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ASTIN Working Party on Implications of IFRS on Non-Life Insurers, Products and Markets

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ACTUARIAL SOCIETY OF SOUTH AFRICA

What is IFRS 17?

IFRS 17 is a new accounting standard for insurance contracts launched in 2017.

IFRS 17 was developed by the International Accounting Standards Board (IASB).

IFRS 17 replaces the previous accounting standard IFRS 4, launched in 2004.

IFRS 17 will be compulsory for insurance groups and listed insurers.

IFRS 17 is due in force in 2022 with at least one-year of lead time.

Advantages of IFRS 17 as seen by the IASB

	IFRS 4	IFRS 17
Comparability among companies	Accounting for insurance contracts varies significantly between companies operating in different jurisdictions.	Companies will apply a consistent accounting framework for all insurance contracts.
Comparability among insurance contracts	A multi-national group is allowed to consolidate subsidiaries using non-uniform accounting policies.	A multi-national group will measure insurance contracts in a consistent way within the group.
	Comparability among industries	
	Some companies present cash or deposits received as revenue.	Revenue will reflect the insurance coverage provided, excluding saving components.

More advantages of IFRS 17 as seen by the IASB

	IFRS 4	IFRS 17
Value of insurance contracts	Use of out-of-date assumptions does not provide useful financial information.	Insurance contracts will be measured at current value.
	Some companies use the 'expected return on assets held' as the discount rate to measure insurance contracts.	Companies will use a discount rate that reflects the characteristics of the insurance cash flows.
	Some companies do not consider the time value of money when measuring liabilities for claims incurred.	Companies will report estimated future payments to settle incurred claims on a discounted basis.
	Some companies include an 'implicit allowance for risk' in the measurement of their insurance contract liabilities.	Companies will calculate and disclose an explicit risk margin.
Information about profitability of insurance contracts	There is a lack of transparency about the sources of profit recognised from insurance contracts.	Companies will provide information about current and future profitability arising from insurance contracts.
	Obligations arising from insurance contracts are highly uncertain.	Companies will provide additional information about estimates and judgements used to measure insurance contracts.
	Many companies provide non-GAAP information, usually about future profitability of long-term insurance contracts.	Limited need to produce non-GAAP information. Improved accounting for insurance contracts will reduce the need for companies and analysts to use non-GAAP performance measures.

What is IFRS 17 seeking to achieve?

IFRS 17 seeks to ...

- Harmonise insurance accounting across companies and countries.
- Harmonise insurance accounting with that used by other industries.
- Enforce the use of current, realistic valuations in the balance sheet.
- Regulate the emergence of revenue and profit in the P&L account.
- Generally, increase focus on the P&L account and on movements.

Some useful acronyms in IFRS 17

Here are some acronyms you should know.

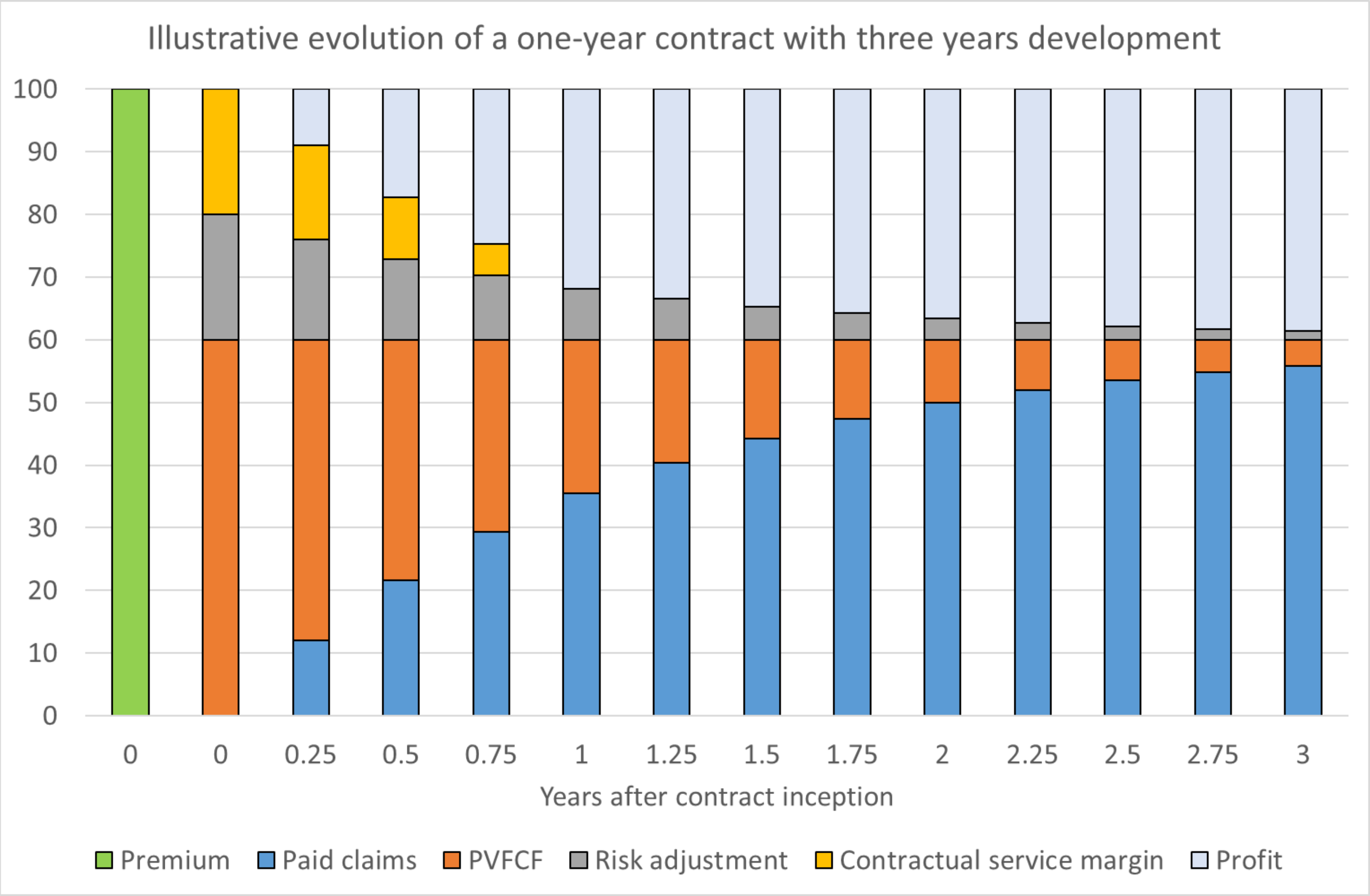
- PVFCF. Present value of future cash flow (wasn't that one easy? ☺)
- RA. Risk Adjustment for Non-Financial Risk.
- FCF. Fulfilment Cash Flow.
- CSM. Contractual Service Margin.
- GMM/BBA: General Measurement Model aka Building Block Approach.
- VFA. Variable Fee Approach.
- PAA. Premium Allocation Approach.
- LRC, LIC. Liability for remaining cover, liability for incurred claims.

Major effects of IFRS 17 on non-life insurance accounting

IFRS 17 presents a few small challenges for non-life insurance accountants and actuaries:

- Organising and following contracts/cohorts by contract year (read: underwriting year).
- Defining contract boundaries and (all) future cash flows within those boundaries.
- Selecting appropriate term structures and discounting future cash flows (PVFCF).
- Determining a Risk Adjustment: RA.
- Calculating the Fulfilment Cash Flow: FCF = PVFCF + RA.
- Finding the Contractual Service Margin: CSM = $(\text{Premium-FCF})^{+}$ at inception.
- Using the Premium Allocation Approach for contracts that cover one year or less.

Don’t despair – life insurance accountants and actuaries will have it much worse!


Illustrative evolution of a one-year contract with three years development
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1
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1.75
2
2.25
2.5
2.75
3
Years after contract inception
Premium
Paid claims
PVFCF
Risk adjustment
Contractual service margin
Profit

The Terms of Reference for the ASTIN Working Party

"The aim of the ASTIN Working Party is to

(a) develop an inventory of the changes in financial reporting that non-life insurers are likely to experience,

(b) consider the behavioural changes of rating agencies, regulators, reinsurers, investors, customers and company management in light of each of the changes, and

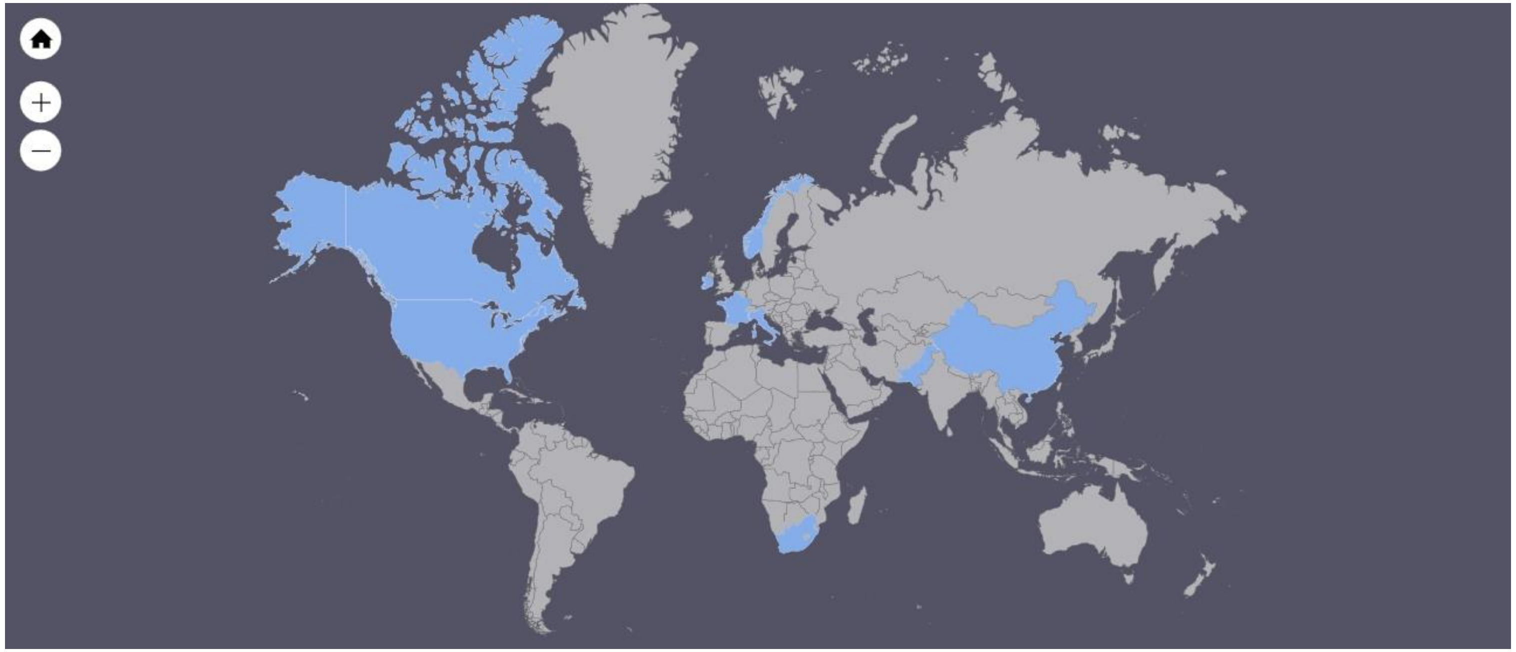
(c) assess the impact of the behavioural changes on markets, products, and company operations."

NB. The aim of the WP is NOT to develop, discover or promulgate any actuarial methods or standards.

The ASTIN Working Party

The Working Party has 13 members from 10 countries:

China
Pakistan (2)
South Africa
Norway
Italy (2)
France
Ireland
Trinidad
Canada (2)
USA



Questionnaire

We sent out a questionnaire focusing on five areas:

1. Accounts as a source of information for stakeholders,
2. The role of regulators and the relationship between IFRS 17 and national GAAP,
3. The form and calibration of the risk adjustment,
4. Uses of the contractual service margin for general insurers,
5. Possible effects of IFRS 17 on premium setting, taxation and portfolio transfers.

We have received 35-40 responses (some joint responses by several authors).

1. Accounts as a source of information

Some findings

- For Management: Potential for better information, but major education effort will be required. The added information is marginal for those who have implemented Solvency II. Some companies will keep IFRS 4 as their internal reporting standard. Traditional KPIs for non-life insurance will continue to be reported.
- For Investors: Potential for better information but major education effort will be needed. Greater reliance on specialist analysts. Small investors, private investors and generalist analysts will find it more difficult to understand insurance accounts. One respondent fears increased risk premium for insurance shares.
- For Rating agencies: no impact, they use their own models and measurements.
- For Policyholders: no impact.

2. National regulators and local GAAP

Some findings

- Majority opinion is that national regulators should not be involved in the implementation of IFRS 17.
- Some respondents think specific guidance is necessary to ensure comparability between companies and between countries. One respondent thinks guidance should come from supranational bodies such as EIOPA, to eliminate differences between countries. Another respondent is stongly opposed to that view.
- Opinions differ on whether IFRS 17 should be compulsory for all companies or only listed companies. Scandinavians favour harmonisation. A new China GAAP will be IFRS 17 compatible. On the other hand, French respondents seem to favour/expect unchanged accounting rules for local and private companies.
- One respondent argues that changing local GAAP would raise difficult tax issues.

3. Risk Adjustment

Some findings

- Preferences are evenly split between confidence level calculation and cost-of-capital calculation.
- Asked for confidence level the reply is generally evasive, but some opt for a high level (75%-99.5%).
- Virtually no respondents think that a confidence level of 50% (using best estimates with no risk adjustment) would be acceptable.
- Some respondents plan to use the Solvency II risk margin with disclosure of its implied confidence level.
- Some respondents argue that different confidence levels will reduce comparability between companies, and that a market standard ought to be developed. Will it be 75%?
- Those who already have a confidence level based risk adjustment, are likely to keep it.

4. Contractual Service Margin

Some findings

- General insurance companies will use the PAA unless forced to use the BBA by the nature of their products or by group directives. If the PAA is used, there is no requirement to calculate a CSM. Interestingly, several respondents from China state that they will use the BBA even if they could used the PAA.
- Most respondents think the CSM (if used) <u>must</u> be released over the coverage period; and that the coverage period is the loss occurrence period of (usually) one year. But it's actually more complicated.
- There are non-life insurance contracts with significant insurance risk beyond the loss occurrence period. For instance, workers' compensation insurance with contingent annuity benefits. Cf. the note of the Transition Resource Group (TRG): Insurance risk consequent to an incurred claim, AP01 of September 2018.
- Gaming of RA vs CSM to manage profitability is seen as a remote possibility only.

5. Behavioural change

Some findings

- Effects of IFRS 17 on taxation not seen as likely. One respondent believes that taxation change, if any, may come from the OECD in the "Base erosion and profit shifting" package. One respondent argues that local GAAP should not be changed in line with IFRS 17, as local GAAP is used for tax accounting.
- IFRS 17 requires disclosure of onerous portfolios. Respondents do not think that this disclosure in itself will affect pricing discipline. Companies use other tools than their accounts, to monitor profitability.
- No effect on trading of portfolios is anticipated, although one participant noted that IFRS 17 and regulation in general, is conducive to increased «corporate structuring».

Main finding of the ASTIN Working Party on Implications of IFRS on Non-Life Insurers, Products and Markets

It's Difficult to Make Predictions, Especially About the Future.

Thank you for your attention!