Actuaries Institute

Insurance Contracts Accounting Standard AASB 17

Update from Task Force

September 2017

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Introduction

Today:

- Purpose of TF
- How TF is tackling its job
- Progress to date
- Major issues
- Future Activity
- Q and A

TF Purpose; Responsibility

Purpose:

- To help prepare the actuarial profession for the implementation of IFRS 17

Responsibility:

- Identify how standard to be applied; potential business implications; how industry might respond.
- Develop a guidance document; all 3 insurance industries
- Liaise with accounting bodies, APRA, ATO, IAA, AASB, FSSA, other AI taskforces and AI practice committees [and others]
- Educate actuaries
- Promote the role of the actuary to relevant third parties
- Influence the transition & interpretation – practical issues.

Proposed Guidance

Some principles:

- Should allow an experienced Australian actuary to implement the requirements of IFRS17 without having to read the IANs;
- Avoid duplicating content which is already contained in the IAN. The guidance should be Australian specific and should reference the IAN where required;
- The initial guidance (end 2017) should be in the form of a structured Q&A with practical examples to illustrate key IFRS17 principles; and
- Definitions used across all technical sub-groups need to be consistent.

Work-streams

- Aggregation, portfolios, groupings
- Building Block Approach (BBA)
- Variable Fee Approach (VFA)
- Premium Allocation Approach (PPA)
- Risk adjustments; discount rates
- Disclosures, OCI, strategic

- Benoit Laganiere
- Grant Robinson
- David Rush
- Brendan Counsell
- Brett Pickett
- Hoa Bui

[plus APRA today]

Strategic/Transition issues

Possible Impact

- Capital levels; ROC
- Regulatory capital: Early adoption? Transition?
- Profit volatility
- Tax: Transition?
- Transition accounting

Possible implications:

- Early adoption
- Product design; marketing
- Reinsurance
- Investments

Aggregation, portfolios, grouping

Benoit Laganiere

Aggregation => Step 1: Split into portfolios (by risks)

Individual insurance contracts

Are contracts managed together?
Are contracts subject to similar risks?

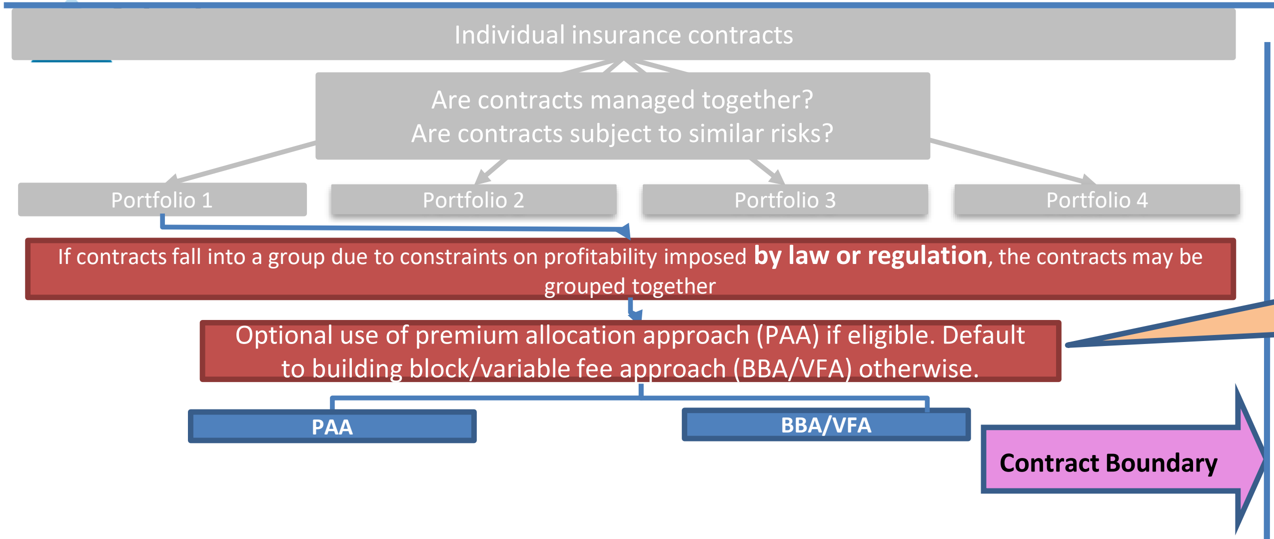
Portfolio 1 | Portfolio 2 | Portfolio 3 | Portfolio 4

Key questions

What does managed together and subject to similar risks mean?

What to do with bundled multi-perils products?

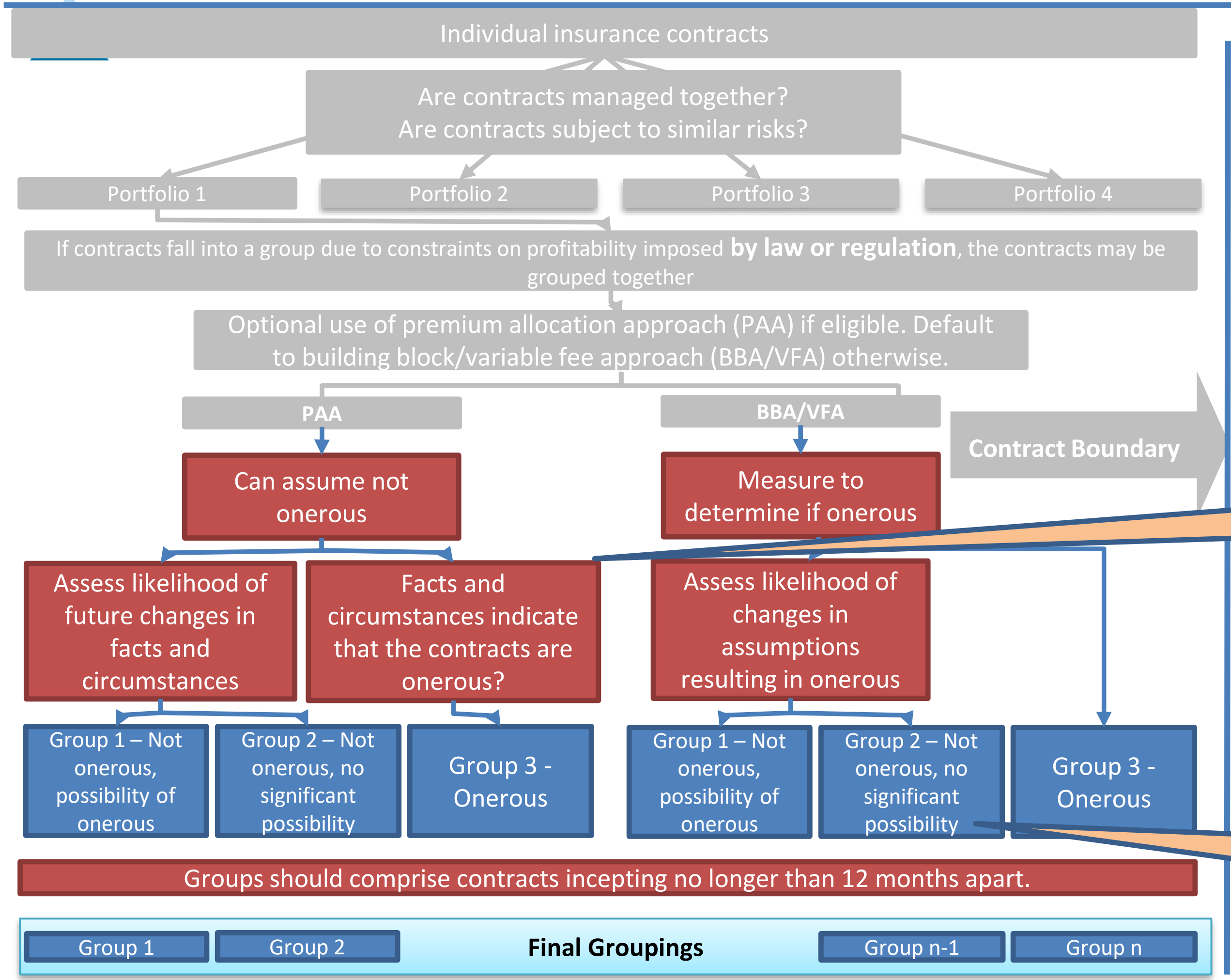
Aggregation => Step 2: Option to use PAA if eligible. Otherwise BBA/VFA



Key questions

PAA eligibility: what does liability for remaining coverage does "not differ materially" mean?

Aggregation => Step 3: group based on profitability and issuance date



Key questions

Under PAA, what "facts and circumstances" would indicate a set of contract is onerous?

What does "no significant possibility" of becoming onerous mean?

Level of Aggregation –Decision Framework

Individual insurance contracts

Are contracts managed together?
Are contracts subject to similar risks?

Portfolio 1

Portfolio 2

Portfolio 3

Portfolio 4

If contracts fall into a group due to constraints on profitability imposed **by law or regulation**, the contracts may be grouped together

Optional use of premium allocation approach (PAA) if eligible. Default to building block/variable fee approach (BBA/VFA) otherwise.

PAA

Can assume not onerous

Assess likelihood of future changes in facts and circumstances

Facts and circumstances indicate that the contracts are onerous?

Group 1 – Not onerous, possibility of onerous

Group 2 – Not onerous, no significant possibility

Group 3 - Onerous

BBA/VFA

Measure to determine if onerous

Assess likelihood of changes in assumptions resulting in onerous

Group 1 – Not onerous, possibility of onerous

Group 2 – Not onerous, no significant possibility

Group 3 - Onerous

Contract Boundary

Groups should comprise contracts incepting no longer than 12 months apart.

Group 1

Group 2

Final Groupings

Group n-1

Group n

Key questions

What does managed together and subject to similar risks mean?

What to do with bundled multi-perils products?

PAA eligibility: what does liability for remaining coverage does "not differ materially" mean?

Under PAA, what "facts and circumstances" would indicate a set of contract is onerous?

What does "no significant possibility" of becoming onerous mean?

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Contract Boundary – Decision Framework

When does the obligation to provide services end?

Does the insurer have the practical ability to set a price or level of benefits that fully reflects the risks of a particular policyholder?

Yes → Obligation ends

No

Does the insurer have the practical ability to set a price or level of benefits that fully reflects the risks of a portfolio that contains the contract?

+

Does the pricing of premiums for coverage only relate to risks up to the assessment date?

Yes → Obligation ends

No → Obligation Continues

The entity shall not recognise as liability or as an asset any amounts relating to expected premiums or claims outside the boundary.

What is the boundary for Yearly Renewal Term business?

What are the implications for health or GI policies paid and contracted by the months?

What risks need to be taken into accounts?

What are the implications for reinsurance contracts?

Building Block Approach (BBA)

Grant Robinson

Building Block Approach (BBA)

- BBA was the terminology the IASB used during development for the General Measurement Model under IFRS 17
- It applies to all insurance contracts with modifications for:
  - short term business (Premium Allocation Approach – PAA); and
  - direct participation business (Variable Fee Approach – VFA)
- See the recent Actuaries Digital for more detail on our activities and a discussion on a key issue relating to the release of profit
- A major developing issue is what expenses can be included with a potentially nasty interaction with consolidation

Building Block Approach (BBA)

- Expenses in the liability, need to be "directly attributable" to the Portfolio
- There is no guidance on what this means in AASB17 (nor Basis for Conclusions)
- Interpretation of similar words in other IFRS suggest a fairly direct relationship is needed and any expenses that are overhead at the portfolio level would be excluded
- Expenses able to be included will very likely change on consolidation, e.g. inter-group charges may be directly attributable in the insurer but not upon consolidation

Building Block Approach (BBA)

- Under AASB 17 the liability is no longer anchored to the insurer but the reporting entity unlike AASB 1023 & AASB 1038
- This the insurance contract liability will change upon consolidation if expenses included do
- This not only changes the Insurance contract liability, it also changes:
  - It's components and the expense experience,
  - The Investment Income and interest accretion expense for the Group of contracts
  - the disclosures of the components and required reconciliations of change from opening to closing; and
  - potentially even which group a contract falls into at inception
- Potentially a very significant disconnect with expenses used in par liabilities and profit shares under the Life Act

Variable Fee Approach

David Rush

Variable Fee Approach

- Which products qualify to use the VFA?
- Criteria in paragraph B101
- Not what is necessarily currently defined as 'participating'
- Likely to include:
  - Participating Conventional
  - Investment Linked bundled with rider
- Probably VFA (depends on size of guarantee)
  - Participating Investment Account
  - Participating Annuities
  - Non-participating Investment Account
- Probably not VFA
  - Group risk with profit share or participating (most cash flows from claim and not investment)

Variable Fee Approach

- Other VFA issues:
  - What things need to be done differently - what are the main differences between AASB 17 and MoS?
    (Aggregation, unbundling, profit release, RA,
    experience...)
  - What are the main difference between VFA and BBA? (Experience, cash flows, discounting...)
  - What is the pool of 'underlying items'?
  - 'Mutualisation' - allowance for cash flows from other groups
  - What VFA issues are peculiar to friendly societies and mutuals?

Premium Allocation Approach

Brendan Counsell

Premium Allocation Approach

- Eligibility criteria for > 12 month contracts
- Allocation of insurance revenue
- Onerous contracts
- Reinsurance
- PAA mechanics & differences to current

Risk Adjustment, Discount Rate

Brett Pickett

Risk Adjustment, Discount Rate

Risk Adjustment:

- How does it compare to what I do now?
- What should be considered when calibrating the risk adjustment?
- What is the inter-relationship of the risk adjustment with the entities risk appetite, tolerance level, regulatory and economic capital?
- What changes are required to an entity's risk margin framework?
- How do you allow for risk mitigation - e.g. reinsurance and profit share
- We are preparing illustrative examples of estimation techniques

Discount Rate, Risk Adjustment

Discount Rate:

- What rate to apply at inception and subsequent measurement?
- What areas of AASB 17 are black and white, and what areas are open to interpretation?
- How does it compare to what I do now?
  - Bottom-up approach: risk-free yield curve plus illiquidity premium
  - Top-down approach: current market rate on a reference portfolio of assets less the market risk premium to be excluded
  - The treatment for liabilities where cash flows depend on the returns of underlying items
  - The alignment of discounting/undiscounting to different products

Disclosures, OCI

Grant Robinson for Hoa Bui

Disclosures & OCI

- Disclosures are significantly more detailed and an integral part of the reporting process driving substantially complexity and effort for preparers.
- Notwithstanding this also need to ensure the objective of disclosure is met and further supplement if necessary
- Starting point was existing IFRS 4 disclosures, which were significantly further enhanced to include:
  - Reconciliations from opening to closing balances for insurance contract liability and components (expected values, inflows , outflows, risk margin and CSM, incurred claims and risk margin)
  - Detail about contracts initially recognized in period including CSM
  - Quantative information about release of CSM over future periods
  - Approach to the risk adjustment as well as its confidence interval
  - Information about the effect of the regulatory framework on the entity

Disclosure Example

Year Two	Estimates of PV future cash flows	Risk Adjustment	Contractual Service Margin	Liability for remaining coverage, excluding loss component	Loss component of the liability for remaining coverage	Liability for incurred claims	Insurance Contract Liability
Opening balance	**372**	**80**	**165**	**617**	**-**	**-**	**617**
Release of CSM & RA		*(40)*	*-*	*(40)*			
Expected Insurance Outflows	*(100)*			*(100)*			
Insurance Contract Revenue				(140)			(140)
Changes related to future service	*238*	*48*	*(173)*		*113*		
Insurance Service Expense	238	48	(173)		113	300	413
Investment Component	(100)			(100)		100	-
Insurance Finance Expense	19	-	8	27			27
Cash outflows			-	-		(400)	(400)
Closing Balance	**429**	**88**	**(0)**	403	226	-	630

APRA

Discussion