Securities & Exchange
Commission of Pakistan

IFRS 17 & RISK-BASED CAPITAL REGIME

DEVELOPMENTS & WAY FORWARD

Karachi, Tuesday, 23rd April 2024,
ICAP Seminar on IFRS 17 Implementation

AGENDA ITEMS

1. History of Insurance Regulatory Environment
2. Overview of the Pakistan Insurance Industry
3. IFRS 17 Developments
4. Risk-Based Capital Regime Developments

<u>Disclaimer</u>

- *The information presented is intended for an audience with insurance and financial knowledge.*
- *The figures presented are as per the specified format issued by SECP and populated by the insurance industry. The figures presented are subject to certain limitations discussed in the report. This may not however reflect the full figures since few companies have internal data challenges*
- *Presentation not aimed at making specific recommendations or suggestions. The comments given in the report are those of the presenter.*
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ABOUT SECP

The Securities & Exchange Commission of Pakistan was set-up in pursuance of the SECP Act 1997 and became operational in January 1999. Its mandate includes financial sectors other than the banking sector:

- Regulation of the corporate sector and capital markets,
- Supervision and regulation of insurance and takaful companies,
- Supervision and regulation of non-banking finance companies and private pension schemes.

Parent law & relevant Ministry

- Formed under the SECP Act of 1997,
- SECP reports to the Ministry of Finance

Administered Laws

SECP administers 14 primary laws including:

- Companies Act 2017
- Insurance Ordinance 2000
- Securities Act 2015
- Futures Market Act 2016
- Modaraba Ordinance 1980
- multiple subordinated legislations

Insurance Framework

Insurance Ordinance 2000.

Secondary legislation includes:

- Takaful Rules 2012,
- Microinsurance Rules 2014,
- Code of Corporate Governance for Insurers 2016
- Insurance Rules 2017,
- Insurance Accounting Rules 2017,
- General Takaful Accounting Rules 2019,
- And some more

INSURANCE REGULATORY LANDSCAPE

Primary Law

- Insurance Ordinance 2000

Rules

- Takaful Rules 2012
- SEC Microinsurance Rules 2014
- Unit-linked Products and Fund Rules 2015
- Small Dispute Resolution Committees (Constitution & Procedures Rules 2015)
- Code for Corporate Governance for Insurers 2016
- Insurance Rules 2017
- Credit & Suretyship (Conduct of Business) Rules 2018

Regulations, Guidelines & Circulars

- Insurance Companies (Sound & Prudent Management Regulations
- Third-Party Administrators for Health Insurance Regulations 2014
- Guidelines for Estimation of IBNR Claims Reserves 2016
- Insurance Accounting Rules 2017
- General Takaful Accounting Regulations 2019
- Corporate Insurance Agents 2020
- Master Circulars 2021

Major updates underway:

- Amendments in Insurance Ordinance underway: stakeholder consultation in-process
- Motor-Third Party Act 1939
- IFRS 17 and RBC developments and necessary changes in rules and regulations
- Updates in Admissibility limits, inclusion of debt-capital under solvency,
- Valuation of Insurance Contract Assets and Liabilities

Areas Master Circular 2021 covers

1. Licensing and Authorization,
2. Product Approvals
3. Reinsurance and Retakaful
4. Code for Corporate Governance
5. Financial Reporting
6. Management expense limits
7. Related-party assets
8. Information Sharing
9. Training & Certification Requirements
10. Complaints Handling
11. Cyber Security Guidelines
12. Miscellaneous

PAKISTAN INSURANCE INDUSTRY OVERVIEW YE2022

Total
- 0.87% Penetration & PKR 2,778 Density
- 42 registered Insurers

Life
- 0.59% Penetration & PKR 1,884 Density
- 11 companies (8 Conventional + 3 Takaful)
- 2 SOE (State Life & Postal Life)

Non-Life
- 0.28% Penetration & PKR 894
- 31 companies (28 Conventional + 2 Takaful + 1 Reinsurer)
- 3 SOE (NICL, Pak Re, Alpha Insurance)

	Life	Non-Life	Total
No of Policies (mn)	7.8	2.3	10.1
GWP (PKR bn)	375	178	553

Product Wise - Premium Distribution

Non-Life
- 27% - Fire, Property and Damage
- 23% - Motor
- 17% Engineering
- 13% Marine, Aviation, Transport
- 12% Accident & Health

Life – Public Sector
- 50% - Health
- 46% - Participating
- 4% - Term Life

Life – Private Sector
- 80% - Unit Linked
- 9% - Health
- 8% Term Life

Billion (USD1 - PKR 228)	2022 (PKR)	2022 (USD)	Prop.
Assets			
Life	2,103	9.22	87%
Non-Life	318	1.39	13%
Total Assets	**2,421**	**10.62**	**100%**
Equity			
Life	56.56	0.25	33%
NonLife	113.16	0.50	67%
Total Equity	**169.72**	**0.74**	**100%**

c. 200,000 Insurance Sales Agents
c. 1,565 Other Employees

Exchequer Revenue: 2022 PKR 34.3b

Paid Up Capital Requirement	Life: Regular	Life: Digital-only	Life: Microinsurer	Non-Life: Regular	Non-Life: Digital-only	Non-Life: Microinsurer
PKR	700m	150m	250m	500m	80m	100m
USD (PKR 280)	2.5m	0.535m	0.893m	1.786m	0.286m	0.357m

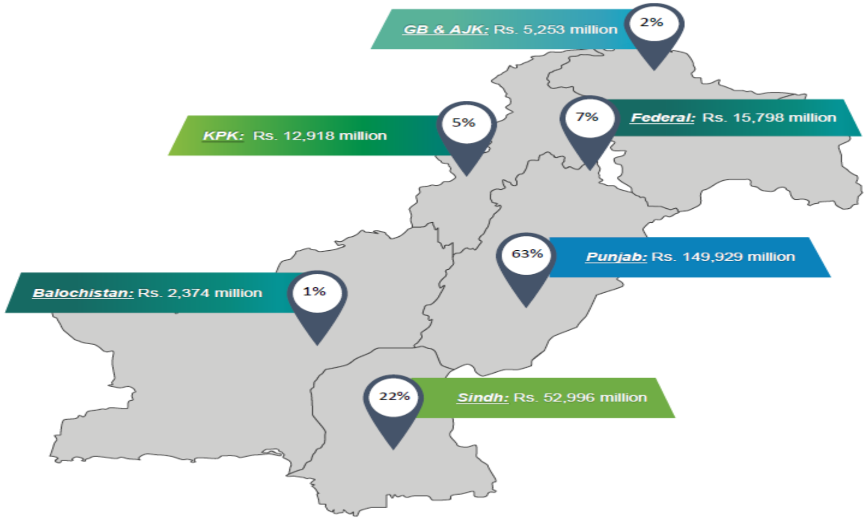
PAKISTAN INSURANCE INDUSTRY OVERVIEW YE2022

Life Insurance premium – PKR 375b				
Public sector: 69%		Private sector: 31%		
Distribution Channels				
99% DSF	1% Banca	54% Banca	33% DSF	12% Corp. Agents

Premiums by

Sales Distribution Channels

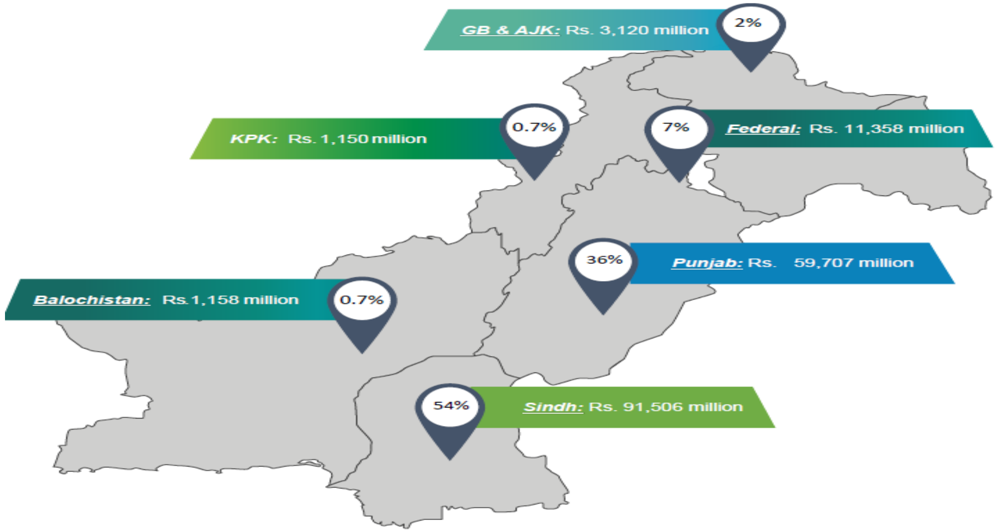
Non- Life Insurance premium - PKR 178b				
Public sector: 14%			Private sector: 86%	
Distribution Channels				
52% DSF	32% Direct	3% Agents	Digital 1.6%	98.4% Traditional



Province-wise Premium Split

Life market Retail-Driven

Non-Life market Corporate-driven



PAKISTAN INSURANCE INDUSTRY OVERVIEW YE2022

Takaful Market Statistics

10 Family Takaful Operators
- 3 Dedicated 7 Window
- 10.9% of Life industry
- PKR 41 billion

33 Takaful Operators
- 3 Dedicated 30 Window
- 11.2% of total industry
- PKR 62 billion

23 General Takaful Operators
- 2 Dedicated 21 Window
- 11.8% of Non-Life industry
- PKR 21 billion

Industry Potential

Population vs Life Policies	Bank Accounts vs Life Policies
225 Mn	67 Mn
7.8 Mn (3.5%)	7.8Mn (12%)

Total Vehicles vs Insured	Properties vs House Loan Borrowers
30 Mn	32Mn
0.9 Mn (3%)	0.3Mn (1%)

Total Farmers vs Covered	Mobile Subscribers
8.2Mn	191Mn
<1Mn	<4Mn

Public Property
No public property insurance program
NICL provides insurance for public assets

Disaster Risk Insurance
5th most vulnerable country
No public program for Disaster Insurance

Micro Insurance
MicroFin borrowers 8M
Potential market 33Mn
Existing products mainly cover credit life insurance

SMEs
>5Mn
No specific program available

FIVE (5) YEAR STRATEGIC PLAN HIGHLIGHTS

VISION: Inclusive, Innovative and Sound Insurance Sector by 2028.

MISSION: Develop and Regulate the Insurance Industry by balancing policyholder protection, industry growth and stability through regulatory excellence

Focus Areas, Strategic Objectives & Operational Targets

- Ease of Doing Business
- Innovation, Digitalization and Access to Data
- Legislation Modernization
- Enhanced Scope and Implementation of Mandatory Insurances
- Facilitate Access to Capital and Reinsurance
- Support Availability and Take-up of Takaful, Inclusive, Disaster and Agri Insurance
- Policy Holder Protection and Market Conduct
- Advocacy and Engagement with Stakeholders
- Financial Stability and Risk Based Supervision
- Awareness and image building

OPERATIONAL OUTCOMES

- Individual lives covered > 15 M
- Insurance Penetration > 1.5%
- Share of Takaful > 30%
- MTP insurance coverage > 20%
- Local Retention Ratio > 60%
- Share of digital distribution > 5%
- Private health insurance premium > 15% of total premium
- Availability of agriculture insurance for non-loanee farmers
- Availability of disaster insurance products
- Availability of annuity products for VPS investors / individual retirees

STRATEGIC OUTCOMES

- Premium growth from Rs. 553 billion to Rs. 1,221 billion by 2028
- Reduced cost of regulatory compliances
- Reduced Complaints Ratio
- Amended Insurance Ordinance
- Complete implementation of IFRS-17 and RBC
- Settlement of Sales Tax issue
- Digitalized regulatory approvals

IFRS 17 DEVELOPMENTS IN PAKISTAN

ICAP issues accounting and financial reporting standards and is endorsed by the SECP. The Working Group was formed in 2018 and an initial work plan was laid out for implementation. However, due to COVID-19 and planning time, the work plan commencement was delayed.

Upon IAP's recommendation in May 2021, SECP recommended adoption of IFRS 17 in four (4) phased manner (timelines revised):

Circular 2021-1716
IFRS 17 Adoption Announced

- Implementation of International Financial Reporting Standard
  Issued on 15th June 2021
  Setting out four (4) phased approach

Phase 1: Gap Assessment
Due by September 30th 2021

- Covering minimum requirements of technical and operational gap assessment, product assessment, roadmap, expected budget and internal committees

Phase 2: Financial Impact Assessment
Due by 31st December 2022

- Interim submissions to FIA report and template with requirements for 30 Jun, 30 Sep and 31 December 2022 submissions.

Phase 3: System Design & Methodology
Due 30 September 2024

- Setting out simplified requirements of data considerations, System and operational Design, Policies and procedures for Methodologies, Governance Structure Work Plan for Implementation, People and Resources Management, and Budget Plans.
- A template to follow

Phase 4: Parallel Run & Implementation
1 January 2026

- implementation of the work plan set out in Phase 3.
- Covering two dry runs and one parallel reporting on IFRS 4 and IFRS 17 for YE 2025.

  Full engagement from the SECP team with industry for IFRS 17 adoption covering valuation requirements, takaful rules changes, IFRS 17 reporting template, etc.

2023	2024	2025 & Beyond
• Kingdom of Saudi Arabia • United Arab Emirates • Oman • Malaysia • Qatar – Live for Conventional business, 2025 for Takaful	• Jordan • Egypt • Thailand • India (Fiscal Year: 1 July 2024; Calendar Year: 1 January 2025)	• India (Fiscal Year: 1 July 2024; Calendar Year: 1 January 2025 • Indonesia - 2025 • Philippines – 2025 • Lebanon and Sri Lanka no-date announced

Setting a timeline was essential to adopt the IFRS 17 Phases. Consequently SRO 1715(I)-2023 on IFRS 17 issued:

- ***Commission issued a notification on 21st November 2023***
- ***Setting out 1 January 2026 to be the go-live date for IFRS 17 standard***

IFRS 17 DEVELOPMENTS IN PAKISTAN

Phase 2 Financial Impact Assessment was conducted by 31 December 2022. All companies submitted results, except 3. The high-level impact on Net Liabilities and Equity:

PKR 2020 Position	Life Insurance	Non-Life Insurance
Net Liabilities	Decrease by 2.6% of PKR 9,800m	Decrease by 1% of PKR 314m
Equity	Increased by 2.6% of PKR 9,800m	Increased by 1% of PKR 314m

Key Reasons:

- For life insurance business, a change in methodology from NPV method to GPV method for FIA purposes considered
- For Life insurance business, the impact attributable due to higher discounting rates, than that used (3.75%) in statutory valuation
- Discounting introduced first-time non-life companies on different bases.
- Risk adjustment bases were calibrated for short-term business to align BE + RA to prudent reserves. No sound reasoning for quantile-selection per risk appetite considered.
- Various methods and approaches adopted by consultants without sufficient scrutiny by companies

IFRS 17 DEVELOPMENTS IN PAKISTAN

Technical Learnings & Concerns

- Level of aggregations insufficient – important to follow adequate segments and LOA requirements. Broad-level product categorization did not yield accurate details and was prone to errors in the estimation of results. Consider granular product nature.
- Onerousness assessment not adequately conducted – alignment with other areas such as RA, expenses and discounting practices is critical, using reasonable experience data.
- Inadequate expense studies and planning. Expense calibration for the bottom line is not fruitful.
  - Need proper expense analysis and attribution to LOBs and level of aggregations and adoption of pricing bases
- Risk adjustment methodology needs to be made consistent with your risk appetite and product nature.
- Discounting practices were not comprehensive, arbitrary bases were reflected without significant justification. A single rate for all products is inappropriate
- IFRS 17 is compatible with IFRS 9 – since market-consistent insurance liabilities need matching from market-consistent assets valuation.
- Data quality is critical for the whole IFRS 17 process
- Reinsurance is not given adequate focus and modelling practices are inconsistent. Reliance on gross patterns is inappropriate as settlement behaviours are different.
- Payables/receivables need mapping contracts and allocation strategies to be defined from high-level to granular-level

IFRS 17 DEVELOPMENTS IN PAKISTAN

General Learnings & Concerns

- Do not treat this as a compliance exercise. This is an opportunity to improve your understanding of the business
- Internal planning and project management are crucial for Implementation by 1 January 2026 to allow buy-in from all stakeholders.
- One size doesn't fit all → Do your homework. Every company has their own business dynamics and operational structure. Your risk margins are not the same as for others.
- Training your human resources is critical. Don't be dependent on consultants, develop and retain your own personnel to build technical capacity and uplift the industry work.
- Data and system challenges – need to understand your own system challenges and how you wish to meet your IFRS 17 compliance. Small companies may adopt different practices than large companies.
- Need to assess IFRS 17 results in comparison to IFRS4 – Use sensitivity and stress testing to assess the impacts and need to understand how your business is being affected. Apprise the Board!
- Methodologies and assumptions should be refined and improved, rather than carried forward from FIA. It is the expectation that Companies would test and validate their models and results.
- Important to take control functions – risk management and internal audit – in confidence
- Auditors need to be engaged to have the materiality defined and the review process to ensure compliance with standards.

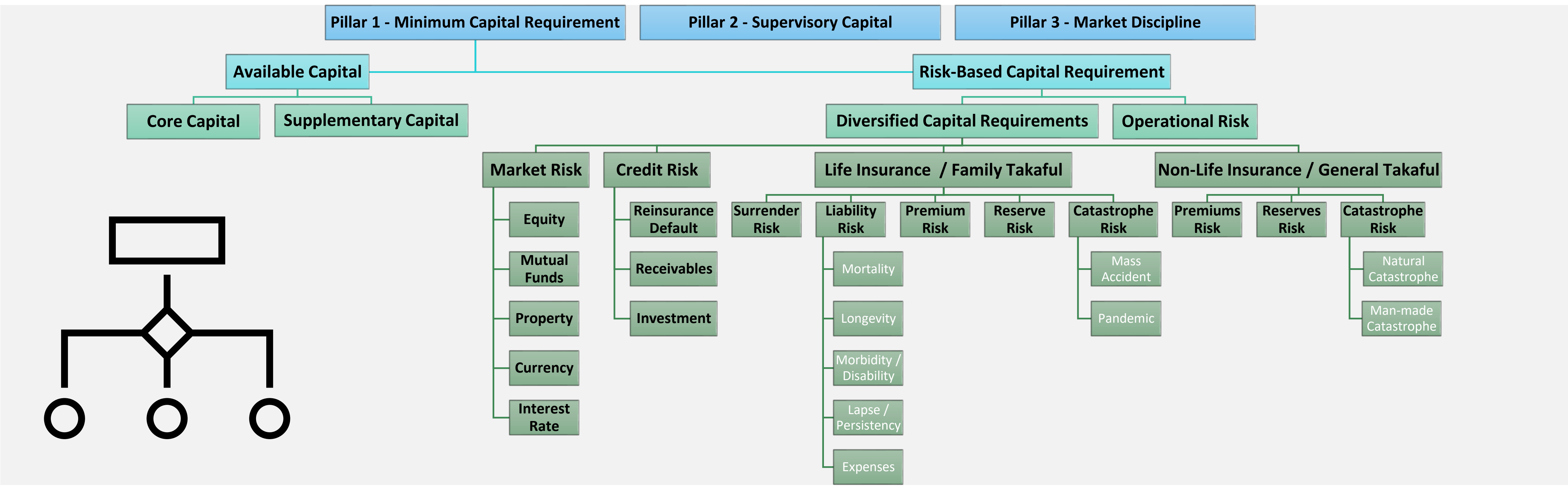
RECENT RBC DEVELOPMENTS IN PAKISTAN

- Currently Solvency regime in Pakistan is defined in Insurance Ordinance 2000 and Insurance Rules 2017:
  - Excess of admissible assets over liabilities subject to a minimum fixed amount and solvency margins – reinsurance impact considered - for:
    - Life Insurers: a factor-based approach for policyholders' liabilities and sum-at-risk under long-term business and 20% max of earned premiums and the sum of unexpired risk and outstanding claims reserves for short-term business
    - Non-Life Insurers: similar to short-term business for Life Insurers.
  - Asset Admissibility rules apply before consideration of solvency excess. A review of asset admissibility calculations is underway to align unit-linked limits and solvency limits.
- Through a joint working group with PSOA, the SECP issued a concept paper on "Risk-Based Capital Regime for Insurance Sector in Pakistan" in December 2022. The overarching purposes of the RBC regime are:
  - Introduce capital requirements which commensurate with risks being undertaken and measures systemic risk for the insurance industry, taking into account the impact of credit risks, market risks, catastrophe risks, operational risks, and more risk-driven insurance risks.
  - Align existing practices with international best practices, as well as encourage and incentivise good risk management practices
- Industry feedback on the concept note was received in August 2023 and continuous improvements are being made to the concept paper and model development in consultation with the industry and other stakeholders.

Concept Paper available on SECP website

RECENT RBC DEVELOPMENTS IN PAKISTAN

Risk-Based Capital Regime Architecture & Risk Flowchart



Plans for RBC Implementation

- Implementation one-year post-IFRS 17 agreed upon with the Industry due to technical complexities and human resource challenges. Phasing approach to alignment with new regime post-implementation.
- Work commencement to assist the industry in developing technical expertise and working with IFRS 17 and other matters.
- Pillar 2 and Pillar 3 are to be considered at a later stage, in consultation with the Industry

RECENT RBC DEVELOPMENTS IN PAKISTAN

The **Life Insurance/ Family Takaful liability risk** charges address the risk of underestimation of insurance liabilities.

- Long-term risks cover surrender risks, mortality, morbidity, longevity, expenses and lapses.
- Short-term risks cover premiums and reserve risks, sum insured risks.
- Catastrophe risks.

The **Non-Life Insurance / General Takaful liability risk** addresses the underestimation of insurance liabilities. This covers short-term risks such as premiums and reserve risks, along with catastrophe risks.

Market Risk aims to mitigate risks of financial losses arising from a reduction in the market value of assets due to exposures to equity, mutual funds, property and currency and non-parallel movements between the value of liabilities & assets. It aims to cover: (i) equity shocks, (ii) mutual funds shocks, (iii) property shocks, (iv) currency shocks, (v) interest rate shocks on assets and (vi) interest rate mismatch risk

Credit Risk – also known as counterparty default - is the risk of losses resulting from asset defaults, related losses of income and the inability of a counterparty to fully meet its contractual financial obligations. This is split into:

- Reinsurers, bank deposits and cash equivalents
- Receivables on aging analysis
- Others – Investments

Operational risk is the risk of loss from failure/errors of human resources and failure of processes and systems, also including external events.

Total Solvency Capital is estimated using diversification impact – for within risk categories and between risk categories – ignoring the Operational risk - for diversification.

Solvency Capital Requirements are to be defined in consultation with the industry post-completion of the study and finalization of the model development process.

RECENT RBC DEVELOPMENTS IN PAKISTAN

Concept note required industry study for the development of RBC model-building and testing.

- The data collection exercise commenced – on 1 April 2024 for issues, with a completion date of 15 May 2024; *selected participants have requested extensions but some comments have been received.* Model building exercise helps:
    - To estimate risk capital requirements based on individual companies' risk exposures in respective categories
    - Familiarise companies with the template workings and model-testing based on information collected by the companies
    - Fine-tuning and finalization of RBC regime based on quantitative impact analysis – risk capital requirement and current capitalisation levels

Engagement with PSOA and IAP shall be made to strengthen the RBC developments in line with international standards and devise a final RBC framework

- Implementation plan to be set in consultation with the industry on adopting RBC and discussion for alignment period for compliance to RBC environment. Consideration could be given to parallel runs during the alignment.

VALUATION OF INSURANCE CONTRACTS ASSETS & LIABILITIES

Presently, the Valuation of Assets and Liabilities is governed briefly by:

- Insurance Ordinance 2000 Section 27 (Appointed Actuary responsibilities for Life Insurers), Section 34 (Valuation of Assets and Liabilities) and Section 50 (Actuarial Report for Life Insurers)
- Insurance Rules 2017 Rule 23 and Annexure V – Minimum Valuation Basis covering prudent bases for valuation of Life Insurance liabilities. Using the Net Premium Valuation Method and conservative discount rate.
- Circular 9 of 2016 – Guidelines for Incurred-But-Not-Reported Claims

Valuation of Insurance Contracts Assets and Liabilities: work is underway with PSOA to set out comprehensive guidelines and requirements, in line with IAIS and IAA principles and standards. Shall cover:

- Submissions and certification requirements – defining roles and responsibilities, submission frequency and timelines, certification requirements
- Data quality assessment – standards adopted, sources and use of data, minimum and required segments, validation and reconciliation process, adjustments and expert judgement
- Methodologies adopted - principles used for technical provisions, long-term and short-term best estimate reserve methodologies, risk margin or margins for adverse deviations, discounting approaches, takaful practices, doubtful debt provisions, catastrophe reserves, etc.
- Assumptions – process for setting assumptions, valuation bases and consistency, deviations
- Results and Analyses – summary, results analyses and change, adequacy assessment, sensitivity and stress testing, and other important matters
- *Standardized templates and report requirements*

→ The testing period may be allowed to align and comply with valuation requirements, however, alignment with IFRS 17 and RBC timelines is imperative.

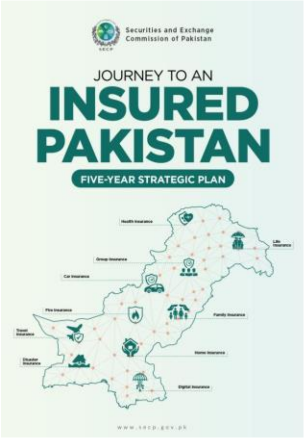
AREAS OF REGULATORY AMENDMENTS

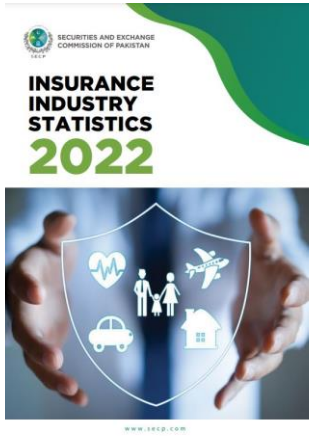
Non-Life Insurance	Life Insurance
Preparation of Published Financial Statements and regulatory returns and formats and disclosures thereof	
• Section 46 of Insurance Ordinance, 2000 require submission of annual statutory returns comprising of statements mentioned therein • Rule 19 of Insurance Rules, 2017 sets out the formats for submission of statements mentioned in Section 46 of the I.O.2000/ annual accounts • Annexure II of Insurance Rules, 2017 comprises of formats of statements required to be submitted under the aforementioned provisions • Insurance Accounting Regulations 2017 gives principles for measurement and reporting of insurance contracts and related transactions • Claims incurred but not reported-Guidelines for IBNR-2016 • Takaful Rules, 2012 & General Takaful Accounting Regulations, 2019 for takaful business	• Section 46 & Section 52 of Insurance Ordinance, 2000 require submission of annual statutory returns comprising of statements mentioned therein • Rule 24 of Insurance Rules, 2017 requires submission of financial statements mentioned in Section 46 of the I.O.2000 on the prescribed formats • Annexure II of Insurance Rules, 2017 comprises of formats of statements required to be submitted under the aforementioned provisions • Insurance Accounting Regulations 2017gives principles for measurement and reporting of insurance contracts and related transactions • Takaful Rules, 2012 & Circular on Family Window Takaful reporting in 2019 for takaful business
Solvency Calculation Requirement	
• Section 36 of Insurance Ordinance, 2000 • Rule 15 of Insurance Rules, 2017	• Section 35 of Insurance Ordinance, 2000 • Rule 14 of Insurance Rules, 2017 read with • Annexure V of Insurance Rules, 2017
Valuation requirements	
No Major Requirements	Annexure V of Insurance Rules, 2017

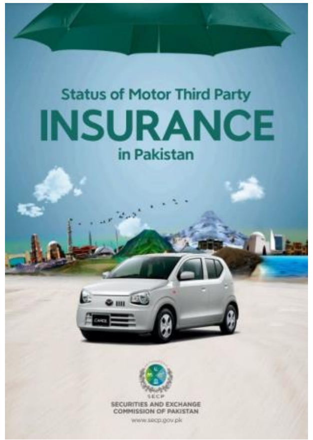
RECENT SECP PUBLICATIONS

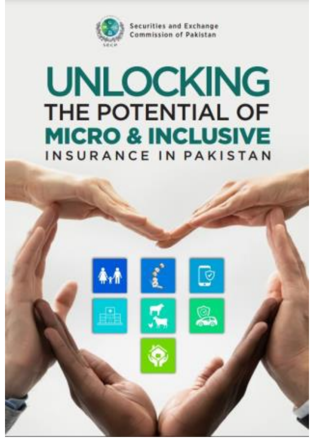
Noteworthy mentions of studies conducted:

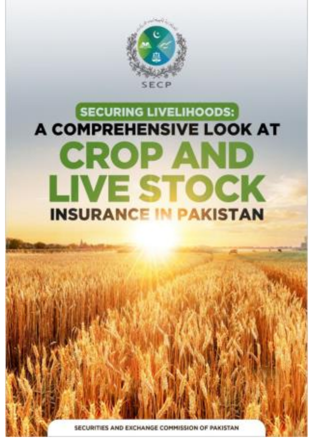
- Five (5) Strategic Plan
- Insurance Industry Statistics 2022
- Status of Motor Third Party Liability Insurance in Pakistan
- Unlocking the Potential of Micro & Inclusive Insurance in Pakistan
- Crop & Livestock Insurance in Pakistan
- Subordinated Debt Securities & Treatment for Solvency
- Insurance Pools Dynamics – in finalization
- Concept Paper Risk-based Capital Regime for Pakistan Insurance Sector – under update
- Reinsurance Market of Pakistan – new study
- Status on IFRS 17 Adoption in Pakistan – new study (based on FIA)











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THANK YOU AND QUESTION?