Asia e-Alert

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The Philippines: Key issues and challenges anticipated as life insurers implement IFRS 17

In March 2018, the Philippines Financial Reporting Standards Council (PFRSC) announced that it would adopt IFRS 17 insurance contracts, in full without amendment. In 2020, the Philippines Insurance Commission (IC) deferred the implementation of IFRS 17 to 1 January 2025, which is two years after the international effective date set by the International Accounting Standards Board (IASB).

While the two-year deferral provides life insurers in the Philippines an opportunity to learn from, and leverage on, IFRS 17 development work carried out in other countries, IFRS 17 represents a paradigm shift in financial reporting for life insurers in the Philippines. In this article we explore several aspects of IFRS 17 which life insurers in the Philippines could find particularly challenging.

Discount rates

IFRS 17 requires market-consistent discount rates. These are generally determined using either a bottom-up or top-down approach:

- Using a bottom-up approach, companies may adjust a liquid risk-free yield curve to reflect differences between the liquidity of the financial instruments' underlying observed market rates and the liquidity characteristics of their insurance contracts. Determining this illiquidity premium can be challenging, as it may be difficult to locate observable assets with the same liquidity characteristics as the insurance contracts.
- Using a top-down approach, companies may first obtain a yield curve reflecting current market rates of return implicit in a fair value measurement of a reference portfolio of assets, then adjust this yield curve by eliminating factors not relevant to the insurance contracts.

Some life insurers in the Philippines market might still be undecided on their discount rate approach, though the risk-free rates used for local statutory reporting could provide a starting point for a bottom-up derivation approach. However, companies will still need an approach to derive discount rates for terms which are beyond the observable yield curve.

Unit of account and contract boundaries

The lowest unit of account under IFRS 17 is the insurance contract, after separation of any investment component. Given the popularity of unit-linked products with attaching riders in the Philippines, this could have implications for many life insurers as this often means that policies will now need to have the base plan and any riders grouped together for measurement under IFRS 17, and thus share a single contract boundary.

This may mean that certain riders may now have long term contract boundaries, whereas they may have had short term contract boundaries if assessed on a standalone basis (a particular example is unit-deducting riders attached to investment-linked contracts which have reviewable cost of insurance rates). Insurers may now need to project cash flows for these riders up to the contract boundary of the policy.

Risk adjustment

Under IFRS 17, insurers need to include a risk adjustment to reflect non-financial risks in the fulfilment cash flows. The standard does not specify a particular approach to calculating the risk adjustment. Insurers are required to disclose the approach and confidence level used to determine the risk adjustment.

In practice, insurers typically calculate the IFRS 17 risk adjustment using an approach that is adapted from an existing regime that they already report under, such as Solvency II or local risk-based capital regimes.

Local insurers in the Philippines may choose to base their risk adjustment calculations on the Philippines' local risk-based capital (RBC2) regime, which requires a margin for adverse deviation (MfAD) to be applied to best estimate assumptions. One challenge insurers may face in applying this approach is specifying the confidence level used, particularly if they are calibrating their risk adjustment confidence levels differently to how the MfADs are calibrated under the prescribed local statutory basis.

Measurement models for investment-linked products

Investment-linked products with attachable protection benefit riders are prevalent in the Philippines. When selecting the measurement model for investment-linked products, there is a natural tendency to steer towards the variable fee approach (VFA).

However, to qualify for the VFA, a contract must satisfy three conditions to be considered to have direct participation features:

- the policyholder participates in a share of a clearly identified pool of underlying items;
- the entity expects to pay the policyholder a substantial share of the fair value returns on the underlying items; and
- the entity expects a substantial proportion of any change in amounts paid to the policyholder to vary with the change in the fair value of underlying items.

Some investment-linked contracts may have a substantial number of attaching protection riders, so the expected payments to policyholders from the unit account could be small in comparison to the total expected payments. It may be challenging for insurers to justify that such contracts meet the second and third criteria for VFA eligibility. Life insurers may need to assess VFA eligibility on a contract by contract basis, taking into consideration the amount of protection coverage and riders offered for each product.

Conclusions

While insurers in the Philippines have the benefit of a later IFRS 17 adoption date compared to the global timeline, there exist technical implementation challenges specific to the Philippines insurance industry. While business units of multinationals will likely be able to leverage on support from their group head offices, local players may have to perform their implementation from scratch. Milliman consultants in the region have worked extensively in the implementation of IFRS 17 for life and non-life insurance companies in the Philippines and across Asia, and we have the experience and the expertise to advise and support you with your IFRS 17 implementation.

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