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IFRS 17 Complexity in practise

Risk adjustment and Outwards Reinsurance

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Overview

- Risk adjustment
  - Calculation approaches
- Outwards Reinsurance

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Risk Adjustment

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Risk Adjustment Requirements

Paragraph 37 - Definition

"An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk."

Paragraph 119 - Disclosure

"An entity shall disclose the confidence level used to determine the risk adjustment for non-financial risk. If the entity uses a technique other than the confidence level technique for determining the risk adjustment for non-financial risk, it shall disclose the technique used and the confidence level corresponding to the results of that technique."

Appendix B, Paragraph 88

"the risk adjustment for non-financial risk also reflects:

(a) the degree of diversification benefit the entity includes when determining the compensation it requires for bearing that risk; and

(b) both favourable and unfavourable outcomes, in a way that reflects the entity's degree of risk aversion."

Risk Adjustment	**Objective:** Compensation the insurer requires to make it indifferent between the present value of the uncertain cash flows and the present value of certain cash flows

Possible methods…?

Value at Risk (VaR)

Tail Value at Risk (VaR)

Cost of Capital (CoC)

- No prescribed approach
- Risk adjustment required on a gross and reinsurance basis separately
- Re-measured at each reporting period
- Allows for effect of diversification between portfolios within a reporting entity
- Regardless of the method chosen, a confidence level equivalent must be calculated and disclosed (i.e. VaR percentile)
- Harder questions
  - Treatment of diversification across products and across legal entities?
  - Treatment of gross risk margin in presence of significant RI

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Risk Adjustment
Discussion of Views

- Diversification credit
  - TRG allows credit for diversification where this diversification is taken into account when pricing the business.
  - The process needs to be efficient enough to run at each reporting period

Q: At what level do you intend to set the risk adjustment: portfolio, entity or by Group?

Q: If it is above portfolio level how might you go about allocating back to portfolio?

Q: What does the “entity’s degree of risk aversion” mean?

- appetite?
- own view of risk?

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Risk Adjustment
Additional areas for discussion

- Will any leverage come from Solvency II?
  - Questionable underlying assumptions? – cost of capital rate.
  - Need to back out confidence interval.
  - Gross and reinsurance.
  - Which capital basis – to ultimate?

- How will a reinsurance risk adjustment be derived?
  - Gross less net?
  - Need to consider the reinsurance contract boundary and cashflows included.

- Do we foresee convergence in confidence intervals across the market over time? (Australia)

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Outwards reinsurance

Reinsurance: aggregation and measurement

- Measurement of liabilities is done for groups of contracts
  - Net to gross ratios calculate a total recoverable but do not value individual reinsurance recoverables
- Requirement to disclose portfolios in asset and liability position
- Measurement is determined by the CASH positions
- Treatment of commissions and RIPs is different to current and will take some getting used to!

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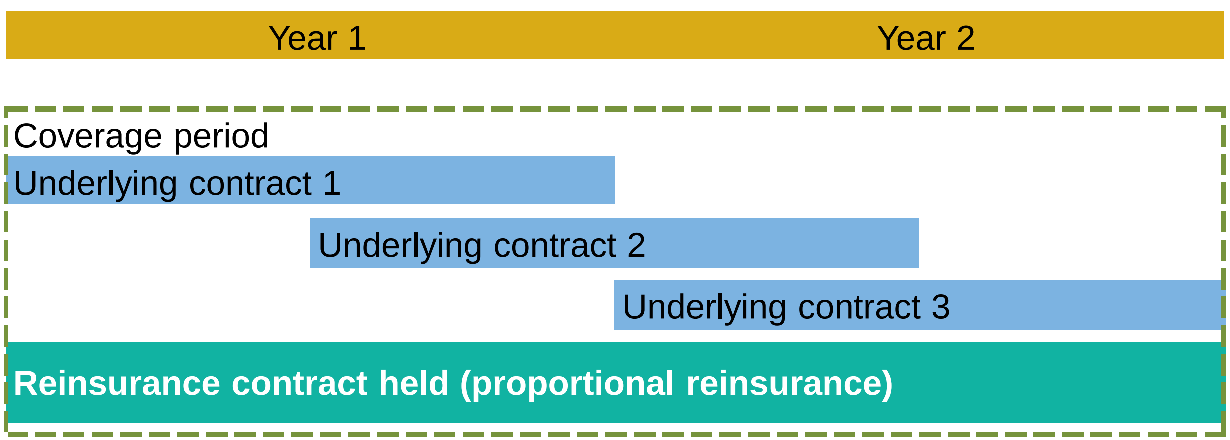
Reinsurance: PAA eligibility

- The period during which the holder of the reinsurance contract receives services
  - For example, a proportional reinsurance treaty that protects an entity for claims arising from contracts it issues in a year
  - Reinsurance contract held may have a coverage period that is longer than the individual underlying contracts an entity issues



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Reinsurance: Some good news

- There 'was' a wholesale mismatch between treatment of onerous inwards contracts and outwards recoveries
- TRG has tenatively proposed to extend p66 (c)(ii) to allow RI offset of onerous contracts (whether or not the RI contract is profitable or not) where:
  - RI provides 'proportionate' coverage to claims incurred
  - RI is already entered into before or at same time as contract

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Reinsurance
Discussion points

- Important to consider PAA vs BBA for outwards contracts separately to inwards.
  - Q: Are people using BBA to calculate ORI or aiming for PAA? What is your rationale for PAA on RAD policies?

- Treatment of a single RI contract/programme which covers multiple underlying inwards risks?
  - e.g. Whole account cover
  - Conflicts with ‘similar risk’ requirement? – one programme per portfolio?

- Cashflow quantification is unlikely to be straight-forward
  - Q: How might we go about estimating cashflows relating to inwards business not yet written?
  - Q: Are your systems set up to consider the reinsurance cash positions, and if not how are you/might you adapt existing systems/assumptions to account for these?

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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