Institute
and Faculty
of Actuaries

Exposure Draft of ISAP 4 on IFRS 17 Insurance Contracts

IFoA response to International Actuarial Association

29 June 2018

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Deadline: 30 June 2018

Please use this template to comment on the Exposure Draft of ISAP 4 on IFRS 17 Insurance Contracts, and the proposed revisions to the Glossary for ISAP 4.

The IAA invites comments on this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) Comment on the questions as stated;
(b) Indicate the specific paragraph or group of paragraphs to which they relate;
(c) Contain a clear rationale; and
(d) Include any alternative that the IAA should consider, if applicable within the scope of the Statement of Intent for ISAP 4.

	Identification and instructions	
Name of Individual:	Please indicate if your comments are personal, or represent your organization:	
Name of organization		**Institute and Faculty of Actuaries**
Disclosure of comments:	Please indicate if your comments should be treated as confidential, and if so why:	**No.**
Instructions for filling in and sending the template	Please follow the following instructions for filling in the template: ⇨ Do **not** write in the yellow shaded cells ⇨ Write in the white cells ⇨ When commenting on a specific paragraph: o Please use a separate row for each paragraph, sub paragraph, or bullet. o Please include the full reference in the first column such as "Introduction 3rd paragraph 2nd bullet" or "2.6.1.b.ii" o Please insert/append extra rows as needed. **Please send the completed template, renamed with the organization's or individual's name, attached in Word Format, to ISAP4.comments@actuaries.org**	

	Specific Questions asked by the ASC	Response
Q1.	Is the guidance clear and unambiguous? If not, how should it be changed?	There are a few instances where the guidance is not clear and/ or can be interpreted in different ways. See specific comments in the table from page 5 below.
Q2.	Is the guidance sufficient and appropriate? If not, how should it be changed?	We believe there are two overarching comments that should be made at/near the beginning of ISAP 4: (i) A note that ISAP 4 covers the adoption of IFRS 17, which is itself a standard. ISAP 4 is not intended to contradict IFRS 17, but if the reader considers there to be inconsistencies, the wording of IFRS 17 itself and related Appendices/Guidance/etc should take precedence over the wording of ISAP 4. (ii) A note that ISAP 4 should be read in conjunction with the relevant IAN (100) and that most of the detailed discussion around technical points is deliberately to be found within the IAN not within ISAP 4. There are certain topics where significant actuarial involvement would be expected, but there is little or no guidance. For example: coverage units to allocate the Contractual Service Margin (CSM); the variable fee approach; and fair value and modified retrospective approaches on transition. We recommend that further guidance on these topics be covered by the upcoming IAN 100, which would be a more appropriate source of such guidance. better placed than this ISAP. There are also a limited number of examples where the guidance does not accurately reflect IFRS 17 requirements and needs to be corrected (e.g. business combinations and reinsurance risk adjustment). See specific comments in the table from page 5 below. Many of the provisions in ISAP 4 are worded in a way that cross-refers to specific provisions in ISAP 1 and that presumes the actuary is required to comply with specific provisions of ISAP 1. In essence, ISAP 4 reads as a standard setting out more specific requirements on how to meet ISAP 1 requirements. However, many member associations (including the IFoA) have not directly adopted

		ISAP 1 as their framework of standards is substantially consistent with it. It would be helpful if ISAP 4 were drafted as a stand-alone ISAP that would work for those member associations that have not adopted ISAP 1 as drafted, including those that have modified it and those that have other standards that are substantially consistent. This would also help to ensure that ISAP 4 is not automatically affected by changes to the numbering of ISAP 1 in the future. For example, in 2.1, instead of '*In applying ISAP 1 para 2.2. Knowledge of Relevant Circumstances, the actuary should have or obtain sufficient knowledge and understanding of information necessary to perform the assignment, such as:…*', it might simply read: '*The Actuary should have or obtain sufficient knowledge of the following: ….*'.
Q3.	Is the guidance at the right level of detail? If not, what text should be omitted because it is too detailed? In what areas do actuaries need more detailed guidance?	In general, the guidance is at the right level of detail. However, it is drafted in a fairly prescriptive manner and there are some instances where too much detail is provided, with the IAN a better place for the detail in our view. One example is the guidance on reinsurance and modelling policyholder options. We believe there is a high degree of variability in the detail covered in each topic within the exposure draft; for example there are many points on reinsurance and very few on discount rates. In general, our view is that details on technical points should be provided in the IAN. The guidance in this ISAP should bear proportionality and materiality in mind, based on the features of insurance contracts held by the entity concerned. As indicated in our specific comments in the table below, there are some instances where the guidance includes interpretation of IFRS 17 which goes beyond the remit of an ISAP.
Q4.	Are there other matters that should be included in this standard? Are there some included here that should not be?	*See responses to Q1 to Q3 above.*

	General Comments on the ISAP 4 Exposure Draft	
	We welcome the development of ISAP 4 and, in general, we view that the guidance is at the right level of detail. However it is drafted in a fairly prescriptive manner, which is a different approach to that taken by the IFoA as well as many other actuarial standards setters. As set out in the responses to Q1 to Q4, we suggest the balance of guidance across different topics within IFRS 17 should be revised. There are a number of provisions in ISAP 4 that do not appear to add any more requirements than are already contained in ISAP 1, and that are effectively guidance to help actuaries comply with those other general actuarial standards in the context of IFRS17 - for example, paragraphs 2.1 to 2.5. We therefore wonder whether much of the material would be more suited to non-mandatory guidance in the form of an IAN rather than a model standard. Note that in the table from page 5 below, we include both general observations and proposed wording changes in the ‘change proposed to the paragraph’ column. Any supplementary reasoning is included in the ‘reason change is needed’ column where necessary.	

Comments on specific paragraphs of the ISAP 4 Exposure Draft		
Full paragraph reference	**Change proposed to the paragraph (markup preferred)**	**Reason the change is needed (can be kept very brief or left blank if obvious from the change)**
2.4 d	We suggest shortening this bullet point to ‘Treatment of insurance contract modifications’.	As the text currently stands, it is not clear why ‘contract modifications’ is the only point that has an expanded description, compared to the other points.
2.6.1 a	(i) We suggest revising the text as follows: ‘For the purpose of setting assumptions, consider ~~disaggregating~~ insurance contracts ~~into separate coverages~~ with similar risks based on the nature of the insurance obligation; (ii) Section 2.6 (in general) reads as quite specific to life-insurance; consideration of a wider non-life perspective would be useful.	(i) The revision is proposed to remove terms that are used elsewhere in IFRS 17 (e.g. separation, unbundling, disaggregation, coverage etc.) and to avoid confusion/introducing additional constraints.
2.6.1 c	We suggest replacing the wording ‘Make links as necessary…’ with ‘Consider linkages as necessary…’.	The wording ‘Make links as necessary to ensure consistency between assumptions…’, suggests that a new process is undertaken where all assumptions are assessed for linkages, which is not reasonable. We believe the wording ‘Consider linkages as necessary…’ better aligns with expected actuarial practice.
2.6.1 e	This bullet could be omitted as it is not necessary to require consideration of credibility techniques. It would be preferable to refer to wording that appears in ISAP 1 (2.7.1) ‘The actuary could consider to what extent it is appropriate to adjust assumptions or methodology to compensate for known deficiencies in the available data’.	

2.6.2	This appears overly prescriptive. It implies that for any change in any part of the process of setting any assumptions, the actuary has to discuss this with the principal and check against IAS 8 giving both the rationale and the impact. Materiality and proportionality are important considerations that should be stated explicitly.	
2.6.3	It is not fully clear what the section is referring to, as the measurement of insurance risks could refer to many aspects of IFRS 17. We suggest clarifying or expanding this section.	
2.6.3 a	As above, this text is potentially unclear. For example, is insurance risk referring to specific contracts and therefore the measurement of fulfilment cash flows?	
2.6.3 e	We suggest adding the text '… that might have a low probability of occurrence.'	'Extreme events' can be interpreted in different ways; it is usually referred to in respect of high severity, low probability events, which is perhaps what is being inferred here.
2.6.3 f	We believe this text is too general. For example, is it referring to the management of insurance risk/ risk mitigation practices?	
2.6.3 g	(i) This is a generic point that could be included in section 2.6.1, rather than repeated in 2.6.3g (and 2.6.4e). (ii) We suggest replacing 'secular trends' with 'long-term trends'.	(ii) The current text might not be accessible to the average reader.
2.6.4	The title 'Options' could be expanded to make it more specific. For example, we suggest replacing it with 'Policyholder options'.	
2.6.4 a	This bullet point could be redrafted to improve its readability. We suggest: 'Sophistication of the policyholder and the relative advantages of exercising any options;'	
2.6.4 b	It is not fully clear how this text relates to policyholder options or the assessment of	

	potential modelled outcome.	
2.6.4. c	We suggest adding text: ‘in relation to the policyholder option’ to make the text more specific to the modelling of policyholder option outcome.	
2.6.4 e	As above, this is a generic point that could be included in section 2.6.1, rather than repeated in 2.6.3g and 2.6.4e.	
2.6.5	(i) It is unclear to us why expense assumptions are included separately from the consideration of other assumptions. (ii) It is also unclear why the specific guidance points for expenses have been chosen. For example, the impact of outsourcing arrangements is included, but using fixed real unit cost assumptions/ issues around expense inflation/ allowance for planned project expenditure are omitted. (iii) Furthermore, the extent to which expenses are directly allocable to contracts is open to interpretation under IFRS 17. For example, what portion of a Chief Finance Officer’s costs are directly attributable to insurance contract? The text could be expanded to acknowledge this point; alternatively it could be addressed in an IAN.	
2.6.5 b	We suggest making the text more specific ‘…from fulfilling **insurance** obligations…’.	
2.6.6	The text is potentially confusing, and could be simplified if it referred to the modelling of cash flows that vary symmetrically and asymmetrically with asset returns.	
2.6.6 a	(i) We believe the text should be revised. As it currently stands, it suggests that a risk-neutral approach cannot be used, which is explicitly permitted in IFRS 17 (paragraph B77). Reference to ‘market consistent’ considerations as set out in IFRS 17 paragraph B48 would be helpful: ‘ … the technique used must result in the measurement of any options and	

	guarantees included in the insurance contracts being consistent with observable market prices (if any) for such options and guarantees.'	
2.6.7	It is not fully clear to us what 'Entity Discretion' refers to. Does it refer to management actions or bonus/participation declarations, for example? The paragraph should also reference policyholder behaviour in response to discretion, together with potential competitor actions in different market environments.	
2.6.8	(i) Much of the content in this section is better suited in IAN 100 as it goes beyond general guidance for an ISAP. (ii) It is unusual for the focus of the guidance document to be reinsurance accepted/issued, as this does not align with the way in which IFRS 17 deals with the topic of reinsurance (i.e. reinsurance contracts held). The text should be clarified if it relates to reinsurance contracts held.	
2.6.10	(i) We suggest changing the title to '**Derivation of**…' as paragraph 2.6.6 also relates to discount rates. (ii) The paragraphs covering discount rates are difficult to understand and should be restructured to note the two fundamental approaches that can be used to derive discount rates (top-down and bottom-up approaches), and the key judgemental areas in each. Alternatively, the judgement areas could be covered in the IAN, with reference made to that within the ISAP 4.	
2.6.10 a	This section provides very little guidance on general considerations for extrapolation of the yield curves. However we note that this could be addressed in the IAN.	
2.6.10 b	This text appears to be referring to the discount rate for participating contracts (linked to paragraph 2.6.6). However, the underlying items may not be invested assets and there is no reference to 'market consistent' type considerations as noted in our above response to 2.6.6.	

2.6.10 c	This section considers only the 'bottom-up' discount rate approach in IFRS 17; we believe it should set out consideration for both top-down and bottom- up approaches. We suggest that the wording 'when deriving the illiquidity adjustment for the discount rate' is amended to better reflect the wording of IFRS 17.	
2.6.10 c ii	Using CDS spread is only one of many methods/reference points to determine a credit risk allowance to deduct from asset yields (as noted in IFRS 17 B85). We suggest referencing more than one method as set out in the draft IAN 100 to give balance to the considerations available.	
2.6.11	(i) It is not clear to us what is meant by 'the insurance acquisition cash flows should replicate actual acquisition costs'. For example, does this mean that overruns should be avoided? (ii) More generally, the linkage to 'actual acquisition' costs should be revised as in some countries there will be distribution-type intangibles (e.g. market access fees), where their amortisation would be a permitted cashflow under IFRS 17.	
2.6.12 e	The risk adjustment is measured and assessed separately for gross and reinsured components. The gross risk adjustment should not allow for uncertainty in reinsurance recovery: this is in the reinsurance-related risk adjustment. We suggest this bullet requires revision as we do not believe it is in line with IFRS 17 requirements.	
2.6.12 f	This statement is open to different interpretations and goes beyond the requirements of IFRS 17. Furthermore, it only applies in certain circumstances i.e. where underlying contract and reinsurance are measured in the same way.	
2.6.12 g (i)	It is not clear to us what 'over the total business' means.	
2.6.13	This paragraph does not add any specific actuarial guidance on the matters noted.	

2.6.13 d	The interpretation of coverage units is an evolving area (e.g. see papers for the May 2018 IASB TRG), and is likely to require significant actuarial involvement. Additional guidance on coverage units should be considered for inclusion in ISAP 4 in due course.	
2.6.14	We do not believe this section on business combination and portfolio transfers is in line with IFRS 17 requirements; therefore we believe it should be revised.	
2.7	The section on the Premium Allocation Approach and how to determine whether a contract of term greater than one year can be included in this model, is open to interpretation and we believe the wording could be tightened if deemed appropriate.	
2.8	(i) The section on the Variable Fee Approach (VFA) is quite limited and does not address the implications for the CSM. (ii) We suggest ISAP 4 notes that the VFA is very similar to the General Measurement Approach (GMA), except in detailed aspects of how the CSM is unlocked over time. Furthermore, when measuring reinsurance contracts held, the VFA approach cannot be used. Therefore the vast majority of section 2.6 also applies to the VFA approach.	
2.9.1	We do not believe it would necessarily be the case that all of the relevant information would be sourced from the actuary.	
2.9.2	This section could imply that the actuary oversees the entirety of the accounts. This is not usually the actuary's role, and so the scope of this reporting should be stated.	
2.10	(i) It is unclear to us whether this section is referring to the fully or modified retrospective approach, and we suggest this be clarified. In relation to data considerations, as well as data availability, we believe the actuary should also consider (a) the practicability of obtaining that data, and (b) the ability of current models to process past data or the availability of historic models. We also believe a section on the fair value approach on transition is required. (ii) In general, our view is that the ISAP 4 could say 'The IAN covers considerations	

	around the three possible transition approaches (full retrospective, partial retrospective and fair value) and also practicability.'	

Comments on specific definitions in the Exposure Draft of the updated Glossary Note that only the proposed revisions are open for comment		
Defined Term	**Change proposed to the definition (markup preferred)**	**Reason the change is needed (can be kept very brief or left blank if obvious from the change)**
Variable Fee Approach	We do not believe the definition of the Variable Fee Approach (VFA) is correct. If the conditions to be a direct participating contract are met, then the VFA would be applied regardless as to whether the Premium Allocation Approach would apply.	