Insurance contracts

Testing questionnaire: Response requested by 23 September 2016

Introduction

1. Thank you for taking part in topic-based testing for the forthcoming insurance contracts Standard.

2. The testing process is explained in the staff paper *Preliminary information on topic-based testing* previously distributed to testing participants. The questions cover the following topics:

   (a) general questions (see paragraphs Q1–Q2);

   (b) aggregation of contracts (see paragraphs Q3–Q7);

   (c) scope of variable fee approach (see paragraphs Q8–Q10);

   (d) derivatives used to mitigate financial market risk (see paragraphs Q11–Q15);

   (e) determining the amount of insurance finance income or expenses in Other Comprehensive Income (OCI) (see paragraphs Q16–Q17);

   (f) recognition of changes in estimates (see paragraphs Q18–Q20); and

   (g) transition (see paragraphs Q21–Q22)

3. The relevant extracts of the staff's working draft are included in this questionnaire and we expect those extracts to be sufficient for you to answer the questions.

4. In some cases, we may ask you for permission to allow staff of national standard-setters and other relevant organisations to observe meetings. However, all testing results will be treated in the strictest confidence and no data from any individual participant will be released to parties other than Board members and staff of the IFRS Foundation, without the express permission of the participant. A summary of the

results of the testing will be presented in a Staff Paper and will be discussed by the Board in a public meeting. Any information that we release publicly about the results of the testing will not allow readers to identify data about individual participants.

5. By responding to this testing on behalf of yourself or an organisation, you agree that the IFRS Foundation may store your details and contact you from time to time for the purpose of seeking further information or consultation in relation to this or other related work.

6. Your Personal Data will be processed and stored by staff in the IASB Insurance Contracts Team at the IFRS Foundation in compliance with the Data Protection Act 1998 and the Foundation's Privacy Policy which can be found at http://www.ifrs.org/pages/PrivacyStatement.aspx.

7. The IFRS Foundation will not pass your Personal Data to third parties under any circumstances. Should you have any questions regarding the handling of your Personal Data please contact the Insurance Contracts Team at insurancecontracts@ifrs.org.

8. Please provide your final submissions by **23 September 2016**.

Questions for participants

General information

Q1. Please provide us with a short description of your company as follows:

(a) name of the listed group that prepares IFRS consolidated financial statements;

(b) the country where your parent company is located;

(c) the size of your company, including total balance sheet, total premiums written, total profit from insurance activities, total insurance reserves; and number of employees (please indicate the date of reference);

(d) the total number of contracts in force and product lines your company underwrites (please explain the basis for determining the different product lines);

(e) the main type of insurance activities your company is involved with and their relevance to your operations as a whole; and

(f) the main type of non-insurance activities your company is involved with and their relevance to your operations as a whole.

Q2. For each product line or group of contracts selected for topic-based testing, please provide:

(a) a description of the nature and characteristics of the group of contracts, i.e. the general terms of the product. This information is intended to allow us to analyse your submission in the context of the chosen group of contracts.

(b) the significance of the group of contracts selected in relation to the businesses your company is involved with. Please indicate the relevance of the group of contracts selected in terms of the total premiums and reserves.

(c) The basis of accounting that your company applies today to that group of contracts or product line.

Topic 1—Aggregation of contracts

Please consider the following paragraphs:

23. This Standard requires an entity to:
    a. measure individual contracts on initial recognition (paragraphs 26-35), unless paragraph 24 applies; and
    b. aggregate contracts into groups (paragraphs 36-39) to;
        i. determine whether a loss is recognised for onerous contracts on initial recognition (paragraphs 44-47); and
        ii. measure the contractual service margin after initial recognition (paragraphs 40-43).
24. The purpose of measuring individual contracts on initial recognition is to assess their profitability and how their expected future cash flows respond in terms of amount and timing to changes in key assumptions. These characteristics of an individual contract determine how an entity will aggregate contracts (see paragraph 36). If an entity can determine these characteristics without measuring the individual contract, for example based on the information used to establish pricing, an entity may measure a group that meets the conditions in paragraph 36 rather than the individual contracts.
25. To measure individual contracts or groups, an entity may estimate the fulfilment cash flows at whatever level of aggregation of contracts is most appropriate from a practical perspective, so long as it is able to make an systematic and rational allocation of those estimates to the individual contracts on initial recognition and groups of contracts in subsequent periods (see paragraphs B36-B38).
36. **Having determined the measurement of individual contracts on initial recognition, an entity shall aggregate contracts into groups to determine whether to recognise a loss for a group of onerous contracts and to measure the contractual service margin after initial recognition. Those groups comprise contracts that on initial recognition have:**
    a. **future cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions; and**
    b. **similar expected profitability. Unless paragraphs 50–54 apply, similar profitability means similar contractual service margin as a percentage of the total expected revenue. As a practical expedient, an entity may instead assess whether the contracts have a similar expected return on premiums, ie the contractual service margin as a percentage of expected premiums.**
37. A group of insurance contracts shall comprise only one contract if there are no other contracts that would create a group that would meet the conditions in paragraph 36.
38. On the initial aggregation of contracts to form a group, the fulfilment cash flows of the group of contracts is the sum of the fulfilment cash flows of the contracts in the group and the contractual service margin is the sum of the contractual service margins of the contracts in the group.
39. An entity may add a new contract to an existing group if, and only if, the conditions in paragraph 36 are met when comparing the response of the expected cash flows and the expected profitability of the new contract with the response of the expected cash flows and expected profitability of the group at the date the contract joins the group. In addition, for *insurance contracts without direct participation features*, the entity must be able to determine the discount rate for the group specified in paragraph 41.b. If a new contract is added to an existing group:
    a. the fulfilment cash flows of the resulting group are the sum of the fulfilment cash flows of the group before the contract joined the group and the fulfilment cash flows of the contract joining the group.
    b. the contractual service margin of the resulting group is the sum of the contractual service margin of the group before the contract joined the group and the contractual service margin of the contract joining the group.
41. For insurance contracts without direct participation features, the carrying amount of the contractual service margin at the end of the reporting period is the carrying amount at the start of the reporting period:
    a. plus the contractual service margin of any contracts added to the group;
    b. plus the interest accreted on the carrying amount of the contractual service margin during the reporting period to reflect the time value of money, measured at the discount rates specified in paragraph B72 that applied when the contracts in the group were initially recognised;
    c. plus or minus the changes in fulfilment cash flows relating to future coverage or other services as

specified in paragraphs B91-B96, except to the extent that:

  i. such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to an onerous loss (see paragraph 44.b); or

  ii. such decreases in the fulfilment cash flows are allocated to the loss component of liability applying paragraph 47;

d. plus or minus the effect of any currency exchange differences.

e. minus an amount released because of the transfer of services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period on the basis of the passage of time (see paragraph B107).

42. For *insurance contracts with direct participation features* (see paragraph B97–B106), the carrying amount of the contractual service margin at the end of the reporting period is the carrying amount at the start of the reporting period:

a. plus the contractual service margin of any contracts added to the group;

b. plus or minus the change in the value of the entity's share of the underlying items (see paragraphs B101-B103);

c. plus or minus the changes in fulfilment cash flows relating to future coverage or other services as specified in paragraphs B101–B106, except to the extent that:

  i. such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to an onerous loss (see paragraph 44.b); or

  ii. such decreases in the fulfilment cash flows that are allocated to the loss component of liability applying paragraph 47;

d. plus or minus the effect of any currency exchange differences;

e. minus an amount released because of the transfer of services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period on the basis of the passage of time (see paragraph B107).

52. *[This paragraph deals with the premium allocation approach]* An entity shall recognise a loss component of a liability for remaining coverage if facts and circumstances indicate that a group of contracts is onerous. An entity shall assess whether whether a group of contracts is onerous for groups that comprise contracts that on initial recognition have:

  a. expected cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions.

  b. similar expected profitability, ie expected consideration minus expected expenses as a percentage of expected consideration.

B36. An entity's rights and obligations arise from individual contracts with policyholders, and the cash inflows from policyholders and cash outflows to policyholders also arise at an individual contract level. Further, in order to determine how to group contracts for subsequent measurement an entity must assess the profitability of the individual contracts and hence, unless paragraph 24 applies, must measure the contracts individually. However, just because measurement at initial recognition is at an individual contract level does not mean that, in practice, some aspects of that measurement cannot be achieved at a higher level of aggregation. Similarly, aspects of subsequent measurement can be achieved at a higher level of aggregation than the grouping specified for in paragraph 36 for the identification of onerous losses and subsequent measurement of the contractual service margin.

B37. For example, the measurement of insurance contracts includes some cash flows that are not directly attributable to individual contracts (see paragraphs 22 and B68). Such cash flows cannot be estimated at an individual contract level and must be estimated at a higher level and then allocated to individual contracts or groups of contracts. In addition, cash flows that are directly attributable to an individual contract can also be estimated at a higher level and then allocated to individual contracts or groups of contracts. Because the expected (probability-weighted) cash flows from any aggregated group of insurance contracts equals the sum of the expected cash flows of the individual contracts, the level of aggregation at which the estimates are made does not matter, as long as the entity can make an appropriate allocation of the estimates to the individual contracts on initial recognition or groups of contracts subsequently.

B38. The risk adjustment is measured for individual contracts and for groups of contracts by incorporating diversification benefits to the extent that the entity considers those benefits in setting the amount of compensation it requires to bear insurance risk (see paragraphs B81-B83).

B107. An amount of the contractual service margin is recognized in the statement of profit or loss to reflect the service provided under the contract (see paragraph 41.e). In determining that amount, the objective is to allocate the contractual service margin for a group of contracts remaining (before any allocation) at the end of the reporting period over the coverage provided in the current period and expected remaining future coverage to be provided, on the basis of the passage of time. The allocation shall be based on coverage units, reflecting the expected duration and size of the contracts in the group.

Appendix A: Defined terms

groups of insurance contracts	**Insurance contracts** that on initial recognition have: (a) future cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions; and (b) similar expected profitability.

Q3. Considering contracts written in a single year for three product lines, what is the minimum number of groups you would need to meet the requirements for measuring the contractual service margin in the above paragraphs?

Q4. Would your answer to Q3 differ should previous-period contracts be combined with current-period contracts (ie where contracts are combined in an 'open portfolio')?

Q5. Please describe how you made the judgements you were required to make in applying the above paragraphs, including:

(a) what key assumptions affecting the expected cash flows you considered;

(b) how you distinguished expected cash flows that you expect will respond similarly and dissimilarly in terms of amount and timing to changes in those key assumptions; and

(c) how you distinguished similar and dissimilar expected profitability.

Q6. Please illustrate how the expected duration and size of contracts remaining in the group at the end of the reporting period affect the contractual service margin released in profit or loss in the period. What assumptions did you use to determine that amount?

Q7. For each of the three product lines identified, how does the number of groups determined in Q3 differ from the groups you currently have for:

(a) management reporting;

(b) pricing purposes (if different);

(c) existing financial reporting; and

(d) regulatory reporting?

Could you please explain the reason for differences in the number of groups?

Topic 2—Scope of variable fee approach

Please consider the following paragraphs:

B97. Insurance contracts with direct participation features are defined as insurance contracts for which:

a. the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items (see paragraphs B98–B100);

b. the entity expects to pay to the policyholder an amount equal to a substantial share of the returns from the underlying items (see paragraph B100); and

c. a substantial proportion of the cash flows that the entity expects to pay to the policyholder should be expected to vary with the cash flows from the underlying items (see paragraph B100).

B98. A share referred to in paragraph B97.a does not preclude the existence of the entity's discretion to vary the amounts paid to the policyholder.

B99. The pool of underlying items referred to in paragraph B97.a can comprise any items, for example a reference portfolio of assets, the net assets of the entity, or a specified subset of the net assets of the entity, as long as they are clearly identified by the terms of the contract. An entity need not hold the identified pool of underlying items. However, a clearly identifiable pool of underlying items does not exist when:

a. an entity can change the underlying items that determine the amount of the entity's obligation with retrospective effect; or

b. there are no underlying items identified, even if the policyholder could be provided with a return that generally reflects the entity's overall performance and expectations, or the performance and expectations of a subset of assets the entity holds. An example of such a return is a crediting rate or dividend payment set at the end of the period to which it relates. In this case, the obligation to the policyholder reflects the crediting rate or dividend amounts the entity has set, and does not reflect an identified underlying item.

B100. An entity shall assess whether the conditions in paragraph B97 are met using its expectations at the inception of the contract and shall not reassess the conditions subsequently.

Appendix A: Defined terms

insurance contract with direct participation features	An **insurance contract** for which, at initial recognition: (a) the contractual terms specify that the **policyholder** participates in a share of a clearly identified pool of underlying items; (b) the entity expects to pay to the **policyholder** an amount equal to a substantial share of the returns from the underlying items; and (c) a substantial proportion of the cash flows the entity expects to pay to the policyholder should be expected to vary with the cash flows from the underlying items.

Q8. For three product lines with participation features, please:

(a) describe the key features of the contracts; and

(b) provide an analysis of whether the contract meets each of the criteria in the above paragraph, and, in particular, the reasons why the contract met or did not meet the criteria.

Q9. Please describe the judgements you made in applying these criteria to these product lines and the key assumptions you have needed to make.

Q10. What additional guidance, if any, do you think is required to assist you in making the judgements needed to apply these paragraphs?

Topic 3— Derivatives used to mitigate financial market risk

Q11. Do you use derivative instruments to mitigate financial market risk for contracts within the scope of the variable fee approach? If so please consider the following paragraphs and answer the questions below:

B101. For insurance contracts with direct participation features, the entity's obligation to the policyholder can be regarded as the net of:

a. the obligation to pay the policyholder an amount equal to the fair value of the underlying items; and

b. a variable fee that the entity will deduct from (a) in exchange for the future services provided by the insurance contract.

B102. Accordingly the variable fee can be regarded as the entity's share of the underlying items less any fulfilment cash flows that do not vary directly with the fair value of the underlying items. Hence the change in the variable fee for the period equals:

a. the change in the entity's share of the underlying items

b. plus or minus the changes in the fulfilment cash flows that do not vary directly with the underlying items, which comprise changes in the fulfilment cash flows:

i. relating to incurred claims;

ii. relating to future insurance coverage and claims; and

iii. not relating to insurance coverage or claims.

B103. To depict the variable nature of the fee in these contracts, an entity shall apply paragraph 42.c to remeasure the contractual service margin to reflect all the changes in the variable fee set out in paragraph B102, except:

a. for changes relating to incurred claims (B102.b.i); and

b. to the extent that paragraph B104 applies, changes that do not vary directly with the underlying items and do not relate to insurance coverage or claims (B102.b.iii).

B104. An entity may choose not to recognise a change in the contractual service margin to reflect the changes in some or all of the fulfilment cash flows set out in B102.b.iii, if, in accordance with a previously documented risk management objective and strategy for using derivatives to mitigate financial market risk arising from those fulfilment cash flows:

a. the entity uses a derivative to mitigate the financial market risk arising from those fulfilment cash flows;

b. an economic offset exists between the specified fulfilment cash flows and the derivative, ie the fulfilment cash flows and the derivative generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated. An entity shall not consider accounting measurement differences in assessing the economic offset; and

c. credit risk does not dominate the economic offset.

B105. The entity shall determine the fulfilment cash flows to which paragraph B104 applies in a consistent manner in each reporting period.

B106. If the economic offset in B104.b ceases to exist, an entity shall:

a. recognise a change in the contractual service margin for changes in the specified fulfilment cash flows from that date;

b. not make any adjustment for changes previously recognised in profit or loss.

Q12. Please describe the key features of the contracts and the derivatives used and the objective of the risk mitigation.

Q13. Please quantify the fair value of the derivative instruments entered into to mitigate financial market risk, relative to the total value of insurance liabilities reported on your balance sheet. Please provide this information for the last two annual reporting periods.

Q14. This question should be answered for those product lines for which the conclusion in Q8 (under Topic 2) was that they qualify for the variable fee approach. Assume that you qualify for and have elected to apply the above paragraphs to recognise changes in some or all of the fulfilment cash flows arising from financial market risk in profit or loss. For the last two annual reporting periods, please:

(a) calculate the amount of the changes in the fulfilment cash flows arising from financial market risk that would be recognised in profit or loss applying these paragraphs; and

(b) illustrate the net effect on the statements of comprehensive income and financial performance of recognising changes in the fulfilment cash flows arising from financial market risk recognised in profit or loss, instead of as an adjustment to the contractual service margin.

Q15. Do any transactions identified under Q12 not meet the scope criteria in the above paragraph. If so, please describe which criteria was not satisfied and why.

Topic 4 – Determining insurance finance income or expenses in OCI

Please consider the following paragraphs:

79. Insurance finance income or expenses comprises the change in the carrying amount of the insurance contract asset or liability arising from:

- **a. the effect of the time value of money arising from the passage of time; and**
- **b. the effect of changes in assumptions that give rise to financial risk.**

80. Unless paragraph 81 applies, an entity shall make an accounting policy choice between:

- **a. including insurance finance income or expenses for the period in the statement of profit or loss; or**
- **b. disaggregating insurance finance income or expenses for the period to include in the statement of profit or loss an amount determined by a systematic allocation of the expected total finance income or expenses over the duration of the contracts, applying paragraphs B115–B119.**

81. For insurance contracts with direct participation features, for which the entity holds the underlying items, an entity shall make an accounting policy choice between:

- **a. including insurance finance income or expenses for the period in the statement of profit or loss; or**
- **b. disaggregating insurance finance income or expenses for the period to include in the statement of profit or loss an amount that eliminates accounting mismatches with the finance income or expenses arising on the underlying items held, applying paragraphs B120–B121.**

83. If an entity chooses the accounting policy set out in paragraph 80.b or 81.b, it shall include in other comprehensive income the difference between the insurance finance income or expense measured on the basis set out in those paragraphs and the total insurance finance income or expenses.

84. When an entity derecognises insurance contracts, it shall reclassify to profit or loss as a reclassification adjustment (see IAS 1 *Presentation of Financial Statements*) any remaining amounts that relate to those contracts and were, applying paragraph 80.b or 81.b, previously recognised in other comprehensive income.

B115. Unless paragraph 81 applies, paragraph 80 requires an entity to make an accounting policy choice whether to disaggregate insurance finance income or expenses for the period to include in the statement of profit or loss an amount determined by a systematic allocation of the expected total finance income or expenses over the duration of the contracts.

B116. An entity shall apply its choice of accounting policy to portfolios of insurance contracts that are subject to broadly similar risks and managed together as a single pool. In making its choice, the entity shall consider for each portfolio the assets that the entity holds and how it accounts for those assets.

B117. In this context, a systematic allocation is in an allocation of the total expected finance income or expenses of a contract over the life of the contract that:

- a. is based on characteristics of the contract, without reference to factors that do not affect the measurement of the contract. For example, the allocation of the finance income or expenses should not be based on expected recognised returns on assets if those expected recognised returns do not affect the measurement of the fulfilment cash flows; and
- b. results in the amounts recognised in other comprehensive income over the life of the contract totaling zero.

B118. For insurance contracts for which changes in assumptions that give rise to financial risk do not have a substantial effect on the amounts paid to the policyholder, the systematic allocation is determined using the discount rate(s) specified in paragraph B72 at the inception of the contract.

B119. For insurance contracts for which changes in assumptions that give rise to financial risk have a substantial effect on the amounts paid to the policyholder:

- a. a systematic allocation for the finance income or expenses arising from the future cash flows can be determined in one of the following ways:

i. using a rate that allocates the remaining revised expected finance cost over the remaining life of the contract at a constant rate; or

ii. for contracts that use a crediting rate to determine amounts due to the policyholder, using an allocation that is based on the amounts credited in the period and expected to be credited in future periods.

b. a systematic allocation for the finance income or expenses arising from the contractual service margin is determined:

i. for insurance contracts that do not have direct participation features, using the discount rate(s) specified in paragraph B72 at the inception of the contract; and

ii. for insurance contracts with direct participation features, using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.

B120. Paragraph 81 applies if an entity, either by choice or because it is required to, holds the underlying items for insurance contracts with direct participation features. If an entity chooses to disaggregate insurance finance income or expenses applying paragraph 81.b, it shall include in the statement of profit or loss expenses or income that exactly match the income or expenses included in statement of profit or loss for the underlying items, resulting in nil net finance income or expenses.

B121. An entity may qualify for the accounting policy choice in paragraph 81 in some periods but not in others because of a change in whether it holds the underlying items. If such a change occurs, the accounting policy choice available to the entity changes from that set out in paragraph 80 to that set out in paragraph 81, or vice versa. Hence, an entity may change its accounting policy between that set out in paragraph 80.b and that set out in paragraph 81.b. In making such a change an entity shall:

a. include as a reclassification adjustment in profit or loss in the period of change and in future periods the accumulated amount previously included in other comprehensive income by the date of the change, as follows:

i. if the entity had previously applied paragraph 80.b, the entity shall include in profit or loss the accumulated amount previously included in other comprehensive income as if the entity were continuing the approach in paragraph 80.b based on the assumptions that applied immediately prior to the change; and

ii. if the entity had previously applied paragraph 81.b, the entity shall include in profit or loss the accumulated amount previously included in other comprehensive income as if the entity were continuing the approach in paragraph 81.b based on the assumptions that applied immediately prior to the change.

In doing this, the accumulated amount previously included in other comprehensive income is not recalculated as if the new disaggregation had always applied and the assumptions used for the reclassification in future periods are not updated after the date of the change;

b. not restate prior period comparatives.

Q16. Assuming you disaggregate insurance finance income and expense into an amount presented in profit or loss and an amount presented in OCI, for three significant product lines, please explain:

(a) which of the disaggregation methods in paragraphs B118 -B120 above would apply?

(b) if B119.a applies

(i) what method would you use to systematically allocate expected insurance finance income or expenses to profit or loss?

(ii) what are the reasons for using that method? Did you consider the asset accounting methodology in selecting the method used?

Q17. Please model the amounts that would have been recognised in profit or loss and OCI by applying the disaggregation method described in Q16 over the last three years. Assume the contracts were written at the beginning of the three-year period and include the effect of the related assets. Please explain your assumptions.

Topic 5 – Recognition of changes in estimates

Q18. For your three most significant product lines, please provide us with a detailed list of the changes in estimates and experience adjustments over the last two annual reporting periods. What prompted those changes in estimates and experience adjustments?

Please consider the following paragraphs:

41. For insurance contracts without direct participation features, the carrying amount of the contractual service margin at the end of the reporting period is the carrying amount at the start of the reporting period:

    a. plus the contractual service margin of any contracts added to the group;

    b. plus the interest accreted on the carrying amount of the contractual service margin during the reporting period to reflect the time value of money, measured at the discount rates specified in paragraph B72 that applied when the contracts in the group were initially recognised;

    c. plus or minus the changes in fulfilment cash flows relating to future coverage or other services as specified in paragraphs B91– B96, except to the extent that:

        i. such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to an onerous loss (see paragraph 44.b); or

        ii. such decreases in the fulfilment cash flows are allocated to the loss component of liability applying paragraph 47;

    d. plus or minus the effect of any currency exchange differences.

    e. minus an amount released because of the transfer of services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period on the basis of the passage of time (see paragraph B107).

42. For *insurance contracts with direct participation features* (see paragraph B97–B106), the carrying amount of the contractual service margin at the end of the reporting period is the carrying amount at the start of the reporting period:

    a. plus the contractual service margin of any contracts added to the group;

    b. plus or minus the change in the value of the entity's share of the underlying items (see paragraphs B101-B103);

    c. plus or minus the changes in fulfilment cash flows relating to future coverage or other services as specified in paragraphs B101–B106, except to the extent that:

        i. such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to an onerous loss (see paragraph 44.b); or

        ii. such decreases in the fulfilment cash flows that are allocated to the loss component of liability applying paragraph 47;

    d. plus or minus the effect of any currency exchange differences;

    e. minus an amount released because of the transfer of services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period on the basis of the passage of time (see paragraph B107).

B91. For insurance contracts without direct participation features, paragraph 41.c requires an adjustment to the contractual service margin of a group for changes in fulfilment cash flows that relate to future coverage or other services. These changes comprise:

    a. experience adjustments and changes in estimates of the present value of expected future cash flows that relate to future coverage or other services (see paragraphs B92–B96), which are measured at the discount rates specified in paragraph B72 that applied when the contracts in the group were initially recognised; and

b. changes in the risk adjustment that relate to future coverage or other services;

B92. The contractual service margin for a group of such contracts is not adjusted for an experience adjustment or a change in the present value of future cash flows of the group if they are caused by changes in assumptions that give rise to financial risk (being the effect, if any, on estimated future cash flows and the effect of a change in discount rate). This is because changes in assumptions that give rise to financial risk are not regarded as related to future service.

B93. In general an entity shall regard experience adjustments other than those described in paragraph B92 as relating to current or past services and changes in estimates of future cash flows other than those described in paragraph B92 as relating to future services. However, circumstances where this does not apply are:

a. the following changes in the liability for remaining coverage:

i. experience adjustments arising from premiums paid in the period that relate to future services. These experience adjustments relate to future service; and

ii. the effect of events that result in an experience adjustment that causes a change in estimate of future cash flows. The combined effect is regarded as relating to future service. Hence, for example, the contractual service margin for insurance contracts that provide death benefits is adjusted for the combined effect of experience adjustments and changes in estimates of future cash flows caused by more or fewer deaths than expected in the current period if that change in the number of deaths causes a change in the number of deaths expected in the group in future periods; and

b. changes in estimates of incurred claims, which relate to current or past services.

B94. The terms of some insurance contracts without direct participation features give an entity discretion over the cash flows to be paid to policyholders. A change in the discretionary cash flows is regarded as relating to future service, and accordingly adjusts the contractual service margin. To determine how to identify discretionary cash flows, an entity shall specify at the inception of the contract:

a. what basis it regards as its commitment under the contract for the payments that it expects to continue with regardless of changes in assumptions that give rise to financial risk and

b. what it regards as discretionary.

B95. An entity shall use that specification to distinguish between the effect of changes in assumptions that give rise to financial risk on that commitment (which do not adjust the contractual service margin) and the effect of discretionary changes to that commitment (which adjust the contractual service margin).

B96. If an entity cannot specify at the inception of the contract what it regards as its commitment under the contract and what it regards as discretionary, it shall regard its commitment to be the return implicit in the estimate of the fulfilment cash flows at the inception of the contract, updated to reflect current l assumptions that give rise to financial risk.

B101 – B106: [Refer to Topic 3 for the relevant paragraphs.]

Appendix A: Defined terms

experience adjustment	A difference between (i) previous assumptions about cash flows and incurred claims in the period and (ii) actual cash flows and incurred claims in the period.

Q19. Please explain which of the changes listed in Q18 you would expect to be recognised in the profit or loss statement, OCI or the contractual service margin under the forthcoming insurance contracts Standard.

Q20. Please provide any relevant information for understanding the distinction you have made to determine these allocations (i.e. allocation of changes to the profit or loss statement; OCI or the contractual service margin).

Topic 6—Transition

Please consider the following paragraphs:

Effective date

C1. An entity shall apply this Standard for annual reporting periods beginning on or after 1 January 20XX. Early application is permitted. If an entity applies this Standard earlier, it shall disclose that fact.

C2. For the purpose of the transition requirements in paragraphs C3-C20, the date of initial application is the start of the reporting period in which an entity first applies this Standard.

Transition

C3. An entity shall apply this Standard retrospectively to each prior reporting period presented, unless impracticable. To apply the Standard retrospectively, an entity shall determine what the measurement of individual contracts would have been on initial recognition to assess to which group of contracts they would have belonged applying paragraph 36, unless the entity can make that assessment by applying paragraph 24 retrospectively.

C4. Having made that assessment, an entity shall:

a. measure each group of insurance contracts at the beginning of the earliest period presented at the sum of:

   i. the fulfilment cash flows; and

   ii. the contractual service margin.

b. estimate, for the purpose of measuring insurance contract revenue, the carrying amount of the liability for the remaining coverage, excluding the loss component.

c. if an entity applies the accounting policy choice in paragraphs 80.b or 81.b, recognise the cumulative effect of difference between the insurance finance income or expenses measured on the basis set out in those paragraphs and the total insurance finance income or expenses as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the earliest period presented.

C5. In applying paragraph C3, an entity shall, at the beginning of the earliest period presented:

a. derecognise any existing balances of deferred acquisition costs relating to insurance contracts.

b. derecognise any intangible assets that arose from insurance contracts that were assumed in previously recognised business combinations and that do not meet the definition of an intangible asset.

c. recognise, applying IFRS 3 *Business Combinations*, any assets or liabilities acquired in a business combination that were not previously recognised because they had been subsumed in amounts recognised applying IFRS 4 *Insurance Contracts* and that are derecognised applying paragraphs a or b. The entity shall measure such assets or liabilities on the basis that relevant Standards would have required for such assets or liabilities at the date of the business combination.

C6. In applying paragraph C3, an entity shall apply prospectively from the date of initial application of the Standard the option in paragraph B104 not to include as a change to the contractual service margin changes in specified fulfilment cash flows if the entity has used a derivative to mitigate their financial market risk.

C7. When it is impracticable for an entity to apply paragraph C3 or C4, an entity shall apply C8-C16.

Estimating the contractual service margin for insurance contracts without direct participation features

C8. When, for contracts without direct participation features, it is impracticable to retrospectively measure the contractual service margin at the beginning of the earliest period presented, an entity shall, unless also impracticable, estimate that amount taking into account all objective information that is reasonably available as follows:

a. estimate the future cash flows at the date of initial recognition at the amount of the future cash flows at the beginning of the earliest period presented, adjusted by the cash flows that are known to have occurred between the date of initial recognition and the beginning of the earliest period presented;

b. estimate the risk adjustment at the date of initial recognition by adjusting the risk adjustment at the beginning of the earliest period presented by the expected release of risk before the beginning of the earliest period presented. The expected release of risk should be determined by reference to release of risk for similar insurance contracts that the entity issues at the beginning of the earliest period presented;

c. estimate the discount rates that applied at the date of initial recognition taking into account all objective information that is reasonably available:

   i. using an observable yield curve that, for at least three years before the date of transition, approximates the yield curve estimated applying paragraphs 32 and B70-B80, if such an observable yield curve exists; and

   ii. if the observable yield curve in (i) does not exist, estimate the discount rates that applied at the date of initial recognition by determining an average spread between an observable yield curve and the yield curve estimated applying paragraphs 32 and B70-B80, and applying that spread to that observable yield curve. That spread shall be an average over at least three years before the date of transition.

d. adjust the contractual service margin at the date of initial recognition determined using a-c for the allocation of the contractual service margin before the beginning of the earliest period presented. The entity shall estimate the amount of the adjustment by comparing the remaining coverage units with the total coverage units of the group of contracts.

C9. To apply paragraph C8, an entity shall assess in which group individual contracts in force at the beginning of the earliest period presented would have belonged at initial recognition to determine whether there is a need to set the contractual service margin at zero for groups of onerous contracts. An entity shall make this assessment applying either paragraph 24 or paragraph 36. If the entity makes the assessment applying paragraph 36, it shall assess:

a. the condition in paragraph 36.a (responsiveness of future cash flows) by considering the future cash flows at the beginning of the earliest period presented; and

b. the condition in paragraph 36.b (profitability) by considering the future cash flows at the date of initial recognition estimated by applying paragraph C8.a.

An entity shall use the groups determined in this way for the purpose of subsequent measurement after the beginning of the earliest period presented. An entity shall not add contracts that are recognised after that date to these groups.

C10. When it is impracticable to estimate the contractual service margin at the beginning of the earliest period presented applying paragraphs C8 and C9, an entity shall determine the contractual service margin at the beginning of the earliest period presented as the difference between the fair value of the insurance contracts at that date and the fulfilment cash flows measured at that date. To do this, an entity shall group contracts by applying only the condition in paragraph 36.a, using the future cash flows at the beginning of the earliest period presented. If the fulfilment cash flows of a group of contracts exceed the fair value of the group of insurance contracts, an entity shall recognise no contractual service margin.

Estimating the contractual service margin for insurance contracts with direct participation features

C11. When, for contracts with direct participation features, it is impracticable to retrospectively measure the contractual service margin at the beginning of the earliest period presented, an entity shall, unless also impracticable, estimate that amount as follows:

a. determine the contractual service margin at the date of initial application of the Standard as:

   i. the total fair value of the underlying items at the date of initial application; less

   ii. the fulfilment cash flows at the date of initial application, adjusted to reflect relevant cash flows that have already occurred between the inception of the contracts and the date of initial application of the Standard; and

   iii. the amount of contractual service that relates to service provided before the date of initial application of the Standard. The entity shall estimate this amount by comparing the remaining coverage units with the total coverage units of the group of contracts.

b. determine the contractual service margin at the beginning of the earliest period presented by adjusting the contractual service margin at the date of initial application assuming that there had been no adjustments to the contractual service margin in the comparative periods other than the allocation of the contractual service margin.

C12. To apply paragraph C11, an entity shall assess in which group individual contracts in force at the the date of initial application of the Standard would have belonged at initial recognition to determine whether there is a need to set the contractual service margin at zero for groups of onerous contracts. An entity shall make this assessment applying either paragraph 24 or paragraph 36. If the entity makes the assessment applying paragraph 36, it shall assess:

a. the condition in paragraph 36.a (responsiveness of future cash flows) by considering the future cash flows at the date of initial application presented; and

b. the condition in paragraph 36.b (profitability) by considering the future cash flows at the date of initial recognition estimated by applying paragraph C11.a.ii.

An entity shall use the groups determined in this way for the purpose of subsequent measurement after the date of initial application of the Standard. An entity shall not add contracts that are recognised after that date to these groups.

C13. When it is impracticable to estimate the contractual service margin at the beginning of the earliest period presented applying paragraph C11, an entity shall determine the contractual service margin at the beginning of the earliest period presented as the difference between the fair value of the insurance contracts at that date and the fulfilment cash flows measured at that date. To do this, an entity shall group contracts by applying the only conditions in paragraph 36.a, using the future cash flows at the beginning of the earliest period presented. If the fulfilment cash flows of a group of contracts exceed the fair value of the group of insurance contracts, an entity shall recognise no contractual service margin.

Insurance contracts revenue

C14. For insurance contracts to which the premium allocation approach described in paragraphs 50-54 is not applied, when it is impracticable to retrospectively measure the amount in paragraph C4.b, an entity shall:

a. determine the carrying amount of the liability for the remaining coverage at the beginning of the earliest period presented as the sum of the fulfilment cash flows and the contractual service margin at that date, applying paragraphs C8-C13.

b. determine any losses on initial recognition unless impracticable applying paragraphs C8-C13.

c. determine any amounts allocated to the loss component of the liability for remaining coverage applying paragraphs C8-C13.

d. assume that there are no changes in estimates between the date of initial recognition and the beginning of the earliest period presented that were recognised in profit or loss before the beginning of the earliest period presented.

C15. If impracticable to estimate any losses on initial recognition applying paragraph C8-C13, an entity shall assume that there are no such losses.

Estimating insurance finance expenses

C16. When it is impracticable to retrospectively measure the cumulative effect of the difference between the insurance finance income or expenses recognised in profit or loss and the total insurance finance income or expenses, an entity shall:

a. for insurance contracts for which changes in financial assumptions do not have a substantial effect on the amounts paid to the policyholder estimate the discount rates that applied at the date of initial recognition, applying paragraph C8.c

b. for insurance contracts for which changes in financial assumptions have a substantial effect on the amounts paid to the policyholder apply methods of systematic allocation set out in paragraph B119.a assuming that the assumptions that give rise to financial risk that applied at the date of initial recognition are those that apply on the date of initial application, resulting in a cumulative difference between the insurance finance income or expenses recognised in profit or loss and the total insurance finance income or expenses equal to zero ; and

c. for insurance contracts with direct participation features for which the entity holds the underlying items assume that:

i. the cumulative difference between the insurance finance expenses or income recognised in profit or loss and the total insurance finance expenses or income equals

ii. the cumulative difference between the finance income or expenses on the underlying items and the total finance income or expenses on the underlying items .

Q21. Identify five significant product lines. It would be useful if those product lines comprise both contracts that would be accounted for using the general model and contracts that would be accounted for using the variable-fee approach. For each of the identified product lines, please provide us with an analysis of the proportion of each product line that would be:

(a) accounted for retrospectively (i.e. as if the forthcoming insurance contracts had always been applied); or

(b) accounted for using the simplified transition approach in paragraphs C8–C9 (for the general model) and paragraphs C11–C12 (for the variable fee approach); or

(c) accounted for using the fair value transition approach in paragraph C10 (for the general model) and paragraphs C13 (for the variable fee approach).

Q22. Please explain the reasons for your conclusions about the relevant transition methods and any key assumptions or judgements you made.