IFRS 17 and its introduction on emerging markets

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Agenda

1. How we got here
2. What will IFRS 17 look like
3. Some implications for emerging markets
4. Conclusion

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Current state of play

(In)consistency

- IFRS 4 differs across jurisdictions, differences more pronounced in life segment
- Asset/liability accounting mismatches

Relationship to market values

- They can't all be 'right' insurance liability
- Often close to 'book value' based local S1 regulatory methods. Not targeting value

Image in public financial markets

- Seen as obscure, specialist, 'black box'
- Yet educated non-specialists and IT based data handlers are often decisive audiences

Resulting to

Other reporting formats	• Role of EV reporting for life • Regulatory reporting used externally despite shortcomings
Focus on cash	• Easier to talk about • But it isn’t value creation or long-term dividend capacity
Even ‘C’ suite understanding compromised	• Pressure for simple products • Influences capital allocation

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Some key characteristics of IFRS 17 (1/2)

1. Market values both sides of balance sheet
   - Principles based
   - Reliance on auditors
   - Insurance liability - discounted best estimate, plus risk adjustment (RA)
   - Applies to global operations. No parallel to ‘equivalence’ under SII.
2. No day-one profit
   - Day one difference/profit goes to Contractual Service Margin (CSM), a liability
   - Take it to profit over term of contract
   - Assumption changes set against relevant year’s CSM
   - ‘Onerous contracts’ losses go straight to P&L
3. Differences from embedded value
   - ‘Dual look’, day one estimated profit is identified but not taken
   - Delivery of new business profit is tracked
   - Audited ‘from the ground up’. No reference to regulatory data.

Some key characteristics of IFRS 17 (2/2)

4. Day one profit tracked by policy group and cohort
   - Experience variances allocated to policy group
   - Visibility to new business profit delivery

5. New data
   - CSM, group level experience variances and other quantities are new
   - Development of new measures over history of current book often can’t be recreated. Approximations allowed on transition.
   - Level of audit scrutiny is new in many cases

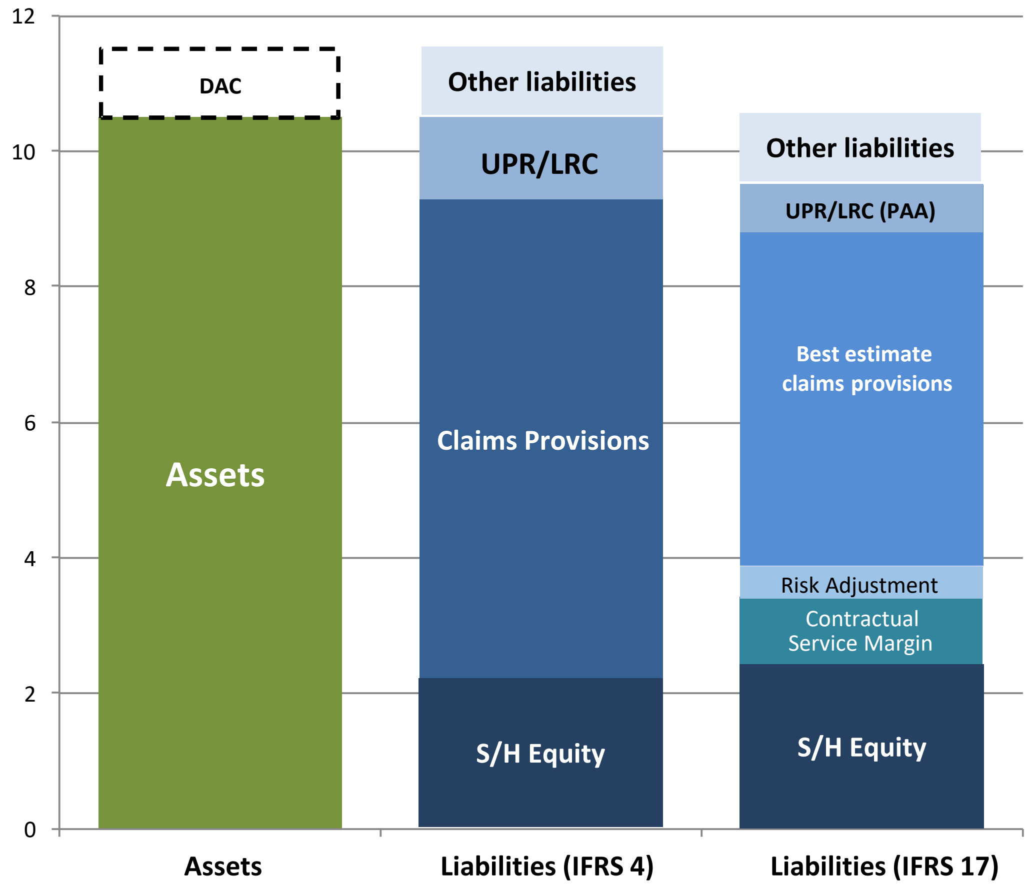
The discount rate

- Principles based
  - Details not specified, unlike in SII
  - Targets market-value. Though discount rate is used for best estimate, RA is an additional amount which completes the targeting of market values.
  - Reflects characteristics of liabilities rather than assets held.
  - Starting point is that nominal return = risk free + illiquidity + default costs
- Top down
  - Expected investment return at contractual terms of instruments
  - Less allowance for expected default costs and variability/unexpected costs
  - Less allowance for ‘basis’ risk if portfolio not representative of liabilities
- Or bottom up
  - Risk free rates
  - Plus illiquidity premium

Three approaches

1. **BBA** (Building Block approach)
   - Changes in estimates for future coverage go to CSM
   - Other variances, including investment, go to profit
   - CSM accreted at rates fixed on issue of policy
2. **VFA** (Variable Fee Approach)
   - For unit linked and endowment life policies. Investment variances go to CSM
   - CSM accreted at current rates
   - As with BBA, option for change in insurance liability due to change in discount rates to go to OCI.
3. **PAA** (Premium allocation approach)
   - 12 month contracts – most retail non-life.
   - No CSM. Reserve for future coverage is through UPR – as now
   - But the UPR, termed LRC (Liability for Remaining Coverage) in IFRS 17, is presented net of DAC
   - Incurred claims split into BEL and RA

Balance Sheet now and under IFRS 17



- DAC netted off against BEL (life) and UPR/LRC (non-life)
- It's the liabilities that change vs IFRS 4
- Assessment of profit on issue is a deduction from liabilities rather than an additional asset (re 'VIF')

P&L under IFRS 17

Underwriting profit + Investment profit + CSM amortisation RA run off

Underwriting profit	Investment profit	CSM amortisation RA run off
Expected claims and expenses less Actual claims and expenses	Investment income less unwind of discount on BEL and CSM	Amortisation of CSM refers to 'coverage units'. RA guidance is looser

Claims and expense ratios and under IFRS 17

1. Net of reinsurance result ratios, using IFRS 17 presentation ("Net/Gross")

Net claims ratio

$$\frac{(\text{Gross claims + reinsurance loss (profit)})}{(\text{Gross premiums})}$$

Net expense ratio

$$\frac{(\text{Expenses})}{(\text{Gross premiums})}$$

Note: net expense ratio is the same as the gross expense ratio

2. Net of reinsurance components ratios (as currently) but using IFRS 17 data ("Net/Net")

Net claims ratio

$$\frac{(\text{Gross claims - reinsurance recoveries})}{(\text{Gross premiums - reinsurance costs})}$$

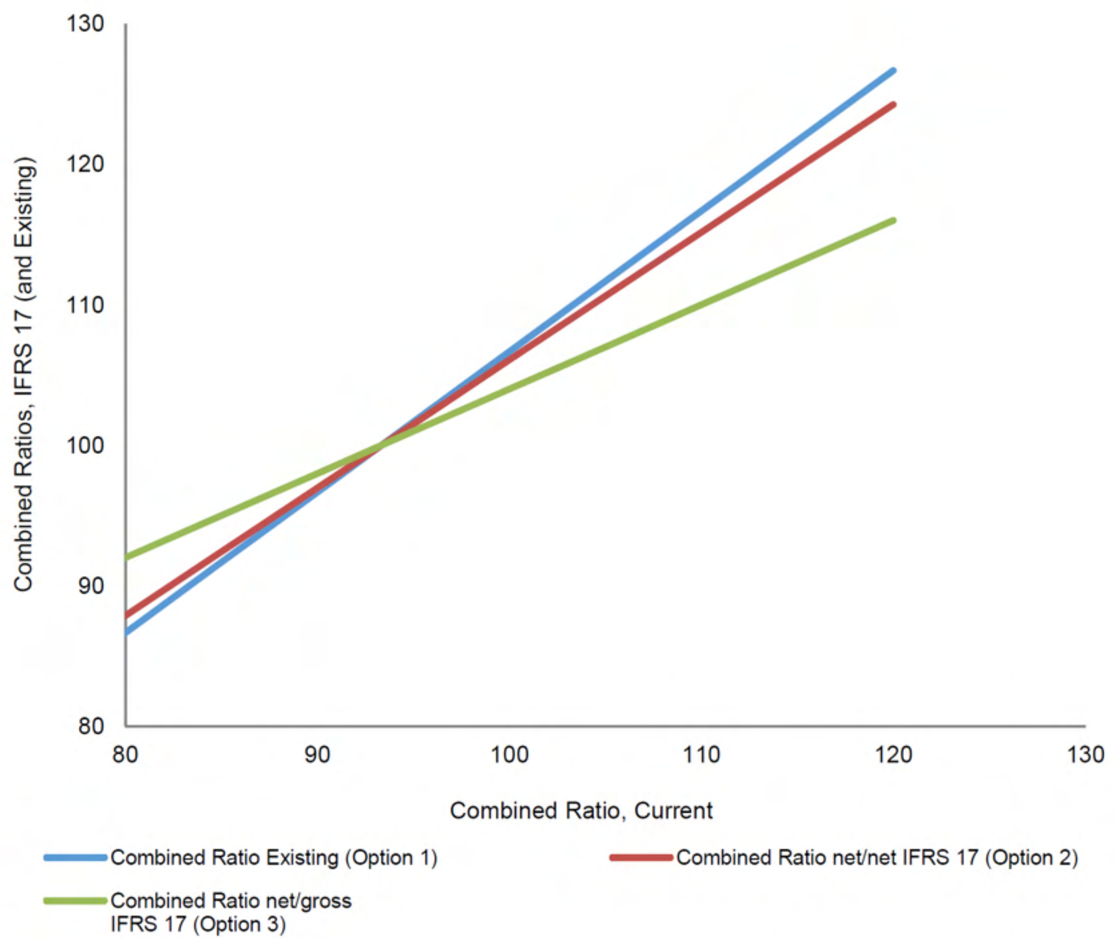
Net expense ratio

$$\frac{(\text{Expenses})}{(\text{Gross premiums - reinsurance costs})}$$

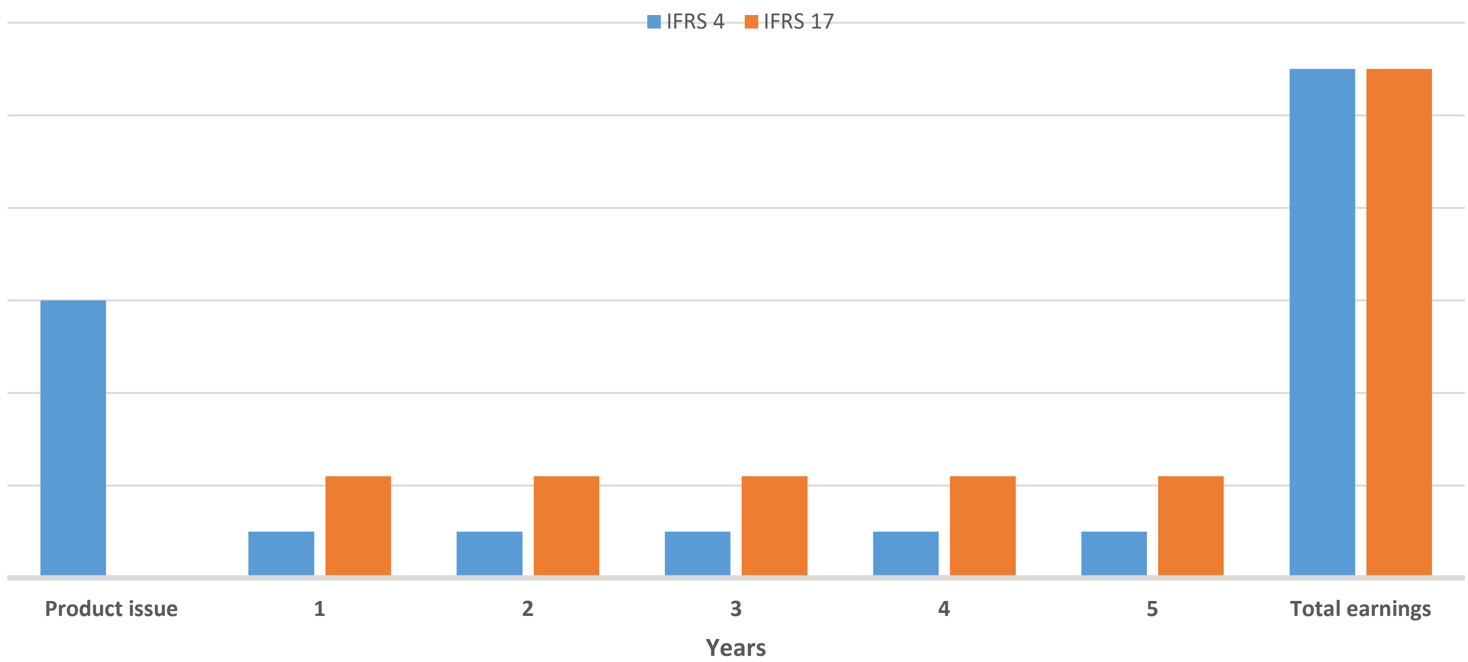
Impact of reinsurance on net claims ratio

Reinsurance Factors	Net Components Claims Ratio (Net/Net) Using IFRS 17 Data		Net of Reinsurance Result (Net/Gross) Claims Ratio Under IFRS 17	
Treatment of ceding commissions	Lowers claims ratios as net premiums are higher	↓	No impact as neutral for reinsurance result	→
Treatment of profit commissions	Lowers claims ratios as net claims are lower and expenses higher	↓	No impact as neutral for reinsurance result	→
Reinsurance loss	Same as for currently calculated ratios. Impact vs gross ratios often more than offset by $-swap effect.	→	Directly increases claims ratio	↑
"$-swap" effect of working layer XoL reinsurance	Same as for currently calculated ratios. Lowers net claims ratios when compared to gross.	→	No benefit from this effect. Net claims ratio therefore higher	↑

Combined ratio now and under IFRS 17



Profit recognition now and under IFRS 17 (GMM)



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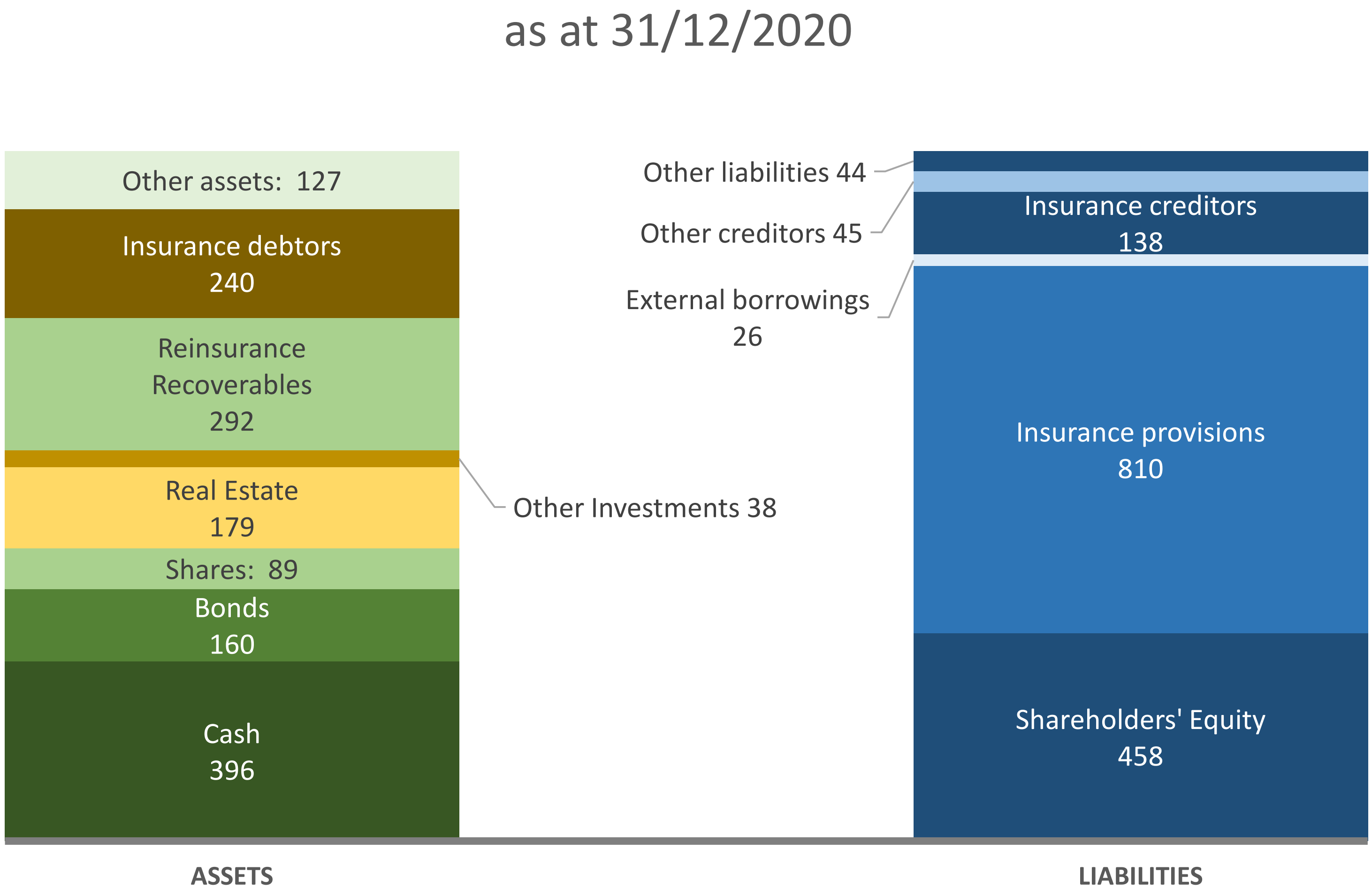
Balance Sheet of Jordanian market



Source: Best's Financial Suite – Global

Non-Life Technical Account of Jordanian insurers as at 31/12/2020

Gross premiums	682	Retention ratio: **62%**
Net premiums	423	
Total u/w income	439	
Net claims incurred	312	Acquisition ratio: **-2%**
Management expenses	106	
Acquisition expenses	-10	
Total u/w expenses	414	
Technical profit	25	Combined ratio: **96%**

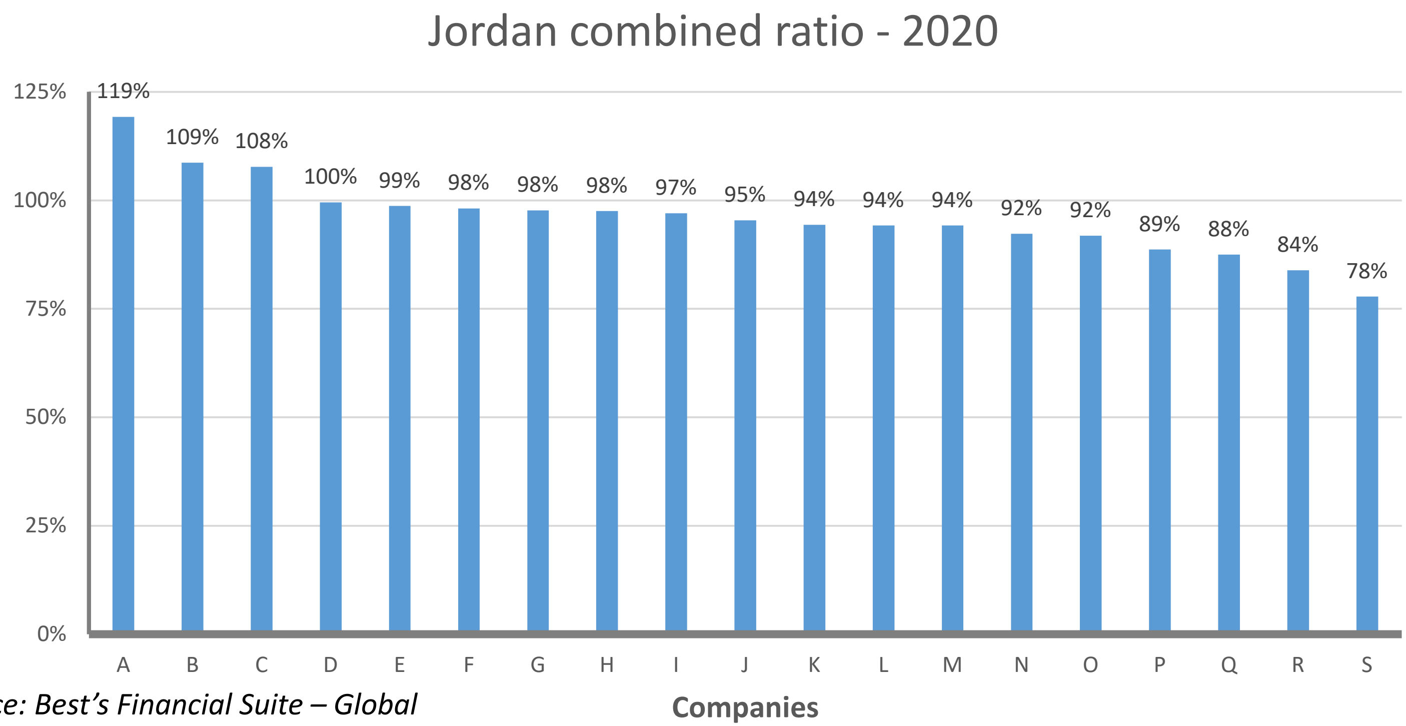
Source: Best's Financial Suite – Global

- Reasonable market performance underpinned by heavy use of reinsurance
- Reinsurance commissions offset most of acquisition expenses in the market
- Questionable profitability without reinsurance

Risk of mismatch in the valuation of reinsurance and the underlying contracts

- Sources of mismatch can arise due to :
  - Difference in contractual boundaries
  - Different valuation models
  - Different level of granularity in assessing the CSM
  - Differences in expenses
  - Foreign exchange
  - Patterns of CSM release do not align
- Under certain conditions impact of reinsurance can be significantly less than currently
- Even when the same, impact on profitability may be significantly delayed

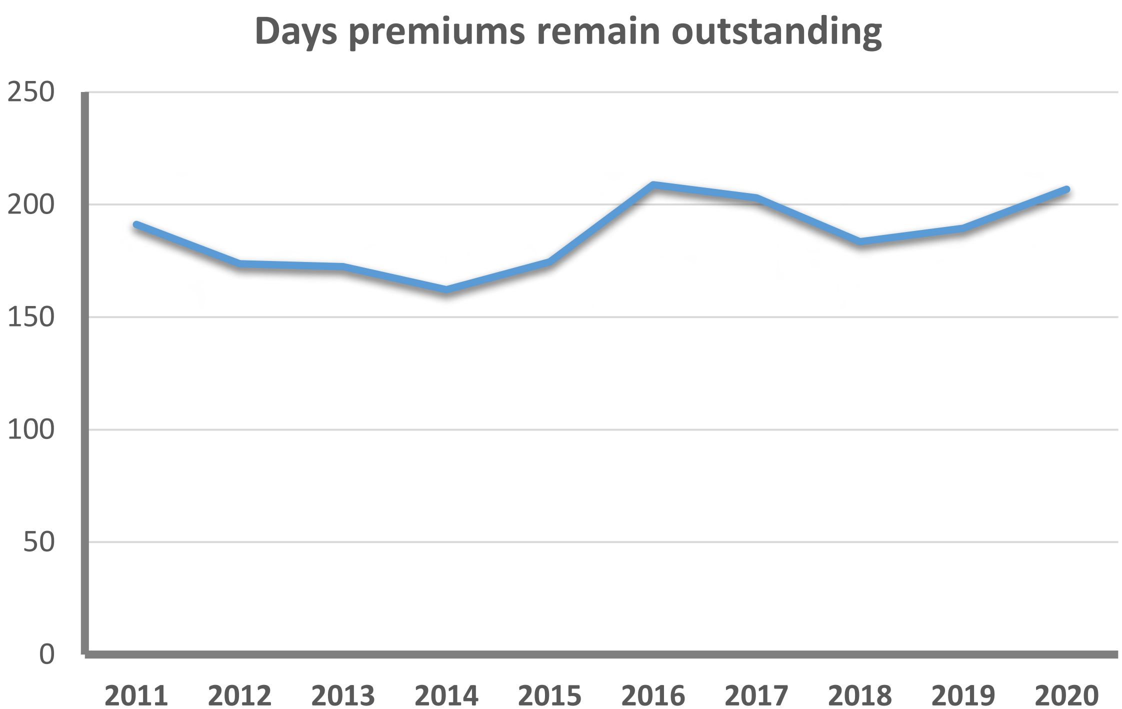
Impact of onerous contract accounting



Source: Best's Financial Suite – Global

- Combined ratio for most Jordanian companies around 100%
- Current accounting system beautifies accounting year performance for loss making contracts such us Motor TPL
- Under IFRS 17 the impact of loss making contracts needs to be booked at inception

Outstanding balances a source of concern



- Premiums remain outstanding for over 200 days, on average
- Under IFRS 9 companies are supposed to reserve for expected defaults
- Potential for significant write offs upon implementation of IFRS

Source: Best's Financial Suite – Global

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Concluding – a long way before achieving stated objectives

(In)consistency	• Inconsistency to remain – just different type • In emerging markets questions as to the assumptions to be used
Relationship to market values	• A major leap forward. Unfortunately, it is of lesser importance in ME markets
Image in public financial markets	• It will take some time before insurance accounting is not seen as obscure

…and finally

4. New data

CSM, group level experience variances and other quantities are new
Development of new measures over history of current book often can't be recreated.
Approximations allowed on transition.
Level of audit scrutiny is new in many cases

- Existing data quality is poor but improving
- Unclear if existing systems and processes can handle new requirements
- Likely to require significant investment in systems
- Management and stakeholders will need to be educated into the new reporting standards

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