1st Capacity Building Seminar on IFRS 17

Institute of Actuaries of India

Implementation Challenges

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Mumbai

Standard in a Nutshell

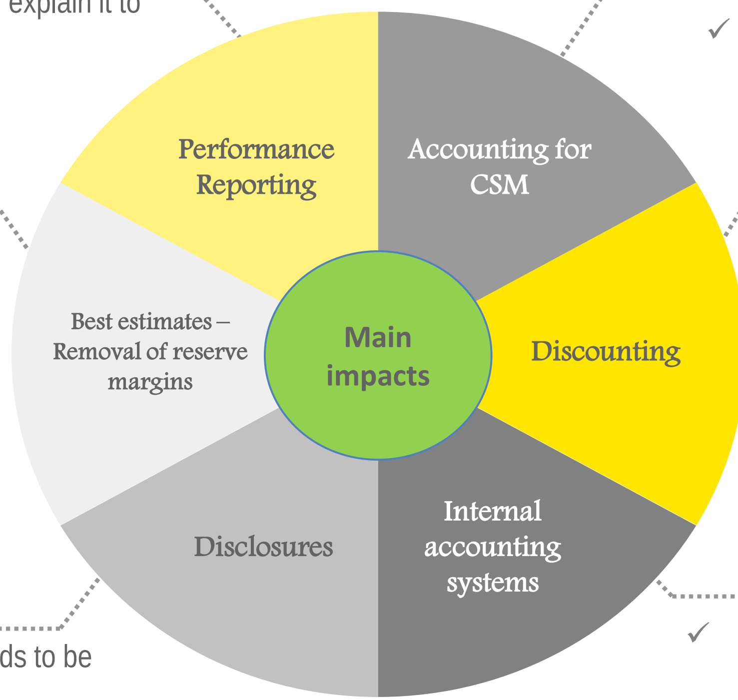
- Defines / identifies insurance contracts
- Divides contracts into portfolios and groups for measurement
- Measurement of liability through risk-adjusted cashflows / unearned profit through CSM
- Recognition of profit over lifetime of contract except onerous contracts
- Separately present insurance revenue, insurance service expenses and insurance finance income / expenses
- Disclose information enabling users to assess effect of contracts on Company’s financial position and performance

What does it mean for your business?

IFRS 17 is much more than an accounting change and can have broad business implications

- ✓ Reporting on new basis – will neeed to understand performance drivers
- ✓ Different revenue metric – need to explain it to stakeholders

- ✓ New processes required to calculate CSM
- ✓ CSM roll forward will need to be understood and explained
- ✓ Estimating CSM on transition will be a critical element impacting future profit



- ✓ Moving to best estimates may make results more volatile.
- ✓ Increased chances of showing a loss during a year for mature insurers

- ✓ Question on whether to align the current reporting requirements
- ✓ Additional process work to determine time value of money
- ✓ Need to explain to stakeholders (More significant for long tail liabilities)

- ✓ Significantly more information needs to be provided
- ✓ Additional processes and data are required to gather the disclosure information

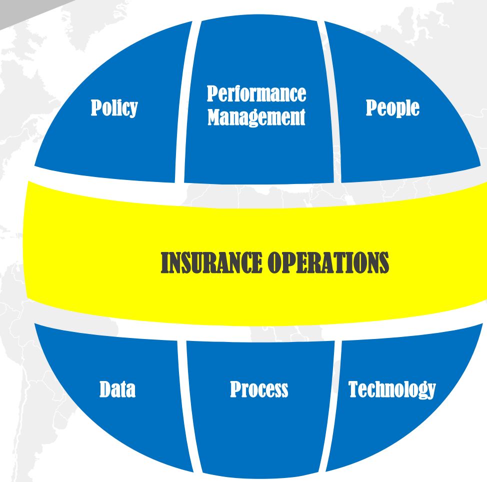
- ✓ New processes and information to be recorded will involve substantial system updates

What you should be doing right now?

1. Engage stakeholders through training and communications
2. Determine the main commercial business impact headlines
3. Plan

   Prepare a gap assessment:
   - Operations
   - Data/ systems
   - Reporting timetable
4. Design decisions
   - Technnical compliance or efficiency
   - Build on existing systems?
5. Prepare the roadmap for implementation

IMPACTS MULTIPLE AREAS



Identifying Portfolios of Contracts

Principle

Contracts subject to similar risks and managed together

Interpretation

What does subject to similar risks and managed together mean?

Discussion points

- No clear definition provided – Deliberately not prescriptive
- Current lines of business an initial indicator
- Similar and not identical risks
- All risks and not only insurance risks
- Profitability groups defined separately
- Managed together might vary by portfolio size
- Impacts of changes to management of business

Grouping of Contracts (1)

Principle

Contracts need to be grouped between onerous; no significant possibility of becoming onerous and others

Interpretation

What risk factors to consider when determining possibility of contract turning onerous?

Discussion points

- Need to set a high bar
- Considerations - Variability of insurance risks / Duration of contract / Level of risk adjustment / CSM level at inception
- In practice test expected to be between onerous and others
- Regulatory pricing constraints

Grouping of Contracts (2)

Principle

Contracts need to be grouped between onerous; no significant possibility of becoming onerous and others

Interpretation

Granularity at which onerous contracts need to be identified?

Discussion points

- Grouping at contract level
- Available "reasonable and supportable information" can be used as justification for grouping multiple contracts
- Dependence on granularity of experience analysis performed
- No revisions allowed unless in case of contract modification

Contract Boundaries

Principle

End of period in which insurer has substantive obligation to provide the policyholders with services

Interpretation

Assessment of substantive obligation to provide services

Discussion points

- Practical ability to reassess risk and reflect fully in revised premiums – Offer same premium as new customers
- Can be at portfolio level as well – provided premium reassessment does not consider risks beyond contract boundary
- Practical ability independent of commercial pricing decision
- Impact of cap on charges – Commercial substance

Expenses

Principle

Fulfilment cashflows to allow only for expenses attributable directly to portfolio of insurance contracts

Interpretation

What does directly attributable imply and does this refer to current or long term expenses?

Discussion points

- CSM excludes overheads not attributable to “portfolio”
- As per insurer’s current actual forecasts - Assuming going concern, future new business sales and inflation consistent with discount rate
- Need to split between acquisition and maintenance
- Expense variations and overheads accounted as they arise

Separating investment component

Principle

Amount payable under insurance contract even if insured event does not occur

Interpretation

Surrender value payable at the time of claim

Discussion points

- Separation does not impact liability or CSM – Investment component deducted both from expected and actual claims
- Is surrender value the best indicator for identifying investment component – MRTA products / Annuity with return of premium
- No surrender value payable in initial period

Releasing CSM - Coverage units

Principle

Quantity of coverage provided determined by considering quantity and expected coverage duration of benefits

Interpretation

Which driver best reflects quantity of coverage provided?

Discussion points

- Controls emergence of profit through unlocking of CSM
- Based on pure insurance or with investment component?
- Not based on expected cashflow pattern, release of risk adjustment or returns on investment component
- Allow for discounted or undiscounted future coverage – Used to offset unexpected pattern of quantity parameter

Variable Fee Approach (VFA)

Principle

VFA to be used for products with direct participating feature

Interpretation

Which contracts have direct participating feature?

Discussion points

- Clearly identified pool of underlying "items" – Holding underlying items not necessary
- Expected payment of substantial share of fair value returns on underlying items to policyholders – Insurer discretion still allowed
- Substantial change in policyholder payouts due to change in fair value of underlying items – Level of guarantee
- Assessment at inception

Impact on Reinsurance

Principle

Base contracts shown gross of reinsurance with reinsurance asset / liability shown separately

Interpretation

What are the impacts of this segregation?

Discussion points

- Reinsurance supported base contracts will be classified as onerous – CSM on reinsurance contract amortised over policy term
- Reinsurance portfolios and groups might be different from base contracts – Mismatch in CSM release
- Reinsurance contracts not classified as onerous – Expected to be loss making

Transition Approach

Principle

Use Full Retrospective Approach, Modified Retrospective Approach or Fair Value Approach

Interpretation

Which approach is to be used for transition?

Discussion points

- Not using Full Retrospective Approach needs to be justified to be impracticable – Lack of data, unbiased assumptions not influenced by hindsight, undue cost and effort
- Fair value approach can be used irrespective of whether reasonable and supportable information available for modified retrospective approach
- CSM = Fair Value – FCF under Fair Value Approach

Questions