IFRS 17
Insurance Contracts

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THE WORLD BANK
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Швеція
Sverige

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Questions and answers

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Questions

If a company defines RA equal to RM calculated according to the SII requirements, should it mention that there was used CoC risk metric with the confidence level equal to 99,5%?

» The standard requires disclosure of:

> *…the confidence level used to determine the risk adjustment for non-financial risk. If the entity uses a technique other than the confidence level technique for determining the risk adjustment for non-financial risk, it shall disclose the technique used and the confidence level corresponding to the results of that technique.' IFRS 17.119*

» To the extent that 99.5% represents the 'confidence level used' or 'confidence level corresponding' then it should be disclosed

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Questions

For the purpose of RA estimation, is it allowed to use different confidence levels for different portfolios? Different confidence levels for LIC and LRC inside the same portfolio? Different risk metrics?

» IFRS 17 requires risk adjustment the entity demands as compensation

» Applying this could logically result in different confidence levels

» However, information about insurance risks and how they are managed must be disclosed *IFRS 17.122*

  » Different method or measures relate to how managed

  » Information would typically be provided to explain both how measured and why measured that way

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Example
Reasons for different confidence level

- Data quality and availability
- Diversification
- Reinsurance availability & price
- Capital availability
- Risk appetite
- Competition
- Product life cycle

Questions

Let us assume that the company holds a proportional reinsurance contract that covers several underlying insurance portfolios. Is it allowed to consider such a reinsurance contract as a collection of different contracts, split according to the underlying insurance portfolios?

» Typically not: contract shouldn't be separated unless that is the substance

» However, this should not change the measurement:

> *….the Board noted that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. Therefore it may not be necessary for an entity to restrict groups in this way to achieve the same accounting outcome in some circumstances. IFRS 17.BC138*

Examples
Separation – reinsurance held

- Separation of reinsurance contract may be justified when:
  - Each underlying portfolio has been separately designated in the contract
  - Duration for each underlying are independent of each other
  - Options on extension/termination are independent
- Typically occurs where an umbrella agreement or treaty establishes all the principles, but each area of cover is subject to separate schedules
- However TRG stated: 'Reinsurance: fact that underlying contracts are included in different groups is not sufficient to conclude that accounting as a single contract does not reflect its substance'

TRG February 2018, Paper 1

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Examples
Separation – reinsurance held

Does it matter:

- IFRS 17 requires reinsurance group be remeasured at each reporting date
- Changes are absorbed in CSM - no requirement for onerousness
- If, and to the extent that:
  - Underlying group in whatever portfolio is onerous **AND**
  - Reinsurance provides protection against related losses
- Then CSM is released as income to profit and loss
- **Unit of account should not matter**

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Questions

In the case where one or more underlying groups are onerous, how to estimate and account for the offsetting effect of reinsurance on loss component for underlying onerous contracts? How to do this when direct insurance and reinsurance are accounted under PAA and GMM respectively? PAA vs. PAA? GMM vs. PAA? GMM vs. GMM?

- At a high level, IFRS 17 allows for the release of profitability from the reinsurance contract to the extent of the protection:
  - Remeasure underlying gives loss
  - Remeasure reinsurance, to the extent that remeasure relates to recognised loss, recognise gain

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Questions

Is it allowed to split the reinsurance contract into components, if it contains both proportional and non-proportional parts? If yes, how exactly?

- No. Accounted for as a single contract unless it is in substance two contracts
- Remeasure contract as a whole. If and too the extent a component of underlying is onerous, identify how much of the onerous is covered by reinsurance

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Example

» Expected claims on underlying group increase by $1 200

Scenarios	Change	Probability	Effect
1. Claims remain the same	0	20%	0
2. Claims increase by $1 000	-1 000	50%	-500
3. Claims increase by $2 000	-2 000	20%	-400
4. Claims increase by $3 000	-3 000	10%	-300
Weighted Present value			-1 200

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Example

» Expected claims on underlying group increase by $1 200

» Group was previously breakeven, now anticipate loss of $1 200

  » Record loss of $1 200 in income statement

» Group is 40% proportionally reinsured and subject to excess of loss above $2 000

  » Reinsurance held is remeasured, expected inflows increased by $540

    » $480 relates to 40% of expected loss

    » $60 relates to additional expected scenarios in which excess of loss in triggered (excess of $1 000 x 10% x 60%)

  » $540 gain released to profit and loss

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Example

» Expected claims on underlying group increase by $1 200

Scenarios	Change	Probability	Effect	Reinsure
1. Claims remain the same	0	20%	0	0
2. Claims increase by $1 000	-1 000	50%	-500	200
3. Claims increase by $2 000	-2 000	20%	-400	160
4. Claims increase by $3 000	-3 000	10%	-300	120 + 60
Weighted Present value			-1 200	540

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Questions

In Ukraine, there are practically no financial instruments denominated in foreign currencies (euro, US dollar), while in terms of life insurance, endowment contracts nominated in euro and dollar are attractive to clients. How can we calculate the discount curve in our case? Especially given the conditions of war and the practically frozen state of the security market.

» How, if an at all, do you measure for pricing, prudential reserving?

» How do you manage the risk?

» What if any assets do you invest in?

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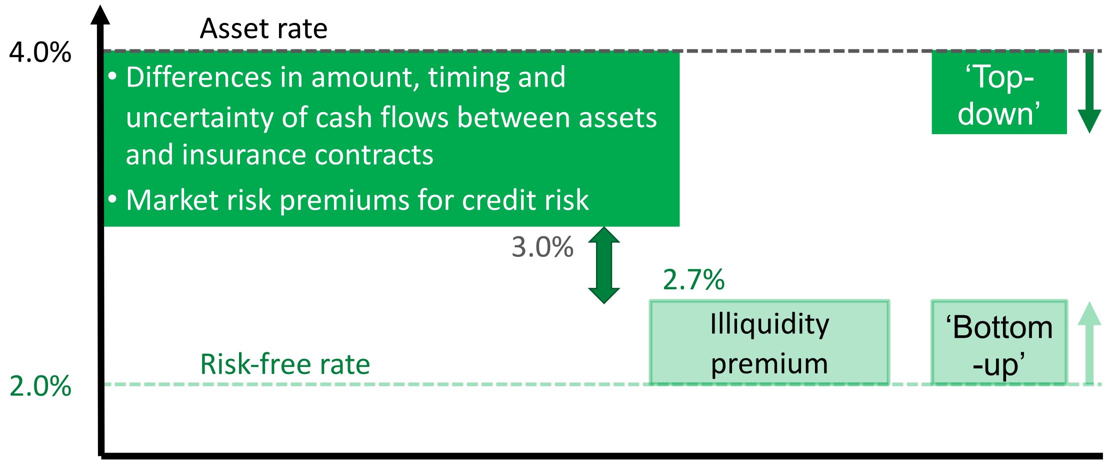
Present value of future cash flows
Determining the discount rates



Questions

Could you please give a practical example of probability weighted cash flows which is not so simple as presented on the slide 42 of the presentation or just explain how to make probability weighting in practice?

» It is not simple!

Questions

» The principle is relatively simple. For a contract with the following possible outcomes (10% discount rate):

	Scenario	Prob	Present value	PV x probability
1.	Pay claim of 5 000 in 6 months	5%	4 761	238
2.	Pay claim of 5 000 in 12 months	5%	4 545	227
3.	Pay no claim, pay rebate of 1 000	80%	909	727
4.	Pay no claim, pay no rebate	10%	0	0
Probability weighted cash outflow				1 193

» The challenge is the data and the number of scenarios

  » Eg assumptions of different sizes of claims, or lapse rates

Questions

Talking of stochastic modelling for financial options and guarantees on the slide 39, could you please provide an example of such embedded derivatives?

» The most common are insurance related eg:

  » The option to increase insurance coverage at predetermined price with re-underwriting

  » A guaranteed minimum return on a unit linked contract

  » An option to add riders to a contract without re-underwriting

Questions

May I ask you to explain of other comprehensive income (OCI) aggregation approach in details?

» Simple example (we will expand on this in disclosures section):

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Example

» Insurer anticipates a claim in 10 years time of $1 000 000

» Discount rate at inception in 10%

» No other cash flows

» Discount rate:

   » At end year 1: 10%

   » At end year 2: 7.5%

   » At end year 3: 7.5%

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Example cont…

End Yr	Liability @ current %	Change in value	Interest unwind @ original %	Profit or loss	Change in rate	Accum OCI
0	385 543					
1	424 098	38 554	385 543 x 10%	38 554	0	0
2[A]	466 507	42 410	424 098 x 10%	42 410	0	0
2[B]	560 702	136 605	424 098 x 10%	42 410	94 194	94 194
3	602 755	42 952	466 597 x 10%	46 650	-4 598	89 597
4	647 962	45 207	513 158 x 10%	51 316	-6 109	83 488
5	696 559	48 597	564 474 x 10%	56 447	-7 850	75 637
6	748 801	65 787	620 921 x 10%	62 092	-9 850	65 787

A Interest rates at 10% B Interest rates are 7.5%

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Example cont…

End Yr	Liability @ current %	Change in value	Interest unwind @ original %	Profit or loss	Change in rate	Accum OCI
7	804 951	56 160	683 013 x 10%	68 301	-12 141	53 646
8	865 333	60 372	751 315 x 10%	75 132	-14 759	38 886
9	930 233	64 900	826 446 x 10%	82 645	-17 745	21 142
10	1 000 000	69 767	909 091 x 10%	90 909	- 21 142	0

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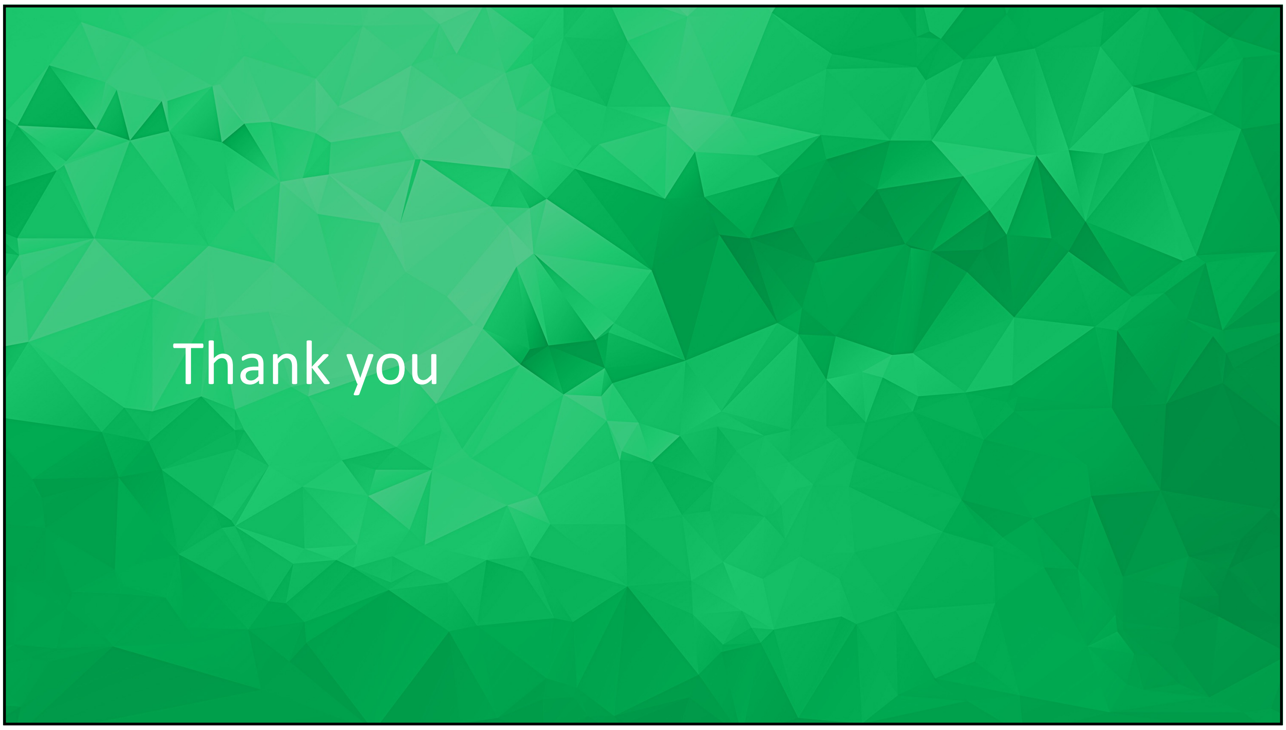

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