



CARIBBEAN ACTUARIAL ASSOCIATION



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Industry Comments on APS2.1 Principles and Considerations for the Selection of the Discount Rate Curve

**A Preliminary Discussion Draft
of the CAA**

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Respondents

- Andrew Affoo
- CAIR
- CARICRIS
- Prescience Insurance Consultants
- Suriname



General Comments

- The purpose of the document needs to be clarified
 - discussion document
 - mandatory/voluntary standard
- Different discount rates may apply to different scenarios
- Conflicts with existing standards and legal requirements
- Do not extend to non-life at this time
- CAA may not be able to deviate from international principles in applying IFRS.



Summary Action List on Discount rate

- In some territories Government and Corporate bonds do not exist (or are limited)
- Term Deposits and Mortgage rates may be the only existing proxies in some cases.
- Sovereign risk should not be zero risk rated given recent defaults/ restructuring.

Section 2 (Question1) : What are available sources of market data?

- Applicability to the Caribbean may vary by jurisdiction.
- No risk-free asset exists without adjustments
 - all countries do not have low probability of default
 - high quality bond market not deep and liquid
 - Swap rate curve includes counter-party risk
- Include adjusted mortgage rates
- Triple A rating requirement should be adjusted to reflect the current ratings in some territories
- CariCris work can help here



Section3 (Q2): How should credit risk, sovereign risk and illiquidity premium be accounted for?

- Committee should share its assessment of the materiality of sovereign risk.
- Indicate macroeconomic indicators of sovereign risk
- Exclusion of provisions for sovereign risk, in reserves, inconsistent with IASB (BCA86)
- Credit risk inherent in insurance liability depends on credit rating of insurer, liquidity, mispricing, and reinsurance counterparty
- For sovereign risk use regional and international ratings with provisions as appropriate.



Section3 (Q 2): How should credit risk, sovereign risk and illiquidity premium be accounted for? (cont'd)

- Liquidity premium – formula recommended ($\max(0, (\text{total spread} - \text{fixed spread}) * \text{ratio})$).
- Does the recommendation suggest that all insurance liabilities regardless of type issued in the Caribbean are illiquid
- Refer to CariCris bond pricing methodology.

Section 4 (Q3): At what point is the last liquidity point?

- What are the experts' views regarding the last liquidity point for Jamaica?
- Who will conduct and participate in the survey? Outsourcing suggested. A wide cross-section of financial sectors also suggested as participants.
- Consider the gov't bond market, corporate bond market, actual investments of insurer and the circumstances under which the market price was determined.
- Based on experience: Trinidad (20yrs), Barbados (15 - 20yrs), EC (10yrs), Netherlands Ant(10 -15yrs), Belize (5-10yrs), Suriname (5yrs)



Section 5 (Q4) Choice of the unconditional ultimate long-term level

- Considerations for determining UFR:
 - Historical and long term trends
 - Economists predictions
 - Shape of yield curve
 - Inertia
 - Political pressure
- Use MA LT growth assumption with CAA recommendations



Section 5 (Q4) Choice of the unconditional ultimate long-term level

- Add Suriname to table in Section 6.3 (real GDP 5%, expected inflation 4%, UFR 9%)
- What other regional and external data sources should be used?
- How is UFR to be kept stable if forecasts change?
- How does the proposed compare with what is currently used by actuaries?



Section6 (Q5): What is the best extrapolation method?

- Either Smith-Wilson or linear
- Results of testing should be shared with the community to give information and opportunity to comment.

Appendix A

1. Issues of discount rate setting are adequately explored in the document. The draft is a good start but there are some additional factors that need to be taken into consideration.
2. Additional guidance related to treatment of participating policies and comment on top-down vs. bottom-up approach. Refer to work of CariCris.
3. The use of regional scale credit ratings as a measure of risk and an approach to the determination of liquidity risk premium based in part on nature of issuer.



Appendix A

4. The idea of a universal Caribbean discount rate is impractical and unfounded. Each currency would require its own discount rate.
5. CariCris provides an independent bond valuation service which may add value in the determination of the discount rate by currency.
6. Other sources of information to facilitate discussion are IFRS newsletters from major audit firms.
7. Next steps – summarize comments and produce another exposure draft. Meet with CariCris.

