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F1: IFRS 17 for General Insurers

IFRS 17 Working Party

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Objectives

Explore the ambiguities in the Standard and facilitate discussion of practical approaches around:

- the Premium Allocation Approach;
- approach to aggregation;
- treatment of outwards reinsurance; and
- risk adjustment.

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Agenda

- Technical Overview
  - *See previous working party materials online*

- Focus Areas & Discussion
  1. Premium Allocation Approach
  2. Aggregation
  3. Reinsurance
  4. Risk Adjustment

- Questions and Feedback

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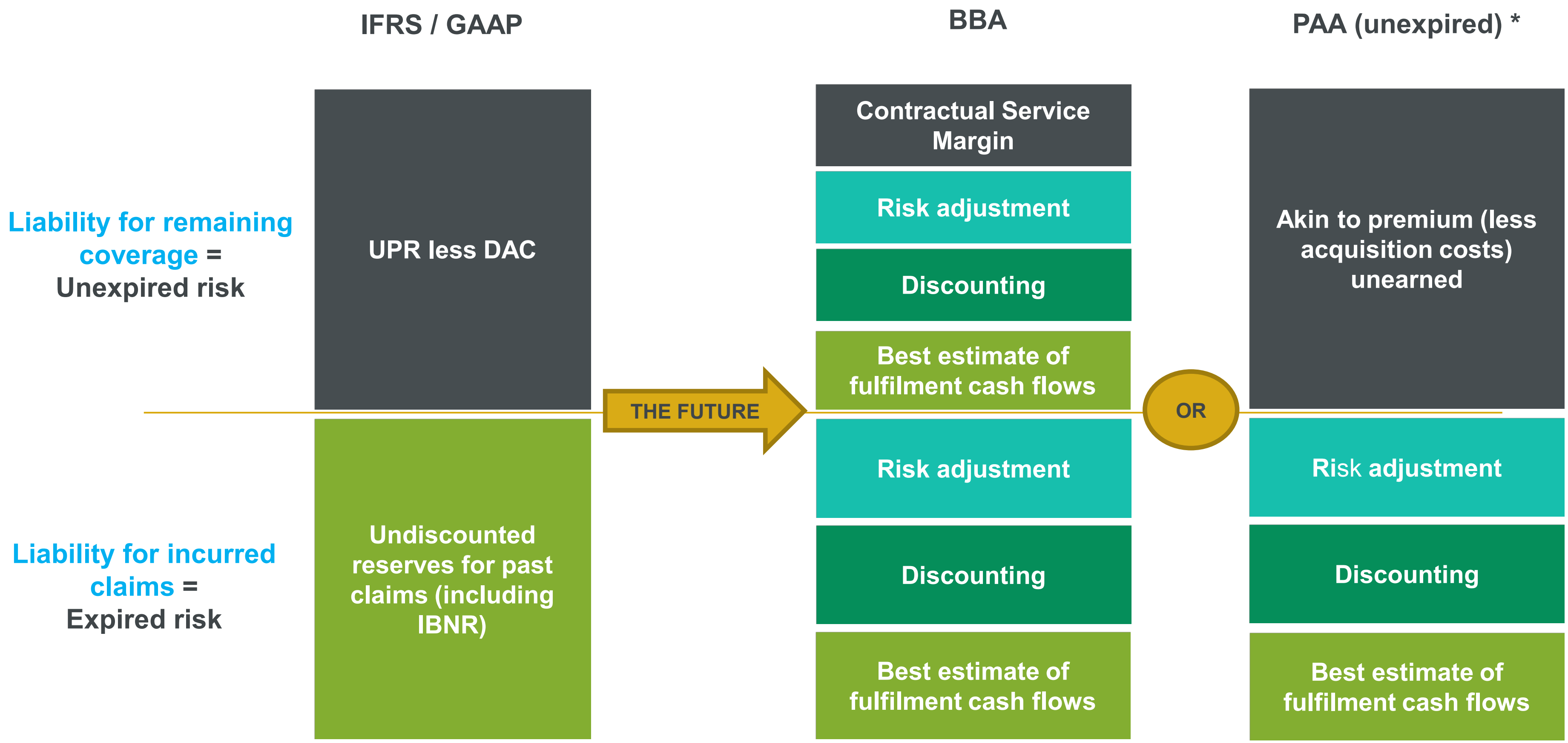
Technical Overview



Size of boxes for illustrative purposes only. Specific conditions must be met for PAA (*)

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Premium Allocation Approach
Working Party Views

1

- Further choices that affect the PAA result when compared to the BBA:
  - Acquisition Cost Recognition: can recognise as incurred if coverage period is 12 months or less.
  - Discounting of LFIC: can choose not to discount if all cashflows are expected to occur 12 months or less from the date a claim is incurred.
- We found little difference in the value of the LFRC between the two approaches for a range of examples where we attempted to use consistent assumptions between PAA and BBA.
- There are two features that cause differences in the measurement of the LFRC:
  - **Unwind of Discount**
    - PAA: Discount rate at initial recognition.
    - BBA: Fulfilment cashflows discounted using current rates and CSM unwound using initial rates.
  - **Pattern of release**
    - PAA: straight line or risk-adjusted earnings pattern.
    - BBA: Fulfilment cashflows - straight line or risk-adjusted earnings pattern.

      CSM – recognition of coverage units in group based on service provided in period
- PAA LFRC based on premiums received only, balance sheet exposure will appear low where there is significant amounts of premium receivable.

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Premium Allocation Approach
Discussion

1

- Is the PAA really a practical alternative?
  - Need to regularly demonstrate the results are not materially different from the BBA (for auditors)
  - Potential cost of implementing and running two different models.
  - Explanations may be required to key stakeholders – Board, Investors, Rating Agencies…

  So is the PAA really only useful if intending to apply it to the entire business?
- How do you interpret the "materially" and "reasonably expects" phrases from paragraph 53?
  - What will be the impact of the "materiality" condition on the level of grouping for entities that wish to use PAA

    (Is there an incentive to use larger groups in order to give a greater chance of passing this test)?
- If the two approaches given similar answers do we need to consider paragraph 54 at all?
  - I.e. if an "entity expects significant variability" in the cashflows that would affect the liability for remaining coverage before a claim is incurred, but the effect is expected to be (materially) the same under the PAA and BBA, then can we just apply paragraph 53?
  - Does the contract coverage period therefore really only impact and relate to the approach to discounting?

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Aggregation
Working Party Views

- Need to define process for allocation to "portfolio" and "group" early.
  - critical for future development; and
  - one-off exercise required at transition, plus ongoing process for new business.
- Definitions of "portfolio" and "group" are key considerations, ideally need to:
  - Avoid unnecessarily onerous calculation and reporting process;
  - Be supported by auditors and explainable by the Board; and
  - Be able to use PAA where suitable/desired.
- Focus on material and uncertain areas, for example:
  - Outwards reinsurance; and
  - Composite/multi-line contracts.
- Requires wider business engagement and agreement:
  - Underwriting, Operations, Finance, Actuarial, Auditors, Board

Aggregation
Discussion

- Is there a conflict between ‘managed together’ and ‘similar risks’?
  - What number of portfolios is realistic and practical?
- Do we really expect to have three groups in practice?
  - Does anyone expect to have any contracts which have ‘no significant possibility of becoming onerous’?
- How do you know a particular group in the portfolio will be onerous until the calculations are performed (e.g. risk adjustment).
  - What might “facts and circumstances” be?
  - At what level do you currently monitor MI?
- Underwriting Year seems like an obvious segmentation basis:
  - But how wold this work for companies who use Accident Year basis?
  - Might we instead align these with the reporting periods to ensure all groups are closed when reported? – Makes analysis of change easier
  - Might we have different calendar periods for each portfolio? (e.g. binder inception, reinsurance contract inception)

Reinsurance
Working Party Views

3

- Important to consider PAA vs BBA for outwards contracts separately to inwards.
  – E.g. risk attaching reinsurance

- Cashflow quantification is unlikely to be straight-forward
  – Treatment and consistency of inwards cashflows – PAA vs BBA;

- Treatment of a single RI contract/programme which covers multiple underlying inwards risks?
  – e.g. Whole account cover
  – Conflicts with 'similar risk' requirement? – one programme per portfolio?

- Overlap with Solvency II
  – 'correspondence' and 'legal obligations'?

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Reinsurance Discussion

- Views on the treatment of reinsurance cashflows differ:
  - *'consistent assumptions'* [with the inwards] might imply that future claims recoveries can only be taken credit for if they are contained within the inwards business. However, the full future premium cashflows need to be allowed for upon recognition.

  OR

  - *'present value of future cashflows'* implies that all future cashflows should be recognised irrespective of the inwards business.

- Pre-payments: Upon recognition, cashflow basis would prohibit any recognition of pre-payments but could be permitted up to the point of recognition.

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Risk Adjustment
Working Party Views

- Derived at entity level and allocated back to portfolio/contract.
  - So consolidation across a group will need to consider the diversification benefit (different from Solvency II)

- Process needs to be efficient enough to run at each reporting period.

- What does the “entity’s degree of risk aversion” mean?
  - appetite?
  - own view of risk?

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Risk Adjustment
Discussion

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- Will any leverage come from Solvency II?
  - Questionable underlying assumptions? – cost of capital rate.
  - Need to back out confidence interval.
  - Gross and reinsurance.
  - Which capital basis – to ultimate?

- How will a reinsurance risk adjustment be derived?
  - Gross less net?
  - Need to consider the reinsurance contract boundary and cashflows included.

- Do we foresee convergence in confidence intervals across the market over time? (Australia)

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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