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IFRS17 : Experiences from implementing a global standard

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01 October 2019

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Agenda

- Introduction
- HSBC Life background
- HSBC IFRS 17 programme
- Technical challenges – VFA eligibility
- Practical challenges – CSM measurement, WDT
- Commercial challenges – non-GAAP measures, optimisation, embedding
- Q&A



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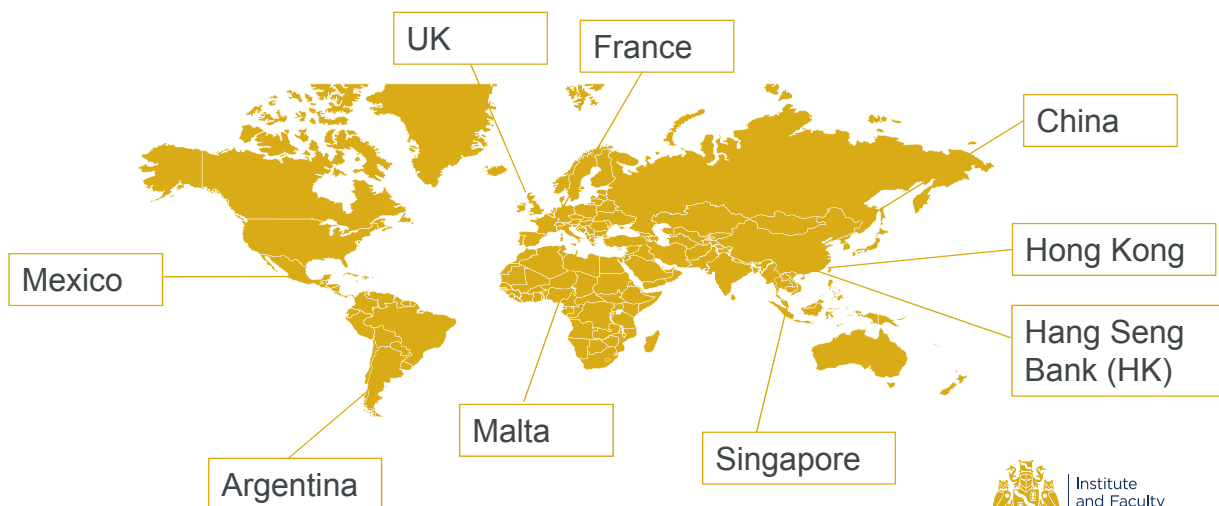
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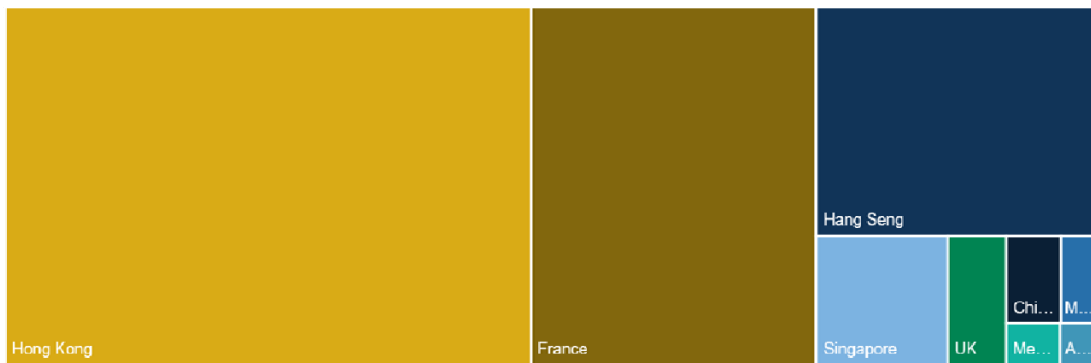
HSBC Life – Manufacturing locations



HSBC Life – Entity scale

HSBC Life Manufacturing Entities

■ Hong Kong ■ Hang Seng ■ Singapore ■ Argentina ■ Mexico ■ UK ■ France ■ China ■ Malta



HSBC Life – Global regulatory environment

Global

- No single regulator or capital regime
- Different IFRS17 adoption timing
- Low interest rate environment

China

- C-ROSS
- IFRS17 yet to be adopted

Mexico

- Solvency II style regime

EU

- Brexit
- Solvency II regime
- IFRS17 yet to be adopted

Hong Kong

- RBC regime at QIS3 stage
- IFRS 17 adopted

Argentina

- Political and economic turbulence

Singapore

- Revised RBC 2 regime being implemented

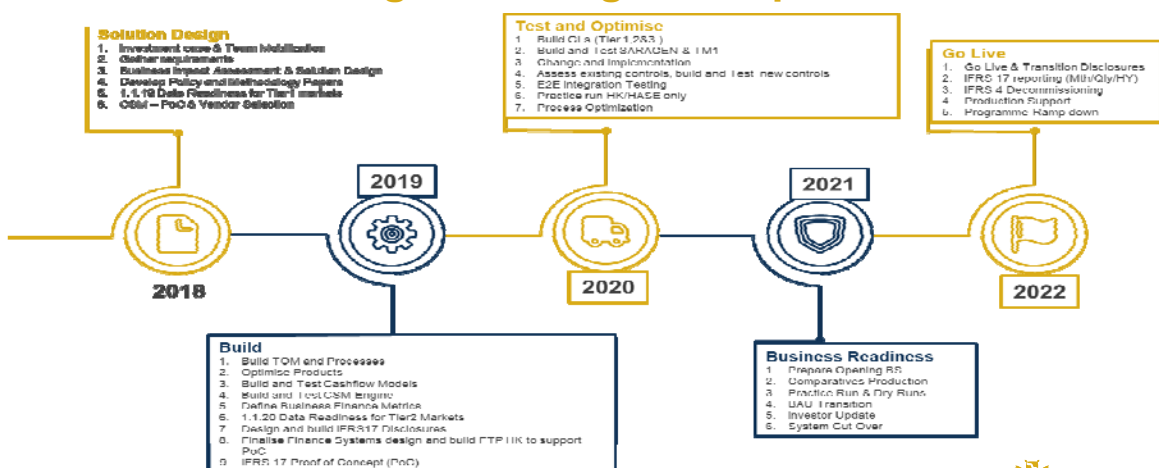


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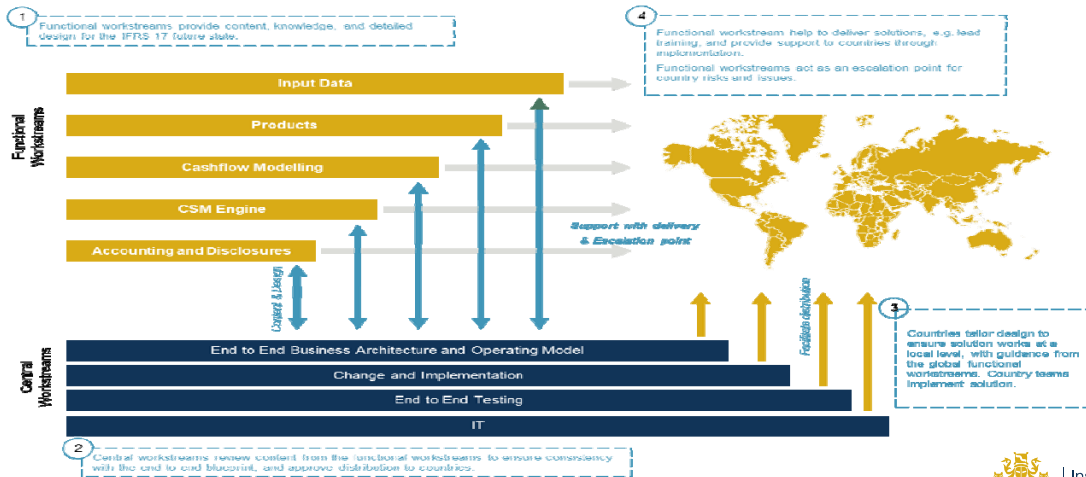
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IFRS17 HSBC Programme high-level plan



IFRS17 HSBC Programme structure



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IFRS17 technical developments

Discount Rate

- Current issues – illiquidity premium methodology – conceptually MA/VA * Application ratio
- SII VA is based on industrial average reference portfolio and application ratio, 65%, which may not be suitable to an individual company.
- SII MA requires rigorous matching requirement to qualify so only very specific type of product may qualify, e.g. traditional annuity.
- HK RBC MA QIS3 is proposing a methodology which derives the application ratio using company's own assets.

Mutualisation

- No market consensus, and lobbying continuing to seek relief within the Standard.
- Transition methodology implications.
- When allocating, what is a systematic and rational methodology over time?
- Can any relief be added to make this requirement achievable?
- What are the implications on future fund structures?
- Does this requirement actually provide any useful information to users of financial statements?



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IFRS17 technical development – VFA eligibility

Background

- For contracts with direct participation features - those that receive a share of the returns on a pre-defined pool of underlying items. An example product might be a unit-linked savings contract.
- This measures the insurance liability as the value of the underlying items to policyholders, less a "variable fee".
- The variable fee is defined as the insurer's share of the underlying items, less the cash flows due to the policyholder that do not vary based on the value of the underlying items.



HSBC challenges – diverse product and fund management structures

- Diversity of contractual arrangements and sharing mechanisms globally
- Lack of separate ring-fenced fund for Hong Kong participating businesses complicating the identification of underlying items
- Evolution of contractual terms over time due to introduction of new regulation and internal policy and management practices



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IFRS17 technical development – VFA eligibility (2)

Current issues – developing a theoretical and functional solution to meet the requirement

Level of granularity required in the eligibility assessment, both in terms of:

- Nature and extent of the evidence required to establish eligibility, including the balance of quantitative versus qualitative arguments and the range of scenarios tested to meet the variability requirements
- Groupings of contracts and allowance for mutualisation impacts

Treatment of certain cashflows, such as mortality/morbidity charges and costs, in any numerical assessments

Principles-based nature of the standard requiring significant judgment to be applied in practical application

HSBC key issues

Underlying items - Should they be based on unit funds/asset shares or something more complex? Expectation of further IASB guidance?

Variability criteria - In particular, where contracts are backed by assets which we intend to hold to maturity, how do we reflect variability?

Contractual links – Evidencing an enforceable link is challenging for some HSBC products given evolution of terms and conditions as well as regulations over time, and no ring-fenced fund approach for many entities.

Substantiality - Assessing and applying an exact definition of substantiality. Market consensus still seems to be moving.



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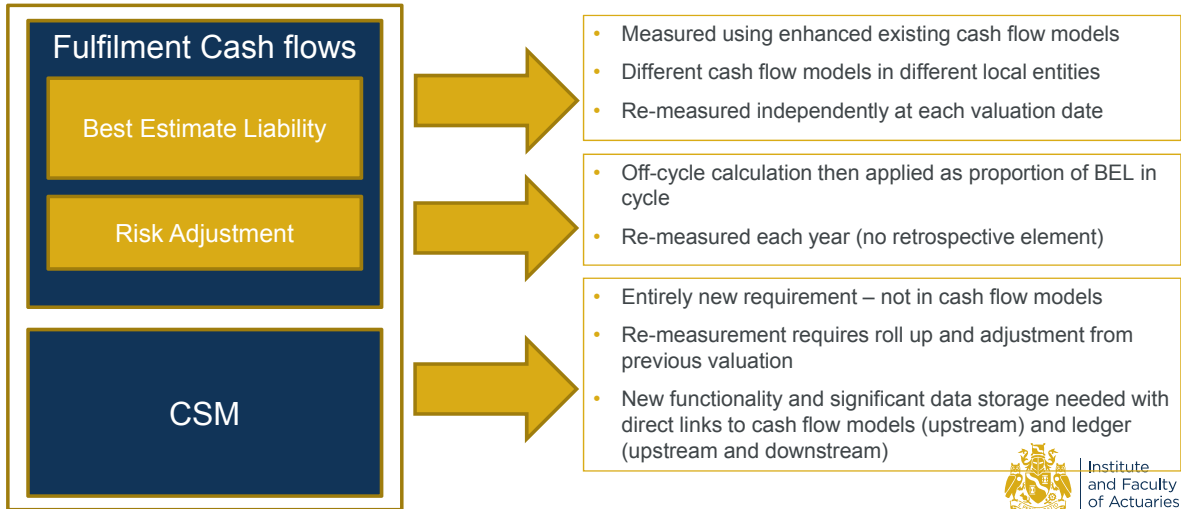
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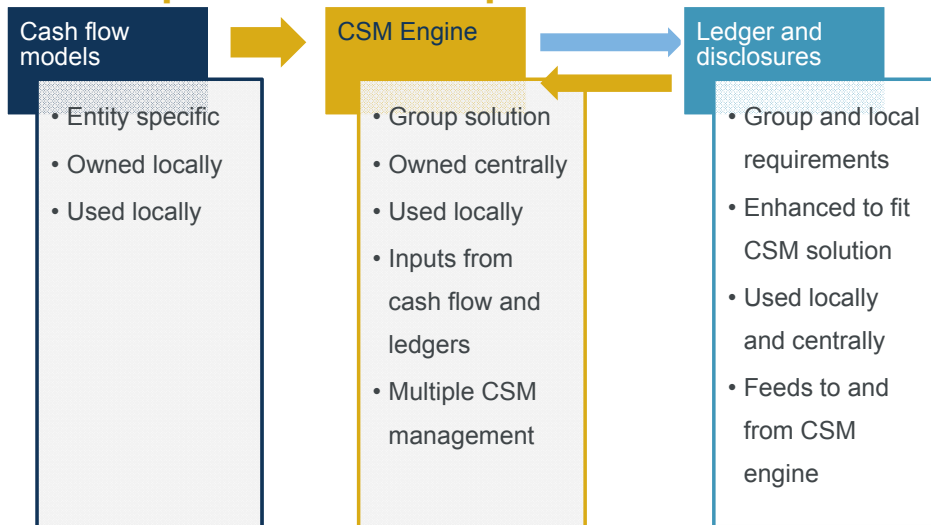
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IFRS17 practical development - CSM



IFRS17 practical development - CSM



IFRS17 practical challenge – Working Day Timetable

1. Current IFRS 4 results production is 5 WDs, performed hard-close and on-cycle (for HK)

Data prep	Run Cashflow modelling Simplified "real world" ESGs	Close GL Full P&L and BS Review	Produce Saracen submission	Full analysis of change on liabilities	Additional results / earnings analysis and explanation
WD1 – 2.5	WD 2.5 – WD5				

- Current focus is new business
- Movements for in-force book are analysed and explained post submission
- Full analysis of change performed post submission

2. Expected IFRS 17 results production is minimum of c. 10 WDs, hence performed off-cycle

Note: once the new process is embedded, automated and well understood, acceleration to 5 WDs could be achievable

Data prep	Run deterministic cash flows and manuals Market consistent ESGs	Run stochastic cashflow models inc. AOC	Risk adj. calculation inc. AOC CSM calculation inc. review, AOC and cashflow matching	Full P&L and BS Review Produce Saracen submission
WD1	WD 2 – 5	WD 4 – 7	WD 6 – 8	WD 9 – 10+

- IFRS17 introduces significant new calculations and process steps for ESGs, CSM calculation and Risk Adjustment [light blue boxes]
- IFRS17 requires movement for in-force book to be calculated and analysed within results
- Full analysis of change, therefore, becomes on the critical path and a key input into the CSM

<ul style="list-style-type: none"> • Validation of the data prep will be more complex (+0.5 day) 	<ul style="list-style-type: none"> • Valuing the cost of guarantees involves a significant increase in number of simulations for Market consistent stochastic cash flows (c5000 vs c1500) • AOC must be performed as an input into the CSM calculation, and for understanding the results drivers. This is a key change compared to the current process 	<ul style="list-style-type: none"> • Additional model run(s) to calculate IFRS 17 Risk Adjustment • New CSM calculation process step, inc. results validation and generating the accounting events / postings • Analysis of change on CSM is a new process step • Potential mismatches or issues with data inputs into CSM calculation 	<ul style="list-style-type: none"> • Additional effort and complexity required to review P&L and BS results at LOA granularity • Additional complexity for results drivers/explain • Analysis and review required on dual CSM, i.e. for local Insurance entity and Bank / Holding Co. entity results • Additional and more complex reporting and disclosures
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IFRS17 commercial challenges – non-GAAP measures

Use of VNB

As part of investor and analyst disclosures, other metrics are often presented. Post implementation of IFRS 17, additional disclosures may be considered either permanently or temporarily until IFRS 17 metrics become embedded and well understood.

Value of New Business (VNB) is such a metric which is used to disclose the impact of new business written in the year. In line with other firms, particularly in Asia, HSBC has historically provided VNB as part of regular disclosures.

IFRS17 and SEC rules

Once IFRS17 has been implemented, VNB will no longer be able to be disclosed in HSBC annual report and accounts or on the Group website without breaching SEC rules (i.e. those which we must comply with as part of our listing on the US stock exchange).

In particular, we interpret that following introduction of IFRS 17, VNB would be considered to be an "individually tailored accounting principle" and would therefore be prohibited in line with CD&I100.104.

Outcome

VNB may continue to be used internally and perhaps be used as supplementary information with analysts in Asia where not reporting VNB may put us out of step with peers.

However, in line with the interpretation of SEC rules, we would not include VNB in annual report and accounts or on Group websites.



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IFRS17 commercial - balance sheet optimisation

Bank Priority : Limiting P&L volatility under IFRS 17

Levers for volatility management

- OCI – A further option to bring some movements through other comprehensive income rather than P&L
- Use of risk mitigation options (and limited transition risk mitigation relief)
- Use of reinsurance offsetting
- Coverage units methodology
- Discount rate
- Grouping / LoA choices
- Optimising new business offering
- Adjusting or renegotiating reinsurance and commission structures where possible

How to maximize CSM (at transition or on new business)

- Transition - Spending money to develop systems (bearing in mind money spent is sunk cost – no additional value is created) – expectation that retrospective methods will provide a greater CSM than fair value.
- Transition - MRA or FVA where FRA is impracticable – making use of limited options under MRA
- VFA eligibility – where business is eligible, CSM offers buffer against some of the financial volatility

Key reliance on having methodology and system availability to give time to optimise before 1 January 2022



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IFRS17 commercial challenge – embedding IFRS17



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HSBC Life - Towards 2022

- **IFRS17 will redefine the results we present.**
- **Implementation must be about more than just producing these results.**
- Biggest insurance project ever undertaken by HSBC.
- Standard still moving, but generally concluding on many key areas and market consensus is beginning to form.
- Great progress made, and lots still to do!
- Ready to deliver by 2022, but crucial to understand, embed and optimise all reported numbers under IFRS 17.



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Questions



Comments

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