Natural Selection

Financial Services Forum

21-22 May 2018 • Hilton Sydney

Actuaries Institute

Natural Selection
Financial Services Forum
21-22 May 2018 • Hilton Sydney

Actuaries Institute

Potential Regulatory Changes in Response to AASB 17

Briallen Cummings, Grant Robinson & Chris Scheuber

© Briallen Cummings, Grant Robinson, Chris Scheuber

This presentation has been prepared for the Actuaries Institute 2018 Financial Services Forum.
The Institute Council wishes it to be understood that opinions put forward herein are not necessarily those of the Institute and the Council is not responsible for those opinions.

Agenda

1. Current landscape (TBC)
2. Suggested Principles Underlying Regulatory Changes
3. Variable Fee Approach
4. Valuation of Contracts that Span Multiple Stat Funds
5. Other Items for APRA to Consider
6. Conclusion (TBC)

Current Landscape

- Life Insurance Act 1995 & Life Insurance Actuarial Standards Board established (LIASB)
- LIASB issued first MoS valuation standard in Oct 1996 applying from 31 Dec 1996 (AS1.01, precursor of LPS 340)
- AASB 1038 – Issued Nov 1998, applied from 31 Dec 1999
- Developed as a whole package driven by actuarial profession, hence:
  - An aligned financial reporting and regulatory reporting framework;
  - AASB is high level, detail is in LPS 340, and interpretation is Australian & actuarially based
- This all changes with AASB 17:
  - All the detail is in AASB 17 and interpretation is global and accounting based
  - Alignment of financial reporting and regulatory reporting framework will be reduced, how much depends on APRA response
- AASB 17 applies for all reporting periods commencing from 1 Jan 2021 with comparatives required for prior year.

Suggested Principles Underlying Regulatory Changes

- Solvency of the entity and stat funds: If any of the changes compromise the solvency and stat fund reporting, then these should be addressed.
- Management of policyholder profits for participating products: The Life Act and Prudential Standards (e.g. para 31 of LPS 600) underlines sound principles for the management of profits from participating products and these requirements should be maintained.
- Comparability: APRA wants to limit the effect of divergence in practice amongst insurers to make reporting results comparable.
- Limit unnecessary reporting burden: AASB 17 is compulsory for Australian insurers so ideal to align regulatory reporting as closely as possible, with deviations only if necessary to maintain the above points.

Variable Fee Approach

VFA Product	APRA Focus
➢ Participating Conventional (Whole of Life & Endowment) ➢ Participating Investment Account: ▪ Individual & Group ▪ with or without insurance riders (which may be non-participating)	➢ Policyholder profit share outcomes protected ➢ Par Retained Profits- 80:20 split ➢ No change to amounts ultimately going to policyholders ➢ Solvency & capital
➢ Investment linked with insurance rider	➢ Solvency & capital ➢ Remains unbundled into separate statutory funds

Variable Fee Approach

Future policyholder bonuses

Future shareholder dividends

SRP

PRP

Recognition of profit

20% x PVFP

80% x PVFP

BEL

Bonus Decl.

Total available assets

VSA

Obligations to policyholders

80% / 20% split must be maintained

MoS / Life Act To IFRS 17

Retained Recognised SH Profit

20%

80%

Risk Adj.

CSM

PH bonuses

PH bonuses

BEL

SRP

20% x PVFP

AASB17 liability

Variable Fee Approach

MoS / APRA	AASB 17	Difference	Handle By?
Policyholder Profits	Shareholder only	No profit split	Treat unvested bonuses as p/h profit?
Release on supportable bonuses	Release on full benefit (SI + RB +TB)	Timing of release	Use AASB 17, timing doesn't change share
Full allocation of expenses	Directly Attributable	Overheads may be outside liability	Model both - Identify & treat extra s/h profit as splitting 80:20?
Separate retained profits	p/h in liability	s/h in CSM	Aligning transfers from PRP to expected value?
Mutualisation via distribution	Mutualisation via cash flows	Mutualisation explicit	Use Portfolio not cohorts / allocate

Variable Fee Approach

MoS / APRA	AASB 17	Difference	Handle By?
Investment Tax included	Only if Fiduciary	☑ VPST & SEA ☒ Ord	Identify & treat extra s/h profit as splitting 80:20?

Valuation of Contracts that Span Multiple Funds

- AASB 17 relates to the valuation of insurance contracts and considers all the cashflows related to that contract.
- From a company perspective those cashflows may sit in multiple funds:
  - (Life Act) IL with Risk Rider – An investment linked statutory fund and a non-investment linked statutory fund
  - (Life Act) Friendly Societies – Benefit fund(s) and management fund
  - May occur more broadly depending upon statutory fund structure
- If APRA was to adopt AASB 17 or a variant of AASB 17 it would therefore be necessary to apportion the policy liability between funds.
- Should a “default” apportionment basis be adopted which must be used unless the Actuary deems it would be misleading?

Valuation of Contracts that Span Multiple Funds

- Scenario: Investment Linked contract with a risk rider. The contract is therefore partly in an investment linked statutory fund and partly in a non-investment linked statutory fund.
- Where should the CSM and RA sit – several options
  - RA (consistent with capital), the RA sits in the fund where the risks occur.
  - CSM: determine an apportionment between investment-linked profit and risk profit at inception for each cohort and then apportion on that basis thereafter
  - CSM: readjust apportionment each year based upon changes in assumptions and expected cashflows.
  - PL: Have the account balance for the investment linked benefit sit in the investment linked statutory fund and the remaining PL reside in the non-investment linked fund. Then identify RA and CSM split accordingly. This will mean that onerous contract losses sit in the non-investment linked fund.

Valuation of Contracts that Span Multiple Benefit Funds

- Scenario: Investment contract with 5 investment options including at least 1 which is classified as discretionary participating. The contract is the spread across 5 benefit funds and 1 management fund.
- Where should the RA and CSM sit?
  - Benefit Fund rules may dictate that everything in the benefit fund belongs to the members in which case the RA and CSM must sit in the Management Fund.
  - Should this approach therefore be adopted universally for consistency, particularly as typically the company profit emerges in the Management Fund? Where company profit also emerges in the Benefit Fund should a different approach be adopted?
  - From a capital perspective, capital relating to lapses, mortality, morbidity etc are held in the Benefit Fund. Capital relating to expenses and operational risk are held in the Management Fund. Should the RA follow this approach where possible?

Other Items for APRA to Consider Consistency of Reporting

- Consistency of reporting – where there are alternative approaches under AASB 17, should APRA consider mandating an approach for regulatory reporting or providing additional guidance?
  - Risk Adjustment: minimum or specified confidence level
  - Use of Other Comprehensive Income
  - Deferral of acquisition costs for policies with short contract boundary
  - Aggregation: minimum standards or specified portfolios of insurance contracts (would APRA need to have these at a finer level of detail than AASB 17?)
- These elements are not expected to impact the Balance Sheet from an APRA "capital" perspective. Are there other considerations which should be made?

Other Items for APRA to Consider Reinsurance

- Key changes in AASB 17
  - Reinsurance is accounted for separately from the insurance contract
  - Reinsurance contract liability will be 0 at inception i.e. it can't offset an onerous liability on the underlying insurance contract
  - The period of projection can differ between insurance contract and reinsurance contracts e.g. reinsurance cash flows can be projected for longer than insurance contracts
  - Reinsurance cash flows will include future new business if the contract includes reinsurance of new business
- These elements are a significant change from what we're used to in our financial and regulatory reporting, but do not contravene any of the suggested principals for regulatory reporting discussed earlier

Other Items for APRA to Consider Capital

- The balance sheet will likely look weaker under AASB 17
- This on it's own won't impact the regulatory capital requirement as the first step in the capital calculations is the capital base (LPS 112) which replaces the balance sheet policy liability with the adjusted policy liability
- This appears to be a reasonable outcome as APRA is comfortable with the level of capital the current prudential standards require
- There will need to be changes in terminology, particularly if there are references to the current LPS 340 e.g.
  - Definition of RFBEL in LPS 112 including allowing for cash flows for the life of the policy and allowing for fully allocated expense assumption
  - Undertaking calculations "net of reinsurance"
- This may mean companies need to have separate projections for capital vs. balance sheet reporting

Conclusion

We see no impediment to APRA adopting AASB 17 for regulatory balance sheet & P&L reporting.

- Additional items will need to continue to be monitored and reported to satisfy Life Act requirements in respect of par business.
- An apportionment approach will need to be defined with respect to contracts that span multiple statutory funds.
- No impact of starting balance sheet position on the solvency of insurers