes in cash flows

- Experience adjustment for premium received
- Changes in estimates of cash flows relating to future service
- Difference between expected and actual investment component paid in the period
- Change in risk adjustment for future service
- CSM cannot be negative/loss reversal

+/- Currency exchange

\- CSM allocated to period

- Allocation based on coverage units

CSM at end of period

- Profit not yet recognised

Reinsurance to be accounted separately

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Aggregation

- Separate and explicit evaluation for RI contracts held – may differ from the gross segmentation.
- May result in many groups (or even portfolios) of just one contract

Measurement

- Eligibility of PAA may be different for reinsurance and underlying insurance contracts
- Explicit measurement of groups of reinsurance contracts (with consistent assumptions)
- Risk adjustment to be estimated as amount of risk transferred

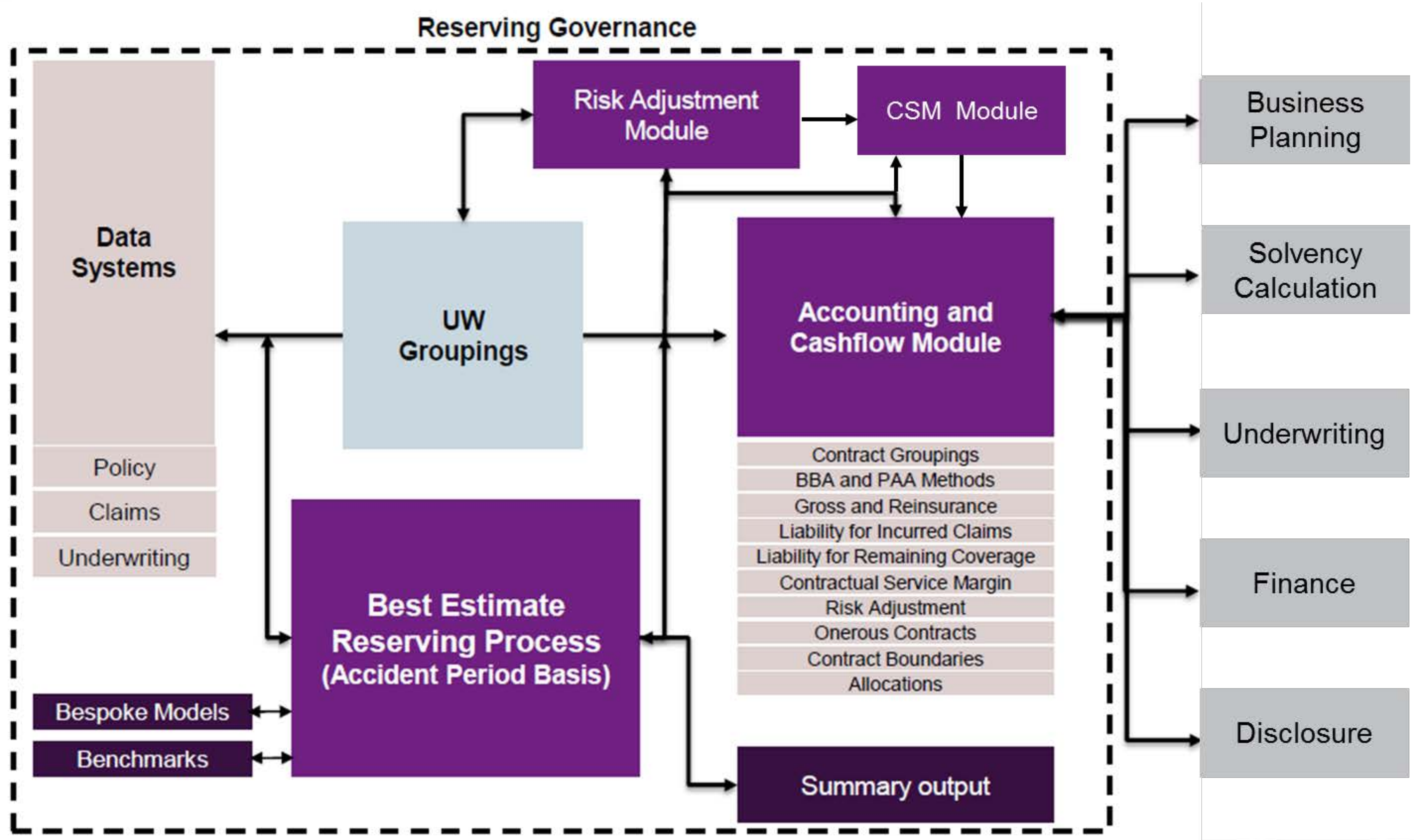
Profit recognition mismatch

- Profits and losses recognized over coverage period
- Gains on reinsurance not available to offset immediately any losses on onerous underlying contracts

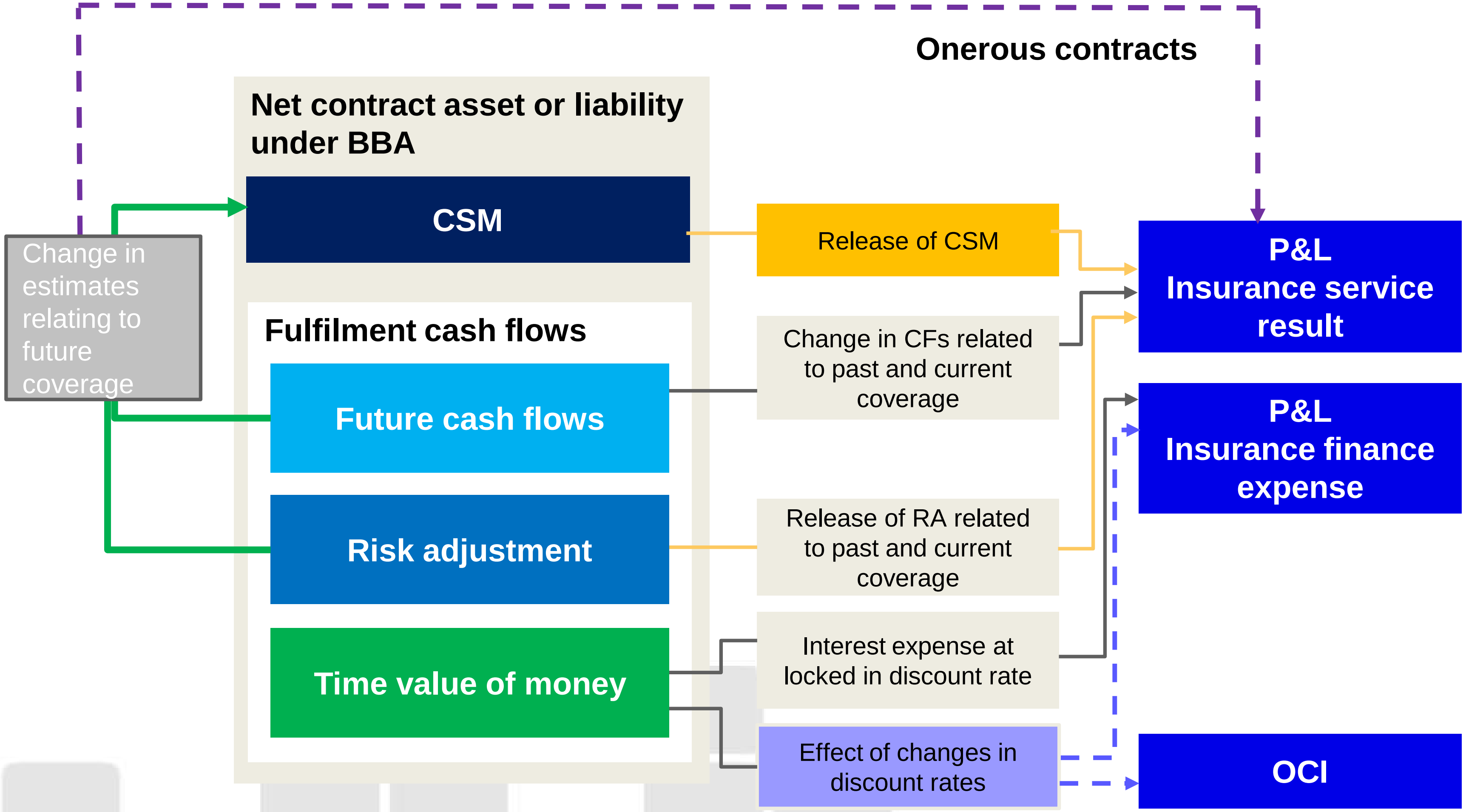
Default risk

- Recognized on an expected, not occurred, basis

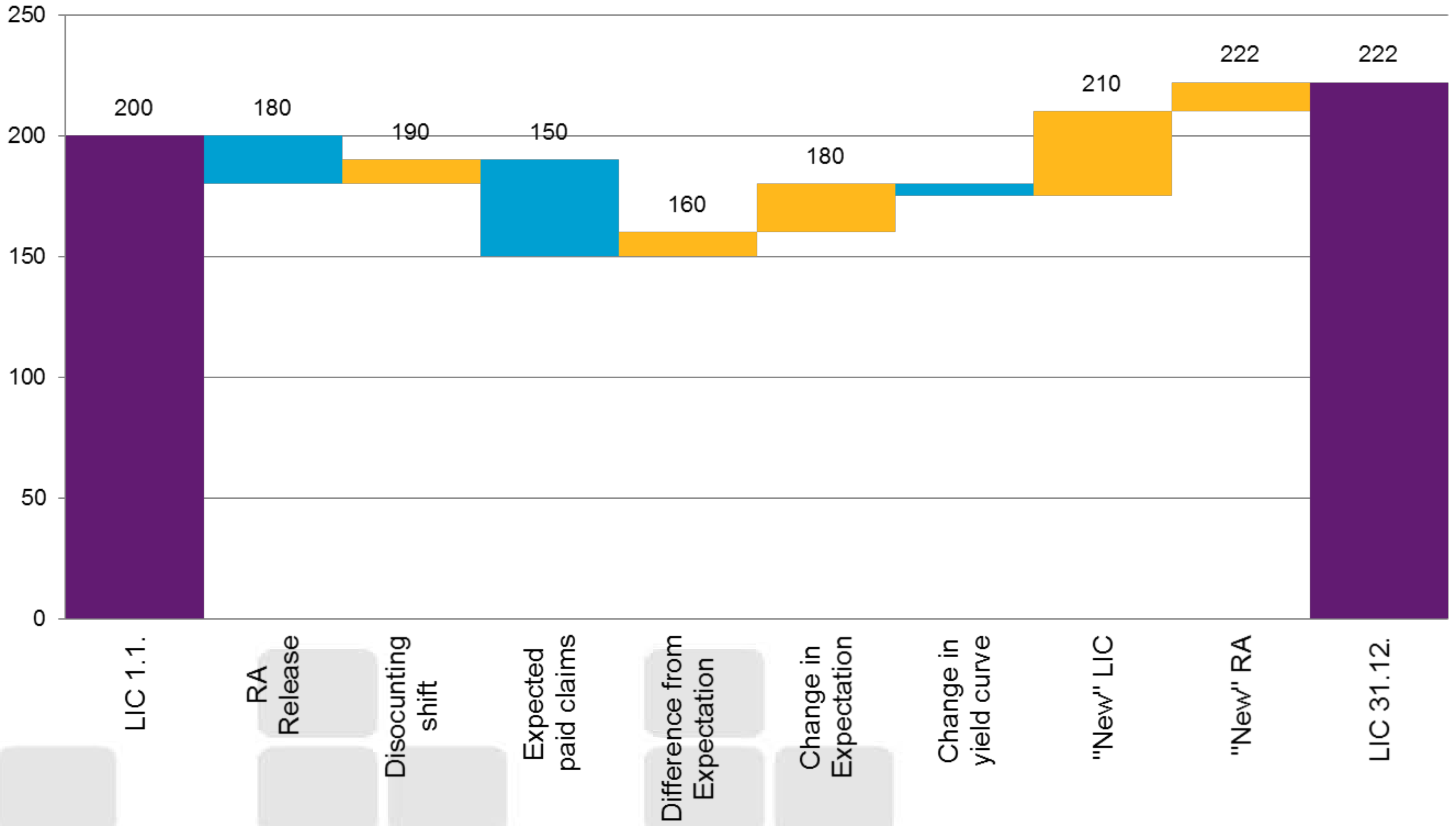
Actuarial model processes may need to be industrialized



Understanding the result drivers



What happens to claims reserves



IFRS 17 – a lot for GI actuaries to do and to think about

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Implementation issues

- Selection of measurement model
- Increased granularity of measurement groups
- Discount rates
- Risk Adjustment approach
- CSM
- New actuarial models and much efficient processes
- Disclosure requirements

Commercial issues

- Greater earnings volatility – increased role GI actuary needs to play in ALM
- Communicating emergence of expected profit – CSM and RA release
- Differences between IFRS 17 and current accounting KPIs
- Revisions to product strategy and design?

THANK YOU