Institute
and Faculty
of Actuaries

Practical challenges of implementing the IFRS 17 Risk Adjustment

Jignesh Mistry - PwC
Rob Walton - PwC

13 November 2019

Agenda

1. Introduction
2. Results from PwC's industry survey:
   - Areas where there is broad agreement across the industry
   - Areas where there are varied proposals across the industry
   - Areas where the industry is undecided
3. Practical implementation challenges
4. Conclusion
5. Q&A

Institute and Faculty of Actuaries

Institute and Faculty of Actuaries

Introduction

13 November 2019

IFRS 17 PwC Risk Adjustment Survey

Our Process:

- PwC conducted a survey in September 2019 on the approaches being proposed for the IFRS 17 Risk Adjustment for non-financial risk ("RA").
- Thirteen large UK life insurers participated in the survey.
- PwC hosted a roundtable discussion with the respondents to discuss the survey results and the implementation challenges.
- We have supplemented these findings with our hands-on experience of supporting UK life insurers with the IFRS 17 RA.

Institute and Faculty of Actuaries

Institute and Faculty of Actuaries

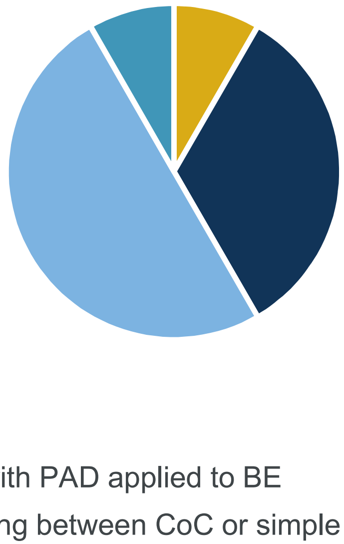
Survey results:

Areas where there is broad agreement across the industry

13 November 2019

Overall approach

What approach were survey participants proposing to use to determine the Risk Adjustment?



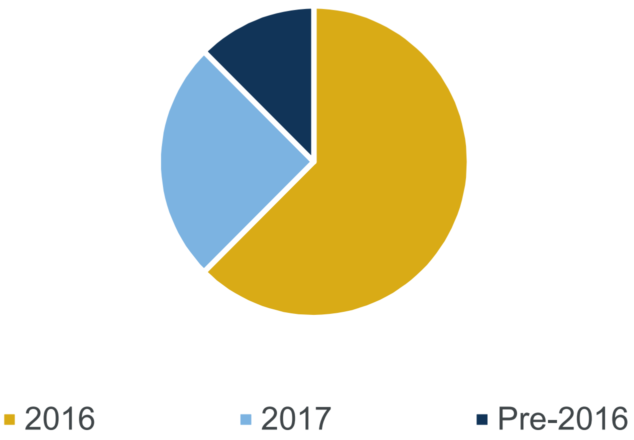
Comments:

- The VaR approach is the most common approach being considered by UK life insurers.
- Survey results showed an underlying desire from firms to leverage significantly from existing SII systems and methodology.
- The Cost of Capital approach is unpopular in the UK due to the volatile nature of the confidence level as a result of exposure to market movements.
- Most firms will adopt a 1-year approach to measurement (though not necessarily disclosure).

Institute and Faculty of Actuaries

Transition

Before what date was it considered impracticable to determine the risk adjustment in a fully retrospective approach at transition?



Comments:

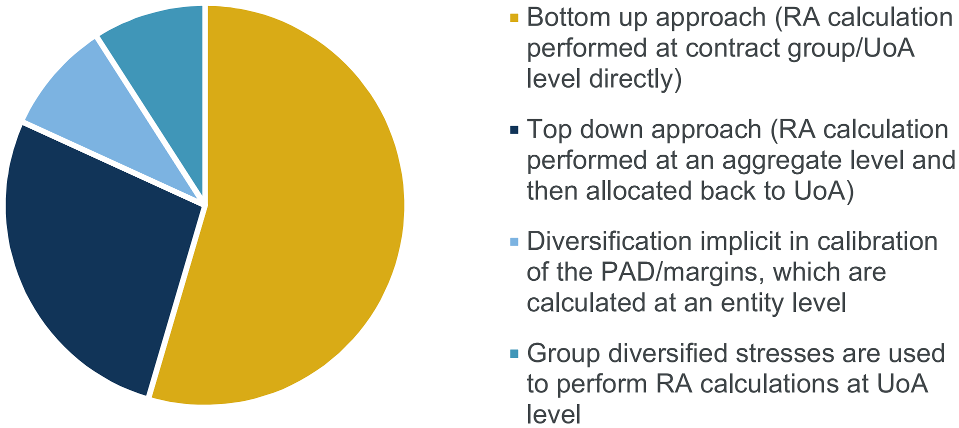
- Most firms are arguing that the advent of Solvency II means going further back than this date is impracticable.
- Analysis to understand what information relating to compensation for risk that was available prior to Solvency II / 2016 and which could have potentially been used to measure the RA will be required.
- Together with justification as to why these measures would not have been suitable for the RA (e.g. use of hindsight, etc.)

Institute and Faculty of Actuaries

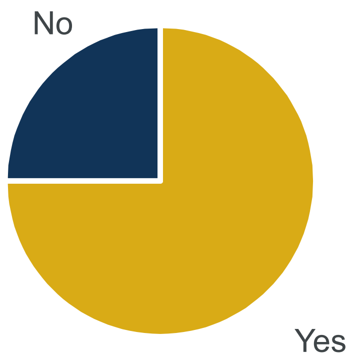
Diversification approach

How are the diversification benefits allowed for in the RA calculation?

i.e. At what level and how it will then be allocated back to units of account (UoA).



Will firms use the same diversification assumptions as SII?



- The most popular approach for aggregation and allowance for diversification is the bottom-up approach, given that most insurers are looking to adopt a PAD approach.

Institute and Faculty of Actuaries

Impact of S118 on reinsurance risk adjustment

The April TRG response to Log # S118 stated:

> *"… if an entity considers reinsurance when determining the compensation it requires for bearing non-financial risk related to underlying insurance contracts, the effect of the reinsurance (both cost and benefit) would be reflected in the risk adjustment for non-financial risk of the underlying insurance contracts.*
>
> *… the risk adjustment for non-financial risk of the reinsurance contract held could not be nil, unless:*
>
> *(a) the entity considers reinsurance when determining the compensation it requires for bearing non-financial risk related to underlying insurance contracts; and*
>
> *(b) the cost of acquiring the reinsurance is equal or less than the expected recoveries."*

We asked if respondents were adjusting their gross RA for the additional certainty of reinsurance given the April TRG response to S118?

- Nearly all aren't making further adjustments for S118.
- Adjustments would add additional complexity - for limited impact - on the net of reinsurance result

Institute and Faculty of Actuaries

Institute
and Faculty
of Actuaries

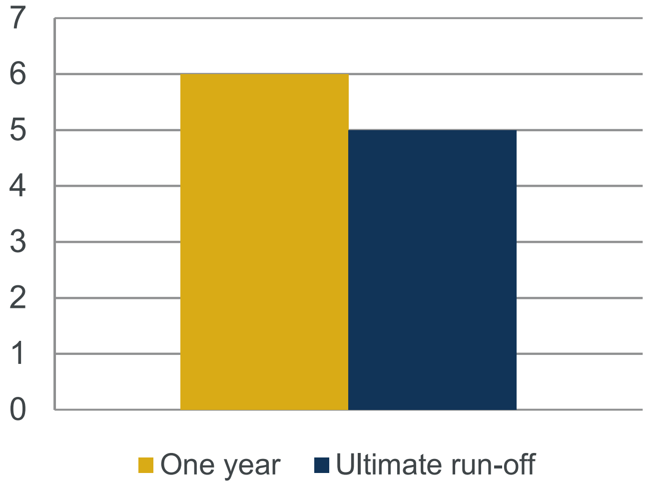
Survey results:

Areas where there are varied proposals across the industry

13 November 2019

Time horizon

What time horizon is being considered in the distribution of losses used when stating the confidence level for the RA in disclosures (as per para 119 of IFRS)?



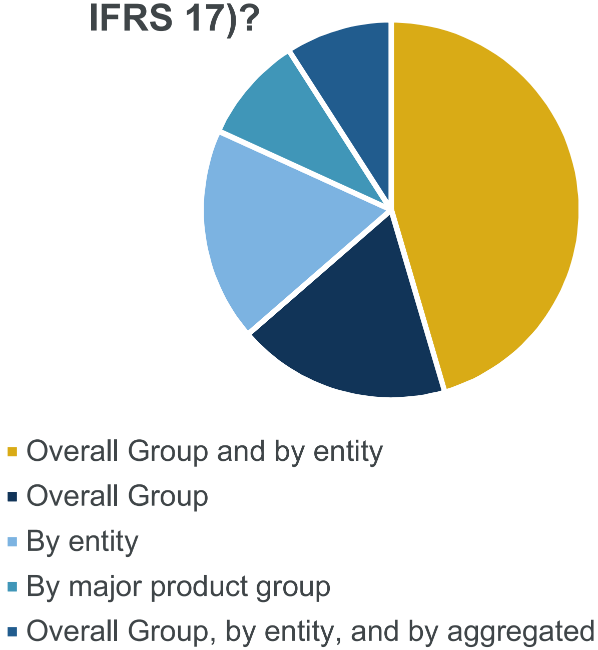
Comments:

- Although most firms are considering using a 1-year approach to measurement, the choice of what time period of losses to <u>disclose</u> the confidence level of the RA against is more evenly split.
- Most firms haven't finalised their approach to converting the RA from a 1-year view to an ultimate run-off view.

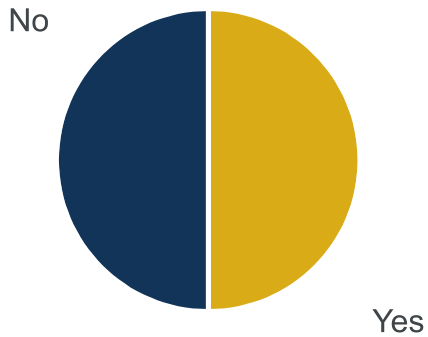
Institute and Faculty of Actuaries

Group treatment

What level are firms intending to disclose the RA at (per para 119 of IFRS 17)?



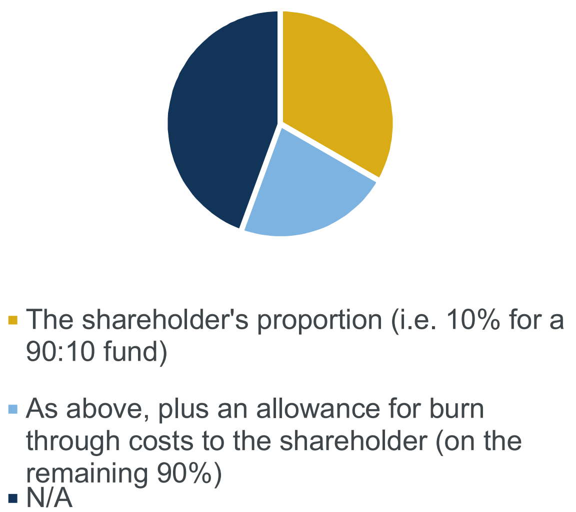
Are firms allowing for diversification benefits of Group entities?



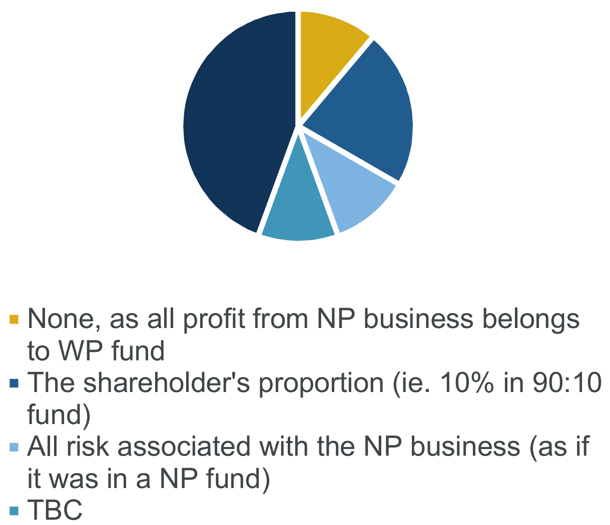
With-Profits

What proportion of risk has been allowed for in the derivation of the RA?

WP business in a 90:10 fund



NP business in a WP fund



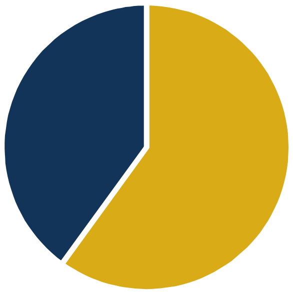
Comments:

- For non-profits business in the with-profits fund in particular, there was no strong consensus over the approach to follow.
- The treatment of non-profit business in a with-profit fund (more broadly) is an area of industry debate as highlighted in comment letters to the June 2019 IASB ED.

Negative risk adjustment

Negative risk adjustments could occur at a product level where the risk for certain products is inverse to the risk that bites at the overall Group level, e.g. protection products for a large annuity writer.

Do firms intend to allow a negative RA at a unit of account level?



- Yes – The RA will be allowed to be negative, noting the total will represent the full RA calculated
- No - Negative RA's will be floored at zero

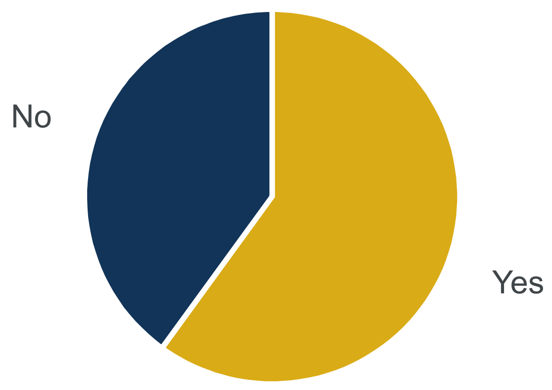
Comments:

- Some firms that are zeroising the negative RA are not proposing to reallocate this to other products with positive RAs.

Subsequent measurement

In view of the proposed clarifications in the June 2019 Exposure Draft, do insurers intend on disaggregating the change in the risk adjustment between the insurance service result and insurance finance income or expenses?

- **Yes**: Impact of discounting and financial risk on the risk adjustment is posted to P&L or OCI
- **No**: Impact of discounting and financial risk on the risk adjustment is posted to CSM



Institute and Faculty of Actuaries

Institute and Faculty of Actuaries

Survey results:

Areas where the industry is undecided

13 November 2019

Choice of confidence level

What confidence level were respondents proposing to use to determine the RA?

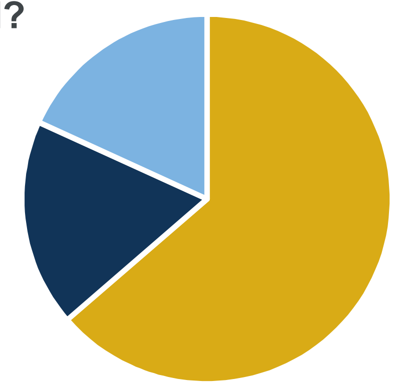
- Some indicated a provisional percentile (e.g. 70th, 75th, 90th percentile);
- Others have indicated a broader range of where this might land (e.g. 70-80th, 75-85th, 70-90th percentile)
- One respondent commented they would align to SII.

Comments:

- Most insurers stated that market practice will influence their chosen confidence level.
- Hence the confidence level is expected to converge over time.
- It was agreed that the most important aspect is the commentary surrounding the chosen confidence level included in the notes to the accounts.

Reinsurance held

How did respondents intend to measure the RA for reinsurance held?



- Directly
- Implicitly based on a 'gross less net' position
- PADs calibrated on net basis and same PADs applied to gross and net

Comments:

- Most insurers are proposing to determine the RA directly for reinsurance held.
- However this process has not yet been fully thought through with simplified methods being suggested.

Institute and Faculty of Actuaries

Operational aspects

Proposed modelling approach in the determination of the RA:

- SII IM
- Internal EC Model
- SII proxy model
- SII SF model
- Both proxy and IM
- Difference between PV of cfs with PAD and BE
- New process for IFRS17

Comments:

- Almost all participants plan to calibrate the stresses used to determine the RA on an annual basis.

- Some examples of the triggers for recalibration were:
  - Significant market movements
  - Event of major rebasing of or new risk drivers
  - Extension of internal model
  - Changes in business mix, risk distributions, correlations
  - Internal governance and review

  - The full operational challenges in producing IFRS 17 results, including the working day timetable, are yet to be fully considered by most insurers.

Institute and Faculty of Actuaries

Institute and Faculty of Actuaries

Practical implementation challenges

13 November 2019

Implementation challenges

- Converting 1-year to ultimate stresses
- Compliance with Group policy, with entities that don’t use Solvency II
- Fitting risk calibration runs into tighter reporting timelines
- Ensuring output RA reflects input confidence level
- Applying S118 requirements from April TRG
- Adjustments to Solvency II
- Storage of locked in assumptions and RA values
- Reinsurance RA methodology
- Use of hindsight & sourcing historical data for transition
- Allocating diversification benefits to the appropriate level

Institute and Faculty of Actuaries

Institute
and Faculty
of Actuaries

Conclusion

13 November 2019

Conclusion

- Broad agreement among UK Life insurers on the high-level measurement of RA.
- However, less consensus as companies move in to the detail of the calculation.
- There are a number of areas that are still undecided across the industry.
- Methodology choices are driven by insurers wanting to use existing Solvency II methods, which has proven difficult.
- Operational aspects of RA calculation are less developed and need more attention to ensure a smooth and successful transition.

Questions

Comments

The views expressed in this presentation are those of invited contributors and not necessarily those of the IFoA. The IFoA do not endorse any of the views stated, nor any claims or representations made in this presentation and accept no responsibility or liability to any person for loss or damage suffered as a consequence of their placing reliance upon any view, claim or representation made in this presentation.

The information and expressions of opinion contained in this publication are not intended to be a comprehensive study, nor to provide actuarial advice or advice of any nature and should not be treated as a substitute for specific advice concerning individual situations. On no account may any part of this presentation be reproduced without the written permission of the IFoA or authors, in the case of non-IFoA research.

Institute and Faculty of Actuaries

Institute
and Faculty
of Actuaries

Contact Details

Jignesh Mistry
Associate Director
M: +44 (0)7803 858526
E: jignesh.mistry@pwc.com

Rob Walton
Associate Director
M: +44 (0)7730 068834
E: robert.j.walton@pwc.com