

# New IFRS *Insurance Contracts* *Project*

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# The need for change

- IFRS 4 Insurance Contracts is **an interim Standard**
  - Permits continuation of **wide variety of practices**
  - Includes a ‘**temporary exemption**’ from general requirement that accounting policies should be relevant and reliable
- IFRS 4 **does not provide transparent information** about the effect of insurance contracts on financial statements
- Existing accounting makes **comparisons difficult** between products, companies and across jurisdictions

# Existing IFRS Accounting

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## Existing issues

Variety of accounting treatments



Estimates not updated



Discount rate based on investment



Lack of discounting



Little information about options and guarantees



## New Accounting model

Consistent accounting

Estimates reflect current information

Discount rate reflects cash flows of the contract

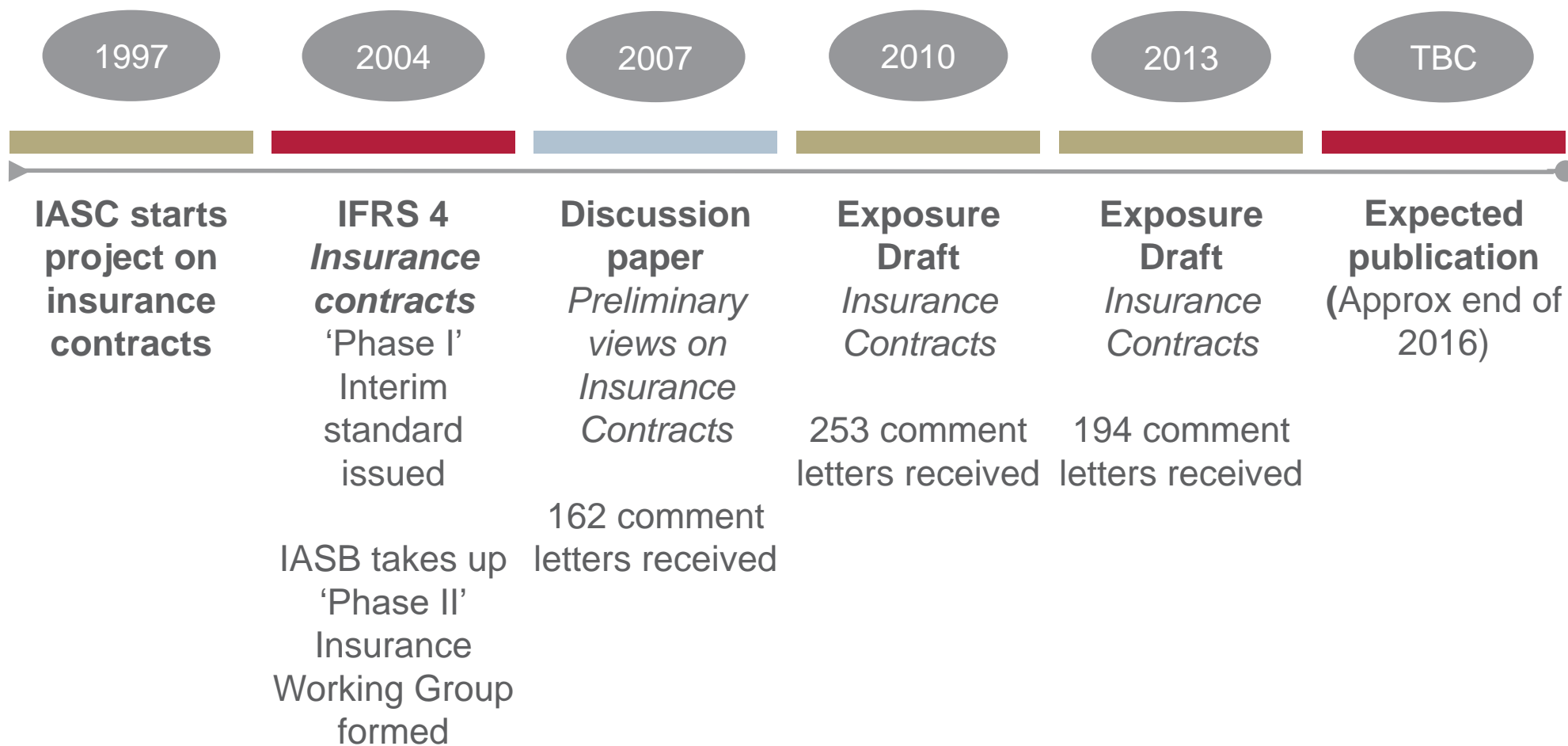
Measurement reflects discounting where significant

Measurement reflects full range of possible outcomes

# Project History

# Project History

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# Extensive consultation

- Three **consultation** documents issued
- **Extensive outreach** with investors, analysts, preparers, regulators, accounting firms and standard-setters, in all regions with significant insurance industry
- Benefitted from **continuous feedback** from industry
- Three rounds of **fieldwork** focused on assessing operationality of the proposals

# Common concerns in feedback

- The IASB has received extensive and detailed feedback on its proposals. Underlying the feedback are three common concerns:
  - Concerns about the effect of changes in current value measurement on profit or loss
  - Concerns about the accounting for contracts with participating features
  - Concerns about complexity of the proposals as a whole
- A summary of how the IASB responded to specific feedback is available on the project website



# Next Steps

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- **Drafting** of the standard underway
- Consistent with recent projects, **engagement will continue**:
  - Targeted **general updates** of specific wording
  - Targeted **testing of specific wording**
  - Extensive **fatal flaw** review
  - **Sweep** Issues
- Detailed **effects analysis** will be included
- Still to consider:
  - **Effective date**

# Scope

- Accounting for insurance contracts, **NOT** insurance entities
- Insurance contract: an **insurer** accepts significant **insurance risk** by agreeing to compensate **policyholder** if uncertain future event **adversely affects** policyholder
- **Insurance risk** is a risk, other than **financial risk**
- **Similar** to IFRS 4 definition

# Example

## Scope

- Entity Z writes credit insurance products for Retailers issuing inhouse credit cards
- Z has two product types:
  - Product A pays out only if the Retailer experiences an actual loss, and compensates that retailer only to the extent of its loss after any recoveries
  - Product B pays out based on a determination of average losses by all Retailers within a jurisdiction

- Scoped in
  - **Discretionary** participating **investment** contracts
  - **Option to** apply insurance contracts Standard to **financial guarantee contracts**
- Scoped out
  - **Option not** to apply insurance contracts Standard to **fixed fee service contracts** which meet definition of insurance contract

# Example

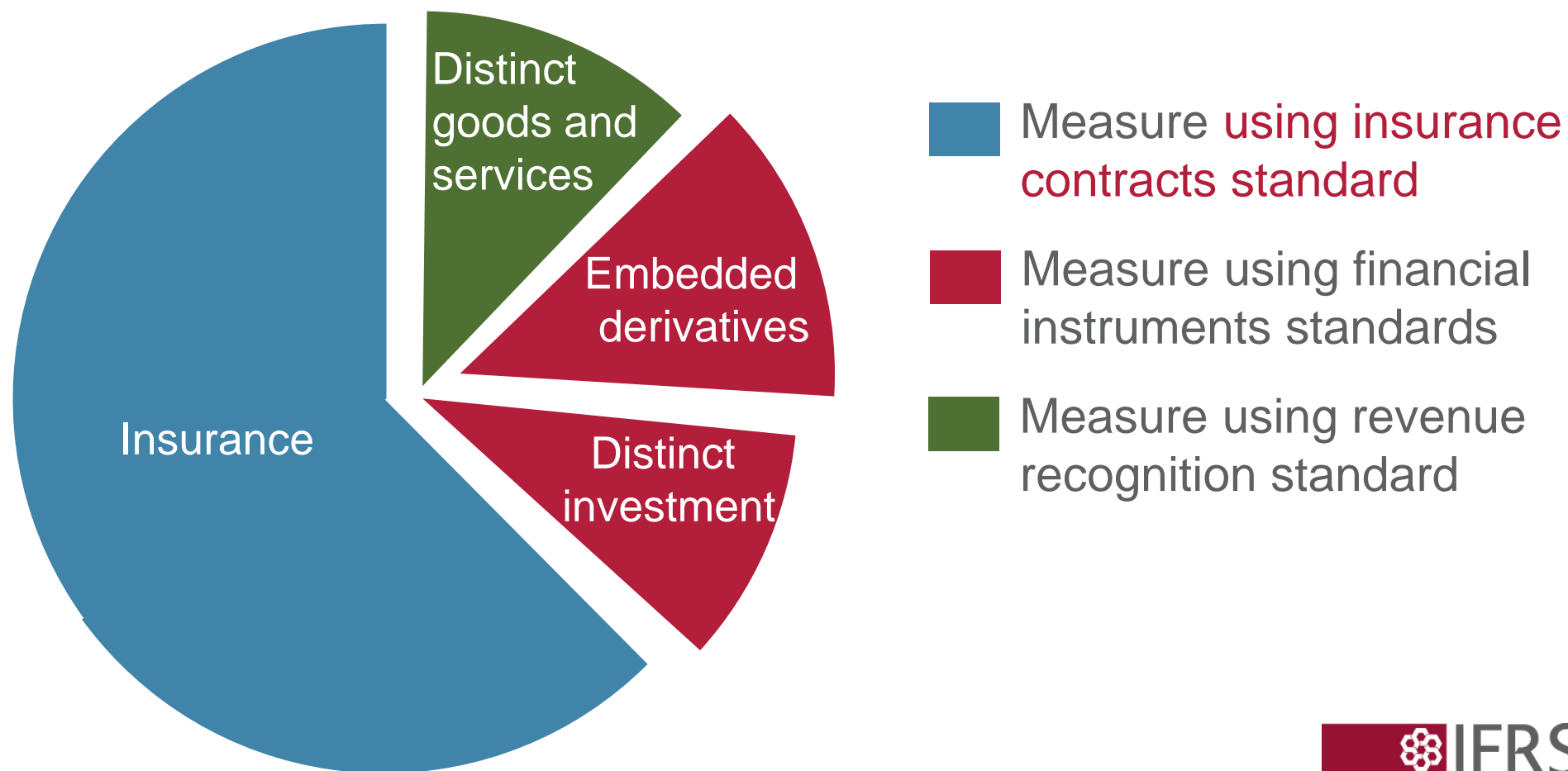
## Scope

- Entity A owns a vehicle repair service
- A offers 'warranty' on 2<sup>nd</sup> hand cars sold by local dealer
- In terms of warranty, A
  - charges fixed amount of CU3 500 per annum,
  - undertakes to perform all repairs to car with no charge for labour,
  - for a period of four years.
- A anticipates unrecovered labour costs of CU1 000 in the first year, escalating to CU4 000 in the 4<sup>th</sup> year.
- Is this an Insurance contract?
- If yes, is it a fixed free service contract?

# Identify and recognise the contract

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- Required to **separate components** of insurance contract



# Example

## *Disaggregation*

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Consider 2 alternatives:

- Entity provides a free Television set to every client that signs an insurance contract within a prescribed period
- Entity provides a free Television set to every client that signs an insurance contract within a prescribed period, if and only if their existing television become inoperable



# Example

## *Disaggregation*

- Entity issues contract with account balance
  - Policyholder single premium of CU1,000 credited to account
  - Thereafter, account balance
    - increases by discretionary payments from policyholder,
    - Increases/decreases by returns on specified assets,
    - decreases by charge for life cover and
    - decreases by fees
- The contract promises to pay :
  - death benefit plus account balance, if policyholder dies
  - account balance, if contract is cancelled by policyholder

# Example *continued*

## **Disaggregation**

- In this contract:
  - policyholder benefits separately from asset management services and insurance coverage and
  - risk and value of death benefit does not depend on the account balance.
- Consequently, asset management services are distinct under IFRS 15
- However,
  - if right to death benefits either lapses or matures at the same time as account balance,
  - then components are highly interrelated and are therefore not distinct

# Example

## *Disaggregation*

- Entity issues a contract to employer (policyholder). Contract provides health coverage and has following features:
  - coverage for aggregate claims exceeding CU25 million
  - claims processing services for the next 12 months, regardless of whether claims have passed the threshold of CU25 million
- Entity considers whether to separate claims processing services

# Example *continued*

## ***Disaggregation***

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- Claims processing services
  - are sold as standalone service
  - benefit policyholder independently of insurance coverage
  - are not highly interrelated with the insurance coverage and
  - entity does not provide a significant service of integrating the services
- Accordingly, the entity would separate the claims processing services

# Initial Measurement

# Measure contract at initial recognition

## *Future cash flows*

22

Measurement of an insurance contract incorporates **all available information**, in a way consistent with **observable market information**.

**Future cash flows**  
expected cash flows from  
premiums, claims and  
benefits

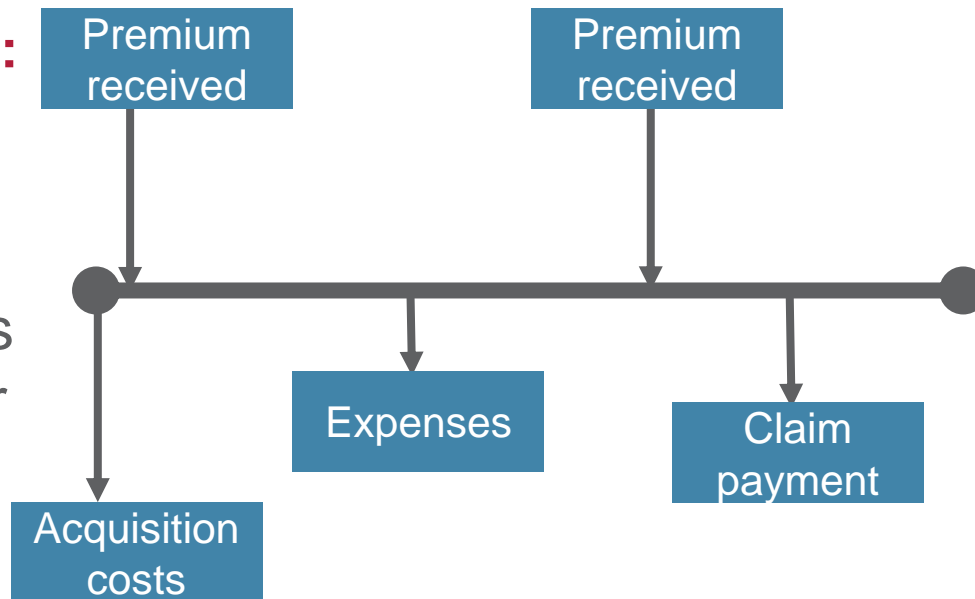
An explicit, unbiased and probability-weighted estimate of future cash flows that will arise as the insurer fulfils the insurance contract

# Measure contract at initial recognition

## *Future cash flows*

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**Recognition:**  
Contract starts when **coverage period** begins (may be after insurer is on risk) **unless** contract is **onerous**



### **Included in cash flows:**

All direct costs of *originating* and all directly attributable costs incurred in *fulfilling* insurance contracts

### **Contract boundary:**

Contract ends when:

- Not required to provide **coverage**
- **Can reprice** to reflect **risks of policyholder**
- Or, In some cases, to reflect **risk of portfolio**
- On **substantial modification**

# Measure contract at initial recognition

## *Future cash flows: mutualisation*

In some contracts or contract types, **other policyholders form first layer of risk absorption**. In such cases:

- **Expected cash flows** from/to participating policyholders are **part of the fulfilment cash flows** of the primary policyholders: A group of policies is not considered to be onerous if another set of policyholders bears those losses
- **Losses are only recognised in profit or loss** from onerous contracts **when the underlying items in the fund as a whole are insufficient to bear those losses**, ie when no other policyholder has the capacity to absorb those losses



- No specific guidance for mutualisation
- Mutualisation is inherent in the **cash flows guidance**, and consequently is subject to that guidance
- Thus, **included in cash flow of individual policyholder** are:
  - Expected future cash flows to any other policyholder, or
  - Expected future cash flows from any other policyholder
- But **mutualisation is not**:
  - diversification of risk or cross subsidisation or discretion
- Requires **explicit right of the insurer to act**:
  - To **the detriment** of one policyholder;
  - To fund loss of another **policyholder** (or visa versa)

# Mutualisation

## *Level of determination*

- **Expected cash flows** from/to participating policyholders are **part of the fulfilment cash flows**
  - In determining present value of future cash flows, it is **irrelevant whether determined at individual or group level**
  - **Entity includes cash flows** which come from or go to other policyholders as part of present value determination
  - **Cash flows are cash flows** (doesn't matter where from, so across portfolios is acceptable)
- Level of aggregation important for **CSM determination only**, but is determined **after** determination of cash flows, thus:
  - Level of aggregation **does not affect mutualisation**
  - **Mutualisation may affect** level of aggregation

# Mutualisation

## *Level of determination*

- Thus **first determine expected cash flows**, including cash flows to other policyholders, and cash flows from other policyholders (level of aggregation not relevant),

Then

- Determine **level of aggregation**, and
- Determine **at inception CSM**,

Thereafter

- Maintain the **level of aggregation** (no reassessment) and
- **Remeasurements of cash flows** include cash flows to and from other policyholders, and if they relate to future services, adjust CSM

# Mutualisation

## Examples

- Most obvious mutualisation **between policyholders sharing same pool of assets, and same generation**, for example:
  - Two policyholders (A & B) share in same underlying items, but A has higher guarantee
  - B shares in residual of underlying **after** A's guarantee settled
  - B is subsidising A – there is mutualisation
- Can also occur across generations, for example:
  - Returns on **underlying assets accumulate**, but are not paid out to current generation of policyholder (generation C)
  - Instead **accumulated as obligation to future generation** (D)
  - There is consequently mutualisation between C and D

# Mutualisation

## *Examples*

- Mutualisation can also occur across product lines, for example:
  - Product E participates in the return on an underlying product line, product F
  - In determining the expected cash flows of E, entity must consider cash flows to and from F
  - In determining the expected cash flows of F, entity must consider cash flows to and from E

# Measure contract at initial recognition

## *Discounting*

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

Future cash flows

**Discounting**  
adjustment that converts  
future cash flows into  
current amounts

# Measure contract at initial recognition

## *Discounting*

- Discount rate should reflect the **characteristics of the liability cash flows**
- Discount rate should be **consistent with observable market** for instruments with cash flows with consistent characteristics
- Operationally, entity **can use either:**
  - A **bottom up** approach, or
  - A **top down** approach

# Measure contract at initial recognition

## *Discounting: unobservable rates*

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- *Discount rate should be **consistent with observable market** for instruments with cash flows with consistent characteristics*
- Use **judgement** to:
  - Appropriately **adjust observable inputs** to accommodate differences between observable market and insurance contract cash flows
  - **Develop unobservable inputs** using best information available consistent with the objective (unobservable inputs should not contradict available and relevant market data).



# Measure contract at initial recognition

## *Risk Adjustment*

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

Future cash flows

Discounting

**Risk adjustment**  
assessment of uncertainty about future cash flows and cost to entity

# Measure contract at initial recognition

## *Risk Adjustment*

- The compensation the entity requires for **bearing the uncertainty**
- Compensation that makes entity **indifferent between**:
  - fulfilling liability that has **range of possible outcomes**; and
  - fulfilling liability that will **generate fixed cash flows** with the same expected present value
- **Entity specific** measure:
  - The entity's level of **risk aversion**
  - The **degree of diversification** benefit the entity considers in determining required compensation

# Measure contract at initial recognition

## *Fulfilment cash flows*

35

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

'Fulfilment cash flows'

Future cash flows

Discounting

Risk adjustment

**Fulfilment cash flows** is a **probability-weighted estimate of cash inflows and outflows** that will arise as the entity fulfils the contract.

# Measure contract at initial recognition

## *Fulfilment cash flows: Level of aggregation*

Level of **aggregation** is **not** relevant for:

- Determination of **fulfilment cash flows**
  - Present value is consistently applied irrespective of level of application
- Determination and **allocation of directly attributable expenses**
  - Allocation based on nature and ‘attribute-ability’ of costs
- Determination and **allocation of risk margin**
  - Based on **entity approach** to determining compensation for risk

# Measure contract at initial recognition

## Contractual Service Margin (CSM)

37

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

Contractual service margin

'Fulfilment cash flows'

Future cash flows

Discounting

Risk adjustment

Contractual service margin is measured as the **positive** (net inflow) difference between the **risk-adjusted present value** of expected inflows and outflows at inception.

**Fulfilment cash flows** is a probability-weighted estimate of cash inflows and outflows that will arise as the entity fulfils the contract.

# Measure contract at initial recognition

## CSM

- CSM is determined as the **risk adjusted present value** of the cash inflows and outflows
- As such, **at inception it captures the expected profitability** of the contract over its entire expected life
  - If **contract expected to be loss making**, CSM is ‘negative’ and recognised in profit or loss (onerous contract)
  - If **contract expected to be profit making**, CSM is ‘positive’ and recognised as a liability (unearned profit)
- At inception, **CSM is not a cash flow**, instead it is the inverse of other cash flows

# Measure contract at initial recognition

## *CSM: Level of aggregation?*

- In some circumstances, CSM gains are treated differently from losses (onerous contracts)
- May create a different accounting outcome depending on level of aggregation
- Need to specify level of aggregation for determining onerous contracts
- Balance between loss of information about individual contracts and providing a faithful representation of the effect of grouping contracts

# Measure contract at initial recognition

## *CSM: Onerous contracts*

- **Loss** for onerous contracts should be recognised **only when the contractual service margin is negative** for a group of contracts, and that group should comprise contracts that at inception have:
  - Cash flows entity expects will respond in similar ways to key drivers of risk in terms of amount and timing AND
  - Similar expected profitability (ie similar contractual service margin as a percentage of the premium)
- Within group, net off the negative and positive CSM
- Group not reassessed after inception



# Measure contract at initial recognition

## *CSM: Effect of regulation*

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- No exception to the level of aggregation for determining onerous contracts or the allocation of the contractual service margin when regulation affects the pricing of contracts
  - Contracts that do not have similar profitability, even if as a consequence of regulation, may not be aggregated for determining onerous contracts

# Measure contract at initial recognition

## *Contractual Service Margin (CSM)*

42

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

Contractual service margin

'Fulfilment cash flows'

Future cash flows

Discounting

Risk adjustment

**Contractual service margin** is measured **as the positive** (net inflow) difference between the **risk-adjusted present value** of expected inflows and outflows at inception.

**Fulfilment cash flows** is a **probability-weighted estimate of cash inflows and outflows** that will arise as the entity fulfils the contract.

# Measure contract at initial recognition

## CSM

- CSM is determined as the **risk adjusted present value** of **all** the cash inflows and outflows (**including** mutualised cash flows)
- As such, **at inception it captures the expected profitability** of the contract over its entire expected life
  - If **contract expected to be loss making**, CSM is ‘negative’ and recognised in profit or loss (**onerous contract**)
  - If **contract expected to be profit making**, CSM is ‘positive’ and recognised as a liability (**unearned profit**)
- At inception, **CSM is not a cash flow**, instead it is the inverse of other cash flows

# Measure contract at initial recognition

## *CSM: Onerous contracts*

- **Loss** for onerous contracts should be recognised **only when the contractual service margin is negative** for a group of contracts, and that group should comprise contracts that at inception have:
  - Cash flows entity expects will respond in similar ways to key drivers of risk in terms of amount and timing AND
  - Similar expected profitability (ie similar contractual service margin as a percentage of the premium)
- Within group, net off the negative and positive CSM
- Model is asymmetric
- Group not reassessed after inception

# Measure contract at initial recognition

## *CSM: Effect of regulation*

45

- **No exception** to the **level of aggregation** for determining onerous contracts or the allocation of the contractual service margin **when regulation affects the pricing** of contracts
  - Contracts that do not have similar profitability, even if as a consequence of regulation, may not be aggregated for determining onerous contracts
  - Normal test applies
  - Regulation does not change the economics of the contracts, aggregation based on economics of the contracts

# Example A

## *Initial Measurement*

- An entity writes group of insurance contracts. Coverage period 3 years, none expected to surrender
- Entity receives premium of CU900 (lump sum) and estimates risk adjustment of CU 120, discount rate of 5%, and annual expected cash outflows equals CU200 (PV of CU545)
- All other expenses are assumed to be immaterial
- Day 1 CSM balance is CU235 (900 – 120 – 545)
  - Profitable group of contracts
  - No profit and loss on day 1

# Example B

## *Initial Measurement*

- An entity writes group of insurance contracts. Coverage period 3 years, none expected to surrender
- Entity receives premium of CU900 (lump sum) and estimates risk adjustment of CU 120, discount rate of 5%, and annual expected cash outflows equals CU200 (PV of **CU1 089**)
- All other expenses are assumed to be immaterial
- Day 1 CSM balance is **-CU429** ( $900 - 120 - 1\ 089$ ),
  - **Onerous group** of contracts
  - **Negative CSM recognised immediately** in profit or loss

# Example

## *Initial Measurement*

- Immediately before any cash flows:

	Example A	Example B
Present value of cash inflows	(900)	(900)
Present value of cash outflows	545	1 089
Risk adjustment	120	120
Fulfilment cash flows	(235)	429
Contractual Service Margin	235	-
Insurance contract Liability	-	429
P&L Loss (day 1)	-	429

*Example 1A and 1B of draft standard*



# Example

## *Initial Measurement*

- Immediately **after premiums received** (1<sup>st</sup> cash flow):

	Example A	Example B
Present value of cash inflows	-	-
Present value of cash outflows	545	1 089
Risk adjustment	120	120
Fulfilment cash flows	<b>665</b>	<b>1 209</b>
Contractual Service Margin	235	-
Insurance contract Liability	<b>900</b>	<b>1 209</b>
Cash Balance	<b>900</b>	<b>900</b>

# Subsequent Measurement

# Remeasure in subsequent periods

IASB believes a **current value measure** of an insurance contract provides the **most useful information** about insurance contracts in the statement of financial position.

Contractual service margin

'Fulfilment cash flows'

Future cash flows

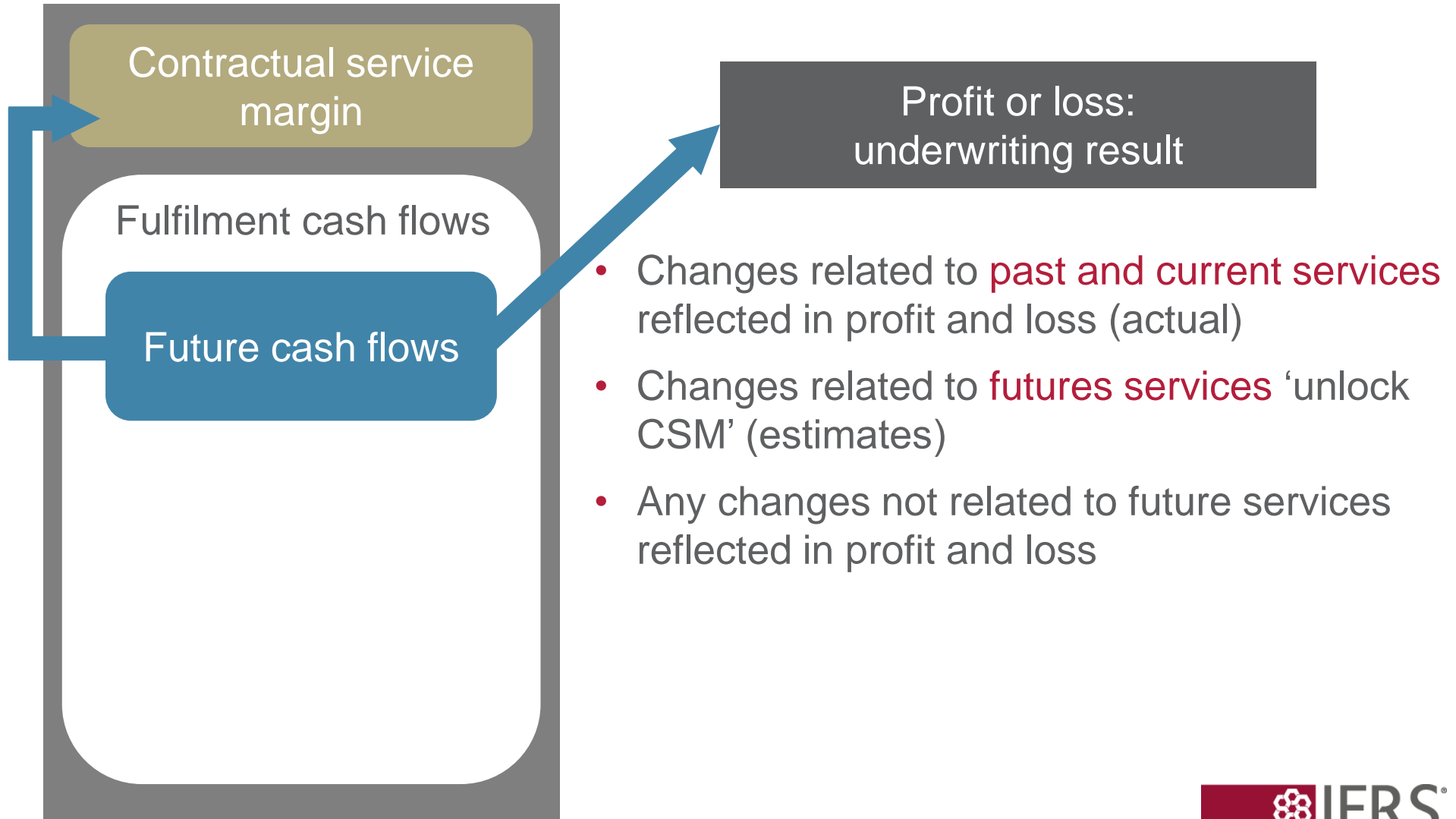
Discounting

Risk adjustment

# Remeasure in subsequent periods

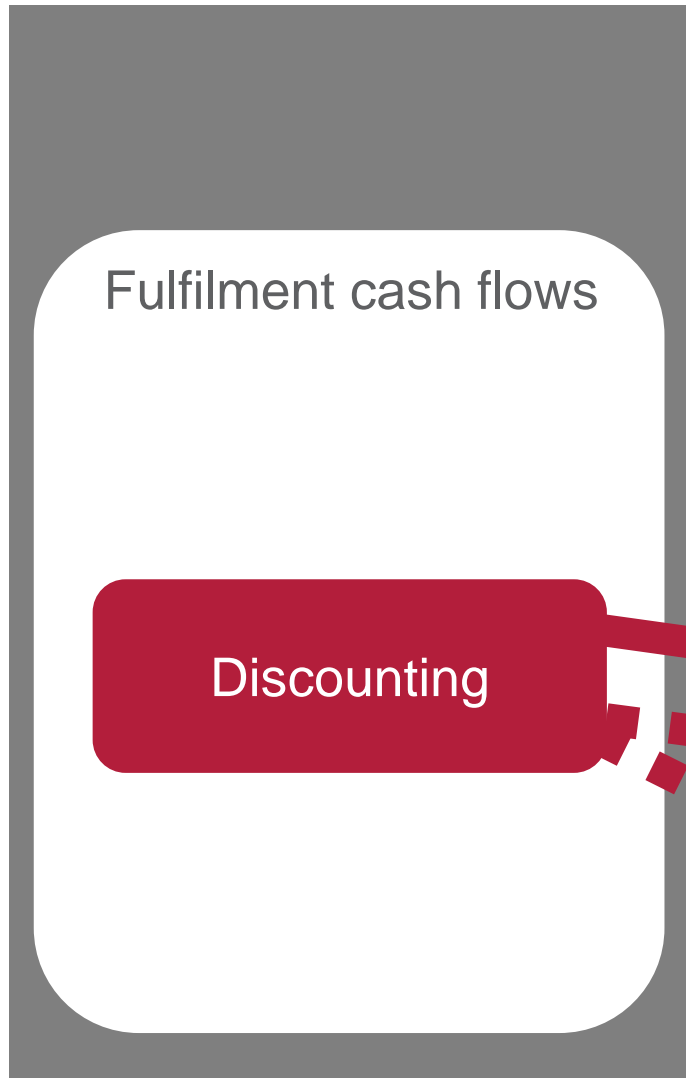
## *Recognition of changes in estimates*

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# Remeasure in subsequent periods

## *Recognition of changes in estimates*



- **Unwind of the discount** (time value of money) in profit or loss
- **Option** to present the effect of change in rate on fulfilment cash flows in either:
  - OCI, or
  - Profit or loss

# Remeasure in subsequent periods

## *Options and guarantees*

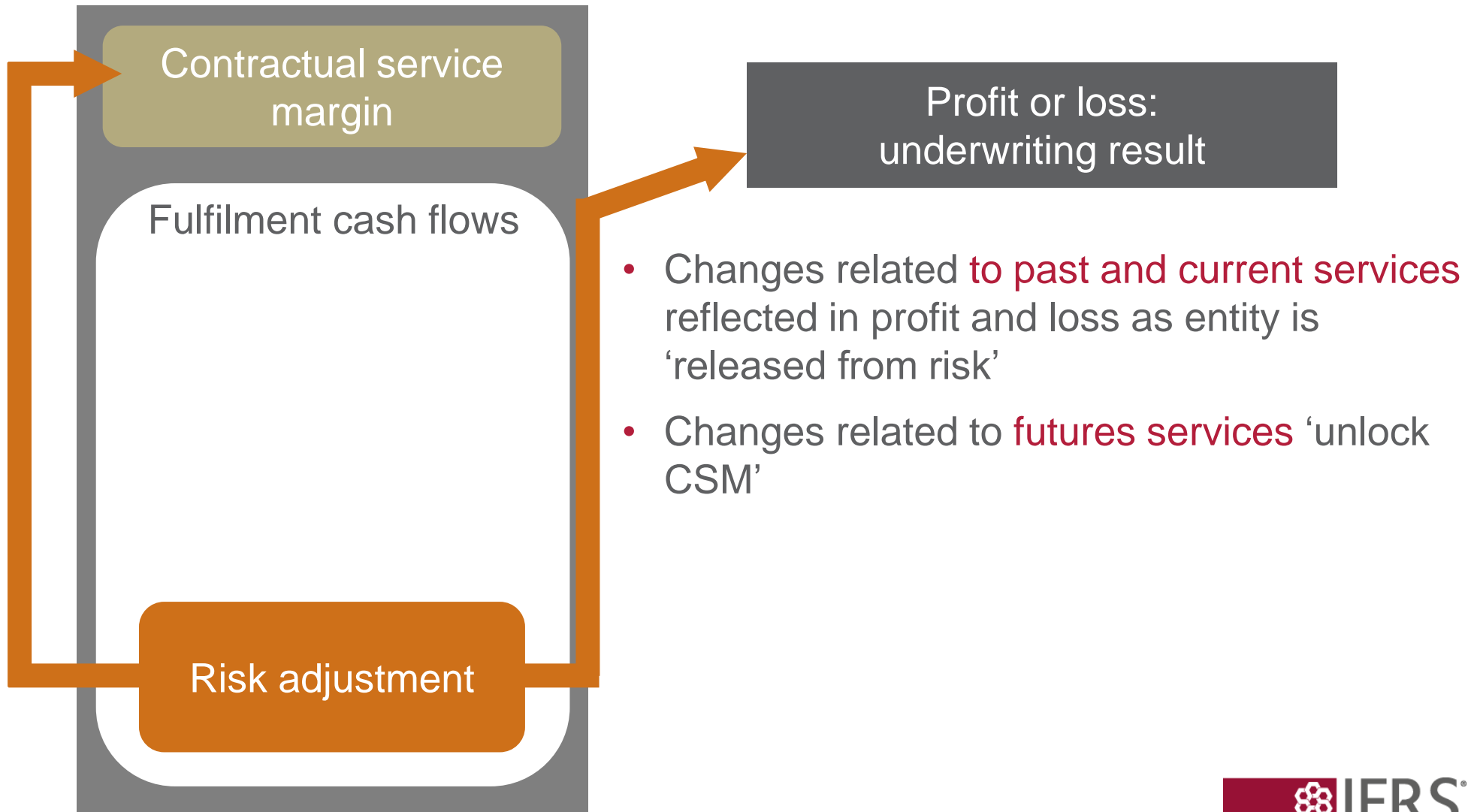
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- Updated value of the insurance contract, includes options and guarantees, consistent with market information
- Standard does not define 'options and guarantees', consequently changes in value of options and guarantees treated the same as other changes in cash flows and discount rates

# Remeasure in subsequent periods

## *Recognition of changes in estimates*

55



# Example A

## *Remeasure in subsequent periods*

- An entity writes group of insurance contracts. Coverage period 3 years, none expected to surrender
- Entity receives premium of CU900 (lump sum) and estimates risk adjustment of CU 120, discount rate of 5%, and annual expected cash outflows equals CU200 (PV of CU545)



# Example A

## *Remeasure in subsequent periods*

- Year 1 (after premium cash flow):

	<b>Total</b>	<b>PV cash flow</b>	<b>Risk Margin</b>	<b>CSM</b>
Opening balance	(900)	(545)	(120)	(235)
Interest accretion	(39)	(27)	-	(12)
Cash flows	200	200	-	-
Experience adjust	-	-	-	-
Change in estimate	-	-	-	-
Margin for service	122	-	40	82
Closing balance	(617)	(372)	(80)	(165)

# Example A

## *Remeasure in subsequent periods*

- An entity writes group of insurance contracts. Coverage period 3 years, none expected to surrender
- Entity receives premium of CU900 (lump sum) and estimates risk adjustment of CU 120, discount rate of 5%, and annual expected cash outflows equals CU200 (PV of CU545)
- **Subsequently:**
  - In Year 1 events happen as expected,
  - In Year 2, claims were CU50 lower than expected and
  - In Year 2, entity also revises expectations for Year 3 by:
    - Reducing outflows by CU48, and
    - Reducing risk margin by CU10

# Example A

## *Remeasure in subsequent periods*

- Year 2:

	Total	PV cash flow	Risk Margin	CSM
Opening balance	(617)	(372)	(80)	(165)
Interest accretion	(27)	(19)	-	(8)
Cash flows	150	150	-	-
Experience adjustment	50	50	-	-
Change in estimate	-	48	10	(58)
Margin for service	156	-	40	116
Closing balance	(288)	(142)	(30)	(116)

# Example A

## *Remeasure in subsequent periods*

- Year 3:

	Total	PV cash flow	Risk Margin	CSM
Opening balance	(288)	(142)	(30)	(116)
Interest accretion	(13)	(7)	-	(6)
Cash flows	150	150	-	-
Experience adjustment	-	-	-	-
Change in estimate	-	-	-	-
Margin for service	151	-	30	121
Closing balance	-	-	-	-

# Example B

## *Remeasure in subsequent periods*

- An entity writes group of insurance contracts. Coverage period 3 years, none expected to surrender
- Entity receives premium of CU900 (lump sum) and estimates risk adjustment of CU 120, discount rate of 5%, and annual expected cash outflows equals CU200 (PV of CU545)
- Subsequently:
  - In Year 1 events happen as expected,
  - In Year 2, claims were CU250 higher than expected and
  - In Year 2, entity also revises expectations for Year 3 by:
    - Reducing outflows by CU48, and
    - Reducing risk margin by CU10

# Example B

## Remeasure in subsequent periods

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- Year 1:

	Total	Present value	Risk Margin	CSM
Opening balance	(900)	(545)	(120)	(235)
Interest accretion	(39)	(27)	-	(12)
Cash flows	200	200	-	-
Experience adjustment	-	-	-	-
Change in estimate	-	-	-	-
Margin for service	122	-	40	82
Closing balance	(617)	(372)	(80)	(165)

Example 2B of draft standard

# Example B

## Remeasure in subsequent periods

- Year 2:

	Total		Income Statement
Opening balance	(617)	Margin for service	64
Interest accretion	(27)	Change in estimate	(250)
Cash flows	450	Onerous contract (238+48-173)	(113)
Experience adjustment	(250)	Interest	(27)
Change in estimate	(113)	Loss	(349)
Margin for service	64		
Closing balance	(493)		

# Example B

## Remeasure in subsequent periods

64

- Year 3:

	Total		Income Statement
Opening balance	(493)	Margin for service	64
Interest accretion	(21)	Change in estimate	-
Cash flows	450	Onerous contract	-
Experience adjustment	-	Interest	-
Change in estimate	-	Profit	64
Margin for service	64		
Closing balance	-		



# Remeasure in subsequent periods

## *Recognition of changes in estimates*



- **Recognise CSM** in profit or loss as entity provides coverage:
  - **Passage of time**
  - Size and duration of contracts in force

# Remeasure in subsequent periods

## *Accretion of CSM*

- At inception, CSM is determined as a **discounted amount**
- Over time, the **effect of that discounting** should be **reversed**
- The **unwinding** of the discounting recognised at inception is referred to as **accretion**

### **BUT**

- CSM is **not a cash flow** in itself
- Consequently, board has concluded that it
  - **cannot** be remeasured, and
  - discount rate should be the **rate determined at inception**

# Remeasure in subsequent periods

## *Allocation of contractual service margin*

- Objective: allocate remaining CSM in profit or loss **over remaining coverage period** in a **systematic way** that best reflects services to be provided
- Can be achieved by **grouping contracts**
- Is **deemed to be achieved** by grouping contracts that:
  - Have cash flows entity expects will respond in **similar ways to key drivers of risk** in terms of amount and timing
  - Had **similar expected profitability**
  - Entity **adjusts the allocation** to reflect expected **duration** and **size** of remaining contracts

# Remeasure in subsequent periods

## *CSM: Onerous contracts*

- **Loss** for onerous contracts should be recognised **only when the contractual service margin becomes negative** for a group of contracts, and that group should comprise contracts **that at inception** have:
  - Cash flows entity expects will respond in similar ways to key drivers of risk in terms of amount and timing AND
  - Similar expected profitability (ie similar contractual service margin as a percentage of the premium)
- Within group, **net off** the negative and positive CSM
- **Model is asymmetric**
- Group **not** reassessed after inception

# Example

## *Remeasure in subsequent periods*

- Entity issues 60 insurance contracts with coverage period of 3 years. Entity colludes contracts can be aggregated
- CSM for the group is estimated as CU210
- The contracts are expected to lapse in accordance with the pattern shown in the table below

<b>Number of contracts</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
Opening balance	66	55	45
Lapsed contracts	5	10	15
Closing balance	55	45	30

# Example

## Remeasure in subsequent periods

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- Entity could determine CSM allocation using coverage as a proportion of total expected coverage as follows:

Years of coverage	Year 1	Year 2	Year 3
Remaining coverage (55+45+30)	130	75	30
Current coverage	55	45	30
% of total coverage	42	60	100

- Would result in CSM allocated as follows:

Balance of CSM	Year 1	Year 2	Year 3
Opening balance	210	121	48
Less: recognised in Profit/loss	89	73	48
Closing balance	121	48	-

# Example

## Remeasure in subsequent periods

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- At end of year 2, entity revises assumptions (now expects no lapses in year 2 and 25 in year 3)

Years of coverage	Year 1	Year 2	Year 3
Remaining coverage (55+30)	130	85	30
Current coverage	55	55	30
% of total coverage	42	64	100

- Would result in CSM allocated as follows:

Balance of CSM	Year 1	Year 2	Year 3
Opening balance	210	121	43
Less: recognised in Profit/loss	89	78	43
Closing balance	121	43	-

# Example

## Remeasure in subsequent periods

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- At end of year 2, entity notes net + changes in cash flows:

	Year 2	Year 3	Total
Lapse related (timing)	15	9	24
Other changes	5	5	10

- The timing differences are carried in CSM, the experience adjustment in profit or loss, thus:

Balance of CSM	Year 1	Year 2	Year 3
Opening balance	210	121	44
Changes in estimates	-	29	-
Less: recognised in Profit/loss	(89)	(96)	44
Closing balance	121	44	-



# Remeasure in subsequent periods

## *CSM: Allocation*

- Objective for adjustment and allocation of CSM is that **CSM at end of reporting period represents profit for future services** for a group of contracts
- The **group is the same** as that for deciding when contracts are onerous
- **Allocation** should reflect **expected duration and size** of contracts remaining in the group

# Importance of aggregation

## *Why aggregate*

- Model is asymmetric
  - This causes **different outcomes** for grouped and individual contracts
  - For example,
    - entity has 2 contracts, based on **data at inception are identical**
    - after inception, **Contract A becomes onerous** (CSM = -CU10), while the contract B remains as expected (CSM = +CU20).
    - If **accounted individually** level, **loss on A recognised immediately, profit on B spread** over its life,
    - if grouped, A set off against B, smaller profit spread over life
- **Nature of insurance is to aggregate risks**
- Operationally, insurers use a myriad of different levels of aggregation

# Importance of aggregation

## *Why limit aggregation*

- **Loss of transparency** of information
  - Insight into **loss making** activities, cohorts, or products
  - **Timing of loss recognition** shielded by profitable business
  - Timing of **profits over contract life** (allocation)
  - At extreme, **no losses until entire entity loss making**
- Current inconsistency of application
  - **Not generally defined** in National GAAPs, or regulatory frameworks
- Consistency within IFRS
  - **Revenue, leases and impairment all allow grouping**, but only in very limited circumstances

# Importance of aggregation

## *Why more generous for Insurance*

- Level of aggregation **guidance** allows considerably fewer **groups** than would be the case for equivalent guidance for **Impairment/revenue/leases**
  - Those **standards** prohibit the setting off of onerous contracts against profitable contracts in the absence of contractual link
- BUT in **balancing reasons** for and against
- Board maintains **importance of transparency**, but
  - Board accepts that **insurance is different**
    - Risk Aggregation
    - Longer term contracts

# Remeasure in subsequent periods

## *Need to identify effect of discretion*

- Changes in fulfilment cash flows relating **to future services** adjust CSM\*
- Changes in FCF arising **from changes in market variables** are recognised in SCI
- **Discretionary changes** by the entity **relate to future service**, so adjust the CSM (measured at the locked-in rate)
- Require **entity to specify what it regards** as non-discretionary (effectively the same as 2013 ED proposals which did not include requirements on how to make the distinction)

\*Change measured at locked-in rate adjusts the CSM, difference between the amount measured at the locked-in rate and the amount measured at the current rate, recognise in SCI

# Example

## *Effect of discretion*

- Entity issues 100 contracts with coverage period of 3 years.
  - Policyholders pay premium at inception of CU15
  - Contract pays CU400 if policyholder dies
  - Survivors receive cash equal to:
    - their initial premium, less
    - CU5 deducted at beginning of each year for life cover, plus
    - discretionary interest on outstanding balance
- Entity determines contract scoped out of variable fee

# Example

## *Effect of discretion*

- Entity specifies (internally) that it will credit interest at a rate equal to return from a specified assets minus a 2% margin
- At inception, the entity expects:
  - One death to occur at the end of each year;
  - The return from the specified fund to be 10% per annum
  - The risk free discount rate is 4% per annum

	PV	Year 1	Year 2	Year 3
Inflows	1 500			
Outflows	(1 210)	(400)	(400)	(532)
Fulfilment cash flows	290			
CSM	(290)			

# Example

## *Effect of discretion*

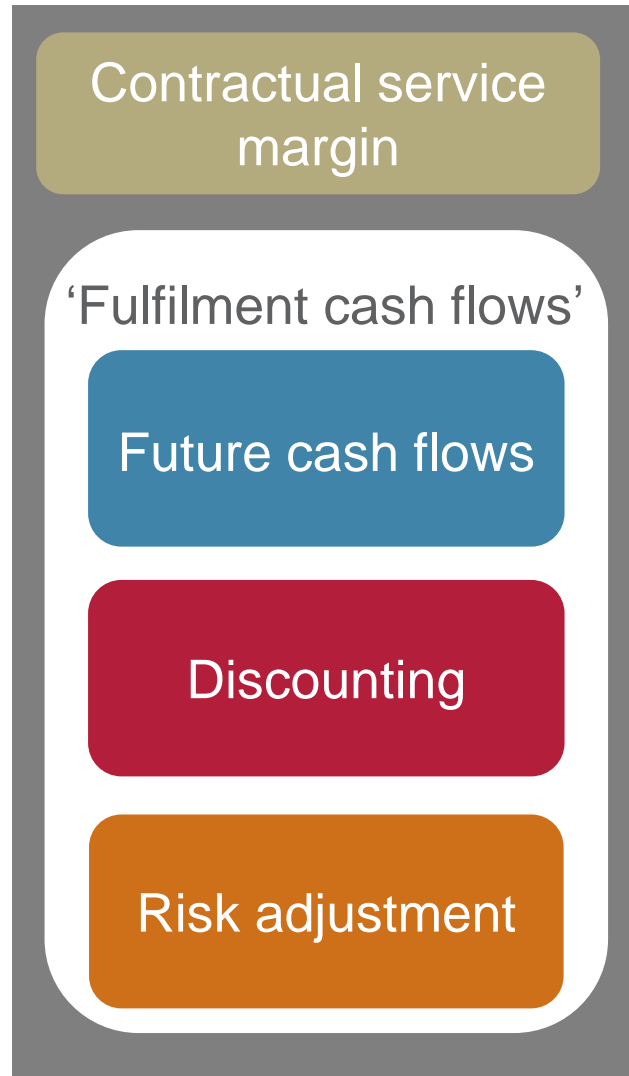
- At end Year 2, expected future return of fund changes to 8%
- Entity decides to credit whole of fund return to policyholders in year 2 and 3 (entity forgoes spread of 2%)
- The effect of the 3 changes is:

	FCF	P&L	CSM
Exercise of discretion (year 2)	11	11	-
Change in financial assumptions (year 3)	0	0	-
Change in discretion (year 3)	2	-	2



# The general model

IASB believes a **current value measure** of an insurance contract **provides the most useful information** about insurance contracts in the statement of financial position.



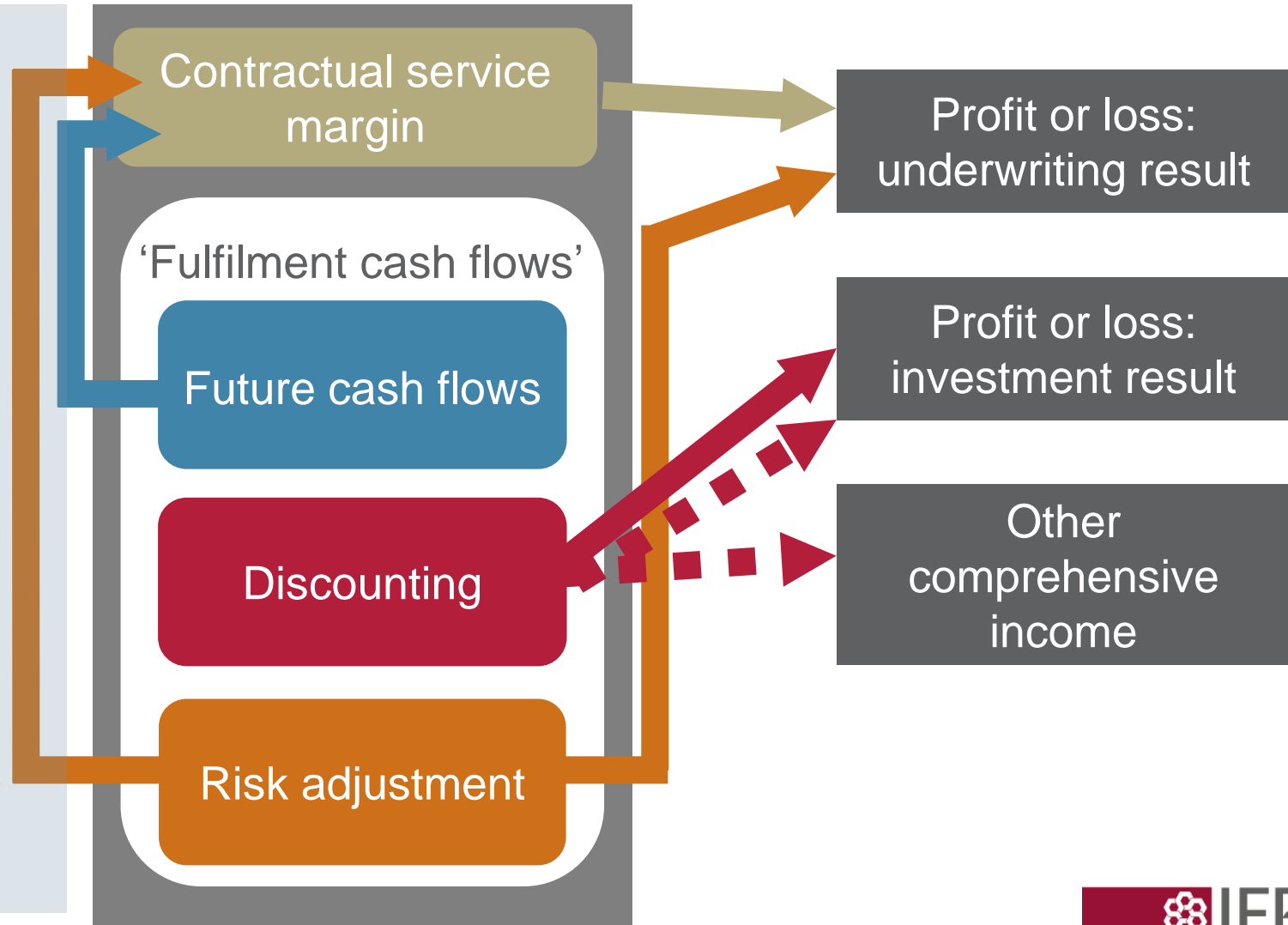
**CSM** is **adjusted by changes in estimates** and is **allocated to profit or loss**

In each reporting period, an **entity remeasures the fulfilment cash flows** using updated assumptions about cash flows, discount rate and risk.

# The general model

## *Recognition of changes in estimates*

The different types of changes in estimates are recognised in different parts of the financial statements.



# Modifications *Variable fee*

# Modifications to the general model

The new insurance contracts Standard **modifies the accounting model** to provide additional accounting models for different types of contract.

- A variable fee approach for contracts with **participation features**
- Accounting requirements for **reinsurance contracts** an entity holds, based on the general model
- Accounting requirements for **investment contracts** with discretionary participation features
- An optional simplified measurement approach for **simpler insurance contracts**, based on the unearned premium reserve approach used in many jurisdictions

# Modifications to the general model

## *Variable fee approach: Scope*

- **Scope** of the variable fee approach
  - Policyholder **participates** in share of clearly identified pool of **underlying items**;
  - Entity expects to pay **policyholder a substantial share** of the returns from those underlying items;
  - **Cash flows expected to vary substantially** with underlying items
- Variable contracts outside the variable fee approach **apply the general model**

# Modifications to the general model

## *Variable fee approach: Sensitivity*

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- Includes any contract which **creates an obligation** linked to underlying items
  - **Explicit** contractual terms
  - **Includes regulatory** requirements
- However, measurement based on **expected cash flows** (not contractually-specified cash flows)
- **Not dependent on holding** of underlying assets
- Obligation **need not be to current generation** of policyholders

# Modifications to the general model

## *Variable fee approach: Mechanics*

- Measurement of **obligation reflects** change in fair value of all underlying items
- **Fulfillment cash flow is calculated consistently** with the general model
- Modify general model so that changes in the estimate of fee entity expects to earn **are adjusted in CSM**
  - Fee is equal to entity's expected share of returns on underlying items, less
  - any expected cash flows that do not vary with the underlying items.

# Example

## *Variable Fee*

- Entity issues 100 contracts with 3 year coverage and a single premium of CU1,500 each
- Entity maintains an account balance (AB) referenced to return on specified fund and charged annually at 2% of AB
- Contract provides death benefit of higher of CU1,700 and AB
- All investments are measured at FVPL. The entity:
  - buys assets with the initial premium
  - Sells assets to fund annual charges and claims
- At inception of the contracts, entity expects:
  - 1 death to occur at end of each year;
  - Fund will yield an annual return of 10% per annum
  - risk free discount rate of 6% per annum



# Example

## *Variable fee*

- Fulfilment cash flows at initial recognition:

	<b>Initial PV</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
Expected cash inflows	150 000			
Expected cash outflows	(141 475)	(1 700)	(1743)	(184 151)
Risk Adjustment	(250)			
Fulfilment cash flows	8 275			
CSM	(8 275)			

# Example 12a

## Reinsurance

90

	Insurance	Reinsurance
<b>Before remeasurement</b>		
- Fulfilment Cash Flows	300	90
- CSM	100	25
Insurance liability/ reinsurance asset	400	115
<b>After remeasurement</b>		
- Fulfilment Cash Flows	350	105
- CSM	50	10
Insurance liability/ reinsurance asset	400	115

# Example 12b

## Reinsurance

	Insurance	Reinsurance
<b>Before remeasurement</b>		
- Fulfilment Cash Flows	300	90
- CSM	100	25
Insurance liability/ reinsurance asset	400	115
<b>After remeasurement</b>		
- Fulfilment Cash Flows	450	135
- CSM	-	(5)
Insurance liability/ reinsurance asset	450	130
Profit and loss	50	15

# Modifications to the general model

## *Variable fee approach: Risk mitigation*

- Entity is permitted to **recognise in profit or loss** changes in value of **guarantee** (ie as in the general model) if:
  - Entity holds derivative instruments
  - consistent with entity's risk management strategy;
  - economic offset exists between guarantee and derivative, and
  - credit risk does not dominate the economic offset
- Entity is required to:
  - document its risk management objective and strategy
  - discontinue prospectively when economic offset ceases
  - disclose the effect of changes in the value of the guarantee in the profit or loss for the period

# Modifications to the general model

## *Variable fee approach: Allocation of CSM*

---

- Release **pattern consistent with general model**
  - Basis of **passage of time**
  - Number of **contracts in force**
- Alternatives rejected:
  - Based only on investment services
  - What is the pattern for those services?
  - How to reflect two services and changes in magnitude in those services over time?

# Contrast with general model

## *General model versus variable fee*

	General model	Variable fee model
Cash flows	No difference	
Discount rate	No difference	
Risk margin	No difference	
CSM at inception	No difference	
Allocation of CSM	No difference	
Discretion	No difference	

# Contrast with general model

## *General model versus variable fee*

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	General model	Variable fee model
<b>CSM</b>		
Subsequent Measurement (financial)	Changes in all financial assumptions in SCI	Changes in guarantees and shareholders share in CSM
- Except risk mitigated	Changes in all financial assumptions in SCI	Changes in sh/share in CSM
Subsequent (non financial)	No difference	
Accretion	Accreted at locked in rate	'Effective' accretion at current rate

# Modifications *Other*



# Modifications to the general model

The new insurance contracts Standard **modifies the accounting model** to provide additional accounting models for different types of contract.

- A variable fee approach for contracts with participation features
- Accounting requirements for **reinsurance contracts** an entity holds, based on the general model
- Accounting requirements for investment contracts with discretionary participation features
- An optional simplified measurement approach for simpler insurance contracts, based on the unearned premium reserve approach used in many jurisdictions

# Modifications to the general model

## *Reinsurance*

- Apply **general model approach** to measure fulfilment cash flows
- If, at inception:
  - CSM is **positive**, record a **liability consistent with general model**
  - CSM is **negative**, record an **asset** (not consistent)
- After inception,
  - Recognise in **CSM changes in** estimates of **FCF** relating to **future service** (consistent), except
  - Recognise in **profit or loss those changes** which arise as a result of changes in **estimates of FCF of underlying direct insurance contract**, and which are **recognised immediately in profit or loss**.

# Example

## *Reinsurance*

- Entity enters into 30% proportional reinsurance contract
- Issues corresponding underlying insurance contracts
- Entity measures corresponding underlying insurance contract at initial recognition as follows:

	CU
EPV of cash Inflows	(1 000)
EPV of cash outflows	900
Risk adjustment	60
Fulfilment cash flows	(40)
CSM	40

# Example

## Reinsurance

100

- For the reinsurance contract, entity estimates:
  - EPV of inflows is CU270 (30% of outflows on underlying);
  - the risk adjustment is CU18 (contract reduces 30% of risk on underlying; and
  - Single premium paid to reinsurer is (A) CU300 or (B) CU280

	A	B
EPV of cash Inflows	(270)	(270)
EPV of cash outflows	300	280
Risk adjustment	18	18
Fulfilment cash flows out/(in)	12	(8)
CSM	(12)	8

# Example

## *Reinsurance*

- Entity issues an insurance contract, which is expected to be profit making
- On the same day, the entity enters into a 30% pro-rata re-insurance contract
- At end of first year, before any change in estimate:
  - CSM of insurance contracts is CU100, and
  - CSM of reinsurance contract is CU25
- Entity changes its estimate of fulfilment cash flows:
  - 12A: increase fulfilment cash outflows by CU50
  - 12B: increase fulfilment cash flows by CU150

# Example A

## Reinsurance

	Insurance	Reinsurance
<b>Before remeasurement</b>		
- Fulfilment Cash Flows	300	90
- CSM	100	25
Insurance liability/ reinsurance asset	400	115
<b>After remeasurement</b>		
- Fulfilment Cash Flows	350	105
- CSM	50	10
Insurance liability/ reinsurance asset	400	115

# Example B

## Reinsurance

	Insurance	Reinsurance
<b>Before remeasurement</b>		
- Fulfilment Cash Flows	300	90
- CSM	100	25
Insurance liability/ reinsurance asset	400	115
<b>After remeasurement</b>		
- Fulfilment Cash Flows	450	135
- CSM	-	(5)
Insurance liability/ reinsurance asset	450	130
Profit and loss	50	15

# Modifications to the general model

## *investment contracts with DPF*

- No insurance risk present in contract
- Apply general model approach to measurement of fulfilment cash flows with modifications to:
  - Recognition date: when entity becomes party to the contract
  - Contract boundary: ends when entity has the right or practical ability to deliver cash at a present or future date
  - Coverage period: period when entity required to provide asset management services under the contract
  - Allocation of CSM: systematic way that **best reflects transfer of asset management services**



# Modifications to the general model

## *Premium allocation approach*

- **Optional practical expedient** to general model – simplified approach (Premium Allocation Approach)
- Therefore:
  - Subject to **entry criteria**
  - Optional to use
- Key criteria: simplified approach should **'mimic' general model**

# Modifications to the general model

## *PAA: Eligibility*

CSM

Time value  
of money

Risk  
adjustment

Cash flows

Permitted if **reasonable approximation** to the general model, ie if:

- coverage period is **12 months or less, or**
- both following apply:
  - **no significant changes** in cash flow estimates are **likely** to occur before the claims incur
  - **no significant judgement** needed **to allocate** the premium over time

# Modifications to the general model

## *PAA: Measurement*

107

CSM

Time value  
of money

Risk  
adjustment

Cash flows

- On initial recognition
  - Record a liability at the PV of premiums received/receivable, less acquisition costs; or
  - Record an asset as the PV of premiums receivable
- Reduce the liability for passage of time
- Reduce asset for receipt of premiums
- Recognise a liability for incurred claims (using general model)

CSM

Time value  
of money

Risk  
adjustment

Cash flows

### **Liability for incurred claims**

- Measured consistently with the general model (with no contractual service margin)
- Discounted if material. Practical expedient 12 months
- Includes a **risk adjustment**

# Example

## *Premium Allocation Approach*

- Entity issues group of annual insurance contracts on 1 July x1
- Entity elected the premium allocation approach to account for this group
- Premium is CU1,220, and is paid on initiation. Acquisition cost of CU20 is paid on initiation
- Entity receives claims on 30 Sept 20x1 and 31 March 20x2  
Both are estimated to be CU500, with risk adjustment of CU30.
- Entity settles claims on 31 August 20x2 for CU1,070
- The risk adjustment is not reduced over the period

# Example

## *Premium Allocation Approach*

- Accounting is as follows:

<b>For the six months ended</b>	<b>Dec x1</b>	<b>Jun x2</b>	<b>Dec x2</b>
<b><i>Profit and Loss</i></b>			
Insurance contract revenue	(610)	(610)	-
Incurred claims	530	530	-
Acquisition costs	20	-	-
Experience adjustment	-	-	10
(Profit)/loss	(60)	(80)	10

# Example

## *Premium Allocation Approach*

For the six months ended	Dec x1	Jun x2	Dec x2
<b><i>Statement of financial position</i></b>			
Retained income	(60)	(140)	(130)
Liability for remaining coverage	(610)	-	-
- Opening balance	-	(610)	-
- Cash inflows	(1 220)	-	
- Revenue recognised	610	610	
Liability for incurred claims	(530)	(1 060)	-
- Opening balance	-	(530)	(1 060)
- Incurred claims	(530)	(530)	
- Cash outflows	-	-	1 060
Cash	1 200	1 200	130

# Presentation and Disclosure



# Present result in financial statements

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The presentation format of the statement of comprehensive income will be consistent between insurers and entities that do not issue insurance contracts.

## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Operating result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Investment result</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability (optional)	(X)
<b>Total comprehensive income</b>	<b>XX</b>

Revenue/expense recognised as earned (not received) or incurred (not paid)

Interest expense either current or 'cost', depending on accounting policy choice

If interest expense is 'cost', effect of difference between current and cost rates is presented in OCI

- Currently, insurance revenue determined as either premiums invoiced (premiums due), or present value of expected future premiums (premiums written)
  - Inconsistently applied
  - May include 'deposit-like' elements
  - May not reflect compensation for risk borne in each period
  - May give the same weight to single and recurring premiums
- Inconsistent with revenue principles in IFRS

- Premiums allocated on an earned basis
- Premium that relates to investment components excluded from premium revenue
- Premium revenue in period represents the compensation insurer earned for coverage provided in that period

# Example Revenue

- An entity writes group of insurance contracts. Coverage period 3 years, no surrenders expected
- Entity receives single premium of CU900 and estimates risk margin of CU120, discount rate of 5%, yearly claims of CU100, and yearly no claim bonuses of CU100 (PV: CU545)
- Subsequently:
  - In Year 1 events happen as expected,
  - In Year 2, claims were CU50 lower then expected and
  - In Year 2, entity also revises expectations for Year 3 by:
    - Reducing outflows by CU48, and
    - Reducing risk margin by CU10

# Example Revenue

- Insurance contract revenue is calculated as follows:

	PV	Year 1	Year 2	Year 3
Difference between opening and closing balance of liability		(617)	329	288
Plus Finance charge		39	27	13
Plus cash inflows		900	-	-
Less Investment component		(100)	(100)	(100)
Less loss component		-	-	-
Revenue		222	256	201

# Example 3a

- Insurance contract revenue is alternatively calculated as

	PV	Year 1	Year 2	Year 3
Margin		82	116	121
Risk Margin		40	40	30
Claims		100	100	50
Double count of loss		-	-	-
		222	256	201

# Example 2a

- Year 1 (after premium cash flow):

	Total	PV cash flow	Risk Margin	CSM
Opening balance	(900)	(545)	(120)	(235)
Interest accretion	(39)	(27)	-	(12)
Cash flows	200	200	-	-
Experience adjust	-	-	-	-
Change in estimate	-	-	-	-
Margin for service	122	-	40	82
Closing balance	(617)	(372)	(80)	(165)

# Example 2a

- Year 2:

	Total	PV cash flow	Risk Margin	CSM
Opening balance	(617)	(372)	(80)	(165)
Interest accretion	(27)	(19)	-	(8)
Cash flows	150	150	-	-
Experience adjustment	50	50	-	-
Change in estimate	-	48	10	(58)
Margin for service	156	-	40	116
Closing balance	(288)	(142)	(30)	(116)



# Example 2a

- Year 3:

	Total	PV cash flow	Risk Margin	CSM
Opening balance	(288)	(142)	(30)	(116)
Interest accretion	(13)	(7)	-	(6)
Cash flows	150	150	-	-
Experience adjustment	-	-	-	-
Change in estimate	-	-	-	-
Margin for service	151	-	30	121
Closing balance	-	-	-	-

## Example 2b

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- Year 1:

	Total	Present value	Risk Margin	CSM
Opening balance	(900)	(545)	(120)	(235)
Interest accretion	(39)	(27)	-	(12)
Cash flows	200	200	-	-
Experience adjustment	-	-	-	-
Change in estimate	-	-	-	-
Margin for service	122	-	40	82
Closing balance	(617)	(372)	(80)	(165)

## Example 2b

123

- Year 2:

	Total	Present value	Risk Margin	CSM
Opening balance	(617)	(372)	(80)	(165)
Interest accretion	(27)	(19)	-	(8)
Cash flows	450	450	-	-
Experience adjustment	(250)	(250)	-	-
Change in estimate	(113)	(238)	(48)	173
Margin for service	64	-	64	-
Closing balance	(493)	(429)	(64)	-

## Example 2b

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- Year 3:

	Total	Present value	Risk Margin	CSM
Opening balance	(493)	(429)	(64)	-
Interest accretion	(21)	(21)	-	-
Cash flows	450	450	-	-
Experience adjustment	-	-	-	-
Change in estimate	-	-	-	-
Margin for service	64	-	64	-
Closing balance	-	-	-	-

## Example 3b

- Insurance contract revenue is calculated as follows:

	PV	Year 1	Year 2	Year 3
Difference between opening and closing balance of liability		(617)	124	493
Plus Finance charge		39	27	21
Plus cash inflows		900	-	-
Less Investment component		(100)	(100)	(100)
Less loss component		-	113	(118)
Revenue		222	164	296

# Example 3b

- Insurance contract revenue is alternatively calculated as

	PV	Year 1	Year 2	Year 3
Margin		82	-	-
Risk Margin		40	64	64
Claims		100	100	350
Double count of loss		-	-	(118)
		222	164	296

# Example 9

- An entity issues contracts with coverage period of 3 years.
- Entity determines the following assumptions:
  - expected inflows of CU900 at inception
  - expected outflows comprise:
    - claims of CU600 (CU200 each year)
    - acquisition costs of CU120 (of which CU90 are directly attributable and are paid at beginning of coverage); and
    - risk adjustment of CU15 with a release of CU5 each year
- Assume time value of money is immaterial
- CSM at initial recognition is CU195 (ie  $900 - 600 - 90 - 15$ )

# Example 9

- Summary of important flows and allocations:

	Total	Year 1	Year 2	Year 3
CSM allocated to P&L	195	65	65	65
Risk margin	15	5	5	5
Amortised acquisition costs	90	30	30	30
Expected claims	600	200	200	200



# Example 9

- Statement of profit or loss:

	Total	Year 1	Year 2	Year 3
Revenue <sup>1</sup>	900	300	300	300
Insurance expenses <sup>2</sup>	(690)	(230)	(230)	(230)
Underwriting margin <sup>3</sup>	210	70	70	70
Overhead expenses	(30)	(30)	-	-
Profit or loss	180	40	70	70

1 Revenue = 65 + 5 + 200 + 30

2 Insurance expenses = 200 + 30

3 Underwriting margin = 65 + 5

# Present results in financial statements

## *Interest expense in profit or loss*

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Presenting interest expense in profit or loss on a cost basis can reduce accounting mismatches with income from related assets measured on a cost basis.

### Approach for determining insurance finance expense in profit or loss

#### Cost measurement basis

- Apply effective yield approaches to determine insurance finance expense in profit or loss
- Different versions appropriate for different contracts

#### Current period book yield approach

- Insurance finance expense in profit or loss eliminates accounting mismatch with items held in profit or loss
- Only for specified contracts (ie with no economic mismatches)

OCI: difference between insurance finance expense in P&L and insurance finance expense determined on current basis

The new standard provides insight into amounts recognised in financial statements and carries forward some existing disclosures in IFRS 4 relating to risk

## Amounts

Expected PV of future cash flows

Risk and the contractual service margin

Time value of money (interest expense)

New contracts written in the period

## Judgements

Estimating inputs and methods

Effects of changes in inputs and methods

Reason for change, identifying the type of contracts affected

## Risk

Nature and extent of risks arising

Extent of mitigation of risks by reinsurance and participation features

Quantitative data about exposure to credit, market and liquidity risk

# Applying the Standard for the first time

# Options permitted by the Standard

133

- Option to apply insurance contracts Standard to:
  - **Fixed fee** service contracts
  - **Financial guarantee** contracts
- Option to apply **premium allocation approach** (PAA), within PAA:
  - Option to **expense acquisition costs** if coverage period one year or less
  - Option **not to accrete interest** if coverage period one year or less
  - Option **not to discount future cash flows** expected to be paid in one year or less

- Variable fee approach **not optional** (VFA), but within VFA:
  - **Constrained option** to recognise **effect of changes in the value of guarantees** in **profit or loss** if entity uses derivatives to mitigate financial market risk in those guarantees
  - **Option to eliminate mismatch** by measuring some assets at FVPL
- **Presentation**: option to present effect of changes in discount rate in profit or loss or **OCI**

# Applying the Standard for the 1st time

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When an entity applies Standard for the 1<sup>st</sup> time, it may have in-force contracts written many years ago.

Historical data about those contracts:

- May require use of hindsight
- May not be available



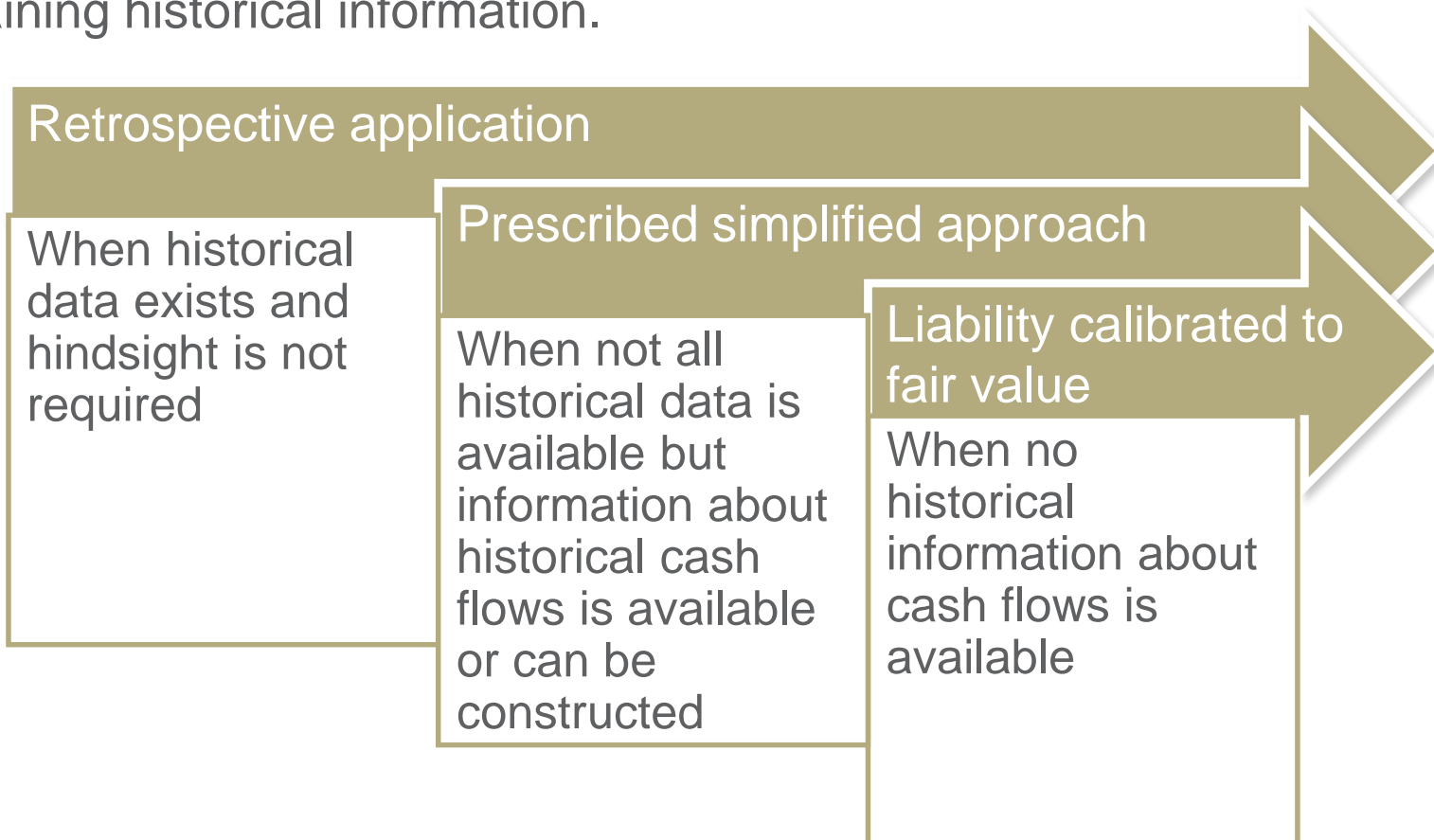
- The entity can measure the fulfilment cash flows directly



- Historical data needed to:
  - Measure remaining balance of CSM
  - Measure liability for remaining coverage for revenue
  - For general model. determine discount rate at date of initial recognition for OCI, interest accretion and unlocking

# Applying the Standard for the 1st time

The IASB has specified different approaches for estimating the contractual service margin in a way that balances comparability with the costs of obtaining historical information.





# Estimating CSM

## *Prescribed simplified approach*

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### General Model

- Estimate CSM at initial recognition using fulfilment cash flows at beginning of earliest period presented adjusted to reflect cash flows that already occurred
- Adjust CSM at initial recognition for allocation in proportion to contract duration
- Approximate discount rates at initial recognition

### Variable fee approach

- Estimate CSM at initial recognition using the fair value of underlying items at date of initial application adjusted to reflect cash flows that already occurred
- Adjust CSM at initial recognition for allocation in proportion to contract duration

# Estimating CSM

## *No information about cash flows available*

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- When it is impracticable to apply the prescribed simplified approach, the CSM is determined as the difference between the fair value of the insurance contracts at that date and the fulfilment cash flows measured at that date

- Opportunity to **fully evaluate accounting** for insurance contracts by permitting **reassessment of classifications for financial assets** under IFRS 9 based on facts and circumstances that exist at the date of initial application
- Includes **use of options available on first application** of IFRS 9

- Information about the **earliest date of initial recognition** of the **portfolios** that are **measured retrospectively**
- **Amounts** in the financial statements **determined** at transition using **simplified approach** or fair value approach, both **on transition and in subsequent periods**.
- If using the simplified approach that results in **accumulated OCI** for insurance contract **being zero**, **disclose** information of **accumulated OCI** for related financial assets measured at **FVOCI** in accordance with IFRS 9.

# Effects analysis

## *Balance sheet*

- Generally, changes in IFRS lead to comparable consequential changes in accounting
- However, IFRS 4 permitted a wide range of practices
- Effects on financial statements will vary
- Factors that influence the effects include:
  - types and nature of contracts
  - differences between new and existing requirements
- Expect relatively little change for short-term insurance
- Greater divergence expected for long-term insurance

- **IFRS 17:** *measure insurance contracts using unbiased current estimates of cash flows*
- Some use cash flows estimates determined at inception, some introduce current flows with a bias to compensate for risk
- All else being equal, the effect is:

Cash flows used applying IFRS 4	Expected effects of IFRS 17	
	Insurance contracts liabilities	Equity
Historic +ve change	↓ Decrease	↑ Increase
Historic -ve change	↑ Increase	↓ Decrease
Current, risk bias	↓ Decrease	↑ Increase

# Balance sheet

## *Discount rates*

- **IFRS 17:** *measure insurance contracts using current estimates of discount rates*
- For companies that used inception discount rates, IFRS 17 will affect amount of insurance assets and liabilities
- All else being equal, the effect is:

Discount rate used applying IFRS 4	Expected effects of IFRS 17	
	Insurance contracts liabilities	Equity
Historic rate < current rate	↓ Decrease	↑ Increase
Historic rate > current rate	↑ Increase	↓ Decrease
Current rate	↔ No effect	↔ No effect



# Balance sheet

## *Risk margin*

- **IFRS 17:** *measure uncertainty in amount and timing of future cash flows at current estimate*
- Most companies included implicit risk margins
- All else being equal, the effect is:

Risk margin used applying IFRS 4	Expected effects of IFRS 17	
	Insurance contracts liabilities	Equity
Margin higher in IFRS 17	↓ Decrease	↑ Increase
Margin lower in IFRS 17	↑ Increase	↓ Decrease

# Balance sheet

## *Options and Guarantees*

- **IFRS 17**: *measure full value of options and guarantees*
- Many do not fully reflect minimum return guarantees in measurement
- All else being equal, the effect is:

Minimum interest guarantee applying IFRS 4	Expected effects of IFRS 17	
	Insurance contracts liabilities	Equity
Not fully reflected	↑ Increase	↓ Decrease
Fully reflected	↔ No effect	↔ No effect

# Balance sheet

## Acquisition costs

- **IFRS 17:** include acquisition costs in measurement of insurance contracts as part of expected cash outflows
- Some companies expense acquisition costs when incurred, others used variety of methods for capitalisation and amortisation
- All else being equal, the effect is:

Acquisition costs applying IFRS 4	Expected effects of IFRS 17	
	Insurance contracts liabilities	Equity
Expensed as incurred	↓ Decrease	↑ Increase
Deferred and amortised	↔ depends	↔ depends

# Effects analysis *Solvency II*

	IFRS 17	Solvency II
Companies affected	IFRS entities that issue insurance contracts	Insurers with operations within EU
Contracts affected	Defined insurance contracts	Contracts issued by insurers
Separating components	Separate distinct non-insurance components	No separations
Acquisition costs	Deferred in liability	Expensed as incurred

	IFRS 17	Solvency II
Recognition	Earlier of day coverage begins or 1 <sup>st</sup> premium	Earlier of day insurer party to contract & cover begins
Grouping of contracts	Contracts with similar risks and profitability	Proscribed
Cash flows	Directly incurred to fulfil	Proscribed
Discount rate	Characteristics of liability	Proscribed
Risk margin	Entities view of risk	Proscribed


	IFRS 17	Solvency II
Profit recognition	CSM eliminates day-1 gain, defers profit and defers some changes	Profit not relevant
Short-term contracts	Optional simplified approach	No simplified approach

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