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Dear Mr. Levac

We are pleased to submit the comments by The Danish Society of Actuaries to the Exposure draft.

Our response consists of a high level comment and some detailed comments with reference to specific chapters.

General comments:
We find that the monograph gives a good introduction to valuation concepts, and that it discusses more than just risk adjustments. Some of the technique chapters relate more to building block one compared to risk adjustment.

The monograph can be read as an introduction to discounted liabilities as well, and it should be considered to expand it to IFRS valuation more broadly, instead of focusing only on risk adjustment.

We find that the monograph does not serve the purpose as an implementation guideline, but that it gives a good description of the interpretation and thinking behind the concepts.

The purpose of the document is hence unclear, and a stricter story line would make the document easier to read.

Comments with reference to specific chapters:
Section 1
The paragraph describes that the risk adjustment is the company’s own assessment of the adjustment the makes the company indifferent about keeping the risk at own balance sheet or transferring to another risk taker. This definition allows an understanding of the company’s own assessment of shareholders equity, but it should be noted that the risk adjustment will vary from company to company. Therefore comparison of liabilities is made cumbersome, and a similar approach would never be taken on the asset side, where less valuation freedom is allowed.

The document clearly states that the risk adjustment is not for solvency systems (1.1.1). The distinction of the purpose is important. The interpretation allows an understanding of the company’s own assessment of the value of shareholder’s equity, and the technical provisions cannot be seen as a market value of the liability.

Section 1.3.1
It is stated that the valuation of insurance liabilities is not based on information on the asset side. This is desirable, but the link between discretionary bonus, asset allocation and participation terms will depend on asset allocation and investment return volatility hence it is difficult to disregard this information if the valuation is supposed to be a probability weighted values of future cash flows.
The comments regarding ‘market consistency’ are not clear and the link to the entity’s own capital requirement or risk appetite is not. We are not sure what the message of the paragraph is.

Section 2.1.3  
(p17) It is unclear how future discretionary benefits (FDB) are modelled in building block one. ‘The unbiased estimate does take into account the current knowledge about possible outcomes…’ which indicates that FDB should be modelled, and hence the link to asset allocation and company behaviour is established (contradicting 1.3.1).

(p19) ‘The claims, benefits and services that the policyholder is entitled to under the insurance contract.’ Future discretionary benefits should be addressed in this context.

Section 2.2  
Diversification is allowed in the calculation of the risk adjustment. For disclosure it could be relevant to disclose risk adjustment by line of business (without diversification) and a total risk adjustment (including diversification)

Section 2.3  
Some of the probability weighted valuation methods require significant implementation cost and will as such not meet requirement 1. Also criterion two is not necessarily met as the risk adjustment is company based and not an indicator of price in a transfer situation (M&A situation).

Possible appendix (p35): The definition of best estimate corresponds to the definition of median, not expected value. This will only be correct for symmetric distributions.

Section 3.1.1 and 3.1.3  
Denmark has used an adjusted discount curve (including a safety margin) for discounting. This means that the TP calculated under this measure includes a risk adjustment. This method can be compared to the quantile method.

Section 4.1  
The technique summary indicates that simulation techniques are required, but it does not mention future discretionary benefits. This factor can dominate the policyholder behaviour such as lapse and surrender, hence it cannot be ignored. This is an area where an insurance contract differs from a financial contract.

Section 4.4.1  
The fitting of the mortality curve should include a discussion about the projection of mortality. The valuation of future cash flows must include future mortality estimates. The fitting in the monograph is not wrong, but insufficient for best estimate calculation. The monograph is about risk adjustment, and in general the description of building block one lacks relevant details on some areas. The same comment applies to lapse and surrender assumptions, which should as well be relevant for the entire cash flow projection period. Best estimate is about the future, not about the (near) past.

Section 9.1  
It might show very difficult to quantify the confidence level corresponding to the risk adjustment. It might make sense from a solvency (policyholder perspective), but it is difficult to quantify the value of the conversion on a confidence scale in financial reporting.

It should be noted that discounting as part of the valuation will make probabilistic assessment more difficult owing the simulation.
We hope that you find our response useful and hereby confirm that it can be placed on the public record. Please let us know if you would like to discuss the point raised.

On behalf of the Danish Society of Actuaries

Kristian Buchardt
Chairperson of the accounting committee of Danish Society of Actuaries
Appendix

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