

10th Webinar on General Insurance

16th October 2024

Introduction to IFRS 17 Risk Adjustment

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Poll Question 1

Agenda

- IFRS 17 Balance Sheet Overview
- Definitions and Key Considerations
- Risk Adjustment Principles
- Scope of Risk Adjustment
- Reinsurance
- Granularity
- Disaggregation
- Disclosures
- Techniques

IFRS 17 balance sheet overview

	Current Reporting	Ind AS 117 GMM	Ind AS 117 PAA
LFRC (Liability for Remaining Coverage) Unearned	Unexpired Risk Reserve (URR)	Contractual Service Margin (CSM) Risk Adjustment Discounting Best estimate of fulfilment cashflows (P.V. Basis)	Akin to Premium (less Acquisition Costs) unearned less future cashflows plus loss component
LFIC (Liability for Incurred Claims) Earned	Undiscounted Reserve for Incurred Claims (including IBNR, Claims Handling Expenses and implicit margins)	Risk Adjustment Discounting Best estimate of fulfilment cashflows (P.V. Basis)	Risk Adjustment Discounting Best estimate of fulfilment cashflows (P.V. Basis)

Size of boxes for Illustrative purpose only

The above illustration does not cover loss making contracts

Definition & Key Considerations

Definition

- The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk

Compensation an entity requires

- **Entity's view** of uncertainty based on their **own risk appetite**, not market value of the risk

Bearing the uncertainty

- **Ultimate view of uncertainty**, not one-year view
- Makes it **indifferent between** the present value of the **uncertain cash flows** and the present value of **certain cash flows**

Non-Financial Risk

- Financial risks like change in interest rates, exchange rates etc. are excluded from risk adjustment



₹???

Heads: ₹100

Tails: -₹100



Risk Adjustment Principles

Low Risk Adjustment

High Frequency, Low Severity

Shorter Duration

Narrower Probability Distribution

Reduction in uncertainty due to emerging experience

Low Frequency, High Severity

Longer Duration

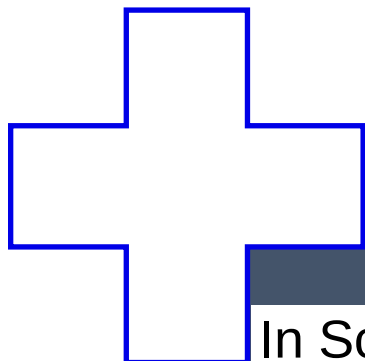
Wider Probability Distribution

Increase in uncertainty due to emerging experience

Lesser knowledge about current estimate and trends

High Risk Adjustment

Scope of Risk Adjustment



In Scope Risks

- Volatility around the best estimate:
 - Claim amounts, development and trends
 - Expense Risk
 - Catastrophes, Events Not in Data
- Claims Inflation, Court Award Inflation
- Regulatory changes
- Cancellation, Withdrawal
- Model Risk, Parameter Risk

Out of Scope Risks

- Risk not related to insurance contracts like General Operational Risk
- Financial Risks like:
 - Asset liability mismatch risk
 - Market Risk
 - Interest Rate Risk

Reinsurance

Risk Adjustment on reinsurance contracts held should represent the amount of risk being transferred by the insurer to the reinsurer.

The impact of the reinsurance contract on the risk appetite for the underlying insurance contract can be reflected in its risk adjustment.

Methodologies

Net Risk
Adjustment
with Net-to-
Gross Ratio

Gross Risk
Adjustment
with Gross-
to-Net Ratio

Gross and
Reinsurance
Risk
Adjustment
models

Separate
Gross and
Net Risk
Adjustment
modelling

Treaty Level
modelling to
assess
impact on
underlying
volatility

Poll Question 2

Granularity



Calculation Granularity Levels

- Separately for LFIC and LFRC (where using GMM) or combined
- Entity / Line of Business / Portfolio / Group of Contract
- By Origin Year (or quarter or month) or combined level

Key Consideration – Allocation from Calculation Level

- Risk Adjustment Principles should not be violated and should be incorporated in allocation methodology instead of a proportional allocation
- Allocation to contract level to allow assessment of onerous contracts
- Allocation to the level at which CSM is determined for accurate calculation

Granularity

Key Consideration – Aggregation (Diversification Benefit)



Risk Adjustment reflects the degree of diversification benefit the entity includes when determining the compensation it requires for bearing the risk

- Diversification between groups of contracts, years and between LFIC and LFRC
- Diversification against LFRC for contracts measured under PAA approach
- For Insurers which are part of a group, should diversification benefit against business written by other group entities be included in its risk adjustment and/or the parent's consolidated risk adjustment

This was discussed in TRG Meeting May 2018 and there were differing opinions by TRG members leaving it to the insurers to determine their approach.

Disaggregation

An entity is not required to disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expenses.

If an entity does not make such a disaggregation, it shall include the entire change in the risk adjustment for non-financial risk as part of the insurance service result.

While the decision to not disaggregate the change in risk adjustment will simplify the calculations and preparation of accounts, it may lead to an increased volatility in insurance service result.

Poll Question 3

Disclosures

Opening Risk Adjustment

Add: Changes that relate to current service

Change in RA for NFR for expired risk

Add: Changes that relate to Future service

Contracts initially recognised during the year

Changes in estimates that adjust the CSM

Changes in estimates that result in losses and reversals of losses on onerous contracts

Add: Changes that relate to past service

Adjustments to liabilities for incurred claims

Closing Risk Adjustment

Significant Judgements	Methodology	Opening to Closing Reconciliation	Changes with reasons
• Approach (Like Reinsurance, Granularity, Allocation, Diversification, Disaggregation) • Qualitative information on inputs	• Confidence Level (Entity Level) • Technique used (if other than confidence level technique)	• Assets and Liabilities • Future Service, Current Service and Past Service	• Approach • Technique

Poll Question 4

Techniques

Bespoke Stochastic Methods
+ Tailored to claim features + Improved Accuracy - High complexity, Low explainability - Judgement in method selection
ODP Bootstrap
+ Simple to understand and implement + Provides full distribution - Computationally intensive - Unable to capture change in development patterns

Stress and Scenario Tests
+ Easy to understand for management + Simple to implement - Doesn't provide confidence level - Judgement in determining stresses
Mack variability
+ Widely Accepted + Doesn't require distributional assumptions - Sensitive to outliers - Dependent on accuracy of underlying CL model

Cost of Capital
+ Synergies with Risk Based Capital + Transparency - Doesn't provide confidence level - Judgement like rate of return, SCR runoff pattern
Stochastic Chain Ladder
+ Flexible Framework + Captures Complex Patterns - Complex with high data requirements - Judgement for stochastic model selection

Risk Metrics for confidence level:

- VaR
- TVaR
- Proportional Hazards Transform

Further Read: <https://www.actuaries.org.uk/system/files/field/document/Carrato%2C%20McGuire%2C%20Scarth%20%282016%29%20-%20%20A%20Practitioner%27s%20Introduction%20to%20Stocha....pdf>

Poll Question 5

References

- IFRS 17: Managing the Risk Adjustment in practice – IFoA CIGI 2018
<https://www.actuaries.org.uk/system/files/field/document/A3%20-%20McMasterCronje.pdf>
- Transition Resource Group Meetings and Discussions
<https://www.ifrs.org/groups/transition-resource-group-for-insurance-contracts/#meetings>
- Supporting material issued by International Accounting Standards Board (IASB)
<https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standards/ifrs-17/>

Disclaimer

The information presented in this session is intended for educational and informational purposes only. It is not intended as professional advice and should not be construed as such. The concepts and methodologies discussed are based on the author's understanding and interpretations of IFRS 17 and related guidelines and may differ from other equally valid interpretations of the standard.

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