

**EXAM 6 – CANADA, FALL 2019**

27. (2.5 points)

a. (1 point)

Briefly describe four qualitative principles to consider when estimating the risk adjustment for non-financial risk under IFRS 17.

b. (0.5 point)

Identify two differences between current Canadian actuarial standards of practice and IFRS 17 with respect to discounting.

c. (1 point)

Identify and briefly describe two methods to select discount rates under IFRS 17.

**CONTINUED ON NEXT PAGE**

## SAMPLE ANSWERS AND EXAMINER'S REPORT

<b>QUESTION 27</b>	
<b>TOTAL POINT VALUE: 2.5</b>	<b>LEARNING OBJECTIVE(S): D1</b>
<b>SAMPLE ANSWERS</b>	
<b>Part a: 1 point</b>	
<u>Sample 1</u> <ul style="list-style-type: none"><li>• Longer contracts require higher risk adjustments</li><li>• Risks with wider probability distributions require higher risk adjustments</li><li>• Less knowledge about current estimate and trend requires a higher risk adjustment</li><li>• High severity, low frequency events/risks require a higher risk adjustment</li></ul>	
<u>Sample 2</u> <ul style="list-style-type: none"><li>• Should be higher when less information is known</li><li>• Should be higher for low frequency, high severity risks</li><li>• Should be higher for longer term contracts</li><li>• Should be higher for risks with higher volatility</li></ul>	
<u>Sample 3</u> <ul style="list-style-type: none"><li>• Amount of uncertainty in the estimate -&gt; select higher</li><li>• If low frequency, high severity -&gt; select higher</li><li>• If policy term &gt; 1 year -&gt; select higher</li><li>• If loss distribution is wide -&gt; select higher</li></ul>	
<b>Part b: 0.5 point</b>	
<u>Sample 1</u> <ul style="list-style-type: none"><li>• If IFRS 17, do not have to discount LRC if coverage period &lt; 1 year or for longer coverage periods where the effect of discounting is not significant. Canadian ASOP requires taking into account the time value of money</li><li>• For IFRS 17, If PAA is used for LRC, no need to account / adjust for time value of money and other financial risks for LIC liabilities if LIC cash flows are expected to be paid / received within 1 year from date claims are incurred. For CSOP, need to account for it.</li></ul>	
<u>Sample 2</u> <ul style="list-style-type: none"><li>• IFRS 17 does not depend on the assets that support the liability and also the assumptions on reinvestment while current practice does</li><li>• IFRS 17 discount rate is to reflect the characteristic of the liability (timing, currency) while the current practice does not look into these characteristics</li></ul>	
<b>Part c: 1 point</b>	
<u>Sample 1</u> <ul style="list-style-type: none"><li>• Bottom-up approach – take risk-free yield curve and add illiquidity premium</li><li>• Top-down approach – can take portfolio of assets similar to liability (e.g. 10-year spot rate on Canadian bonds) and remove all characteristics not relevant to liabilities in question.</li></ul>	
<u>Sample 2</u>	

## SAMPLE ANSWERS AND EXAMINER'S REPORT

- Bottom-up approach: Select a risk-free yield curve, then make liquidity adjustments (e.g. adding liquidity premium)
- Top-down approach – select a portfolio with similar characteristics as insurer's liability portfolio, then make adjustment to remove anything not related to insurance contracts

### Sample 3

- Bottom-up – adjust risk free rate by adding illiquidity premium to reflect the characteristics of liability cash flow expected
- Top-down – using reference portfolio of assets with similar characteristics to the liabilities. Then remove asset characteristics from the yield curve that are not relevant to liabilities.

### **EXAMINER'S REPORT**

Candidates were expected to know the different treatment of risk adjustment and discounting under the current Canadian Standard of Practice and IFRS 17.

#### **Part a**

Candidates were expected to know how the risk adjustment for non-financial risk is determined under IFRS 17.

A common error included:

- Describing the general principles of IFRS 17 rather than those specific to estimating the risk adjustment for non-financial risk

#### **Part b**

Candidates were expected to understand the different treatment of discounting between the Canadian actuarial standards of practice and IFRS 17.

Common errors included:

- Stating that the current Canadian Standards of Practice requires a fixed discount rate
- Stating that IFRS 17 does not require discounting without mentioning the specific scenario under which this is not required
- Describing the two methods of selecting the discount rate instead of comparing the different treatment under the two standards

#### **Part c**

Candidates were expected to understand how discount rates are selected under IFRS 17.

Common errors included:

- Providing an incorrect method name
- Identifying the method name but not describing the method