IFRS 17 CSM Working Party

Transitional Arrangements

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11 March 2019

Agenda

- Overview of the working party
- Introduction to measurement models
- Introduction to transition:
  - Full retrospective
  - Modified retrospective
  - Fair value
- Closing thoughts
- Questions / comments

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Overview of the working party

Aims for the WP

1. Analyse the impact of different approaches to calculating the CSM at initial recognition and subsequent measurement

2. Consider the operational implications of the different approaches

3. Provoke thought leadership and innovation within the industry through presentations and forums to gain wider input

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Introduction to measurement models

Overview of the measurement models

Measurement model	Criteria	Examples
General Model (GM) / Building Block Approach (BBA)	• Cash flows are independent of underlying investment strategy	• Conventional non-profit annuities • Protection business
Variable Fee Approach (VFA)	• Clear pool of underlying items • Policyholders receive a substantial share of the returns • Substantial portion of amount paid to policyholders to vary with underlying items	• Conventional and unitised with-profit contracts • Unit-linked contracts
Premium Allocation Approach (PAA)	• Short duration (12 months or less) • No embedded options / guarantees • Measurement is a good approximation to the GM	• Reinsurance contracts held • General insurance contracts • Group protection contracts

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Components of GM and VFA

Fulfilment Cash flows

Present value of future cash flows

- Expected present value of premiums, benefits and expenses etc. arising within the contract boundary.
- Estimated using up-to-date information valued using market consistent discount rates

Risk adjustment

- The compensation an entity expects for bearing the uncertainty about the amount and timing of the cash flows that arise from non-financial risks

Contractual service margin

- Represents the unearned profit of an insurance contract

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Premium Allocation Approach

PAA = **Liability for remaining coverage** + **Liability for incurred claims**

Liability for remaining coverage:

Premiums Received

less

Acquisition cash flows

Liability for incurred claims:

PV of cash flows +
Risk Adjustment

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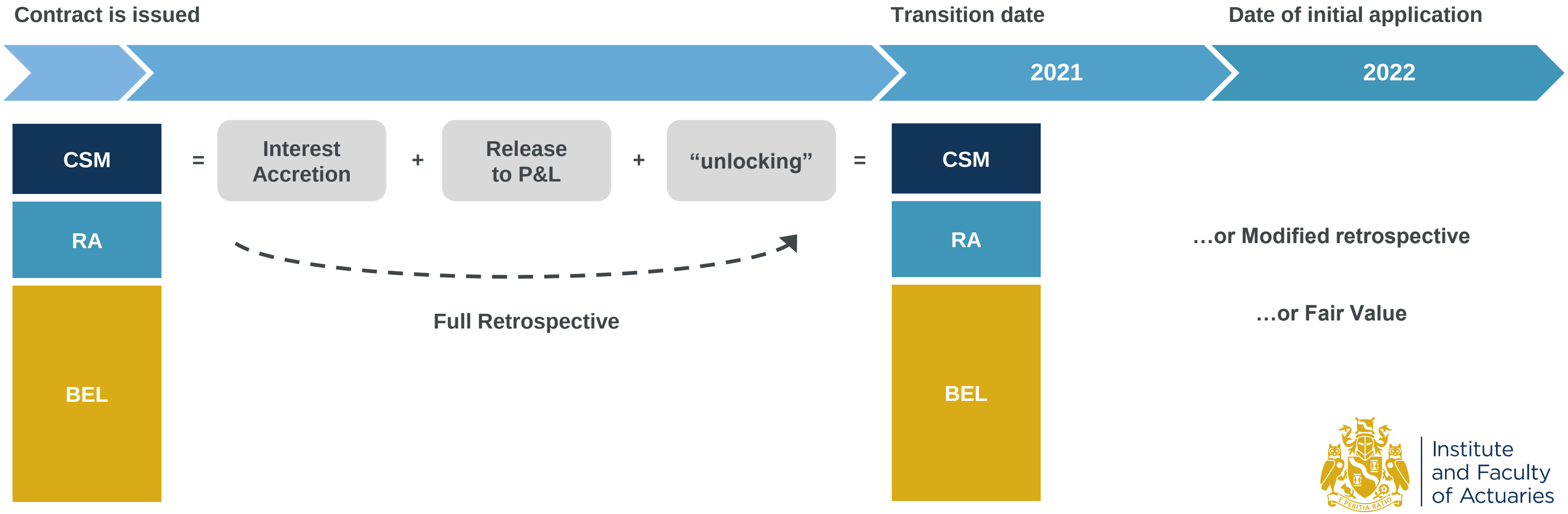
Introduction to transition

Transition

The transition date is the beginning of the annual reporting period preceding the date of initial application.

An entity is required to calculate the opening balance sheet for IFRS 17 at the transition date.



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Transition approach

Is it impracticable?
(IAS 8)

No

Full retrospective approach
(C3-C4 pf IFRS 17)

Yes, choose between…

Modified retrospective approach
(C6-C19 of IFRS 17)

Fair value approach
(C20-C24 of IFRS 17)

If the entity **does not have** reasonable and supportable information to apply the modified retrospective approach it must apply the fair value approach

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Full retrospective approach

Identify, recognise and measure each group of insurance contracts as if IFRS 17 had always applied

Derecognise any existing balances that would not have existed had IFRS 17 always applied

Recognise any resulting net differences in equity

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When is it impracticable to apply the full retrospective approach?

1. Effects of retrospective applications are not determinable

2. Requires assumptions about what management's intent would have been in that period

3. Requires significant estimates and it is impossible to distinguish objectively information about those estimates

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Modified retrospective approach

Objective: achieve the closest possible outcome to the fully retrospective approach using reasonable and supportable information available without undue cost or effort.

Use reasonable and supportable information

Maximise the use of information that would have been used to apply a fully retrospective approach

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Hierarchy in application of the modified retrospective approach

Is it impracticable?
(IAS 8)

No → **Full retrospective approach (C3-C4 pf IFRS 17)**

Yes, choose between…

- **Modified retrospective approach (C6-C19 of IFRS 17)**
- **Fair value approach (C20-C24 of IFRS 17)**

If the entity **has** reasonable and supportable information to apply the modified retrospective approach → **Is there reasonable and supportable information to retrospectively apply the IFRS 17 requirement covered by the specified modification? (C8 of IFRS 17)**

If the entity **does not have** reasonable and supportable information to apply the modified retrospective approach → **Fair value approach (C20-C24 of IFRS 17)**

To the extent yes → **Retrospectively apply the IFRS 17 requirement (C8 of IFRS 17)**

To the extent no → **Use reasonable and supportable information to apply the specified modification, and in doing so, maximise the use of information without undue cost or effort that would have been used to apply a full retrospective approach. (C6(a)-(b) of IFRS 17)**

Note: An entity is not permitted to use a combination of the modified retrospective approach and the fair value approach for a group of insurance contracts.

Source: AP2D Amendments to IFRS 17 Insurance Contracts, Appendix A

Summary of permitted modifications*

	Full Retrospective	Permitted Modification	Reference
Identification of IFRS 17 groups	Determine at initial recognition date	Determine at transition date	C9
VFA assessment			
How to identify DCF			
Cohort size	No more than 1 year	More than 1 year	C10
Estimates of cash flows at the date of initial recognition	Calculate retrospectively	Use actual occurred cash flows instead of projections prior to transition date	C12
Estimates of the risk adjustment at the date of initial recognition		Adjust risk adjustment at transition date for expected release prior to transition date	C14
Determining discount rates at the date of initial recognition		Approximate using observable yield curve	C13
Determining the contractual service margin recognised in profit or loss prior to transition		By comparing the remaining coverage units at transition with the coverage units provided before the transition date	C15

*Permitted modifications for groups of insurance contracts without direct participation features

Operational and data challenges

Determine groups / profitability testing

- Allocate contracts to annual groups (if sufficient information), otherwise decide on groups
- Perform assessment of profitability at inception (or transition if applying modification)

Calculate BEL

- Projection models may need to be re-run to calculate an IFRS 17 appropriate BEL
- Where onerous or data not available, estimation may be required

Develop proxy RA approach (example)

- Choose a driver for each risk type: mortality, morbidity, longevity, expenses, lapse up and lapse down etc.
- Calibrate factors to be applied to driver based on latest years full runs

Source account data

- Perform a mapping of account items to high-level cashflow items; premiums, claims, expenses etc.
- Make a decision on a basis for allocating annual cashflows across cohorts

Concerns expressed by stakeholders

Concern	Suggested amendment
Difficulty in applying modified retrospective approach	To permit an entity to develop its own modifications
Difficulty of establishing whether the entity does or does not have reasonable and supportable information	1) to apply modifications even when the entity **has** reasonable and supportable information for a full retrospective; or 2) to apply modifications even when the entity **does not have** reasonable and supportable information for them
Difficulty of establishing actual cash flows that are known to have occurred because not available / tracked in that way	To allow the use of reasonable and supportable information to determine cash flows that are known to have occurred
Difficulty of estimating CSM on transition for claims development coverage for contracts acquired in business combinations and portfolio transfers	To allow an entity to classify a liability that relates to the settlement of claims incurred before an insurance contract was acquired as a liability for incurred claims
Whether modifications available to contracts accounted under the general model could be extended to direct participating (variable fee approach—VFA) contracts	To allow modifications to be applied to VFA contracts

Source: AP2D Amendments to IFRS 17 Insurance Contracts

What has the IASB decided? (IASB meeting 7 - 8 February 2019)

Concern	Suggested amendment
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What does the IASB say on estimates?

The board chose not to permit entities to develop their own modifications as part of the modified retrospective approach. It also chose not to amend the specified modification related to the use of cash flows known to have occurred before the date of transition.

However, it was noted that the existence of specified modifications does not preclude entities from:

a) Making estimates necessary in applying accounting policy retrospectively as per IAS 8:51.

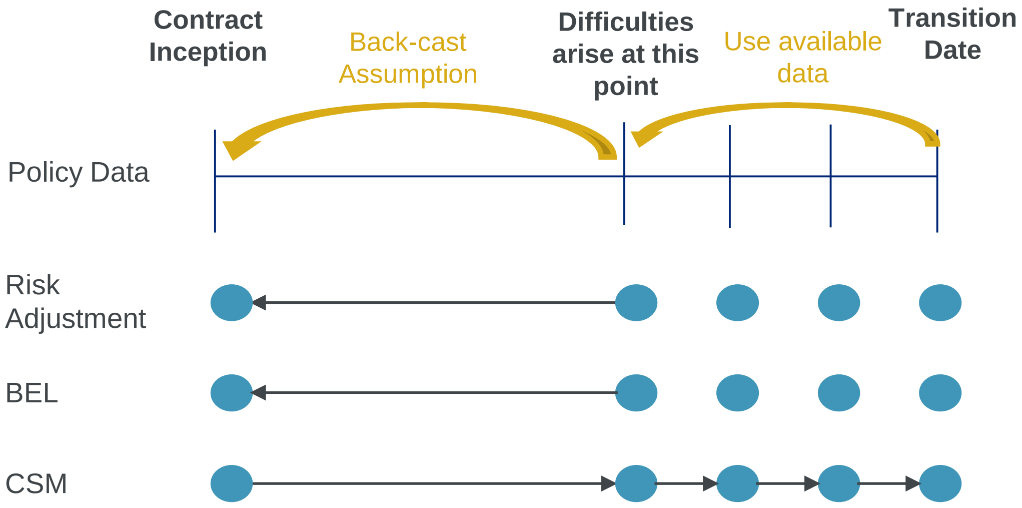
b) Making estimates in applying a specified modification in the modified retrospective approach.

Paragraph 51 of IAS 8 discusses making estimates when retrospectively applying an accounting policy.

Back-casting example

One application of estimates in retrospective application that has been discussed is back-casting. An entity shall:

- Use cash flows if they can be determined retrospectively until the point a difficulty arises
- Then policy data and values are projected backwards, “back-cast”, to the inception date of the policies



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Fair value approach

Fair value of liabilities (applying IFRS 13) − **Fulfilment cash flows (applying IFRS 17)** = **CSM if +ve or loss component if -ve**

! Loss components not commonly expected to arise through this approach but entirely possible

! Once the CSM/loss component balance at transition is determined, subsequent calculations revert to the usual requirements of IFRS 17

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Possible methods for calculating the fair value CSM

Either determine this

Alternatively calculate this directly

Fair value of liabilities (applying IFRS 13) − **Fulfilment cash flows (applying IFRS 17)** = **CSM if +ve or loss component if -ve**

Examples:

Use observable market prices

Adjust the fulfilment cash flows

Leverage existing EV or SII calculations

Examples:

Cost of capital or IRR approach

Estimating compensation required by the market

Either way, the main challenges related to judgement and calibration

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Examples of judgement and calibration required for fair value

Use observable market prices:

- is the data representative of the business being valued?

Adjust fulfilment cash flows:

- How to allow for the risk of the company's own non-performance
- Should the underlying demographic or attributable expense basis be changed?

Cost of capital or IRR approach:

- What measure of capital: solvency? economic? other?
- How should the cost be calibrated?

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Closing thoughts

Questions

Comments

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