Moody's Analytics Webinar: Setting the Discount Curve for IFRS 17

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Our speakers

Moderator: **Sohini Chowdhury**
Director - Solutions Specialist
Moody's Analytics

Alasdair Thompson
Associate Director – Research
Moody's Analytics

Ruth Moore
Associate Director - Advisory Services
Moody's Analytics

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What does IFRS 17 ask of insurers in terms of discount curves?

IFRS17 Standard

What does the standard say?

Discount rates (paragraphs B72–B85)

An entity shall adjust the estimates of future cash flows to reflect the time value of money and the financial risks related to those cash flows, to the extent that the financial risks are not included in the estimates of cash flows. The discount rates applied to the estimates of the future cash flows described in paragraph 33 shall:

(a) reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;

(b) be consistent with observable current market prices (if any) for financial instruments with cash flows whose characteristics are consistent with those of the insurance contracts, in terms of, for example, timing, currency and liquidity; and

(c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.

Reflect the **liquidity of the liabilities**

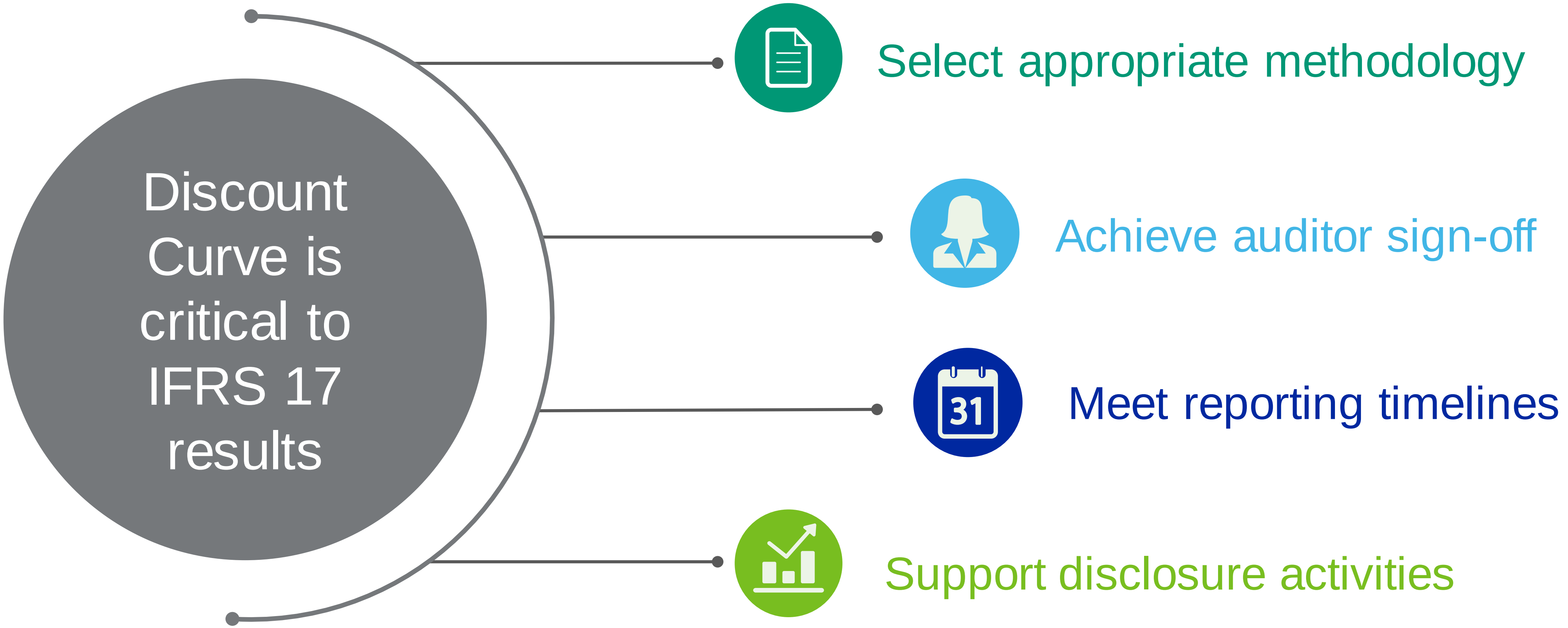
Market-consistent

Implies that **actual assets** could be used, if they produce cash flows which are consistent with the liabilities. If not consistent, then could use a reference portfolio

2

What methodology and practical challenges do insurers face in choosing an approach?

Challenges facing insurers



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What modelling options could insurers consider for constructing the discount curve for IFRS 17 and are there any trends developing in the market?

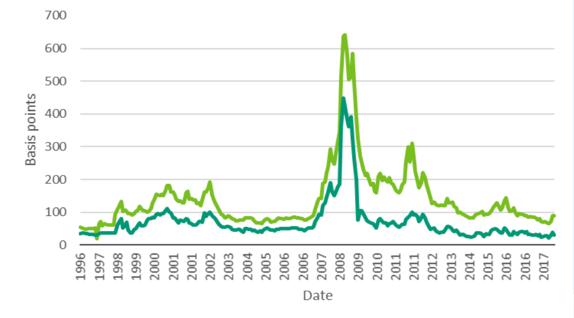
Potential Discount Curve approaches

Volatility Adjustment style

	AAA	AA	A	BBB	BB	B	CCC	Default
AAA	92.6%	7.1%	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%
AA	2.5%	88.6%	7.6%	0.4%	0.4%	0.3%	0.0%	0.2%
A	1.7%	2.7%	89.0%	5.1%	0.6%	0.6%	0.0%	0.2%
BBB	1.3%	1.4%	4.3%	88.9%	1.9%	0.8%	0.8%	0.5%
BB	0.1%	0.5%	1.0%	5.5%	81.9%	8.0%	0.9%	2.0%
B	0.0%	0.0%	1.0%	1.5%	5.0%	80.4%	6.6%	5.5%
CCC	0.0%	0.0%	0.6%	1.0%	2.6%	8.3%	75.5%	12.0%
Default	0	0	0	0	0	0	0	1

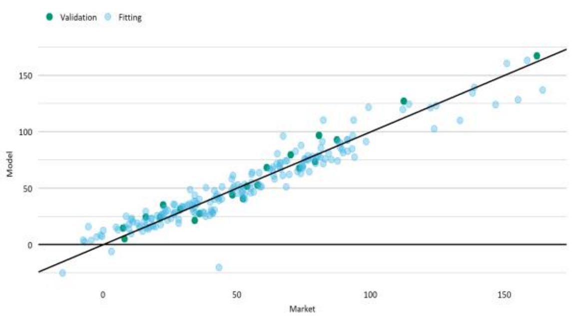
- » Based on historical data
- » No term structure of Illiquidity Premium
- » Need to justify application ratio
- » Low responsiveness to changes in credit risk

Credit Default Swap spread



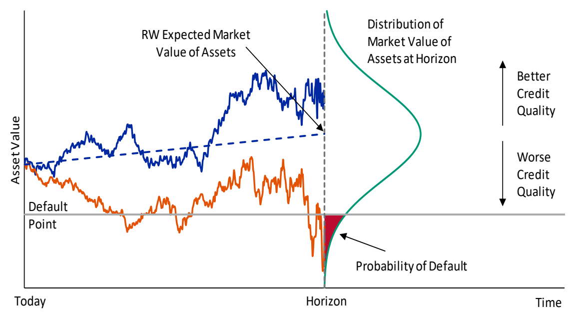
- » Market-driven
- » Limited data availability
- » Does not account for counterparty and Credit Default Swap liquidity risk

Proxy model



- » Simple to apply
- » Need to justify coefficients

Structural model



- » Market-driven
- » Term structure of Illiquidity Premium
- » Granular output
- » Requires sufficient input data

4

What should Insurers consider when it comes to implementing discount curve approach for IFRS 17?

Discount Curve Implementation Considerations

Reflecting liabilities

How does an insurer align the discount curve with liability characteristics?

Approximations

How can curves be produced in the absence of market data?

Sensitivity Testing

Insurers should have a robust framework for stressing curves and scenarios for disclosures

Curve Production

How can curves be produced in a stable, robust production framework?

Historical Curves

Production of backdated curves for transition calculations.

Scenario Generation

If an insurer has guaranteed business, discount curves may need to be reflected in economic scenarios.

5

How can Moody’s Analytics Discount service for IFRS 17 help insurers meet the challenges and accelerate their implementation and production timelines?

Moody's Analytics Recurring Service

Moody's Analytics Discount Curve Service for IFRS 17

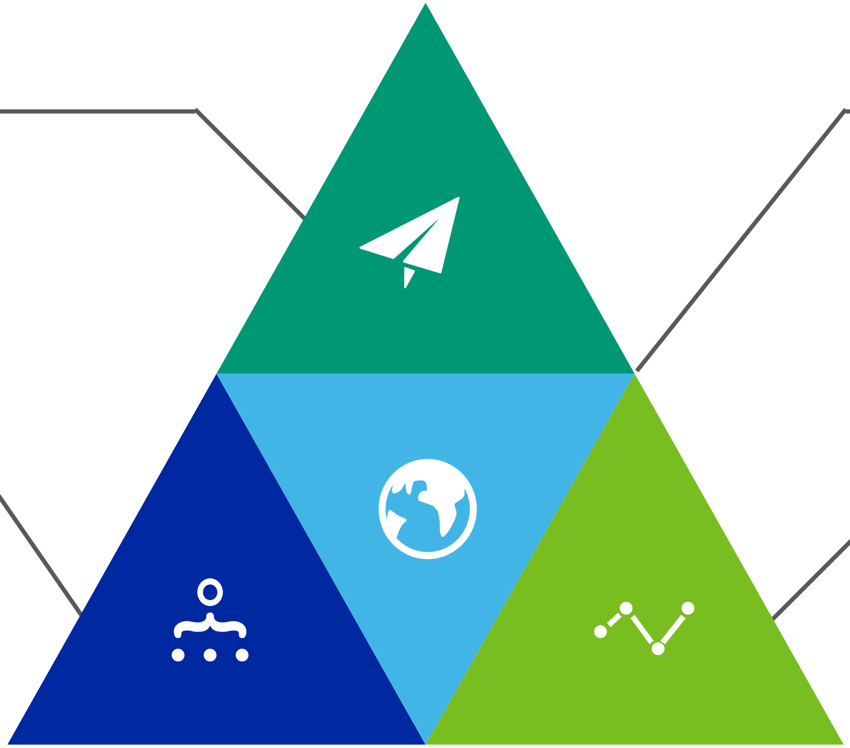
Economy Coverage

19 currencies with ability to expand to additional currencies.

Granularity

Illiquidity premium estimates quoted for:

- Full term structure
- Range of credit classes
- Range of maturity and rating buckets
- Single value based on a weighted average



Delivery

- Quarterly or Monthly delivery by Working Day 1
- Fully documented
- Sensitivity analysis

Additional Curves

- Choice of Swap (e.g. IBOR, OIS) and Government rates
- Range of Credit Spread curves

Benefits of the Moody's Analytics solution

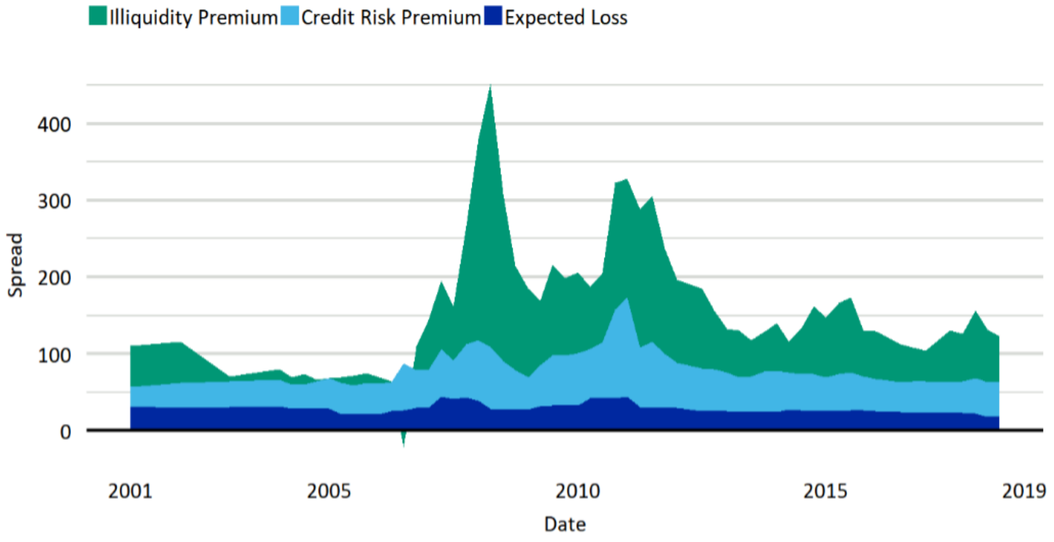
Reliability: Leverage Moody's Analytics unique calibration infrastructure

Fully documented: Communicate to internal and external stakeholders

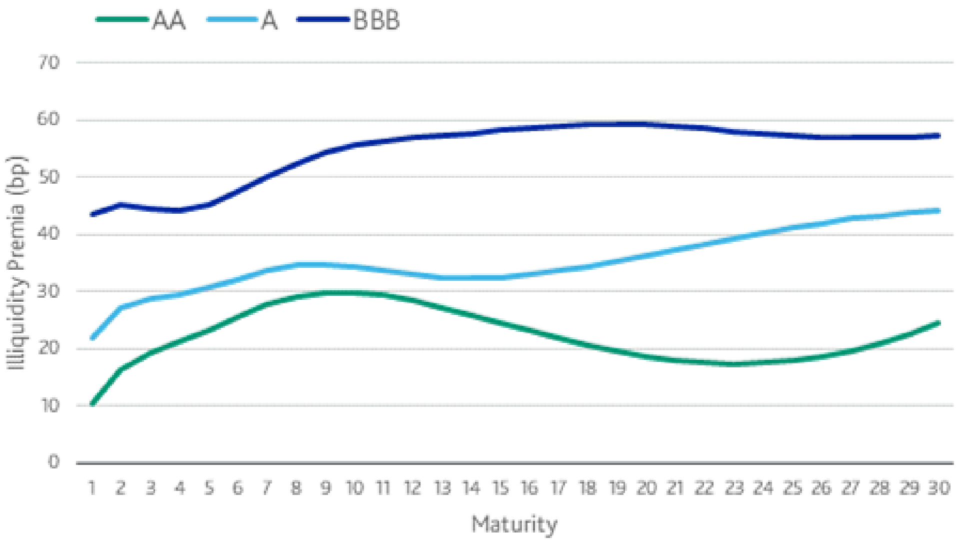
Flexibility: Insurers can tailor the solution to their requirements

Benchmarking capability: Perform analysis on different approaches (Volatility Adjustment, negative Credit Default Swap, covered bonds)

GBP historical decomposition of credit spreads



GBP End Dec 2019 IP term structures



IFRS 17 Thought Leadership

Discount Rate Curves

A Cost of Capital approach to estimating Credit Risk Premia

Illiquidity and Credit Premia for IFRS 17

Implementing IFRS 17 Discount Curves

Profit Emergence under IFRS 9 and IFRS 17

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