



Thai General Insurance Association

IFRS 17 Insurance Contracts
Practical Guidance

Topic 8: Risk Adjustment

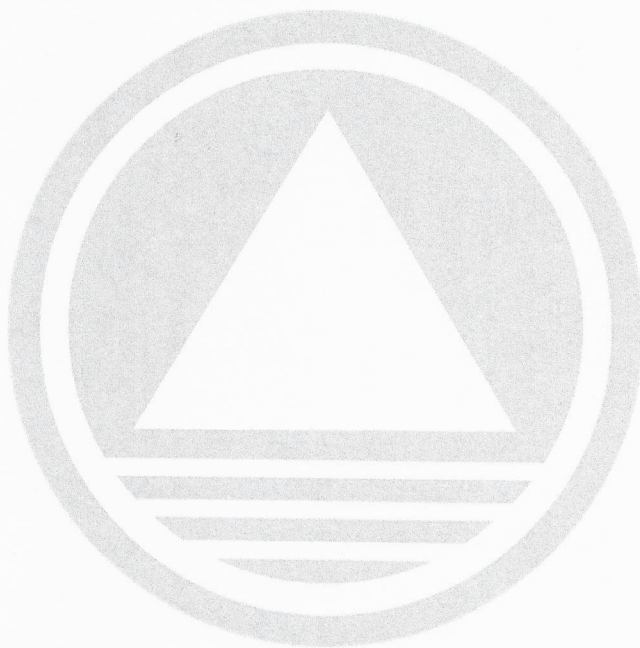
30 September 2021

Disclaimer

This is a Practical Guidance in the application of IFRS 17 Insurance Contracts and is by no means a financial reporting standards.

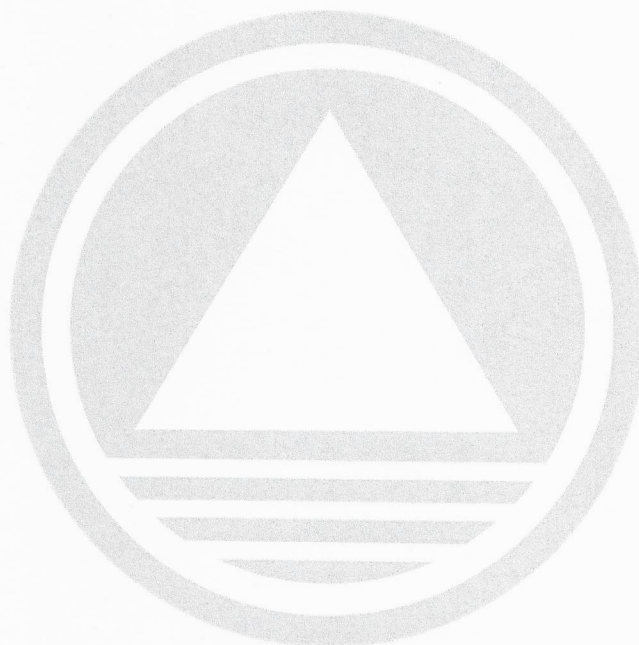
The IFRS is principles-based, therefore this guide aims to provide illustrative examples on how to apply the standards by IASB.

In the event of any conflict or inconsistency between the IFRS and the Practical Guidance, the IFRS shall prevail, and the accounting treatment should comply with the IFRS. Similarly, should the interpretation of the IFRS results in a contradicted conclusion from the example given in the Practical Guidance, the accounting treatment should observe IFRS.



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1.0 Executive Summary

This report is part of a series of study papers guiding non-life insurers' implementation of the new Thai Financial Reporting Standard 17 for Insurance Contracts ("TFRS 17"), which has a mandatory effective date of 1 January 2024 or later (1 year after IASB effective date for IFRS 17).

As defined under the Standard, risk adjustment represents the compensation that the entity requires for bearing risks (i.e., the economic burden of risks). It should incorporate both favourable and unfavourable outcomes in a way that reflects the entity's risk aversion. It represents the compensation that the entity would require if it was to charge the policyholder an explicit separate amount for non-financial risk. Therefore, risk adjustment should reflect the measurement of risk as well as the financial position that the entity places on different levels and characteristics of cash flow risks inherent in its insurance contract.

The definition of risk adjustment provided in the Standard is more aligned with the principle of measuring risk adjustment under a 'cost of capital' approach, as the approach provides a more direct link to the compensation required for the risk-taking activities of the entity. For example, assuming a target minimum risk-adjusted return on capital of 10% per annum and a regulatory capital requirement for a group of insurance contracts of say THB 100m (associated with non-financial risk charges in this example), the entity would require a compensation of only THB 10m for bearing the non-financial risks. Therefore, the entity only has to set aside RM 10m of risk premium for the group of contracts for future release until all contracts are derecognised.

The paper will also provide a perspective whether the regulatory PAD under RBC can be directly interpreted as risk adjustments under IFRS 17, if it provides a better alignment between the regulatory reporting and the general financial reporting. Though in this case, entities may need to quantify and disclose a higher confidence level for risk adjustments. Further, as demonstrated above, the quantification of implied confidence level may require the entity to have a gross risk appetite (i.e., target minimum return on capital on a gross of reinsurance basis).

Reinsurance risk adjustment is defined as the amount of risk being transferred by the entity to the reinsurers. This is similar to insurance contracts and as mentioned earlier, PAD method does not explicitly consider the 'compensation' required for bearing risks.

Reinsurance risk adjustment may be interpreted as the difference between the compensation that would make the entity indifferent between entering into the reinsurance contracts and retaining these risks without reinsurance, or could be considered as the difference in the risk position of the entity with and without entering into any reinsurance arrangements. Therefore, an appropriate risk adjustment for the reinsurance contracts held may be determined based on the difference between the gross and net amounts.

However, given that all entities hold regulatory gross PAD as its risk adjustments for insurance contracts under IFRS 17, in our opinion the entities should also hold a consistent regulatory reinsurance PAD as the risk adjustment for reinsurance contracts. Similar to insurance contracts, by holding regulatory reinsurance PAD, the entity may be holding a risk adjustment for its reinsurance contracts that is higher than 75% confidence level. Similarly, it is difficult to quantify the implied confidence level of the risk adjustments for reinsurance contracts, as the entity may not have an explicit reinsurance appetite (e.g., a target returns on capital for reinsurance).

This paper will propose a few methods to estimate risk adjustments for gross and reinsurance held, the results of the assessment for the topic are discussed in sections below.

2.0 References

International Financial Reporting Standard 17

The following are references to the IFRS 17 referred to in this Practical Guidance:

Name of the IFRS17 Topics	Reference in IFRS 17 (Paragraph)
	37, B86 – B92

Risk adjustment for non-financial risk (paragraphs B86–B92)

37 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.

Risk adjustment for non-financial risk (paragraph 37)

B86 The risk adjustment for non-financial risk relates to risk arising from insurance contracts other than financial risk. Financial risk is included in the estimates of the future cash flows or the discount rate used to adjust the cash flows. The risks covered by the risk adjustment for non-financial risk are insurance risk and other non-financial risks such as lapse risk and expense risk (see paragraph B14).

B87 The risk adjustment for non-financial risk for insurance contracts measures the compensation that the entity would require to make the entity indifferent between:

- (a) fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and
- (b) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contracts.

For example, the risk adjustment for non-financial risk would measure the compensation the entity would require to make it indifferent between fulfilling a liability that—because of non-financial risk—has a 50 per cent probability of being CU90 and a 50 per cent probability of being CU110, and fulfilling a liability that is fixed at CU100. As a result, the risk adjustment for non-financial risk conveys information to users of financial statements about the amount charged by the entity for the uncertainty arising from nonfinancial risk about the amount and timing of cash flows.

B88 Because the risk adjustment for non-financial risk reflects the compensation the entity would require for bearing the non-financial risk arising from the uncertain amount and timing of the cash flows, the risk adjustment for nonfinancial 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.

B89 The purpose of the risk adjustment for non-financial risk is to measure the effect of uncertainty in the cash flows that arise from insurance contracts, other than uncertainty arising from financial risk. Consequently, the risk adjustment for non-financial risk shall reflect all non-financial risks associated with the insurance contracts. It shall not reflect the risks that do not arise from the insurance contracts, such as general operational risk.

B90 The risk adjustment for non-financial risk shall be included in the measurement in an explicit way. The risk adjustment for non-financial risk is conceptually separate from the estimates of future cash flows and the discount rates that adjust those cash flows. The entity shall not double-count the risk adjustment for non-financial risk by, for example, also including the risk adjustment for non-financial risk implicitly when determining the estimates of future cash flows or the discount rates. The discount rates that are disclosed to comply with paragraph 120 shall not include any implicit adjustments for non-financial risk.

B91 IFRS 17 does not specify the estimation technique(s) used to determine the risk adjustment for non-financial risk. However, to reflect the compensation the entity would require for bearing the non-financial risk, the risk adjustment for non-financial risk shall have the following characteristics:

- (a) risks with low frequency and high severity will result in higher risk adjustments for non-financial risk than risks with high frequency and low severity;
- (b) for similar risks, contracts with a longer duration will result in higher risk adjustments for non-financial risk than contracts with a shorter duration;
- (c) risks with a wider probability distribution will result in higher risk adjustments for non-financial risk than risks with a narrower distribution;
- (d) the less that is known about the current estimate and its trend, the higher will be the risk adjustment for non-financial risk; and
- (e) to the extent that emerging experience reduces uncertainty about the amount and timing of cash flows, risk adjustments for non-financial risk will decrease and vice versa.

B92 An entity shall apply judgement when determining an appropriate estimation technique for the risk adjustment for non-financial risk. When applying that judgement, an entity shall also consider whether the technique provides concise and informative disclosure so that users of financial statements can benchmark the entity's performance against the performance of other entities. Paragraph 119 requires an entity that uses a technique other than the confidence level technique for determining the risk adjustment for nonfinancial risk to disclose the technique used and the confidence level corresponding to the results of that technique.

3.0 Practical Guidance

3.1 Definition

Risk adjustment (RA) should be determined as the amount of compensation that the entity (not a market participant) would require for bearing then non-financial risk associated with the contract, i.e. reflects an entity's own perception of its degree of risk aversion.

Non-financial risks include Insurance risk (that is, the risk the entity accepts from the policyholder) and other non-financial risk (lapses or expenses risk). The risk adjustment for non-financial (RA) risk relates to risk arising from insurance contracts other than financial risk:

- a. Financial risk is included in the estimates of the future cash flows or the discount rate used to adjust the cash flows.
- b. It should not reflect the risk that do not arise from the insurance contract, such as general operational risk, although it can include "operational risk of the contract".

The RA conveys information to users of financial statements about the risk adjusted return and risk profile disclosure of the entity related to the amount and timing of the cash flows used to assess balance sheet items.

3.2 Estimation Techniques

The Standard does not specify the estimation technique(s) used to determine the RA. It does, however, define a principles-based approach for its measurement and a list of characteristics that the risk adjustment should meet:

- a. Risk with low frequency and high severity will result in higher risk adjustment than risks with high frequency and low severity;
- b. Contracts with longer duration should show a higher risk adjustment than contracts with a shorter duration for similar risks;
- c. The risk adjustment should be higher for risks with a wider probability distribution;
- d. The higher uncertainty around the amounts and the trend of the risks the higher the risk adjustment should be; and
- e. To the extent that emerging experience reduces uncertainty about the amount and timing of cash flows, the risk adjustment for non-financial risk will decrease and vice versa.

The Standard does not indicate the confidence level with which to calculate the RA, but IFRS 17 requires entities to disclose the confidence level with which RA has been calculated.

The RA should also reflect:

- a. The degree of diversification benefit the entity includes when determining the compensation it requires for bearing that risk
- b. Both favourable and unfavourable outcomes, in a way that reflects the entity's degree of risk aversion.

An entity is permitted to measure the RA at different levels of its business – e.g. contract, portfolio, group of portfolios or entity level and it is also permitted to use different methods for different risk types or for different levels of its business. Such definition of risk adjustment provided in the Standard is more aligned with the principle of measuring risk adjustment under a 'cost of capital' approach, as the approach provides a more direct link to the compensation required for the risk-taking activities. Cost of capital approach could be a popular pick for entity selling long coverage period insurance contracts to better reflect the proxy for value of inforce in its contractual service margin disclosure in the financial statement.

The risk adjustment for a group of reinsurance contracts issued represents 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.

The same methodology can be used for direct and assumed reinsurance. Simplification such as the PAD approach can be used, in case of accounting choice by the company to align the measurement methodology with the regulatory approach.

Risk adjustment for Liability for Remaining Coverage - insurance contracts issued

The preferred approach for PAA is to estimate a distribution based on the ultimate LR variability and then apply the risk measurement (similar to RBC PAD approach but without diversification benefit). This means that we will assess the variability between the projected ultimate Combined Ratios for the remaining coverage and the realized ultimate loss ratio, then fit a statistical distribution on this and then apply a risk measurement.

- a. The projected ultimate combined ratio is more granular than the budget Combined ratio, unless the break down is available for contracts with remaining coverage vs. renewal and new business. Consistency with the budget assumption is required.
- b. The realized ultimate loss ratio is the one assessed at the end of the first development year, as the risk of boni/mali will be covered through the LIC Risk Adjustment.

The preferred approach for GMM is to estimate a cost of capital. Practical examples from IFOA website on how to calculate cost of capital rate is attached in the Appendix section as Item 1. It is a matter of discretion in the parameters selected by the entity. If company chooses a method other than the confidence level, then the company shall disclose its technique (IFRS 17 B92) in the financial statement. The amount is then translated to a percentage incurred claim or paid claim cash flows. A stream of risk adjustment will then be projected together with the future cash flows.

Risk adjustment for Liability for Remaining Coverage - reinsurance contracts held

Proportional reinsurance

- a. The risk adjustment for a group of reinsurance contracts held represents the amount of risk being transferred by the cedant to the reinsurer. This risk adjustment represents an asset for the ceding entity Proportional reinsurance:
- b. The risk adjustment is based on the risk adjustment of the underlying contracts, adjusted for the cession rate or the ratio ceded UPR / gross UPR.

Non proportional reinsurance

- a. The risk adjustment can be based on the risk adjustment of the underlying contracts, adjusted for the ratio ceded UPR / gross UPR. In the case of non proportional reinsurance, the ceded UPR if it doesn't exist, other approximation techniques could be considered.
- b. For simplification, if the ceded reinsurance is immaterial in terms of risk transfer, the risk adjustment transferred could be set to nil.

Risk adjustment for Liability for Incurred Claims

The risk adjustment concept is coincidentally same as PAD, which are required due to uncertainty in estimating claim liability such as:

- i. Parameter error such as Error in determining the values of the parameters of the claims run-off process and the parameter might evolve over time.
- ii. Process error - Future payments are random and unknown.
- iii. Model specification error
- iv. Data error

The risk adjustment will be calculated over the direct business and reinsurance contract held. In practice the gross and net unpaid claim liabilities will be projected from the existing claim triangles by accident years and by RBC classes for direct insurer. For reinsurer, the existing claim triangles by underwriting years could be maintained for IFRS17. Common methods used to derive PAD for Claim Liability are:

- i. Mack Method
- ii. Bootstrapping
- iii. Stochastic Chain Ladder Method
- iv. Industry Benchmark

The popular methods are Bootstrapping and Mack. It is not the intention of this paper to provide details of the two methods. The paper will not also discuss the allocation techniques of RBC classes to the respective groups of insurance contracts. It is not a requirement to compute LIC at the group of insurance contracts level and therefore RA for LIC is also simplified, so long it could be allocated systematically and rationally from the portfolio.

3.3 Risk Adjustment Measurement Approaches

Cost of Capital Approach

$$\begin{aligned}
 \text{Undiscounted Risk Adjustment} &= \text{RC Required Capital} \times \text{CoC Cost of Capital} \\
 &= \max(\text{EC Economic Capital}, \text{RegC Regulatory Capital}, \text{ITC Internal Target Capital}) \times \text{CoC Cost of Capital}
 \end{aligned}$$

In a cost of capital method, the entity level RA is based on the compensation that the entity requires to meet a target return on capital. In this calculation, three elements are required:

- Projected capital amounts, which are used to determine the level of non-financial risk during the duration of the contract;
- Cost of capital rate(s), which represent the relative compensation required by the entity for holding this capital; and
- Discount rates, which are used to obtain the present value of future compensation required. The actuary may use similar discount rates for the discounted RA calculation as are used for other IFRS 17 calculations (such as discounting the LIC).

This method has the benefit of being conceptually close to the definition of the RA and potentially allows allocation of the RA at a more granular level assuming a more granular allocation method for capital amounts. On the other hand, the cost of capital (CoC) method may be operationally complex, as the projection of capital requirements is an input to the liability calculation.

Whereas the general formula for the CoC is simple, however, operationally it is tedious because the RA will then be distributed to the respective groups of insurance contracts as a percentage of present value of claim outgo and present value of expense outgo (percentage of RA). The percentage of RA shall be revisited at least annually.

General Formula for Allocation and Aggregation

The general formula for the allocation of entity level RA estimated annually based on a cost of capital method is:

$$\text{Discounted RA} = \text{CoC} * \sum_{t \geq 0} \frac{\text{Capital Required (t)}}{(1+d_t)^{(t+1)}}$$

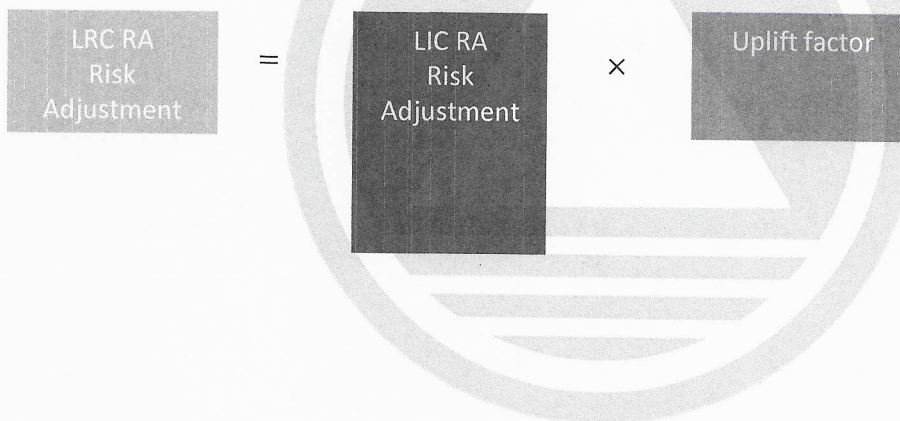
where,

- CoC = 6% for example;
- d_t is rate of interest
- The capital required figures presented are 'as at the end of period t', where $t \geq 0$

An illustration has been prepared in the Appendix section 3 for the discounted cost of capital approach with and without diversification benefits.

PAD Approach

This is obtained by leveraging the risk margin percentages on the LIC, applying an uplift using actuarial judgment to represent the additional uncertainty relating to future claim events in the Liability for Remaining Coverage.



PAD Approach (cont'd)

Quantile techniques, including VaR and CTE, may be used to assess the probability of the adequacy of the fulfilment cash flows and thus to quantify the RA. One key advantage of a quantile technique is that it directly satisfies the IFRS 17 disclosure requirements regarding confidence level corresponding to the RA.

The IAA *Risk Adjustment* monograph states: “A key advantage of the quantile techniques is that the mathematics enable risks to be represented graphically which creates ease and convenience in understanding the result. A disadvantage is that if misrepresented, it may introduce spurious accuracy.” Assessment of the confidence level corresponding to the RA would generally require underlying assumptions of the risk distribution. Given a risk distribution, both VaR and CTE can be calculated. It is important for the actuary to recognize that a VaR calculation may not capture the risk for a particularly skewed distribution of cash flows, which are common for certain P&C risks, and thus may not be an appropriate method to use. For further discussion of the use of VaR and CTE for RA, the actuary is referred to the IAA *Risk Adjustment* monograph.

This section provides a high-level overview of possible methods to generate a risk distribution and describes how quantile techniques (including VaR and CTE) are applied to determine the RA. Detailed theoretical background information and implementation guidance for quantile techniques are beyond the scope of this practical guidance.

Generating a Distribution

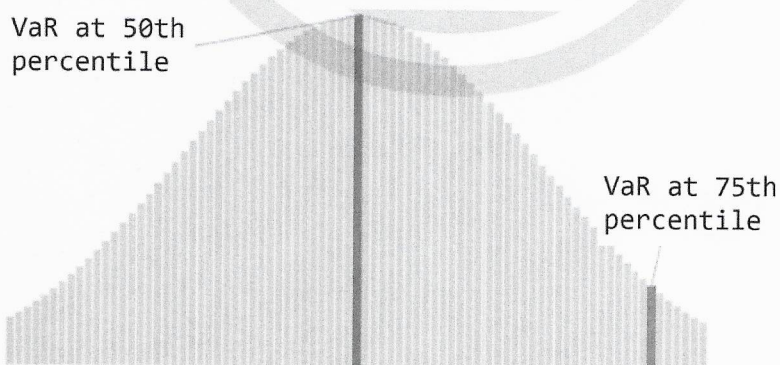
To generate a distribution of the underlying future cash flows, different methods may be considered:

- Fit future cash flows for non-financial risks to a suitably skewed probability distribution (e.g., lognormal or gamma distribution);
- Monte Carlo simulation;
- Bootstrapping; and
- Scenario modelling.

Measuring Risk

Once a distribution is generated, both VaR and CTE can be calculated or observed.

1. VaR



The VaR technique can be summarized in the following three steps:

- a. Entity determines the target confidence level at which it determines its compensation required (e.g., xth percentile);
- b. VaR is determined such that the probability of the present value of actual cash flows being less than VaR is x%;
- c. RA is then determined as VaR at Xth percentile less the 50th percentile of present value of probability-weighted cash flows.

PAD Approach (cont'd)

The VaR technique is similar to the technique frequently used for economic capital calculations (such as own risk and solvency assessment, ORSA). An entity's existing VaR techniques may be applied to the calculation of RA. There are, however, important differences including:

- a. Risk profile – Economic capital typically includes all risks faced by the entity, whereas the RA only reflects non-financial risk.
- b. Time horizon – Economic capital tends to be calculated over a one-year time horizon, whereas the time horizon for the calculation of the confidence level of the RA would reflect all cash flows within the contract boundaries (i.e., the lifetime horizon, where lifetime is limited by the contract boundary). The entity may, if it so chooses based on its own compensation requirements, determine the level of the RA based on one-year shocks, but the associated confidence level would be calibrated against a lifetime horizon.
- c. Comparability – Economic capital is often calculated at a higher percentile (e.g., 99.5%) over a one-year time horizon. The confidence level of the RA would generally reflect a lower percentile over a longer time horizon. As such, the two amounts are generally not directly comparable.

2. Conditional Tail Expectation (CTE)

VaR at 50th percentile

CTE = average of VaR
from 75th - 100th
percentile

Conditional tail expectation (CTE), also known as Tail value at risk (TVaR), is a risk measure associated with the more general value at risk. It quantifies the expected value of the loss given that an event outside a given probability level has occurred.

The CTE method can be summarized in the following three steps:

1. Entity determines the target confidence level at which it determines its compensation required (e.g., Xth percentile).
2. From the probability distribution, an entity can determine:
 - a. Conditional mean of the present value of future cash flows beyond the target percentile; and
 - b. 50th percentile of the present value of probability-weighted cash flows.
3. RA is then determined as the difference between A and B.

A publication from IFOA was attached in the Appendix section 2 on their pros and cons of each RA approach.

3.4 Diversification Benefit Methods

Implied method

Use the risk margin output from the aggregate entity level triangles. The difference between this risk margin and the weighted average risk margin of the classes is the implied diversification benefit.

Aggregation method

Use the Iman-Conover method to aggregate the marginal distributions based on the desired correlation matrix. The difference between the risk margin of this aggregated distribution and the weighted average risk margin of the classes is the implied diversification benefit.

An illustration has been prepared in the Appendix section 4 for the Iman-Conover method.

Variance-covariance (CoV) method

Calculate the CoV of the aggregate distribution based on the specified correlation matrix using the statistical formula (extended for matrices calculations): $Var(A + B) = Var(A) + Var(B) + 2 \times Cov(A, B)$

Then, assuming the aggregate distribution is either normally or lognormally distributed, the parameters are estimated, and percentile of the theoretical distributions are calculated. The difference between this percentile and the weighted average risk margin of the classes is the implied diversification benefit.

An illustration has been prepared in the Appendix section 5 for the CoV method.

3.5 Reinsurance Held RA

Under IFRS 17, the RA on reinsurance held is reported as a positive asset in most cases. In effect, the reinsurance RA represents the risk ceded to the reinsurer. Reinsurance credit risk is reflected through a reduction in expected cash flows, not through the RA.

In practice, an entity's reinsurance portfolio will likely contain a mix of proportional contracts (at potentially different ceding percentages by portfolio and/or by year) as well as excess of loss or other forms of reinsurance contracts. From the entity's perspective, when the price of reinsurance is not proportional to the level of risk being ceded, the ceded RA may not be proportional to the gross RA. The cost of the reinsurance may be viewed as evidence of the price the entity is willing to pay to be relieved of risk and therefore indicative of the entity's compensation requirements related to the uncertainty of the risk being ceded.

The RA reflects the compensation the entity requires for uncertainty related to non-financial risk and would be apportioned to gross and ceded insurance contract liabilities. Ultimately, the key concepts underlying the RA are:

- the gross RA (i.e., pertaining to insurance contracts including reinsurance contracts issued) represents the compensation for non-financial risk that the entity requires for writing those contracts; and
- the ceded RA (i.e., pertaining to reinsurance contracts held) represents the non-financial risk transferred from the entity to the reinsurer(s).

Alternative method that respects these concepts would generally be acceptable under IFRS17. For example, the ceded RA could be calculated on gross RA minus the net RA, whereby the net RA is determined according to residual risk not effectively transferred to the reinsurer(s).

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4.0 Frequently Asked Questions

4.1 Diversification, Allocation and Aggregation

Question 1:

Should risk adjustments and diversification be calculated at the aggregate level or at a more granular level, i.e. unit of account level?

View A: RA and diversification should be calculated at the **aggregate level**. the aggregate risk distribution would reflect the entity's perspective of the benefits of diversification among its component risks. The benefits of diversification reflected in an aggregate RA calculation are passed down to the unit of account via an allocation process. The RA can be allocated to groups directly (using a proportional or other method) or indirectly (by calibrating margins such that a unit of account calculation aggregated across all groups yields the same RA as the entity level calculation). In both direct and indirect allocations, the sum of the RA for all units of account would be equal to the aggregate entity level RA. 

View B: RA and diversification should be calculated at the **unit of account level**. When the RA is developed at the unit of account level, the entity's aggregate RA is equal to the sum of the RA for all units of account. The RA developed independently for one unit of account may or may not reflect the benefits of diversification with other units of account of the entity. To the extent that the benefits of diversification are fully reflected in the assumed underlying probability distribution but are not fully reflected in the calculation of the entity's RA, the resulting confidence level of the RA would be higher than had the full benefits of diversification been passed down to the unit of account level. 

View C: IFRS 17 prescribes neither the aggregation nor allocation techniques. It does not require the risk adjustment to be directly determined at any specific level of granularity; however, to obtain appropriate fulfilment cashflows for each group of contracts the risk adjustment needs to be allocated at least to the group of contracts level for various purposes (e.g., CSM, liability for onerous contracts). 

Explanation

Any of the views presented is acceptable. Ultimately, the level of the RA for any given group is a matter of judgment, and the entity should ensure that the resulting aggregate RA reflects the compensation the entity requires for uncertainty related to non-financial risk.

Question 2:

How should risk adjustments and diversification be calculated when a parent entity is comprised of subsidiary entities?

View A: Each subsidiary entity would assess the compensation it requires for its own non-financial risks independent of any potential diversification with risks across the collective entities. The assumed probability distribution underlying the calculation of the confidence level of the subsidiary entity's RA would not reflect between-entity diversification. The parent entity would either: (1) apply a diversification benefit at the parent entity level such that the RA of the parent would be less than the sum of the RA of the subsidiaries or (2) simply sum the RA of the subsidiary entities. The confidence level of the parent entity RA would be higher in the second approach than the first. ☒

View B: The diversification benefits of the parent entity would be reflected at the subsidiary entity level. Thus, the assumed probability distribution underlying the calculation of the confidence level of the subsidiary entity's RA would reflect between-entity diversification, and the degree of diversification credit reflected in the subsidiary's RA calculation would affect the confidence level of the subsidiary's RA. The parent entity RA would be the sum of the subsidiary entity RA. ☒

Explanation

Any of the views presented is acceptable. The method should be consistent from period to period and reflect how the level of risk is considered and managed by the entity.

Question 3:

Can RA be estimated based on different approaches for each cohort?

View A: Yes ☒

View B: No

Explanation

An entity is permitted to measure the RA at different levels of its business – e.g., contract, portfolio, group of portfolios or entity level and it is also permitted to use different methods for different risk types or for different levels of its business. However, we expect the approach will be consistently applied for the reporting entity instead of varying by cohort, unless there are evidence the new cohort is significant different in the risk, arising from the uncertain amount and timing of the cash flows.

Question 4:

Can RA be selected at different confidence levels for each cohort?

View A: Yes

View B: No ☒

Explanation

We expect the approach once decided will be consistently applied for the reporting entity instead of varying by cohort. Company is required to disclose the confidence level in the financial statement, it is odd if the confidence levels are different by cohort.

Question 5:

Under Cost of Capital approach, what is the reason behind the equation that sets RA equal the compensation of retaining the risks?

Explanation

That is the definition of RA in the Appendix A of the standard “The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts.”

In some companies, they have intention to streamline as much as possible the repetitive works of embedded value, solvency and IFRS17 computation in their modelling.

Question 6:

Under Cost of Capital approach, the capital amounts that should be estimated along the coverage period can have more than a single value along the timing horizon, which value to be selected or which method should be used to derive the final capital amount?

Explanation

The risk adjustment will be discounted if the coverage period is longer than a year. The single value of “Required Capital” at valuation date is required to be multiplied by the “Cost of Capital”, and this is an example for short term general insurance contract.

For long term General Insurance contract, we should also consider run down of capital amount over a long period of time.

On the question of what run down measures are appropriate, the insurance risk for remaining coverage should be run down by the UPR chosen computed earlier for the respective group of insurance contracts.

Question 7:

Should direct insurance RA be estimated on gross or net of reinsurance basis?

View A: Gross ☒

View B: Net

Explanation:

Direct insurance RA should be estimated on a gross of reinsurance basis. If the entity has already produced the RA on a net basis, the gross RA can be produced from the net-to-gross ratio by underwriting year.

Reinsurance RA is estimated separately, under the reinsurance held measurement.

Question 8:

What is the usual range of uplift factor? Does this value depend on the LOB?

Explanation

It is a matter of discretion in which the company can decide and discuss with the actuary. A common range of 1.0 - 1.75 is observed in the industry however.

Question 9:

For direct insurance, can RA be selected at 50% confident level, which is equivalent to zero RA?

View A: Yes

View B: No

View C: It depends ☒

Explanation

For estimates with 100% certainty, the standard deviation is zero, hence there is no difference between 50th and 75th percentiles. B91 in IFRS 17 Standard prescribes the situation when RA is required, in which the higher the uncertainty, higher RA is expected. For example, investment component may not require an explicit RA if the amount payable is absolutely certain, as it will be repaid to policyholder in all circumstances .