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Discount rates under IFRS 17

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What’s new with discounting?

Use of discount rates has been core to actuarial work for centuries, so are there any new issues?

Core principle underlying liability valuation under IFRS 17:

Insurance liabilities should be calculated independent of the rest of the balance sheet to reflect the characteristics of insurance contracts

Core requirements (a)

Discount rates shall reflect:

time value of money

characteristics of cash-flows

liquidity characteristics

Core requirements (b)

Discount rates shall be consistent with:

observable current market prices for financial instruments with similar <u>characteristics</u>

as against “business model” for valuation of assets

consider implications

would "business model" determine accounting policy?

or accounting outcomes inform the "business model"?

Core requirements (c)

Discount rates shall **exclude**:

the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.

consider implications

Implications for India

Pricing of assets within capital markets influenced by **imperfect market conditions** and constraints:

- **Balance of demand and supply (including regulatory investment limits influencing pricing)**
- **Prices subject to influences from "bulk deals" – potential lack of depth at specific durations**
- **Lack of sufficient instruments to meaningfully determine liquidity premiums**
- **Need to carefully consider role of "future outlook" (insurers perspectives) versus "current market prices"**

Liquidity characteristics: whose perspective?

Liquidity = the ability to convert the asset into cash or extinguish the liability on demand

Contract perspective: i.e. from the perspective of features embedded within the insurance contract	Insurer’s perspective: i.e. the insurer’s ability to sell the contract / extinguish the liability

Liquidity characteristics: not a binary yes/no answer

Consider:

- exit costs
- inherent value build-up
- exit value
- predictability (?)

evolution over time

Potential (key) gaps

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Top down

reference portfolio construction

…adjustments thereof

VROI style derivation?

Bottom up

assessment of "risk-free"

liquidity premium calibration

leap of faith?

Theory versus practice – likely to be the biggest gap!