Session 32: Impact of IFRS 17 on ULSG Products

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Impact of IFRS on ULSG Products

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IFRS 17 – Introduction, Challenges & Opportunities

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MAY 2019

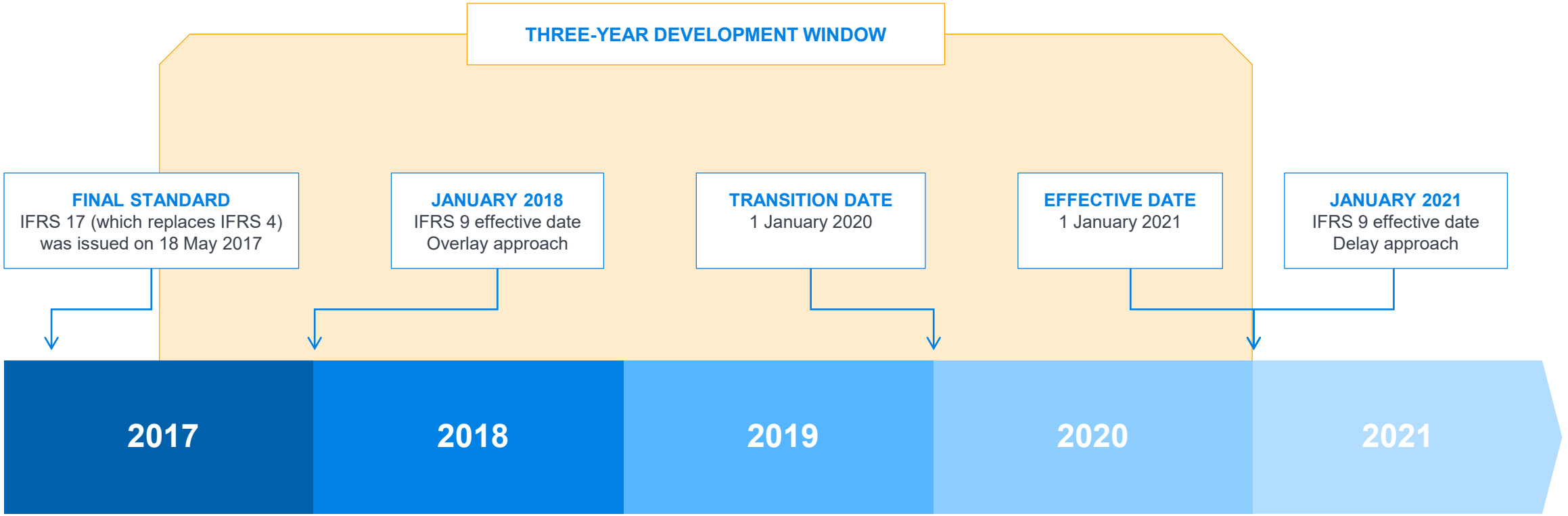
Milliman

Agenda

1. **Introduction to IFRS 17**
   i. Scope and unit of account
   ii. Measurement models
2. **Presentation and profit patterns**
   i. Examples of UL with Secondary Guarantee
   ii. Link with IFRS 9
3. **Link with local regulatory and other valuation regimes**
4. **Challenges of IFRS 17**
   i. Change of the target operating model

Introduction to IFRS 17

Time lines IFRS 17 and IFRS 9



Scope and Unit of Account

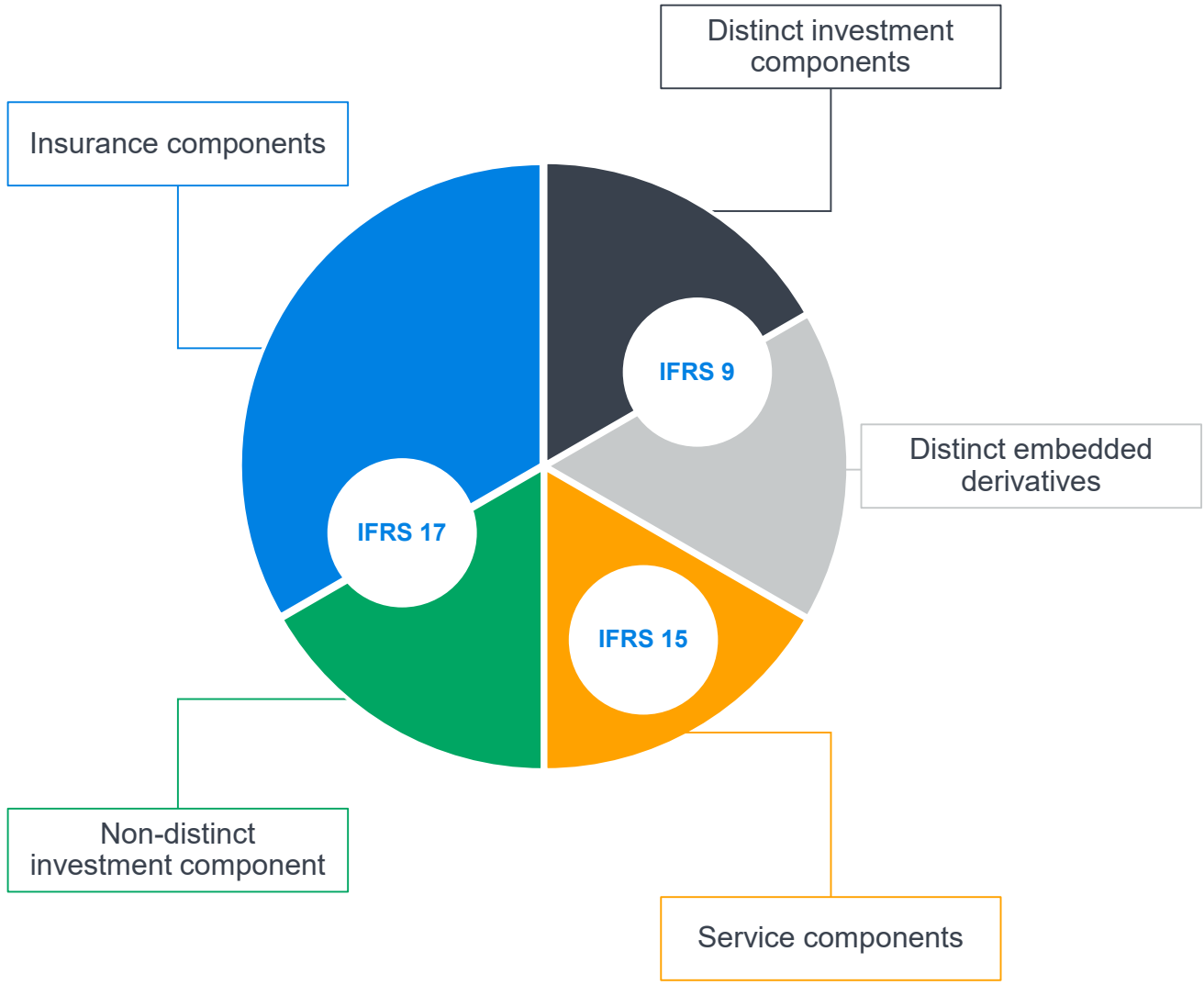
What and how is IFRS 17 applied to

Scope of IFRS 17: Mostly unchanged from IFRS 4

- Applies to:
  - Insurance and reinsurance contracts issued
  - Reinsurance contracts held,
  - Investment contracts with discretionary participation features
- Does not apply to:
  - Warranties or residual value guarantees provided by manufacturer, retailer
  - Employer provided benefits
  - Contingent payments on non-financial items
  - Financial guarantee contracts
  - Policyholder accounting other than reinsurance ceded
- Optionally applies to fixed fee service contracts (or can apply IFRS 15 – Revenue)

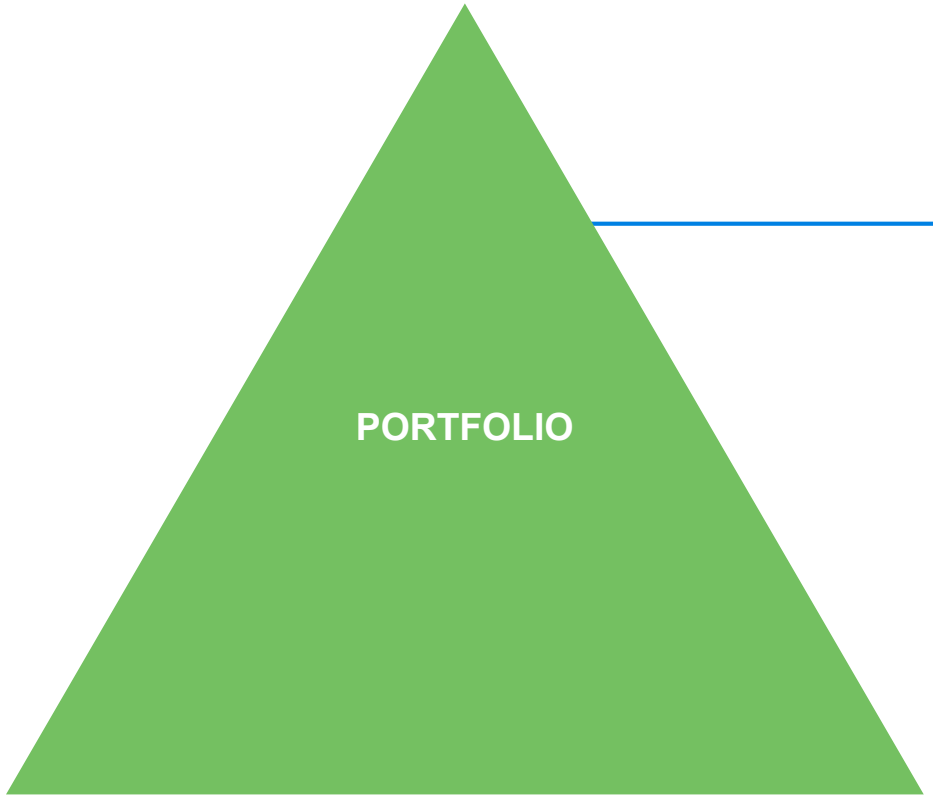
Bifurcation - Investment components

- Distinct investment components should be separated from the host insurance contract unless highly interrelated
- A distinct investment component is sold or can be sold separately
- An insurance contract and investment contract are highly interrelated if:
  - It is not possible to measure the one without considering the other; or
  - The policyholder is unable to benefit from one component unless the other is also present
- Promises to transfer distinct goods or non-insurance services to the policyholder – apply IFRS 15



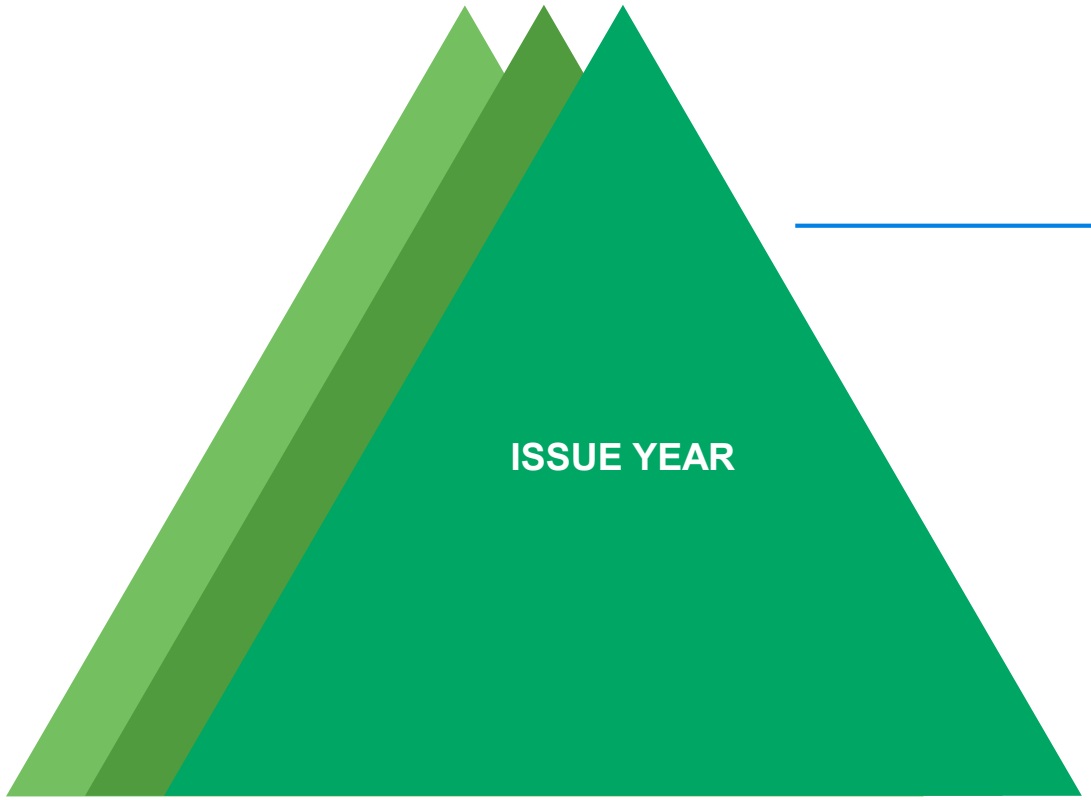
Level of Aggregation

Start at the portfolio level



Contracts that are subject to similar risks and managed together

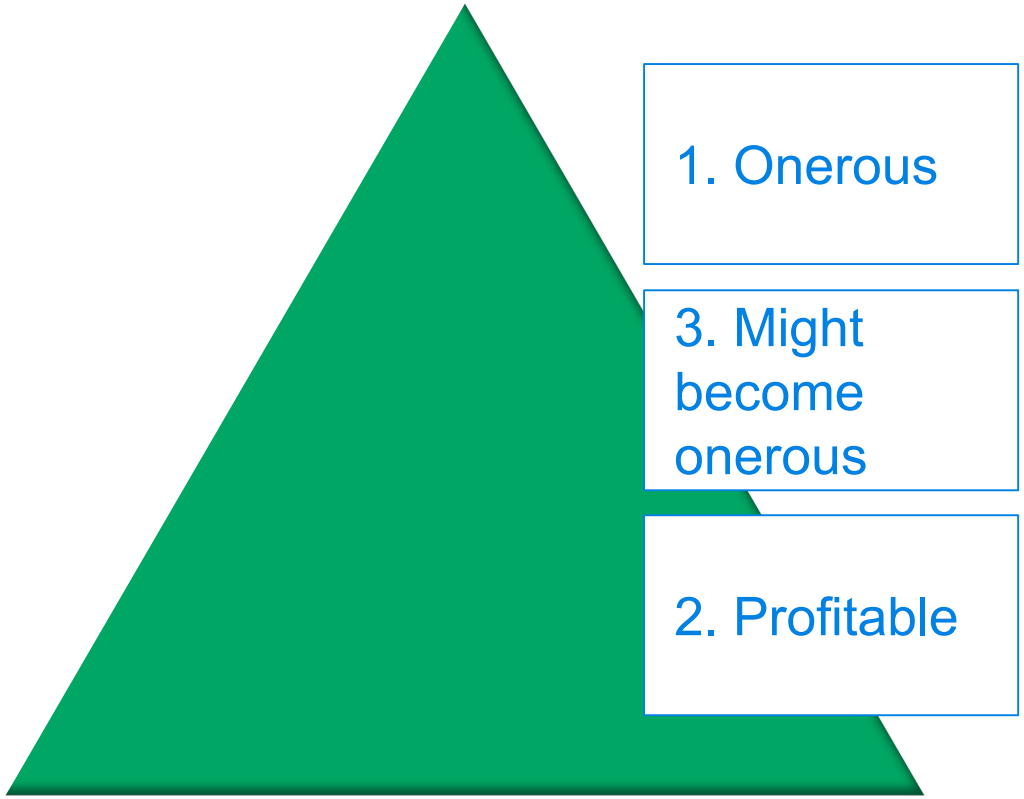
Level of Aggregation – Yearly Cohorts



Contracts issued more than 1 year apart cannot be in same group

Level of Aggregation – Minimum Grouping

3 groups minimum for each issue year within a portfolio



Exception

A legal or regulatory restriction on entity's ability to reprice the product.

Can include in same group

Key issue

Assessing significant possibility of becoming onerous

Groups of contracts are the unit of measurement used in IFRS 17

Measurement Models

Introduction – Measurement Approaches

There are three measurement approaches in IFRS 17, depending on the type of insurance contracts:

GENERAL MODEL
(aka Building Block Approach or BBA)

Default valuation approach

VARIABLE FEE APPROACH
(VFA)

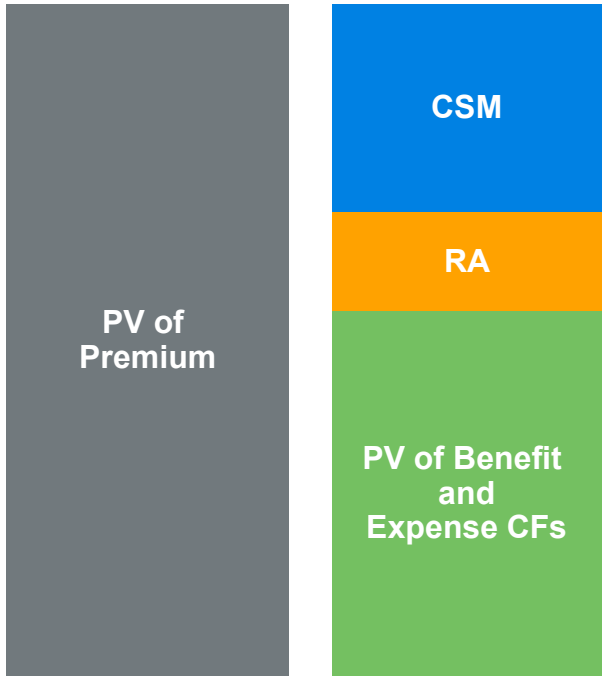
Approach for contracts with direct participation features (e.g. unit-linked, with-profit contracts)

PREMIUM ALLOCATION APPROACH
(PAA)

Simplified approach for short duration contracts (coverage period up to one year)

General Model (aka Building Block Approach or BBA)

Initial Calibration of General Model



- Contractual Service Margin

Represents unearned profit to be recognized as it provides the services in the future.

- Risk Adjustment

Adjustment equal to entity's required compensation for bearing uncertainty in underlying cash flows from non-financial risk.

- Present Value of Best Estimate of future cash flows

Present value of best estimate cash flows to fulfill the contract within the contract boundary; discounted at rates that reflect characteristics of the liability including timing, currency and liquidity.

Best Estimate - Future Cash Flows

Objective: Estimate the expected (mean) present value of future cash flows

- Best estimate cash flows under all possible scenarios based on conditions as of the reporting date – captures the time value of options and guarantees
- Incorporate in unbiased way all reasonable and supportable information
- Reflect perspective of the entity as long as market variables are consistent with observable market prices for those variables

- Only include cash flows within the boundary of the contract
  - As long as the company can compel the policyholder to pay the premiums or has a substantive obligation to provide the policyholder with coverage
  - Until the company has the right or the practical ability to reassess the risks by changing the price or level of benefits
- Only include cash flows directly attributable to insurance contracts – excludes general overhead expense.
- May estimate cash flows at a higher level of aggregation than group of contracts

Best Estimate - Discount Rate

The discount rates applied to the estimates of the future cash flows shall:

a. reflect the time value of money,
b. reflect the characteristics of the cash flows,
c. reflect the liquidity characteristics of the insurance contracts
d. be consistent with observable current market prices for financial instruments with cash flows whose characteristics are consistent
e. exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts

- If cash flows are not dependent on underlying items – can use top down or bottom up approach
- If cash flows are dependent on underlying items (VFA) – discount rates need to reflect the variability of the cash flows
- Own credit risk should be disregarded
- Weighted average discount rates per annum (underwriting year) are acceptable

Discount Rate - Top down or Bottom up

BOTTOM UP	
Risk "free" rate	Swap rate, Government bonds or Corporate bonds in relevant currency and without credit risk
Illiquidity premium	Dependent of variability of cash flows; ▪ Predominantly longevity risk ▪ Policyholder options: surrender values ▪ Tax regime Not directly observable. Several methods to determine the illiquidity premium on assets.
TOP DOWN	
Reference portfolio	Same characteristics as liability - currency, cash flows (timing, level, variability)
Exclude market risk premiums for credit risk, which are relevant only to the assets included in the reference portfolio	Possible approach: price of CDS for expected and unexpected credit risk Fundamental spread approach from Solvency II
Correct for other differences necessary	e.g. different liquidity

Use observable inputs if available – otherwise adjust for differences or use an estimation technique (e.g., use last liquid point, assume constant forward or spot rate)

Risk Adjustment

- Adjustment to PV of cash flows to reflect compensation entity requires for bearing uncertainty as to amount and timing of CFs due to non-financial risk
  - Financial risk is reflected in cash flows or in discount rate and not in the RA
  - Non-financial risk includes insurance risk and other risks such as lapse and expense risk
- Only reflects risk arising from insurance contracts; not general operational risk.

- Reflects degree of diversification the entity includes when determining the compensation to require. For measurement on a more granular level it will be necessary to allocate the amount of diversification (marginal approaches, game theory)
- Reflects both favorable and unfavorable outcomes in a way that reflects the entity's degree of aversion to risk.

- Key: A higher risk adjustment means a lower CSM and vice versa.

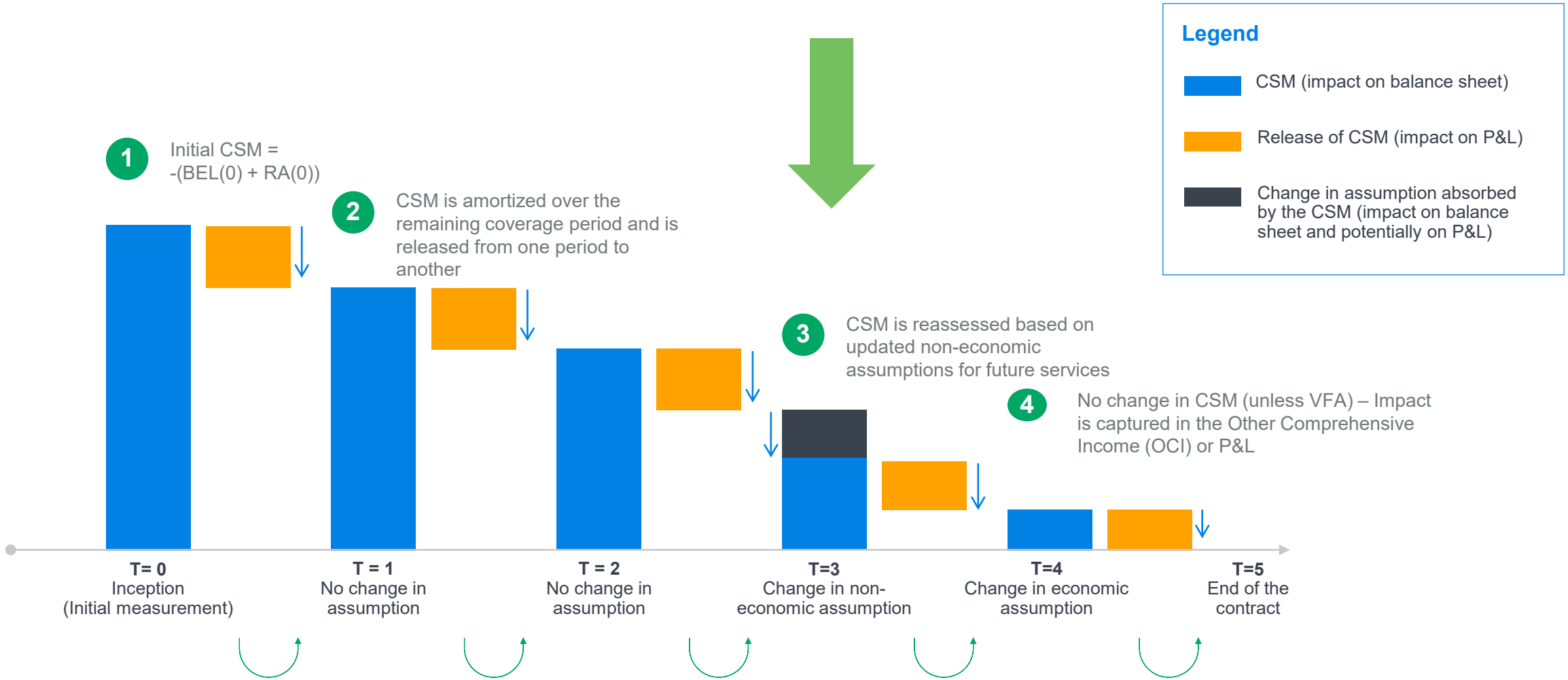
Criteria for Risk Adjustment method

- No requirements about the confidence level or horizon. To be determined by the company.
  - Risks with low frequency/high severity should have higher risk adjustment than risks with high frequency/low severity
  - For similar risks, contracts with longer durations should have higher risk adjustments than shorter duration contracts
  - Risks with a wider probability/heavy tail distribution will have a higher risk adjustment than risks with narrower probability distributions
  - The less that is known about the current level and trend, the higher the risk adjustment
- To the extent that emerging experience reduces uncertainty about the amount and timing of cash flows, risk adjustments will decrease and visa versa
- Need to disclose confidence interval associated with risk adjustment if use another method. One possible approach is to benchmark with the Solvency II SCR (99.5% percentile) and assume normality (99.5% percentile ~ 2.58 x SD)

Contractual Service Margin

- An amount that reflects the excess of the consideration charged for the contract over the risk-adjusted expected present value of the fulfilment cash outflows.
- The contractual service margin is a measure of the service the entity would perform in fulfilling the contract. Accordingly the entity would not recognise the excess as an immediate gain, but would instead recognise that gain over time as the entity satisfies its obligation to provide service over the coverage period.
- The contractual service margin can not be negative.
- Amortized over coverage period in proportion to service provided (insurance coverage or benefits).
- CSM released in year t = (expected release of coverage units in year t) / (sum of expected coverage units in all years)
- CSM unlocked for changes in estimates of future cash flows related to providing future service that derive from non-financial risks.
- CSM not unlocked for changes in discount rates

General Model: Contractual Service Margin



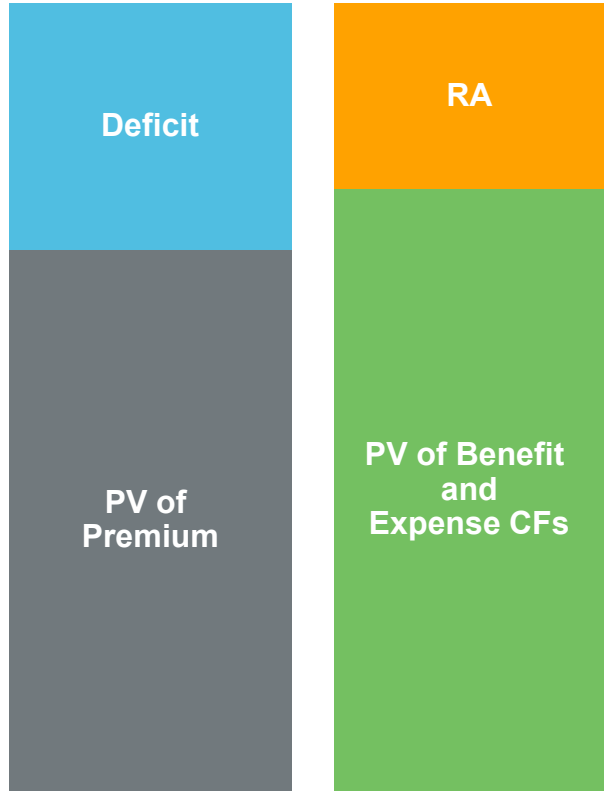
Onerous Contracts

At inception

- A contract can be onerous at inception. In that case the deficit is recognized as a loss.

During the lifetime of a contract

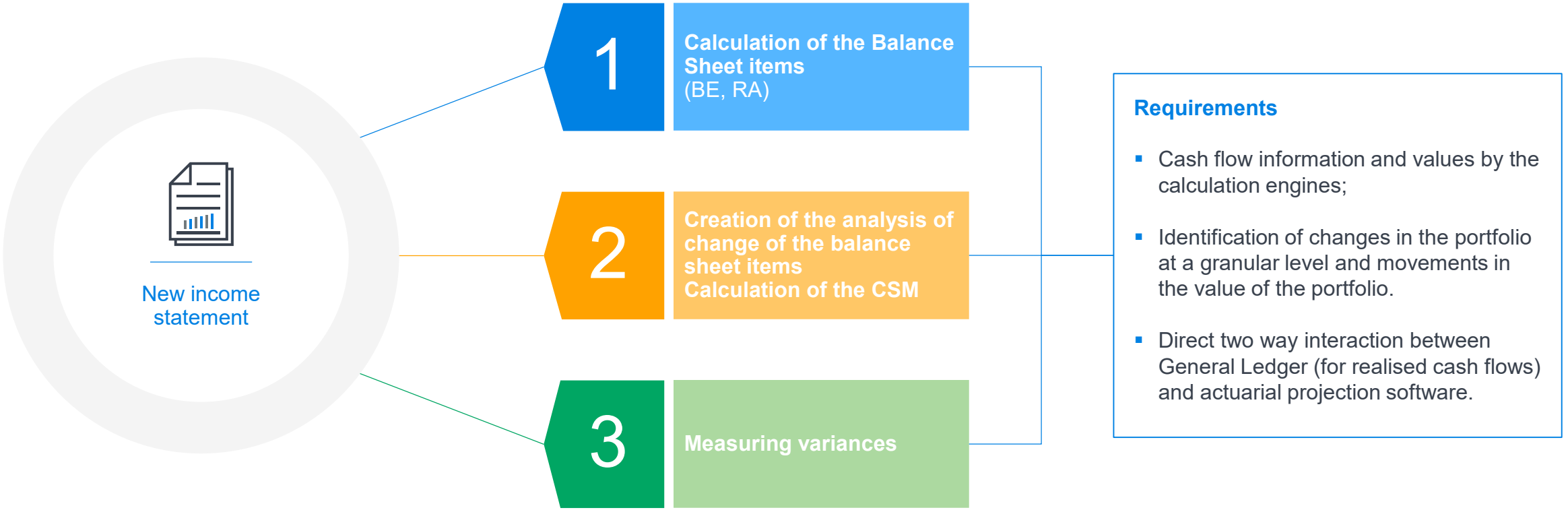
- During the lifetime of a contract the CSM can decrease to zero due the unfavourable changes in the fulfilment cash flows. The change is recognized via CSM until it is depleted.
- Additional losses are recognized as losses and off balance a negative CSM is administered. If the contracts becomes profitable again due favourable changes in the fulfilment cash flows, first the recognized losses need to be earned back. When the losses are earned back a new CSM can be created.



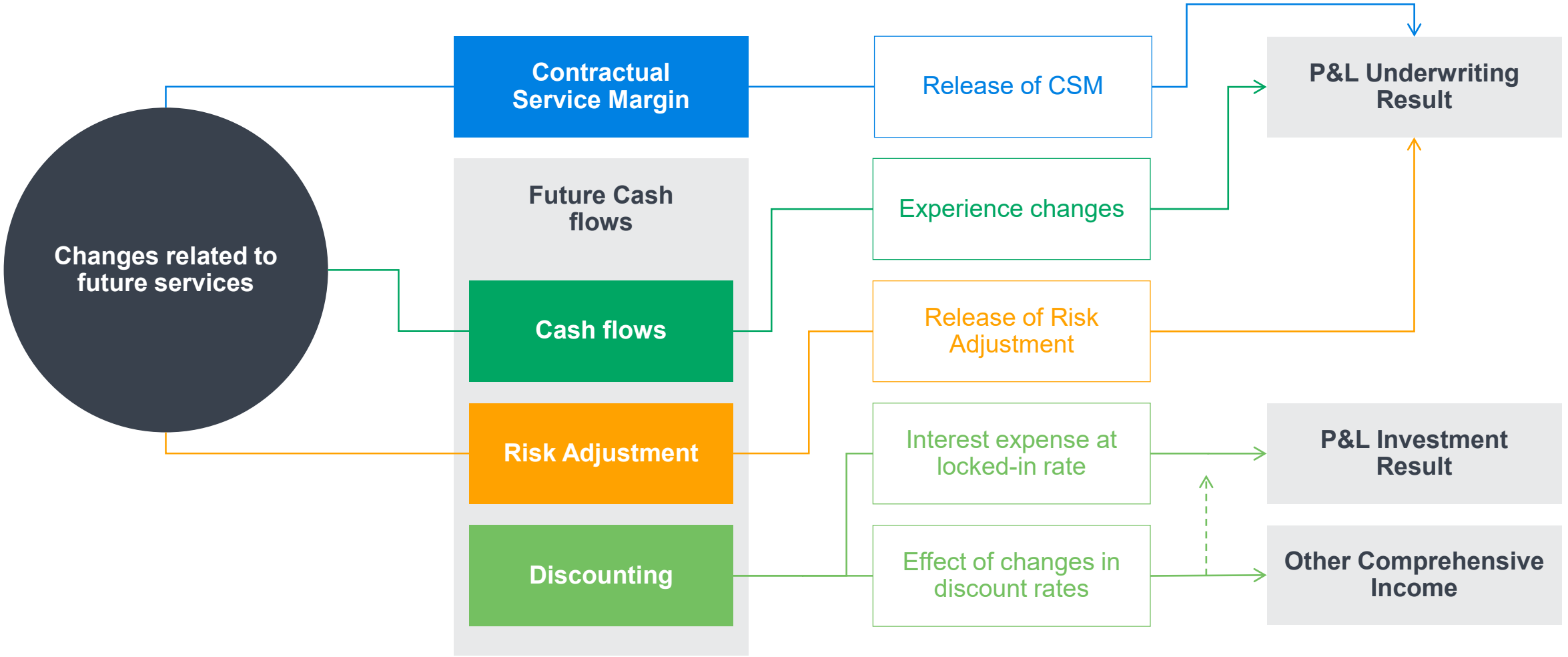
Presentation and Profit Patterns

About IFRS 17
Balance sheet and income statement components

To construct the new income statement “requires” a three step approach



Subsequent Measurement & Impact on P&L



Link with IFRS 9

IFRS 9 – deferral approach

- Insurance companies are allowed to defer the introduction of IFRS 9 to 1 January 2021
- The following requirements apply:
  - they have not previously applied IFRS 9; and
  - they have activities that are predominantly connected with insurance
- Each (solo and group) reporting entity has to assess the applicability of the requirements
- A consolidated group can be allowed to defer where a subsidiary is not
- Predominantly connected with insurance:
  - the amount of its insurance liabilities is significant compared with its total amount of liabilities; and
  - the percentage of its liabilities connected with insurance relative to its total amount of liabilities is:
    - greater than 90 per cent; or
    - less than or equal to 90 per cent but greater than 80 per cent, and the company does not engage in a significant activity unconnected with insurance

IFRS 9 – Business Model Test for financial assets

- FVOCI is an option for solely principal and interest instruments like bonds and loans
- Classification can be made on an instrument-by-instrument basis

Accounting mismatch – analysis

Valuation of financial assets	Valuation of insurance liabilities
Premium allocation approach ▪ Amortized cost and FVOCI	Premium allocation approach ▪ No discounting
General model ▪ FVOCI ▪ FVP&L ▪ Amortized cost and FVOCI	General model ▪ Discounting through OCI and roll forward P&L ▪ Discounting and roll forward P&L ▪ No discounting (short term claims reserves)
Variable fee approach ▪ FVP&L	Variable fee approach ▪ FVP&L, but CSM will absorb significant part of the change of the variable fee. Option to use P&L.

Actual <> Required investment income Accounting mismatch

The OCI has been introduced to reduce the accounting mismatch in the income statement between the insurance liability measurement and related assets recorded at either amortized cost or FVOCI:

- Volatility in the income statement is expected to decrease significantly in comparison with statutory income statement.
- The income statement investment margin rely materially on assumptions at inception while the balance sheet is based on current assumptions. This may result in changes in spreads from inception being recognized only as they are realized.

However, accounting mismatches may not be entirely eliminated due to

- Future reinvestment / divestment of future net cash flows (in particular premiums) at a future rate which may not be in line with lock-in rate at inception;
- Assets classified at FVPL (although there will be technics to solve this) ; and
- Impairment impacts on assets.
- In that case the effect of changes of the discount rate better go through P&L via the investment income instead of via OCI.

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Life & Annuity Symposium

Impact of IFRS 17 on Universal Life with Secondary Guarantee

Alexandre Lemieux

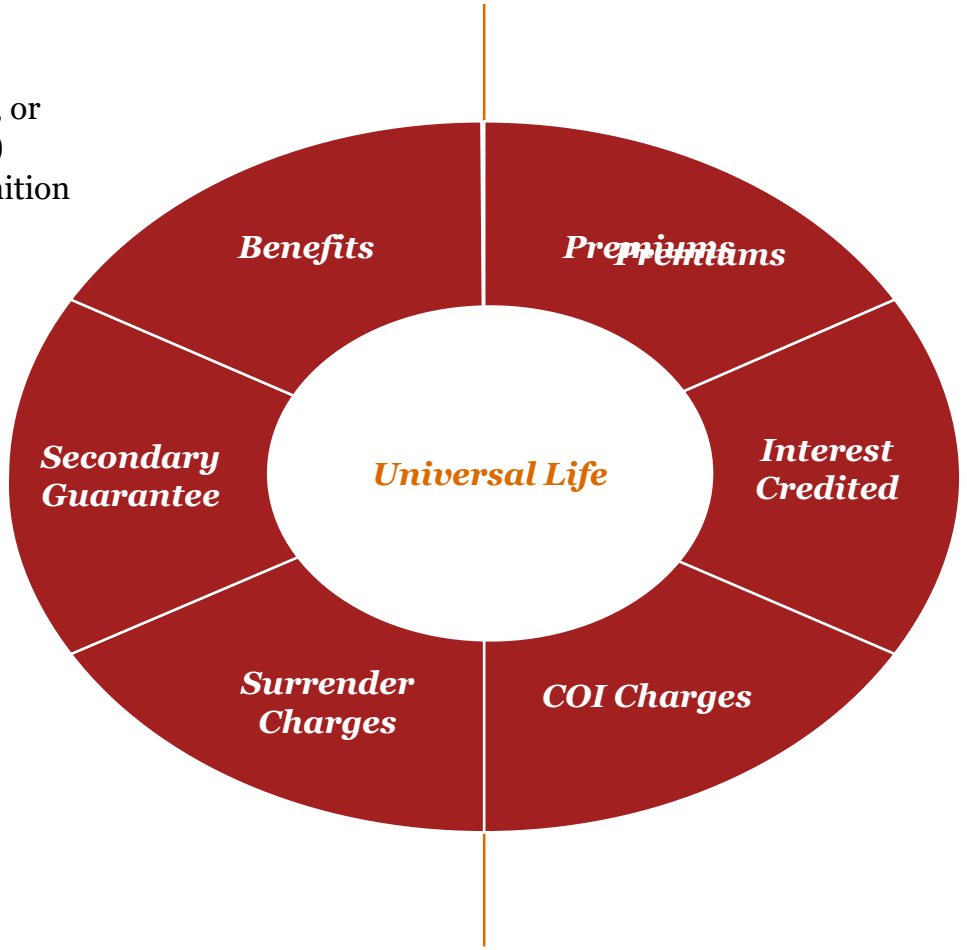
pwc

What is Universal Life with Secondary Guarantee?

Benefits
- Death benefits can be level (Option A), or increase with account value (Option B)
- Death benefit amount must meet definition of insurance (IRS guidance)

Secondary Guarantee Benefit
- Mechanism to ensure policy does not lapse from lack of surrender value — even if the cash surrender value becomes negative
- Specified Premium, or Shadow Account

Surrender Charges
- Fee applied to the account value upon cancellation of the policy
- Back end load that can be a flat fee or can gradually decrease over time



Premiums
- Flexible premiums are varied in amount and timing
- Premiums are used to pay the cost of insurance and build up cash value

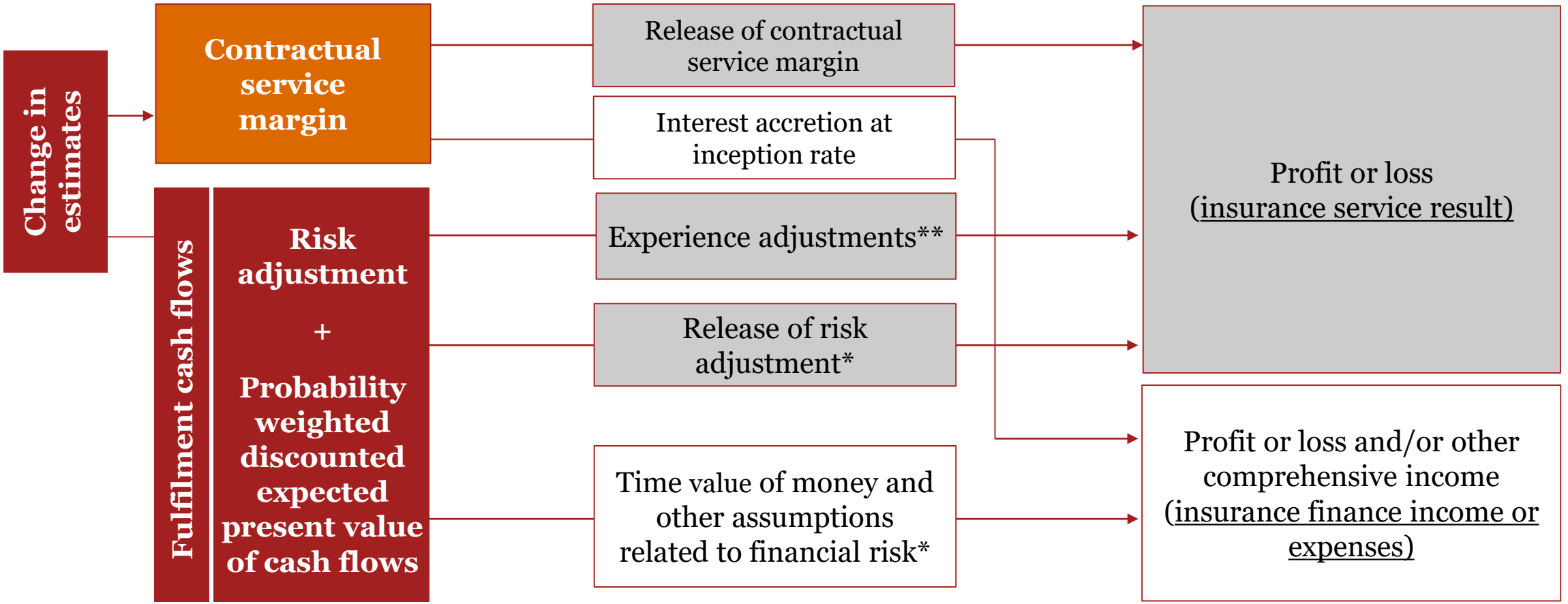
Interest Credited
- Based on company discretion and investment portfolio performance
- Fixed account UL is protected by a minimum guaranteed interest credited rate

Cost of Insurance (COI) Charges
- Includes charges for mortality and other direct expenses
- Typically calculated as a rate times the net amount at risk
- Rates are either current or guaranteed

Accounting Treatment under US GAAP

Deferred Acquisition Costs ("DAC") (ASC 944-30)	DAC asset reduces first year strain of writing new business by allowing the expenses associated with writing a new policy to be recognized over the lifetime of the policy. DAC is amortized over the estimated gross profits ("EGPs").
SOP 03-1 (ASC 944-605)	SOP 03-1 liabilities are held for Secondary Guarantee benefit features that lead to profits for the company in the early years followed by losses in the later years.
SFAS 97 (ASC 944-40) - Account Value, Unearned Revenue Liability ("URL")	Benefit reserves consist of the policyholder account value and an Unearned Revenue Liability ("URL"). URL accounts for front-end loads and/or excess COI charges.

Building Block Approach under IFRS 17



* Accounting policy choice for future cash flows and risk adjustment.
** Experience adjustments for premiums to CSM.

Comparison

	US GAAP	IFRS 17
Cashflow	Required to fulfil the contract	Required to fulfil the contract
Assumptions	Unlocked	Unlocked
Discount Rate	Contract rate or investment yield expected at the issue of the contract	Reflects characteristics of the cash flows arising from the insurance contract
Risk Margin	Not applicable (implicit)	Explicit risk margin
Level of Aggregation	Grouped consistent with acquiring, servicing, and measuring profitability	Subdivided by onerous, non-onerous and remaining contracts into annual cohorts
Liability	AV plus SOP 03-1 liability that accrues the ultimate expected benefits over time.	Fully reflected cost of all options and guarantees embedded in the contract, similar to a fair value measurement. Implicit deferral of current premiums into future through GPV reserve valuation.

How would Income Statement change…

Revenues
Gross written premiums
- Premiums ceded to reinsurers
Net written premiums
+ Net change in reserves for unearned premiums
Net earned premiums
+ Management fees and other related revenues
+ Net investment result
+ Net capital gain/(loss) and impairments on investments
+ Net gain/(loss) on divestments of businesses
+ Other income
Total revenues
Benefits, losses and expenses
Gross insurance benefits and losses
- Less ceded insurance benefits and losses
Net insurance benefits and losses
- Net policyholder dividends and participation in profits
- Net underwriting and policy acquisition costs
- Administrative and other operating expense
- Interest expense on debt
- Interest credited to policyholders and other interests
Net income before tax

Revenue consists of the following:
- Expected claims and benefits
- Expected expenses
- Acquisition cost amortization
- Release of risk adjustment
- Amortization of CSM

Premiums due or written prohibited.

Insurance contracts revenue	x
Incurred claims and expenses	(x)
Gross underwriting result	x
Investment income	x/(x)
Interest expense on insurance liability	(x)
Investment result	x
Profit or loss	x

Illustrative Example

Best Estimate Annual cash flow were used to produce results for Inforce Business (issue year 2009) and New Business under US GAAP and IFRS 17 framework.

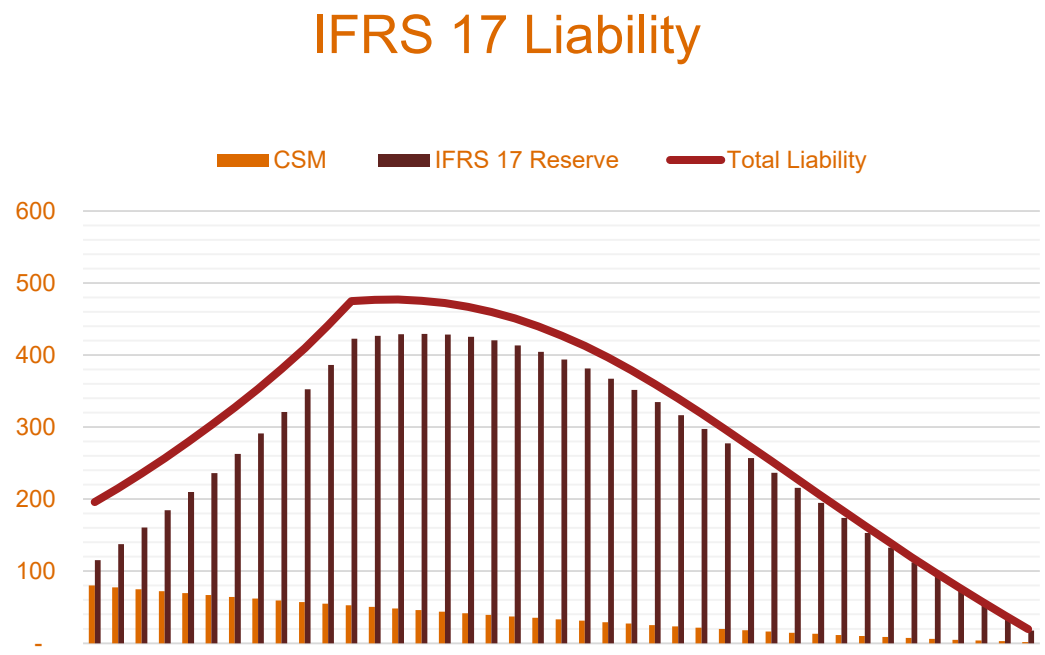
US GAAP

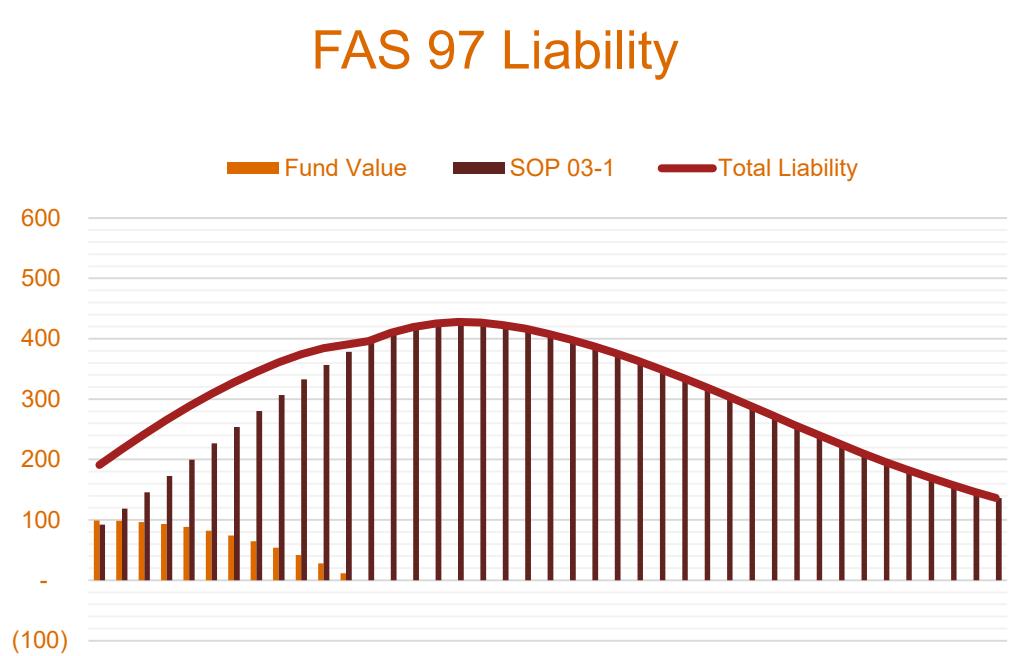
- Best Estimate cash flows
- For simplicity, deferred acquisition expenses are set to equal front-end loads.

IFRS 17

- Best Estimate cash flows
- Risk Adjustment = 10% increase to death benefits and expenses
- Fair Value = calculated using Actuarial Appraisal method
- Discount rate = Top down discount rate

Total Liability - Inforce Block





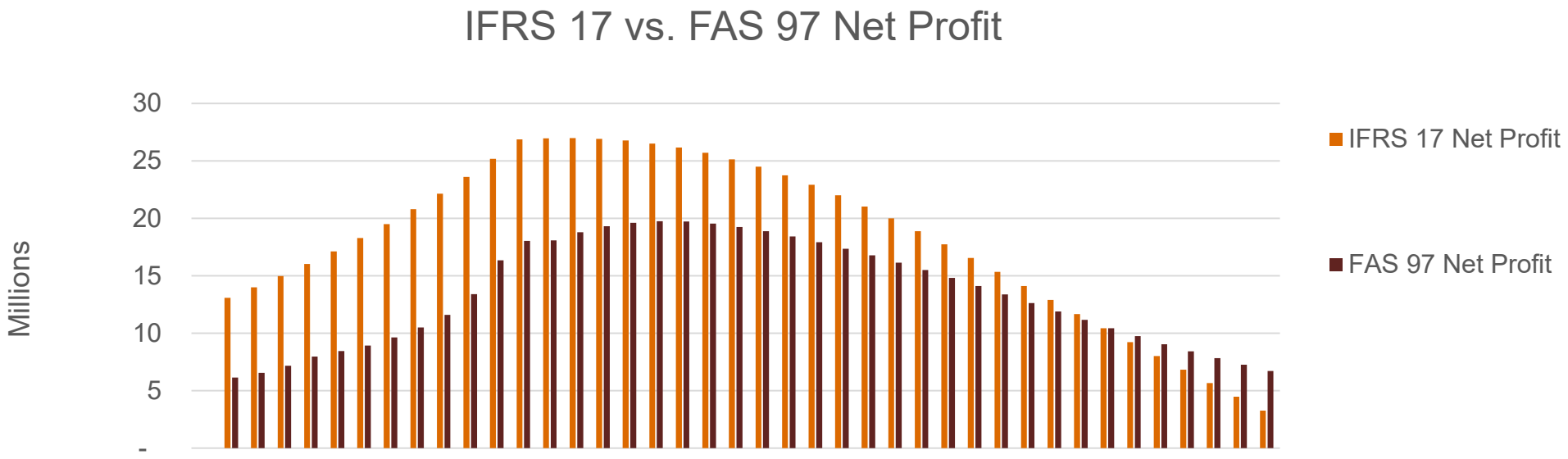
The methodology and assumptions underlying the fair valuation of the product will drive the amount of liability as well as the size of the CSM for the product. In our example, we achieve a higher CSM at transition though higher overall liabilities in the future.

The incorporation of the Risk Adjustment as well as a lower discount rate (as compared to the SOP) increase liabilities compared to current US GAAP

Inforce Business Impacts

- The methodology and assumptions underlying the fair valuation of the product will drive the amount of liability and more importantly the size of the CSM for the product.
- This allows companies to potentially recapture prior period profits though it did result in larger overall liabilities (the larger the CSM, the larger the transition impact)
- The reserve is further increased by including a Risk Adjustment of 10% as well as a lower discount rate (as compared to the SOP)

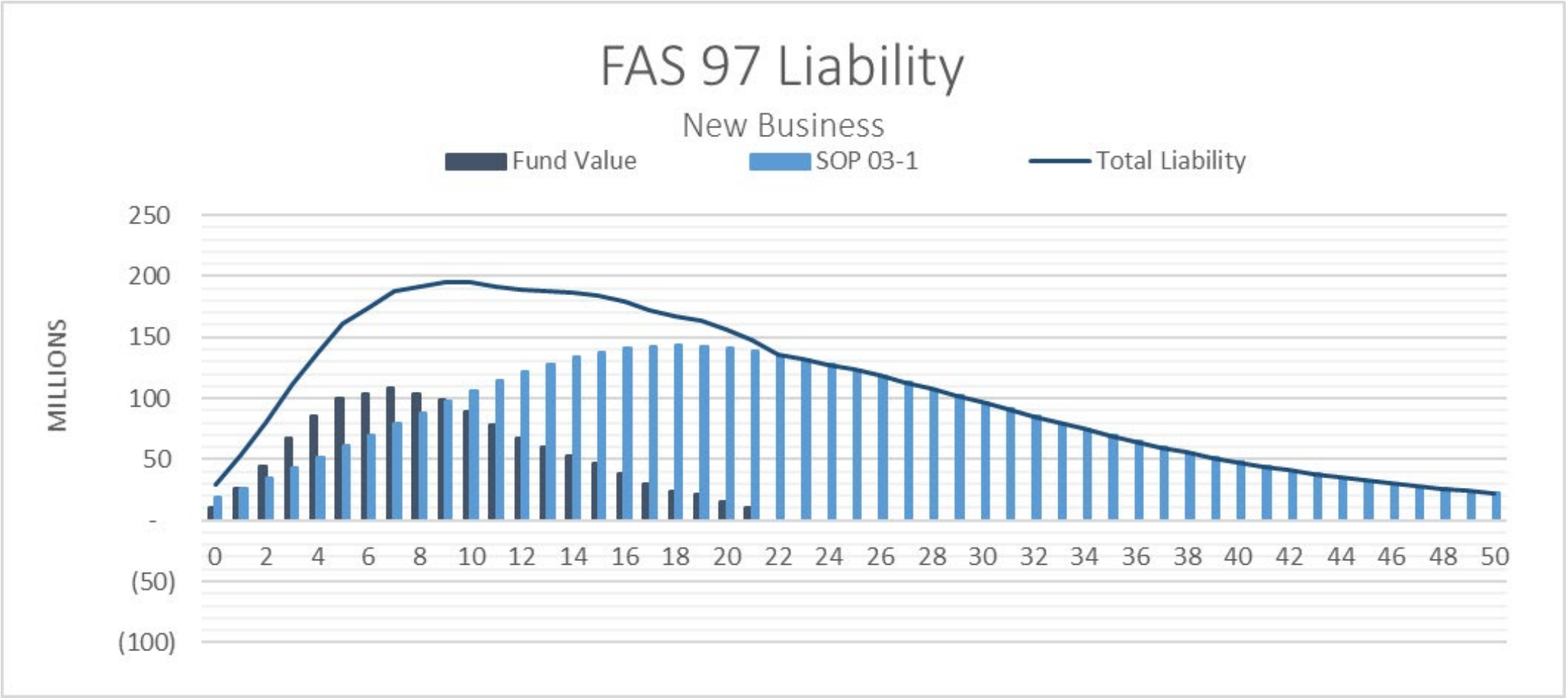
Profit Emergence - Inforce Block



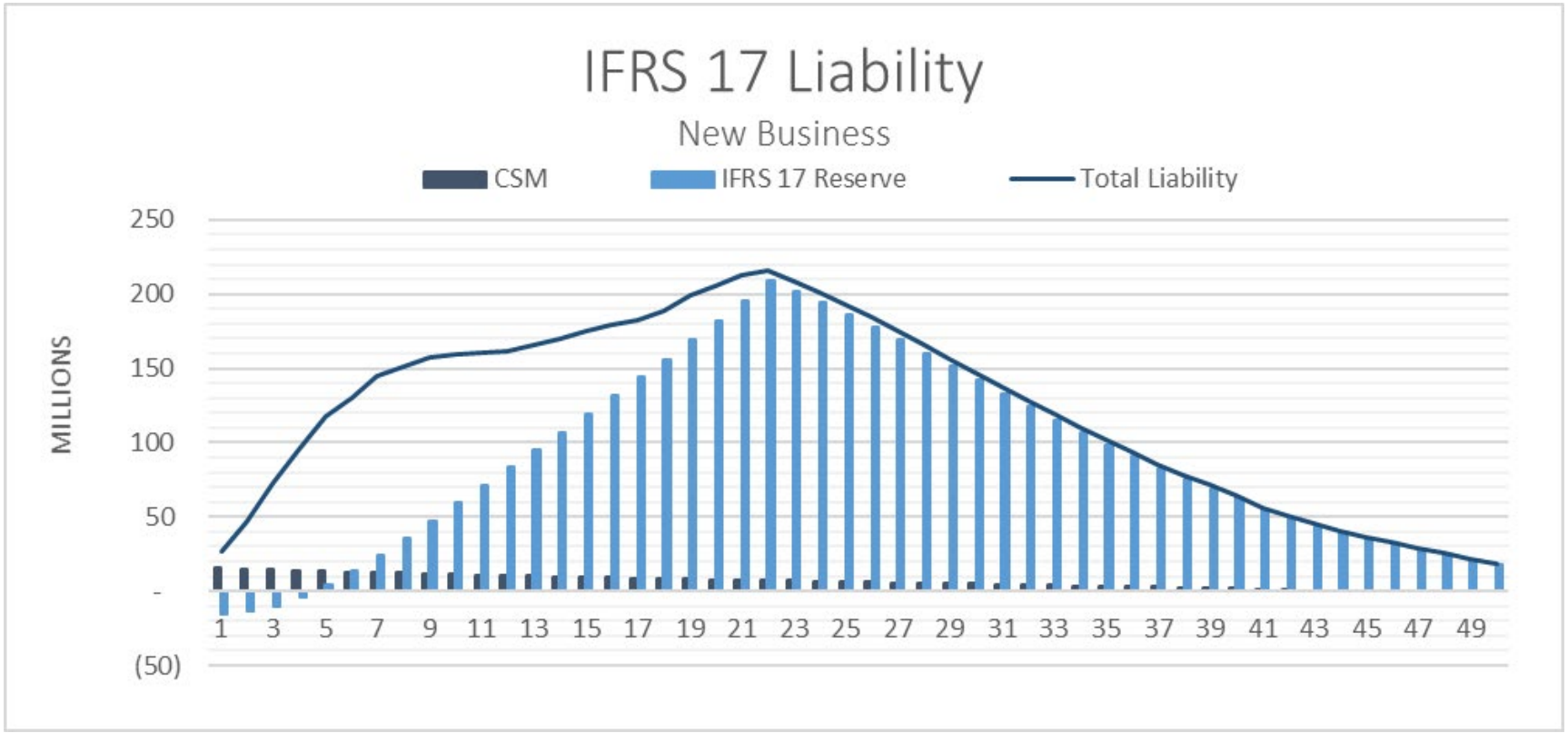
IFRS17—
Due to our work to increase the CSM at issue we generate higher overall profits as compared to FAS97
Further source of profit is generated by releasing the risk adjustment component of the reserve which is not included in the FAS97 amount

**The pattern of profit emergence reflects a scenario where there are no changes to assumptions or discount rate, and actual cash flows are exactly equal to expected at inception.*

Total Liability - New Business



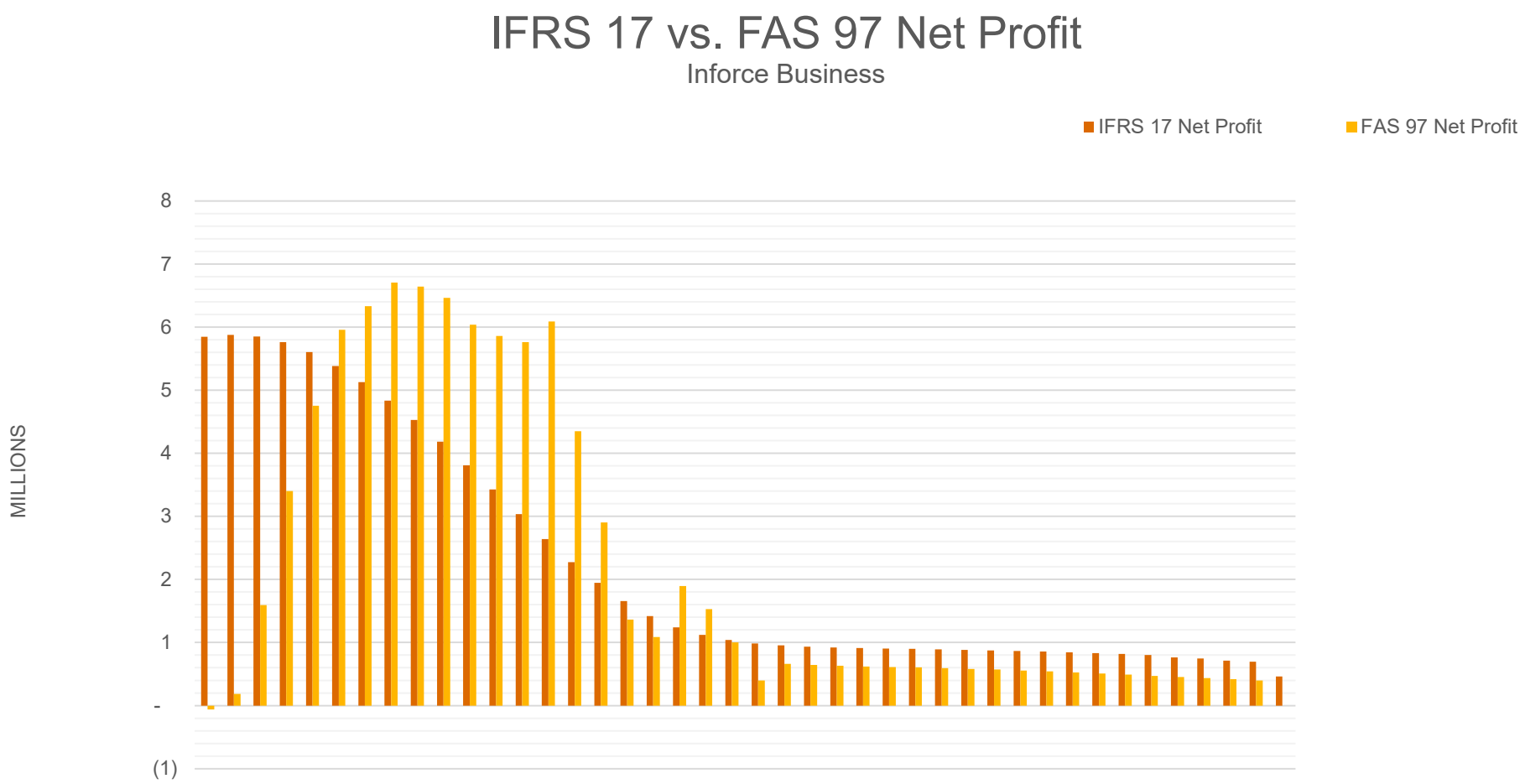
Total Liability - New Business



The incorporation of the risk adjustment and the lower discount rate results in a net higher liability for new business as opposed to current GAAP.

The reserve peak under IFRS17 is at the moment the account value runs outs reflecting the period of increased risk.

Profit Emergence - New Business

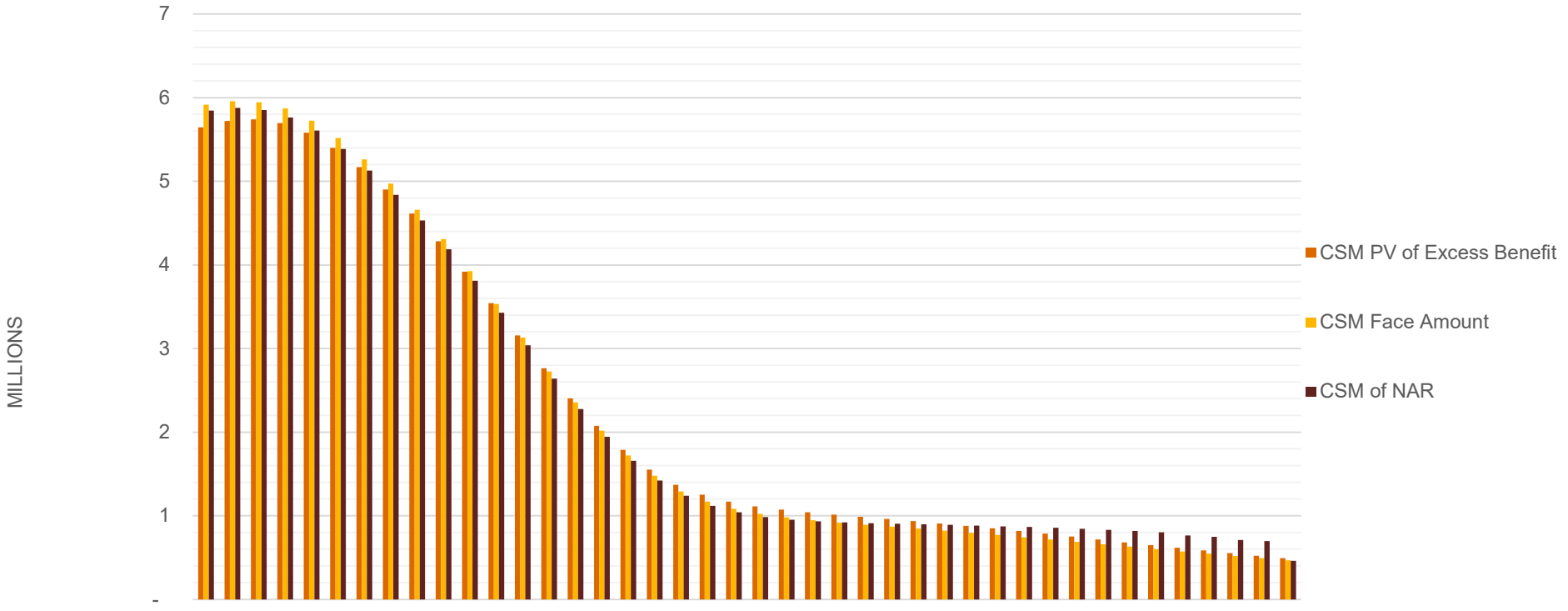


IFRS17 New Business Impact

Accelerated profit emergence

- Under US GAAP, the investment margin is recognized as it is earned. For IFRS 17, part of the investment margin is included in the CSM given that an asset-based discount rate is used for discounting cash flows
- Assuming that the CSM is amortized in proportion to the net amount at risk (NAR), the recognition of the investment spread will accelerate compared to US GAAP.
- IFRS 17 will mitigate some amount of volatility stemming from changes in non-financial cash flow estimates and changes in discretionary components

CSM Amortization Method



Generally speaking using the PV of excess benefit slows down CSM amortization while using face amount maximizes recognition

Challenges of IFRS 17 Lead to New Target Operating Model

Product classification

- It is required to identify and categorize the different product groups.
- The categorization is an ongoing activity

Aspects:

- Unbundling of investment and insurance components
- Participating and non participating contracts (different types)
- Onerous, possibly onerous and non onerous contracts
- Grouping of products in the case of the modified approach

Business issues

- Develop a clear set of criteria and a decision tree for the product classification
- Ideally develop an IT solution for the classification
- Product information may need to be stored on a granular level in order to monitor the variances and movements
- Grouping of model points must lead to homogeneous profitability groups (no mix up of profitable and onerous contracts)
- Monitor and analyze the development of the portfolio between reporting moments

Direct participating features

There are fundamental differences in the revenue statement of direct participating and non-participating contracts

- Non-participating contracts will lock-in the discount rate used to determine the CSM at inception of the contract. An amortized interest rate cost, using this locked in discount rate, must be reported in P&L
- For direct participating contracts, it will be possible to unlock this discount rate, to reflect the fact that higher participation payments are related with a higher expected investment return. The way this is done depends heavily on:
  - the nature of the participation features
  - the IFRS measurement of the corresponding asset portfolio

Business issues

- Products need to classified as participating or non participating
- The valuation of the participating feature and its development
- Determination of the methodology and the required information to determine the components for the revenue presentation.

Valuation - Methodology

- IFRS 17 is principle based and companies need to develop a company specific methodology which is compliant
- The way that the discount rate, Risk Adjustment and CSM are defined will determine :
  - how future profits will be released over time;
  - how and when a contract becomes onerous, with all future losses to be booked at once in P&L

Business issues

- A successful implementation requires a lot of interpretation of the principles
- Analysis of the portfolio and its features,
- Although the valuation is forward looking information from the past is necessary to determine the Contractual Service Margin (CSM) and the classification of the results

Valuation - Assumptions

- The assumptions used in the projections need to be current and best estimates. On the other hand there will be strong preference for stability of the assumptions.
- The choice of the assumptions should capture the current view of future trends in order to avoid too much fluctuation of the technical provision.

Business issues

- The assumptions need to be set on a sufficiently granular level, but should be stable. Too small groups of products may lead to undesired volatility
- The allocation of expenses to the products and into the relevant phases of a product is a process that many companies have done. For IFRS it requires to carve out the overhead expenses and to assess the stability.
- The assumption setting process needs to be formalised

Valuation - Discount rate

- The discount rate used for the valuation of the best estimate, CSM and risk adjustment needs to be consistent with observable market prices of financial instruments comparable with the cash flows of the insurance liabilities.
- This leaves the company with sufficient freedom to determine the discount rate. Instead of comparability between companies, this will lead to differences and difficulties for financial analysts.
- The discount rate will definitely be different from the discount rate of Solvency II
- The locked in discount rate (at inception) will be used to unwind the technical provision and the amount will be reflected in P&L. The update of the discount rate and its effect will be reflected in P&Lor other comprehensive income.

Business issues

The selection of the discount rate is important for:

- The management of the mismatch between assets and liabilities.
- The determination of the scenario sets for the calculation of the stochastic components of the technical provision like the Time Value of Financial Options and Guarantees
- The level of the CSM at the start of the contract or per the first application date
- A high historical discount rate for the unwind of the CSM will lead to a higher cost to be reflected in the insurance finance result

Valuation - Contractual Service Margin

- The CSM is created at inception of the contract and released over duration of the contract. The release is presented in profit and loss.
- In the case of a negative evolution of the contract, the financial impact is absorbed in the CSM.
- For onerous contracts the CSM is set to zero.
- All accumulated losses from the moment that the CSM is set to zero are registered. In the case of a positive evolution first the accumulated losses need to be off set.
- Companies need a methodology to determine drivers (coverage units) for the development of the CSM.

Business issues

The determination of the CSM and its development need to be registered at a unit of account level:

- There are products that given their nature will have frequent changes, like universal life products or products where the benefits follow some index (not being unit linked). It will be difficult to determine the CSM for the subsequent premiums.
- The CSM for group contracts may be difficult to determine given the nature of those products with new entrants/employees and people leaving the company.
- Segmentation of the portfolio per reporting moment including the development of the CSM. This may lead to reclassification of the portfolio between onerous and not onerous.
- A large group has to stabilize the development of the CSM, but it will become more important to monitor the sensitivity of the CSM for development of the portfolio. For instance if a subportfolio with a positive CSM compensates an onerous subportfolio. If there is significant lapse in the subportfolio the compensating effect may become insufficient.

Valuation – Risk Adjustment

- The risk adjustment is defined as being the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract.
- The risk adjustment methodology can be based on the perspective on risk of the insurer.
- Note that a higher risk adjusment means:
  - a lower CSM, which absorbes changes in assumptions on future cash flows
  - a higher likelihood that a contract becomes onerous (negative CSM, to be managed in a more complex way than a positive CSM)
  - reduction of the insurance finance expense, because normal changes in the RA can be reflected in insurance service income

<u>Business issues</u>

- The methodology and assumptions need to be determined for the calculation of the RA. It seems logical for European companies to use the Solvency II Risk Margin methodology.
- The entity also needs to define a methodology to determine the confidence interval for the whole technical provision. This is a challenge, given that it is uncommon for life business to determine the distribution of the outcomes.
- The methodology needs to be implemented in projection software.

Valuation – Historical data

Historical data is needed for various purposes:

- Calibration of parameters
- The transition
- Development of the CSM
- Classification of onerous contracts
- Information for revenue presentation
- Information for analysis, comparatives and errors

Business issues

- Information about the changes in the portfolio during the reporting period. Required to construct the income statement
- Historical economic data (scenarios) may not be available

Forecast process and predictability of results

The forecast process is generally based on aggregated models. The current revenue presentation consists of the traditional components like premium income, outflow, expenses and change of reserves.

Business issues

- The set up of the forecast and analysis of the differences between actuals and forecast have to be adjusted to reflect the new presentation
- The models to create the forecast are likely to be adjusted
- The indicators used to measure the performance during the year may need to be changed

Stability and predictability of results is key in creating confidence of analysts and shareholders. Unexpected movements and effects may lead to a negative impact of the share price.

Business issues

- The identification and monitoring of key drivers will help to reduce unexpected effects.
- Via sensitivity testing the key drivers can be identified. This is an ongoing process.
- The forecasting process needs to be sufficiently detailed to capture the key drivers.

Presentation and comparability of results

- There is no prescribed template for the presentation of results and disclosures. Analysts have a strong preference to receive transparent, detailed and comparable information. Comparable over time but also between companies.
- Companies will have to develop a template which is applicable for all lines of business.
- Also there is a need to define all components of the revenue presentation. Complexities will be:
  - Separation of the deposit and insurance components
  - Experience variance
  - Separation of the OCI components
- Due to the different structure of the revenue presentation management may need additional education.

Measuring the performance over time is important for analysts and shareholders. In order to come to a meaningful analysis it will be necessary to identify the causes and drivers of the performance.

The analysis of change (see MCEV reporting) will provide important information about the performance. However, that analysis needs to be normalised to make it comparable over time. Furthermore, it is too high level and does not capture non life business.

<u>Business issues</u>

- Meaningful analysis over time requires normalised or benchmarked historical information for comparison reasons
- The information needs to be sufficiently granular and structured to allocate effects to the different portfolios and steps

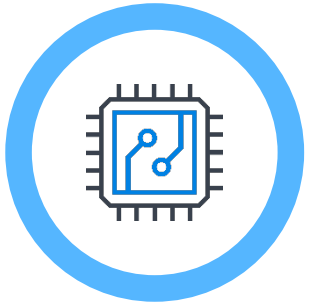
Summary: Conceptual challenges

PARAMETERS

- Historical information – parameters and results
- Discount rate – top down or bottom up, evidence of correctness
- Expense allocation – only attributable

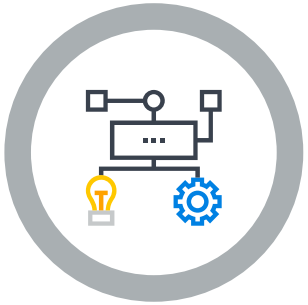
PRESENTATION

- Balance sheet and income statement components
- Presentation of income statement – need to develop template
- Granularity, homogeneous value groups



CALCULATIONS

- Retrospective application to in-force business
- CSM – need historical information and asymmetric treatment of “negative CSM”. Determination of the “coverage unit” per line of business
- Risk adjustment – need to select method and calibration
- OCI – when to use it and how to structure calculations to support it



PERFORMANCE & RECONCILIATIONS

- Forecasting – How to forecast under new regime
- Performance metrics – more focus on the development of the CSM and the OCI
- Reconciliations – to current IFRS regime and other reporting bases (SII,etc)
- Interaction with IFRS 9

Data quality

- There is no strict requirement regarding data quality in the IFRS principles
- However, the models to determine the insurance liabilities and components for the revenue presentation use data and parameters derived from the insurance portfolio. Even the economic parameters are impacted by the characteristics of the insurance portfolio (currency, timing, liquidity)
- The data needs to meet the data quality standards of the company regarding granularity, accuracy, completeness and correctness
- The used data will be an important part of the audit by the external auditors

<u>Business issues</u>

The data quality policies developed for Solvency II need to be expanded to include

- data for the movement analysis,
- historical information for the CSM and classification as onerous contracts
- the requirements of volatility of earnings materiality (generally lower materiality level),

Data processes need to be adjusted to monitor the quality on an ongoing basis

Model governance

- There is no strict requirement regarding model governance in the IFRS principles
- However, in order to convince the auditors and users of the results, it is advisable to develop and apply a robust system of model governance. That will reduce the model risks and hence, risks of incorrect conclusions.
- The finance department will have more responsibilities in this
- Errors in results have a significant impact, because prior material needs to be corrected retrospectively (IAS 8 art 41)

Business issues

The development and maintenance of models needs to be meet the highest standards. Model governance should include the models used to determine the IFRS results.

- Expand the policy with the elements of the revenue presentation
- Simplifications and proxy models may be acceptable for one purpose but not for another
- Determine minor and major changes
- Define errors, changes in parameters, changes in estimates and changes of accounting policies from a model governance perspective
- Materiality levels are generally lower for the P&L than for balance sheet items

Parameter setting process

Several economic and non economic parameters are used to determine the best estimate liability as per the valuation date. Some parameters, like the discount rate, will change each reporting date. Others will be kept stable during the reporting year

The accounting policy will capture the criteria to adjust the parameters. Per model the parameters will be defined and documented.

Business issues

- The identification of the parameters and impact on the results (sensitivity) is a key activity during the preparation of IFRS
- The substantiation of the parameters shall documented in sufficient detail
- It is likely that expert judgement will be applied for situations where sparse data is available (for instance new products or markets) or where a change in the trend can be identified. The expert judgement will be documented and challenged on an ongoing basis
- It will be required to test if parameters can be kept unchanged during the reporting year. In case of significant changes in parameters the changes need to be applied in the models.

Fast close

Most publicly listed companies inform their stakeholders within 6 – 10 weeks after the closing. That disclosure includes the consolidation and analysis of the results and risks. Consequently, the IFRS 17 calculations and analysis need to be completed very quickly. The Solvency II time scales are more relaxed.

Business issues

- The calculation process need to be industrialized to reduce problems during the process. Redo's and restarts of the calculation process due to errors in the data, models, or hick ups in the calculations are main causes of not meeting deadlines.
- Data and parameters need to be made available one or ultimately two days after closing.
- The tools used for the calculations will be tested and implemented before the closing. This may impact the release and version control processes

Risk management

Commonly risk management is focused on protection of capital or the solvency ratio. The main focus of the CFO is on stabilizing the P&L. The accepted volatility of the P&L is lower than the risk appetite re Capital.

The valuation of insurance liabilities under Solvency II and IFRS will be different. The difference will impact the measures used in risk management.

Business issues

- Risk management policies may need to be adjusted
  - Prioritize
  - Risk appetite levels

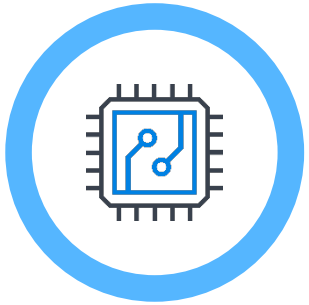
Summary: Impact on the organisation

DATA

- Higher data requirement: more granular, more historical information
- Effective data storage
- Better auditability

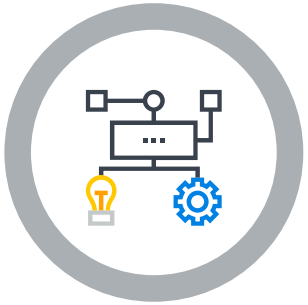
PEOPLE & STRUCTURE

- Training & Education
- Integration of Actuarial, Risk and Finance functions
- Policies & processes



TECHNOLOGY

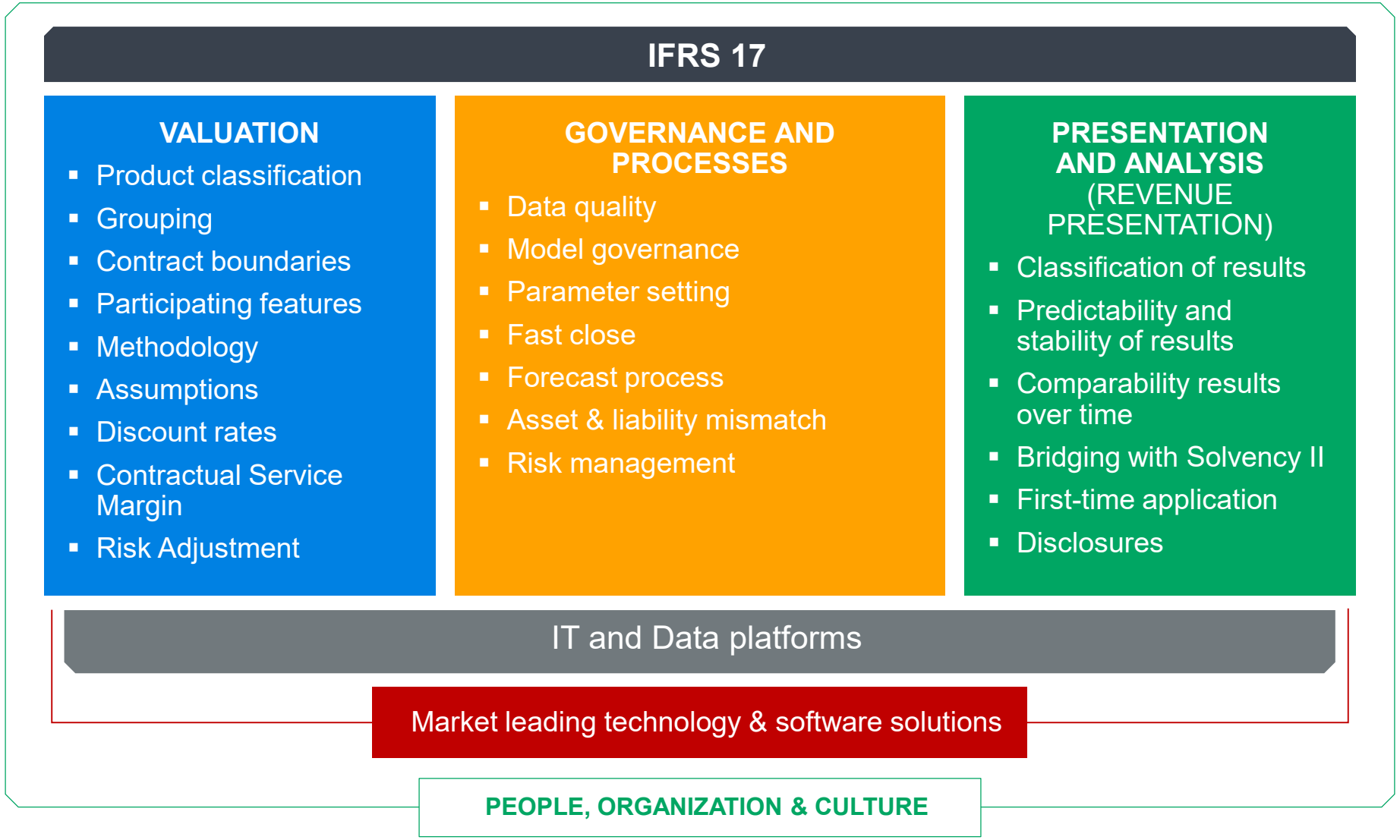
- Better technology and less End-User-Computing



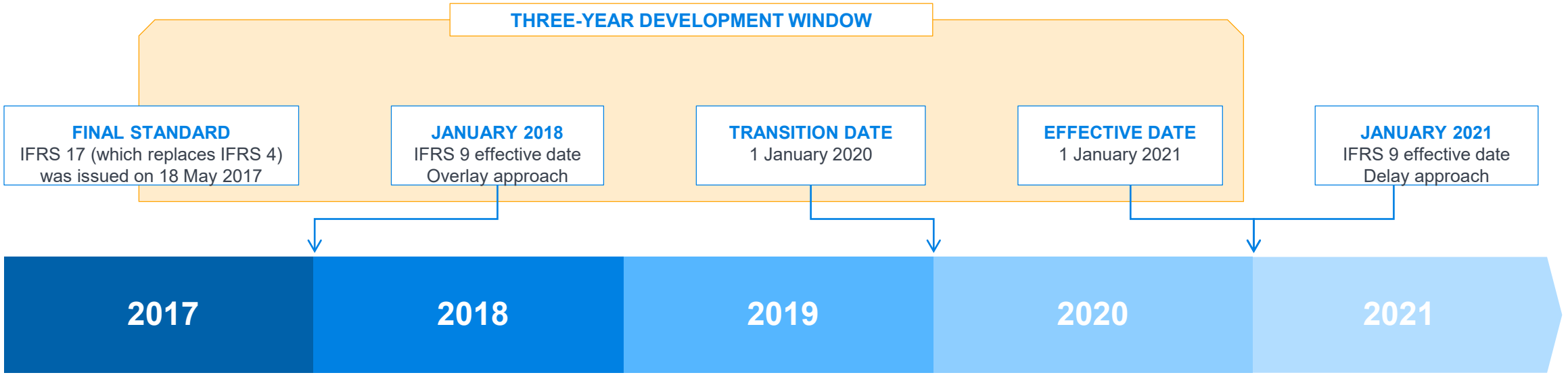
STRATEGY & GOVERNANCE

- Capital generation and earnings
- Asset allocation and ALM
- Product design and distribution
- Operational impact of the transition

Three pillars



Timing of activities IFRS 17



- GAP analysis
- Field testing and planning

- Development of methodology
- Chart of accounts
- Data definitions and storage
- Reporting engines
- Start with the modelling of the high priority products

- Testing and implementation of tools and development of models for low priority products
- Development of governance structure
- Risk management on IFRS
- Forecasting models

- Further testing and implementation of tools
- Testing of entire valuation and reporting chain
- Development of disclosures
- Shadow runs
- Collecting information for comparatives

Questions?

Milliman