# IFRS 17
# The shifting landscape in Insurance

PRESENTED AT IAC 2019 CONFERENCE
JUNE 4, 2019

# Introduction

- This presentation does not constitute actuarial advice
- Views are my own, and not necessarily those of:
  - the Caribbean Actuarial Association
  - Colina Insurance
- I am a practitioner, not an expert
- This presentation will contain no heavy formulas
- Little IFRS 17 jargon

# Organization

- Tell you some stuff that IFRS 17 requires
- Some practical implications of some of this stuff?
- Goals:
  - Even if you know (or remember) nothing about IFRS 17, you leave with some knowledge about it
  - You start to think about how users might interpret results under the standard

# Grouping

- Policies subject to “similar risk and managed together”
- Policies not issued by more than one year apart
- Likelihood of being loss-making at initial recognition
  - Loss making or “onerous” at issue
  - No significant possibility of becoming “onerous” subsequently
  - Somewhere in between

# Grouping

- Separate valuation models
  - IFRS 17 has three different valuation models and rules as to which can be applied
  - General model – Most long-term business
  - Variable fee approach – par & UL
  - Premium allocation approach – short-term business
- Currency

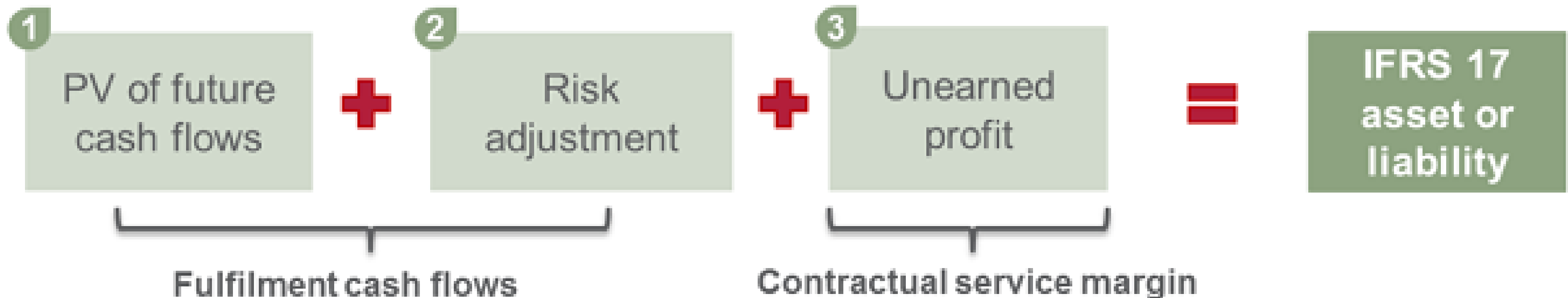
# Grouping

- What does “no significant possibility of becoming onerous mean?”
- How do you evaluate this?
  - Stress tests as a tool to help but what thresholds to use?
- BTW, combining moderately profitable and wildly profitable products would minimize likelihood of having to recognize a loss

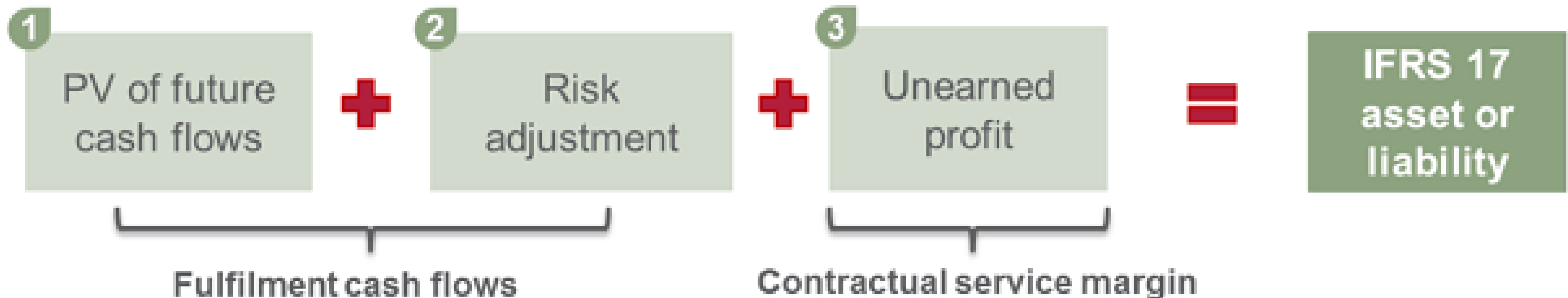
# Grouping

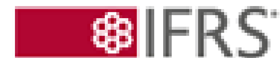
- The multiple grouping criteria means that companies will have many groups
- Grouping or disaggregation?
- Small groups likely have greater financial volatility than larger ones

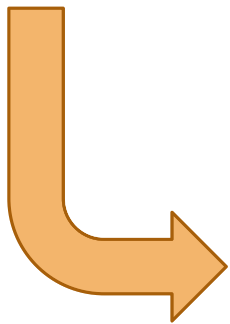
# Digging deeper

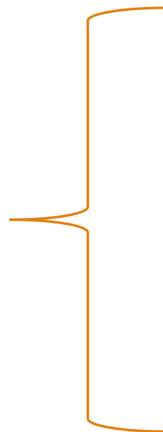


# Digging deeper



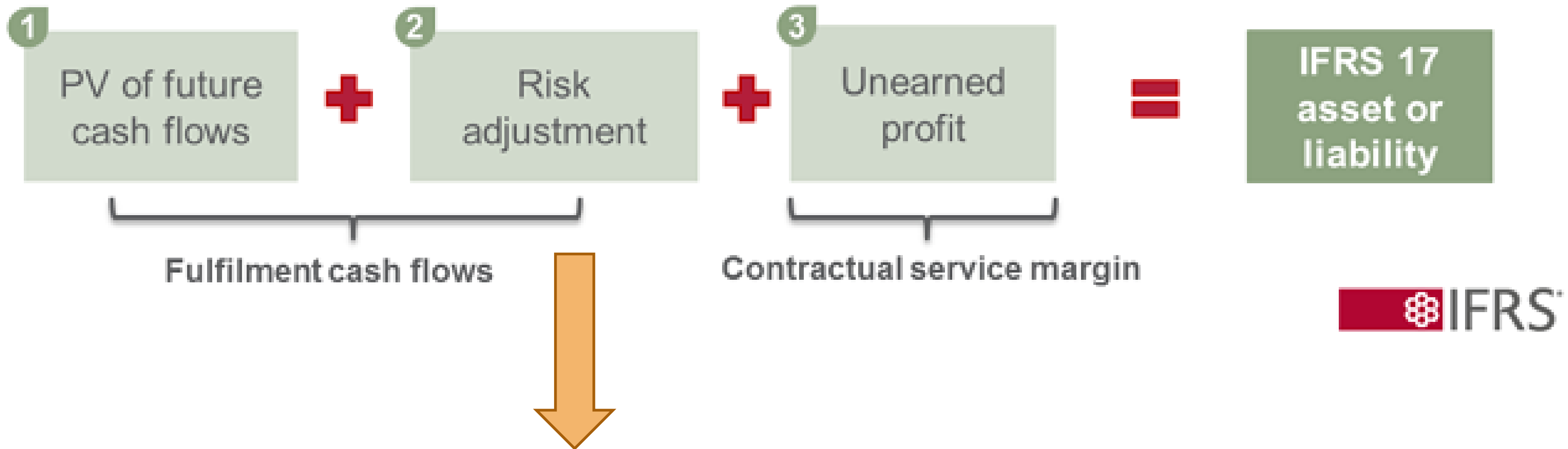





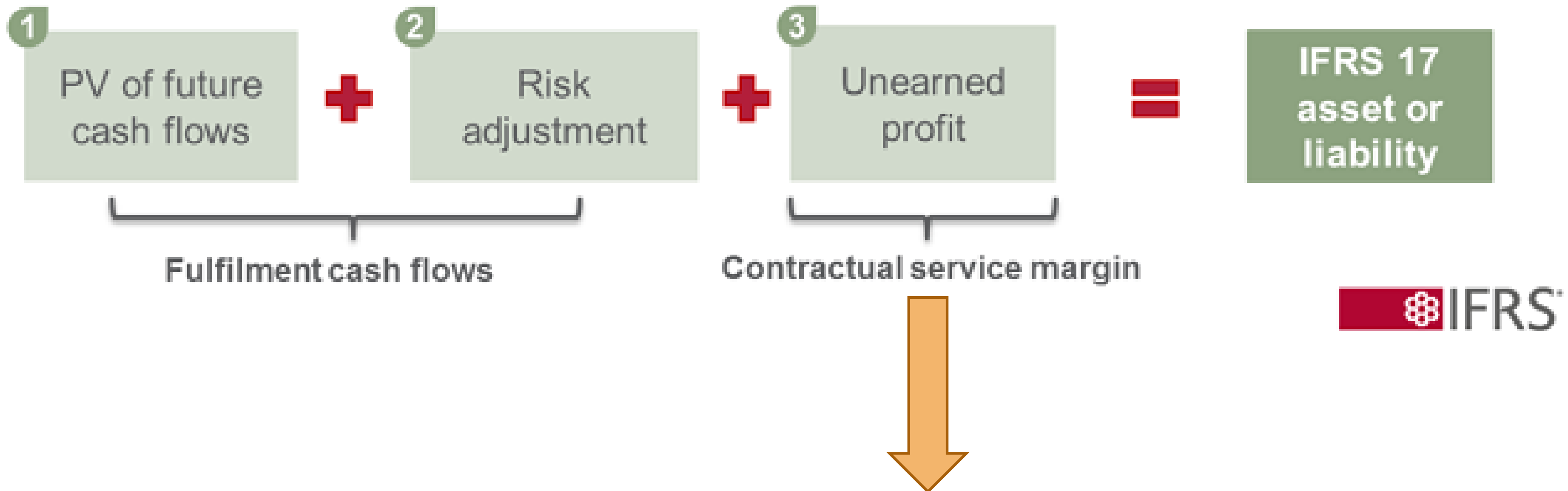
- Unbiased
- Current assumptions
- Policy loans are included as cash flows
- Reinsurance flows are not aggregated with those of the policy

# Digging deeper



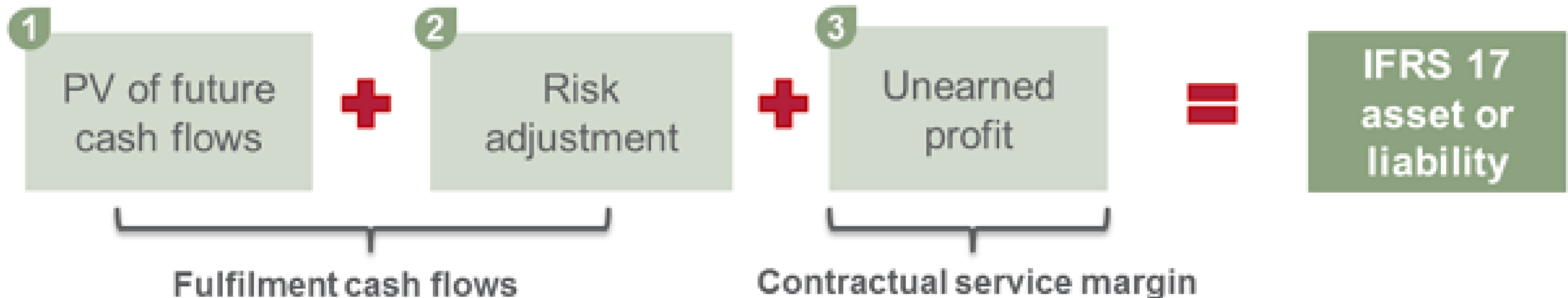

- Non-financial risks only
- Similar to a traditional actuarial margin for uncertainty
- Compensation for bearing the risk

# Digging deeper



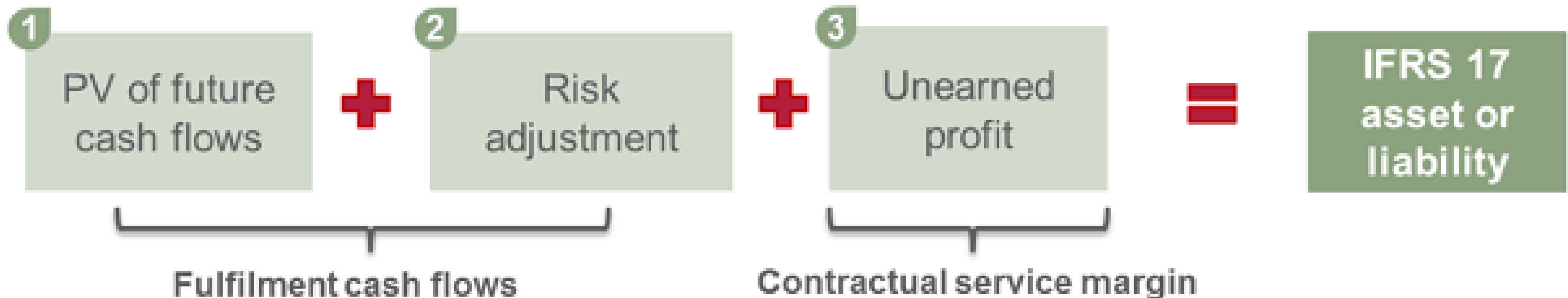

- "Plug" to prevent the initial recognition of profit

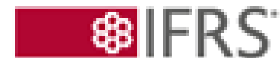
# Measurement



| EXAMPLE #1 | |
|---|---|
| PV of future cash flows | (200) |
| Risk adjustment | 75 |
| Unearned profit | 125 |
| **IFRS 17 liability** | 0 |

# Measurement




| EXAMPLE #2 | |
|---|---|
| PV of future cash flows | 50 |
| Risk adjustment | 75 |
| Unearned profit | 0 |
| **IFRS 17 liability** | 125 |

# Measurement - Discounting

- Reflect the characteristic of cash flows (currency, timing, liquidity)
- Consistent with observable market prices
- Not based on the Company's assets

# Reinsurance

- Treated as a separate contract – no more netting
- Method chosen depending on the terms of the reinsurance treaty, not the underlying policies

# Method for short-term business

- Much like a traditional unearned premium approach
- Except:
  - Discounting and risk adjustment for incurred claims if settlement would take more than 1 year
  - Have to immediately recognize loss for onerous groups

# Caribbean implementation challenges

- Mañana culture
- Determination of the discount rate
- Actuarial resources
- Data collection and analysis

# Implications – Smoothing is back (sort of)

- Expected profit is recognizing over time
- Unearned profit liability reduces volatility on income statement
- Might make it more attractive for insurers to write long-term business that is inherently volatile, e.g.
  - Term to 100
  - Individual long-term disability

# Implications – less recognition of pooling

- Consider a simplified issue life product covering funeral expense, credit card balance, etc.
- Often sold with very simple premium rates. Not distinct by sex, age, etc.
- Even if this coverage may be profitable, it may be onerous for certain ages and genders
- Rather than treat as a pool, IFRS 17 would require the profitable parts separated from the loss-making

# Implications – less recognition of pooling

- If this is a short-term product, it might not be a huge problem as the profits are recognized over the short coverage period …
- Unless the policies are sold in particular months
- If it is a long-term product:
  - the expected loss recognized immediately
  - The expected profit is deferred
- The net result will be an upfront loss

# Implications – less recognition of pooling

- Might the tail wag the dog?
- A possible insurer reaction is to charge premiums rates that match underlying risk
- Easier with modern technology as the software can easily calculate the correct premium
- Not all selling situations are automated for insurance.
- May have implication for the customer experience and the sales volumes

# Implications – capital intensive products

- These products' profitability is significantly reliant on investment income
- But the actuarial reserves must be calculated using discount rates that exclude market risk, etc.
- This leads to a greater likelihood that segments of these products are onerous at issue
- As the products themselves are very long-term, the profits will be recognized slowly as realized investment income, exceeds that anticipated

# Implications – capital intensive products

- Consider a life company bidding for a large group of payout annuities as part of a pension windup.
- Will the accounting treatment cause:
  - Upward pressure on premium rates to limit the initial loss that has to be recognized?
  - Reduce companies willingness to quote?
  - If either is the case, this is a net loss for consumers and insurers.

# Implications – capital assessment

- Is the risk adjustment and unearned profit, capital?
- What will regulators do? Need new capital models or adjustments to existing ones.
- If insurers barely complete their readiness in time, there is no way that regulators will be ready
- How will the potential unavailability of revised capital models affect shareholder dividends, product filings, etc.?

# Implications – capital assessment

- What will rating agencies do?
- What will lenders do?

# Implications - bonuses

- How would employee bonus structures be affected?
  - Today’s profit will be due to yesterday’s sales
  - Will metrics other than profit be used to make bonus more responsive to business performance?
  - There are arguments in favour of tying executive pay to long-term results in order to reduce excessive risk taking

# Summary

- Law of unintended consequences is not an argument against IFRS 17
- IFRS 17 financials do <u>not</u> convey the same information as do IFRS 4 financials. Users need to appreciate the differences