International Actuarial Association
Association Actuarielle Internationale

IAN 100 Webinar

Wednesday, October 20, 2021

Agenda

- Introduction
- IAN 100
- Next Steps
- Bow-wave effect
- Questions / Discussion

Today's presenters

Derek Wright

Derek is the current chair of the Insurance Accounting Committee and was joint chair of the groups that developed IAN 100. He was also a member of both the IAA's ISAP4 and IFRS17 task forces. Prior to his retirement, Derek was a partner of Deloitte LLP in the UK and latterly Canada and is now a non-executive Director.

Tara Wolf

Tara Wolf is a Principal with EY's New York office, with over 25 years serving the life insurance industry. She specialized in advanced financial reporting topics such as IFRS, US GAAP LDTI and Fair Value. She is a past chair of the SOA's Financial Reporting Section Council and current Vice Chair of the IAAs Insurance Accounting Committee as the SOA's representative.

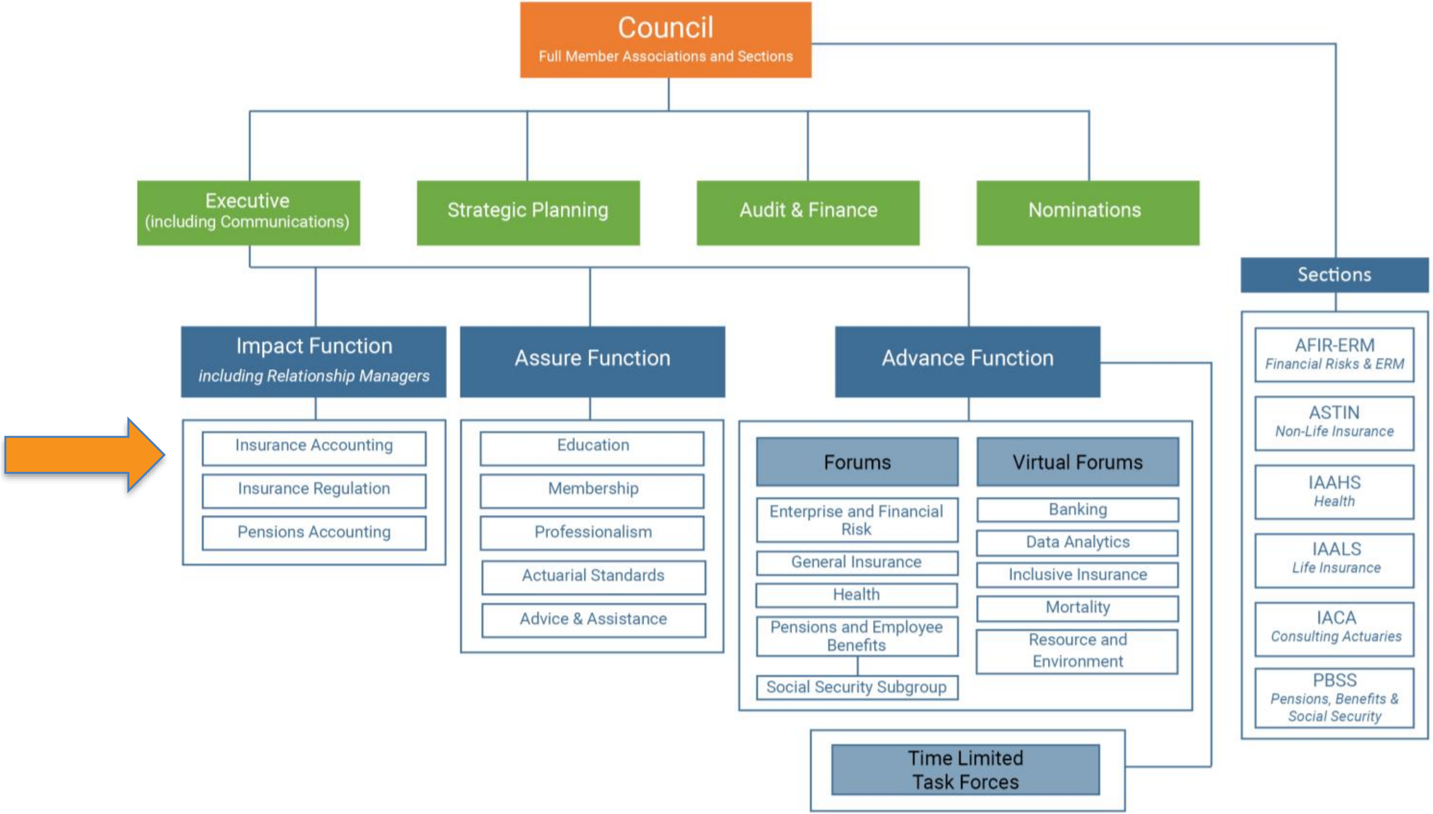
Max Happacher

Dr. Maximilian Happacher has been a member of the German Actuarial Association (DAV) since 2003, where he was elected as Vice Chair of the Executive Board in April 2021. In addition to this, he heads the "IFRS 17" working group as well as the "Accounting & Regulation" committee. Moreover, he is member of the committee "Life Insurance". On top of his involvement within the DAV, Maximilian Happacher is Vice Chair of the Insurance Accounting Committee of the IAA as DAV representative.

Dave Finnis

Dave is an actuary specializing in international insurance accounting, regulatory and supervisory issues. He has over 40 years' experience working predominantly in the UK and Australia, but also, Europe, Asia and the Middle East.

The Insurance Accounting Committee



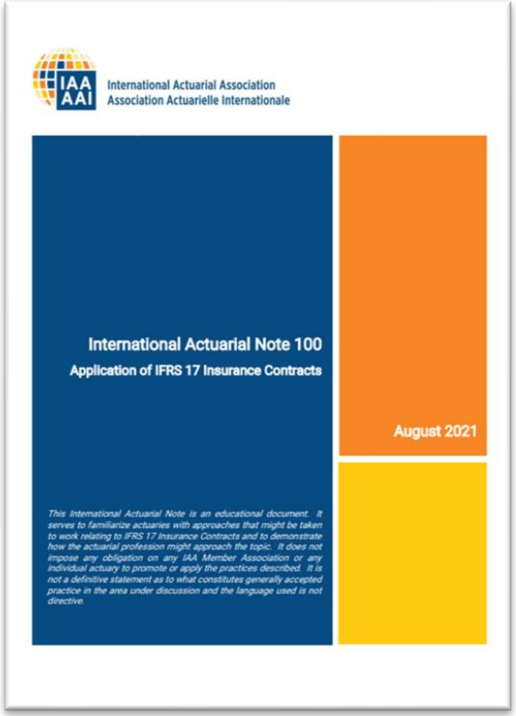
What is an IAN

- An educational document on an actuarial subject that has been adopted by the IAA in order to advance the understanding of the subject by readers of the IAN, including actuaries and others, who use or rely upon the work of actuaries.
- It is not an ISAP and is not intended to convey in any manner that it is authoritative.
- IANs may be issued

a) To assist actuaries in complying with an ISAP, for example by offering practical examples of ways in which actuaries might implement an ISAP or International Financial Reporting Standard (IFRS) in the course of their work, or

b) To provide non-binding guidance on an actuarial topic for which the IAA has not developed an ISAP.

International Actuarial Note 100 (IAN 100)


International Actuarial Association
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International Actuarial Note 100
Application of IFRS 17 Insurance Contracts

August 2021

This International Actuarial Note is an educational document. It serves to familiarize actuaries with approaches that might be taken to work relating to IFRS 17 Insurance Contracts and to demonstrate how the actuarial profession might approach the topic. It does not impose any obligation on any IAA Member Association or any individual actuary to promote or apply the practices described. It is not a definitive statement as to what constitutes generally accepted practice in the area under discussion and the language used is not directive.

- Written to assist actuaries in complying with IFRS 17 and ISAP 4
- Covers main topics of IFRS 17 in five sections / 17 chapters
- Not a definitive statement of accepted practice and language is not directive

To access: www.actuaries.org → Publications → IANs

Introduction & Section A – General Measurement Approach (GMA)

	Chapter	Key content
	1. Introduction	• Scope, classification & measurement
	2. Estimates of future cash flows	• Current estimates, scope of fulfilment cash flows
	3. Discount rates	• Techniques for setting discount rates
	4. Risk Adjustment (RA)	• Requirements and considerations for setting RA
	5. Level of aggregation	• Portfolios, groups and onerous contracts
	6. Contractual Service Margin (CSM) and Loss Component (LC)	• Requirements and considerations for CSM & LC

Section B – variations to GMA

	Chapter	Key content
	7. Premium Allocation Approach (PAA)	• Assessing eligibility for PAA • Initial and subsequent measurement using PAA • Onerous contract assessment
	8. Contracts with participation features	• Requirements and considerations for contracts with different types of participation features • Eligibility and measurement using the Variable Fee Approach (VFA)
	9. Reinsurance	• Requirements and considerations for both reinsurance contracts held and reinsurance contracts issued

Sections C, D & E – other topics

	Section	Key content
	C. Uses of fair value	• Fair value approaches • Business combinations & portfolio transfers • Transition
	D. Other IFRS 17 topics	• Embedded derivatives • Contract modification & derecognition
	E. Presentation and disclosure	• Explanation of key terms • Presentation requirements • Disclosure requirements

Next steps………

Aim: to maintain, and upgrade, if necessary, the educational support for IFRS 17, through

1) **Influencing** relevant global participants

2) Obtaining **assurance** regarding the type and detail of support

3) **Advancing** actuarial practice as needed

This will require the establishment of one or more task forces.

Influence

- Continuing liaison with IASB
- Monitoring the use of the “actuarial model” that acts as the foundation for IFRS17
- Organisation of Webinars and other educational tools to spread the word

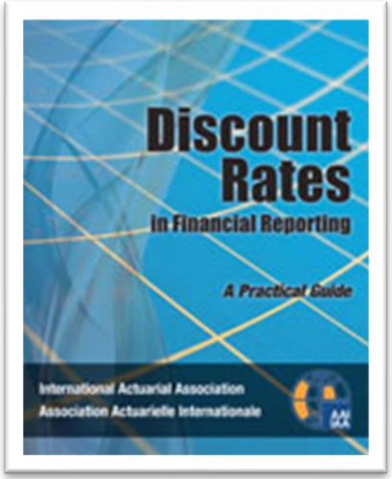
Assurance

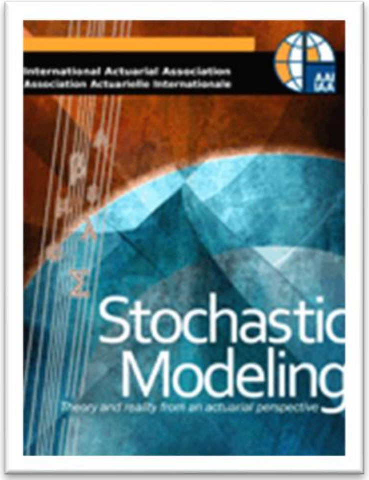
- Monitor usage of IAN 100 by various IAA member associations
- Maintain the “boundary” between IAN 100 and education produced by individual associations
- Assess additional educational needs for various associations

Advancement

- Production of examples to augment current IAN 100 educational material
- Continuing reflection of developing actuarial practice in IAN 100
- Keeping abreast with the effects of any changes to IFRS17 and actuarial perspective on the Standard

Other IAA Reference Materials





Model International Standard of Actuarial Practice 4

IAA Monographs

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Bow-wave-effect

an example for what comes next

IAN100 – next steps

Agenda

1 What is the bow-wave-effect?

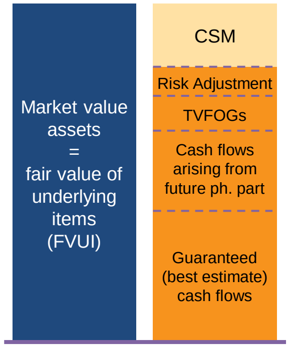
2 An effect most likely not intended by IASB –
Why is the bow-wave-effect a problem?

3 Two approaches to solve the problem

4 The process to find a solution, including discussions with audit firms and IFRIC

Recap: Calculation of unlocking

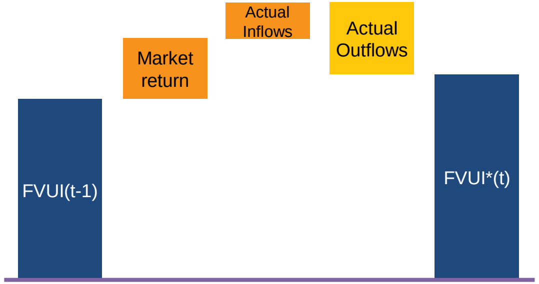
Underlying Items (UI)



The fair value of underlying items equals the market value of assets backing the liabilities and is defined per mutualisation unit (i.e. Sicherungsvermögen).

Roll forward of UI

$$FVUI^{*}(t) - FVUI(t-1)$$
$$= MVreturn(t) + CashIn(t) - CashOut(t)$$

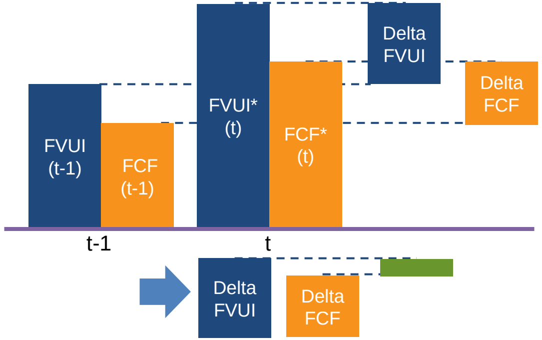


The change in the underlying items of a mutualisation unit can be precisely determined, it contains:

- The market return on assets, i.e.
  - Assets IFRS Investment income on assets
  - IFRS OCI for assets measured at FVtOCI
  - Changes in hidden reserves on assets measured at amortized cost.
- Actual cash in- and outflows of the reporting period

CSM unlocking

The change in entity's share for one mutualisation unit is determined from the reconciliation of the fair value of underlying items and the fulfilment cash flows.



$$CSMunlocking(t)$$
$$= MVreturn(t) + CashIn\,(t) - CashOut\,(t)$$
$$-\ (FCF^{*}(t) - FCF\,(t-1))$$

What is the bow-wave-effect?

Explanation of the "Bow-wave-effect" in the VFA

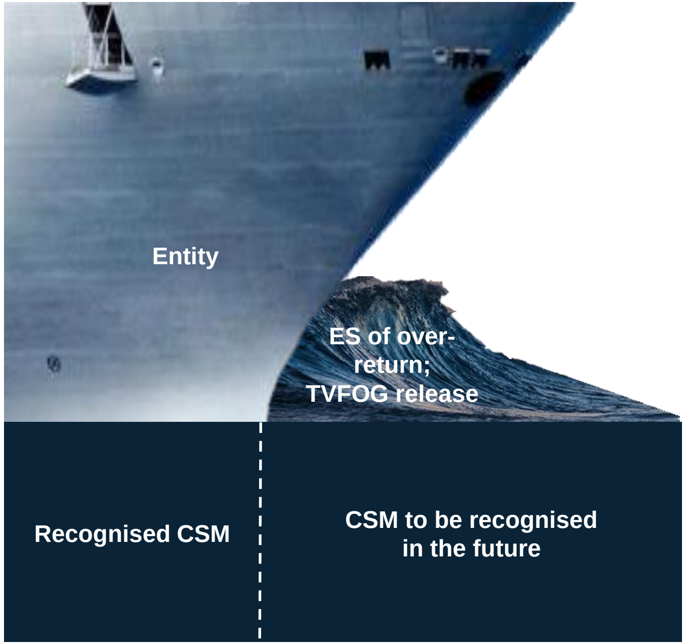
- The liabilities under the VFA are measured using market consistent stochastic modelling, which implies that under arbitrage-free pricing assumptions only a risk neutral interest can be generated.
- In reality, however, insurers expect to earn some interest in excess of what is implied in the risk neutral valuation, often called over-return.
- This discrepancy is set off against the CSM via the CSM-unlocking. In addition, the value of in the insurance contracts embedded options and guarantees „naturally“ decrease over time (i.e. release of TVFOG) and would also be reflected in the CSM-unlocking. This approach does not differentiate between unit-linked business and traditional business.

Thus, the expected (real world) CSM-unlocking can be depicted as:

$$CSMunlocking(t) = CSMinterest_{riskneutral}(t) + OverreturnES_{Exp}(t) + TVFOGrelease_{Exp}(t)$$

- Apart from the adjustment for the risk-neutral interest on the CSM, the CSM is also adjusted for the entity's share of the over-return $OverreturnES_{Exp}(t)$ and the release of TVFOGs $TVFOGrelease_{Exp}(t)$. Including these effects in the CSM would give rise to:

Illustration of the "Bow-wave-effect" in the VFA



An effect not intended by IASB – why is the bow-wave-effect a problem?

1

Neither the IFRS 17 Standard nor further sources close to the IASB address this issue.

2

Consequently, the preparer has to comply with the rules stated in IFRS 17 B119 regarding the CSM release via coverage units.

3

In contrast, a systematic delay of profits appears to be not in line with the objective of IFRS 17 B119

Ultimately, the “Bow-wave-effect” needs to be challenged and potentially corrected.

Paragraph B119 of IFRS 17[1]

“An amount of the contractual service margin for a group of insurance contracts is recognized in profit or loss in each period to reflect the services provided under the group of insurance contracts in that period (see paragraphs 44(e), 45(e) and 66(e)).

The amount is determined by:

a) identifying the coverage units in the group. The number of coverage units in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration.
b) allocating the contractual service margin at the end of the period (before recognizing any amounts in profit or loss to reflect the services provided in the period) equally to each coverage unit provided in the current period and expected to be provided in the future.
c) recognizing in profit or loss the amount allocated to coverage units provided in the period.”

[1] Source: https://www.ifrs.org/content/dam/ifrs/meetings/2018/february/trg-for-ic/ap5-quantity-of-benefit-for-coverage-units.pdf

Two approaches to solve the problem

Approach 1

Derivation of the CSM release on the basis of a separately calculated real world shadow CSM. This CSM is calculated on a deterministic basis using real world assumptions (similar to traditional embedded value calculations).

Approach 2

Using an additional step for the CSM release to show the annual impact on the entity share of the overreturn and the expected release of the time value of options & guarantees (TVFOG) directly in the P&L:

Additional release to reflect

- the **credit spreads and expected over-return earned** in the current period
- the **expected release of TVFOG's**

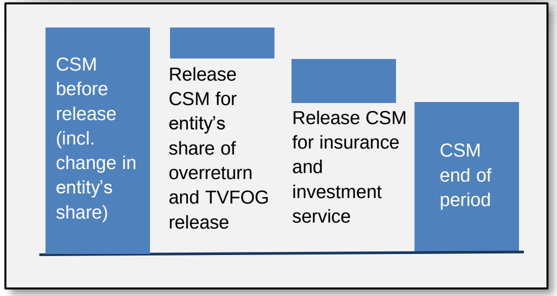
Releasing the CSM based on the volume-based coverage units

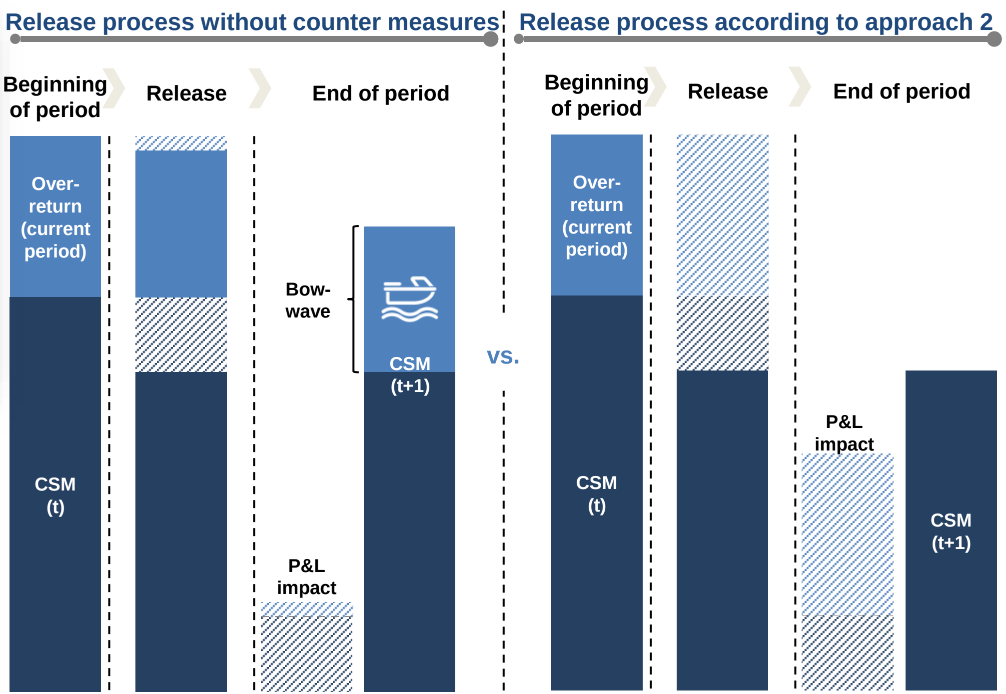
- the remaining CSM is released to the P&L on the basis of coverage units
- the released amount in to the P&L is to reflect the provision of both insurance and investment related services to the policyholder.

Illustration of today's release process vs. release according to approach 2

IFRS 17 P&L - VFA *Illustrative & simplified*

€m	Year X
Expected claims & expenses	1,200
Release CSM	50
Release risk adjustment	30
Insurance Revenue	**1,280**
Incurred claims & expenses	(1,220)
Changes through underlying items	20
Insurance service expenses	**(1,200)**
Insurance service result	**80**
Investment income (IFRS 9)	300
Insurance finance expenses	(300)
Net financial result	**-**
Profit or loss (VFA business)	**80**





Backup: Motivation for second approach

- Differences between a risk neutral and an actual expected ("real world") view are adequately considered in the IFRS result.
- Had the actual expected return been considered at inception the CSM release would be comparable.
- The approach to release the shareholders' part of differences between actual expected and risk-neutral return directly into profit resolves the bow wave effect.

- **The accounting justification** for this approach is that it meets the objective set out in IFRS 17.B119 sentence 1.
- The guidance in sentence 2, (a) – (c) is not seen to be intended to provide an exact formula, as clarified by IFRS 17.BC282, hence the formula applied may be styled to meet the objective. That is as well done by the proposed styling of the formula in IFRS 17.BC282 in case of the General Model, where not discounting the coverage units would result as well to a bow wave due to the systematic increase of the CSM by accreting interest. The equivalent to accreting interest in the General Model is in the VFA the adjustment for insurer's share due to deviations of the actual returns on underlying items from those considered before. The correction of the second approach in the VFA represents the same type of correction as the discounting of coverage units in the General Model.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Questions?

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Thank you for your attention

International Actuarial Association
Association Actuarielle Internationale
1203-99 Metcalfe, Ottawa ON K1P 6L7 Canada
Tel: +1-613-236-0886 **Fax:** +1-613-236-1386
Email: secretariat@actuaries.org
www.actuaries.org