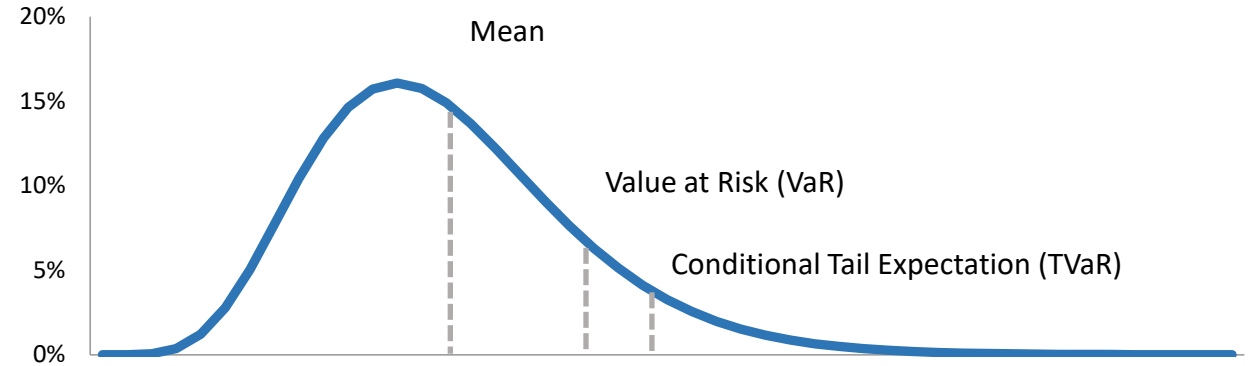


Risk Adjustment



Confidence level techniques

- Easy to communicate to users
- Calculated with reference to a “confidence level”
- Require calculating of risk profile (risk distribution)
- Possibility to leverage Solvency II calculations



Value at Risk

How bad is my loss going to be?
What loss will not be exceeded (with high probability)?

Focuses on probability of loss

Less useful for skewed distributions

More common, simple concept, clear interpretation

Lack of subadditivity (coherence)

vs

Conditional Tail Expectation

If things get bad – what is my expected loss?

Takes into account the size of loss (shape in the tail)

Better reflection of extreme values

More advanced, more difficult

Superior mathematical properties (coherence)

Cost of Capital method



Benefits of using Solvency II Risk Margin may not be as great as could be expected.

If Solvency II Risk Margin was to be used, entities need to consider:

- Only non-financial risks included (non-hedgable market and general operational risk should not be covered by the RA)
- Separate calculations for insurance contracts and reinsurance contracts
- Allocation to IFRS 17 groups of contracts
- Discount rates should be consistent with cash flows
- RA at the consolidated level is the same as the RA at entity level

Companies already have Solvency II Risk Margin based on a CoC method

but...

Under IFRS 17, the equivalent „confidence level” has to be disclosed – additional work for CoC method.

Provision for Adverse Deviation (PAD)

What is it?

- Explicit margins on best estimate assumptions (non-financial risks)
- RA equal to the difference between base scenario and shock scenario
- Easy to implement – entities need to repeat base calculations
- Easy to divide into groups of insurance contracts (policy by policy calculations)
- Becoming more popular among companies

Challenges

- Confidence level still needs to be assessed
- Setting up explicit margins (selection of risks, selection of margins)
- RA should be in line with principles defined in IFRS 17

BEA + %

Examples:

- Adjustment to mortality
- Adjustment to morbidity
- Minimum loss ratio
- Lower discount rate
- RA as fixed percentage of discounted cash flows (by line of business)

Risk Adjustment for reinsurance contracts

IFRS 17.64:

Instead of applying paragraph 37, an entity shall determine the risk adjustment for non-financial risk so that it represents the amount of risk being transferred by the holder of the group of reinsurance contracts to the issuer of those contracts.

Main consequence

- Reinsurer share in RA cannot be calculated in separation from underlying contracts.
- For proportional reinsurance (quote share), a percentage of gross RA can be a good proxy for reinsurer risk (depending on the size of risks on entity's share).

