IFRS 17 Preparedness Survey Report

PHILIPPINES | NOVEMBER 2021

Background

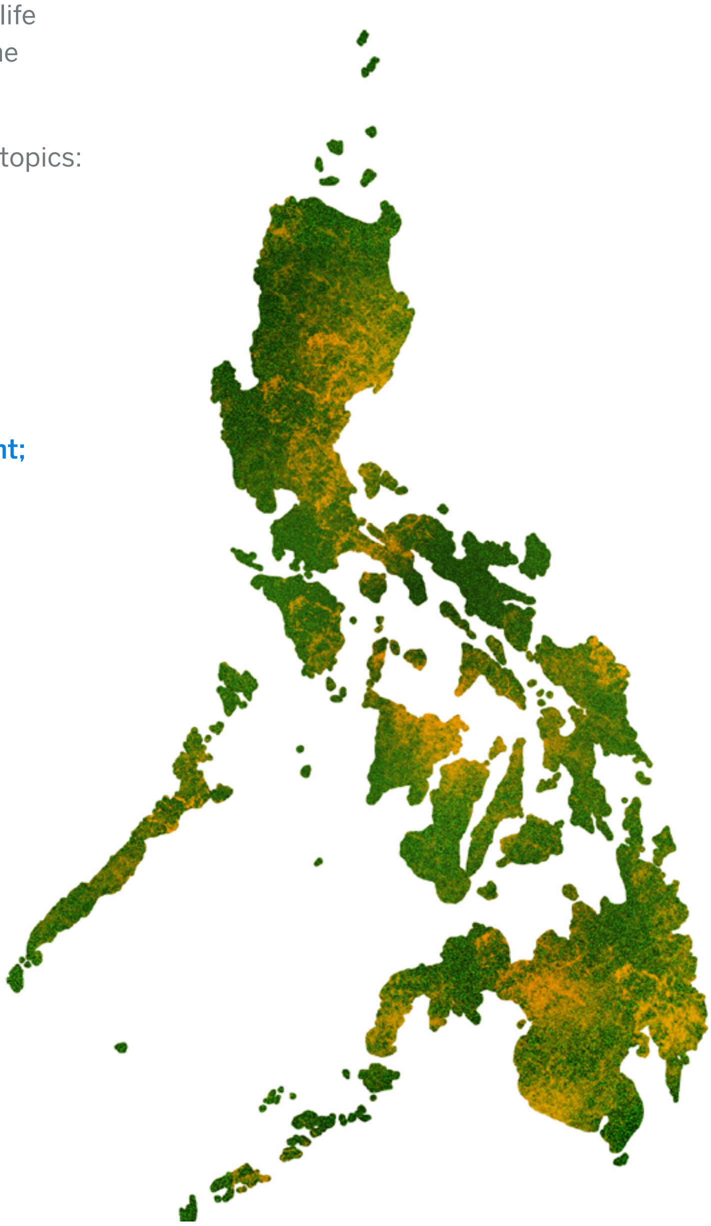
While the implementation of the International Financial Reporting Standard (IFRS) 17 has been deferred to 2025 in the Philippines, it is understood that insurance companies in the market are at various stages of preparation, with some more advanced than others.

In August 2021, Milliman conducted a survey to measure the preparedness for IFRS 17 amongst life and composite insurance companies based in the Philippines.

The questions are divided into the following key topics:

Status of preparedness;
Link with capital regime / embedded value;
Assumptions update process;
Discount rates setting;
Risk adjustment methodology;
Contractual service margin and loss component;
Methods and choices;
Asset valuation choices;
Transition method;
Other business issues; and
Impact on strategy.

The survey was sent to 16 clients, of whom 11 responded. We would like to thank all who have provided input into the study.

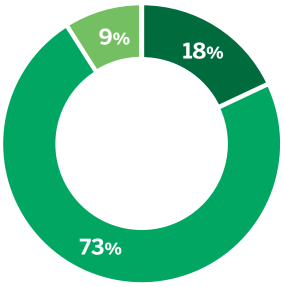


STATUS OF PREPAREDNESS

01 What is the status of your preparations for the implementation of IFRS 17?

Implementation project underway
Scoping activities underway
Gap analysis underway
Waiting and watching before beginning
No activity

02 Who will be responsible for implementing IFRS 17 in your company?

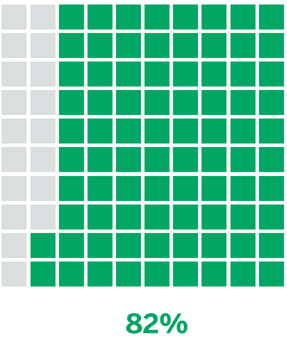


Chief Actuary
Chief Accounting Officer
Chief Financial Officer
Chief Risk Officer
Other

Most companies have already started their implementation project while some companies are still making progress with gap analysis and scoping activities. One participant, however, noted that they have not started.

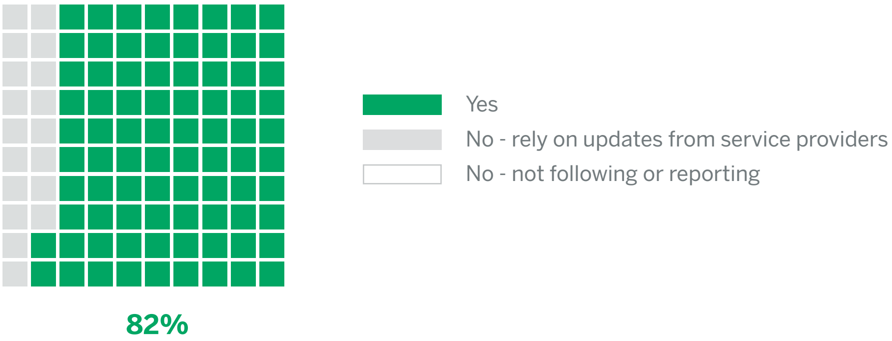
While the Chief Financial Officer is responsible for implementing IFRS 17 for most of the companies, the Chief Actuary also has a key role in this process. One participant indicated that a combination of Chief Financial Officer, Chief Actuary / Appointed Actuary and Chief Operating Officer will be managing the project.

03 Are you currently using or do you expect to use external resources to assist in implementation?



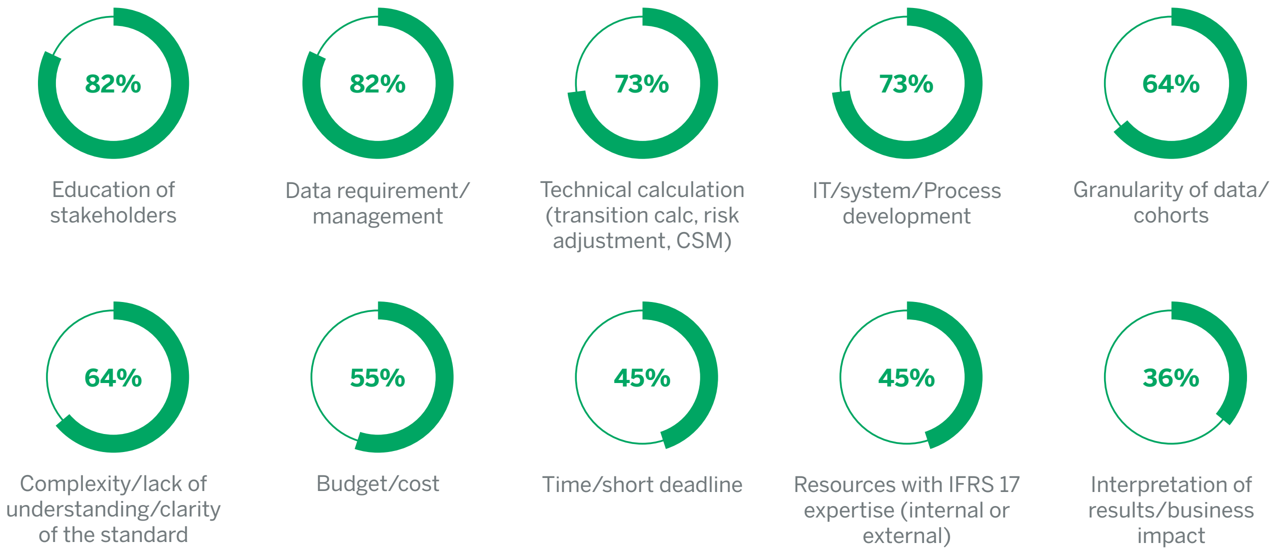
Yes
No

04 Is there someone within your organisation whose job responsibilities include following the IFRS 17 project and reporting internally?

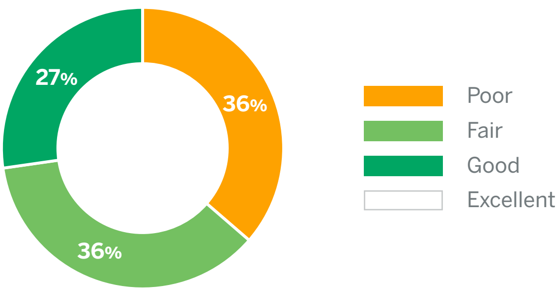


05 What do you consider to be the main challenges of implementing IFRS 17?

(multiple selections allowed)



06 What is the current level of understanding of IFRS 17 amongst key stakeholders (e.g. accounting, actuarial, senior management) compared to your ideal end state?



Many respondents replied with more than one area of concern and the responses are quite dispersed.

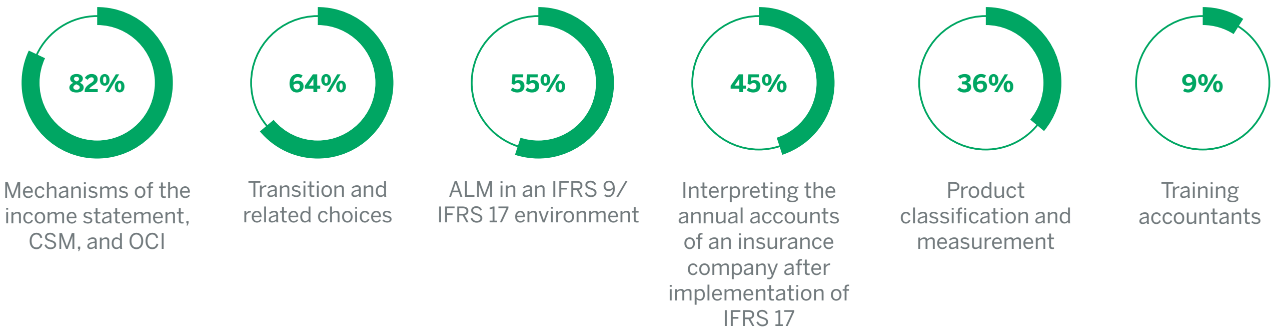
Stakeholder education and data requirement/management were the most common issues cited by respondents, followed by technical calculations and IT/system and process development.

Granularity of data and cohorts and the complexity of the standards leading to a lack of understanding is another common concern.

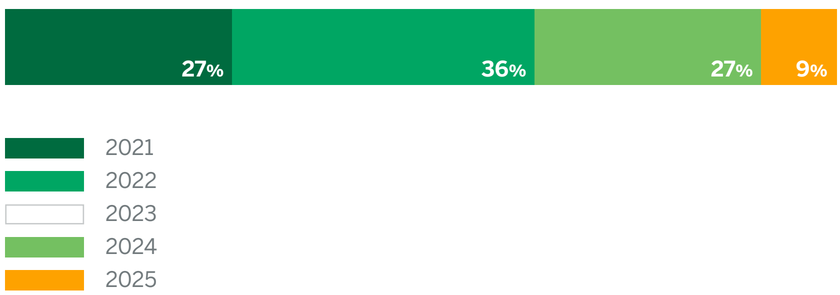
Some respondents also see the cost of implementation as a key challenge.

07 In which areas do you expect additional training will be required?

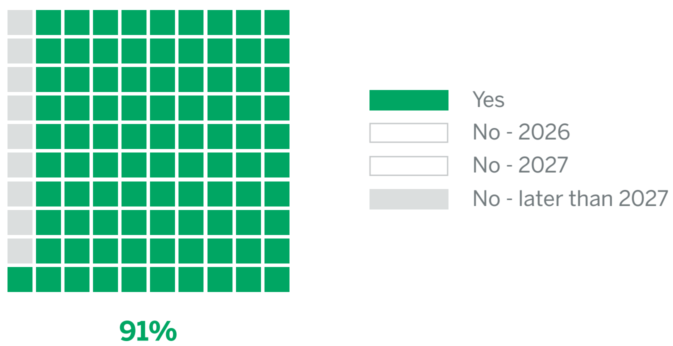
(multiple selections allowed)



08 What year does your company plan to be ready for shadow/dry runs?



09 Do you think the implementation date of 2025 is achievable? If not what year would be achievable?

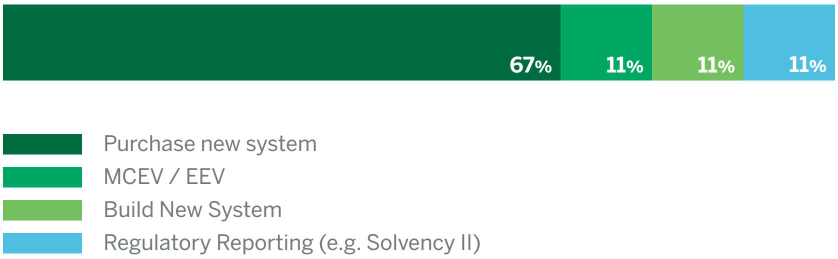


Majority of the companies indicated that shadow / dry run should be ready by 2022 while some companies plan to be ready between 2024 and 2025.

The majority of respondents indicated that implementation by 2025 was achievable. 1 respondent thinks that the implementation date should be delayed to beyond 2027.

LINK WITH CAPITAL REGIME / EMBEDDED VALUE

10 Which of the following existing calculation platforms do you plan to leverage for IFRS 17, or do you plan to build or buy a new system?

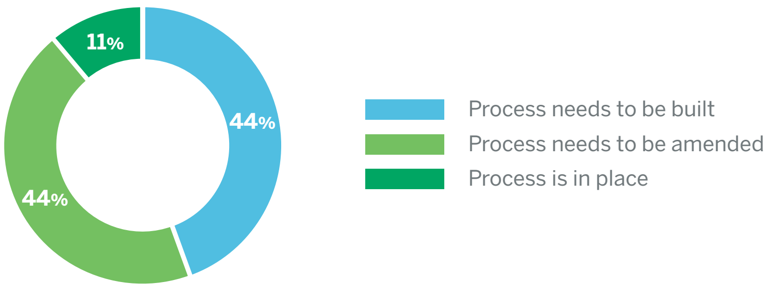


More than half of the respondents did not plan to leverage existing calculation platforms. They would either buy or build a new system for IFRS 17, which is explained by the fact that most do not have economic balance sheet / market consistent frameworks in place (i.e. shareholder reporting under a Traditional Embedded Value (TEV) basis and local RBC regime is not as complex as IFRS 17).

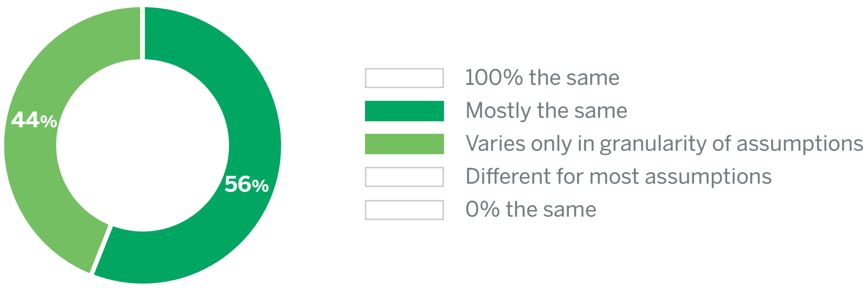
This is also common amongst other Asian companies, although it is noted that European companies with operations in Asia tend to leverage the existing Solvency II calculation platform for IFRS 17 implementation.

ASSUMPTION UPDATE PROCESS

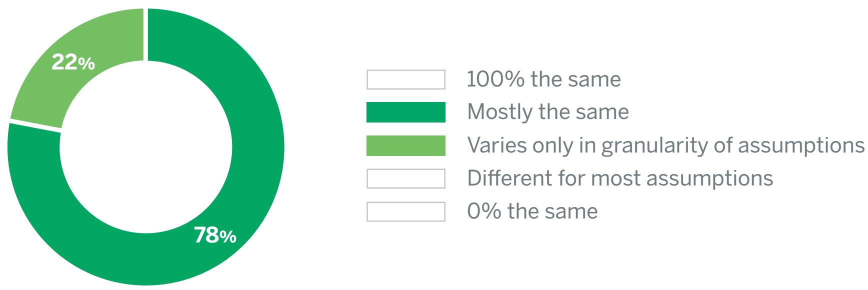
11 Under IFRS 17, all assumptions for the best estimate liability will need to be current as of the valuation date. Do you have a process in place to produce current assumption sets at each valuation date or will this process need to be built?



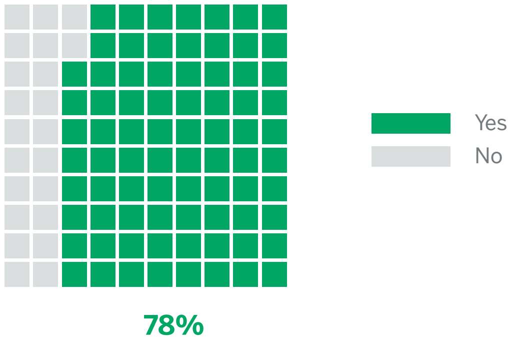
12 If you report under Solvency II / local RBC regime, do you expect the IFRS 17 assumptions to be the same as under this regime?



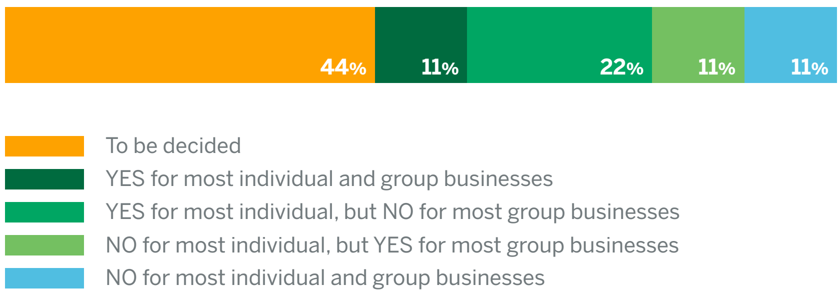
13 If you report under Embedded Value, do you expect the IFRS 17 assumptions to be the same as under Embedded Value?



14 When determining contract boundaries, do you expect to apply existing definitions you currently use for IFRS or regulatory reporting?



15 Do you plan to include cash flows after a future renewal date within a boundary for your renewable products?



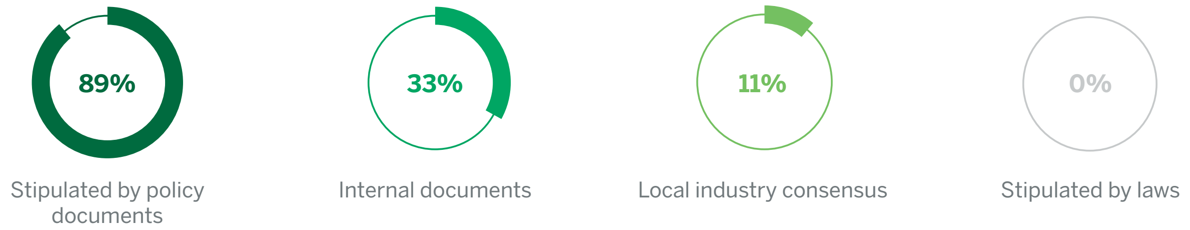
Most of the respondents expect to have a similar definition of contract boundaries to what they are currently adopting for existing reporting.

44% of the respondents have yet to decide which cashflows to include within the boundary. For respondents who have decided, the choice is rather dispersed with 22% of the respondents indicated that future cash flows of most of their individual products willl be included within the boundary while they will not be included for most of the group business. This is slightly surprising, and we anticipate further industry convergence on this topic as we have observed in other markets in the region.

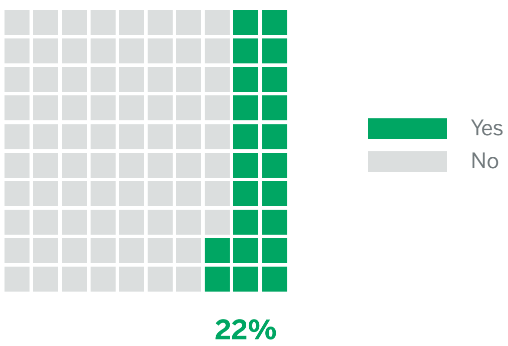
16 If you plan to include cash flows after a future renewal date within a boundary for your renewable products, what is the evidence you plan to cite for support?

(multiple selections allowed)

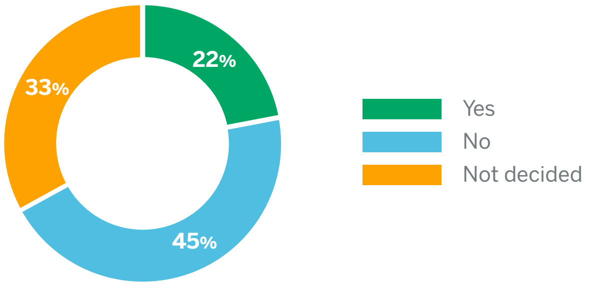
17 How do you plan to prove the evidence used to include post-renewal cash flows? (multiple selections allowed)



18 Is the intended renewal treatment significantly different from the basis you use to evaluate shareholder value?

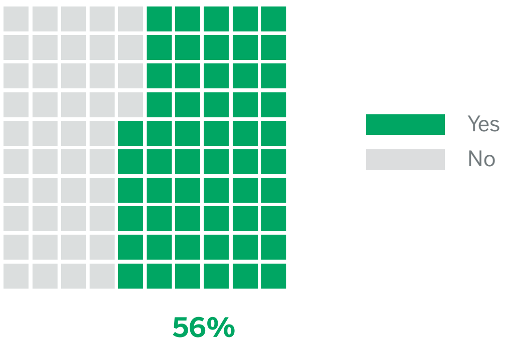


19 Do you plan to apply the option to use the fair value of the replicating portfolio instead of the fulfilment cash flows (paragraph B46 of IFRS 17) for the measurement of IFRS 17 liabilities at transition?

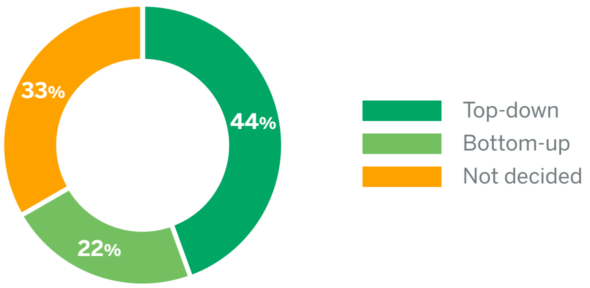


DISCOUNT RATE SETTING

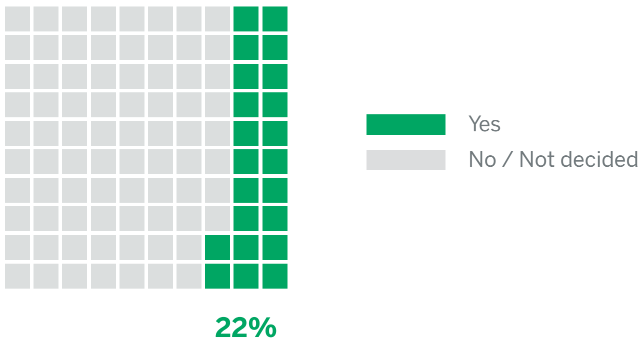
20 Discount rates will need to be derived that reflect the characteristics of the liabilities. Has your company determined the process it will use to determine the discount rates?



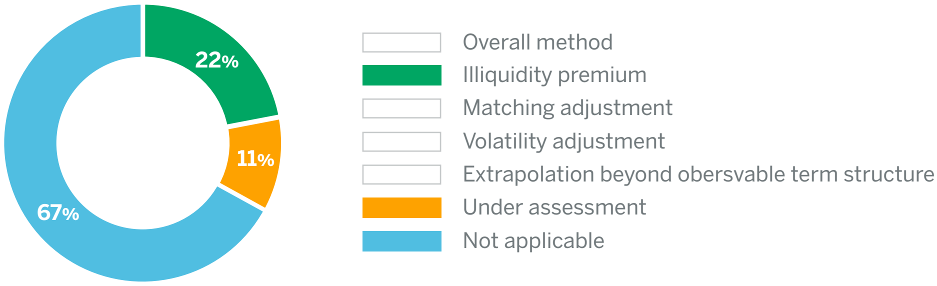
21 Will it be a “bottom-up” or “top-down” approach?



22 Have you determined how you will derive discount rates beyond the observable market yield curve?

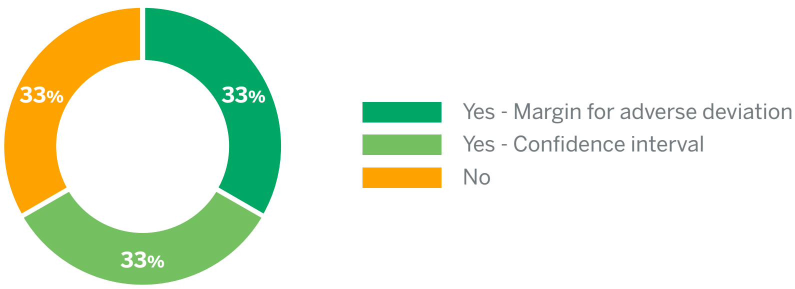


23 If you report under Solvency II, what differences do you expect in deriving the discount rates?



METHODOLOGY OF RISK ADJUSTMENT CALCULATION

24 Have you defined a methodology that you expect to use to determine the risk adjustment?

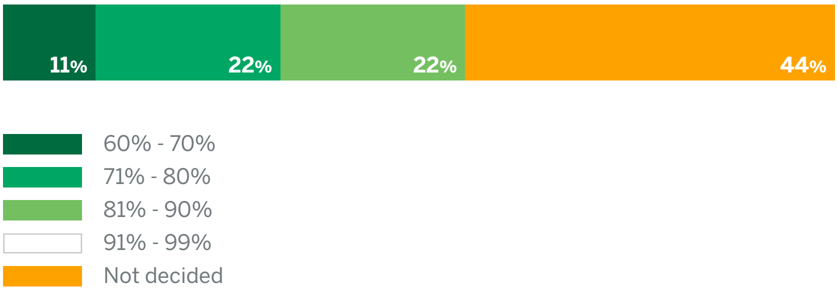


67% of the respondents have defined a methodology to determine the risk adjustments.

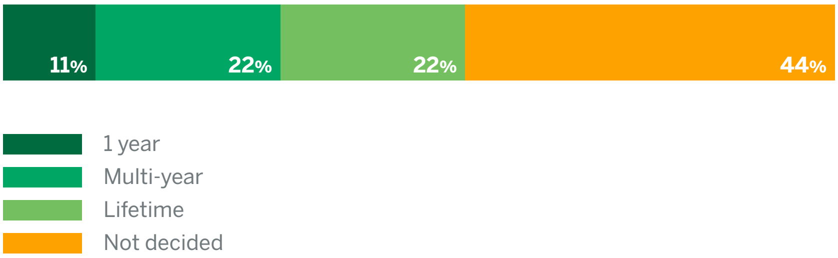
The choice of methodology is evenly split between margin for adverse deviation and confidence interval.

The confidence interval approach is more popular with local business units of multinational insurers which report under a Solvency II basis, which indicates a tendency for companies to adopt a risk adjustment methodology based off an existing reporting basis.

25 At what confidence level do you expect the risk adjustment to be set?



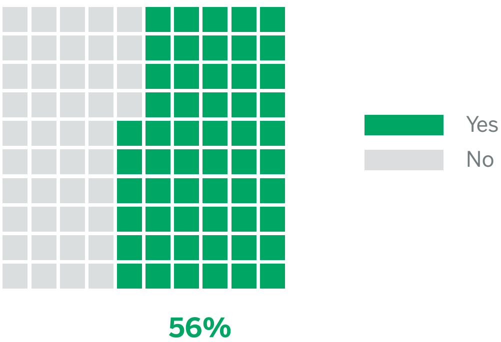
26 What is the time horizon used to determine the risk adjustment?



Many respondents indicated that they were still in the discussion stage for the confidence level to be set for the risk adjustment. Most of the responses fall in the range between 60% to 90%.

Most companies are still contemplating the time horizon used to determine the risk adjustment. For those who have decided, the responses were rather dispersed. Slightly more respondents selected time horizon of more than one year.

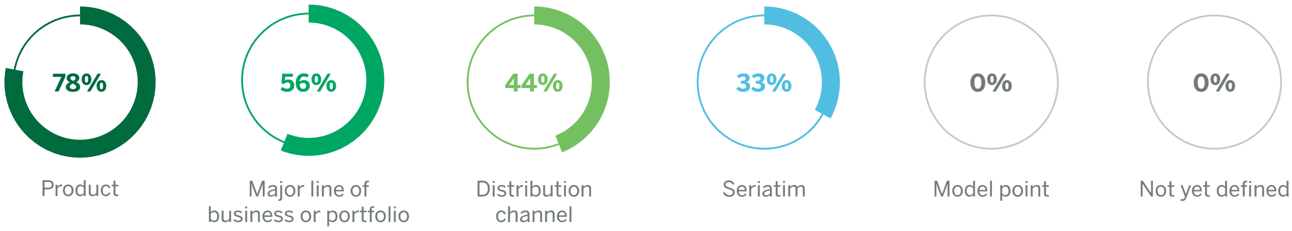
27 Do you have a solution in place to determine the confidence interval of the risk adjustment that is required to be disclosed under IFRS 17?



CONTRACTUAL SERVICE MARGIN AND LOSS COMPONENT

28 Do you expect that you will use further distinctions when defining the groups at which the Contractual Service Margin (CSM) is calculated?

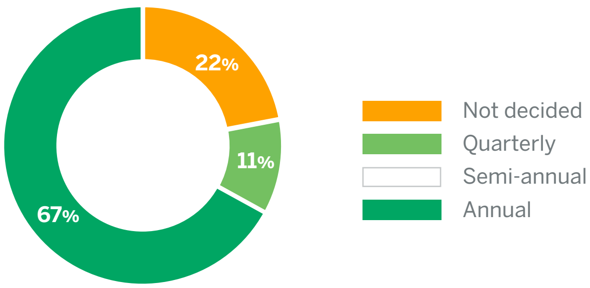
(multiple selections allowed)



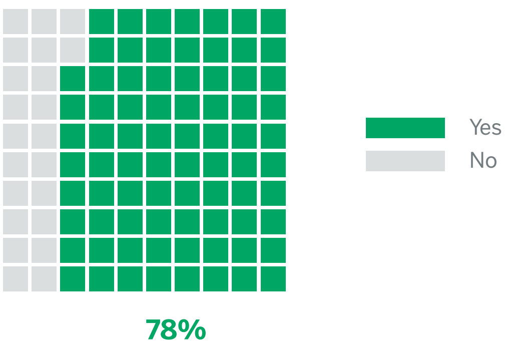
More than three quarters of the respondents expected to calculate the CSM at a product group level while 56% of respondents expected to calculate the CSM at a line of business level.

44% of the respondents selected an even broader distribution channel level, while 33% of the respondents chose to calculate this at a seriatim level.

29 Do you expect to use quarterly, semi-annual or annual cohorts?



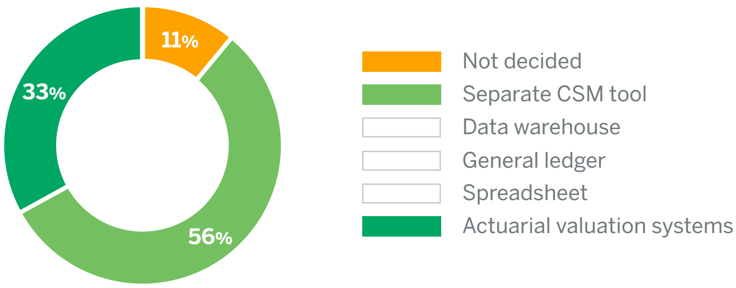
30 Will your current valuation system support this level of cohorts?



Two-thirds of respondents intend to use annual cohorts, while 22% of the respondents indicated the level of aggregation was under review.

For most of the respondents, their current valuation system are able to support the intended level of cohorts.

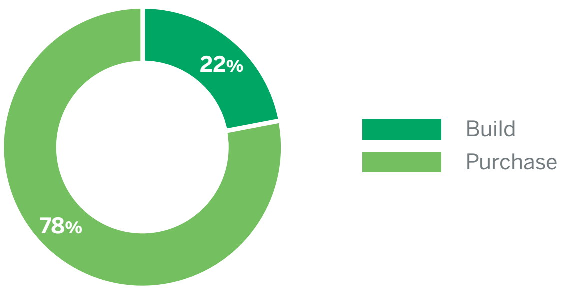
31 In what environment do you plan to do the following? Amortize CSM, Calculate initial CSM, Track loss component.



Most of the respondents expect to calculate the initial CSM, amortise the CSM and track the loss component within a separate CSM tool, while the next popular option is through the actuarial valuation systems.

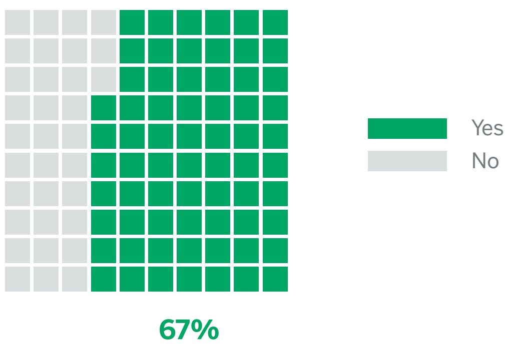
11% of the respondents are still contemplating on the system they plan to use.

32 Do you expect to build or purchase new systems to calculate and/or track CSM or loss components?

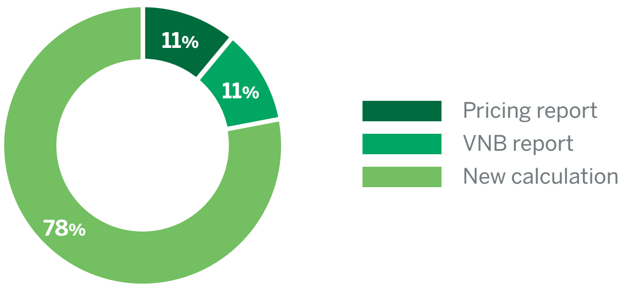


78% of the companies expect to purchase a new system to calculate / track CSM and loss components. Most of the them have started the implementation.

33 If you will be purchasing a system, have you started implementation of such system?



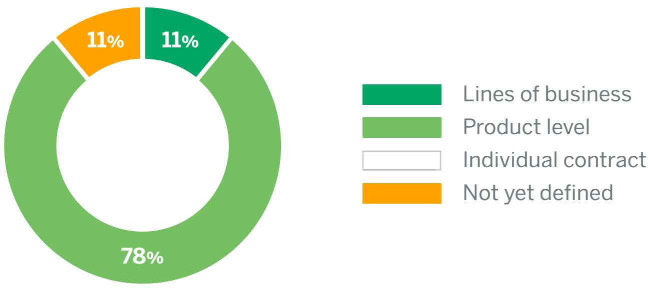
34 How will you define onerous contracts at initial recognition (e.g., pricing reports, embedded value VNB reports, new calculation)?



78% of the respondents said they were planning to use new calculations to define onerous contracts while approximately 22% of the respondents said they were planning to leverage existing pricing and VNB reports.

Most companies have decided to define onerous contracts at a product group level. 11% of the respondents are still reviewing the level of aggregation for onerous contracts.

35 At what level of aggregation will you determine onerous contracts at initial recognition?

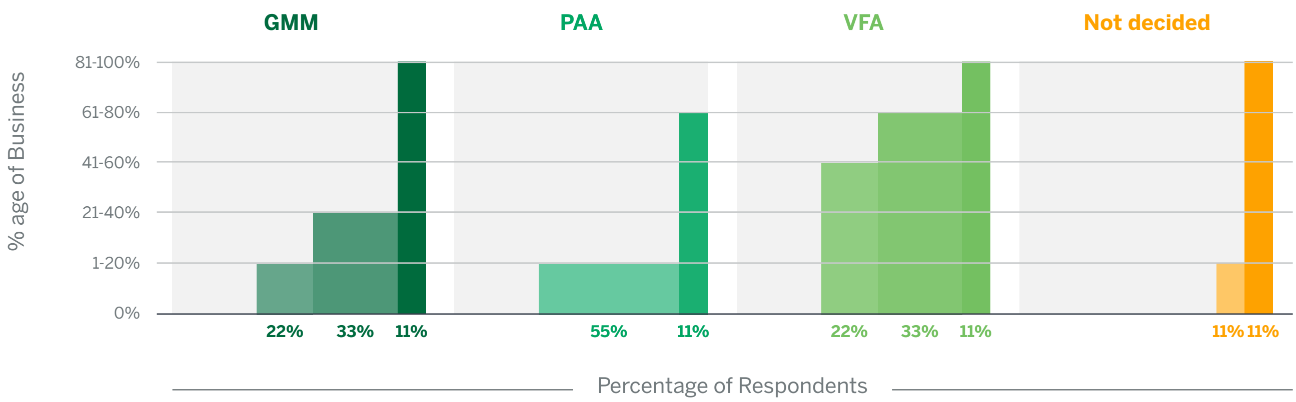


METHODS AND CHOICES

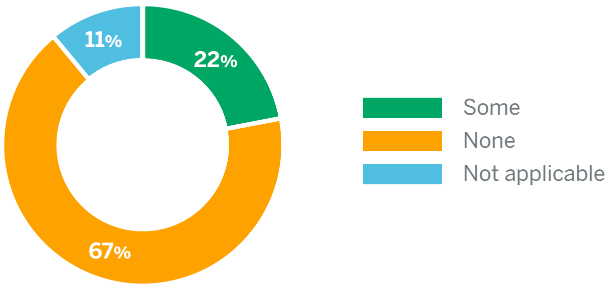
Most companies have decided on the method to apply to classify contracts, expecting to use a mix of the three potential methodologies, with the GMM and VFA approaches being applied to a greater proportion of the business. Note that most of the companies surveyed are life companies, which may explain the lower proportion of the PAA approach.

Participants anticipated applying the variable fee approach on products such as unit-linked or participating business.

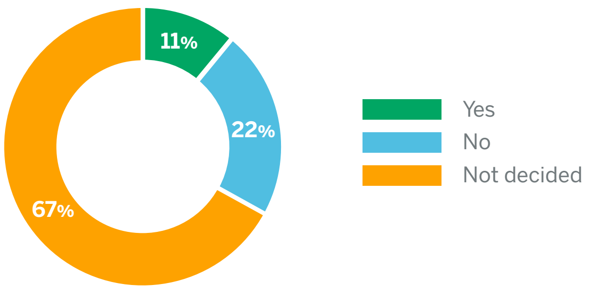
36 What portion of your business do you expect to apply the following methods?



37 For lines of business where you intend to apply the VFA, in what percentage of cases do you not hold the underlying assets?



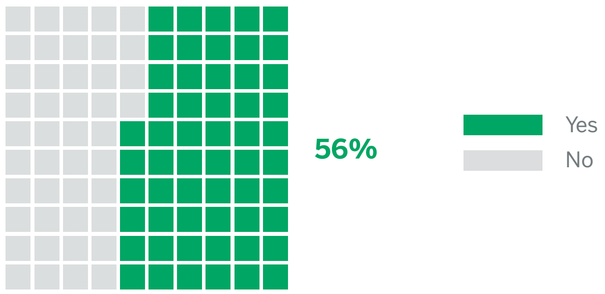
38 Do you expect to apply the option regarding risk mitigation when applying the VFA?



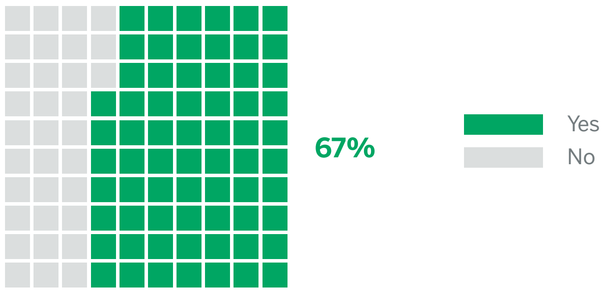
39 For lines of business where you intend to apply the VFA, do you anticipate any challenges in fulfilling the requirements for insurance contracts with direct participation features, and if so which requirements? (multiple selections allowed)

ASSET VALUATION CHOICES

40 Do you anticipate changes to existing asset valuation categories with IFRS 17 implementation?



41 Do you plan to defer adoption of IFRS 9 until adoption of IFRS 17?



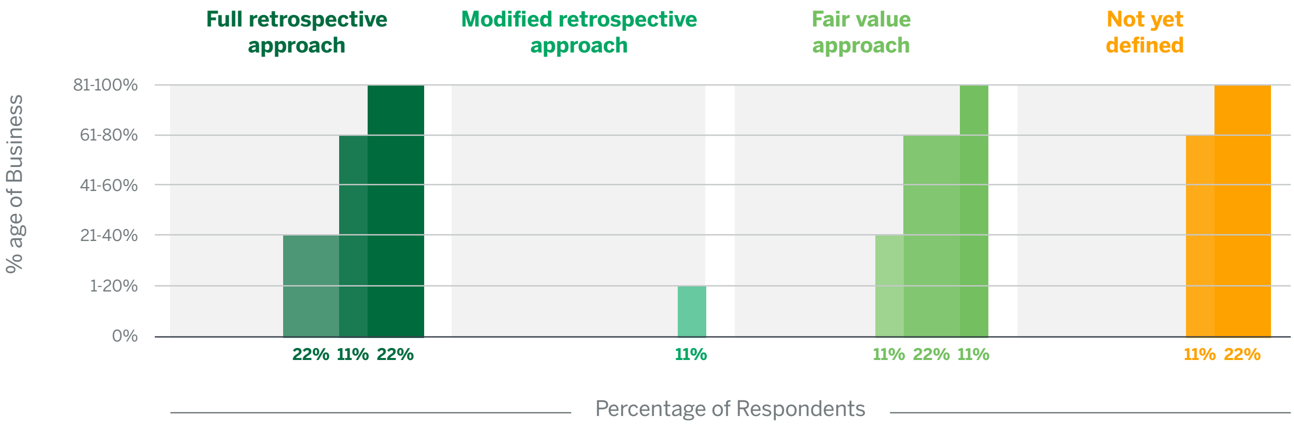
Most of the respondents indicated that full retrospective approach and fair value approach are suitable to be applied to majority of their business.

There are also some companies who are still reviewing the transition method to be applied on their business.

The modified retrospective approach appears unpopular. This may be because not many insurers have a significant legacy in-force long term portfolio for which granular data is not available to perform a full retrospective approach.

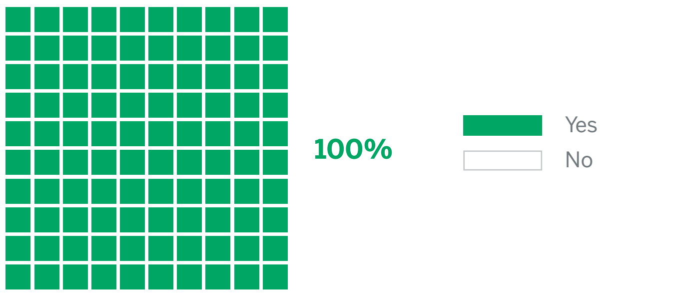
TRANSITION METHOD

42 What portion of your business do you expect to apply the following methods (based on number of contracts)?

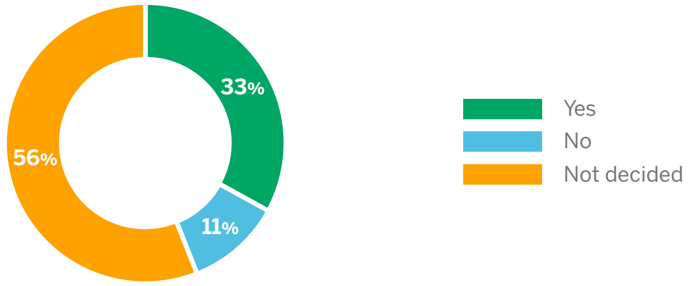


OTHER BUSINESS ISSUES

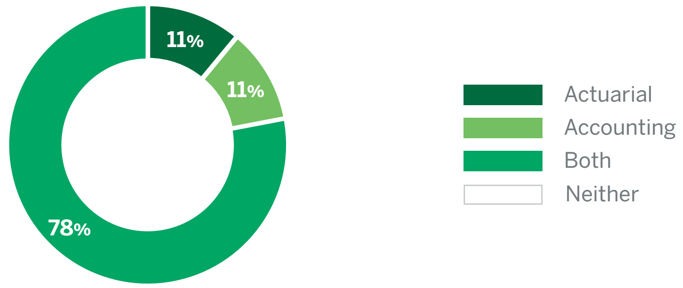
43 Do you anticipate you will continue to present financial results in the current format (premiums, investment return, claims, expenses, change in reserves) as additional information once IFRS 17 is adopted?



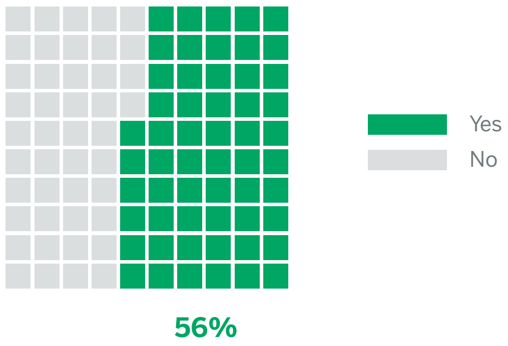
44 Do you expect to use the option to present historic changes in insurance liability amounts in OCI as well as retained earnings at transition?



45 Do you plan to invest in new accounting or actuarial systems during implementation of IFRS 17?



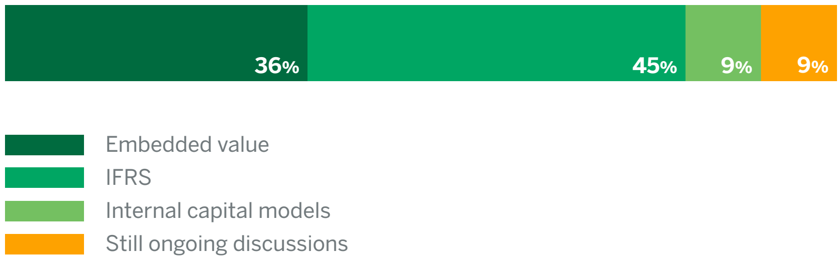
46 Will the treatment of reinsurance under IFRS 17 be a significant issue for your business?



Majority of the respondents mentioned that reinsurance is a significant issue under IFRS 17. While the technical requirements appear to be complicated for some companies, it will also require material enhancements to the existing systems (data and models).

IMPACT ON STRATEGY

47 What reporting basis will primarily drive your day-to-day decision making after implementation of IFRS 17 and IFRS 9?



Most of the respondents mentioned that IFRS is expected to be their primary reporting measure after implementation of IFRS 17 and IFRS 9.

Key Takeaways

- ✓ Despite the implementation deadline being delayed to 1 January 2025, many multinationals and domestic insurers have begun their preparation work, appreciating the complexity and amount of work required from the new standards. A majority of participants indicated that their shadow / dry run should be ready by 2022 while some companies plan to be ready between 2024 and 2025.

- ✓ With IFRS 17 requiring significantly more actuarial input, the role of actuaries is expected to expand further, especially within the financial reporting function of an insurance company.

- ✓ Stakeholder education and data requirement/management were the most common challenges cited by respondents, followed by technical calculations and IT/system and process development

- ✓ With IFRS 17 being a principles-based framework, it's not surprising to see different approaches and methodologies adopted across players, particularly around discount rates, risk adjustment, transition approach and level of aggregation. With the experience of several IFRS 17 implementation projects with multiple clients in the region, Milliman consultants are well positioned to support clients in the Philippines, wherever they are in the process.

We hope that insurers find the results of the survey useful for benchmarking themselves against peers and guide senior management decision-makers in selecting the most optimal implementation approaches and methodologies. Our thanks to all the survey participants for their prompt responses.

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