

AASB Exposure Draft

ED 244
June 2013

Insurance Contracts

Comments to the AASB by 27 September 2013



Australian Government

**Australian Accounting
Standards Board**

Commenting on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 27 September 2013. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 25 October 2013. Comments should be addressed to:

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Australian Accounting Standards Board
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Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@asb.gov.au

Respondents to the IASB are asked to send their comments electronically to the IFRS Foundation website (www.ifrs.org), using the 'Comment on a proposal' page.

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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This AASB Exposure Draft is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this AASB Exposure Draft are available by contacting:

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AASB REQUEST FOR COMMENTS

In 2010 the International Accounting Standards Board (IASB) issued ED/2010/8 *Insurance Contracts* (the '2010 Exposure Draft'), published in Australia as AASB ED 201 *Insurance Contracts* in August 2010, which proposed new requirements for insurance contracts to replace interim IFRS 4 *Insurance Contracts*. In response to feedback received on the 2010 Exposure Draft, the IASB issued ED/2013/7 *Insurance Contracts*, which incorporates the majority of the proposals from the 2010 Exposure Draft, seeking comments only on the revisions. The main revisions are:

- (a) to refine the approach to measurement; in particular to propose that:
 - (i) an entity would adjust the contractual service margin for changes in the estimate of the present value of future cash flows that relate to future coverage and other future services; and
 - (ii) an entity should apply a specified measurement and presentation exception when a contract requires the entity to hold underlying items and specifies a link to returns on those underlying items;
- (b) to develop the approach to presentation, to propose that an entity should:
 - (i) present revenue and expenses in profit or loss for all insurance contracts; and
 - (ii) present interest expense to reflect the time value of money using an approach that is similar to that applied to financial instruments measured at amortised cost; and
- (c) to amend the approach to transition to propose that an entity should apply the requirements retrospectively if practicable and with a modified retrospective approach otherwise.

Appendix C to the Basis for Conclusions of ED/2013/7 (located on the IASB website) summarises the revisions made to the 2010 Exposure Draft.

Australian Accounting Standards Board (AASB) staff plan to provide a comparison of the ED/2013/7 proposals and the current requirements of AASB 1023 *General Insurance Contracts*, AASB 1038 *Life Insurance Contracts* and AASB 4 *Insurance Contracts*. The comparison is to be made available on the AASB website as an aid to constituents responding to this Exposure Draft.

In light of the AASB's policy of incorporating International Financial Reporting Standards (IFRSs) into Australian Accounting Standards, the AASB is inviting comments on:

- (a) any of the proposals in the attached IASB Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and
- (b) the 'AASB Specific Matters for Comment' listed below.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Due Date for Comments to the AASB

Comments should be submitted to the AASB by 27 September 2013. This will enable the AASB to consider those comments in the process of formulating its own comments to the IASB. Constituents are also strongly encouraged to send their response to the IASB.

Reduced Disclosure Requirements

AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements:

- (a) Tier 1: Australian Accounting Standards; and
- (b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

In the Tier 2 Supplement to ED 201 *Insurance Contracts* the AASB outlined its view that entities with material insurance activities that prepare general purpose financial statements would be publicly accountable. Accordingly, they would be required to comply with Tier 1. In forming this view the AASB considered feedback received from constituents in response to a specific question in AASB ED 201 about Tier 2. The AASB has not changed its view and it is not intended that a separate consultative document outlining Tier 2 disclosure requirements would be issued. However, the AASB would reconsider its view if the responses to this Exposure Draft indicate that Tier 2 requirements would be relevant.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
 - (a) not-for-profit entities; and
 - (b) public sector entities, including any GAAP/GFS implications;
2. whether, overall, the proposals would result in financial statements that would be useful to users;
3. whether the proposals are in the best interests of the Australian economy; and
4. unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

June 2013

Exposure Draft ED/2013/7
A revision of ED/2010/8 *Insurance Contracts*

Insurance Contracts

Comments to be received by 25 October 2013

Insurance Contracts

Comments to be received by 25 October 2013

Exposure Draft ED/2013/7 *Insurance Contracts* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments need to be received by **25 October 2013** and should be submitted in writing to the address below or electronically via our website www.ifrs.org using the 'Comment on a proposal' page.

All responses will be put on the public record and posted on our website unless the respondent requests confidentiality. Requests for confidentiality will not normally be granted unless supported by good reason, such as commercial confidence.

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APPROVAL BY THE BOARD OF *INSURANCE CONTRACTS*

BASIS FOR CONCLUSIONS (*see separate booklet*)

ILLUSTRATIVE EXAMPLES (*see separate booklet*)

Introduction

Why is the IASB publishing this Exposure Draft?

This Exposure Draft has been developed to improve the transparency of the effects of insurance contracts on an entity's financial position and financial performance and to reduce diversity in the accounting for insurance contracts. The proposals in this Exposure Draft would supersede IFRS 4 *Insurance Contracts*.

At present, IFRS has no comprehensive Standard that deals with the accounting for insurance contracts. IFRS 4, published in 2004, is an interim Standard that permits a wide range of practices and includes a 'temporary exemption', which explicitly states that an entity does not need to ensure that its accounting policies are relevant to the economic decision-making needs of users of financial statements, or that those accounting policies are reliable. This means that companies account for insurance contracts using different accounting models that evolved in each jurisdiction according to the products and regulations prevalent in that jurisdiction. As a result, there are substantial differences in the accounting policies used by different companies to account for insurance contracts. Accordingly, the IASB is committed to issuing a Standard on insurance contracts expeditiously, and expects to finalise a Standard for insurance contracts after reviewing the responses to this Exposure Draft.

Proposals in this Exposure Draft

The Exposure Draft proposes that an entity should measure insurance contracts using a current value approach that incorporates all of the available information in a way that is consistent with observable market information. Many of the proposed requirements in this Exposure Draft are similar to those previously set out in:

- (a) the Discussion Paper *Preliminary Views on Insurance Contracts*, published in May 2007, which explained the IASB's initial views on insurance contracts; and
- (b) the Exposure Draft *Insurance Contracts* (the '2010 Exposure Draft'), published in July 2010, which developed those initial views into a draft Standard.

This Exposure Draft reflects the IASB's view that insurance contracts blend financial elements with service elements in various proportions, depending on the type of contract. It proposes that an entity should measure an insurance contract in a way that portrays a current assessment of the combined package of cash inflows and cash outflows generated by those elements, assuming that the entity expects to fulfil the liability by paying benefits and claims to policyholders as they become due. That measurement has two components:

- (a) a measurement of the amount, timing and uncertainty of the future cash flows that the entity expects the contract to generate as it fulfils the contract; and
- (b) a contractual service margin (known in the IASB's previous proposal as the 'residual margin') that represents a current estimate of the profitability that the entity expects the contract to generate over the coverage period.

The feedback received on the IASB's earlier documents confirmed that there was widespread acceptance that the proposed approach to measuring insurance contracts would provide financial information that is relevant to users of the financial statements of entities that issue insurance contracts, and would faithfully represent the financial position and performance of such entities. The feedback also identified areas that needed greater clarity

or simplification. In response to that feedback, the IASB has revised various aspects of its proposals on the accounting for insurance contracts to:

- (a) refine the approach to measurement; in particular, to propose that:
 - (i) an entity would adjust the contractual service margin for changes in the estimate of the present value of future cash flows that relate to future coverage and other future services; and
 - (ii) an entity should apply a specified measurement and presentation exception when a contract requires the entity to hold underlying items and specifies a link to returns on those underlying items.
- (b) develop the approach to presentation, to propose that an entity should:
 - (i) present revenue and expenses in profit or loss for all insurance contracts; and
 - (ii) present interest expense to reflect the time value of money using an approach that is similar to that applied to financial instruments measured at amortised cost.
- (c) amend the approach to transition to propose that an entity should apply the [draft] Standard retrospectively if practicable and with a modified retrospective approach otherwise.

Appendix E shows how the contents of the 2010 Exposure Draft and this Exposure Draft correspond. Appendix C to the Basis for Conclusions summarises the revisions made to the 2010 Exposure Draft.

Who would the proposals affect?

The proposed requirements would affect any entity that issues insurance contracts, not only entities that are regulated as insurance entities.

When would the proposals be effective?

The IASB proposes that the [draft] Standard would be effective approximately three years after it publishes the final Standard. The IASB will set the effective date in the light of the feedback received on this Exposure Draft.

Invitation to comment

Questions for respondents

The IASB invites comments on the questions set out in the following paragraphs. Comments are most helpful if they:

- (a) respond to the questions as stated;
- (b) indicate the specific paragraph or paragraphs to which the comments relate;
- (c) contain a clear rationale; and
- (d) describe any alternatives that the IASB should consider, if applicable.

Comments are requested from both those who agree with the proposed requirements and those who do not. Those who disagree with a proposal are asked to describe their suggested alternative(s), supported by specific reasoning. Respondents need not comment on all of the questions.

The IASB has provided a complete draft of the proposed Standard on insurance contracts to enable respondents to consider the new proposals in context. However, the IASB is seeking input only on the significant changes it has made in response to the feedback it received on its proposals in the 2010 Exposure Draft. It does not intend to revisit issues that it has previously rejected or to reconsider consequences that it has previously considered. The IASB is interested in receiving input on how it has balanced costs and benefits when developing those proposed changes. Furthermore, the IASB welcomes views on whether the proposals are drafted clearly and whether they reflect the decisions made by the IASB.

The IASB will consider all comments received in writing by **25 October 2013**. When considering the comments, the IASB will base its conclusions on the merits of the arguments rather than on the number of comments it receives.

Adjusting the contractual service margin (paragraphs 30–31, B68, BC26–BC41 and IE9–IE11)

Paragraphs 30–31 propose that the contractual service margin should be adjusted for differences between the current and previous estimates of the present value of future cash flows that relate to future coverage and other future services, provided that the contractual service margin would not be negative. That proposal revises the IASB's conclusion in the 2010 Exposure Draft, which stated that all changes in the estimate of the present value of future cash flows should be recognised immediately in profit or loss.

Question 1—Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:

- (a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and
- (b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?

Why or why not? If not, what would you recommend and why?

Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items (paragraphs 33–34, 66, B83–B87, BC42–BC71 and IE23–IE25)

Paragraphs 33–34 and 66 propose a measurement and presentation exception that would apply when the contract requires the entity to hold underlying items and the contract specifies a link between the payments to the policyholder and the returns on those underlying items.

The 2010 Exposure Draft did not propose different accounting for such cash flows.

Question 2—Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity:

- (a) measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?
- (b) measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (ie using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?
- (c) recognises changes in the fulfilment cash flows as follows:
 - (i) changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;
 - (ii) changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and
 - (iii) changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard?

Why or why not? If not, what would you recommend and why?

Presentation of insurance contract revenue and expenses (paragraphs 56–59, B88–B91, BC73–BC116 and IE12–IE18)

Paragraphs BC73–BC76 describe the IASB's view that any gross measures of performance presented in profit or loss should be consistent with commonly understood measurements of revenue and expense. Accordingly, paragraphs 56–59 propose that an entity shall present insurance contract revenue that depicts the transfer of promised services arising from the insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. Similarly, paragraph 58 proposes that an entity should exclude from insurance contract revenue and incurred

claims presented in the statement of profit or loss and other comprehensive income any investment components, defined as amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur.

This proposal revises the proposal in the 2010 Exposure Draft that entities would use a summarised-margin presentation, unless the entity was required to apply the premium-allocation approach. The summarised-margin approach proposed in the 2010 Exposure Draft would have presented, in profit or loss, information about changes in the components that make up the insurance contract liability. In effect, the summarised-margin approach would have treated all premiums as deposits and all claims and benefit payments as returns of deposits, by not presenting revenue and expenses in profit or loss.

Question 3—Presentation of insurance contract revenue and expenses

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts?

Why or why not? If not, what would you recommend and why?

Interest expense in profit or loss (paragraphs 60–68 and BC117–BC159)

Paragraphs 60, 64 and 66 propose that an entity should recognise:

- (a) in profit or loss interest expense determined on an amortised cost basis; and
- (b) in other comprehensive income the difference between the carrying amount of the insurance contract measured using the discount rates that were used to determine that interest expense, and the carrying amount of the insurance contract measured using the current discount rates.

These proposals are intended to segregate the effects of the underwriting performance from the effects of the changes in the discount rates that unwind over time.

These proposals revise the conclusion in the 2010 Exposure Draft that the effects of changes in discount rates should always be presented in profit or loss.

Question 4—Interest expense in profit or loss

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:

- (a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and
- (b) recognising, in other comprehensive income, the difference between:
 - (i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and
 - (ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?

Why or why not? If not, what would you recommend and why?

Effective date and transition (paragraphs C1–C13, BC160–BC191 and IE26–IE29)

Paragraphs C1–C13 propose that an entity should apply the [draft] Standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when it is practicable. When it would not be practicable, paragraphs C5–C6 propose a modified retrospective application, which simplifies the transition requirements while maximising the use of objective information. These proposals revise those in the 2010 Exposure Draft, which proposed that the entity should recognise no contractual service margin for contracts in force at the beginning of the earliest period presented. These proposals increase the comparability of contracts in existence at the date of transition with those that are written after the date of transition. However, estimates of the contractual service margin may not be verifiable.

Question 5—Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Why or why not? If not, what do you suggest and why?

The likely effects of a Standard for insurance contracts

The proposals in this Exposure Draft result from the IASB's consideration of the comments received on its 2010 Exposure Draft. In the IASB's view, the revised proposals would result in a more faithful representation and more relevant and timely information about insurance contracts in the financial statements of entities that issue insurance contracts compared to the proposals in the 2010 Exposure Draft and with IFRS 4. In developing these proposals, the IASB has sought to balance those benefits with the costs of greater operational complexity for preparers, and any increased costs for users of financial statements in understanding the more complex information produced.

Those costs arise both on initial application and on an ongoing basis, and are described in the following sections of the Basis for Conclusions:

- (a) adjusting the contractual service margin (see paragraph BC35);
- (b) contracts that require the entity to hold underlying items and specify a link to returns on those underlying items (see paragraphs BC56–BC62);
- (c) presentation of insurance contract revenue and expenses (see paragraphs BC99–BC100);
- (d) interest expense in profit or loss (see paragraphs BC127–BC132);
- (e) effective date and transition (see paragraphs BC164–BC173); and
- (f) the likely effects of a Standard for insurance contracts (see Appendix B: Effect Analysis).

The IASB is particularly interested in receiving feedback on how its response to the comments on the 2010 Exposure Draft balance the costs of applying these proposals with the benefits of the resulting information provided.

Question 6—The likely effects of a Standard for insurance contracts
<p>Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1–5? How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft?</p> <p>Please describe the likely effect of the proposed Standard as a whole on:</p> <ul style="list-style-type: none"> (a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and (b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.

Clarity of drafting

The IASB welcomes views on whether the proposals are drafted clearly and whether they reflect the decisions made by the IASB. If a proposed requirement is not clear, the IASB invites suggestions on how to clarify the drafting of the proposed requirement.

Question 7—Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB?

If not, please describe any proposal that is not clear. How would you clarify it?

[Draft] International Financial Reporting Standard X *Insurance Contracts*

Objective

- 1 This [draft] Standard establishes the principles that an entity should apply to report useful information to users of its financial statements about the nature, amount, timing and uncertainty of cash flows from *insurance contracts*.

Meeting the objective

- 2 To meet the objective in paragraph 1, this [draft] Standard requires an entity:
- (a) to measure an insurance contract it issues using a current value approach that incorporates all of the available information in a way that is consistent with observable market information; and
 - (b) to present insurance contract revenue to depict the transfer of promised services arising from an insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services, and to present expenses as the entity incurs them.

Scope

- 3 An entity shall apply this [draft] Standard to:
- (a) an insurance contract, including a *reinsurance contract*, that it issues;
 - (b) a reinsurance contract that it holds; and
 - (c) an *investment contract with a discretionary participation feature* that it issues, provided that the entity also issues insurance contracts.
- 4 All references in this [draft] Standard to insurance contracts also apply to:
- (a) a reinsurance contract held, except as described in paragraphs 41–42; and
 - (b) an investment contract with a discretionary participation feature, except as described in paragraphs 47–48.
- 5 Appendix A defines an insurance contract and Appendix B provides guidance on the definition of an insurance contract (see paragraphs B2–B30).
- 6 This [draft] Standard does not address other aspects of accounting by entities that issue insurance contracts, such as accounting for their financial assets and financial liabilities, other than the transition requirements related to the redesignation of financial assets as set out in paragraphs C11–C12.
- 7 An entity shall not apply this [draft] Standard to:

- (a) product warranties that are issued by a manufacturer, dealer or retailer (see [draft] IFRS X *Revenue from Contracts with Customers* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).¹
- (b) employers' assets and liabilities that arise from employee benefit plans (see IAS 19 *Employee Benefits* and IFRS 2 *Share-based Payment*) and retirement benefit obligations that are reported by defined benefit retirement plans (see IAS 26 *Accounting and Reporting by Retirement Benefit Plans*).
- (c) contractual rights or contractual obligations that are contingent on the future use of, or the right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items; see IAS 17 *Leases*, [draft] IFRS X *Revenue from Contracts with Customers* and IAS 38 *Intangible Assets*).
- (d) residual value guarantees that are provided by a manufacturer, dealer or retailer, and a lessee's residual value guarantee that is embedded in a finance lease (see IAS 17 and [draft] IFRS X *Revenue from Contracts with Customers*).
- (e) fixed-fee service contracts that have, as their primary purpose, the provision of services and that meet all of the following conditions:
 - (i) the entity does not reflect an assessment of the risk that is associated with an individual customer in setting the price of the contract with that customer;
 - (ii) the contract compensates customers by providing a service, rather than by making cash payments; and
 - (iii) the *insurance risk* that is transferred by the contract arises primarily from the customer's use of services.

An entity shall apply [draft] IFRS X *Revenue from Contracts with Customers* to such contracts.
- (f) financial guarantee contracts, unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, in which case the issuer may elect to apply either IAS 32 *Financial Instruments: Presentation*, IFRS 7 *Financial Instruments: Disclosures* and IFRS 9 *Financial Instruments* or this [draft] Standard to such financial guarantee contracts. The issuer may make that election on a contract-by-contract basis, but the election for each contract is irrevocable.
- (g) contingent consideration that is payable or receivable in a business combination (see IFRS 3 *Business Combinations*).
- (h) insurance contracts in which the entity is the *policyholder* unless those contracts are reinsurance contracts (see paragraph 3(b)).

¹ The proposals arising from the IASB's 2011 Exposure Draft *Revenue from Contracts with Customers* would replace IAS 18 *Revenue*. [Draft] IFRS X *Revenue from Contracts with Customers* is expected to be finalised in 2013. The IASB plans to update the requirements in the proposals to be consistent with [draft] IFRS X *Revenue from Contracts with Customers* when it finalises this [draft] Standard, where applicable.

Combination of insurance contracts

- 8 An entity shall combine two or more insurance contracts that are entered into at or near the same time with the same policyholder (or related policyholders) and shall account for those contracts as a single insurance contract if one or more of the following criteria is met:
- (a) the insurance contracts are negotiated as a package with a single commercial objective;
 - (b) the amount of consideration to be paid for one insurance contract depends on the consideration or performance of the other insurance contract(s); or
 - (c) the coverage provided by the insurance contracts to the policyholder relates to the same insurance risk.

Separating components from an insurance contract (paragraphs B31–B35)

9 An insurance contract may contain one or more components that would be within the scope of another Standard if they were separate contracts. For example, an insurance contract may include an *investment component* or a service component (or both). Such a contract may be partially within the scope of this [draft] Standard and partially within the scope of other Standards. An entity shall apply paragraphs 10–11 to identify and account for the components of the contract.

10 An entity shall:

- (a) separate an embedded derivative from the host contract and account for the embedded derivative in accordance with IFRS 9 if, and only if, it meets both of the following criteria:
 - (i) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract (see paragraphs B4.3.5 and B4.3.8 of IFRS 9); and
 - (ii) a separate financial instrument with the same terms as the embedded derivative would meet the definition of a derivative and would be within the scope of IFRS 9 (for example, the derivative itself is not an insurance contract).

The entity shall measure the embedded derivative as if it had issued it as a stand-alone financial instrument that is initially measured in accordance with IFRS 9 and attribute any remaining cash flows to the other components of the insurance contract.

- (b) separate an investment component from the host insurance contract and account for it in accordance with IFRS 9 if that investment component is distinct (see paragraphs B31–B32). The entity shall measure a distinct investment component as if it had issued it as a stand-alone financial

instrument that is initially measured in accordance with IFRS 9 and attribute any remaining cash flows to the other components of the insurance contract.

- (c) separate from the host insurance contract a performance obligation (as defined in [draft] IFRS X *Revenue from Contracts with Customers*) to provide goods or services (see paragraphs B33–B35). The entity shall account for a distinct performance obligation to provide goods or services in accordance with paragraph 11 and other applicable Standards if that performance obligation to provide goods and services is distinct.
- (d) apply this [draft] Standard to the remaining components of an insurance contract. Throughout this [draft] Standard, the components of an insurance contract that remain after separating the components within the scope of other Standards in accordance with (a)–(c) are deemed to be an insurance contract.

11 After applying paragraph 10 to separate any cash flows related to embedded derivatives and distinct investment components, an entity shall, on initial recognition:

- (a) attribute the remaining cash inflows between the insurance component and any distinct performance obligations to provide goods or services in accordance with [draft] IFRS X *Revenue from Contracts with Customers*; and
- (b) attribute the remaining cash outflows between the insurance component and any distinct performance obligations to provide goods or services in a way that attributes:
 - (i) cash outflows that relate directly to each component to that component; and
 - (ii) any remaining cash outflows on a rational and consistent basis, reflecting the costs that the entity would expect to incur if it had issued that component as a separate contract.

Recognition

12 **An entity shall recognise an insurance contract that it issues from the earliest of the following:**

- (a) **the beginning of the coverage period;**
- (b) **the date on which the first payment from the policyholder becomes due; and**
- (c) **if applicable, the date on which the portfolio of insurance contracts to which the contract will belong is onerous.**

13 **An entity shall recognise any pre-coverage cash flows as they occur as part of the portfolio that will contain the contract to which they relate.**

14 If there is no contractual due date, the first payment from the policyholder is deemed to be due when it is received.

- 15 An entity needs to assess whether a contract is onerous when facts and circumstances indicate that the portfolio of contracts that will contain the contract is onerous. A portfolio of insurance contracts is onerous if, after the entity is bound by the terms of the contract, the sum of the *fulfilment cash flows* and any pre-coverage cash flows is greater than zero. Any excess of this sum over zero shall be recognised in profit or loss as an expense.
- 16 An entity shall not recognise as a liability or as an asset any amounts relating to expected premiums that are outside the boundary of the contract (see paragraphs 22(e) and B67). Such amounts relate to future insurance contracts.

Measurement (paragraphs B36–B87)

- 17 An entity shall apply paragraphs 18–32 to all contracts within the scope of the [draft] Standard with the following exceptions:
- (a) for insurance contracts in which the contract requires the entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items (see paragraph 33), an entity shall apply paragraph 34 to modify the measurement of the fulfilment cash flows required by paragraphs 18–32.
 - (b) for insurance contracts meeting the eligibility criteria in paragraph 35, an entity may simplify the measurement of the *liability for the remaining coverage* using the premium-allocation approach in paragraphs 38–40.
 - (c) for reinsurance contracts held, the entity shall apply paragraphs 18–32 in accordance with paragraphs 41–42.
 - (d) for insurance contracts acquired in a portfolio transfer or a business combination, an entity shall apply paragraphs 18–32 in accordance with paragraphs 43–46.
 - (e) for investment contracts with a discretionary participation feature, an entity shall apply paragraphs 18–32 in accordance with paragraphs 47–48.

Measurement on initial recognition of an insurance contract (paragraphs B36–B67 and B69–B82)

- 18 **An entity shall measure an insurance contract initially at the sum of:**
- (a) the amount of the fulfilment cash flows, measured in accordance with paragraphs 19–27, B36–B67 and B69–B82; plus**
 - (b) any contractual service margin, measured in accordance with paragraph 28.**
- 19 The resulting measurement can be regarded as comprising two elements:
- (a) a liability for the remaining coverage, which measures the entity's obligation to provide coverage to the policyholder during the remaining coverage period; and

- (b) a *liability for incurred claims*, which measures the entity's obligation to investigate and pay claims for insured events that have already occurred, including incurred claims for events that have occurred but for which claims have not been reported.

20 When applying IAS 21 *The Effects of Changes in Foreign Exchange Rates* to an insurance contract that results in cash flows in a foreign currency, an entity shall treat the contract, including the contractual service margin, as a monetary item.

21 The fulfilment cash flows shall not reflect the non-performance risk of the entity that issues the insurance contract (non-performance risk is defined in IFRS 13 *Fair Value Measurement*).

Future cash flows (paragraphs B39–B67)

22 **The estimates of cash flows used to determine the fulfilment cash flows shall include all cash inflows and cash outflows that relate directly to the fulfilment of the portfolio of contracts. Those estimates shall:**

- (a) **be explicit (ie the entity shall estimate those cash flows separately from the estimates of discount rates that adjust those future cash flows for the time value of money and the risk adjustment that adjusts those future cash flows for the effects of uncertainty about the amount and timing of those cash flows);**
- (b) **reflect the perspective of the entity, provided that the estimates of any relevant market variables do not contradict the observable market prices for those variables (see paragraphs B43–B53);**
- (c) **incorporate, in an unbiased way, all of the available information about the amount, timing and uncertainty of all of the cash inflows and cash outflows that are expected to arise as the entity fulfils the insurance contracts in the portfolio (see paragraph B54);**
- (d) **be current (ie the estimates shall reflect all of the available information at the measurement date) (see paragraphs B55–B61); and**
- (e) **include the cash flows within the boundary of each contract in the portfolio (see paragraphs 23–24 and B62–B67).**

23 Cash flows are within the boundary of an insurance contract when the entity can compel the policyholder to pay the premiums or has a substantive obligation to provide the policyholder with coverage or other services. A substantive obligation to provide coverage or other services ends when:

- (a) the entity has the right or the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or
- (b) both of the following criteria are satisfied:

- (i) the entity has the right or the practical ability to reassess the risk of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and
- (ii) the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to future periods.

24 An entity shall determine the boundary of an insurance contract by considering all of the substantive rights that are held by the policyholder, whether they arise from a contract, law or regulation. However, an entity shall ignore restrictions that have no commercial substance (ie no discernible effect on the economics of the contract).

Time value of money (paragraphs B69–B75)

25 **An entity shall determine the fulfilment cash flows by adjusting the estimates of future cash flows for the time value of money, using discount rates that reflect the characteristics of those cash flows. Such rates shall:**

- (a) **be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract, in terms of, for example, timing, currency and liquidity; and**
- (b) **exclude the effect of any factors that influence the observable market prices but that are not relevant to the cash flows of the insurance contract.**

26 Estimates of discount rates shall be consistent with other estimates used to measure the insurance contract to avoid double counting or omissions, for example:

- (a) to the extent that the amount, timing or uncertainty of the cash flows that arise from an insurance contract depends wholly or partly on the returns on underlying items, the characteristics of the liability reflect that dependence. The discount rate used to measure those cash flows shall therefore reflect the extent of that dependence.
- (b) nominal cash flows (ie those that include the effect of inflation) shall be discounted at rates that include the effect of inflation.
- (c) real cash flows (ie those that exclude the effect of inflation) shall be discounted at rates that exclude the effect of inflation.

Risk adjustment (paragraphs B76–B82)

27 **When determining the fulfilment cash flows, an entity shall apply a risk adjustment to the expected present value of cash flows used.**

Contractual service margin

28 **Unless the portfolio of insurance contracts that includes the contract is onerous at initial recognition, an entity shall measure the contractual**

service margin recognised at initial recognition in accordance with paragraph 18(b) at an amount that is equal and opposite to the sum of:

- (a) the amount of the fulfilment cash flows for the insurance contract at initial recognition; and**
- (b) any pre-coverage cash flows.**

Subsequent measurement

29 Unless paragraphs 35-40 apply, the carrying amount of an insurance contract at the end of each reporting period shall be the sum of:

- (a) the fulfilment cash flows at that date, measured in accordance with paragraphs 19-27, B36-B67 and B69-B82; and**
- (b) the remaining amount of the contractual service margin at that date.**

30 The remaining 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 interest accreted on the carrying amount of the contractual service margin during the reporting period to reflect the time value of money (the interest accreted is calculated using the discount rates specified in paragraph 25 that applied when the contract was initially recognised);
- (b) minus the amount recognised in accordance with paragraph 32 for services that were provided in the period;
- (c) plus a favourable difference between the current and previous estimates of the present value of future cash flows, if those future cash flows relate to future coverage and other future services (see paragraph B68);
- (d) minus an unfavourable change in the future cash flows:
 - (i) if the change arises from a difference between the current and previous estimate of the present value of future cash flows that relate to future coverage and other future services; and
 - (ii) to the extent that the contractual service margin is sufficient to absorb an unfavourable change. The contractual service margin shall not be negative.

31 An entity shall recognise in profit or loss any changes in the future cash flows that, in accordance with paragraph 30, do not adjust the contractual service margin (see paragraph B68).

32 An entity shall recognise the remaining contractual service margin in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract.

Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items (paragraphs B83-B87)

33 An entity shall apply paragraph 34 if the contract:

- (a) requires the entity to hold underlying items such as specified assets and liabilities, an underlying pool of insurance contracts, or if the underlying item specified in the contract is the assets and liabilities of the entity as a whole; and
- (b) specifies a link between the payments to the policyholder and the returns on those underlying items.

The entity shall determine whether the contract specifies a link to returns on underlying items by considering all of the substantive terms of the contract, whether they arise from a contract, the law or regulation.

34 When paragraph 33 applies, the entity shall, at initial recognition and subsequently:

- (a) measure the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items (meaning that paragraphs 18–27 do not apply); and
- (b) measure the fulfilment cash flows that are not expected to vary directly with returns on underlying items in accordance with paragraphs 18–27. Such cash flows include fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated in accordance with paragraph 10.

Simplified approach for measuring the liability for the remaining coverage

35 An entity may simplify the measurement of the liability for the remaining coverage using the premium-allocation approach set out in paragraphs 38–40 if:

- (a) doing so would produce a measurement that is a reasonable approximation to those that would be produced when applying the requirements in paragraphs 18–32; or
- (b) the coverage period of the insurance contract at initial recognition (including coverage arising from all premiums within the contract boundary determined in accordance with paragraphs 23–24) is one year or less.

36 When an entity simplifies the measurement of the liability for the remaining coverage in accordance with paragraphs 38–40, it shall recognise an onerous contract liability if, at initial recognition or subsequently, facts and circumstances indicate that the portfolio of insurance contracts containing the contract is onerous.

37 The application of the premium-allocation approach in paragraphs 38–40 cannot produce a reasonable approximation to the measurements that result from the requirements in paragraphs 18–32 if, at contract inception, the entity expects significant variability, during the period before a claim is incurred, in the fulfilment cash flows that are required to fulfil the contract. Variability in the fulfilment cash flows increases:

- (a) with the extent of future cash flows relating to any options or other derivatives embedded in the contract that remain after separating any embedded derivatives in accordance with paragraph 10(a); or
- (b) with the length of the coverage period of the contract.

38 If either of the criteria in paragraph 35 is satisfied, an entity may measure the liability for the remaining coverage as follows:

- (a) at initial recognition, the carrying amount of the liability for the remaining coverage is:
 - (i) the premium, if any, received at initial recognition;
 - (ii) less any payments that relate to *acquisition costs*, unless paragraph 39(a) applies;
 - (iii) plus (or minus) any pre-coverage cash flows;
 - (iv) plus any onerous contract liability recognised in accordance with paragraph 36 and measured in accordance with paragraph 39(c).
- (b) at the end of each subsequent reporting period, the carrying amount of the liability for the remaining coverage is the previous carrying amount:
 - (i) plus the premiums received in the period;
 - (ii) minus the amount recognised as insurance contract revenue for coverage that was provided in that period (see paragraph B91);
 - (iii) plus any onerous contract liability recognised in the period in accordance with paragraph 36 and measured in accordance with paragraph 39(c);
 - (iv) plus (or minus) the effect of any changes in estimates that relate to any onerous contract liability recognised in previous periods, measured in accordance with paragraph 39(c);
 - (v) plus any adjustment to reflect the time value of money in accordance with paragraph 40.

39 When an entity simplifies the measurement of the liability for the remaining coverage using the approach set out in paragraph 38, it:

- (a) may elect to recognise the directly attributable acquisition costs as an expense when it incurs those costs, provided that the coverage period at initial recognition is one year or less.
- (b) shall measure the liability for incurred claims for those contracts at the fulfilment cash flows relating to incurred claims, in accordance with paragraphs 19–27, B36–B67 and B69–B82. However, the entity need not adjust future cash flows for the time value of money if those cash flows are expected to be paid or received in one year or less.
- (c) shall measure any onerous contract liability that is recognised in accordance with paragraph 36 as the difference between the carrying amount of the liability for the remaining coverage and the fulfilment cash flows. However, if, in accordance with (b), the entity does not adjust future cash flows relating to the liability for incurred claims to reflect

the time value of money, it shall measure any onerous contract liability without adjusting those future cash flows to reflect the time value of money.

- 40 If a contract has a financing component that is significant to the contract an entity shall adjust the liability for the remaining coverage to reflect the time value of money using the discount rates specified in paragraph 25, as determined at initial recognition. However, the entity need not adjust the liability for the remaining coverage to reflect the time value of money if the entity expects, at contract inception, that the time between the entity providing each part of the coverage and the due date for the premium that relates to that part of the coverage is one year or less.

Reinsurance contracts held

- 41 An entity that holds a reinsurance contract pays a premium and receives reimbursement if it pays valid claims arising from underlying contracts, instead of receiving premiums and paying valid claims to the policyholder. Consequently, some of the requirements in this [draft] Standard are modified to reflect that fact, as follows:
- (a) the recognition requirements of paragraph 12 are modified so that an entity shall recognise a reinsurance contract held:
 - (i) from the beginning of the coverage period of the reinsurance contract, if the reinsurance contract provides coverage for the aggregate losses of a portfolio of underlying contracts; and
 - (ii) when the underlying contracts are recognised, in all other cases.
 - (b) in applying the measurement requirements of paragraphs 19–27 to estimate the fulfilment cash flows for a reinsurance contract held, the entity shall use assumptions that are consistent with those that are used to measure the corresponding part of the fulfilment cash flows for the underlying insurance contract(s). In addition, the entity shall, on an expected present value basis:
 - (i) treat cash flows, including ceding commissions, that are contingent on the occurrence of claims of the underlying contracts as part of the claims that are expected to be reimbursed under the reinsurance contract;
 - (ii) treat ceding commissions that it expects to receive that are not contingent on the occurrence of claims of the underlying contracts as a reduction of the premiums to be paid to the reinsurer;
 - (iii) apply the requirements of paragraph 21 so that the fulfilment cash flows reflect the risk of non-performance by the issuer of the reinsurance contract, including the effects of collateral and losses from disputes; and
 - (iv) determine the risk adjustment required by paragraph 27 so that it represents the risk being transferred by the holder of the reinsurance contract.

- (c) the requirements of paragraph 28 that relate to determining the contractual service margin on initial recognition are modified so that, at initial recognition:
- (i) the entity shall recognise any net cost or net gain on purchasing the reinsurance contract as a contractual service margin measured at an amount that is equal to the sum of the amount of the fulfilment cash flows and pre-coverage cash flows for the reinsurance contracts; unless
 - (ii) the net cost of purchasing reinsurance coverage relates to events that occurred before the purchase of the reinsurance contract, in which case the entity shall recognise such a cost immediately in profit or loss as an expense.
- (d) the requirements of paragraphs 30–31 that relate to the subsequent measurement of the contractual service margin are modified so that the entity shall measure the remaining amount of the contractual service margin at the end of the reporting period at the carrying amount that was determined at the start of the reporting period:
- (i) plus the interest accreted on the carrying amount of the contractual service margin to reflect the time value of money (the interest accreted is calculated using the discount rates specified in paragraph 25 that applied when the contract was initially recognised);
 - (ii) minus the amount recognised relating to services that were received in the period; and
 - (iii) plus (or minus) a favourable (or unfavourable) change in the future cash flows if that change arises from a difference between the current and previous estimates of the future cash flows that relate to future coverage and other future services. Changes in the expected present value of cash flows that result from changes in the expected credit losses of the reinsurer do not relate to future coverage or other future services and shall be recognised immediately in profit or loss.

42 Other requirements of this [draft] Standard apply to a reinsurance contract held. For example:

- (a) an asset that arises under a reinsurance contract may be regarded as comprising both the expected value of the recovery that relates to the remaining risk coverage and the expected value of the recovery that relates to incurred claims. An entity may simplify the measurement of the expected value of the recovery that relates to the remaining coverage using the approach set out in paragraphs 38–40 if:
 - (i) doing so would produce measurements that are a reasonable approximation to those that would be produced by applying the requirements in paragraph 41; or
 - (ii) the coverage period of the reinsurance contract is one year or less.

- (b) disclosure requirements apply to reinsurance contracts.

Portfolio transfers and business combinations

- 43 The date of the portfolio transfer or business combination is deemed to be the date of recognition for insurance contracts and reinsurance contracts that are acquired in a portfolio transfer or a business combination.
- 44 The entity shall treat the consideration received or paid for a contract acquired in a portfolio transfer or business combination as a pre-coverage cash flow. The consideration received or paid for the contract excludes the consideration received or paid for any other assets and liabilities that were acquired in the same transaction. In a business combination, the consideration received or paid is the fair value of the contract at that date. That fair value reflects the portion of the total consideration for the business combination relating to the liability assumed.
- 45 The initial measurement of contracts acquired in a business combination shall be used when determining any goodwill or gain from a bargain purchase in accordance with IFRS 3.
- 46 Other requirements of this [draft] Standard apply to an insurance contract issued, or a reinsurance contract held, that is acquired in a portfolio transfer or a business combination.

Investment contracts with a discretionary participation feature

- 47 An investment contract with a discretionary participation feature does not transfer significant insurance risk and therefore does not specify a coverage period. Consequently, some of the requirements in this [draft] Standard are modified to explain how the coverage period should be interpreted, as follows:
- (a) the beginning of the coverage period (see paragraph 12) is modified to be the time when the entity becomes party to the contract. Thus, an entity shall recognise an investment contract with a discretionary participation feature when it first has a contractual obligation to deliver cash at a present or future date.
- (b) the determination of the contract boundary (see paragraph 23) is modified so that cash flows are within the boundary of the contract when the entity has a substantive obligation to deliver cash at a present or future date. This ends when the entity has the right or practical ability to set a price that fully reflects the benefits provided.
- (c) the coverage period (see paragraph 32) is modified to be the period over which the entity is required to provide asset management or other services under the contract. The entity shall recognise the contractual service margin over the life of the contract in the systematic way that best reflects the transfer of asset management services under the contract.

- 48 Other requirements of this [draft] Standard apply to investment contracts with a discretionary participation feature, even though those contracts do not transfer significant insurance risk.

Modification and derecognition of an insurance contract

Modification of an insurance contract

- 49 A contract modification occurs when the parties to the contract agree on a change to the terms of a contract. An entity shall:

- (a) derecognise the original insurance contract and recognise the modified contract as a new contract in accordance with this or other applicable Standards if any of the following conditions are satisfied:
- (i) the modified contract would have been excluded from the scope of this [draft] Standard in accordance with paragraphs 3-7 if it had been written at contract inception with the modified terms;
 - (ii) the entity applied the premium-allocation approach in paragraphs 38-40 to the original contract, but the modified contract no longer meets the eligibility criteria for that approach in paragraph 35 or paragraph 42(a); or
 - (iii) the modified contract would have been included in a different portfolio from the one in which it was included at initial recognition if it had been written at contract inception with the modified terms.

The consideration for the new contract is deemed to be the premium that the entity would have charged the policyholder if it had entered into a contract with equivalent terms at the date of the contract modification.

- (b) account for modifications that do not meet the conditions in (a) as follows:
- (i) recognise an obligation to provide additional benefits that result from the contract modifications as a new contract—the entity shall determine the contractual service margin for the new contract by reference to the additional premium that was charged for the modification;
 - (ii) account for a reduction in benefits that results from the contract modifications by derecognising in accordance with paragraph 50 the part of the contract that is related to the reduction of benefits; and
 - (iii) apply paragraphs 30-31 to changes in cash flows that are not accompanied by a change in the level of benefits as changes in estimates of fulfilment cash flows.

Derecognition of an insurance contract

- 50 **Unless paragraph 49(a) applies, an entity shall derecognise an insurance contract (or part of it) from its statement of financial position when, and**

only when, it is extinguished (ie when the obligation specified in the insurance contract is discharged, cancelled or expires). At that point, the entity is no longer at risk and is therefore no longer required to transfer any economic resources to satisfy the insurance contract.

51 When an entity buys reinsurance, it shall derecognise the underlying insurance contract(s) if, and only if, the underlying insurance contract(s) are extinguished.

Gains and losses on modification or derecognition

52 When an issuer or holder of a reinsurance contract applies paragraph 49, any gains or losses that arise on modification are recognised as an adjustment to the cash outflows arising from the contract.

53 When an entity derecognises an insurance contract and recognises a new contract in accordance with paragraph 49(a), or derecognises a portion in accordance with paragraph 49(b)(ii), the entity recognises a gain or loss in profit or loss, as applicable, measured as the difference between:

- (a) the deemed consideration for the modified contract determined in accordance with paragraph 49(a); and
- (b) the carrying amount of the derecognised contract.

Presentation (paragraphs B88–B91)

Statement of financial position

54 **An entity shall present separately in the statement of financial position:**

- (a) **the carrying amount of portfolios of insurance contracts that are in an asset position; and**
- (b) **the carrying amount of portfolios of insurance contracts that are in a liability position.**

55 **An entity shall present separately in the statement of financial position:**

- (a) **the carrying amount of portfolios of reinsurance contracts held that are in an asset position; and**
- (b) **the carrying amount of portfolios of reinsurance contracts held that are in a liability position.**

Statement of profit or loss and other comprehensive income

Revenue and expenses

56 **An entity shall present revenue relating to the insurance contracts it issues in the statement of profit or loss and other comprehensive income. Insurance contract revenue shall depict the transfer of promised services arising from the insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. Paragraphs B88–B91 specify how an entity measures insurance contract revenue.**

57 **An entity shall present incurred claims and other expenses relating to an insurance contract it issues in the statement of profit or loss and other comprehensive income.**

58 **Insurance contract revenue and incurred claims presented in the statement of profit or loss and other comprehensive income shall exclude any investment components that, in accordance with paragraph 10(b), have not been separated.**

59 An entity shall present the expense of purchasing reinsurance contracts held, excluding any investment components, in profit or loss as the entity receives reinsurance coverage and other services over the coverage period.

Profit or loss and other comprehensive income

60 **An entity shall recognise in profit or loss:**

- (a) **losses, if any, at initial recognition of insurance contracts (see paragraph 15).**
- (b) **changes in the risk adjustment (see paragraph 27).**
- (c) **the change in the contractual service margin that reflects the transfer of services in the period (see paragraph 32).**
- (d) **changes in estimates of future cash flows that do not adjust the contractual service margin (see paragraphs 30–31 and B68).**
- (e) **differences between actual cash flows that occurred during the period and previous estimates of those cash flows (experience adjustments) (see paragraphs 30–31 and B68).**
- (f) **any changes in the carrying amount of onerous contracts recognised in accordance with paragraph 36.**
- (g) **any effect of changes in the credit standing of the issuer of reinsurance contracts held (see paragraph 41(b)(iii)).**
- (h) **unless paragraph 66 applies, interest expense on insurance contract liabilities determined using the discount rates specified in paragraph 25 that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when it expects any changes in those returns to affect the amount of those cash flows.**
- (i) **any gains or losses other than those recognised in other comprehensive income in accordance with paragraph 64.**

61 For contracts that were acquired in a business combination or a portfolio transfer, the discount rates at initial recognition that are used to measure the interest expense recognised in profit or loss are the discount rates that applied at the acquisition date.

62 For reinsurance contracts held, interest income is recognised as described in paragraph 60(h). That interest income is determined using the discount rates that applied when the contract was initially recognised. The entity shall

recognise in other comprehensive income the difference between the carrying amount of the reinsurance contract measured using the interest rates specified in paragraph 25, as determined at the reporting date, and the carrying amount of the reinsurance contract measured using the discount rate specified in paragraph 60(h).

63 An entity shall not offset income or expense from reinsurance contracts against the expense or income from insurance contracts.

64 Unless paragraph 66 applies, an entity shall recognise and present in other comprehensive income the difference between:

- (a) the carrying amount of the insurance contract measured using the discount rates specified in paragraph 25 that applied at the reporting date; and**
- (b) the carrying amount of the insurance contract measured using the discount rates specified in paragraph 60(h).**

65 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 that were previously recognised in other comprehensive income in accordance with paragraph 64.

66 If an entity applies paragraphs 33-34 because the insurance contract requires the entity to hold underlying items and specifies a link to returns on those underlying items, an entity shall recognise:

- (a) changes in the fulfilment cash flows that result from applying paragraphs 33-34 in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of the underlying items;**
- (b) changes in the fulfilment cash flows that are expected to vary indirectly with those returns on underlying items in profit or loss; and**
- (c) changes in the fulfilment cash flows that are not expected to vary with those returns on underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), in profit or loss and in other comprehensive income in accordance with paragraphs 60-65.**

67 An entity shall not offset income or expense from the underlying items against expense or income from the insurance contract.

68 Paragraph 20 requires an entity to treat an insurance contract as a monetary item under IAS 21 for the purpose of recognising foreign exchange gains and losses. Accordingly, an entity recognises exchange differences on changes in the insurance contract in profit or loss, unless they relate to changes in the insurance contract that are recognised in other comprehensive income in accordance with paragraph 64, in which case they shall be recognised in other comprehensive income.

Disclosure

69 **The objective of the disclosure requirements is to enable users of financial statements to understand the nature, amount, timing and uncertainty of future cash flows that arise from contracts within the scope of this [draft] Standard. To achieve that objective, an entity shall disclose qualitative and quantitative information about:**

- (a) **the amounts recognised in its financial statements that arise from insurance contracts (see paragraphs 73–82);**
- (b) **the significant judgements, and changes in those judgements, made when applying the [draft] Standard (see paragraphs 83–85); and**
- (c) **the nature and extent of the risks that arise from contracts within the scope of this [draft] Standard (see paragraphs 86–95).**

70 If any of the disclosures set out in paragraphs 73–95 are not considered relevant in meeting the requirements in paragraph 69, they may be omitted from the financial statements. If the disclosures provided in accordance with paragraphs 73–95 are insufficient to meet the requirements in paragraph 69, an entity shall disclose additional information that is necessary to meet those requirements.

71 An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. The entity shall aggregate or disaggregate information so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or by the aggregation of items that have different characteristics.

72 Examples of disaggregation bases that might be appropriate are:

- (a) type of contract (for example, major product lines);
- (b) geographical area (for example, country or region); or
- (c) reportable segment, as defined in IFRS 8 *Operating Segments*.

Explanation of recognised amounts

73 An entity shall provide sufficient information to permit a reconciliation of the amounts disclosed to the line items that are presented in the statements of profit or loss and other comprehensive income and of financial position. To comply with this requirement, an entity shall disclose, in tabular format, the reconciliations required by paragraphs 74–76, separately for insurance contracts and reinsurance contracts.

74 An entity shall disclose reconciliations that show how the carrying amounts of insurance contracts that are in a liability position and insurance contracts that are in an asset position are affected by cash flows and income and expenses recognised in profit or loss and other comprehensive income. Those reconciliations shall separately reconcile from the opening to the closing balances of:

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- (a) liabilities for the remaining coverage, excluding any amounts included in (b);
 - (b) liabilities for the remaining coverage that are attributable to amounts immediately recognised in profit or loss; and
 - (c) liabilities for any incurred claims.
- 75 An entity shall disclose reconciliations that show how the aggregate carrying amounts of reinsurance contracts held in an asset position and reinsurance contracts held in a liability position are affected by cash flows and income and expense presented in profit or loss. Those reconciliations shall separately reconcile from the opening to the closing balances of:
- (a) the expected value of the recovery that relates to the remaining coverage, excluding the amounts included in (b);
 - (b) the expected value of the recovery that relates to the remaining coverage that is attributable to changes in estimates that are immediately recognised in profit or loss; and
 - (c) the expected value of the recovery that relates to any incurred claims that arise from the underlying insurance contract.
- 76 Subject to paragraph 77, an entity shall disclose a reconciliation that separately reconciles the opening and closing balances of:
- (a) the expected present value of the future cash flows;
 - (b) the risk adjustment; and
 - (c) the contractual service margin.
- 77 An entity need not provide the reconciliation in paragraph 76 to the extent that the entity:
- (a) applies the measurement exception in paragraphs 33–34 for contracts that require the entity to hold underlying items and specify a link to returns on those underlying items; or
 - (b) simplifies the measurement of insurance contracts or reinsurance contracts in accordance with paragraphs 38–40 or 42(a).
- 78 For each reconciliation required by paragraphs 74–76, an entity shall separately identify each of the following, if applicable:
- (a) premiums received for insurance contracts issued (or paid for reinsurance contracts held);
 - (b) claims paid for insurance contracts issued (or recovered under reinsurance contracts held);
 - (c) each of the amounts recognised in profit or loss in accordance with paragraph 60, if applicable;
 - (d) gains and losses that arose on modification or derecognition of an insurance contract (see paragraphs 52–53);

- (e) amounts that relate to contracts acquired from, or transferred to, other entities in portfolio transfers or business combinations (see paragraphs 44–45); and
 - (f) any additional line items that may be needed to understand the change in the contract assets and the contract liabilities.
- 79 An entity shall disclose a reconciliation from the premiums received in the period to the insurance contract revenue recognised in the period.
- 80 If an entity applies the requirements of paragraphs 33–34 and 66 to insurance contracts that require the entity to hold underlying items and specify a link to returns on those underlying items:
- (a) the entity shall disclose the amounts in the financial statements that arise from the cash flows to which the entity has applied paragraphs 33–34 and 66; and
 - (b) if the entity discloses the fair value of underlying items that are measured on a basis other than fair value, it shall disclose the extent to which the difference between the fair value and the carrying amount of the underlying items would be passed on to policyholders.
- 81 For contracts to which paragraphs 38–40 or 42(a) are not applied, the entity shall disclose:
- (a) the following inputs that are used when determining the insurance contract revenue that is recognised in the period:
 - (i) the expected cash outflows for the period, excluding investment components;
 - (ii) the acquisition costs that are allocated to the period;
 - (iii) the change in risk adjustment in the period; and
 - (iv) the amount of the contractual service margin recognised in the period.
 - (b) the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position. That disclosure shall separately show the effect of those contracts on:
 - (i) the expected present value of future cash outflows, showing separately the amount of the acquisition costs;
 - (ii) the expected present value of future cash inflows;
 - (iii) the risk adjustment; and
 - (iv) the contractual service margin.
- 82 An entity shall disclose the interest on insurance contracts in a way that highlights the relationship between the interest on the insurance contracts and the investment return on the related assets that the entity holds.

Significant judgements in applying the [draft] Standard

83 An entity shall disclose the judgements, and changes in those judgements, that were made in applying this [draft] Standard. At a minimum, an entity shall disclose:

- (a) the methods used to measure insurance contracts and the processes for estimating the inputs to those methods. When practicable, the entity shall also provide quantitative information about those inputs.
- (b) to the extent not covered in (a), the methods and inputs that are used to estimate:
 - (i) the risk adjustment;
 - (ii) discount rates;
 - (iii) the pattern of recognition of the contractual service margin; and
 - (iv) any investment components that are not separated in accordance with paragraph 10(b).
- (c) the effect of changes in the methods and inputs that are used to measure insurance contracts, separately showing the effect of each change that has a material effect on the financial statements, together with an explanation of the reason for each change. The entity shall identify the type of contracts affected.

84 If the entity uses a technique other than the confidence level technique for determining the risk adjustment, it shall disclose a translation of the result of that technique into a confidence level (for example, that the risk adjustment was estimated using technique Y and corresponds to a confidence level of Z per cent).

85 An entity shall disclose the yield curve (or range of yield curves) that is used to discount the cash flows that do not depend on the returns from underlying items in accordance with paragraph 25. When an entity provides disclosures in total for a grouping of portfolios, it shall provide such disclosures in the form of weighted averages or relatively narrow ranges.

Nature and extent of risks that arise from insurance contracts

86 An entity shall disclose information about the nature and extent of risks that arise from insurance contracts to enable users of financial statements to understand the nature, amount, timing and uncertainty of future cash flows that arise from insurance contracts. Paragraphs 87–95 contain the minimum disclosures that would normally be required to comply with this requirement.

87 An entity shall disclose:

- (a) the exposures to risks and how they arise;
- (b) its objectives, policies and processes for managing risks that arise from insurance contracts and the methods that are used to manage those risks; and
- (c) any changes in (a) or (b) from the previous period.

88 An entity shall disclose information about the effect of each regulatory framework in which the entity operates; for example, minimum capital requirements or required interest rate guarantees.

89 An entity shall disclose information about insurance risk on a gross basis and a net basis, before and after risk mitigation (for example, by reinsurance), including information about:

- (a) sensitivity to the insurance risk in relation to its effect on profit or loss and equity. This shall be disclosed by a sensitivity analysis that shows any material effect on profit or loss and equity that would have resulted from:
 - (i) changes in the relevant risk variable that were reasonably possible at the end of the reporting period; and
 - (ii) changes in the methods and inputs that are used in preparing the sensitivity analysis.

However, if an entity uses an alternative method to manage sensitivity to market conditions, such as embedded value analysis or value at risk analysis, it can meet this requirement by disclosing that alternative sensitivity analysis.

- (b) concentrations of insurance risk, including a description of how management determines the concentrations and a description of the shared characteristic that identifies each concentration (for example, the type of *insured event*, geographical area or currency). Concentrations of insurance risk can arise if an entity has underwritten risks that:
 - (i) are concentrated in one geographical area or one industry; or
 - (ii) are present in its investment portfolio, for example, if an entity provides product liability protection to pharmaceutical companies and also holds investments in those companies.

90 An entity shall disclose actual claims compared with previous estimates of the undiscounted amount of the claims (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim(s) arose for which there was uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. The entity need not disclose information about the development of claims for which uncertainty about the amount and timing of the claims payments is typically resolved within one year. The entity shall reconcile the disclosure about claims development with the aggregate carrying amount of the insurance contracts in a liability position and insurance contracts in an asset position, which the entity discloses to comply with paragraph 74.

91 For each type of risk, other than insurance risk, that arises from insurance contracts, an entity shall disclose:

- (a) summary quantitative information about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information that was provided internally to the key management

personnel of the entity and shall provide information about the risk management techniques and methodologies that are applied by the entity.

- (b) concentrations of risk if not apparent from other disclosures. Such concentrations can arise, for example, from interest rate guarantees that come into effect at the same level for an entire portfolio of contracts.
- 92 For credit risk that arises from insurance contracts issued and reinsurance contracts held, an entity shall disclose:
- (a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period; and
 - (b) information about the credit quality of reinsurance contract assets.
- 93 With regard to liquidity risk, an entity shall disclose:
- (a) a description of how it manages the liquidity risk that results from its insurance liabilities;
 - (b) the amounts that are payable on demand, in a way that highlights the relationship between such amounts and the carrying amount of the related contracts; and
 - (c) a maturity analysis that shows, at a minimum, the net cash flows that result from recognised insurance contracts for each of the first five years after the reporting date and in aggregate beyond the first five years. This may take the form of an analysis, by estimated timing, of the amounts recognised in the statement of financial position. However, an entity is not required to disclose a maturity analysis for the liability for the remaining coverage measured in accordance with paragraphs 38–40 or 42(a).
- 94 For market risk that arises from embedded derivatives that are contained in a host insurance contract and not separated in accordance with paragraph 10(a), an entity shall disclose:
- (a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss, other comprehensive income and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date. If an entity uses an alternative method to manage the sensitivity to market conditions, such as an embedded value analysis, or a sensitivity analysis such as the value at risk, that reflects interdependencies between the risk variables and that can be used to manage *financial risks*, it may use that sensitivity analysis to meet this requirement.
 - (b) an explanation of the methods and the main inputs that were used in preparing the sensitivity analysis.
 - (c) changes from the previous period in the methods and inputs that were used and the reasons for such changes.

- 95 If the quantitative information about the entity's exposure to risk at the end of the reporting period is not representative of its exposure to risk during the period, it shall disclose that fact and the reasons for those conclusions and provide further information that is representative of the exposure during the period.

Appendix A Defined terms

This appendix is an integral part of the [draft] Standard.

acquisition costs	The costs of selling, underwriting and initiating an insurance contract .
contractual service margin	A component of the measurement of the insurance contract representing the unearned profit that the entity recognises as it provides services under the insurance contract .
coverage period	The period during which the entity provides coverage for insured events . That period includes the coverage that relates to all premiums within the boundary of the insurance contract.
financial risk	The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.
fulfilment cash flows	An explicit, unbiased and probability-weighted estimate (ie expected value) of the present value of the future cash outflows less the present value of the future cash inflows that will arise as the entity fulfils the insurance contract , including a risk adjustment .
insurance contract	A contract under which one party (the issuer) 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 .
insurance risk	Risk, other than financial risk , transferred from the holder of a contract to the issuer.
insured event	An uncertain future event that is covered by an insurance contract and that creates insurance risk .
investment component	The amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur.

investment contract with a discretionary participation feature	<p>A financial instrument that provides a particular investor with the contractual right to receive, as a supplement to an amount that is not subject to the discretion of the issuer, additional amounts:</p> <ul style="list-style-type: none"> (a) that are likely to be a significant portion of the total contractual benefits; (b) whose amount or timing is contractually at the discretion of the issuer; and (c) that are contractually based on: <ul style="list-style-type: none"> (i) the returns from a specified pool of insurance contracts or a specified type of insurance contract; (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or (iii) the profit or loss of the entity or fund that issues the contract.
liability for incurred claims	The obligation that an entity has to investigate, and pay claims for, insured events that have already occurred, including incurred claims for events that have occurred but for which claims have not been reported (IBNR).
liability for the remaining coverage	An entity's obligation to pay valid claims that arise under existing insurance contracts for insured events that have not yet occurred (ie the obligation that relates to the unexpired portion of the coverage period).
policyholder	A party that has a right to compensation under an insurance contract if an insured event occurs.
portfolio of insurance contracts	<p>A group of insurance contracts that:</p> <ul style="list-style-type: none"> (a) provide coverage for similar risks and that are priced similarly relative to the risk taken on; and (b) are managed together as a single pool.
pre-coverage cash flows	Cash flows paid or received before the insurance contract is recognised that relate directly to the acquisition or the fulfilment of the portfolio of insurance contracts that will contain the insurance contract .
reinsurance contract	An insurance contract issued by one entity (the 'reinsurer') to compensate another entity (the 'cedant') for claims arising from one or more insurance contracts that are issued by the cedant.
risk adjustment	The compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract .

Appendix B Application guidance

This appendix is an integral part of the [draft] Standard.

- B1 This appendix provides guidance on the following issues:
- (a) definition of an insurance contract (see paragraphs B2–B30);
 - (b) separating components from an insurance contract (see paragraphs B31–B35);
 - (c) measurement (see paragraphs B36–B82);
 - (d) contracts that require the entity to hold underlying items and specify a link to returns on those underlying items (see paragraphs B83–B87); and
 - (e) presentation of insurance contract revenue and expenses (see paragraphs B88–B91).

Definition of an insurance contract (Appendix A)

- B2 This section provides guidance on the definition of an insurance contract as specified in Appendix A. It addresses the following:
- (a) the term ‘uncertain future event’ (see paragraphs B3–B5);
 - (b) payments in kind (see paragraph B6);
 - (c) the distinction between insurance risk and other risks (see paragraphs B7–B16);
 - (d) significant insurance risk (see paragraphs B17–B23);
 - (e) changes in the level of insurance risk (see paragraphs B24–B25); and
 - (f) examples of insurance contracts (see paragraphs B26–B30).

Uncertain future event

- B3 Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:
- (a) the probability of an insured event occurring;
 - (b) when the insured event will occur; or
 - (c) how much the entity will need to pay if the insured event occurs.
- B4 In some insurance contracts, the insured event is the discovery of a loss during the term of the contract, even if that loss arises from an event that occurred before the inception of the contract. In other insurance contracts, the insured event is an event that occurs during the term of the contract, even if the resulting loss is discovered after the end of the contract term.
- B5 Some insurance contracts cover events that have already occurred but whose financial effect is still uncertain. An example is an insurance contract that

provides coverage against an adverse development of an event that has already occurred. In such contracts, the insured event is the discovery of the ultimate cost of those claims.

Payments in kind

- B6 Some insurance contracts require or permit payments to be made in kind. In such cases, the entity provides goods or services to the policyholder to settle its obligation to compensate them for insured events. An example is when the entity replaces a stolen article instead of reimbursing the policyholder for the amount of its loss. Another example is when an entity uses its own hospitals and medical staff to provide medical services covered by the insurance contract. Such contracts are insurance contracts, even though the claims are settled in kind. Fixed-fee service contracts that meet the conditions specified in paragraph 7(e) are insurance contracts, but not within the scope of this [draft] Standard.

Distinction between insurance risk and other risks

- B7 The definition of an insurance contract requires that one party must accept significant insurance risk from another party. This [draft] Standard defines insurance risk as risk, other than financial risk, that is transferred by the contract from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract.
- B8 The definition of financial risk in Appendix A refers to financial and non-financial variables. Examples of non-financial variables that are not specific to a party to the contract include an index of earthquake losses in a particular region or temperatures in a particular city. Financial risk excludes risk from non-financial variables that are specific to a party to the contract, such as the occurrence or non-occurrence of a fire that damages or destroys an asset of that party. Furthermore, the risk of changes in the fair value of a non-financial asset is not a financial risk if the fair value reflects not only changes in the market prices for such assets (ie a financial variable) but also the condition of a specific non-financial asset held by a party to a contract (ie a non financial variable). For example, if a guarantee of the residual value of a specific car in which the policyholder has an insurable interest exposes the guarantor to the risk of changes in the car's physical condition, that risk is insurance risk, not financial risk.
- B9 Some contracts expose the issuer to financial risk in addition to significant insurance risk. For example, many life insurance contracts guarantee a minimum rate of return to policyholders, creating financial risk, and, at the same time, promise death benefits that may significantly exceed the policyholder's account balance, creating insurance risk in the form of mortality risk. Such contracts are insurance contracts.
- B10 Under some contracts, an insured event triggers the payment of an amount that is linked to a price index. Such contracts are insurance contracts, provided that the payment that is contingent on the insured event could be significant. For example, a life-contingent annuity that is linked to a cost-of-living index transfers insurance risk because the payment is triggered by an uncertain future

event—the survival of the person who receives the annuity. The link to the price index is an embedded derivative, but it also transfers insurance risk because the number of payments to which the index applies depends on the survival of the annuitant. If the resulting transfer of insurance risk is significant, the embedded derivative meets the definition of an insurance contract, in which case it shall not be separated from the host contract (see paragraph 10(a)).

- B11 Insurance risk is the risk that the entity accepts from the policyholder. This means that the entity must accept from the policyholder a risk that the policyholder was already exposed to. Any new risk for the entity or the policyholder that is created by the contract is not insurance risk.
- B12 The definition of an insurance contract refers to an adverse effect on the policyholder. This definition does not limit the payment by the entity to an amount that is equal to the financial effect of the adverse event. For example, the definition does not exclude ‘new for old’ coverage that pays the policyholder an amount that permits the replacement of a used and damaged asset with a new one. Similarly, the definition does not limit the payment under a life insurance contract to the financial loss suffered by the deceased’s dependants, nor does it exclude contracts that specify the payment of predetermined amounts to quantify the loss that is caused by death or an accident.
- B13 Some contracts require a payment if a specified uncertain future event occurs, but do not require an adverse effect on the policyholder as a precondition for the payment. This type of contract is not an insurance contract even if the holder uses it to mitigate an underlying risk exposure. For example, if the holder uses a derivative to hedge an underlying financial or non-financial variable that is correlated with the cash flows from an asset of the entity, the derivative is not an insurance contract because the payment is not conditional on whether the holder is adversely affected by a reduction in the cash flows from the asset. Conversely, the definition of an insurance contract refers to an uncertain future event for which an adverse effect on the policyholder is a contractual precondition for payment. That contractual precondition does not require the entity to investigate whether the event actually caused an adverse effect, but it does permit the entity to deny the payment if it is not satisfied that the event did cause an adverse effect.
- B14 Lapse or persistency risk (the risk that the policyholder will cancel the contract earlier or later than the issuer had expected when pricing the contract) is not insurance risk because the payment to the policyholder is not contingent on an uncertain future event that adversely affects the policyholder. Similarly, expense risk (ie the risk of unexpected increases in the administrative costs associated with the servicing of a contract, rather than in the costs associated with insured events) is not insurance risk because an unexpected increase in such expenses does not adversely affect the policyholder.
- B15 Consequently, a contract that exposes the entity to lapse risk, persistency risk or expense risk is not an insurance contract unless it also exposes the entity to significant insurance risk. However, if the entity mitigates that risk by using a second contract to transfer part of that non-insurance risk to another party, the second contract exposes the other party to insurance risk.

- B16 An entity can accept significant insurance risk from the policyholder only if the entity is separate from the policyholder. In the case of a mutual entity, the mutual entity accepts risk from each policyholder and pools that risk. Although policyholders bear that pooled risk collectively in their capacity as owners, the mutual entity is a separate entity that has accepted the risk that is the essence of the insurance contracts.

Significant insurance risk

- B17 A contract is an insurance contract only if it transfers significant insurance risk. Paragraphs B7–B16 discuss insurance risk. Paragraphs B18–B23 discuss the assessment of whether insurance risk is significant.
- B18 Insurance risk is significant if, and only if, an insured event could cause the issuer to pay amounts that are significant in any single scenario, excluding scenarios that have no commercial substance (ie no discernible effect on the economics of the transaction). If an insured event could mean that additional amounts that are significant would be payable in any scenario that has commercial substance, the condition in the previous sentence can be met even if the insured event is extremely unlikely or even if the expected (ie probability-weighted) present value of the contingent cash flows is a small proportion of the expected present value of all of the remaining cash flows from the insurance contract.
- B19 In addition, a contract does not transfer insurance risk if there is no scenario that has commercial substance in which the present value of the net cash outflows that is paid by the issuer can exceed the present value of the premiums. However, if a reinsurance contract does not expose the issuer to the possibility of a significant loss, that contract is deemed to transfer significant insurance risk if it transfers to the reinsurer substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts.
- B20 The additional amounts described in paragraph B18 are determined on a present value basis. Thus, if an insurance contract requires payment if the insured event occurs earlier and if the payment is not adjusted for the time value of money, there may be scenarios in which additional amounts are payable on a present value basis, even if the nominal value of the payment is the same. An example is whole-life insurance for a fixed amount (ie insurance that provides a fixed death benefit whenever the policyholder dies, with no expiry date for the cover). It is certain that the policyholder will die, but the date of death is uncertain. Payments may arise because an individual policyholder dies earlier than expected. Because those payments are not adjusted for the time value of money, significant insurance risk could arise, even if there is no overall loss on the whole portfolio of contracts. Similarly, contractual terms that delay timely reimbursement to the policyholder can eliminate significant insurance risk.
- B21 The additional amounts described in paragraph B18 refer to the present value of amounts that exceed those that would be payable if no insured event had occurred (excluding scenarios that lack commercial substance). Those additional amounts include claims handling and claims assessment costs, but exclude:

- (a) the loss of the ability to charge the policyholder for future services. For example, in an investment-linked life insurance contract, the death of the policyholder means that the entity can no longer perform investment management services and collect a fee for doing so. However, this economic loss for the entity does not result from insurance risk, just as a mutual fund manager does not take on insurance risk in relation to the possible death of a client. Consequently, the potential loss of future investment management fees is not relevant when assessing how much insurance risk is transferred by a contract.
- (b) a waiver, on death, of charges that would be made on cancellation or surrender. Because the contract brought those charges into existence, the waiver of these charges does not compensate the policyholder for a pre-existing risk. Consequently, they are not relevant when assessing how much insurance risk is transferred by a contract.
- (c) a payment that is conditional on an event that does not cause a significant loss to the holder of the contract. For example, consider a contract that requires the issuer to pay CU1 million if an asset suffers physical damage that causes an insignificant economic loss of CU1 to the holder.² In this contract, the holder transfers the insignificant risk of losing CU1 to the entity. At the same time, the contract creates a non-insurance risk whereby the issuer will need to pay CU999,999 if the specified event occurs. Because the risk of loss is insignificant compared to the payment that would be made in the event of the loss, the issuer does not accept significant insurance risk from the holder and this contract is not an insurance contract.
- (d) possible reinsurance recoveries. The entity accounts for these separately.

B22 An entity shall assess the significance of insurance risk on a contract-by-contract basis. Thus, insurance risk can be significant even if there is minimal probability of significant losses for a portfolio of contracts.

B23 It follows from paragraphs B18–B22 that, if a contract pays a death benefit that exceeds the amount payable on survival, the contract is an insurance contract unless the additional death benefit is not significant (judged by reference to the contract rather than to an entire portfolio of contracts). As noted in paragraph B21(b), the waiver on death of cancellation or surrender charges is not included in this assessment if that waiver does not compensate the policyholder for a pre-existing risk. Similarly, an annuity contract that pays out regular sums for the rest of a policyholder's life is an insurance contract, unless the aggregate life-contingent payments are insignificant.

Changes in the level of insurance risk

B24 For some contracts, the transfer of insurance risk to the issuer occurs after a period of time. For example, consider a contract that provides a specified investment return and includes an option for the policyholder to use the proceeds of the investment on maturity to buy a life-contingent annuity at the annuity rates that are charged by the entity to other new annuitants at the time

² In this [draft] Standard, currency amounts are denominated in 'currency units' (CU).

that the policyholder exercises that option. Such a contract does not transfer insurance risk to the issuer until the option is exercised because the entity remains free to price the annuity on a basis that reflects the insurance risk that was transferred to the entity at that time. Consequently, the cash flows that would occur on exercise of the option fall outside the boundary of the contract, and before exercise there are no insurance cash flows within the boundary of the current contract. However, if the contract specifies the annuity rates (or a basis for setting the annuity rates), the contract transfers insurance risk to the issuer because the issuer is exposed to the risk that the annuity rates will be unfavourable when the policyholder exercises the option. In that case, the cash flows that would occur when the option is exercised are within the boundary of the current contract.

- B25 A contract that meets the definition of an insurance contract remains an insurance contract until all rights and obligations are extinguished (ie discharged, cancelled or expired), unless the contract is derecognised in accordance with paragraph 49(a).

Examples of insurance contracts

- B26 The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:
- (a) insurance against theft or damage.
 - (b) insurance against product liability, professional liability, civil liability or legal expenses.
 - (c) life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance).
 - (d) life-contingent annuities and pensions (ie contracts that provide compensation for the uncertain future event—the survival of the annuitant or pensioner—to provide the annuitant or pensioner with a level of income, which would otherwise be adversely affected by his or her survival).
 - (e) insurance against disability and medical cost.
 - (f) surety bonds, fidelity bonds, performance bonds and bid bonds (ie contracts that compensate the holder if another party fails to perform a contractual obligation, for example, an obligation to construct a building).
 - (g) product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are within the scope of this [draft] Standard. However, product warranties issued directly by a manufacturer, dealer or retailer are not within the scope of this [draft] Standard and are instead within the scope of [draft] IFRS X *Revenue from Contracts with Customers* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

- (h) title insurance (insurance against the discovery of defects in the title to land or buildings that were not apparent when the insurance contract was issued). In this case, the insured event is the discovery of a defect in the title, not the defect itself.
- (i) travel insurance (compensation in cash or in kind to policyholders for losses suffered in advance of, or during, travel).
- (j) catastrophe bonds that provide for reduced payments of principal, interest or both if a specified event adversely affects the issuer of the bond (unless the specified event does not create significant insurance risk, for example, if the event is a change in an interest rate or a foreign exchange rate).
- (k) insurance swaps and other contracts that require a payment depending on changes in climatic, geological or other physical variables that are specific to a party to the contract.
- (l) reinsurance contracts.

B27 The following are examples of items that are not insurance contracts:

- (a) investment contracts that have the legal form of an insurance contract but do not expose the entity to significant insurance risk. For example, life insurance contracts in which the entity bears no significant mortality or morbidity risk are not insurance contracts; such contracts are non-insurance financial instruments or service contracts—see paragraphs B28–B29. However, investment contracts with a discretionary participation feature are within the scope of this [draft] Standard, although those contracts do not meet the definition of an insurance contract.
- (b) contracts that have the legal form of insurance, but pass all significant insurance risk back to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder to the issuer as a direct result of insured losses. For example, some financial reinsurance contracts or some group contracts pass all significant insurance risk back to the policyholders; such contracts are normally non-insurance financial instruments or service contracts—see paragraphs B28–B29.
- (c) self-insurance (ie retaining a risk that could have been covered by insurance). In such situations, there is no insurance contract because there is no agreement with another party. Thus, if an entity (this type of issuer is often referred to as a ‘captive’) issues insurance contracts only to other entities within a group, the parent would not account for those contracts as insurance contracts in the consolidated financial statements of the group because there is no contract with another party. However, in the financial statements of the captive, the contract would be accounted for as an insurance contract.
- (d) contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but that do not require, as a contractual precondition for payment, the event to adversely affect the

policyholder. However, this does not preclude the specification of a predetermined payout to quantify the loss that is caused by a specified event such as a death or an accident—see paragraph B12.

- (e) derivatives that expose a party to financial risk but not insurance risk, because they require that party to make (or give them the right to receive) payment solely on the basis of the changes in one or more of a specified interest rate, a financial instrument price, a commodity price, a foreign exchange rate, an index of prices or rates, a credit rating or a credit index or any other variable, provided that, in the case of a non-financial variable, the variable is not specific to a party to the contract. Such contracts are within the scope of IFRS 9 *Financial Instruments*.
- (f) credit-related guarantees (or letters of credit, credit derivative default contracts or credit insurance contracts) that require payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due; such contracts are accounted for in accordance with IFRS 9—see paragraph B30.
- (g) contracts that require a payment that depends on a climatic, geological or any other physical variable that is not specific to a party to the contract (commonly described as weather derivatives).
- (h) catastrophe bonds that provide for reduced payments of principal, interest or both, that depend on a climatic, geological or any other physical variable that is not specific to a party to the contract.

B28 If the contracts described in paragraph B27 create financial assets or financial liabilities, they are within the scope of IFRS 9.

B29 If the contracts described in paragraph B27 do not create financial assets or financial liabilities, they are within the scope of other applicable Standards, such as [draft] IFRS X *Revenue from Contracts with Customers*.

B30 The credit-related guarantees and credit insurance discussed in paragraph B27(f) can have various legal forms, such as that of a guarantee, some types of letters of credit, a credit default contract or an insurance contract. If those contracts require the issuer to make specified payments to reimburse the holder for a loss that the holder incurs because a specified debtor fails to make payment when due to the policyholder in accordance with the original or modified terms of a debt instrument, they are insurance contracts. However, those insurance contracts are excluded from the scope of this [draft] Standard unless the issuer has previously asserted explicitly that it regards the contract as an insurance contract and has used accounting that is applicable to insurance contracts (see paragraph 7(f)). Credit-related guarantees and credit insurance contracts that require payment even if the policyholder has not incurred a loss on the failure of the debtor to make payments when due are not within the scope of this [draft] Standard because they do not transfer significant insurance risk. Such contracts include those that require payment:

- (a) regardless of whether the counterparty holds the underlying debt instrument; or

- (b) on a change in the credit rating or the credit index, rather than on the failure of a specified debtor to make payments when due.

Separating components from an insurance contract (paragraphs 9–11)

Investment components

- B31 Paragraph 10(b) requires an entity to separate a distinct investment component from the host insurance contract. Unless the investment component and insurance component are highly interrelated, an investment component is distinct if a contract with equivalent terms is sold, or could be sold, separately in the same market or same jurisdiction, either by entities that issue insurance contracts or by other parties. The entity shall take into account all information that is reasonably available in making this determination. The entity need not undertake an exhaustive search to identify whether an investment component is sold separately.
- B32 An investment component and insurance component are highly interrelated if:
- (a) the entity is unable to measure the one without considering the other. Thus, if the value of one component varies according to the value of the other, an entity shall apply this [draft] Standard to account for the whole contract containing the investment component and the insurance component; or
 - (b) the policyholder is unable to benefit from one component unless the other is also present. Thus, if the lapse or maturity of one component in a contract causes the lapse or maturity of the other, the entity shall apply this [draft] Standard to account for the whole contract containing the investment component and insurance component.

Performance obligations to provide goods or services

- B33 Paragraph 10(c) requires an entity to separate from an insurance contract a distinct performance obligation to provide goods or services. A performance obligation is defined in [draft] IFRS X *Revenue from Contracts with Customers* as a promise in a contract with a customer to transfer a good or service to the customer. Performance obligations include promises that are implied by an entity's customary business practices, published policies or specific statements if those promises create a valid expectation held by the policyholder that the entity will transfer a good or service. Performance obligations do not include activities that an entity must undertake to fulfil a contract unless the entity transfers a good or service to the policyholder as those activities occur. For example, an entity may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the policyholder as the tasks are performed. Hence, those promised set-up activities are not a performance obligation.
- B34 Subject to paragraph B35, a performance obligation to provide a good or service is distinct if either of the following criteria is met:

- (a) the entity (or another entity that does or does not issue insurance contracts) regularly sells the good or service separately in the same market or same jurisdiction. The entity shall take into account all information that is reasonably available in making this determination. The entity need not undertake an exhaustive search to identify whether a good or service is sold separately.
 - (b) the policyholder can benefit from the good or service either on its own or together with other resources that are readily available to the policyholder. Readily available resources are goods or services that are sold separately (by the entity or by another entity that might not issue insurance contracts), or resources that the policyholder has already obtained (from the entity or from other transactions or events).
- B35 A performance obligation to provide a good or service is not distinct if the cash flows and risks associated with the good or service are highly interrelated with the cash flows and risks associated with the insurance components in the contract, and the entity provides a significant service of integrating the good or service with the insurance components.

Measurement (paragraphs 17–48)

Level of measurement (paragraph 22)

- B36 The expected (probability-weighted) cash flows from a portfolio of insurance contracts equals the sum of the expected cash flows of the individual contracts. Consequently, the level of aggregation for measurement should not affect the expected present values of future cash flows.
- B37 However, from a practical point of view, it may be easier to make estimates in aggregate for a portfolio rather than for individual insurance contracts. For example, incurred but not reported (IBNR) estimates are typically made for a portfolio as a whole. If expenses are incurred at the portfolio level but not at an individual insurance contract level, it may be easier, and perhaps even necessary, to estimate them at an aggregate level. Accordingly, this [draft] Standard requires that entities measure an insurance contract using:
- (a) expected cash flows assessed at the level of a portfolio of insurance contracts (see paragraph 22);
 - (b) a risk adjustment measured by incorporating diversification benefits to the extent that the entity considers those benefits in setting the amount of compensation it requires to bear risk (see paragraphs B76–B77);
 - (c) the contractual service margin at initial recognition at the level of a portfolio of insurance contracts, consistent with the cash flows (see paragraph 28); and
 - (d) the amount of contractual service margin recognised in profit or loss at a level of aggregation such that once the coverage period of the insurance contract has ended, the related contractual service margin has been fully recognised in profit or loss (see paragraph 32).

B38 However, the expected value of estimates made at the portfolio level reflects the expected value of the equivalent estimates of those amounts attributed to the individual contracts. In principle, this should be no different from making expected value estimates for individual insurance contracts and then aggregating the results for the portfolio of those contracts.

Estimates of future cash flows (paragraphs 22–24)

B39 This section addresses:

- (a) uncertainty and the expected present value approach (see paragraphs B40–B42);
- (b) market variables and non-market variables (see paragraphs B43–B53);
- (c) estimating probabilities of future payments (see paragraph B54);
- (d) using current estimates (see paragraphs B55–B58);
- (e) future events (see paragraphs B59–B61); and
- (f) cash flows within the contract boundary (see paragraphs B62–B67).

Uncertainty and the expected present value approach (paragraph 22)

B40 The objective of estimating cash flows to measure the fulfilment cash flows is to determine the expected value, or statistical mean, of the full range of possible outcomes. Thus, the starting point for an estimate of the cash flows is a range of scenarios that reflects the full range of possible outcomes. Each scenario specifies the amount and timing of the cash flows for a particular outcome, and the estimated probability of that outcome. The cash flows from each scenario are discounted and weighted by the estimated probability of that outcome in order to derive an expected present value that is consistent with market variables. Thus, the objective is not to develop a most likely outcome, or a more-likely-than-not outcome, for future cash flows. Instead, the objective is to identify and reflect all of the possible scenarios in order to make unbiased estimates of the probability of each scenario. In some cases, an entity has access to considerable data and may be able to develop those cash flow scenarios easily. In other cases, an entity may not be able to develop more than general statements about the variability of cash flows or their related probabilities without incurring considerable costs. When this is the case the entity shall use those general statements for estimating the future cash flows.

B41 When considering the full range of possible outcomes, the objective is not necessarily to identify every possible scenario but instead to incorporate all of the relevant information and not ignore any that is difficult to obtain. In practice, it is not necessary to develop explicit scenarios if the resulting estimate is consistent with the measurement objective of considering all of the relevant information when determining the mean. For example, if an entity estimates that the probability distribution of outcomes is broadly consistent with a probability distribution that can be described completely with a small number of parameters, it will suffice to estimate that smaller number of parameters. Similarly, in some cases, relatively simple modelling may give an answer within an acceptable range of precision, without the need for a large number of

detailed simulations. However, in some cases, the cash flows may be driven by complex underlying factors and may respond in a highly non-linear fashion to changes in economic conditions. This may happen if, for example, the cash flows reflect a series of interrelated options that are implicit or explicit. In such cases, more sophisticated stochastic modelling is likely to be needed to satisfy the measurement objective.

- B42 The scenarios developed shall include unbiased estimates of the probability of catastrophic losses under existing contracts. Those scenarios exclude possible claims under possible future contracts. For example, suppose that there is a 5 per cent probability that an earthquake will occur during the remaining coverage period of an existing contract causing losses with a present value of CU1,000,000. In that case, the expected present value of the cash outflows includes CU50,000 (ie CU1,000,000 × 5 per cent) for those losses. The expected value of the cash outflows for that contract does not include the possible losses from an earthquake that could happen after the end of the coverage period.

Market variables and non-market variables (paragraph 22(b))

- B43 This application guidance identifies two types of variables:
- (a) market variables—variables that can be observed in, or derived directly from, markets (for example, prices of publicly traded securities and interest rates); and
 - (b) non-market variables—all other variables (for example, the frequency and severity of insurance claims and mortality).

Market variables (paragraph 22(b))

- B44 Estimates of market variables shall be consistent with observable market prices at the end of the reporting period. An entity shall not substitute its own estimates for observed market prices except as described in paragraph 79 of IFRS 13. In accordance with IFRS 13, if market variables need to be estimated (for example, because no observable market variables exist), they shall be as consistent as possible with observable market variables.
- B45 Market prices blend a range of views about possible future outcomes and also reflect the risk preferences of market participants. Consequently, they are not a single-point forecast of the future outcome. If the actual outcome differs from the previous market price, this does not mean that the market price was 'wrong'.
- B46 An important application of market variables is the notion of a replicating asset or a replicating portfolio of assets. A replicating asset is one whose cash flows *exactly* match the contractual cash flows in amount, timing and uncertainty. In some cases, a replicating asset may exist for some of the cash flows that arise from an insurance contract. The fair value of that asset both reflects the expected present value of the cash flows from the asset and the risk associated with those cash flows. If a replicating portfolio of assets exists for some or all of the cash flows that arise from an insurance contract liability, the entity can, for those contractual cash flows, use the fair value of those assets for the relevant fulfilment cash flows instead of explicitly estimating the expected present value of those particular cash flows and the associated risk adjustment. For cash flows

that are not measured by a replicating portfolio of assets, an entity shall explicitly estimate the expected present value of those particular cash flows and the associated risk adjustment.

B47 This [draft] Standard does not require an entity to use a replicating portfolio technique. However, if a replicating asset or portfolio does exist and an entity chooses to use a different technique, the entity shall satisfy itself that a replicating portfolio technique would be unlikely to lead it to a materially different answer. One way to assess whether this is the case is to verify that applying the other technique to the cash flows that are generated by the replicating portfolio produces a measurement that is not materially different from the fair value of the replicating portfolio.

B48 As an example of a replicating portfolio technique, suppose an insurance contract contains a feature that generates cash flows that are equal to the cash flows from a put option on a basket of traded assets. The replicating portfolio for those cash flows would be a put option on the same terms on that basket of traded assets. The entity would observe or estimate the fair value of that option and include that amount in the measurement of the insurance contract. However, the entity could use a technique other than a replicating portfolio if that technique is expected to achieve the same measurement of the contract as a whole. For example, other techniques may be more robust or easier to implement if there are significant interdependencies between the embedded option and other features of the contract. Judgement is required to determine the approach that best meets the objective in particular circumstances.

Non-market variables (paragraph 22(b))

B49 Estimates of non-market variables shall reflect all of the available evidence, both external and internal.

B50 Non-market external data (for example, national mortality statistics) may have more or less relevance than internal data (for example, internally developed mortality statistics), depending on the circumstances. For example, an entity that issues life insurance contracts shall not rely solely on national mortality statistics, but shall consider all other available internal and external sources of information when developing unbiased estimates of probabilities for mortality scenarios for its insurance contract portfolios. In developing those probabilities, an entity shall consider all of the evidence that is available, giving more weight to the more persuasive evidence. For example:

- (a) internal mortality statistics may be more persuasive than national mortality data if national data is derived from a large population that is not representative of the insured population. This is because, for example, the demographic characteristics of the insured population could significantly differ from those of the national population, meaning that an entity would need to place more weight on the internal data and less weight on the national statistics.

- (b) conversely, if the internal statistics are derived from a small population with characteristics that are believed to be close to those of the national population, and the national statistics are current, an entity would place more weight on the national statistics.
- B51 Estimated probabilities for non-market variables shall not contradict observable market variables. For example, estimated probabilities for future inflation rate scenarios shall be as consistent as possible with probabilities implied by market interest rates.
- B52 In some cases, an entity may conclude that market variables vary independently of non-market variables. If so, the entity shall consider scenarios that reflect the range of outcomes for the non-market variables, with each scenario using the same observed value of the market variable.
- B53 In other cases, market variables and non-market variables may be correlated. For example, there may be evidence that lapse rates are correlated with interest rates. Similarly, there may be evidence that claim levels for house or car insurance are correlated with economic cycles and therefore with interest rates and expense amounts. The entity shall ensure that the probabilities for the scenarios and the risk adjustments that relate to the market variables are consistent with the observed market prices that depend on those market variables.

Estimating probabilities of future payments (paragraph 22(c))

- B54 An entity estimates the probabilities associated with future payments under existing contracts on the basis of:
- (a) information about claims already reported by policyholders.
 - (b) other information about the known or estimated characteristics of the portfolio of insurance contracts.
 - (c) historical data about the entity's own experience, supplemented when necessary with historical data from other sources. Historical data is adjusted if, for example:
 - (i) the characteristics of the portfolio differ (or will differ, for example because of adverse selection) from those of the population that has been used as a basis for the historical data;
 - (ii) there is evidence that historical trends will not continue, that new trends will emerge or that economic, demographic and other changes may affect the cash flows that arise from the existing insurance contracts; or
 - (iii) there have been changes in items such as underwriting procedures and claims management procedures that may affect the relevance of historical data to the portfolio of insurance contracts.
 - (d) current price information, if available, for reinsurance contracts and other financial instruments (if any) covering similar risks, such as catastrophe bonds and weather derivatives, and recent market prices for

transfers of portfolios of insurance contracts. This information shall be adjusted to reflect the differences between the cash flows that arise from those reinsurance contracts or other financial instruments, and the cash flows that would arise as the entity fulfils the underlying contracts with the policyholder.

Using current estimates (paragraph 22(d))

- B55 In estimating the probability of each cash flow scenario, an entity shall use all of the available current information at the end of the reporting period. An entity shall review the estimates of the probabilities that it made at the end of the previous reporting period and update them for any changes. In doing so, an entity shall consider whether:
- (a) the updated estimates faithfully represent the conditions at the end of the reporting period; and
 - (b) the changes in estimates faithfully represent the changes in conditions during the period. For example, suppose that estimates were at one end of a reasonable range at the beginning of the period. If the conditions have not changed, changing the estimates to the other end of the range at the end of the period would not faithfully represent what has happened during the whole period. If an entity's most recent estimates are different from its previous estimates, but conditions have not changed, it shall assess whether the new probabilities that are assigned to each scenario are justified. In updating its estimates of those probabilities, the entity shall consider both the evidence that supported its previous estimates and all of the new available evidence, giving more weight to the more persuasive evidence.
- B56 The probability assigned to each scenario shall reflect the conditions at the end of the reporting period. Consequently, in accordance with IAS 10 *Events after the Reporting Period*, an event that occurs after the end of the reporting period and resolves a condition that existed at the reporting date does not provide evidence of a condition that existed at the end of the reporting period. For example, there may be a 20 per cent probability at the end of the reporting period that a major storm will strike during the remaining six months of an insurance contract. After the end of the reporting period and before the financial statements are authorised for issue, a storm strikes. The fulfilment cash flows under that contract shall not reflect the storm that, with hindsight, is known to have occurred. Instead, the cash flows that were included in the measurement are multiplied by the 20 per cent probability that was apparent at the end of the reporting period (with appropriate disclosure, in accordance with IAS 10, that a non-adjusting event occurred after the end of the reporting period).
- B57 Current estimates of expected cash flows are not necessarily identical to the most recent actual experience. For example, suppose that mortality experience last year was 20 per cent worse than the previous mortality experience and previous expectations of mortality experience. Several factors could have caused the sudden change in experience, including:
- (a) lasting changes in mortality;

- (b) changes in the characteristics of the insured population (for example, changes in underwriting or distribution, or selective lapses by policyholders in unusually good or bad health);
- (c) random fluctuations; or
- (d) identifiable non-recurring causes.

B58 An entity shall investigate the reasons for the change in experience and develop new probability estimates for the possible outcomes in the light of the most recent experience, the earlier experience and other information. Typically, the result for the example in paragraph B57 would be that the expected present value of death benefits changes, but not by as much as 20 per cent. Actuaries have developed ‘credibility’ techniques that an entity could use when assessing how new evidence affects the probability of different outcomes. In the example in paragraph B57, if the mortality continues to be significantly higher than the previous estimates, the estimated probability assigned to the high mortality scenarios will increase as new evidence becomes available.

Future events (paragraph 22(d))

B59 Estimates of non-market variables shall consider not just current information about the current level of insured events but also information about trends. For example, mortality rates have consistently declined over long periods in many countries. The determination of the fulfilment cash flows reflects the probabilities that would be assigned to each possible trend scenario in the light of all of the available evidence.

B60 Similarly, if cash flows from the insurance contract are sensitive to inflation, the determination of the fulfilment cash flows shall reflect possible future inflation rates (see also paragraphs 26 and B53). Because inflation rates are likely to be correlated with interest rates, the measurement of fulfilment cash flows reflects the probabilities for each inflation scenario in a way that is consistent with the probabilities that are implied by market interest rates (those that are used in estimating the discount rate, as specified in paragraphs 25–26).

B61 When estimating the cash flows from an insurance contract, an entity shall take into account future events that might affect those cash flows. The entity shall develop cash flow scenarios that reflect those future events, as well as unbiased estimates of the probability weights for each scenario. However, an entity shall not take into account future events, such as a change in legislation, that would change or discharge the present obligation or create new obligations under the existing insurance contract.

Cash flows within the contract boundary (paragraphs 22(e) and 23–24)

B62 Estimates of cash flows in a scenario shall include, on an expected value basis, all cash flows within the boundary of an existing contract, and no other cash flows.

B63 Many insurance contracts have features that enable policyholders to take actions that change the amount, timing, nature or uncertainty of the amounts that they will receive. Such features include renewal options, surrender options,

conversion options and options to cease paying premiums while still receiving benefits under the contracts. The measurement of an insurance contract shall reflect, on an expected value basis, the entity's view of how the policyholders in the portfolio that contains the contract will exercise options available to them, and the risk adjustment shall reflect the entity's view of how the actual behaviour of the policyholders in the portfolio of contracts may differ from the expected behaviour. Thus, the measurement of an insurance contract shall not assume that all policyholders in the portfolio of contracts:

- (a) surrender their contracts if that is not the expected behaviour of the policyholders; or
- (b) continue their contracts if that is not the expected behaviour of the policyholders.

B64 When an issuer is required by the insurance contract to renew or otherwise continue the contract, it shall apply paragraphs 23–24 to assess whether premiums and related cash flows that arise from the renewed contract are within the boundary of the original contract.

B65 Paragraph 23 refers to an entity's right or practical ability to set a price at a future date (a renewal date) that fully reflects the risks in the contract or portfolio from that date. An entity has that right or practical ability when there are no constraints to prevent it from setting the same price as it would for a new contract that is issued on that date, or if it can amend the benefits to be consistent with those that it would provide for the price that it will charge. Similarly, an entity has that right or practical ability when it can reprice an existing contract so that the price reflects overall changes in the risks in the portfolio, even if the price set for each individual policyholder does not reflect the change in risk for that specific policyholder. When assessing whether the entity has the right or practical ability to set a price that fully reflects the risks in the contract or portfolio, it should consider all the risks that it would consider when underwriting equivalent contracts on the renewal date for the remaining coverage.

B66 Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the portfolio of contracts and include:

- (a) premiums (including premium adjustments and instalment premiums) from policyholders and any additional cash flows that result from those premiums.
- (b) payments to (or on behalf of) policyholders, including claims that have already been reported but have not yet been paid (ie reported claims), incurred claims for events that have occurred but for which claims have not been reported (IBNR) and all future claims within the boundary of the existing contract.
- (c) directly attributable acquisition costs that can be allocated on a rational and consistent basis to the individual portfolios of insurance contracts. Acquisition costs include costs that cannot be attributed directly to individual insurance contracts in the portfolio.

- (d) claim handling costs (ie the costs that the entity will incur in processing and resolving claims under existing insurance contracts, including legal and loss-adjusters' fees and internal costs of investigating claims and processing claim payments).
- (e) the costs that the entity will incur in providing contractual benefits that are paid in kind.
- (f) cash flows that will result from options and guarantees embedded in the contract, to the extent that those options and guarantees are not separated from the insurance contract (see paragraph 10(a)). When insurance contracts contain embedded options or guarantees, it is important to consider the full range of scenarios.
- (g) policy administration and maintenance costs, such as costs of premium billing and handling policy changes (for example, conversions and reinstatements). Such costs also include recurring commissions that are expected to be paid to intermediaries if a particular policyholder continues to pay the premiums within the boundary of the insurance contract.
- (h) transaction-based taxes (such as premium taxes, value added taxes and goods and services taxes) and levies (such as fire service levies and guarantee fund assessments) that arise directly from existing insurance contracts, or that can be attributed to them on a reasonable and consistent basis.
- (i) payments by the insurer in a fiduciary capacity to meet tax obligations incurred by the policyholder, and related receipts.
- (j) potential recoveries (such as salvage and subrogation) on future claims that are covered by existing insurance contracts and, to the extent that they do not qualify for recognition as separate assets, potential recoveries on past claims.
- (k) payments arising from existing contracts that provide policyholders with a share in the returns on underlying items (see paragraph 33), regardless of whether those payments are made to current or future policyholders.
- (l) fixed and variable overheads (such as the costs of accounting, human resources, information technology and support, building depreciation, rent and maintenance and utilities) that are directly attributable to fulfilling the portfolio that contains the insurance contract and that are allocated to each portfolio of insurance contracts using methods that:
 - (i) are systematic and rational, and are consistently applied to all costs that have similar characteristics; and
 - (ii) ensure that the costs included in the cash flows that are used to measure insurance contracts do not exceed the costs incurred.
- (m) any other costs that are specifically chargeable to the policyholder under the terms of the contract.

B67 The following cash flows shall not be considered when estimating the cash flows that will arise as the entity fulfils an existing insurance contract:

- (a) investment returns on underlying items. The investments are recognised, measured and presented separately. However, the measurement of an insurance contract may be affected by the cash flows, if any, that depend on the investment returns.
- (b) cash flows (payments or receipts) that arise under reinsurance contracts. Reinsurance contracts are recognised, measured and presented separately.
- (c) cash flows that may arise from future insurance contracts, ie cash flows that are outside the boundary of existing contracts (see paragraphs 23–24).
- (d) cash flows relating to costs that cannot be directly attributed to the portfolio of insurance contracts that contain the contract, such as product development and training costs. Such costs are recognised in profit or loss when incurred.
- (e) cash flows that arise from abnormal amounts of wasted labour or other resources that are used to fulfil the contract. Such costs are recognised in profit or loss when incurred.
- (f) income tax payments and receipts that the insurer does not pay or receive in a fiduciary capacity. Such payments and receipts are recognised, measured and presented separately in accordance with IAS 12 *Income Taxes*.
- (g) cash flows between different components of the reporting entity, such as policyholder funds and shareholder funds, because those cash flows do not change the amount that will be paid to the policyholders.
- (h) cash flows that arise from components that are separated from the insurance contract and accounted for using other applicable Standards (see paragraph 10).

Changes in current estimates of cash flows (paragraphs 30–31)

B68 Paragraph 30 requires an adjustment to the remaining amount of the contractual service margin for a difference between the current and previous estimates of the cash flows that relate to future coverage and other future services. Accordingly:

- (a) the contractual service margin is not adjusted for changes in estimates of incurred claims, because these claims relate to past coverage. Such changes are recognised immediately in profit or loss.
- (b) the contractual service margin is adjusted for experience differences that relate to future coverage; for example, if they relate to premiums for future coverage. The entity adjusts the margin for both the change in premiums and any resulting changes in future outflows.
- (c) the contractual service margin is not adjusted for a delay or acceleration of repayments of investment components if the change in timing did not affect the cash flows relating to future services. For example, if an entity estimates that there will be a lower repayment in one period because of a

corresponding higher repayment in a future period, the change in timing does not affect the cash flows relating to future periods. The contractual service margin is adjusted only for any net effect on the contractual service margin of the delay or acceleration.

- (d) the contractual service margin is not adjusted for changes in estimates of cash flows that depend on investment returns if those changes arise as a result of changes in the value of the underlying items. Such changes do not relate to services provided under the contract.
- (e) the contractual service margin is adjusted for changes in estimates of cash flows that are expected to vary directly with returns on underlying items only if those cash flows relate to future services under the insurance contract. For example, changes in cash flows relating to asset management services that are provided under a contract relate to future services under the insurance contract. Gains or losses on the underlying items do not relate to unearned profit from future services from the insurance contract and are recognised in accordance with the Standards relevant to the underlying items.

Time value of money (paragraphs 25–26)

- B69 Discount rates that reflect the characteristics of the cash flows of an insurance contract may not be directly observable in the market. An entity shall maximise the use of current observable market prices of instruments with similar cash flows, but shall adjust those prices to reflect the differences between those cash flows and the cash flows of the insurance contract in terms of timing, currency and liquidity. This [draft] Standard does not prescribe the method for making those adjustments.
- B70 In making the adjustments described in paragraph B69, an entity shall include in the discount rates for the insurance contract only those factors that are relevant for the insurance contract, as follows:
- (a) in some cases, the entity determines the yield curve for the insurance contract based on a yield curve that reflects the current market rates of returns either for the actual portfolio of assets that the entity holds or for a reference portfolio of assets as a starting point. The rates of return for the portfolio include market risk premiums for credit risk and liquidity risk. In a ‘top-down’ approach, an entity:
 - (i) excludes, from the observable rates of return that apply to a portfolio of assets, its estimates of the factors that are not relevant to the insurance contract. Such factors include market risk premiums for assets included in the portfolio that are being used as a starting point.
 - (ii) adjusts for differences between the timing of the cash flows of the assets in the portfolio and the timing of the cash flows of the insurance contract. This ensures that the duration of the assets is matched to the duration of the liability.
 - (iii) does not include, in accordance with paragraph 21, the risk of the entity’s own non-performance.

While there may be remaining differences between the liquidity characteristics of the insurance contract and the liquidity characteristics of the assets in the portfolio, an entity applying the top-down approach need not make adjustments to eliminate those differences.

- (b) in other cases, the entity adjusts a risk-free yield curve to include its estimates of the factors that are relevant to the insurance contract (a 'bottom-up' approach). Factors that are relevant to the insurance contract include differences between the liquidity characteristics of the financial instruments that underlie the rates observed in the market and the liquidity characteristics of the insurance contract. For example, some government bonds are traded in deep and liquid markets and the holder can typically sell them readily at any time without incurring significant transaction costs such as bid-ask spreads. In contrast, insurance contract liabilities cannot generally be traded, and it may not be possible to cancel the contract before it matures.
- B71 When observable market variables are not available, or do not separately identify the relevant factors, an entity uses estimation techniques to determine the appropriate discount rate, taking into account other observable inputs when available. For example, the entity may need to determine the discount rates applied to cash flows that are expected beyond the period for which observable market data is available using the current, observable market yield curve for shorter durations. Another example would be the estimate of the credit risk premium that is included in the spread of a debt instrument using a credit derivative as a reference point. An entity assesses the extent to which the market prices for credit derivatives includes factors that are not relevant to determining the credit risk component of the market rate of return so that the credit risk component of the overall asset spread can be determined.
- B72 In principle, the discount rates that are not expected to vary with returns on underlying items will result in the same yield curve for all cash flows because the different liquidity characteristics of the contracts will be eliminated to result in an illiquid risk-free yield curve that eliminates all uncertainty about the amount and timing of cash flows. However, applying paragraph B70(a) may result in different yield curves in practice, even in the same currency.
- B73 To the extent that the amount, timing or uncertainty of the cash flows that arise from an insurance contract depends on the returns on underlying items, paragraph 26(a) requires the characteristics of the liability to reflect that dependence. The discount rates used to measure those cash flows shall therefore reflect the extent of that dependence. This is the case regardless of whether that dependence arises as a result of contractual terms or through the entity exercising discretion, and regardless of whether the entity holds the underlying items.
- B74 The [draft] Standard does not specify restrictions on the portfolio of assets used to determine the discount rates in applying paragraph B70(a). However, fewer adjustments would be required to eliminate those factors not relevant to the liability when the reference portfolio of assets has similar characteristics to those of the insurance contract liabilities. Accordingly:

- (a) for debt instruments, the objective is to eliminate from the total bond yield the factors that are not relevant for the insurance contract. Those factors include the effects of expected credit losses, the market risk premium for credit and a market premium for liquidity.
- (b) for equity investments, more significant adjustments are required to eliminate the factors that are not relevant to the insurance contract. This is because there are greater differences between the cash flow characteristics of equity investments and the cash flow characteristics of insurance contracts. In particular, the objective is to eliminate from the portfolio rate the part of the expected return for bearing investment risk. Those investment risks include the market risk and any other variability in the amount and timing of the cash flows from the assets.

B75 In some circumstances, the most appropriate way to reflect any dependence of the cash flows that arise from an insurance contract on specified assets might be to use a replicating portfolio technique (see paragraphs B46–B48). In other cases, an entity might use discount rates that are consistent with the measurement of those assets, and that have been adjusted for any asymmetry between the entity and the policyholders in the sharing of the risks arising from those assets.

Risk adjustment (paragraph 27)

B76 The risk adjustment measures the compensation that the entity would require to make the entity indifferent between:

- (a) fulfilling an insurance contract liability that has a range of possible outcomes; and
- (b) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contract.

For example, the risk adjustment would measure the compensation that the entity would require to make it indifferent between fulfilling a liability that has a 50 per cent probability of being CU90 and a 50 per cent probability of being CU110 and fulfilling a liability that is fixed at CU100. As a result, the risk adjustment conveys information to users of financial statements about the entity's perception of the effects of uncertainty about the amount and timing of cash flows that arise from an insurance contract.

B77 Because the measurement of the risk adjustment reflects the compensation that the entity would require for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the contract, the risk adjustment also reflects:

- (a) the degree of diversification benefit that the entity considers when determining the compensation it requires for bearing that uncertainty; and
- (b) both favourable and unfavourable outcomes in a way that reflects the entity's degree of risk aversion.

B78 The purpose of the risk adjustment is to measure the effect of uncertainty in the cash flows that arise from the insurance contract. Consequently, the risk

adjustment shall reflect all risks associated with the insurance contract, other than those reflected through the use of market consistent inputs (see paragraph B44). It shall not reflect the risks that do not arise from the insurance contract, such as investment risk relating to the assets that an entity holds (except when that investment risk affects the amounts payable to policyholders), asset-liability mismatch risk or general operational risk that relates to future transactions.

- B79 The risk adjustment shall be included in the measurement in an explicit way. Thus, in principle, the risk adjustment is separate from the estimates of future cash flows and the discount rates that adjust those cash flows for the time value of money. The entity shall not double-count the risk adjustments by, for example, including the risk adjustment implicitly when determining the estimates of future cash flows or the discount rates. The estimates of future cash flows and the discount rates that are disclosed to comply with paragraphs 73–85 shall not include any implicit adjustments for risk.
- B80 The requirement that a risk adjustment must be included in the measurement in an explicit way (ie separately from the expected cash flows and the discount rate building blocks) does not preclude a ‘replicating portfolio’ approach as described in paragraphs B46–B48. To avoid double-counting, the risk adjustment does not include any risk that is captured in the fair value of the replicating portfolio.
- B81 The [draft] Standard does not specify the technique that is used to determine the risk adjustment. However, to meet the objective in paragraph B76, the risk adjustment shall have the following characteristics:
- (a) risks with low frequency and high severity will result in higher risk adjustments than risks with high frequency and low severity;
 - (b) for similar risks, contracts with a longer duration will result in higher risk adjustments than contracts with a shorter duration;
 - (c) risks with a wide probability distribution will result in higher risk adjustments than risks with a narrower distribution;
 - (d) the less that is known about the current estimate and its trend, the higher the risk adjustment; and
 - (e) to the extent that emerging experience reduces uncertainty, risk adjustments will decrease and vice versa.
- B82 An entity shall apply judgement when determining an appropriate risk adjustment technique to use. When applying that judgement, an entity shall also consider whether the technique provides concise and informative disclosure so that users of financial statements can benchmark the entity’s performance against the performance of other entities. Paragraph 84 requires an entity to translate the result of that technique into a confidence level if it uses a different technique to determine the risk adjustment.

Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items (paragraphs 33–34 and 66)

- B83 Paragraph 34 specifies requirements that eliminate accounting mismatches between the cash flows from an insurance contract and underlying items when the terms of the contract mean that the entity will not suffer any economic mismatches. That is the case when the criteria in paragraph 33 are met, ie when the contract specifies a link to those underlying items.
- B84 The criteria in paragraph 33 would not be met if either of the following apply:
- (a) the payments arising from the contract reflect the returns on identifiable assets or liabilities only because the entity chooses to make payments on that basis. In that case, the entity may choose to avoid economic mismatches by making payments that are expected to vary directly with returns on underlying items, but it is not required to do so. However the entity is not required to avoid the economic mismatches that would arise if it held other assets or liabilities.
 - (b) the entity could choose to hold the underlying items and so could avoid the economic mismatches, but is not required to hold those underlying items.
- B85 For contracts meeting the criteria in paragraph 33, an entity determines the fulfilment cash flows that are expected to vary directly with returns on underlying items and measures those fulfilment cash flows on a different basis from the other fulfilment cash flows. An entity shall decompose the cash flows in a way that maximises the extent to which the measurement both:
- (a) expresses the cash flows in a way that illustrates the extent to which they are expected to vary with returns on underlying items; and
 - (b) maximises the minimum fixed payment that the policyholder will receive.
- B86 For example, if a contract promises to pay a policyholder a minimum of CU1,000 plus 90 per cent of the increase in the fair value of underlying items ('A') above an initial fair value of CU1,000, the cash flows could be decomposed in the following ways:
- (a) as a fixed amount plus a written call option, ie
 $CU1,000 + [90\% \times \text{the greater of } (A - CU1,000) \text{ and } CU0]$;
 - (b) as 100 per cent of the assets plus the value of the guarantee (a written put option) less the value of the entity's 10 per cent participation in the upside (a call option held), ie
 $A + [\text{the greater of } (CU1,000 - A) \text{ and } CU0] - [10\% \times \text{the greater of } (A - CU1,000) \text{ and } CU0]$; or
 - (c) as 90 per cent of the assets plus a fixed payment of CU100 plus 90 per cent of the increase in the assets above CU1,000, ie
 $[90\% \times A] + CU100 + [90\% \times \text{the greater of } (CU1,000 - A) \text{ and } CU0]$.

However, only (c) would meet the conditions in paragraph B85 because it expresses the cash flows in a way that maximises the extent to which they are expected to vary with returns on underlying items, and the minimum fixed payment the policyholder will receive.

- B87 The general requirements in paragraphs 60–65 for presentation in profit or loss or other comprehensive income would not apply to those cash flows that are expected to vary directly with returns on underlying items. However, the entity would apply the requirements in paragraphs 60–65 to the cash flows in contracts that are not expected to vary with returns on underlying items.

Presentation of insurance contract revenue and expenses (paragraphs 56–59)

- B88 Paragraph 56 states that insurance contract revenue depicts the transfer of promised services arising from the insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The liability for the remaining coverage at the end of the reporting period represents the remaining obligation to provide services in the future. Consequently, the change in the liability for the remaining coverage during the reporting period represents the coverage or other services that the entity provided in that period, assuming no other changes occur. As a result, the entity measures the amount of insurance contract revenue that is presented in each reporting period at the difference between the opening and closing carrying amounts of the liability for the remaining coverage, excluding changes that do not relate to coverage or other services for which the entity expects to receive consideration. Those changes would include, for example, changes resulting from any cash flows in the period and any amounts that are recognised immediately in profit or loss in accordance with paragraphs 60(a) and 60(d).
- B89 The premium paid by the policyholder includes, in addition to the amount relating to providing coverage and other services:
- (a) amounts the entity charged to recover directly attributable acquisition costs. For the purpose of measuring insurance contract revenue, an entity shall allocate the directly attributable acquisition costs over the coverage period in the systematic way that best reflects the transfer of services provided under the contract. However, paragraph 39(a) permits an entity to recognise those costs as an expense when incurred in some circumstances.
 - (b) amounts that relate to investment components. In accordance with paragraph 58, an entity shall exclude from insurance contract revenue any investment components that have not been separated in accordance with paragraph 10(b).
- B90 Accordingly, insurance contract revenue can also be expressed as the sum of:
- (a) the latest estimates of the expected claims and expenses relating to coverage for the current period excluding those recognised immediately in profit or loss in accordance with paragraphs 60(a) and 60(d). That amount relates to the latest estimates of the expected claims and

expenses before the claim is incurred and excludes any repayments of investment components that are included in the latest estimates of the expected claims.

- (b) the change in the risk adjustment.
- (c) the amount of the contractual service margin recognised in profit or loss in the period.
- (d) an allocation of the portion of the premium that relates to recovering directly attributable acquisition costs. The entity allocates the part of the premium relating to the recovery of those costs to each accounting period in the systematic way that best reflects the transfer of services provided under that contract.

B91 When an entity applies the premium-allocation approach in paragraphs 38–40 or 42(a), the entity measures the liability for the remaining coverage using the premium-allocation approach specified in paragraph 38, rather than using the fulfilment cash flows and contractual service margin. When an entity applies the premium-allocation approach, insurance contract revenue for the period is determined as the amount of the expected premium receipts allocated in the period. The entity shall allocate the expected premium receipts as insurance contract revenue to each accounting period in the systematic way that best reflects the transfer of services that are provided under the contract.

Appendix C

Effective date and transition

This Appendix is an integral part of this [draft] Standard.

Effective date

- C1 An entity shall apply this [draft] Standard for annual periods beginning on or after [date approximately three years from the date of publication]. Early application is permitted.

Transition

- C2 The transition requirements in paragraphs C3–C12 apply when an entity first applies this [draft] Standard. The application of this [draft] Standard is a change in accounting policy, to which IAS 8 *Accounting Policies, Changes in Accounting Estimates and Changes in Accounting Policies* applies. Unless otherwise specified, an entity shall recognise the cumulative effect of such changes in the accounting policy as, at the beginning of the earliest period presented, an adjustment to the opening retained earnings and, if applicable, to the opening balance of the accumulated other comprehensive income.
- C3 At the beginning of the earliest period presented, an entity shall, with a corresponding adjustment to retained earnings, derecognise:
- (a) 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, in accordance with 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 in accordance with IFRS 4 *Insurance Contracts* and that are derecognised in accordance with (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.
 - (d) measure each portfolio of insurance contracts at the sum of:
 - (i) the fulfilment cash flows; and
 - (ii) a contractual service margin, determined in accordance with paragraphs C4–C6.
 - (e) recognise, in a separate component of equity, the cumulative effect of the difference between the expected present values of the cash flows at the beginning of the earliest period presented, discounted using:
 - (i) current discount rates, as determined in accordance with paragraph 25; and

- (ii) the discount rates that were applied when the portfolios were initially recognised, determined in accordance with paragraph C6.
- C4 Except when paragraph C5 applies, an entity shall apply this [draft] Standard retrospectively in accordance with IAS 8 to measure an insurance contract in existence at the beginning of the earliest period presented.
- C5 IAS 8 specifies when it would be impracticable to apply this [draft] Standard to measure an insurance contract retrospectively. In those situations, an entity shall, at the beginning of the earliest period presented:
- (a) measure the insurance contract at the sum of:
 - (i) the fulfilment cash flows in accordance with this [draft] Standard; and
 - (ii) an estimate of the remaining contractual service margin, using the information about the entity's expectations at initial recognition of the contract that were determined in accordance with paragraph C6.
 - (b) estimate, for the purpose of measuring insurance contract revenue after the beginning of the earliest period presented, in accordance with paragraph C6, the carrying amount of the liability for the remaining coverage, excluding:
 - (i) any losses on the date of initial recognition; and
 - (ii) any subsequent changes in the estimates between the date of initial recognition and the beginning of the earliest period presented that were immediately recognised in profit or loss.
 - (c) determine, for the purpose of measuring the interest expense to be recognised in profit or loss, the discount rates that applied when the contracts in a portfolio were initially recognised in accordance with paragraph C6.
- C6 In applying paragraph C5, an entity need not undertake exhaustive efforts to obtain objective information but shall take into account all objective information that is reasonably available and:
- (a) estimate the expected cash flows at the date of initial recognition at the amount of the expected 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 at the same amount of the risk adjustment that is measured at the beginning of the earliest period presented. The entity shall not adjust that risk adjustment to reflect any changes in risk between the date of initial recognition and the beginning of the earliest period presented;

- (c) estimate the discount rates that applied at the date of initial recognition using an observable yield curve that, for at least three years before the date of transition, approximates the yield curve estimated in accordance with paragraphs 25–26 and B69–B75, if such an observable yield curve exists; and
- (d) if the observable yield curve in (c) 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 in accordance with paragraphs 25–26 and B69–B75, 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.

Disclosure

- C7 An entity applying this [draft] Standard for periods beginning before [date specified in paragraph C1] shall disclose that fact.
- C8 For each period presented for which there are contracts that were measured in accordance with paragraphs C3–C6, an entity shall disclose, in addition to the disclosures required by IAS 8:
- (a) the earliest date of initial recognition of the portfolios for which the entity applied this [draft] Standard retrospectively; and
 - (b) the disclosures required by paragraphs 83–85 separately for portfolios to which paragraphs C3–C6 apply. At a minimum, an entity shall provide those disclosures for:
 - (i) the contractual service margin as determined in accordance with paragraphs C5–C6, including a description of the extent to which the entity used information that is not objective in determining that margin; and
 - (ii) the discount rates as determined in accordance with paragraph C6.
- C9 In applying paragraph 90, an entity need not disclose previously unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it first applies this [draft] Standard. However, if an entity does not disclose that information, it shall disclose that fact.
- C10 An entity is not required to disclose, for the current period and for each prior period presented, the amount of the adjustment for each financial statement line item that is affected, as paragraph 28(f) of IAS 8 would otherwise require.

Redesignation of financial assets

- C11 At the beginning of the earliest period presented, when an entity first applies this [draft] Standard, it is permitted, but not required:
- (a) to redesignate a financial asset as measured at fair value through profit or loss if that financial asset meets the condition in paragraph 4.1.5 of IFRS 9, as applicable, at the date when the entity first applies this [draft] Standard.

- (b) if the entity has previously applied IFRS 9:
 - (i) to designate an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9; or
 - (ii) to revoke a previous designation of an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9.

C12 An entity is required to revoke previous designations of financial assets as measured at fair value through profit or loss if the initial application of this [draft] Standard eliminates the accounting mismatch that led to that previous designation.

Withdrawal of other IFRSs

C13 This [draft] Standard supersedes IFRS 4, issued in 2004.

Appendix D Consequential amendments to other Standards

This appendix sets out the [draft] amendments to other Standards that are a consequence of the IASB issuing this [draft] Standard. An entity shall apply those amendments when it applies this [draft] Standard. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

In Appendix B, paragraph B1 is amended and a heading and paragraph B13 are added. New text is underlined and deleted text is struck through.

Appendix B Exceptions to the retrospective application of other IFRSs

...

B1 An entity shall apply the following exceptions:

- (a) ...
- (e) embedded derivatives (paragraph B9); ~~and~~
- (f) government loans (paragraphs B10–B12); ~~and~~
- (g) insurance contracts (paragraph B13).

...

Insurance contracts

B13 An entity shall apply the transition provisions in paragraphs C4–C6 of [draft] IFRS X *Insurance Contracts*, which specifies a modified retrospective approach.

In Appendix D, paragraph D1 is amended and paragraph D4 and its related heading are deleted. New text is underlined and deleted text is struck through.

Appendix D Exemptions from other IFRSs

D1 An entity may elect to use one or more of the following exceptions:

- (a) ...
- (b) ~~insurance contracts (paragraph D4); [deleted]~~
- (c) ...

IFRS 3 *Business Combinations*

A heading and paragraph 31A are added.

Insurance contracts

- 31A The acquirer shall measure a portfolio of insurance and reinsurance contracts acquired in the business combination in accordance with paragraphs 43–46 of [draft] IFRS X *Insurance Contracts*, at the acquisition date.

IFRS 7 Financial Instruments: Disclosures

Paragraph 3 is amended. New text is underlined and deleted text is struck through.
--

Scope

- 3 This IFRS shall be applied by all entities to all types of financial instruments, except:
- (a) ...
- (d) ~~insurance contracts within the scope of as defined in [draft] IFRS X IFRS 4 Insurance Contracts.~~ However, this IFRS applies to:
- (i) derivatives that are embedded in such insurance ~~contracts~~ if IFRS 9 requires the entity to account for them separately; and
- (ii) distinct investment components that are embedded in such contracts if such components are required to be separated in accordance with [draft] IFRS X Insurance Contracts.
- Moreover, an issuer shall apply this IFRS to *financial guarantee contracts* if the issuer applies IFRS 9 in recognising and measuring the contracts, but shall apply [draft] IFRS X IFRS 4 if the issuer elects, in accordance with paragraph ~~7(f) 4(d)~~ of [draft] IFRS X IFRS 4, to apply [draft] IFRS X IFRS 4 in recognising and measuring them.
- (e) ...

IFRS 9 Financial Instruments

Paragraph 3.3.4A is added.

3.3 Derecognition of financial liabilities

- ...
- 3.3.4A Some entities operate, either internally or externally, an investment fund that issues notional units in linked contracts. As part of the entity's asset pool, these funds may include the entity's own financial liabilities (for example, corporate bonds issued). The entity may elect not to derecognise its own financial liabilities that are included in such an asset pool. Instead, it can elect to recognise and present such instruments as financial liabilities and recognise a corresponding financial asset. An entity shall measure the resulting financial asset at fair value through profit or loss.

In Appendix B, paragraph B4.1.30 is amended. New text is underlined and deleted text is struck through.

Designation eliminates or significantly reduces an accounting mismatch

...

B4.1.30 The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 4.1.5 or 4.2.2(a).

- (a) An entity issues ~~has liabilities under~~ insurance contracts whose measurement, in accordance with [draft] IFRS X *Insurance Contracts*, incorporates current information ~~(as permitted by IFRS 4, paragraph 24)~~, and financial assets it considers related that would otherwise be measured at amortised cost.
- (b) ...

IAS 1 *Presentation of Financial Statements*

Paragraphs 7 and 54 are amended. New text is underlined.

Definitions

7 ...

Other comprehensive income comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other IFRSs.

The components of other comprehensive income include:

- (a) ...
- (fa) gains and losses from contracts within the scope of [draft] IFRS X *Insurance Contracts*.
- ...

Information to be presented in the statement of financial position

54 **As a minimum, the statement of financial position shall include line items that present the following amounts:**

- (a) ...
- (o) **deferred tax liabilities and deferred tax assets, as defined in IAS 12;**
- (oa) **liabilities and assets arising from insurance contracts issued by an entity that are within the scope of [draft] IFRS X;**

(ob) **assets and liabilities arising from reinsurance contracts held by an entity that are within the scope of [draft] IFRS X;**

(p) ...

IAS 16 Property, Plant and Equipment

Paragraphs 29A and 29B are added.

Measurement after recognition

...

29A Some entities operate, either internally or externally, an investment fund that issues notional units in linked contracts. As part of the entity's asset pool, these funds may include owner-occupied properties. An entity shall apply this Standard to such owner-occupied properties held. In addition, it may elect to measure those properties at fair value with the changes presented in profit or loss in accordance with the requirements of IAS 40 for investment properties measured at fair value.

29B An entity shall, for the purpose of this Standard, treat owner-occupied property, which is measured in accordance with paragraph 29A, as a separate class of property, plant and equipment.

IAS 32 Financial Instruments: Presentation

Paragraphs 4 and 33 are amended and paragraph 33A is added. New text is underlined.

Scope

4 **This Standard shall be applied by all entities to all types of financial instruments except:**

(a) ...

(d) **insurance contracts within the scope of as defined in [draft] IFRS X IFRS-4 Insurance Contracts.** However, this Standard applies to:

(i) **derivatives that are embedded in such insurance contracts if IFRS 9 requires the entity to account for them separately;**
and

(ii) **distinct investment components that are embedded in such contracts if such components are required to be separated in accordance with [draft] IFRS X Insurance Contracts.**

Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies IFRS 9 in recognising and measuring the contracts, but shall apply **[draft] IFRS X IFRS-4** if the

issuer elects, in accordance with paragraph 7(f) 4(d) of [draft] IFRS X IFRS 4, to apply [draft] IFRS X IFRS 4 in recognising and measuring them.

(e) ~~financial instruments that are within the scope of IFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15-32 and AG25-AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see IFRS 9).~~ ~~[deleted]~~

(f) ...

...

Treasury shares (see also paragraph AG36)

33 If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity, unless paragraph 33A applies. No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments that have been deducted from equity. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognised directly in equity.

33A Some entities operate, either internally or externally, an investment fund that issues notional units in linked contracts. As part of the entity's asset pool, these funds may include treasury shares. The entity may elect not to apply the requirements of paragraph 33 to these treasury shares. Instead, it can elect to recognise and present these treasury shares as issued equity and as a corresponding financial asset.

IAS 36 *Impairment of Assets*

Paragraph 2 is amended. New text is underlined and deleted text is struck through.

Scope

2 This Standard shall be applied in accounting for the impairment of all assets, other than:

(a) ...

(h) ~~deferred acquisition costs, and intangible assets,~~ assets arising from an insurer's entity's contractual rights under insurance contracts within the scope of [draft] IFRS X IFRS 4 Insurance Contracts; and

(i) ...

IAS 38 Intangible Assets

Paragraph 3 is amended. New text is underlined and deleted text is struck through.
--

Scope

...

3 If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:

(a) ...

(g) ~~deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of [draft] IFRS X IFRS 4 Insurance Contracts. IFRS 4 sets out specific disclosure requirements for those deferred acquisition costs but not for those intangible assets. Therefore, the disclosure requirements in this Standard apply to those intangible assets.~~

(h) ...

IAS 39 Financial Instruments: Recognition and Measurement

Paragraph 2 is amended. New text is underlined and deleted text is struck through.
--

Scope

2 This Standard shall be applied by all entities to all types of financial instruments except:

(a) ...

(e) ~~rights and obligations arising under (i) an insurance a contract as defined in within the scope of [draft] IFRS X IFRS 4 Insurance Contracts, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in Appendix A of IFRS 9 Financial Instruments, or (ii) a contract that is within the scope of IFRS 4 because it contains a discretionary participation feature.~~ However, this Standard applies to:

(i) a derivative that is embedded in a contract within the scope of draft IFRS X IFRS 4 if ~~the derivative is not itself a contract within the scope of IFRS 4;~~ and

(ii) distinct investment components that are embedded in a contract if such components are required to be separated in accordance with [draft] IFRS X Insurance Contracts.

INSURANCE CONTRACTS

Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or [draft] IFRS X ~~IFRS 4~~ to such financial guarantee contracts (see paragraphs AG4 and AG4A). The issuer may make that election contract by contract, but the election for each contract is irrevocable.

Paragraph 103B is footnoted as follows.

[Draft] IFRS X *Insurance Contracts* issued in [201X] replaced IFRS 4 *Insurance Contracts* issued in 2004.

Appendix E Table of concordance

This table shows how the contents of the 2010 Exposure Draft and this 2013 Exposure Draft correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

Exposure Draft ED/2010/8	This Exposure Draft ED/2013
1	1–2
2–3, 6–7 (application)	3–6
4 (exclusions)	7
5	Deleted
8–11	9–11
12	10(a), 11
13	12
14	Deleted
15	16
16	17
17	18–19, 28
18	15
19	28
20	Deleted
21	Deleted
22–25	22
26–28, 29 (deleted)	23 (amended), 24, B63
30	25
31	Deleted
32–33	26 (see also 33–34)
34	Deleted
35, 36 (deleted), 37	27 (amended)
38	21
39	B66(c)
40–42	43–46
43–46	41–42 (rewritten)

continued...

INSURANCE CONTRACTS

...continued

Exposure Draft ED/2010/8	This Exposure Draft ED/2013
47–51	22, 29, 30(a)–(b), 32, 41(b)(iii)
52–53	Deleted
54–60	35–40 (rewritten)
61	20
62–66	47–48 (rewritten)
67–68	50–51
69	Deleted
70	54–55
71–72	Deleted
73	82
74–75	Deleted
76	60 (amended), 64 (amended)
77	63
78	Deleted
79–81	69 (amended)–71 (amended)
82	73 (amended)
83	Deleted
84	72 (amended)
85	73 (amended)
86–87	74–76
88–89	Deleted
90	83
91–97	86–95
98	Deleted
99	C1 (amended)
100	C3 (amended)
101	C9
102	C11 (amended)–C12 (amended)
Appendix A	Appendix A (amended)
B1	B1

continued...

...continued

Exposure Draft ED/2010/8	This Exposure Draft ED/2013
B2	B2
B3–B30 (except B18(g)), B31 (deleted), B32–B33	B3–B30
B18(g)	Deleted
B34	Deleted
B35	IE4–IE7
B36	IE8
B37–B66 (except B55(c), B62(d))	B36–B67
B55(c), B62(d)	Deleted
B67–B72	B76–B82
B73–B103	Deleted
B104–B109	IE19–IE22 (amended)
B110	IE26–IE29 (amended)

Approval by the Board of *Insurance Contracts* published in June 2013

The Exposure Draft *Insurance Contracts* was approved for publication by thirteen of the sixteen members of the International Accounting Standards Board. Mr Cooper voted against its publication. His alternative view is set out after the Basis for Conclusions. Ms Tokar and Mr Kabureck abstained from voting in view of their recent appointment to the IASB.

Hans Hoogervorst

Chairman

Ian Mackintosh

Vice-Chairman

Stephen Cooper

Philippe Danjou

Martin Edelmann

Jan Engström

Patrick Finnegan

Amaro Luiz de Oliveira Gomes

Gary Kabureck

Prabhakar Kalavacherla

Patricia McConnell

Takatsugu Ochi

Darrel Scott

Chung Woo Suh

Mary Tokar

Wei-Guo Zhang

