



STAFF PAPER

February 2022

IFRS® Interpretations Committee meeting

Project	Profit recognition for annuity contracts (IFRS 17)	
Paper topic	Education session	
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the recognition of profit applying IFRS 17 *Insurance Contracts*. An entity includes unearned profit in the measurement of insurance contracts and subsequently recognises it as revenue as the entity provides services. The submission is about determining how to recognise unearned profit as revenue based on the services an entity provides to policyholders of annuity contracts.
2. That submission will be discussed at a future meeting. The purpose of this paper is to prepare the Committee for that discussion by providing an overview of the applicable IFRS 17 requirements and other background related to those requirements. We welcome any comments or questions on this paper.

Structure of the paper

3. This paper comprises:
 - (a) Section 1—main features of IFRS 17 (paragraphs 6–8);
 - (b) Section 2—overview of IFRS 17 general measurement approach (paragraph 9–15); and
 - (c) Section 3—recognising the contractual service margin in profit or loss (paragraphs 16–28).

4. Section 3 discusses the IFRS 17 requirements applicable to the question in the submission. Section 1 and Section 2 provide context about how those requirements fit within the other principles and requirements of IFRS 17.
5. The appendix to this paper includes examples considered by the Transition Resource Group for IFRS 17 (TRG) that illustrate the application of the IFRS 17 requirements discussed in Section 3.

Section 1—Main features of IFRS 17

6. An insurance contract combines features of both a financial instrument and a service contract. To provide useful information about these features, IFRS 17:
 - (a) combines current measurement of the future cash flows with the recognition of profit over the period services are provided under the contract; and
 - (b) presents insurance service results (including presentation of insurance revenue) separately from insurance finance income or expenses.
7. The key principles in IFRS 17 are that an entity:
 - (a) identifies as insurance contracts those contracts under which the entity accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
 - (b) separates specified embedded derivatives, distinct investment components and distinct performance obligations from the insurance contracts.
 - (c) divides the contracts into groups it will recognise and measure.
 - (d) recognises and measures groups of insurance contracts at:
 - (i) a risk-adjusted present value of the future cash flows (the fulfilment cash flows); and
 - (ii) an amount representing the unearned profit in the group of contracts (the contractual service margin).
 - (e) recognises the profit from a group of insurance contracts over the period the entity provides insurance contract services, and as the entity is released from

risk. If a group of contracts is or becomes loss-making, an entity recognises the loss immediately.

- (f) presents separately insurance revenue, insurance service expenses and insurance finance income or expenses.
 - (g) discloses information to enable users of financial statements to assess the effect that contracts within the scope of IFRS 17 have on the financial position, financial performance and cash flows of an entity.
8. IFRS 17 includes two modifications to the general measurement approach:
- (a) a simplified measurement approach permitted for some short-term insurance contracts (the premium allocation approach); and
 - (b) an approach that includes additional adjustments to the contractual service margin required for insurance contracts that are substantially investment-related service contracts (the variable fee approach).

Section 2—Overview of IFRS 17 general measurement approach

Groups of insurance contracts

9. An entity measures insurance contracts in groups determined at initial recognition. Insurance contracts in a single group are, at a minimum, in the same:
- (a) **portfolio** (subject to similar risks and managed together);
 - (b) **profitability category** (expected to be (i) loss-making; (ii) profitable; or (iii) profitable with no significant possibility of becoming loss-making); and
 - (c) **annual cohort** (issued within a period of one year).

Measuring groups of insurance contracts

10. On initial recognition, an entity measures a group of insurance contracts as consisting of:
- (a) the **fulfilment cash flows**:

- (i) **estimates of future cash flows.** A current, present value, probability-weighted estimate that is consistent with observable market information and is adjusted to reflect financial risk.
 - (ii) **risk adjustment for non-financial risk.** An explicit adjustment to the estimates of future cash flows to reflect the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk (insurance risk and other non-financial risk such as lapse risk).
 - (b) the **contractual service margin.** The margin the entity has charged for the service it provides in addition to the compensation it requires for bearing risk.
11. On initial recognition, an entity measures the contractual service margin as the difference between the expected present value of cash inflows and cash outflows, after adjusting for uncertainty and any cash flows received or paid before or on initial recognition. For example, assume the estimate of future cash flows consists of premium inflows of CU100 (debit) and claim outflows of CU70 (credit). The compensation the entity requires for bearing the uncertainty about the amount and timing of the claims (ie the risk adjustment for non-financial risk) is CU10 (credit). In this example, the contractual service margin at initial recognition is CU20 (credit).
12. At the end of each reporting period, the measurement of a group of insurance contracts is the sum of:
- (a) the **liability for remaining coverage:**
 - (i) the **fulfilment cash flows** (estimates of future cash flows and risk adjustment for non-financial risk) related to future service. At the end of the reporting period, an entity remeasures the fulfilment cash flows to reflect current estimates applying the same requirements applied on initial recognition.
 - (ii) the **contractual service margin.** At the end of the reporting period, an entity adjusts the contractual service margin for any changes related to future service and other changes specified in IFRS 17, including a reduction for an amount recognised as insurance revenue as the entity provides services to the policyholder (see paragraph 13 of this paper).

- (b) the **liability for incurred claims**. The fulfilment cash flows related to past service. The liability for incurred claims is created when an entity has an obligation to pay valid claims for insured events that already occurred and other amounts related to past service. The period between the occurrence of the insured event and the payment to the policyholder is often referred to as the settlement period.

Recognising revenue and expenses

13. As an entity provides services over the coverage period, it reduces the liability for remaining coverage and recognises insurance revenue. Some changes in the liability for remaining coverage do not give rise to insurance revenue (for example, changes relating to investment components and insurance finance income or expenses). The changes that give rise to **insurance revenue** can be analysed as the total of:
- (a) **insurance service expenses** incurred in the period (measured at the amounts expected at the beginning of the period).
 - (b) changes in the **risk adjustment for non-financial risk** that do not relate to future service. An entity recognises the risk adjustment for non-financial risk in profit or loss as the entity is released from risk over the coverage period and the settlement period.
 - (c) the amount of the **contractual service margin** recognised in profit or loss in the period. An entity recognises the contractual service margin in profit or loss as the entity provides services over the coverage period.
14. An entity recognises insurance service expenses as they are incurred. If incurred expenses are not yet paid, an entity recognises a liability for incurred claims.
15. Over the life of a simple group of insurance contracts that consists only of premium and claim cash flows, after adjusting for financing effects (reflected in insurance finance income or expenses) and investment components (not reflected in profit or loss):
- (a) total insurance revenue will be equal to total premiums;
 - (b) total insurance service expenses will be equal to total claims incurred;

- (c) total insurance service result (insurance revenue minus insurance service expenses) will be equal to the total of:
- (i) the release of the risk adjustment for non-financial risk; and
 - (ii) the amount of the contractual service margin recognised as insurance revenue.

Note on the submission to the Committee

The question submitted to the Committee for discussion at a future meeting relates to recognising the contractual service margin in profit or loss.

Section 3—Recognising the contractual service margin in profit or loss

16. IFRS 17 requires an entity to recognise in profit or loss the contractual service margin of a group of insurance contracts over the coverage period in a pattern that reflects the provision of insurance coverage as required by the contract. To achieve this, an entity:
- (a) identifies the coverage units in the group. The number of coverage units in a group is the quantity of **insurance contract services** provided by the contracts in the group, determined by considering for each contract the **quantity of the benefits** provided under the contract and its **expected coverage period**.
 - (b) allocates the contractual service margin at the end of the period equally to each coverage unit provided in the current period and expected to be provided in the future.
 - (c) recognises in profit or loss the amount allocated to coverage units provided in the period.

Illustrative example

An entity issues 100 insurance contracts on the same day, each with a coverage period of four years. The contracts are homogenous and provide equal service in each period. This example illustrates the application of coverage units at the end of year 1.

The entity recognises and measures the insurance contracts as a group and at initial recognition the contractual service margin is 800. The example ignores the time value of money.

At the end of year 1, 5 policyholders cancel their contracts. At that time, the entity expects that 5 policyholders will cancel their contracts at the end of each of the remaining periods in the coverage period. No other changes have occurred.

At the end of year 1, the coverage units are calculated as follows:

	Year 1	Year 2	Year 3	Year 4
A. Contracts during period	100	95	90	85
B. Coverage units per contract	1	1	1	1
C. Coverage units allocated to the period (A x B)	100	95	90	85

At the end of year 1, the entity allocates the 800 contractual service margin at the end of the period equally to the coverage unit provided in the current period of 100 and expected to be provided in the future of 270 (95 + 90 + 85). The entity recognises in profit or loss an amount of **216** ($800 \times 100 \div (100 + 270)$).

17. Coverage units are identified prospectively at the end of each reporting period based on the information available at that date.
18. The IASB had considered alternative methods of allocating the contractual service margin to coverage units, including an allocation based on:
 - (a) the pattern of expected cash flows or the change in the risk adjustment for non-financial risk. However, the IASB decided that those factors are not relevant in determining the satisfaction of the entity's performance obligation for insurance contract services. They are already included in the measurement of the fulfilment cash flows and do not need to be considered in the allocation of the contractual service margin.
 - (b) all services provided by the contract. Under an insurance contract, an entity may provide other services in addition to insurance contract services (as

defined by IFRS 17). However, the IASB decided that considering all services would result in more subjectivity and complexity than entities already face when determining the pattern of service provision for the defining services provided under the contract—insurance contract services.

Identifying coverage units

19. An entity is required to apply judgement to identify the coverage units in a group of insurance contracts.
20. The steps to identify the coverage units in a group could be described as:
 - (a) Step 1—identify the insurance contract services provided under the group;
 - (b) Step 2—consider the expected coverage period for each contract in the group; and
 - (c) Step 3—consider the quantity of benefits provided under each contract in the group.

Note on the submission to the Committee

The question submitted to the Committee for discussion at a future meeting is focused on step 3, and could have implications for step 2.

Step 1—identify the insurance contract services provided under the group

21. The coverage period is the period over which an entity provides insurance contract services. IFRS 17 defines **insurance contract services** as the following services provided to a policyholder of an insurance contract:
 - (a) **insurance coverage**—coverage for an insured event (an uncertain future event covered by an insurance contract that creates risk);
 - (b) **investment-related service**—a service provided by all insurance contracts in the variable fee approach—the management of underlying items on behalf of the policyholder; and

(c) **investment-return service**—a service provided by some insurance contracts not in the variable fee approach (general measurement model contracts)—the generation of an investment return on behalf of the policyholder.

22. Each insurance contract service may be provided across the entire life of the contract or for only part of that life. For insurance contracts that provide both insurance coverage and an investment service, an entity needs to apply judgement to determine the relative weighting of each service when allocating the contractual service margin.

Note on the submission to the Committee

The question submitted to the Committee for discussion at a future meeting is about the provision of insurance coverage only.

Step 2—consider the expected coverage period for each contract

23. IFRS 17 requires the coverage units in a group to be determined considering the expected coverage period for each contract in the group.

24. The TRG previously discussed how to determine the quantity of benefits provided in identifying coverage units (Step 3 in this paper).¹ That discussion also considered the expected coverage period for each contract. TRG members observed that:

- (a) the requirement for coverage units to consider the expected coverage period for *each contract* in the group means that an entity needs to factor in its expectation of lapses and cancellations of contracts; and
- (b) the period in which an entity bears insurance risk is not necessarily the same as the coverage period.

Step 3—consider the quantity of benefits provided under each contract

25. How to determine the quantity of benefits provided in identifying coverage units was one of the first questions asked of the TRG and was discussed at the [February 2018](#) and [May 2018](#) TRG meetings.

26. At those meetings, TRG members observed that:

¹ Information about the TRG including meeting papers and summaries are available at ifrs.org

- (a) IFRS 17 establishes a principle for determining coverage units that an entity must apply (reflecting the services provided under a group of insurance contracts in each period);
 - (b) determining the quantity of benefits in each period involves judgements and estimates to best achieve the principle of reflecting the services provided in each period; and
 - (c) it would not have been possible for the IASB to develop detailed requirements that could be applied to determine the quantity of benefits provided for the wide variety of insurance contracts existing globally.
27. In considering how to achieve the principle of reflecting the services provided under a group of insurance contracts in each period, TRG members observed:
- (a) different levels of service provided across periods are reflected in the determination of the quantity of benefits provided. So, for example, coverage units reflect different levels of service in situations such as when a group contains:
 - (i) contracts that provide a death benefit of CU10m and other contracts that provide a death benefit of CU1m, and those contracts have different durations to each other.
 - (ii) contracts that provide a death benefit of CU10m in the first year of the coverage period and CU1m for the remainder of the coverage period.
 - (b) an entity is required to consider the benefits expected to be received by the policyholder, not the entity's costs of providing those benefits.
 - (c) a policyholder benefits from the entity standing ready to meet valid claims for an insured event, not just making a claim if an insured event occurs. The quantity of benefits provided therefore relates to the amounts that *can* be claimed by the policyholder.
 - (d) different probabilities of an insured event occurring in different periods do not affect the benefits provided in those periods.

- (e) IFRS 17 does not specify methods to determine the quantity of benefits provided. Different methods may achieve the objective of reflecting the services provided in each period, depending on facts and circumstances.
28. TRG members observed that the following methods might achieve the principle if they are a reasonable proxy for the services provided under the group of insurance contracts in each period:
- (a) a straight-line allocation over the passage of time that reflects the number of contracts in a group.
 - (b) a method based on the maximum contractual cover in each period.
 - (c) methods based on expected cash flows. However, methods that result in no allocation of the contractual service margin to periods in which the entity is standing ready to meet valid claims do not meet the principle of reflecting the services provided.
 - (d) a method based on premiums. However, premiums are not a reasonable proxy when:
 - (i) comparing services across periods if the premiums are receivable in periods different from those in which the services are provided;
 - (ii) reflect different probabilities of claims for the same type of insured event in different periods rather than different levels of service of standing ready to meet claims; or
 - (iii) when comparing contracts in a group if the premiums reflect different levels of profitability in contracts. The level of profitability in a contract does not affect the services provided under the contract.

Appendix A—extract of examples considered by the TRG

- A1. This appendix is an extract from Agenda Paper 5 of the May 2018 TRG meeting. It outlines 13 examples submitted to the TRG and for each example:
- (a) possible methods suggested by the submitter for determining coverage units; and
 - (b) IASB staff views on whether those methods meet the IFRS 17 principle of reflecting the insurance contract services provided, considering the facts and circumstances presented in the example.
- A2. When discussing those examples, TRG members noted the analysis depends on the fact patterns presented and would not necessarily apply to other fact patterns. In addition, identifying the method that best reflects the services provided in each period is a matter of judgement based on facts and circumstances.
- A3. Examples:

Example	Type of contract
1	Credit life loan insurance
2	Credit life product with variable amount of cover
3	Mortgage loss cover
4	Product warranty
5	Extended product warranty
6	Health cover
7	Proportional reinsurance issued
8	Reinsurance adverse development of claims with claim limit
9	Reinsurance adverse development of claims without claim limit
10	Transaction liability
11	Combination of different types of cover
12	Life contingent annuity
13	Forward purchase of fixed rate annuity

Example 1—Credit life loan insurance

Example	A life insurance policy pays a death benefit equal to the principal and interest outstanding on a loan at the time of death. The balance of the loan will decline because of contractually scheduled payments and cannot be increased.
Methods suggested — expected coverage duration ²	The expected coverage duration should reflect expected deaths and lapses.
Methods suggested— quantity of benefits	(a) constant cover, being cover of a death benefit; or (b) cover for the contractual balance outstanding.

A4. Staff views:

- (a) the staff agree the expected coverage duration should reflect expected deaths and lapses.
- (b) quantity of benefits—method (b) is valid because it is both the maximum contractual cover and the amount the entity expects the policyholder to be able to make a valid claim for if the insured event occurs. Method (a) is not valid because it does not reflect different levels of cover provided across periods.

² In June 2020 the IASB amended IFRS 17. As part of those amendments, in the coverage units requirement ‘expected coverage duration’ was replaced with ‘expected coverage period’. This appendix refers to ‘expected coverage duration’ because it is an extract of a paper published prior to the amendments.

Example 2—Credit life product with variable amount of cover

Example	Credit life products for which the amount payable on an insured event varies (for example, claims might relate to an outstanding credit card balance). In these cases the sum assured will vary over time, rather than simply reducing. In addition, the sum assured may be limited based on the lender’s credit limits.
Methods suggested — expected coverage duration	No comments.
Methods suggested— quantity of benefits	(a) constant cover of contractual maximum amount of the credit limit; or (b) cover based on expected credit card balances.

A5. Staff views:

- (a) the expected coverage duration is the period during which cover is provided, adjusted for any expectations of lapses.
- (b) quantity of benefits—either method suggested could be valid. Method (a) is the maximum contractual cover and method (b) is the amount the entity expects the policyholder to be able to make a valid claim for if the insured event occurs.

Example 3—Mortgage loss cover

Example	A contract provides cover for five years for default losses on a mortgage, after recovering the value of the property on which the mortgage is secured. The balance of the mortgage will decline because of contractually scheduled payments and cannot be increased.
Methods suggested — expected coverage duration	No comments.
Methods suggested— quantity of benefits	<p>(a) contractual balance of mortgage; or</p> <p>(b) the amount for which the policyholder has the ability to make a valid claim, ie the contractual balance of the mortgage, less the expected value of the property.</p>

A6. Staff views:

- (a) the expected coverage duration is the five years during which cover is provided, adjusted for any expectations of lapses.
- (b) quantity of benefits—either method suggested could be valid. Method (a) is the maximum contractual cover and method (b) is the amount the entity expects the policyholder to be able to make a valid claim for if the insured event occurs.

Example 4—Product warranty

Example	A five-year warranty coverage contract provides for replacement of a purchased item if it fails to work properly within five years of the date of purchase. Claims are typically skewed toward the end of the coverage period as the purchased item ages.
Methods suggested — expected coverage duration	No comments.
Methods suggested— quantity of benefits	<p>(a) the cover provided is constant until a claim is made; or</p> <p>(b) the coverage units should include expectations about the cost of replacing the item, for example, inflation.</p>

A7. Staff views:

- (a) the expected coverage duration is the five years the cover is provided, adjusted for any expected lapses.
- (b) quantity of benefits—method (a) is valid if the price of the product is expected to remain constant. Method (b) is valid if the price of the product increases. The benefit to the policyholder is not having to buy a replacement product.

Example 5—Extended product warranty

Example	Extended warranty policies cover the policyholders after the manufacturer’s original warranty has expired. The policies provide new for old cover in the event of a major defect to the covered asset.
Methods suggested — expected coverage duration	The expected coverage duration does not start until the manufacturer’s original warranty has expired.
Methods suggested— quantity of benefits	No comments.

A8. Staff views: the staff agree the expected coverage duration does not start until the manufacturer’s original warranty has expired. The policyholder cannot make a valid claim to the entity until then.

Example 6—Health cover

<p>Example</p>	<p>A contract provides health cover for 10 years for specified types of medical costs up to CU1m over the life of the contract, with the expected amount and expected number of claims increasing with age.</p>
<p>Methods suggested — expected coverage duration</p>	<p>No comments.</p>
<p>Methods suggested— quantity of benefits</p>	<p>(a) compare contractual maximum amount that could have been claimed in the period with remaining contractual maximum amount that can be claimed as a constant amount for each future coverage period. So, if a claim of CU100,000 were made in the first year, at the end of the year the entity would compare CU1m coverage provided in the year with coverage of CU900,000 for the following nine years, resulting in an allocation of 1/9.1 of the contractual service margin for the first year.</p> <p>(b) compare maximum amount that could be claimed in the period with the expected maximum amounts that could be claimed in each of the future coverage periods, reflecting the expected reduction in cover because of claims made. This approach involves looking at the probabilities of claims in different periods to determine the expected maximum amounts in future periods. However, in this case, the probability of claims in one period affects the amount of cover for future periods, so affects the level of service provided in those periods. So if a claim of CU100,000 were expected in each year, at the end of the year the entity would compare CU1m coverage</p>

	<p>provided in the year with coverage of CU4.5m (900k + 800k +...) over the following nine years, resulting in an allocation of 1/5.5 of the contractual service margin for the first year.</p> <p>(c) compare the amount expected to be claimed in the period with the amounts expected to be claimed in future periods.</p>
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A9. Staff views:

- (a) the expected coverage duration is the 10 years during which cover is provided, adjusted for any expectations of the limit being reached during the ten years and lapses.
- (b) quantity of benefits—either method (a) or (b) could be valid. Method (c) is not valid because if no claims are expected in a period, there would be no contractual service margin recognised. In addition, it appears that applying method (c) the amount representing the contractual cover remaining is not reduced as claims are made.

Example 7—Proportional reinsurance issued

<p>Example</p>	<p>A reinsurance contract issued provides proportional cover for underlying contracts issued during the contract period. The reinsurance contract issued is for a period of one year. Underlying contracts are written uniformly throughout the year and are annual policies that are reasonably homogenous and provide relatively even cover over their one-year coverage periods.</p>
<p>Methods suggested — expected coverage duration</p>	<p>The insurer has a substantive obligation to provide services under the contract for a period of two years as the risks attaching over a single policy year will cover two-years of exposure to risk. The expected coverage duration of the reinsurance contract issued is therefore two years.</p>
<p>Methods suggested— quantity of benefits</p>	<p>The amount for which the policyholder has the ability to make a valid claim—ie the pattern of coverage—should reflect the expected pattern of underwriting of the underlying contracts because the level of service provided depends on the number of underlying contracts in-force—the more contracts in force, the higher the level of service.</p>

A10. Staff views:

- (a) the staff agree the expected duration is two years, adjusted for any expectations of lapse; and
- (b) the method presented for determining the quantity of benefits is valid.

Example 8—Reinsurance adverse development of claims with claim limit

<p>Example</p>	<p>A reinsurance adverse development cover contract will pay claims in excess of a stated aggregate amount on a group of underlying property and casualty contracts for which the claim event has already been incurred. There is a total aggregate limit to the amount payable under the contract. Because there is uncertainty in the ultimate amount and timing of the final settlements of the underlying claims, the insured event is the determination of the ultimate cost of settling those claims.</p>
<p>Methods suggested — expected coverage duration</p>	<p>If the contract has an upper limit that is expected to be reached, the expected coverage duration would be the period from inception of the contract to the time at which the limit of cover is expected to be reached, adjusted for expected lapses, if any.</p>
<p>Methods suggested— quantity of benefits</p>	<ul style="list-style-type: none"> (a) compare the contractual maximum amount that could have been claimed in the period with the remaining contractual maximum amount that can be claimed as a constant amount for each future coverage period; (b) straight line over the life of the contract, which would end at the date of the last expected settlement payment; or (c) compare the expected amount of underlying claims covered in the period with the expected amount of underlying claims remaining to be covered in future periods.

A11. Staff views:

- (a) the staff agree that the expected coverage duration is the period from inception of the contract to the time at which the limit of cover is expected to be reached, adjusted for expected lapses.
- (b) quantity of benefits—methods (a) and (c) could be valid methods. Method (b) is not valid because it does not reflect different levels of cover provided across periods.

Example 9—Reinsurance adverse development of claims without claim limit

<p>Example</p>	<p>A reinsurance adverse development cover contract will pay claims in excess of a stated aggregate amount on a group of underlying property and casualty contracts where the claim event has already been incurred. There is no total aggregate limit to the amount payable under the contract. Because there is uncertainty in the ultimate amount and timing of the final settlements of the underlying claims, the insured event is the determination of the ultimate cost of settling those claims.</p>
<p>Methods suggested — expected coverage duration</p>	<ul style="list-style-type: none"> (a) in the case of unlimited cover, the expected coverage duration would be the period to when it is expected there will be no other cash payments—ie the end of the expected claims settlement period. (b) some contracts for adverse claims development have no limit on the period in which claims can be made. For example, asbestos claims were still being made in 2017 under 1950s commercial liability policies in the US. In such situations there is no ‘date of the last expected settlement payment’. There is no clear date when potential claims are no longer possible.

<p>Methods suggested— quantity of benefits</p>	<p>(a) equal benefits in each coverage period, which would end at the date of the last expected settlement payment;</p> <p>(b) compare the number of underlying claims covered in the period with the number of underlying claims remaining to be covered in future periods; or</p> <p>(c) compare the expected amount of underlying claims covered in the period with the expected amount of underlying claims remaining to be covered in future periods</p>
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A12. Staff views:

- (a) the staff think the expected coverage duration is the period to when the financial effect of the claims becomes certain. This may be before the claims are paid if certainty has been achieved prior to the actual payment. The staff observe that an entity will need to estimate the expected duration of the period in which claims will be made and payments will be made to estimate the fulfilment cash flows.
- (b) quantity of benefits—methods (a) and (c) could be valid. The staff think method (a) could be valid in this example, while the same method was not valid in example 8 (method (b) in example 8). This is because, unlike example 8, the amount of contractual cover remaining is not reduced as claims are made. The staff observe that equal benefits in each coverage period for each contract (method (a)) will not necessarily result in a straight-line allocation of the contractual service margin of a group because different numbers of contracts will provide cover in different periods. Method (b) could be valid if the underlying claims were expected to be of similar size.

Example 10—Transaction liability

<p>Example</p>	<p>A transaction liability policy will pay claims for financial losses arising as a result of breaches of representations and warranties made in a specified and executed acquisition transaction. The policy period (contract term) is for 10 years from the policy start date. The insurer will pay claims for financial losses reported during the 10-year policy period up to the maximum sum insured.</p>
<p>Methods suggested — expected coverage duration</p>	<p>(a) the insured event is the representations and warranties made in the final executed transaction agreement, which is dated the transaction closing date. Therefore, the coverage period (expected coverage duration) is one day, which is the transaction closing date. The policy period has been included in the contract to limit the reporting period for claims so it is not an indefinite period. This limits the timescale for loss reporting in the same way that the maximum sum insured limits the quantum of loss. Given the insured event arises from representations and warranties, the concept of an ‘insurable interest’ is difficult to apply without needing to assess the expected frequency and severity of the loss, ie incidence of risk. However, a valid claim is permitted only in relation to the executed representations and warranties and therefore limited to a one-day period.</p> <p>(b) the insured event is the discovery of breaches of representations and warranties. Coverage starts when the contract is signed and lasts for 10 years.</p>
<p>Methods suggested— quantity of benefits</p>	<p>No comments.</p>

A13. Staff views: view (b) is valid. The staff do not agree with the interpretation of the insured event in view (a). The insured event is not that the policyholder will knowingly make false representations. The insured event is the future event that indicates that the representations made in good faith were in fact misrepresentations and resulted in financial losses. This is consistent with paragraph B18(i) of IFRS 4 *Insurance Contracts*, which states:

title insurance (ie insurance against the discovery of defects in title to land that were not apparent when the insurance contract was written). In this case, the insured event is the discovery of a defect in the title, not the defect itself.

Example 11—Combination of different types of cover

Example	Combinations of different benefits. Assume there are five contracts (A-E) in a single group of insurance contracts. Each contract has a different combination of four coverages (accidental death, cancer diagnosis, surgery and inpatient treatment). Each contract has a different coverage period. Coverages have a high level of interdependency in the same insurance contract; if a coverage of an insurance contract in the group of insurance contracts lapses, other coverages of the same insurance contract lapse simultaneously.
Methods suggested — expected coverage duration	No comments.
Methods suggested— quantity of benefits	<p>(a) the quantity of benefits is the same for each contract.</p> <p>(b) the quantity of benefits for each contract is the maximum level of cover given by any of the benefits, ignoring the amounts of cover for the other benefits. So if, for example, the highest level of cover for contract A was 2,000 for accidental death and for</p>

	<p>contract B was 1,000 for cancer diagnosis, the coverage units would be determined by reference to those amounts.</p> <p>(c) the quantity of benefits for each contract is the sum of all the levels of cover provided.</p> <p>(d) the annual premiums can be used to determine the coverage units because they reflect the amount of insurance service provided.</p>
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A14. Staff views:

- (a) the expected coverage duration is the period in which cover is provided, adjusted for expectations of lapses.
- (b) quantity of benefits—method (c) is valid. Method (a) is not valid because it does not reflect the different amounts of cover provided by each contract. Method (b) is not valid for the same reason. Whether method (d) is valid depends on facts and circumstances.

Example 12—Life contingent annuity

Example	A life contingent pay out annuity pays a fixed annual amount of CU10 each period until the annuitant dies.
Methods suggested — expected coverage duration	Comments combined with quantity of benefits comments below.
Methods suggested— quantity of benefits	(a) there is a constant level of benefits provided over the life of the annuitant. The contractual service margin would be amortised straight line over the remaining expected life of the annuitant. That is the quantity of benefit is 10 per year, and the coverage duration is the length of time until there is zero probability of making a payment to the policyholder (40 years).

	<p>(b) the contract is a series of individual promises to pay a fixed amount at a future point in time if the annuitant is alive at that point in time. The cumulative coverage units in the first period are the total expected dates a payment will be made. The second period cumulative coverage units would be one less coverage unit as a coverage unit expired with the reaching of the first promise to pay at a point in time. That is the quantity of benefit and coverage duration are determined together by multiplying the face amount by the probability of making payment in each year (not the probability weighted cash flow).</p> <p>(c) the coverage units are determined by the quantity of benefits and the expected duration. The quantity of benefits is a constant benefit of 10 per year. The expected duration is the probability-weighted average duration of the contract.</p>
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A15. Staff views:

- (a) the expected coverage duration is the probability-weighted average expected duration of the contract. The expected coverage duration is reassessed each period (same as view (c)).
- (b) the quantity of benefits is the fixed monthly amount of CU10 (same as view (c)).
- (c) view (a) is not valid because it does not reflect the expected duration of the contract. The staff do not agree with view (b) because it requires an entity to split a contract into multiple individual contracts. It also does not seem to require reassessment of the expected coverage duration.

Example 13—Forward purchase of fixed rate annuity

Example	Forward contract to buy an annuity in the future at a fixed rate. The premium is payable when the annuity is bought. If the policyholder dies, or cancels the contract, before the date the annuity can be purchased, the policyholder receives no benefit.
Methods suggested — expected coverage duration	<p>(a) the entity bears insurance risk from the date the forward contract is issued. Hence, the coverage period starts at that date.</p> <p>(b) the entity bears insurance risk from the date the forward contract is issued, but the coverage period does not start until the date the annuity starts. The insured event is that the policyholder lives long enough to receive payments under the annuity.</p>
Methods suggested— quantity of benefits	No comments.

A16. Staff views: view (b) is valid. The staff think an insured event cannot happen in the period before the annuity starts.