ACTUARIAL SOCIETY OF SOUTH AFRICA

Quantifying Risk, Enabling Opportunity.

Role of the HAF in IFRS 17

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AGENDA

Introduction

Should the HAF be involved in IFRS 17?

What should the HAF's involvement be?

Conclusion

INTRODUCTION

Most insurers still coming to terms with IFRS 17

HAF role seems to differ between life and non-life insurers

Life

Most HAFs previously performed the statutory actuary role.

Part of statutory actuary role included confirming that the insurers were financially sound.

To do this, included having ownership of actuarial numbers (reserves).

Often observed that life HAF's sign-off on IFRS reserves, even though no requirement too. This is driven by tradition, and preferences of the Board.

Non-Life

No benefit of previous statutory actuary role to guide HAF role.

Research[1] shows that there is a large variation in the understanding of the HAF role for non-life insurers.

No requirements to sign-off on IFRS reserves, and no legacy of signing-off results.

Most non-life HAFs do not sign-off IFRS reserves.

Industry discussion around role of non-life HAF in IFRS 17.

1: "Why the HAF is not the head of the actuarial function" by M Ilsley, R Richman, N von Rummell & E Vigoureux

LEGISLATION DIFFERS FOR HAF AND IFRS 17

HAF : SA specific

- Derives mandate from Insurance Act
- Scope of work set out in GOI 3
- Guiding regulations contained in GOIs and FSIs
- Guidance from ASSA in APN 403

IFRS 17 : Global

- Requirements set out in IFRS 17 standard issued by IASB
- Applies to South Africa given we follow IFRS accounting standards

Currently no apparent overlap between HAF and IFRS 17.

IFRS 17 IS NOT EXPLICITLY IN THE SCOPE OF THE HAF

HAF Scope	GOI 3	APN 403
Technical provisions SCR / MCR	Methodologies, data, assumptions, calculations, judgements	Methodologies, data, assumptions, analyses of changes
ORSA	Actuarial matters	Future solvency, risk monitoring
Products	Actuarial soundness of T&Cs	Includes design and rates
Policies	Appropriateness, adequacy of RI	GOI requirements, coverage, consistency
Financial soundness	Including impact of dividends	Impact of dividends on future financial soundness

HYPOTHESIS: THE HAF SHOULD REVIEW IFRS 17 RESERVES

When signing off (SAM) reserves there is an implicit sign-off of underlying **assumptions**.

As HAF, should consider these assumptions, and how they relate to assumptions made for IFRS 17 reserves.

Assumption that both IFRS 17 and SAM reserves will have a **consistent** starting point. The alternative results in duplication of reserving and audit work.

Thus need to be comfortable with IFRS 17 calculations underlying SAM results.

HAF is required to evaluate and provide advice on **financial soundness** position of insurer.

To do this, HAF needs to be comfortable with technical provisions held on insurer's balance sheet.

HAF should review IFRS 17 reserves

IDENTIFYING HOW THE HAF ADDS VALUE

IFRS 17 assumptions / choices / judgements

Contract boundaries	Onerous contract tests & loss allocation	Initial recognition & subsequent measurement
Risk adjustment	Coverage units	Discount rate
Amortisation of CSM	Contract grouping	Cost allocation and deferral
Other comprehensive income approach	Illiquidity premium	Applicability of PAA
Transition treatment	Reinsurance contracts	

Key questions to ask:

- What is the link between SAM and IFRS 17?
- What should the HAF do?
- When should the HAF be involved?

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TYPICAL YEAR-END TIMELINE

- Year-end
- IFRS reserving
- SAM reserving
- SAM capital calculations

1: CONTRACT BOUNDARIES

IFRS 17 Standard, 34:

Entity can compel the policyholder to pay premiums
OR
has substantive obligation to provide policyholder with services

Substantive obligation ends when entity has practical ability to reassess risks

FSI 2.2 and FSI GN 2.2

Boundary is when insurer has unilateral right to:
a) Terminate contract
b) Reject premiums payable
c) Amend premiums

Should take into account internal and external limitations on ability to review policy conditions to reflect future risk

SAM and IFRS 17 align
Both speak of obligation to provide benefits for a given rate and practical ability to change rates.

HAF should opine on IFRS 17 boundaries
For SAM HAF should review boundaries, and these should not differ for IFRS 17.
There is a link in underlying assumptions.

Review during reserve setting
Review of SAM annual return is usually performed after IFRS 17 reserves have been set – too late to then identify concerns, thus should be done when reserves are set.

2: ONEROUS CONTRACT TESTS & LOSS ALLOCATION

IFRS 17 Standard, 47:

A contract is onerous if fulfilment cashflows, acquisition cashflows and cashflows arising from date of initial recognition are in total a net outflow.

FSI 2.2

Cashflow projections for premium provisions should comprise all future claim payments and claim administration expenses arising from future claim events, ongoing administration expenses and future premiums.

FSI GN 2.2

Simplification allows application of combined ratio to UPR, and combined ratio less 1 plus acquisition expense ratio to present value of future premiums.

SAM and IFRS 17 share key assumptions
Requirement to project future claims, expenses and premiums, either directly or based on combined ratio under both IFRS 17 and SAM. Expected future claims and expenses should align between SAM and IFRS 17.

HAF should ensure consistent assumptions between SAM and IFRS 17
HAF must be comfortable with assumptions made in setting SAM premium provisions, which should in turn be consistent with what is used to determine IFRS 17 reserves.

Review during reserve setting
Should be done when reserves are set.

3: DISCOUNT RATE

IFRS 17 Standard, 36 and B72 - 85:

Insurers need to determine discount rate.

Discount rate should reflect time value of money, characteristics of cashflows and liquidity characteristics of insurance contracts.

Discount rates are required for various points in time for a given valuation.

FSI 2.2, 13

Risk free discount rate in SA is government bond curve prescribed by PA.

Outside of SA insurers must derive interest rate term structure, where government bond rates should be used to determine risk free rates.

Methodology differs between SAM & IFRS 17 but applies to same base cashflow projections
There remains a given level of consistency in the underlying reserves, despite large differences in discounting methodology.

HAF should consider build-up
A build-up of differences between SAM and IFRS 17 reserves should be performed, and the impact of different discount rates would need to be included as part of the build-up.

When reviewing SAM reserves
A build-up should be done as part of the review of SAM reserves.
The IFRS 17 discount rate methodology and calculations should be reviewed when determining IFRS 17 reserves.

4: RISK ADJUSTMENT

IFRS 17 Standard, B86 – B92:

Compensation the entity requires for uncertainty in cashflows.
Linked to reserve volatility over full run-off period.

No methodology prescribed. Should have following characteristics:

- Low frequency & high severity → higher RA
- Longer duration → higher RA
- Wider probability distribution → higher RA
- Greater uncertainty around estimate → higher RA

Disclose technique used and corresponding confidence level.

FSI 2.2, 14 Risk Margin

Compensation another insurer requires to take over the obligations.
Linked to cost of providing own funds equal to SCR required to support insurance obligations.

Considers volatility over a single year period.

Methodology (and simplifications) is prescribed.

Methodology differs completely between SAM & IFRS 17
IFRS 17 linked to reserve volatility, SAM linked to capital required to support business.

HAF should review risk adjustment
To opine on financial soundness, HAF must have insight into the risk adjustment and appropriateness thereof.

Review during reserve setting
Should be done when reserves are set.

MAKING SENSE OF IT ALL

Same underlying assumptions

- Contract boundaries
- Onerous contract tests & loss allocation
- Coverage units

Consistent starting points

- Discount rate
- Cost allocation and deferral
- Initial recognition and subsequent measurement
- Contract grouping
- Reinsurance contracts

Impacts financial soundness

- Risk adjustment
- Amortisation of CSM
- Illiquidity premium
- Transition treatment
- Other comprehensive income approach
- Applicability of PAA
- Reinsurance contracts

CONCLUSION

HAF involvement not clear for non-life insurers	Argue that HAF should be involved	How should HAF be involved?	When should HAF be involved?
	Similar assumptions are required as input for IFRS 17 and SAM	Ensure consistency in assumptions applied for SAM with IFRS 17	When reviewing SAM reserving results
	IFRS 17 and SAM reserves likely to have same starting point	Review recon of IFRS 17 and SAM reserves to ensure consistency	When reviewing SAM reserving results
	Need to opine on financial soundness which requires opinion on reserves	Review and sign-off IFRS 17 reserves	Prior to finalising IFRS 17 reserves