YEAR 10 ANNIVERSARY

2020 ASIA-PACIFIC VIRTUAL SYMPOSIUM

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Session 14 – Transitioning to IFRS 17

29 September 2020

SOCIETY OF ACTUARIES®

SOCIETY OF ACTUARIES
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- Do not discuss what you or other entities plan to do in a particular geographic or product markets or with particular customers.
- Do not speak on behalf of the SOA or any of its committees unless specifically authorized to do so.
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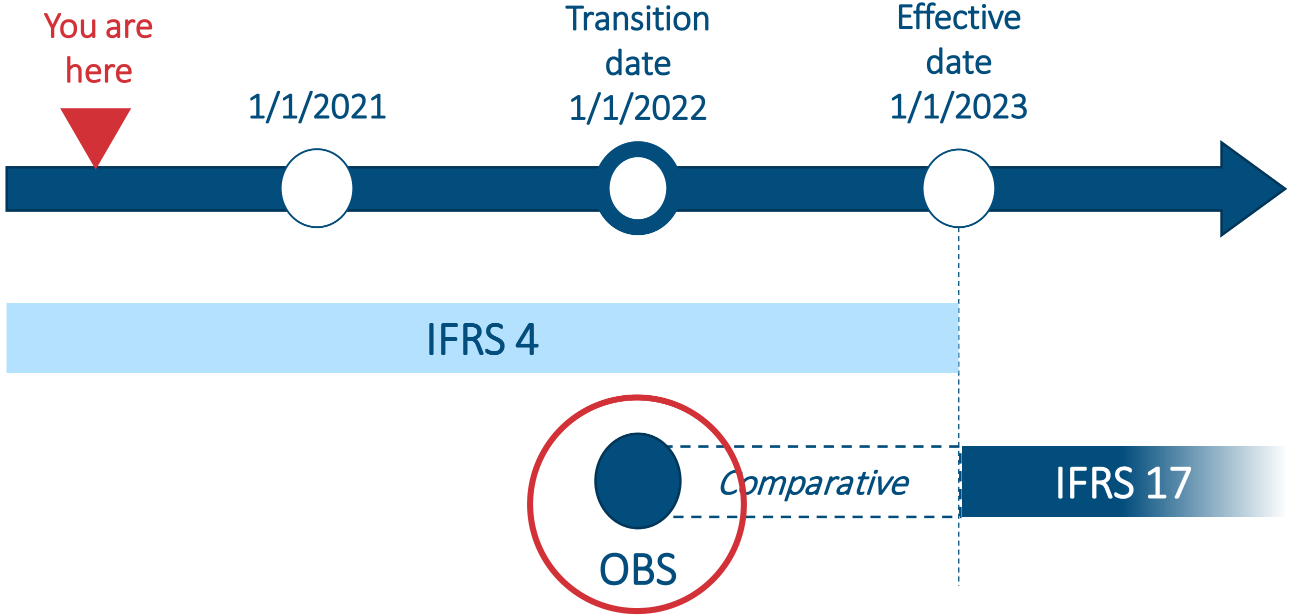
Introduction

Transitioning to IFRS 17 – Timeline



Transitioning to IFRS 17 – OBS

	Assets	Liabilities	Equity
1	Intangible assets	Insurance contract liabilities (LRC) • PVCF (BEL) • Risk adjustment • CSM / Loss component 4	Retained earnings
	Financial assets		Accumulated OCI • Financial assets AOCI • Insurance contracts AOCI
2	~~Deferred acquisition costs~~		
3	Assets for acquisition cash flows	Insurance contract liabilities (LIC)	
	Deferred tax assets	Deferred tax liabilities	
	Other assets	Other liabilities	

Relevant to transition approaches

1 Unchanged

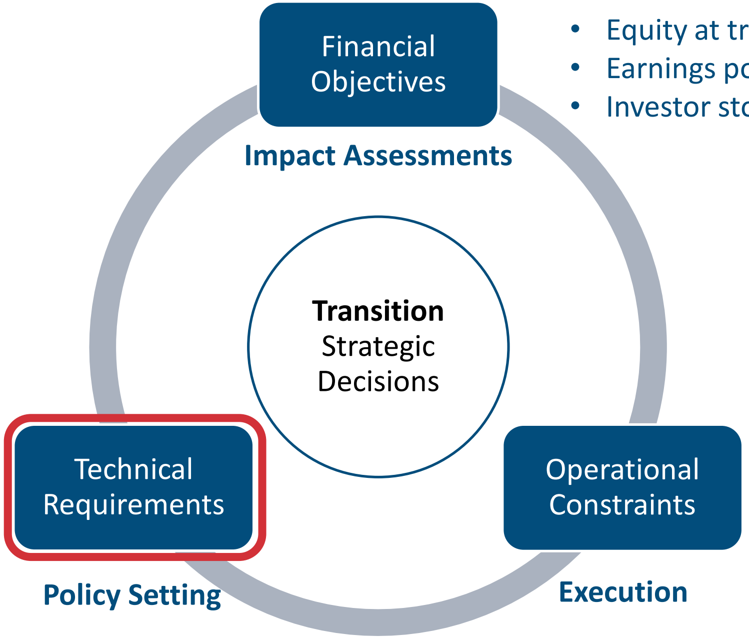
2 Removed

3 New

4 Replaced

Transitioning to IFRS 17 – Strategic View

One-off exercise, long-lasting impacts



- Equity at transition
- Earnings post-transition
- Investor story

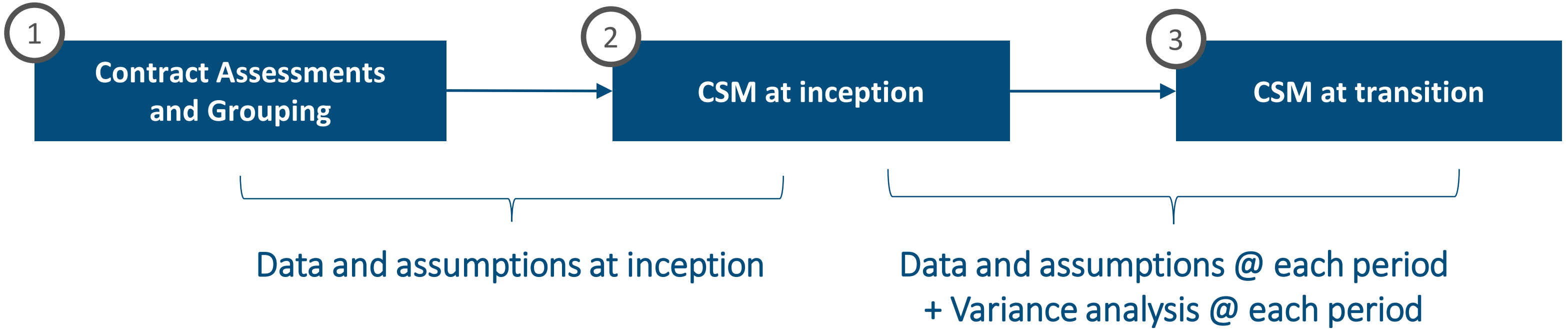
- General requirements
- Transition requirements
- Accounting choices

- Data availability
- Data compatibility
- Process and controls

Transition Approaches

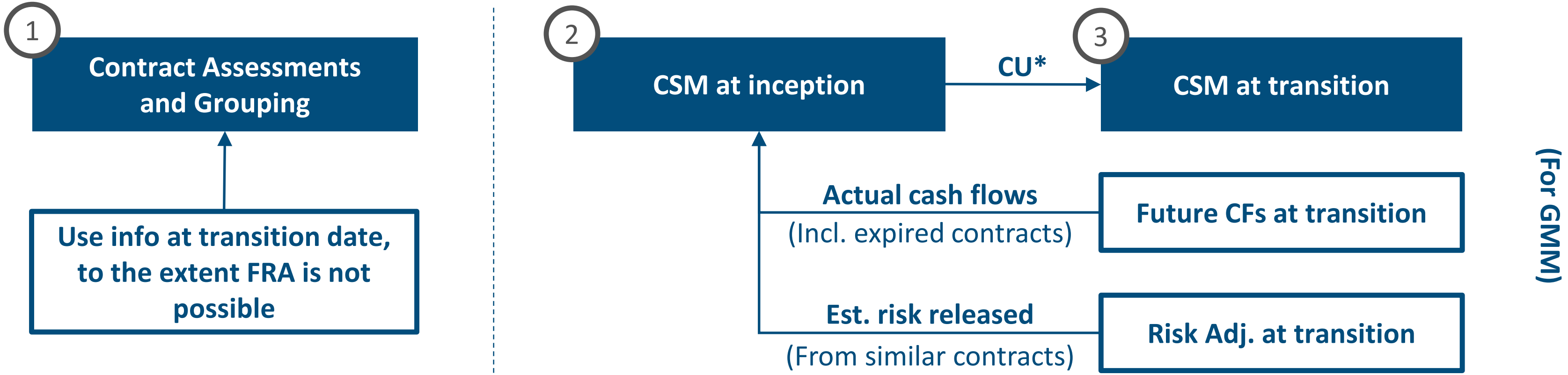
FRA, MRA, FVA

Transition Approaches – Full Retrospective Approach



- Historical data compatible with new systems?
- Historical data available at required granularity?
- Assumptions that did not exist pre-IFRS 17?
- Costly to set up and run results for historical periods?

Transition Approaches – Modified Retrospective Approach



- Historical cash flows by cohort available? Are estimates allowed?
- Historical attributable expenses (IFRS 17 basis) available?
- What are “similar contracts”?
- Historical coverage units available?

*** Coverage units**

Transition Approaches – Fair Value Approach

1

Contract Assessments and Grouping

Use info at transition date or inception date

2

Fair value* (IFRS 13) – FCF at transition

=

3

CSM at transition

** IFRS 13: fair value = the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit value)*

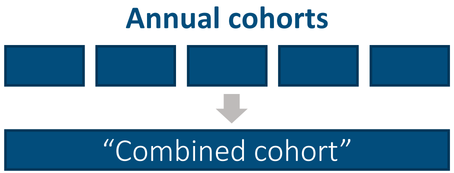
- Unit of account
- Contract boundary
- Exclusion of NB

- Information at transition date = Assessment as of transition date?
- Fair value determination – Are past transactions relevant? What's the context under transition?
- Fair value technique – Direct approach or indirect approach? How to estimate parameters?
- Fair value for reinsurance contracts held – What are we measuring? Is net approach allowed?

Transition Approaches – Fair Value Approach

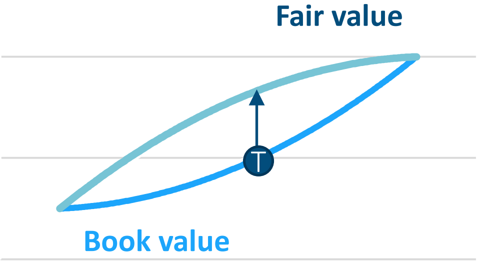
Additional considerations over the MRA:

1. **Separation into annual cohorts is not required**
   - Reduced chance of loss recognition post-transition



2. **Locked-in discount rates can be reset at transition date**
   - No historical discount rates and economic scenarios required
   - Affects post-transition P&L from CSM interest accretion and CSM unlocking

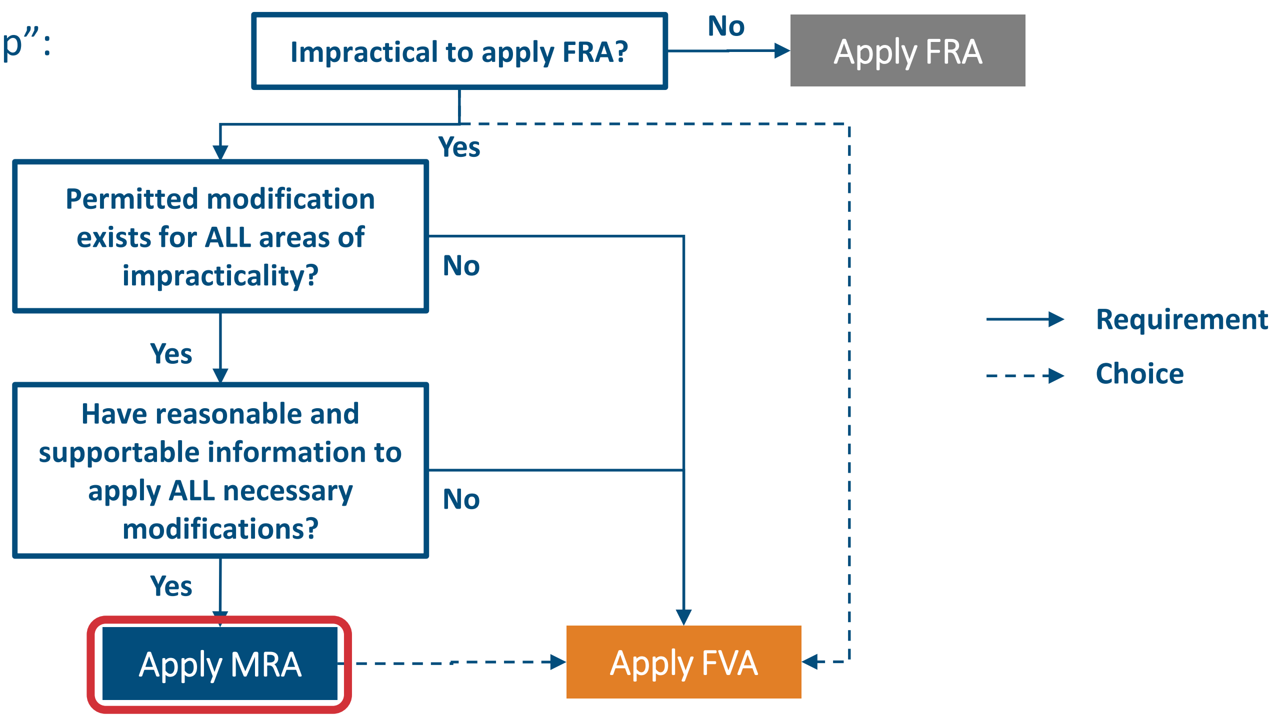
3. **Accumulated OCI can be set to zero***
   - Pre-transition interest rate volatility absorbed in retained earnings
   - Effectively, book value reset to equal to fair value at transition
   - Affects post-transition P&L with a different “liability interest unwind”



** Applicable if OCI option is chosen (except for some VFA contracts)*

Transition Approaches – Eligibility

For each "CSM Group":



Transition Approaches – Industry Perception

- Too demanding
- Difficult to apply
- Forced to apply FVA

- Low CSM
- Low future earnings

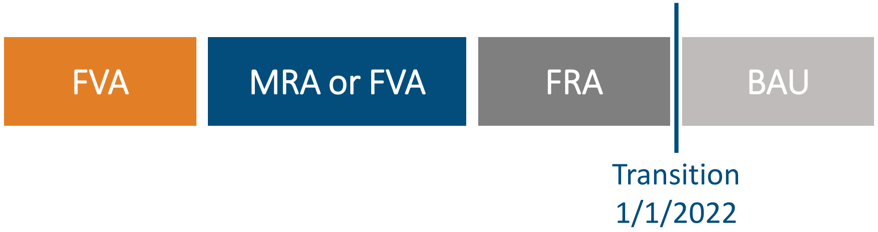
- Maximize use of FRA/MRA
- Loosely interpret FRA/MRA
- More use of estimates (e.g. based on existing reporting information)

Transition Approaches – Application

Ideal outcome:

- FVA is the simplest operationally
- Additional flexibility of FVA over MRA (e.g. combined cohort relief)
- FRA needs to be proven to be impractical

Expected outcome:



- FRA for most recent cohorts may be inevitable
- FVA for older businesses with limited data
- Limited cohorts with a choice between MRA and FVA to allow for financial flexibility

Illustrative Example

Illustrative Example – Fact Pattern

- Company A and Company B have identical assets and insurance contract portfolios at transition date:
  - Asset value = 1,000 (cash)
  - Best-estimate liability = 500
  - Duration of contracts = 3 years, total expected duration = 10 years
  - Single premium of 1,000
  - Claims and expenses = 70% of premium → Profit margin = **30%** of premium
  - Interest rate = 5% (stayed constant since inception)
  - No experience variance since inception
  - CSM is amortized on a straight line basis (assume decrement is negligible)
  - OCI option is adopted

- The only difference between the companies is the accounting for transition under IFRS 17:
  - Company A: Modified retrospective approach
  - Company B: Fair value approach + choose to reset locked-in rates and AOCI

Illustrative Example – Base Case

Company A - MRA

	0	……	3	4	5	6	7	8	9	10
Assets			1000							
Liabilites										
BEL	-300	←	500							
CSM	300	→	200	180	158	132	104	73	38	0
P&L (partial)										
CSM Release				30	32	33	35	36	38	40
CSM Accretion				-10	-9	-8	-7	-5	-4	-2
Total				**20**	**23**	**25**	**28**	**31**	**35**	**38**
Equity			**300**	**320**	**343**	**368**	**396**	**427**	**462**	**500**
Retained earnings			300	320	343	368	396	427	462	500
OCI			0	0	0	0	0	0	0	0

30% of premium

Locked-in rate = 5%

Transition

Company B - FVA

	3	4	5	6	7	8	9	10
Assets	1000							
Liabilites								
BEL	500							
CSM	50	44	38	31	24	17	9	0
P&L (partial)								
CSM Release		7	8	8	8	8	9	9
CSM Accretion		-2	-1	-1	-1	-1	0	0
Total		**6**	**6**	**7**	**7**	**8**	**8**	**9**
Equity	**450**	**456**	**462**	**469**	**476**	**483**	**491**	**500**
Retained earnings	450	456	462	469	476	483	491	500
OCI	0	0	0	0	0	0	0	0

Est. fair value margin = 10% of BEL

Transition

Illustrative Example – Interest Rate Drop Before Transition

Company A - MRA

	0	……	3	4	5	6	7	8	9	10
Assets			1000							
Liabilites										
BEL	-300	←	600							
CSM	300	→	200	180	158	132	104	73	38	0
P&L (partial)										
CSM Release				30	32	33	35	36	38	40
CSM Accretion				-10	-9	-8	-7	-5	-4	-2
BEL Int. Savings*										
Total				**20**	**23**	**25**	**28**	**31**	**35**	**38**
Equity			**200**	**234**	**271**	**311**	**353**	**398**	**447**	**500**
Retained earnings			300	320	343	368	396	427	462	500
OCI			-100	-86	-71	-57	-43	-29	-14	0

Transition

Int rate dropped to 3% in year 3

Locked-in rate = 5%

Company B - FVA

	3	4	5	6	7	8	9	10
Assets	1000							
Liabilites								
BEL	600							
CSM	60	52	44	35	27	18	9	0
P&L (partial)								
CSM Release		9	9	9	10	10	10	11
CSM Accretion		-2	-2	-1	-1	-1	-1	0
BEL Int. Savings*		14	14	14	14	14	14	14
Total		**21**	**22**	**22**	**23**	**23**	**24**	**25**
Equity	**340**	**361**	**383**	**405**	**428**	**452**	**475**	**500**
Retained earnings	340	361	383	405	428	452	475	500
OCI	0	0	0	0	0	0	0	0

Transition

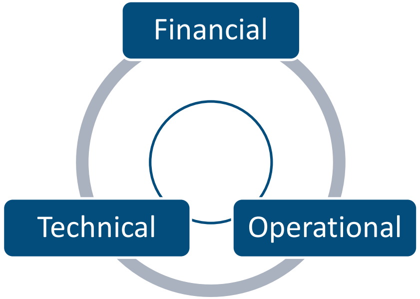
Locked-in rate = 3%

AOCI set to 0 at transition

** Difference between interest unwind on BEL using 5% (MRA) and 3% (FVA)*

Transition Planning

Transition Planning



- Define your **strategic goals**
  - Equity vs. earnings
  - Investor story

- Perform high-level **financial impact assessments** (FIA)
  - How big is the gap?
  - Where are the effective “gap-fillers”?
  - Understanding the limitations of FIAs
  - Regular updates are essential

Which parts of the business will have a significant financial advantage in applying the MRA over the FVA?

- Perform high-level **operational assessments**
  - Where are the major deal breakers?

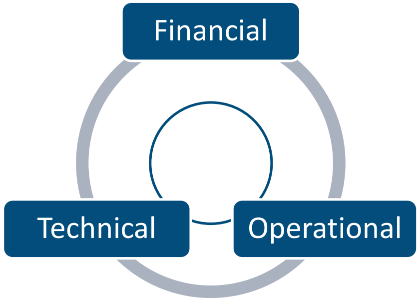
Which is the point in time that any business written before that have no choice but to apply the FVA?

Transition Planning

- **Strategically prioritize** certain blocks for further analyses
  - Which product types?
  - How many cohorts?

Which products and which cohorts do you really have a choice between MRA and FVA?

- Make timely strategic decisions
  - Strategic goals
  - Accounting choices (e.g. MRA vs. FVA)
  - Level of technical risks retained
  - Level of flexibility retained



- Engage with the **auditor** at an appropriate time

- Execution, external communications, etc.

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