Product, Performance and EV in an IFRS 17 World: South Africa

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INTRODUCTION

We have prepared this brief note as a supplement to our webinar hosted on 27 October 2023 entitled ‘Product, Performance and EV in an IFRS 17 World.’ For access to the webinar recording, please reach out to africa@milliman.com to receive a link to this.

This note will highlight some key points on what we’ve learnt from the transition to IFRS 17, reconciling IFRS 17 net asset value (NAV) to embedded value (EV), and reconciling Solvency Assessment and Management (SAM) Own Funds to EV.

IFRS 17 INTENDED TO BE MORE CONSISTENT – BUT IS IT?

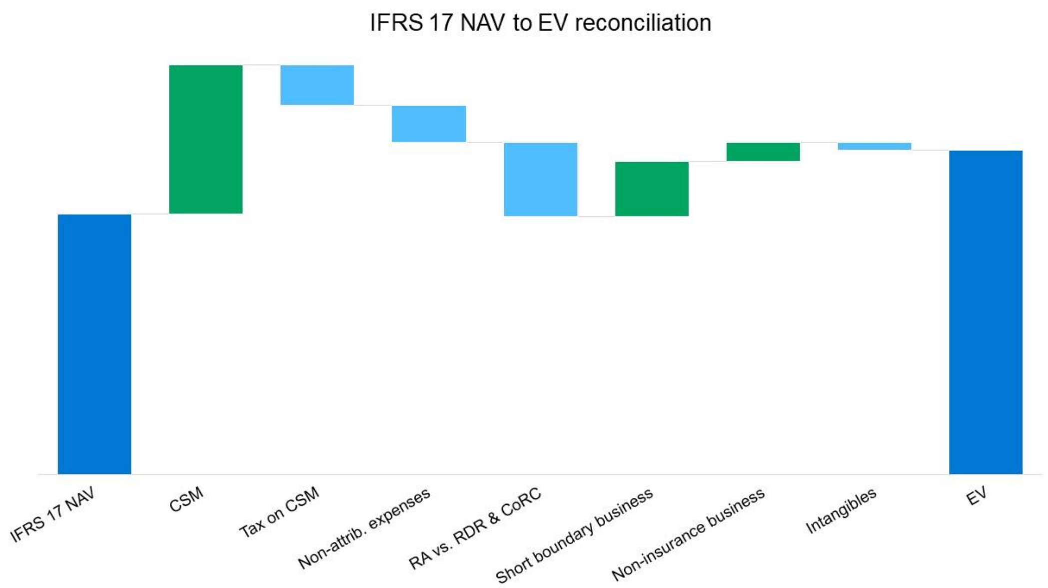
From what we have seen in South Africa, disclosures and additional presentations have varied across insurers in terms of detail. There are also differing levels of commentary on impact on earnings, other metrics and the business.

Areas which have been giving rise to differences due to subjectivity include:

- Choice of coverage units (and whether or not to discount or partially discount these coverage units)
- Risk adjustment (RA) methodology and calibration
- Grouping, onerous contract definitions and product cross-subsidies
- Expense attribution and spreading of acquisition expenses
- Choice to use other comprehensive income (OCI)

RECONCILING IFRS 17 TO EV

Reconciling IFRS 17 NAV to EV is complex. The figure below outlines key adjustments which need to be made for these measures to reconcile.

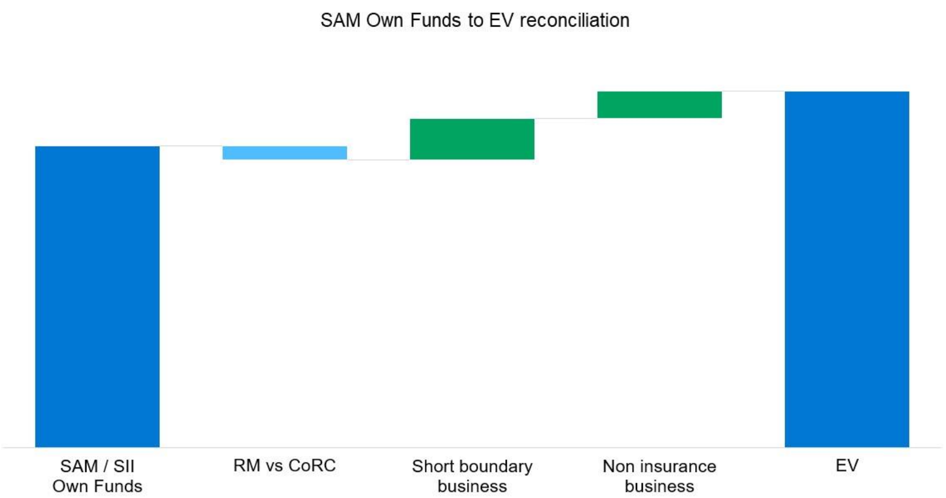


These adjustments include:

- Contractual service margin (CSM)
  - This is a store of future value in the form of earnings which are expected to be earned in future.
- Tax on CSM
  - Since EV looks at the value to shareholders, the tax on the CSM must be removed.
- Non-attributable expenses
  - There is a significant level of expenses which are necessary to run the business but have not been viewed as sufficiently directly attributable to the contracts.
- Risk adjustment (RA) vs. risk discount rate (RDR) & cost of required capital (CoRC)
  - An area of complexity comes from allowing for the difference between the RA, and the impact of an RDR and the CoRC. In a real-world EV, the present value of future profits is discounted at the RDR, and also the further deferral of profits arising from the CoRC needs to be accounted for.
- Short contract boundary business
  - For any short contract boundary business which is part of covered business in the EV, the present value of this business beyond the IFRS 17 contract boundary needs to be included.
- Non-insurance business
  - Similarly, the value of any non-insurance business which is part of EV covered business needs to be added.
- Intangibles
  - Whilst there can be exceptions, intangible assets and goodwill which are included in IFRS 17 NAV should generally be removed.

RECONCILING SAM OWN FUNDS TO EV

Similar to IFRS 17, there are some adjustments required when reconciling between SAM Own Funds and EV.



These adjustments include:

- SAM risk margin vs. EV CoRC
  - The risk margin is based only on non-hedgeable risks, rather than all risks.
  - The risk margin is based on 1x SCR rather than a multiple greater than 1 which is typically required in practice.
  - There are differences between the risk margin discount rate of risk-free plus 6% and a typically lower RDR used for EVs prepared for financial reporting. (EVs used for other purposes may use higher RDRs.)
  - Differences also arise from the use of an iterative vs. non-iterative risk margin.
- Short contract boundary business
  - As with the IFRS 17 NAV to EV reconciliation, we need to add the present value of any short contract boundary business which is part of covered business in the EV.

- Non-insurance business
  - Similarly, the value of non-insurance business which is part of EV covered business needs to be added.

CONCLUDING REMARKS

Below are our predictions arising from our analysis:

- EV will likely still be produced for many South African life insurers for at least two to three years.
- Listed insurers may be de-rated by analysts and the market.
  - This may be due to a lack of consistency and track record or results which are not easily reconcilable to cash.
  - Too generous new business measures will result in lower true margins and possibly destruction of shareholder value.
- There will be only a limited product impact in the short term, but eventually the change in measures will change incentives and management focus. This in turn will result in changes in products to optimise for value (or management remuneration) in line with new measurement standards.
- EV will be even more important for mergers and acquisitions (M&As) as a consistent and coherent measure of value.
- Determination of non-attributable expenses will remain a contentious issue indefinitely.

WEBINAR RECORDING

Please reach out to africa@milliman.com to receive a link to access the webinar recording.

HOW MILLIMAN CAN HELP

Please contact us if you would like to discuss any of the content in this note or the accompanying webinar.

Milliman can also provide a range of services including but not limited to:

- Guidance on EV reporting and key performance indicators (KPIs) in an IFRS 17 world
- Due diligence and buy- or sell-side support for M&As
- Allocation of capital for optimal decision making
- Product design, incorporation of cost of capital, model building and pricing
- Solo and group Head of Actuarial Function
- Independent review of actuarial and risk functions
- Independent review of Own Risk and Solvency Assessments (ORSAs)
- First-line actuarial team secondment support
- Microinsurance products, distribution and licensing
- New licence applications
- Regulatory compliance and approvals

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