

## IFRS 17 Future of Discount Rates Working Party

Setting insurance liability discount rates were a challenge under Solvency II, with agreement being reached in “Omnibus II” less than two years before the regime went live and some still see the matching adjustment and volatility adjuster as controversial.

IFRS 17 discount rates may prove no different. Whilst there are broad, high-level principles, setting the discount rate is a challenge for those tackling the new accounting standard (many of whom will already be becoming jaded after hearing the problem described as “it’s just top down or bottom up isn’t it? There’s nothing more to it, is there?!”)

So what are the issues? The underlying principle behind IFRS 17 is that the insurance liabilities should be calculated independently of the rest of the balance sheet, with the discount rate reflecting the characteristics of the liabilities. As there is no readily quoted price for insurance liabilities this makes setting such a discount rate difficult, if not impossible.

The IASB recognised this was challenging and IFRS 17 allows insurers to measure the discount rate by:

- Adjusting a risk-free yield curve to reflect the liquidity characteristics of the insurance contracts (a bottom-up approach); or
- Using the yield on a reference portfolio of assets adjusted to eliminate any factors that are not relevant to the insurance contracts (a top-down approach).

So far so good, but then there’s a multitude of further decisions that need to be made, which can be very important when a small number of basis points can lead to a significant proportion of a year’s profit.

The working party is considering a range of issues, including:

- Setting top-down discount rates, including what portfolio of assets might be selected, how this might be updated over time and adjustments for credit risk
- Are there robust ways to set bottom-up discount rates?
- Whether the discount rate should be the same for gross liabilities and reinsurance
- Averaging of discount rates over a reporting period
- Complications that arise when the liability discount rate is stochastic

We plan to publish articles on these topics and would welcome any insights and views from others on these or any discount rate related issue.

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*More information about the working party can be found at <https://www.actuaries.org.uk/practice-areas/life/research-working-parties/ifrs-17-future-discounting>*

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