

# IFRS 17 issues – Level of aggregation

## *Amended draft for discussion*

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## 1 Current IASB requirements and TRG conclusions

### 1.1 IFRS 17 requirements

- 1 IFRS 17.14: An entity shall identify portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together. Contracts within a product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are managed together. Contracts in different product lines (for example single premium fixed annuities compared with regular term life assurance) would not be expected to have similar risks and hence would be expected to be in different portfolios.
- 2 IFRS 17.15: Paragraphs 16–24 apply to insurance contracts issued. The requirements for the level of aggregation of reinsurance contracts held are set out in paragraph 61.
- 3 IFRS 17.16: An entity shall divide a portfolio of insurance contracts issued into a minimum of:
  - (a) a group of contracts that are onerous at initial recognition, if any;
  - (b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
  - (c) a group of the remaining contracts in the portfolio, if any.
- 4 IFRS 17.17: If an entity has reasonable and supportable information to conclude that a set of contracts will all be in the same group applying paragraph 16, it may measure the set of contracts to determine if the contracts are onerous (see paragraph 47) and assess the set of contracts to determine if the contracts have no significant possibility of becoming onerous subsequently (see paragraph 19). If the entity does not have reasonable and supportable information to conclude that a set of contracts will all be in the same group, it shall determine the group to which contracts belong by considering individual contracts.
- 5 IFRS 17.18: For contracts issued to which an entity applies the premium allocation approach (see paragraphs 53–59), the entity shall assume no contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise. An entity shall assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous subsequently by assessing the likelihood of changes in applicable facts and circumstances.
- 6 IFRS 17.19: For contracts issued to which an entity does not apply the premium allocation approach (see paragraphs 53–59), an entity shall assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous:
  - (a) based on the likelihood of changes in assumptions which, if they occurred, would result in the contracts becoming onerous.

(b) using information about estimates provided by the entity's internal reporting. Hence, in assessing whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous:

(i) an entity shall not disregard information provided by its internal reporting about the effect of changes in assumptions on different contracts on the possibility of their becoming onerous; but

(ii) an entity is not required to gather additional information beyond that provided by the entity's internal reporting about the effect of changes in assumptions on different contracts.

- 7 IFRS 17.20: If, applying paragraphs 14–19, contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics, the entity may include those contracts in the same group. The entity shall not apply this paragraph by analogy to other items.
- 8 IFRS 17.21: An entity is permitted to subdivide the groups described in paragraph 16. For example, an entity may choose to divide the portfolios into:
- (a) more groups that are not onerous at initial recognition—if the entity's internal reporting provides information that distinguishes:
- (i) different levels of profitability; or
- (ii) different possibilities of contracts becoming onerous after initial recognition; and
- (b) more than one group of contracts that are onerous at initial recognition—if the entity's internal reporting provides information at a more detailed level about the extent to which the contracts are onerous.
- 9 IFRS 17.22: An entity shall not include contracts issued more than one year apart in the same group. To achieve this, the entity shall, if necessary, further divide the groups described in paragraphs 16–21.
- 10 IFRS 17.23: A group of insurance contracts shall comprise a single contract if that is the result of applying paragraphs 14–22.
- 11 IFRS 17.24: An entity shall apply the recognition and measurement requirements of IFRS 17 to the groups of contracts issued determined by applying paragraphs 14–23. An entity shall establish the groups at initial recognition, and shall not reassess the composition of the groups subsequently. To measure a group of contracts, an entity may estimate the fulfilment cash flows at a higher level of aggregation than the group or portfolio, provided the entity is able to include the appropriate fulfilment cash flows in the measurement of the group, applying paragraphs 32(a), 40(a)(i) and 40(b), by allocating such estimates to groups of contracts.
- 12 IFRS 17.B37: The objective of estimating future cash flows is to determine the expected value, or probability-weighted mean, of the full range of possible outcomes, considering all reasonable and supportable information available at the reporting date without undue cost or effort. Reasonable and supportable information available at the reporting date without undue cost or effort includes information

about past events and current conditions, and forecasts of future conditions (see paragraph B41). Information available from an entity's own information systems is considered to be available without undue cost or effort.

- 13 IFRS 17.B38: 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 to derive an expected present value. Consequently, the objective is not to develop a most likely outcome, or a more-likely-than-not outcome, for future cash flows.
- 14 IFRS 17.B39: When considering the full range of possible outcomes, the objective is to incorporate all reasonable and supportable information available without undue cost or effort in an unbiased way, rather than to identify every possible scenario. In practice, developing explicit scenarios is unnecessary if the resulting estimate is consistent with the measurement objective of considering all reasonable and supportable information available without undue cost or effort 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 be sufficient to estimate the 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 many detailed simulations. However, in some cases, the cash flows may be driven by complex underlying factors and may respond in a 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 necessary to satisfy the measurement objective.
- 15 IFRS 17.B40: 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.
- 16 IFRS 17.B41: An entity shall estimate the probabilities and amounts of future payments under existing contracts on the basis of information obtained including:
- (a) information about claims already reported by policyholders.
  - (b) other information about the known or estimated characteristics of the insurance contracts.
  - (c) historical data about the entity's own experience, supplemented when necessary with historical data from other sources. Historical data is adjusted to reflect current conditions, for example, if:
    - (i) the characteristics of the insured population 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 are indications 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 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 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.

17 IFRS 17.B67: Some insurance contracts affect the cash flows to policyholders of other contracts by requiring:

(a) the policyholder to share with policyholders of other contracts the returns on the same specified pool of underlying items; and

(b) either:

(i) the policyholder to bear a reduction in their share of the returns on the underlying items because of payments to policyholders of other contracts that share in that pool, including payments arising under guarantees made to policyholders of those other contracts; or

(ii) policyholders of other contracts to bear a reduction in their share of returns on the underlying items because of payments to the policyholder, including payments arising from guarantees made to the policyholder.

18 IFRS 17.B68: Sometimes, such contracts will affect the cash flows to policyholders of contracts in other groups. The fulfilment cash flows of each group reflect the extent to which the contracts in the group cause the entity to be affected by expected cash flows, whether to policyholders in that group or to policyholders in another group. Hence the fulfilment cash flows for a group:

(a) include payments arising from the terms of existing contracts to policyholders of contracts in other groups, regardless of whether those payments are expected to be made to current or future policyholders; and

(b) exclude payments to policyholders in the group that, applying (a), have been included in the fulfilment cash flows of another group.

19 IFRS 17.B69: For example, to the extent that payments to policyholders in one group are reduced from a share in the returns on underlying items of CU350 to CU250 because of payments of a guaranteed amount to policyholders in another group, the fulfilment cash flows of the first group would include the payments of CU100 (ie would be CU350) and the fulfilment cash flows of the second group would exclude CU100 of the guaranteed amount.

- 20 IFRS 17.B70: Different practical approaches can be used to determine the fulfilment cash flows of groups of contracts that affect or are affected by cash flows to policyholders of contracts in other groups. In some cases, an entity might be able to identify the change in the underlying items and resulting change in the cash flows only at a higher level of aggregation than the groups. In such cases, the entity shall allocate the effect of the change in the underlying items to each group on a systematic and rational basis.
- 21 IFRS 17.B71: After all the coverage has been provided to the contracts in a group, the fulfilment cash flows may still include payments expected to be made to current policyholders in other groups or future policyholders. An entity is not required to continue to allocate such fulfilment cash flows to specific groups but can instead recognise and measure a liability for such fulfilment cash flows arising from all groups.
- 22 IFRS 17.B81: Alternatively, an entity may determine the appropriate discount rates for insurance contracts based on a yield curve that reflects the current market rates of return implicit in a fair value measurement of a reference portfolio of assets (a top-down approach). An entity shall adjust that yield curve to eliminate any factors that are not relevant to the insurance contracts, but is not required to adjust the yield curve for differences in liquidity characteristics of the insurance contracts and the reference portfolio.
- 23 IFRS 17.B 98: The terms of some insurance contracts without direct participation features give an entity discretion over the cash flows to be paid to policyholders. A change in the discretionary cash flows is regarded as relating to future service, and accordingly adjusts the contractual service margin. To determine how to identify a change in discretionary cash flows, an entity shall specify at inception of the contract the basis on which it expects to determine its commitment under the contract; for example, based on a fixed interest rate, or on returns that vary based on specified asset returns.
- 24 IFRS 17.B 104: The conditions in paragraph B101 ensure that insurance contracts with direct participation features are contracts under which the entity's obligation to the policyholder is the net of:
- (a) the obligation to pay the policyholder an amount equal to the fair value of the underlying items; and
  - (b) a variable fee (see paragraphs B110–B118) that the entity will deduct from (a) in exchange for the future service provided by the insurance contract, comprising:
    - (i) the entity's share of the fair value of the underlying items; less
    - (ii) fulfilment cash flows that do not vary based on the returns on underlying items.
- 25 IFRS 17.B 112: Changes in the entity's share of the fair value of the underlying items (paragraph B104(b)(i)) relate to future service and adjust the contractual service margin, applying paragraph 45(b).
- 26 IFRS 17.B 119: B119 An amount of the contractual service margin for a group of insurance contracts is recognised in profit or loss in each period to reflect the services provided under the group of insurance

contracts in that period (see paragraphs 44(e), 45(e) and 66(e)). The amount is determined by:

(a) identifying the coverage units in the group. The number of coverage units in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration.

(b) allocating the contractual service margin at the end of the period (before recognising any amounts in profit or loss to reflect the services provided in the period) equally to each coverage unit provided in the current period and expected to be provided in the future.

(c) recognising in profit or loss the amount allocated to coverage units provided in the period.

27 IFRS 17.BC 119: Once the Board had decided that the contractual service margin should be measured for a group, the Board considered what that group level should be. The Board considered whether it could draw on requirements for groups set by insurance regulators. However, as noted in paragraph BC15, regulatory requirements focus on solvency not on reporting financial performance. The decisions about grouping in IFRS 17 were driven by considerations about reporting profits and losses in appropriate reporting periods. For example, in some cases the entity issues two groups of insurance contracts expecting that, on average, the contracts in one group will be more profitable than the contracts in the other group. In such cases, the Board decided, in principle, there should be no offsetting between the two groups of insurance contracts because that offsetting could result in a loss of useful information. In particular, the Board noted that the less profitable group of contracts would have a lesser ability to withstand unfavourable changes in estimates and might become onerous before the more profitable group would do so. The Board regards information about onerous contracts as useful information about an entity's decisions on pricing contracts and about future cash flows, and wanted this information to be reported on a timely basis. The Board did not want this information to be obscured by offsetting onerous contracts in one group with profitable contracts in another.

28 IFRS 17.BC 120: The level of aggregation is also relevant to the recognition of the contractual service margin in profit or loss. Paragraph BC279 explains that, following the Board's principle for the allocation of the contractual service margin, an entity should systematically recognise the remaining contractual service margin in profit or loss over the current and remaining coverage period to reflect the remaining transfer of services to be provided by the insurance contracts.

29 IFRS 17.BC 121: In many cases, the coverage period of individual contracts in a group will differ from the average coverage period for the group. When this is the case, measuring the contracts on:

(a) an individual basis would mean that the contractual service margin associated with contracts with a shorter than average



coverage period would be fully recognised in profit or loss over that shorter period;

(b) a group basis would mean that the contractual service margin associated with contracts with a shorter than average coverage period would not be fully recognised in profit or loss over that shorter period.

30 IFRS 17.BC 122: Thus, measuring the contracts as a group creates the risk that the contractual service margin for a group might fail to reflect the profit relating to the coverage remaining in the group, unless the entity tracked the allocation of the contractual service margin separately for groups of insurance contracts:

(a) that have similar expected profitability, on initial recognition, and for which the amount and timing of cash flows are expected to respond in similar ways to key drivers of risk. In principle, this condition would ensure the contractual service margin of a particularly profitable individual contract within a group is not carried forward after the individual contract has expired.

(b) that have coverage periods that were expected to end at a similar time. In principle, this condition would ensure the contractual service margin of an individual contract that expired was not carried forward after the contract had expired.

31 IFRS 17.BC 123: The Board concluded that it was necessary to strike a balance between the loss of information discussed in paragraphs BC119 and BC121–BC122, and the need for useful information about the insurance activity as discussed in paragraphs BC118 and BC120. The Board:

(a) did not want entities to depict one type of contract as cross-subsidised by a different type of contract, but also did not want to recognise losses for claims developing as expected within a group of similar contracts; and

(b) did not want the contractual service margin of an expired contract to exist as part of the average contractual service margin of a group long after the coverage provided by the contract ended, but also did not want to recognise a disproportionate amount of contractual service margin for contracts lapsing as expected within a group of similar contracts.

32 IFRS 17.BC 124: The Board concluded that the balance described above could be achieved in principle by:

(a) requiring contracts in a group to have future cash flows the entity expects will respond similarly in amount and timing to changes in key assumptions—meaning that losses on insurance contracts for one type of insurance risk would not be offset by gains on insurance contracts for a different type of risk, and would provide useful information about the performance of contracts insuring different types of risk.

(b) requiring contracts in a group to have similar expected profitability—meaning that loss-making contracts could not be grouped with profitable contracts, whether at initial recognition or if changes in conditions make a previously profitable group loss-making. Hence, such a requirement would provide information about loss-making groups of insurance contracts.

(c) requiring groups not be reassessed after initial recognition.

33 IFRS 17.BC 125: The Board also noted that, in principle, it would be possible to meet the objective of the recognition of the contractual service margin in profit or loss discussed in paragraph BC120 either by grouping only contracts with a similar size of contractual service margin and the same remaining coverage period, or by reflecting the different duration and profitability of the contracts within the group in the allocation of the contractual service margin.

34 IFRS 17.BC 130: To identify whether contracts (or sets of contracts) are onerous at initial recognition, an entity measures the contracts (or sets of contracts) applying the measurement requirements of IFRS 17. The Board decided that to assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous subsequently, an entity should use the information provided by its internal reporting system but need not gather additional information. The Board concluded that such information would provide a sufficient basis for making this assessment and that it would not be necessary to impose costs of gathering additional information. Some stakeholders nonetheless expressed the view that separating contracts that have no significant possibility of becoming onerous from other contracts that are not onerous was burdensome and unnecessary. The Board, however, concluded that in the absence of such a requirement, should the likelihood of losses increase, IFRS 17 would fail to require timely recognition of contracts that become onerous.

35 IFRS 17.B132: For groups of insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders:

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

(i) using a rate that allocates the remaining revised expected finance income or expenses over the remaining duration of the group of contracts at a constant rate; or

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

(b) a systematic allocation for the finance income or expenses arising from the risk adjustment for non-financial risk, if separately disaggregated from other changes in the risk adjustment for non-financial risk applying paragraph 81, is determined using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.

(c) a systematic allocation for the finance income or expenses arising from the contractual service margin is determined:

(i) for insurance contracts that do not have direct participation features, using the discount rates specified in paragraph B72(b); and

- (ii) for insurance contracts with direct participation features, using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.
- 36 IFRS 17.B134: Paragraph 89 applies if an entity, either by choice or because it is required to, holds the underlying items for insurance contracts with direct participation features. If an entity chooses to disaggregate insurance finance income or expenses applying paragraph 89(b), it shall include in profit or loss expenses or income that exactly match the income or expenses included in profit or loss for the underlying items, resulting in the net of the two separately presented items being nil.
- 37 IFRS 17.BC 136: The Board noted that the decisions outlined in paragraph BC127 could lead to perpetual open portfolios. The Board was concerned that this could lead to a loss of information about the development of profitability over time, could result in the contractual service margin persisting beyond the duration of contracts in the group, and consequently could result in profits not being recognised in the correct periods. Consequently, in addition to dividing contracts into the groups specified in paragraph BC127, the Board decided to prohibit entities from including contracts issued more than one year apart in the same group. The Board observed that such grouping was important to ensure that trends in the profitability of a portfolio of contracts were reflected in the financial statements on a timely basis.
- 38 IFRS 17.BC 137: The Board considered whether there were any alternatives to using a one-year issuing period to constrain the duration of groups. However, the Board considered that any principle-based approach that satisfied the Board's objective would require the reintroduction of a test for similar profitability, which as set out in paragraph BC126, was rejected as being operationally burdensome. The Board acknowledged that using a one-year issuing period was an operational simplification given for cost-benefit reasons.
- 39 IFRS 17.BC 138: The Board considered whether prohibiting groups from including contracts issued more than one year apart would create an artificial divide for contracts with cash flows that affect or are affected by cash flows to policyholders of contracts in another group. Some stakeholders asserted that such a division would distort the reported result of those contracts and would be operationally burdensome. However, the Board concluded that applying the requirements of IFRS 17 to determine the fulfilment cash flows for groups of such contracts provides an appropriate depiction of the results of such contracts (see paragraphs BC171–BC174). The Board acknowledged that, for contracts that fully share risks, the groups together will give the same results as a single combined risk-sharing portfolio, and therefore considered whether IFRS 17 should give an exception to the requirement to restrict groups to include only contracts issued within one year. However, the Board concluded that setting the boundary for such an exception would add complexity to IFRS 17 and create the risk that the boundary would not be robust or appropriate in all circumstances. Hence, IFRS 17 does not include such an exception. Nonetheless, the Board noted that the requirements

specify the amounts to be reported, not the methodology to be used to arrive at those amounts. Therefore it may not be necessary for an entity to restrict groups in this way to achieve the same accounting outcome in some circumstances.

40 IFRS 17.BC 140: The Board considered whether an entity should recognise the obligations and associated benefits arising from a group of insurance contracts from the time at which it accepts risk. Doing so would be consistent with the aspects of IFRS 17 that focus on measuring the obligations accepted by the entity. However, such an approach would differ from that required for revenue contracts within the scope of IFRS 15, which focuses on measuring performance. Under IFRS 15, an entity recognises no rights or obligations until one party has performed under the contract. That model would be consistent with the aspects of IFRS 17 that focus on measuring performance.

41 IFRS 17.BC 162: However, it may be more difficult to decide the contract boundary if the contract binds one party more tightly than the other. For example:

(a) an entity may price a contract so that the premiums charged in early periods subsidise the premiums charged in later periods, even if the contract states that each premium relates to an equivalent period of coverage. This would be the case if the contract charges level premiums and the risks covered by the contract increase with time. The Board concluded that the premiums charged in later periods would be within the boundary of the contract because, after the first period of coverage, the policyholder has obtained something of value, namely the ability to continue coverage at a level price despite increasing risk.

(b) an insurance contract might bind the entity, but not the policyholder, by requiring the entity to continue to accept premiums and provide coverage but permitting the policyholder to stop paying premiums, although possibly incurring a penalty. In the Board's view, the premiums the entity is required to accept and the resulting coverage it is required to provide fall within the boundary of the contract.

(c) an insurance contract may permit an entity to reprice the contract on the basis of general market experience (for example, mortality experience), without permitting the entity to reassess the individual policyholder's risk profile (for example, the policyholder's health). In this case, the insurance contract binds the entity by requiring it to provide the policyholder with something of value: continuing insurance coverage without the need to undergo underwriting again. Although the terms of the contract are such that the policyholder has a benefit in renewing the contract, and thus the entity expects that renewals will occur, the contract does not require the policyholder to renew the contract. The Board originally decided that ignoring the entity's expectation of renewals would not reflect the economic circumstances created by the contract for the entity. Consequently, the Board originally proposed that if the entity can reprice an existing contract for general but not individual-specific changes in policyholders' risk profiles, the cash flows resulting from the renewals repriced in this way lie within the boundaries of the existing contract.

- 42 IFRS 17.BC 171: Sometimes insurance contracts in one group affect the cash flows to policyholders of contracts in a different group. This effect is sometimes called 'mutualisation'. However, that term is used in practice to refer to a variety of effects, ranging from the effects of specific contractual terms to general risk diversification. Consequently, the Board decided not to use the term but instead to include in IFRS 17 requirements that ensure the fulfilment cash flows of any group are determined in a way that does not distort the contractual service margin, taking into account the extent to which the cash flows of different groups affect each other. Hence the fulfilment cash flows for a group:
- (a) include payments arising from the terms of existing contracts to policyholders of contracts in other groups, regardless of whether those payments are expected to be made to current or future policyholders; and
  - (b) exclude payments to policyholders in the group that, applying (a), have been included in the fulfilment cash flows of another group.
- 43 IFRS 17.BC 173: The Board considered whether it was necessary to amend the requirements in IFRS 17 relating to the determination of the contractual service margin for insurance contracts with cash flows that affect or are affected by cash flows to policyholders of contracts in another group. The Board concluded that it was not necessary because the fulfilment cash flows allocated to a group described in paragraph BC171 result in the contractual service margin of a group appropriately reflecting the future profit expected to be earned from the contracts in the group, including any expected effect on that future profit caused by other contracts.
- 44 IFRS 15.BC 295: However, many respondents to the 2010 and the 2011 Exposure Drafts disagreed with the onerous test and highlighted a number of practical application difficulties. Furthermore, many explained that strict application of the onerous test would have resulted in recognition of liabilities in cases in which the outcome of fulfilling a single performance obligation was onerous but the outcome of fulfilling the entire contract would be profitable. A number of respondents suggested removing the onerous test from the revenue proposals because, in addition to being complex and difficult to apply, the requirements for recognition of onerous losses are already sufficiently addressed in other Standards. Those respondents commented that:
- (a) for IFRS, the onerous test in IAS 37 and the requirements in IAS 2 Inventories already provide sufficient guidance for determining when to recognise losses arising from contracts with customers.
  - (b) for US GAAP, existing requirements for recognition of losses from contracts are adequate and if a change to those requirements is necessary, that change could instead be handled in a separate project that addresses liabilities in Topic 450.
- 45 IFRS 15.BC 296: The boards agreed that existing requirements in both IFRS and US GAAP could adequately identify onerous contracts. Furthermore, the boards noted that although their existing requirements for onerous contracts are not identical, they are not

aware of any pressing practice issues resulting from the application of those existing requirements. Consequently, the boards decided that IFRS 15 should not include an onerous test. Instead, entities applying IFRS or US GAAP will use their respective existing requirements for the identification and measurement of onerous contracts.

- 46 IFRS 15.4: This standard specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this Standard to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

## 1.2 TRG

### TRG Staff analysis (2018-09 AP10)

- 47 § 18: Contracts with policyholders that share in 100% of the returns on a pool of underlying items that includes the insurance contracts issued to those policyholders i.e. that fully share all risks, do not cause the entity to be ultimately affected by the expected cash flows of each individual contract issued. For those contracts, applying paragraph B68 of IFRS 17, the contractual service margin will be nil.

### TRG Conclusion (2018-09 Summary)

- 48 § 40(d): when contracts share to a lesser extent [than 100%] in the return on a pool of underlying items consisting of the insurance contracts, an entity could be affected by the expected cash flows of each contract issued. Therefore, the contractual service margin of the groups of contracts may differ from the contractual service margin measured at a higher level, such as the portfolio level. To assess whether measuring the contractual service margin at a higher level would achieve the same accounting outcome as measuring the contractual service margin at an annual cohort level, an entity would need to determine what the effect would be of applying the requirements in IFRS 17. To be able to measure the contractual service margin at a higher level, the accounting outcome would need to be the same in all circumstances, i.e. regardless of how assumptions and experience develop over the life of the contract.

## 1.3 Tentative board's decisions

- 49 Issues relating to the level of aggregation have been discussed at the March 2019 IASB board meeting.
- 50 IASB 2019-03 AP 2A.17: On the other hand, measuring insurance contracts at too high a level of aggregation could obscure three types of information the Board regards as fundamentally important:
- (a) trends in the entity's profits from insurance contracts over time (see example in paragraphs 18–19 of this paper);
  - (b) timely recognition of profit on profitable contracts so that all profit has been recognised by the end of the coverage period (see example in paragraphs 18–19 of this paper); and
  - (c) timely recognition of losses on onerous contracts (see example in paragraphs 20–21 of this paper).
- 51 IASB 2019-03 AP 2A.39: The allocation of the cash flows to the groups required by paragraphs B67–B71 of IFRS 17 prevents a group of contracts being onerous when the loss is borne by policyholders of other groups of contracts (column D in the table in paragraph 38 of this paper). But it does not average the profits of the two groups of contracts. Each group has its own separately determined contractual service margin which reflects the profit the entity makes from each group, after taking into account the extent to which the group supports or is supported by contracts in other groups.
- 52 IASB 2019-03 AP 2A.40. Some stakeholders think that determining the contractual service margin separately for each annual cohort does not provide useful information. They argue that because the returns on the underlying items are shared across policyholders in different

annual cohorts, the profit should be regarded as arising from the combined groups that share those returns (column E in the table in paragraph 38 of this paper).

- 53 IASB 2019-03 AP 2A.41. In contrast, the staff think that keeping the profit of the annual cohorts separate is necessary to avoid deferring the recognition of profit beyond the coverage period of a group and obscuring trends in profitability for an entity from its insurance contracts over time (see paragraphs 17(a) and 17(b) of this paper). In the example in Appendix A to this paper, using annual cohorts, the contractual service margin from the first group of contracts is considerably higher than from the second group of contracts. This appropriately depicts the entity's share of the higher fair value returns generated by the first group of contracts. The entity allocates the policyholders' share of fair value gain on the underlying items that arises in Year 1 between the policyholders in the two groups. But that does not mean that the entity's share of the fair value gain is not created by the contracts in Group 1.

#### *1.4 Current understanding of the accounting treatment*

##### Contracts grouping in order to track onerous contracts

- 54 IFRS 17 recognises the existence of portfolios of insurance contracts which comprise contracts subject to similar risks and managed together (IFRS 17.14).
- 55 For accounting purposes, portfolios must be divided into groups following two criteria:
- Onerous nature or not (IFRS 17.16),
  - Annual cohorts (IFRS 17.22).
- 56 Even if it is suggested to create groups following IFRS 17.16 first then to subdivide them following IFRS 17.22, in practical terms it seems to be more appropriate to operate the other way around.
- 57 The annual cohorts requirement will generally be irrelevant for contracts eligible to the PAA, when their coverage period is of "one year or less" (IFRS 17.53(b)).
- 58 In order to apply the "onerous nature or not" criterion to divide portfolios when necessary, a first step is to investigate "sets of contracts" on the basis of reasonable and supportable information and conclude on their classification in one of the three relevant categories (onerous at initial recognition, no significant possibility of becoming onerous subsequently, other). If there is no reasonable and supportable information of a conclusive nature, the second step is to consider individual contracts. This way to proceed is a combination of a top-down approach (portfolio → "sets of contracts" → groups) and a bottom-up approach (individual contracts → groups) depending upon the quality of available information (IFRS 17.17).
- 59 In order to estimate fulfilment cash-flows, an entity may start from a higher level of aggregation than the group or portfolio, provided the allocation to each group is appropriate (IFRS 17.24).

##### Mutualisation

- 60 As explained in IFRS 17.BC 171, IASB decided not to refer to "mutualisation" since "that term is used in practice to refer to a variety of effects".



- 61 IFRS 17 however addresses some of these effects:
- (a) By acknowledging that “fulfilment cash flows may be estimated at a higher level of aggregation than the group or portfolio” (IFRS 17.24)
  - (b) By introducing the concept of “contracts with cash flows that affect or are affected by cash flows to policyholders of contracts in another group” also described as “cross-subsidisation” (IFRS 17.B67-.B70)
  - (c) By considering the possibility of “contracts that fully share risks” (IFRS 17.BC 138)

#### **Estimation of fulfilment cash flows at a higher level of aggregation**

- 62 Opening the possibility of estimating fulfilment cash flows at a higher level of aggregation than the group or portfolio, the standard acknowledges that expected cash flows may not reliably or relevantly be determined at group or portfolio level but would rather result from a top-down pricing more efficiently set within a broader population.

#### **Cross-subsidisation**

- 63 IFRS 17.B68-B71 provides guidance on “contracts with cash flows that affect or are affected by cash flows to policyholders of contracts in another group”. No specific CSM provisions were required since the measurement at group level already “ensure[s] the fulfilment cash flows of any group are determined in a way that does not distort the contractual service margin, taking into account the extent to which the cash flows of different groups affect each other.” (IFRS 17.BC 171 and .BC 173).

- 64 In addition, TRG staff has suggested that:

- IFRS 17.B70 allows for “allocating the effect of the change in the underlying items to each group on a systematic and rational basis” only when an entity cannot identify the change in the underlying items and resulting change in the cash flows at the level of aggregation of the groups but at a higher level.
- According to IFRS 17.B68 the extent to which the contracts in the group cause the entity to be affected by expected cash flows is reflected in the fulfilment cash flows of each group. In other words, the effect on the insurer (i.e. the CSM) has to be calculated at the level of each group, not at portfolio level.

#### **Fully shared risks**

- 65 When mentioning “contracts that fully share risks”, IFRS 17.BC 138 (i) acknowledges that “the groups together will give the same results as a single combined risk-sharing portfolio” and (ii) notes that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. In other words, the standard acknowledges that the level of aggregation proves unnecessary when contracts “fully share risks”.

- 66 TRG staff has illustrated a very specific situation where “all risks are fully shared” since it does “not cause the entity to be ultimately affected by the expected cash flows of each individual contract issued”, i.e. where the “contractual service margin will be nil”. TRG did not agree on a definition of “full risk sharing”.

- 67 In addition, TRG staff has suggested that, according to the standard, the annual cohort requirement applies except when not necessary to achieve exactly the same outcome. “Exact” meaning that the same outcome is expected at inception and achieved whatever happens.

#### Reflecting performance and mutualisation with annual cohorts

- 68 Notice can be taken that there is no “inception” *per se* for an annual cohort because it builds up during the one year period.

- 69 IASB 2019-03 AP 2A.17 recalls the 3 informative objectives set to annual cohorts in the bases for conclusions:
- Objective 1: Ensuring that onerous contract are immediately recognised in the P&L (BC 119 and BC 136);
  - Objective 2: (i) Ensuring a “correct” allocation of the margin (CSM) during the contract (BC 120) and (ii) prohibiting open portfolios in order to ensure that the CSM is not allocated beyond the longest contract within the group (BC 123(b) and BC 136);
  - Objective 3: Providing information on “trends in the profitability of a portfolio” (BC 136).

Analysis and comments on the examples

- 70 AP 10 of TRG 2018-09 §A4 (example 1) and §A11 (Example 2) mention that “claims incurred in group 1 amount to 4,000”. IFRS 17.32(a)(i) states that the fulfilment cash flows are measured at inception considering estimates of future cash flows, not actual ones. Consequently, the very specific assumption retained by the staff, that all claims were originally expected to happen solely on group 1 cannot be considered. Rather, absent any other information, it should be assumed that all contracts in the portfolio are exposed to the same risk and that therefore the risk of claim is evenly allocated on all contracts/groups within the portfolio. Consequently, the CSM, measured at portfolio level (600) could be evenly allocated to each of the 10 groups (i.e. 60). Other allocations methods may also be considered.
- 71 The conclusions of the IASB Staff on the example discussed in IASB 2019-03 AP 2A.39-40 are discussed in § 2.3.

## 2 Issue

### 2.1 Insurance business model and mutualisation

#### Managing insurance risks in portfolios

- 72 The insurance business model is based upon grouping contracts in portfolios in order to manage the (insurance and financial) risks. The law of large numbers provides insurers with a more reliable assessment of the probability and distribution of risks and therefore enables an appropriate risk management and pricing. Putting together risks within a portfolio enables this assessment and management, but does not in itself eliminate risks.
- 73 When managing similar risks together in a portfolio:
- The starting point for segregation is the “product line” level;
  - The risk is considered from the standpoint of the insurer rather than from the standpoint of the policyholder;
  - Additional guarantees generally belong to the same risk if not sold separately. For instance, loan insurance mainly provides death insurance coverage, i.e. indemnify the borrower in case of death. Additional optional coverages (such as job-loss) belong to the same risk and have not to be separately addressed.
- 74 The nature of risks in a portfolio priced and managed as such shall not be confused with the pattern or distribution of the occurrence of that risk within the population. In other words, the existence of drivers of the probability that a risk happens does not create a specific risk that would require dividing further the portfolio (except if actually not managed together). Accordingly, a portfolio has not to be further disaggregated, for instance:
- because of the age of a policyholder, even if the age is a factor increasing the probability that a risk happens (it changes the distribution of the risk, not its nature);
  - Similarly, different durations are not in themselves a separate risk that would require being isolated.
- 75 Managing the risks, an insurer may:
- Organise a mutualisation by sharing risks among policyholders and generations,
  - Hedge financial risk by investing in appropriate financial assets,
  - Hedge insurance risk by transferring risks to a third party (through reinsurance or derivatives),
  - Diversify its risk exposure in having different portfolios and activities.

#### Mutualisation and risk sharing

- 76 “Mutualisation” may be defined as the risk transfer accepted by a policyholder when he or she joins a defined population of policyholders the boundary of which is defined by the contract proposed by the insurer. The premium may be different from one policyholder to another because of certain characteristics of each policyholder (which may lead to introduce, within a single population of policyholders, different levels of risk intensity) and may also be adjusted from time to time on the basis of experience (in accordance with contractual terms), but once – and as long as – having joined the population on the agreed upon premium basis, each policyholder benefits from the same guarantees. This definition of “mutualisation” reflects what is happening in practice and also the policyholders’ understanding and acceptance of such practice.

- 77 Minimum financial guarantee may be offered to certain policyholders. Note that such guarantees are rare in our jurisdiction on current life insurance contracts in a context of low interest rate, except as a “zero-floor”. In a mutualised population, minimum financial guarantees granted to certain but not all policyholders represent a concentration of financial risks to be considered when assessing the profitability of the population taken as a whole. However, it does not, in itself, prevent from mutualising or sharing risks within that population.
- 78 Organising the mutualisation among policyholders is the primary goal of insurance activity. However, the insurer bears the risk that, ultimately, costs may exceed revenues so that the portfolio becomes onerous and that he will have to bear the loss (for instance in an investment contract with guaranteed participation features exceeding returns). Mutualisation therefore does not exclude sharing policyholders’ risks with the insurer who offers a second level of protection: if the organised mutualisation at policyholders’ level is not sufficient, the insurer will have to fill the gap.

#### Risks and returns to be shared

- 79 Insurance contracts may share risks and returns of two natures: a financial one and a “technical” one. The technical risks and results relate to any non-financial change in the insurance commitment, e.g. changes in biometric assumptions.
- 80 Both components are referred to as the “underlying items” in IFRS 17, among which the financial part mainly relates to the underlying assets whereas the technical part mainly relates to other changes in the insurance liability itself.
- 81 Participating contracts may share the returns in the underlying assets but not in insurance risk (e.g. risk of mortality). In other words, a death coverage (e.g. where one get paid out twice the premium) may be (i) funded in the contracts, i.e. taken from the underlying fund or (ii) paid by the insurer. For instance “Universal Life” policies share in the financial risk but not in the technical one (which is supported by the insurer only). In other policies, policyholders may share not only the financial result but also the technical result.
- 82 Changing its pricing or trying to expand its market share in a particular year, an entity may create a specific risk in that year. Mutualisation in such a case is where the additional risk created in a year is shared with other policyholders or other periods, i.e. the entity is not taking additional risk because that risk is actually carried by the other policyholders.
- 83 Changes in the underlying items of a mutualised group of contracts might be profitable on the underlying asset but onerous on the underlying liabilities (or the other way around). However from a contractual as well as from an accounting point of view, there is actually no such distinction within the CSM as if transfers between financial and technical sides exist until there is no capacity left in the mutualised portfolio to face those obligations and the insurer has to fill the gap. The latter situation would lead to a decrease in the entity’s share in the return (CSM) or even to onerous contracts (all contracts in the portfolio would then become onerous).

#### Types of mutualisation

- 84 Mutualisation is a core feature of the insurance business, which is actually to organise the solidarity of policyholders against the emergence of an adverse event.
- 85 One may distinguish two types of mutualisation:
- Mutualisation by tariff: based on the law of large numbers, the insurer assesses the probability of occurrence of a risk within a population and shares *ex ante* the

costs of that risk among policyholders through a pricing factoring the key drivers of risk. Mutualisation by tariff is a mutualisation since each policyholder pays a premium without knowing who will eventually benefit from it, but knowing that, thanks to this premium and the premiums of the other policyholders, the insurer will be in a situation to indemnify future claims (examples: life insurance risk within loan insurance).

- Mutualisation by cross-subsidisation: in addition to the mutualisation by tariff, a cross-subsidisation mechanism is contractually organised in order to allocate expected and unexpected cash-flows among policyholders and possibly among generations (example: mutual funds, life insurance with participating features).

Where both mutualisation mechanisms are not sufficient to cover risks and contractual commitments, the insurer provides for the difference (§ 78).

#### Correlation of risk and pricing; definition of onerous

- 86 The occurrence of an expected risk in a contract does not make the individual contract “onerous”.
- 87 A transaction is onerous for the insurer when the pricing does not sufficiently cover the insured risk. This may happen (i) at inception if the pricing does not reflect the expected distribution of risks within a portfolio in order to ensure a proper margin or (ii) when risks evolve in an unexpected manner and when the insurer has to bear a loss as a consequence (§ 78).
- 88 Conversely, as long as adding contracts eventually contributes to increasing the entity’s share in the returns of the underlying assets, that new business is not onerous. This is the case even if these added contracts need transfers from other group of contracts to meet the contractual commitments of the insurer against its policyholders. This situation is illustrated in Example 1 § 184.
- 89 In a population where policyholders accept to share risks, a contract does not become onerous (for the insurer) before the cross-subsidisation among policyholders is not sufficient to cover the risks, so that the insurer is eventually exposed to a loss. There is no “onerous” contract in a mutualised population except if the whole population becomes onerous.
- 90 When the risk evolves with age, an insurer generally reflects this evolution in the pricing. He may however also decide not to reflect such changes but instead offer the same pricing along the duration of the coverage. A policyholder would accept a steady rate, i.e. to pay more in the first years (when the risk for the insurer is lower) if he gets a lower rate in the future. Such pricing mechanism may lead to group together policyholders currently having different risks priced the same. Steady pricing reflects levelling the risk distribution for one policyholder over the coverage period and is distinct from (but not contrary to) mutualising risks with several policyholders in a defined population.

#### Consistency with IFRS 15

- 91 A portfolio approach is also possible under IFRS 15.4. as a practical expedient and not for identifying onerous contracts. The onerous test has been removed from IFRS 15 mainly because it “would have resulted in recognition of liabilities in cases in which the outcome of fulfilling a single performance obligation was onerous but the outcome of fulfilling the entire contract would be profitable” (IFRS 15.BC 295-296).
- 92 In addition, the same argument could apply to IFRS 15 contracts where the selling price is unique (i.e. electricity or telecom distribution with unique price across a territory) but service costs vary depending on the customer (i.e. risks/costs significantly differ from one area to the other).

- 93 Finally, there are similarities between the situation of a single obligation in an IFRS 15 contract and the situation of a single contract/group in an IFRS 17 portfolio where groups and contracts are mutualised.

## *2.2 Issue 1: Underwriting policies and contracts grouping*

- 94 The way insurers organise mutualised populations is a highly sensitive feature of insurance markets since it reflects and also shapes up a level of “social/societal” understanding of what is covered by insurance and what is left to the direct responsibility of the individual (natural or moral person). In this context the coherence and consistency of pricing and detailed coverage policies is a key element of stability and decision making for individuals and businesses in the development of their respective activities.
- 95 The perimeter of mutualised populations and the terms and conditions offered to them by insurers are the outcome of very long term evolutions and decisions reflecting fundamental choices made at the level of the society as a whole (explicitly via regulations, semi-explicitly when practices reflect or influence changes in behaviour). In many cases, the strategy of insurers is heavily influenced by a prevailing insurance environment (or culture) the evolution of which requires extensive debates.
- 96 Modifying the perimeter of mutualised populations for accounting purposes only may lead to unintended changes in the way insurers cover insurance risks. There is a significant difference between (i) reflecting, via accounting treatments, a slow and complex evolution of the insurance coverage system and (ii) introducing accounting treatments which may directly influence the way the insurance coverage system is organised. For instance, additional granularity as compared to the current understanding is a “social/societal” risk of reducing the current and accepted level of mutualisation, since insurers would have to reduce the risk to have onerous groups the loss of which is today covered by mutualisation and which would have to be borne tomorrow day one. The terms and conditions, including pricing, of the insurance coverage would probably be affected as a consequence.

## *2.3 Issue 2: Reflecting performance and mutualisation with or without annual cohorts*

### Recognition of onerous groups when the contracts’ cash flows affect or are affected by cash flows to policyholders of other contracts **[IASB 2019-03 AP 2A.37-38]**

- 97 We concur with the analysis laid down in § 38 of the March 2019 agenda paper 2A that when the contracts’ cash flows affect or are affected by cash flows to policyholders of other contracts, IFRS 17 allows reflecting the intergenerational sharing of returns between cohorts.

### Concept of “fair value returns”

- 98 The example of agenda paper 2A considers contracts whereby the policyholders receive 80% of the “fair value returns” from the underlying pool of assets with the entity having discretion over the timing and allocation across policyholders.
- 99 It is noteworthy that the examples about the level of aggregation (see 4.Appendix 1: Example 1 and 5.Appendix 2: Example 2) consider contracts whereby the contractual minimum participation to policyholders is determined based on the “historical cost measurement” returns (i.e. measured based on historical costs in the statutory

accounts) as required legally & contractually in the main European countries (see also § 4.8).

- 100 Accordingly, considering the theoretical case where all policyholders of a cohort would surrender their insurance contract at the same time, the leaving policyholders waive their right to possibly benefit from the unrealised accumulated changes in fair value of the underlying assets.
- 101 This does however not preclude that 80% of the fair value returns are paid to policyholders but nonetheless also depends on the discretionary assumptions / decisions made by management.

Are the fair value changes of shared underlying items created by a group?  
**[IASB 2019-03 AP 2A.41]**

- 102 IASB 2019-03 AP 2A.41 concludes that the increase in the entity's share in the fair value returns is *created* by the group of contracts (G 1 in the example).
- 103 In a mutualised pool of underlying items, the entity's share in the fair value of the underlying items stems from the overall portfolio, which includes all the items acquired from investing the premiums collected from all policyholders. As a consequence, there is no contractual link between any subset of the portfolio of underlying items and a group of contracts. Those underlying items belong to the community of policyholders without any group having individual rights on any subset of the overall portfolio. This is also illustrated by the fact that an insurer may decide to use the premiums received from the new business to indemnify the lapse of policyholders instead of selling assets.
- 104 For the purpose of measuring the CSM, IFRS 17.B 101(b)(i) and .B 112 implicitly require allocating the entity's share of the fair value of the underlying items to groups of contracts. However, this does not mean that the fair value returns are *created* by the groups.
- 105 Whenever a change in interest rate takes place when two or more cohorts already exist, the fair value gain from the pool of underlying items has to be allocated to the groups. We have analysed that effect in example 2 (see Appendix 2 § 268-269).
- 106 In fact, considering that a change in the fair value of the assets acquired with the premium paid by a group solely belongs to this group would be equivalent to considering that the underlying items are ring-fenced on a cohort by cohort basis. This conclusion is contrary to the example's assumption that the returns on the underlying assets are shared between the groups.
- 107 In the example of agenda paper 2A, we do not think that the entity's share in the fair value of the underlying items is created by G 1 and should consequently be recognised over the coverage period of G 1 only. Instead, we believe that the entity's share of the fair value of the underlying items has been allocated to G 1 for measurement purpose but contractually stems from all policyholders taking into consideration the contractual intergenerational mutualisation.
- 108 Furthermore, as mentioned during the Board's discussion, we would like to highlight the operational complexity of applying IFRS 17 to such contracts as IFRS 17.B 68:
- allows taking into account the fulfilment cash flows (FCF) allocated to groups of contracts already written (G 1 in the example) for the determination of the CSM of a newly underwritten cohort (G 2);
  - but does not reflect how FCF are expected to be allocated *between* the groups.
- 109 IFRS 17 implicitly requires tracking the part of the FCF included in the measurement of G 1, which will ultimately be paid to G 2. This therefore results in an artificial

division of the FCF allocated to the groups into layers (depending on the group to which the payment is expected to be made) that *de facto* creates an additional level of disaggregation contradicting the objective of “an operational simplification given for cost benefit reasons” as highlighted in IFRS 17.BC137.

- 110 For instance in the Example 2 hereafter, from year Y+1 to Y+3 (see Appendix 2 § 267 and § 276) the FCF of G 1 allocated to G 2 reflect the crediting rate of 4.1 % determined before the issuance of G 2 (i.e. expected final payments of 12 272, see Appendix 2 § 253) even though the entity’s expectation fell down to 3 % from year Y+1 onward.

Does tracking the entity’s share of the underlying item at group level provide meaningful information?

**IASB 2019-03 AP 2A.43**

- 111 The example addresses the case where, in a context of low interest rates, the entity receives from newly issued G 2 contracts an initial premium that is sufficient to serve the contractual minimum of 80 % of the return from the underlying pool of assets.
- 112 Applying paragraph 41 of the March 2019 agenda paper 2A, the entity’s share of the fair value of the underlying items is allocated to each group under the assumption that :
- 113 (i) insurance contracts are issued under current market conditions (regardless of the decision taken by the entity on previous groups) and
- 114 (ii) the underlying items purchased by investing the premium from the groups are segregated into ring-fenced fund backing specifically each group.
- 115 Arguably, this provides information as to whether adding such new business increases the overall share of the entity in the underlying pool of asset. However, the assumptions underlying such a calculation are contrary to the ones retained in the example, which assume mutualisation. And in fact, immediately after having been issued, G 2 is part of the mutualisation and the initial information provided by that CSM becomes obsolete.
- 116 Applying IFRS 17.B 68, the calculation of the CSM of G 2 is largely arbitrary as it depends on the amounts of discretionary cash flows initially assigned to G 1. We have described that effect in example 2 (see Appendix 2 § 261-263 and § 299-302). This highlights that the entity’s share in the fair value returns allocated to G 2 depends on discretionary assumptions made in the periods *before* issuing G 2.
- 117 In addition, any change in the market rate or in the return rate to policyholders has to be allocated between the groups on a discretionary way that is not necessarily related with the original expected entity’s share of the fair value returns (i.e. before mutualisation) of each group (see Appendix 2 § 268-269). Accordingly, even if the initial CSM of G 2 were deemed valuable, it becomes obsolete after initial recognition because of the discretion left with regards to the allocation of subsequent changes in discretionary estimates.
- 118 In that context, we are struggling with the supposed informative value of the CSM of G 2 *alone* which appears largely artificial. Thus, we do not concur with the statement (IASB 2019-03 AP 2A.43) that removing the distinction of the CSM of both groups in that context “would lead to an unacceptable loss of useful information”. We believe that, under these circumstances, the only relevant information about profitability is the cumulative CSM for both groups.
- 119 The CSM represents the expected profit to be recognised when the service will be rendered. It therefore relates to the evolution of groups (including upcoming new



cohorts) rather than to initial conditions ignoring the other groups it is supposed to be mutualised with.

Are separate annual cohorts necessary to prevent the CSM from being spread over a longer period than originally assessed?

**[IASB 2019-03 AP 2A.41 and .45]**

- 120 We concur with the objective set by the board to ensure that the allocation of the CSM in the P&L cannot be indefinitely postponed. We however do not consider that separate annual cohorts are necessary to achieve this goal.
- 121 The Example 2 shows (see Appendix 2 § 264 and 302) that by taking into account FCF from G 1 to G 2, the entity *duly* postpones a portion of G 1 CSM in a period that exceeds the initial G 1 coverage period. This is evidenced by a slight increase in the CSM due to the accretion effect by one year on that deferred part.
- 122 Further, we consider that adding new business to an existing group (in-Force) does not extend the portfolio duration indefinitely or make it “perpetual” since cash-flows attributable to the policyholders and the entity are permanently added and consumed. This mechanism is better and sufficiently reflected by the coverage units.
- 123 Therefore, we do not concur with the statement (IASB 2019-03 AP 2A.41 and .45) that “keeping the profit of the annual cohort separate is necessary to avoid deferring the recognition of profit beyond the coverage period of a group”.

#### Overall conclusion

- 124 Current IFRS 17 provisions (and especially IFRS 17.B67-B71) make it possible to reflect the intergenerational mutualisation, even if removing cohorts would probably better reflect the business practice as well as the contractual and legal situation.
- 125 Adding annual cohort in that context is however a very burdensome route to follow with no conceptual substance. The additional information provided does not prove to be useful but artificial.
- 126 In our view, such case has already been addressed by the board, as mentioned in IFRS 17.BC 138. We therefore suggest crystallising that exception in an amendment to annual cohorts in that specific context (see § 3.1).

## 2.4 Issue 3: Improving information provided to users

### Users' expectations

- 127 IASB explains that investors expects from the Insurance standard to provide information on (i) specific risks taken in a year as well as on (ii) trends in the profitability (i.e. whether new business is less or more profitable than the old one).

### Limits of annual cohorts in providing such information

- 128 According to IASB annual cohorts provide a series of discrete yearly data that help analysing profitability trends.
- 129 Annual cohort is a unit of account for measuring and allocating the CSM, but does not lead to readable information separately presented or disclosed for users.
- 130 There is indeed limited evidence about the usefulness of the information provided by annual cohorts to users, as reported in an EFRAG's user outreach that rather refers to annual cohorts as a concern.

### Merits of embedded value in providing the expected information

- 131 Users are generally interested in the effects of new business on in-force contracts, as referred to in the market consistent embedded value reports.
- 132 An analysis of the impact (contribution or dilution) of newcomers (new business) on an existing mutualised portfolio (In-force) is usual and represents very useful information since it clearly indicates business profitability trends. By contrast, identifying which of the former generations of policyholders is actually "subsidising" a new coming one, or the other way around, is not usual and the information usefulness is questionable in particular if groups are numerous on the basis of a very granular approach to contracts grouping.
- 133 There is a large practice of listed life-insurers in Europe (and a large support of users) on the performance content of information on the "embedded value". The financial communication on the embedded value is notably based on an analysis of in-force and new business. It generally provides for a reconciliation with IFRS financial statements over several periods of time, providing useful information on profitability trends.

### 3 Suggested solution (tentative)

134 The analysis of current provisions in the standard and their adequacy to the insurance business model leads to suggest addressing the following two concerns:

- Underwriting policies and contracts grouping:  
The relevance of subdividing a mutualised population at a level that does not reflect the insurer's underwriting policy and the policyholders' understanding and acceptance raises concerns regarding the onerous test. Current provisions in the standard may prove sufficient but a clarification may facilitate the implementation.
- Reflecting performance and mutualisation with annual cohorts:  
An exception to the application of annual cohorts should be considered when (as acknowledged by IFRS 17.BC 138) contracts fully share risks, so that "the groups together will give the same results as a single combined risk-sharing portfolio". The field test has demonstrated that applying annual cohorts in the case of intergenerational risk-sharing (mutualisation) is not conceptually necessary, does not provide useful information and adds complexity and costs. The concept of "fully shared risks" has to be defined in a broader way than contemplated by TRG staff (and rejected by TRG members) in order to address, for instance, life contracts with direct participation features where policyholders share financial and insurance risks. Limiting the use of the concept of "fully shared risks" to contracts where the CSM is nil or cannot be affected does not reflect reality.

#### 3.1 Suggested modifications to the standard related to "fully shared risks" and annual cohorts

##### General

- 135 We suggest exempting applying annual cohorts where insurance and financial risks are fully shared among the generations of policyholders. A definition of "fully shared risk" has to be added in the standard.
- 136 Limiting the exception to VFA contracts may prove efficient. But on the one hand it potentially leaves out reinsurance contracts under the general model, and on the other hand it may improperly embed non mutualised VFA contracts.
- 137 As mentioned above, where "risks are fully shared", a contract or group may not become onerous until the whole portfolio is.

##### Suggested definition of "fully shared risks"

- 138 Contracts where "risks are fully shared" are referred to in the extreme situation presented in the TRG where cash flows are 100% shared among policyholders so that the insurer's share in the risks and returns is nil.
- 139 This feature is however not limited to that extreme scenario but should also be considered when:
- the existence of an insurer's share in the risks or in the returns on underlying items of a mutualised population of policyholders does not prevent from having first a genuine mutualisation (full risk sharing) among policyholders (see § 78);
  - the existence of specific guarantees granted to certain policyholders, concentrating risks or returns on the underlying items on certain contracts, does not prevent from having also a genuine mutualisation (full risk sharing) among policyholders (see § 77).

- 140 Some suggested that in a portfolio where “risks are fully shared” among policyholders, the insurer’s share should remain stable (i.e. 10%) rather than being nil. This may actually address many situations but would not be sufficient. The key criterion is in fact the onerous nature or not of the group of contracts: a population actually becomes onerous when the insurer’s share in the risks increases to a point where the insurer is making or contemplating a loss.
- 141 We therefore suggest defining that risks are “fully shared” among policyholders when “policyholders share a significant amount of the financial returns and of the insurance risks across generations so that no set of contract within the group could possibly become onerous (alone)”. With regards to the classification referred to previously (§ 61), it is equivalent to a comprehensive cross-subsidisation scenario or to a broad definition of risk sharing.

#### Suggested modifications

- 142 IFRS 17.22: An entity shall not include contracts issued more than one year apart in the same group. This provision does not apply to contracts belonging to a portfolio where insurance and financial risks are fully shared among generations of policyholders. Risks are fully shared among policyholders when policyholders share a significant amount of the financial returns and of the insurance risks across generations so that no set of contract within the group could possibly become onerous alone. [...]

### *3.2 Suggested clarification regarding contracts grouping and underwriting policies*

#### General

- 143 The relevance of subdividing a mutualised population at a level that does not reflect the insurer’s underwriting policy and the policyholders’ understanding and acceptance raises concerns regarding the onerous test. These concerns may depend upon the accounting model used (PAA or general model).

#### **Onerous test under the PAA**

- 144 Under the PAA, IFRS 17.18 applies: rebuttable presumption that “no contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise”. Similar presumption assessing whether contracts have “significant possibility of becoming onerous subsequently by assessing the likelihood of changes in applicable facts and circumstances.” The standard does not provide for a definition of facts and circumstances.

#### **Onerous test under the general model**

- 145 Under the general model, the “onerous test” has to be performed at inception (IFRS 17.16) and subsequently (IFRS 17.19). Applying IFRS 17.17 the test is first performed for “a set of contracts”. The standard does not provide a precise definition of “a set of contracts” but indicates its classification depends upon “reasonable and supportable information”.
- 146 IFRS 17.33 and IFRS 17.37 provide information on the level of details required for performing an assessment of the expected cash-flows which may help setting the scope of the onerous testing. In order to make that assessment, the entity has to “incorporate, in an unbiased way, all reasonable and supportable information available without undue cost or effort”. The concept of “undue cost or effort” is further detailed in IFRS 17.B36-B41. It is mentioned that “information available from an entity’s own information systems is considered to be available without undue cost or effort”. In providing this guidance, the standard does not refer to the relevance of the

information, assuming there is no criterion for limiting drilling down to the lowest level of granularity (the contract).

- 147 Applying IFRS 17.33 and IFRS 17.37 for identifying “onerous” sets of contracts may eventually leads to performing the assessment at contract level and hence prove contrary to the top-down approach introduced by IFRS 17.17. As a matter of fact, the more detailed the available information would be, the lower the level of granularity of a “set of contracts” for onerous test purpose could be, disregarding the relevance and usefulness of such information, and only considering the cost of gathering it (not even the cost of using this information for setting the level of aggregation).
- 148 In order to prevent applying the “onerous test” at the same level of granularity as the level required for defining expected cash-flows requires clarifying what could be the “reasonable and supportable information” referred to in IFRS 17.17.
- 149 For instance, assuming the relevant information for users being related to the profitability of contracts, it could be assumed that the granularity should not be lower than the one used for pricing policy, whereas regarding expected cash-flows, the standard refers to “any information system” that may encompass very detailed information. Profitability finally results from the pricing policy set by management and therefore also reflects (i) the exposure to risks at a level considered relevant by management as well as (ii) the pricing mutualisation organised by management.
- 150 Introducing a linkage with the pricing policy may also have the merit to converge the onerous concept under IFRS 17 to the one applied in other standards such as IFRS 15 (see § 92-93).

#### Suggested amendment for clarification purposes

- 151 The following solution may be contemplated: relating the top down approach to the existence of a defined population with defined terms and conditions.
- 152 IFRS 17.17 could therefore be amended as follows for clarification purposes:
- 153 IFRS 17.17: If an entity has reasonable and supportable information to conclude that a set of contracts will all be in the same group applying paragraph 16, it may measure the set of contracts to determine if the contracts are onerous (see paragraph 47) and assess the set of contracts to determine if the contracts have no significant possibility of becoming onerous subsequently (see paragraph 19). Such measurement shall take into account the terms and conditions of the insurance coverage organised by the entity and offered to the policyholders. If the entity does not have reasonable and supportable information to conclude that a set of contracts will all be in the same group, it shall determine the group to which contracts belong by considering individual contracts.
- 154 IFRS 17.19: For contracts issued to which an entity does not apply the premium allocation approach (see paragraphs 53–59), an entity shall assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous:
- (a) based on the likelihood of changes in assumptions which, if they occurred, would result in the contracts becoming onerous.
  - (b) using information about estimates provided by the entity’s internal reporting. Hence, in assessing whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous:

(i) an entity shall not disregard information provided by its internal reporting about the effect of changes in assumptions on different contracts on the possibility of their becoming onerous; but

(ii) an entity is not required to gather additional information beyond that provided by the entity's terms and conditions of the insurance coverage ~~internal reporting about the effect of changes in assumptions on different contracts.~~

Draft for discussion

## 4 Appendix 1: Example 1

### 4.1 Assumptions

- 155 An insurance company issues the following participating contracts:
- In year Y : 10 contracts with an individual premium of 1 000
  - In year Y+1 : 15 contracts with an individual premium of 1 000
- 156 The contracts share the returns of a common pool of assets segregated in a dedicated fund and are entitled contractually to a minimum of 80% of the returns from the pool yet with the insurer's discretion as to the timing and allocation among policyholders of the distribution. The contract duration is five year. Upon the contractual term, policyholders are entitled to the account balance including the accumulated premiums and discretionary bonuses. Discretionary bonuses are set by management on a yearly basis and credited to policyholders' account. Afterwards, policyholders have an enforceable right to the payment of the bonus. For commercial reasons, management credits all policyholders' accounts using a single crediting rate (no distinction by year of subscription). Furthermore, it is assumed that management only credits accounts with a view to abiding by the contractual profit sharing obligation of 80% of the returns. No additional bonuses are credited to policyholders' accounts beyond the contractual minimum.
- 157 The contracts are investment contracts with discretionary participation features that fall under IFRS 17. The example assumes that they meet the criteria for the variable fee approach (IFRS 17.B101).
- 158 The premiums are assumed to be paid on January 1<sup>st</sup> and immediately invested:
- in year Y : 10 000 in bonds with a 5 year maturity and an interest rate of 5% capitalised until maturity;
  - in year Y+1: 15 000 in bonds with a 5 year maturity and an interest rate of 1% capitalised until maturity;
- 159 At the end of year Y, the market interest rate for bonds goes down to 1%. For simplicity reason, yield curves are assumed to be flat. The rates are constant afterwards.
- 160 In future periods, notwithstanding this drop of market interest rate, everything happens as expected at inception.
- 161 The credit risk of the bonds is assumed to be negligible. Coupons are not invested and remain on the insurer's bank account. The bonds are accounted for at amortised costs. Applying IFRS 17.B81, the entity determines the discount rate based on the yield curve implicit in the fair value measurement of the dedicated fund.
- 162 For simplicity reason, it is assumed that the company starts its activity in Y and has no other portfolios. Furthermore, the CSM is allocated to profit and loss based on the passage of time and no risk adjustment for non-financial risk is considered.

#### 4.2 In year Y:

##### Recognition of the first group of contracts

- 163 Upon receipt of the premium, the entity recognises the group of contracts issued in year Y.
- 164 The investment in bonds will provide a cash inflow of  $10\,000 \times 1.05^5 = 12\,763$  in year 5 (Y+4).
- 165 The insurance company expects to make a final pay-out upon year Y+4 with an implicit yearly yield rate of 4,1% for the policyholder. The final expected payment is therefore  $10\,000 \times 1.041^5 = 12\,225$ . The participation of the policyholders is therefore  $2\,225 / 2\,763 = 80\%$  and the insurer's fee amount to 538 ( $2\,763 - 2\,225$ ).
- 166 The dedicated portfolio of assets is considered as the reference portfolio for the determination of the discount rate. The bonds bear no credit risk and the entity decides to apply the option in IFRS 17.B81 not to adjust the reference portfolio's rate for differences in the liquidity characteristics. Therefore, the discount rate equals the rate of return implicit in the fair value of the dedicated portfolio of assets. At initial recognition the discounted value of the payment is  $12\,225 / 1.05^5 = 9\,579$ .
- 167 The initial CSM is therefore  $10\,000 - 9\,579 = 421$

|   | Debit  | Credit |
|---|--------|--------|
| Cash  | 10 000 |        |
| Provision for remaining coverage              |        | 9 579  |
| Contractual service margin                    |        | 421    |
| To record the initial recognition of group 1. |        |        |

##### At the end of year Y:

- 168 The bonds are accounted for at amortised cost, the entity records the interests earned over the period : 500

|   | Debit | Credit |
|---|-------|--------|
| Bonds   | 500   |        |
| Finance income  |       | 500    |
| To record the amortised costs of the bonds at the end of year Y |       |        |

- 169 As interest rate have fallen to 1%, the fair value of the bonds purchased in year Y has increased to  $10\,000 \times 1.05^5 / 1.01^4 = 12\,265$ .
- 170 The discount rate for the determination of the liability for remaining coverage is updated to reflect the current market rate of returns implicit in the fair value measurement of the reference portfolio, which is 1 %.
- 171 The liability for remaining coverage under IFRS 17 is the discounted value of the expected terminal payment which is  $10\,000 \times 1.041^5 / 1.01^4 = 11\,748$ . The increase is  $11\,748 - 9\,579 = 2\,169$ .

|   | Debit | Credit |
|---|-------|--------|
| Insurance finance expense   | 2 169 |        |
| Liability for remaining coverage  |       | 2 169  |
| To record the effect of the time value of money and the change in interest rate |       |        |



The increase in the liability for remaining coverage consecutive to the increase in the fair value of the assets represents the obligation of the entity to repay 80% of future interests received on the assets. It is not a liability against the current policyholders (G 1) only since the contractual obligation relates to the interest rates flows and not to changes in fair value.

Accordingly, if the mutualisation of the policy leads to share future interest returns on these assets with future policyholders, a portion of the 80% of the recorded change in fair value is attributable to future policyholders and consequently that change in fair value does not exclusively belong to current policyholders (G 1).

172 Furthermore, as the contracts are accounted for under the variable fee approach, the entity also updates the CSM up to 96, the difference between :

- the change in the fair value of the underlying assets :  $12\,265 - 10\,000 = 2\,265$
- the change in the liability for remaining coverage :  $9\,579 - 11\,748 = -2\,169$

|   | Debit | Credit |
|---|-------|--------|
| Insurance finance expense   | 96    |        |
| Contractual service margin  |       | 96     |
| To adjust the CSM for the entity's share in the fair value of the underlying items. |       |        |

The change in CSM by 96 results from a change in financial assets and how that change is reflected in the insurance liability.

The evolution of the CSM results from changes in the underlying items, e.g. both (i) changes in financial assets and (ii) changes in the liability for remaining coverage.

The liability for remaining coverage may also change for technical reasons, due to a change in the insurance risk (change in actuarial assumptions or pricing). For participating contracts sharing insurance risks, transfer between groups would be accounted for the same way.

173 In addition, as the entity holds the underlying items, it chooses to disaggregate the insurance finance income between profit and loss and OCI so as to eliminate the mismatch with the assets carried at amortised costs. The difference is  $2\,169 + 96 - 500 = 1\,765$ . The entry is therefore the following:

|  | Debit | Credit |
|--|-------|--------|
| Other comprehensive income                               | 1 765 |        |
| Insurance finance expense                                |       | 1 765  |
| To disaggregate finance income according to IFRS 17.B134 |       |        |

174 Finally, the entity allocates the contractual service margin to P&L:

|  |      |
|--|------|
| New contracts issued                                 | 421  |
| Change in the entity's share of the underlying items | 96   |
| Amounts before allocation to profit and loss         | 517  |
| Allocation to profit and loss 1 / 5                  | -103 |
| CSM at year end                                      | 414  |

|                            | Debit | Credit |
|----------------------------|-------|--------|
| Contractual Service margin | 103   |        |

|   |  |     |
|---|--|-----|
| Insurance service income                                |  | 103 |
| To record the release of the contractual service margin |  |     |

| Balance sheet                    | Year Y   | Profit and loss statement  | Year Y |
|----------------------------------|----------|----------------------------|--------|
| Bonds                            | 10 500   | Insurance revenue          | 103    |
| Liability for remaining coverage | (11 748) | Finance income (Bonds)     | 500    |
| Contractual service margin       | (414)    | Insurance finance expenses | (500)  |
| Net income                       | (103)    |                            |        |
| Other comprehensive income       | 1 765    | Net income                 | 103    |

#### 4.3 In year Y + 1:

##### Recognition of the second group of contracts

##### **Expected returns from the joint underlying assets**

- 175 The implicit rate of return in the fair value measurement of the reference portfolio of assets is 1%.
- 176 The expected returns from the overall portfolios of investments in bonds amounts to:  
 $10\,000 \times (1.05^5 - 1) + 15\,000 \times (1.01^5 - 1) = 3\,528$
- 177 Of which 80% will, by regulation, be returned to policyholders that is 2 822. The expected total insurer's fee is therefore  $3\,528 - 2\,822 = 706$ .

##### **Entity's decision to allocate 2% of actual assets' return to each group**

By the term of the contracts, policyholders are collectively entitled to receive a minimum of 80% of the assets' returns. Since both groups 1 and 2 are managed together and mutualised (sharing risks and returns on their underlying items) the entity estimates a unique rate applicable to assets' return equivalent to meeting that obligation.

- 178 In the current case, that amount is equivalent to  $(80\% \times 5\% \times 10\,000 \text{ on } 4 \text{ years} + 80\% \times 1\% \times 15\,000 \text{ on } 5 \text{ years}) = 2\% \times 25\,000 \text{ on } 5 \text{ years}$ .
- 179 In future periods, the entity intends to allocate evenly the financial returns between policyholders by crediting an implicit steady yearly rate to all policyholders' accounts (IFRS 17.B132), which amounts to 2%.
- The expected terminal payment to group 1 (G 1) is expected to be  $10\,400 \times (1.02)^4 = 11\,257$
  - The expected terminal payment to group 2 (G 2) is expected to be  $15\,000 \times (1.02)^5 = 16\,561$
  - Thus the expected returns to be passed to the policyholders amount to  $11\,257 + 16\,561 = 27\,818$
- 180 In year Y, the entity had used a higher rate of discretionary bonus to compute the fulfilment cash flows assigned to group 1 (4.1% instead of 2%).
- 181 In year Y, the initial assumptions used to compute the CSM of group 1 relied on a discretionary participation of policyholders included in the terminal payment up to  $10\,000 \times (1.041^5 - 1) = 2\,225$  with a difference of  $2\,225 - 1\,257 = 968$  as compared with the revised expectation. The provision for remaining coverage for G 1 should reflect the new expected terminal payment and would therefore amount to  $11\,257 / 1.01^4 = 10\,818$  instead of  $12\,225 / 1.01^4 = 11\,748$ . This difference of  $10\,818 - 11\,748 = (930)$  correspond to the discounted  $968 @ 1\%$  ( $930 = 968 / 1.01^4$ ).

182 The estimates of the future cash flows arising from G 2 would also reflect the expected terminal payment of 16 561 and the discounted amount would be  $16\,561 \times 1.01^{-5} = 15\,757$ . The discounted amount is higher than the received premiums.

In a new group of contracts, if the amount of discretionary returns exceeds the discount rate implicit in the fair value of the underlying items (applying the top-down approach) the fulfilment cash flows are negative.

Applying VFA with no transfer of FCF

183 Applying the VFA approach, changing the FCF in G 1 would increase the amount of CSM to be released over the future periods by 930.

184 Conversely G 2 contracts would then be considered onerous and an immediate loss of 757 (and no CSM) would have to be recognised.

If the entity is organising the profitability of each group without transferring FCF among them (i.e. not applying IFRS 17.B68), corresponding changes in the CSM may lead to recognise “onerous” contracts in an accounting perspective.

In fact, since adding the new G 2 business eventually contributes to increasing the entity’s share in the returns of the underlying assets by 168 from 538 in year Y to 706 in year Y+1, group 2 should not “economically” be considered “onerous”.

Applying VFA with transfer of FCF according to B68

185 Applying IFRS 17.B68 (b) the entity decides to allocate 968 from G 1 FCF as future discretionary payments to G 2.

186 Thanks to the transferred FCF from G 1, the outflows to G 2 policyholders in year 6 would amount to 16 561 (15 597 +964), which correspond to a 2% return. However, as long as the transfer is accounted for as an outflow (not to G1 but to G2) of GA, the outflows under G2 remains 15 597, i.e. on the basis of a 0.78% return.

187 The basic case to represent the obligation to allocate 80% of the assets’ returns to the policyholders of each group is to consider that G 1 policyholders are entitled to 80% @5%, with roughly corresponds to the 4,1% (modulo the discounting effect) and G 2 policyholders are entitled to 80% @1%, with roughly corresponds to the 0,78% (modulo the discounting effect). Ensuring that both receive the 2% equalising rate for the whole population in the next 4 years, is equivalent for G 1 to transfer to G 2 the lacking @1,2% on 5 years: ~ roughly equivalent to  $15\,000 @ 1,2\% * 5 = 900$  (modulo the discounting effect).

188 The theoretical outflows allocated to G 1 remain 12 225. In fact, FCF of G 1 have been transferred to G 2 by 968: the whole outflow remains the same but is partly allocated to another group. Accordingly, the CSM of G 1 has not changed.

189 The discounted value of the future expected cash flows for G 2 is  $15\,597 / 1.01^5 = 14\,840$  and consequently the CSM is 160. In other words, G2 discounted outflows have decreased by 917 from 15 757 (before transfer) to 14 840 (with transfer). Instead of recognising an immediate loss of 757, G2 records a CSM of 160 (i.e. CSM has been correspondingly increasing by  $160 + 757 = 917$ ). The transferred amount corresponds to  $917 = 964 / 1.01^5$ . The difference between 917 and 930 (see § 181) mainly comes from the deferral of cash-flows by one year.

|                                  | Debit  | Credit |
|----------------------------------|--------|--------|
| Cash                             | 15 000 |        |
| Provision for remaining coverage |        | 14 840 |

|   |  |     |
|---|--|-----|
| Contractual service margin                    |  | 160 |
| To record the initial recognition of group 2. |  |     |

Ensuring that policyholders of G 1 and G 2 get 80% of the returns on the underlying items, is equivalent to providing for a 2% return on the assets (in a 1% interest rate environment).

Not applying IFRS 17.B68 leads to unduly recognise onerous contracts in G 2 (see § 184).

Applying transfers among groups (IFRS 17.B68) enables to achieve the management's objective of allocating 2% return on each group.

On the one hand this objective is not represented in the assessment of G 1 flows or CSM which remains based on the original @4.1% return: the FCF gained on the decrease in crediting rate allocated to G1 policyholders (from 4.1 % down to 2.0%) have been fully transferred to G2 so that neither the FCF nor the CSM have changed.

On the other hand the transfer has not been neutral to the CSM of G 2, which is eventually not related with the @2.0% objective set to that group (which, alone, would have made the group onerous).

Amounts included in the measurement of IFRS 17 groups of contracts require a specific allocation pattern and an extensive historic follow-up, and eventually do not reflect in all circumstances the actual expectations or expected margin of the management.

Actually only a consolidated analysis of both groups provides a view corresponding to the management's expectation. That overarching approach also shows that the conclusions remain the same even if one group benefits from a minimum guaranteed return rate, as long as (i) transfers are possible between groups and (ii) consolidated FCF exceed guaranteed amounts so that the entity's share in the underlying items remains the same.

#### At the end of year Y+1

- 190 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $10\,500 \times 5\% + 15\,000 \times 1\% = 675$

|   | Debit | Credit |
|---|-------|--------|
| Bonds   | 675   |        |
| Finance income  |       | 675    |
| To record the amortised costs of the bonds at the end of year Y+1 |       |        |

- 191 The current market interest rate is flat at 1%. The fair value of the bonds held by the entity amounts to  $10\,000 \times 1.05^5 / 1.01^3 + 15\,000 \times 1.01^5 / 1.01^4 = 12\,387 + 15\,150 = 27\,537$ . The fair value change is therefore  $27\,537 - 15\,000 - 12\,265 = 273$ .

- 192 The entity computes the liability for remaining coverage :

- For group 1, the liability is  $12\,225 / 1.01^3 = 11\,866$  with an increase of  $11\,866 - 11\,748 = 118$
- For group 2, the liability is  $15\,597 / 1.01^4 = 14\,988$  with an increase of  $14\,988 - 14\,840 = 148$ .

|                                  | Debit | Credit |
|----------------------------------|-------|--------|
| Insurance finance expense        | 266   |        |
| Liability for remaining coverage |       | 266    |

To record the change in the liability for remaining coverage

- 193 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying items that is  $273 - 266 = 7$ .

The standard does not provide guidance on how to apply IFRS 17.B104(b)(i) and IFRS 17.B112 to groups of contracts that share in the same pool of underlying assets. As group 1 and 2 are backed by the same dedicated fund, the entity needs to perform an allocation of the changes in the fair value of the bonds to each group.

In our example, by simplification the change to the variable fee is fully allocated to the most recent cohort. This example does not preclude other methodologies and does not consider whether this simplification would comply with the requirements of IAS 8.

- 194 Based on this assumption, the change in the variable fee is assigned to G 2.

|   | Debit | Credit |
|---|-------|--------|
| Insurance finance expense   | 7     |        |
| Contractual service margin  |       | 7      |
| To adjust the CSM for the entity's share in the fair value of the underlying items. |       |        |

- 195 Then the entity applies IFRS 17.B134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore  $266 + 7 - 675 = (402)$

|  | Debit | Credit |
|--|-------|--------|
| Other comprehensive income   |       | 402    |
| Insurance finance expense  | 402   |        |
| To record the disaggregation of finance expenses according to IFRS 17.B134 |       |        |

- 196 Then the entity allocates CSM to P&L according to IFRS 17.B119

|   | Group 1 | Group 2 | Total |
|---|---------|---------|-------|
| Opening balance   | 414     |         | 414   |
| New contracts issued  |         | 160     | 160   |
| Change in the entity's share of the underlying items                  |         | 7       | 7     |
| Amounts before allocation to profit and loss                          | 414     | 167     | 581   |
| Allocation to profit and loss 1 / 4 for group 1 and 1 / 5 for group 2 | (103)   | (33)    | (137) |
| CSM at the end of year Y+1  | 310     | 134     | 444   |

- 197 The financial statements are as follows :

| Balance sheet                    | Year Y+1 |
|----------------------------------|----------|
| Bonds                            | 26 175   |
| Liability for remaining coverage | -26 854  |
| Contractual service margin       | - 444    |
| Net income                       | -137     |
| Retained earnings                | -103     |
| Other comprehensive income       | 1 363    |

| Profit and loss statement | Year Y+1 |
|---------------------------|----------|
| Insurance revenue         | 137      |
| Finance income            | 675      |
| Insurance finance expense | (675)    |
| Net income                | 137      |

#### 4.4 At the end of year Y+2 and Y+3

198 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is:

- In Y+2:  $11\,025 \times 5\% + 15\,150 \times 1\% = 703$  ;
- In Y+3:  $11\,576 \times 5\% + 15\,302 \times 1\% = 732$ .

199 The current market interest rate is flat at 1%. The fair value of the bonds held by the entity amounts to :

- In Y+2:  $10\,000 \times 1.05^5 / 1.01^2 + 15\,000 \times 1.01^5 / 1.01^3 = 12\,511 + 15\,301 = 27\,812$ ;
- In Y+3:  $10\,000 \times 1.05^5 / 1.01 + 15\,000 \times 1.01^5 / 1.01^2 = 28\,091$ .

200 The fair value changes of the bonds are therefore:

- In Y+2:  $27\,812 - 27\,537 = 275$ ;
- In Y+3:  $28\,091 - 27\,812 = 278$ .

201 The entity computes the liability for remaining coverage:

202 For group 1, the liability is :

- In Y+2:  $12\,225 / 1.01^2 = 11\,984$  with an increase of  $11\,984 - 11\,866 = 119$
- In Y+3:  $12\,225 / 1.01 = 12\,104$  with an increase of  $12\,104 - 11\,984 = 120$

203 For group 2, the liability is:

- In Y+2:  $15\,597 / 1.01^3 = 15\,138$  with an increase of  $15\,138 - 14\,988 = 150$
- In Y+3:  $15\,597 / 1.01^2 = 15\,290$  with an increase of  $15\,290 - 15\,138 = 151$

204 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is:

- In Y+2 :  $275 - 119 - 150 = 7$ ;
- In Y+3:  $278 - 120 - 151 = 7$ .

205 Consistent with the entity's accounting policy, the changes in the variable fee are assigned to group 2.

206 Then the entity applies IFRS 17.B134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore:

- In Y+2:  $119 + 150 + 7 - 703 = (427)$ ;
- In Y+3:  $120 + 151 + 7 - 732 = (454)$ .

207 Then the entity allocates the CSM to profit and loss according to IFRS 17.B119

|   | Group 1 | Group 2 | Total |
|---|---------|---------|-------|
| Opening balance Y+1   | 310     | 134     | 444   |
| Change in the entity's share of the underlying items                  |         | 7       | 7     |
| Allocation to profit and loss 1 / 3 for group 1 and 1 / 4 for group 2 | (103)   | (35)    | (138) |
| CSM at the end of year Y+2  | 207     | 105     | 312   |
| Change in the entity's share of the underlying items                  |         | 7       | 7     |
| Allocation to profit and loss 1 / 2 for group 1 and 1 / 3 for group 2 | (103)   | (37)    | (141) |
| CSM at the end of year Y+3  | 103     | 75      | 178   |

208 The financial statements are as follows :

| Balance sheet                    | Y+2      | Y+3                   | Profit and loss           | Y+2   | Y+3   |
|----------------------------------|----------|-----------------------|---------------------------|-------|-------|
| Bonds                            | 26 878   | 27 610                | Insurance revenue         | 138   | 141   |
| Liability for remaining coverage | (27 122) | (27 394) <sup>1</sup> | Finance income            | 703   | 732   |
| Contractual service margin       | (312)    | (178)                 | Insurance finance expense | (703) | (732) |
| Net income                       | (138)    | (141)                 |                           |       |       |
| Retained earnings                | (240)    | (378)                 |                           |       |       |
| Other comprehensive income       | 935      | 481                   | Net income                | 138   | 141   |

#### 4.5 At the end of year Y+4

209 Underlying assets:

- The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $12\,155 \times 5\% + 15\,455 \times 1\% = 762$ .
- The bonds subscribed in year Y reach their maturity and the entity receives the final inflow of 12 763.
- The fair value of the remaining bonds held by the entity amounts to  $15\,000 \times 1.01^5 / 1.01^1 = 15\,609$ .
- The change in fair value of the underlying assets is therefore  $(15\,609 + 12\,763) - 28\,091 = 281$ .

210 The entity computes the liability for remaining coverage:

211 The contracts of group 1 reach their maturity. The entity assigns the 2% returns to the policyholders' accounts and makes its expected final payment of  $10\,000 \times 1.04 \times 1.02^4 = 11\,257$ . With regards to the legal obligation, this payment corresponds to the G 1 share in 80% of the yearly interest income on assets.

212 At the end of year Y+4, the company has cash at hand up to  $12\,763 - 11\,257 = 1\,506$

213 The opening balance of the liability for remaining coverage of group 1 was  $12\,104 = 12\,225 / 1.01$ .

214 The measurement of group 1 still includes 968 of future discretionary benefits allocated to policyholders of group 2.

215 The change in the liability for remaining coverage for group 1 is therefore :

|   |               |
|---|---------------|
| <b>Opening balance</b>  | <b>12 104</b> |
| Unwind of the discount rate (1%)                              | 121           |
| Terminal payment to policyholders of group 1                  | -11 257       |
| <b>Closing balance – Residual amount allocated to group 2</b> | <b>968</b>    |

216 The entity applies IFRS 17.B71 and recognises a liability for the fulfilment cash flows allocated to group 2 up to 968.

All the CSM attributable to G 1 FCF has actually been allocated. The remaining 968 FCF have been transferred to G 2 thanks to IFRS 17.B 68 and IFRS 17.B 71 provisions.

<sup>1</sup>  $27\,394 = 15\,290 + 12\,104$

- 217 For group 2, the liability is  $15\,597 / 1.01^1 = 15\,443$  with an increase of  $15\,443 - 15\,290 = 153$ .
- 218 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is  $281 - 153 - 121 = 7$ . Consistent with the previously applied accounting policy, the change in the variable fee is assigned to group 2.
- 219 Then the entity applies IFRS 17 B134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore  $274 + 7 - 762 = (481)$

|   | Debit | Credit |
|---|-------|--------|
| Other comprehensive income  |       | 481    |
| Insurance finance expense   | 481   |        |
| To record the disaggregation of finance expenses according to IFRS 17.B134. |       |        |

- 220 Then the entity allocates the CSM to profit and loss according to IFRS 17.B119.

|   | Group 1 | Group 2 | Total |
|---|---------|---------|-------|
| Opening balance   | 103     | 75      | 178   |
| Change in the entity's share of the underlying items                  |         | 7       | 7     |
| Allocation to profit and loss 1 / 1 for group 1 and 1 / 2 for group 2 | - 103   | -41     | -144  |
| CSM at the end of Y+4   | 0       | 41      | 41    |

- 221 The financial statements are as follows :

| Balance sheet                    | Y+4     | Profit and loss statement | Y+4  |
|----------------------------------|---------|---------------------------|------|
| Cash at hand                     | 1 506   | Insurance revenue         | 144  |
| Bonds                            | 15 609  | Finance income (bonds)    | 762  |
| Liability for remaining coverage | -16 410 | Insurance finance expense | -762 |
| Contractual service margin       | - 41    |                           |      |
| Net income                       | -144    |                           |      |
| Retained earnings                | -519    |                           |      |
| Other comprehensive income       | 0       | Net income                | 144  |

#### 4.6 At the end of year Y+5

- 222 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $15\,609 \times 1\% = 156$ . The change in the fair value of the bonds is also 156.
- 223 The bonds subscribed in year Y+1 reach their maturity and the entity receives the final inflow of 15 765.
- 224 The contracts of group 2 reach their maturity. The entity assigns an additional 2% discretionary bonus to the policyholders' accounts and makes its expected final payment of  $15\,000 \times 1.02^5 = 16\,561$ .
- 225 The balance of cash in hands amounts to  $1\,506 + 15\,765 - 16\,561 = 709$



226 The changes in the liability for remaining coverage is the following :

|                                   | Residual amount from group 1 | Group 2        |
|-----------------------------------|------------------------------|----------------|
| <b>Opening balance</b>            | <b>968</b>                   | <b>15 443</b>  |
| Unwind of the discount rate (1%)  |                              | 154            |
| Transfer of fulfilment cash flows | -968                         | 968            |
| <b>Terminal payment</b>           |                              | <b>-16 561</b> |
| <b>Closing balance</b>            | <b>0</b>                     | <b>4</b>       |

227 The entity re-measures the contractual service margin to take into account the entity's share of the changes in the fair value of the underlying assets  $156 - 154 = 2$ .

|  | Group 1 | Group 2 | Total |
|--|---------|---------|-------|
| CSM at the end of Y+4                                | 0       | 41      | 41    |
| Change in the entity's share of the underlying items |         | 2       | 2     |
| Allocation to profit and loss                        |         | -43     | -43   |
| CSM at the end of Y+4                                | 0       | 0       | 0     |

228 The financial statements are as follows:

| Balance sheet                    | Y+5   | Profit and loss statement | Y+5   |
|----------------------------------|-------|---------------------------|-------|
| Cash at hand                     | 709   | Insurance revenue         | 43    |
| Bonds                            | 0     | Finance income (bonds)    | 156   |
| Liability for remaining coverage | (4)   | Insurance finance expense | (156) |
| Contractual service margin       | 0     |                           |       |
| Net income                       | (43)  |                           |       |
| Retained earnings                | (663) |                           |       |
| Other comprehensive income       | 0     | Net income                | 43    |

#### 4.7 Conclusion on the objectives of annual cohorts requirement

##### Recognising onerous contracts on a timely basis (IFRS 17.BC119)

Without considering transfers from one group to the other, the annual cohort approach may lead to conclude that a group is onerous (from an accounting point of view) whereas it is actually not and still positively contributes to increasing the shareholders' value (see § 184).

In order to take into account the intergenerational nature of the underlying pool of assets and in order to avoid a misstatement of performance, a transfer has to be organised. Such a transfer is a significant complexity leading to an unnecessary administrative burden.

The example shows that as long as a sufficient amount of unallocated past return to past generations is available to serve, together with future return of the underlying portfolio of assets, the expected return to future generations there is no need for a cohort approach and the administrative overburden can be avoided.

### Recognising expected profit over the lifetime of the group (IFRS 17.BC136)

Both the general model (IFRS 17.B98) and the VFA (IFRS 17.B112) allow the insurer to reassess the discretionary cash-flows allocated to a contract after the initial recognition and to adjust the CSM.

The example confirms that transfers of discretionary cash-flows from one group to another (applying IFRS 17.B68) also adjust the CSM in each group separately, thus also change the time-allocation of the CSM:

- G 1, without transfer, would have recognised an increase in CSM by 930 (see § 181);
- G 2 recognises an initial CSM amounting to 160 whereas, without transfer (of 917), it would have recognised a negative CSM e.g. a loss of 757 at inception (see § 189).

Transfers however do not materially adjust the total CSM ( $930-757-160=13$ ), since they actually do not materially change the shareholder's part in the underlying items. The residual amount (13) however mainly stems from the deferral of cash flows by one year. The case demonstrates that transfers allow to defer CSM from one group to the other e.g. from one period to another (similar to what would happen in an open portfolio).

The example illustrates transfers of financial returns between groups sharing financial risks, regardless of the existence of minimum guaranteed returns (See § 189).

As mentioned in § 172 the same reasoning is applicable to groups that transfer insurance/technical returns because such groups share insurance/technical risks.

Accordingly contracts/groups that share risks on underlying items (assets and liabilities/insurance) may transfer financial and technical returns from one group to the other in order to achieve the same result as "a single combined risk-sharing portfolio" (IFRS 17.BC138).

#### 4.8 Additional observation: profit sharing obligation in the annual FS

Even though the profit sharing obligation relates to annual financial statement under local GAAP and not IFRS FS, it is useful to analyse such impact since it eventually sets the binding legal obligation.

For instance, the way the 80% allocation rule is applied demonstrates that such an obligation relates to the interest income regardless of the changes in the fair value of the underlying assets.

##### Year Y

229 In the annual account, the entity decides to allocate a bonus of 4% to the individual policyholders' accounts. The policyholders' accounts are therefore credited by 400. The legal amount of profit sharing is 80% of the interest income that is  $500 \times 80\% = 400$ . The collective reserve is therefore not credited. The total policyholders' accounts balance is 10 400.

##### Year Y+1

230 In the annual account, the entity decides to allocate a bonus of 2% to the individual policyholders' accounts. The policyholders accounts are therefore credited by 508 ( $10\,400 \times 2\% + 15\,000 \times 2\% = 508$ ). The legal amount of profit sharing is 80% of the interest income that is  $675 \times 80\% = 540$ . The collective reserve is therefore credited for 32 with an overall balance of 32 at the end of year Y+1. The total policyholders' accounts balance is  $10\,400 + 15\,000 + 508 = 25\,908$ .

##### Years Y+2 and Y+3

231 In the annual account, **for both years** the entity allocate a bonus of 2% to the individual policyholders' accounts.

|  | Y+2           | Y+3           |
|--|---------------|---------------|
| <b>Policyholders' accounts at opening</b>    | <b>25 908</b> | <b>26 426</b> |
| Interests credited (2%)                      | 518           | 529           |
| <b>Policyholders' account at closing</b>     | <b>26 426</b> | <b>26 955</b> |
| Amount of financial income from bonds        | 703           | 732           |
| x 80% (profit sharing obligation)            | 562           | 585           |
| Difference with credited interests           | 44            | 57            |
| Collective reserve on opening balance        | 32            | 76            |
| <b>Collective reserve on closing balance</b> | <b>76</b>     | <b>133</b>    |

##### Year Y+4

232 In the annual account, the entity decides to allocate a bonus of 2% to the individual policyholders' accounts and makes the terminal payments to policyholders of group 1 up to 11 257. The policyholders accounts are therefore credited by 539 ( $26\,954 \times 2\% = 539$ ). The legal amount of profit sharing is 80% of the interest income that is  $762 \times 80\% = 610$ .

233 The collective reserve is therefore credited for 71 with an overall balance of 204 at the end of year Y+1.

234 The accumulated policyholders' accounts balance is  $26\,954 + 539 - 11\,257 = 16\,236$ .

Year Y+5

|  | Y+5           |
|--|---------------|
| <b>Policyholders' accounts at opening</b>    | <b>16 236</b> |
| Interests credited (2%)                      | 325           |
| Terminal payment to group 2                  | -16 561       |
| <b>Policyholders' account at closing</b>     | <b>0</b>      |
| Amount of financial income from bonds        | 156           |
| x 80% (profit sharing obligation             | 125           |
| Difference with credited interests           | -200          |
| Collective reserve on opening balance        | 204           |
| <b>Collective reserve on closing balance</b> | <b>4</b>      |

## 5 Appendix 2: Example 2

### 5.1 Problem statement

- 235 An insurance company issues the following participating contracts:
- In year Y: 10 contracts with an individual premium of 1 000
  - In year Y+1: 15 contracts with an individual premium of 1 000
- 236 The contracts share the returns of a common pool of assets segregated in a dedicated fund and are contractually entitled to a minimum of 80 % of the returns (determined based on the historical cost of the investments) from the pool, yet with the insurer's discretion as to the timing and allocation of the payments to individual policyholders. The contract duration is five years. Upon the contractual terms, policyholders are entitled to the account balance including the accumulated premiums and discretionary bonuses. Discretionary bonuses are set by management on a yearly basis and credited to policyholders' account. Afterwards, policyholders have an enforceable right to the payment of the bonus. For commercial reasons, management credits all policyholders' accounts using a single crediting rate (no distinction by year of subscription). Expected payment may exceed the contractual minimum of 80 % depending on market conditions and competitive pressure.
- 237 The contracts are investment contracts with discretionary participation features that fall under IFRS 17. The example assumes that they meet the criteria for the variable fee approach (IFRS 17.B 101).
- 238 The premiums are assumed to be paid on January 1<sup>st</sup> and immediately invested in zero-coupon bonds:
- in year Y: 10 000 in bonds with a 5 year maturity and an interest rate of 5 % capitalised until maturity;
  - in year Y+1: 15 000 in bonds with a 5 year maturity and an interest rate of 3 % capitalised until maturity.
- 239 At the end of year Y, the market interest rate for bonds goes down to 3 %. For simplicity reason, yield curves are assumed to be flat.
- 240 At the end of year Y+1, the market interest rate for bonds goes down to 1 % and remains flat afterwards.
- 241 In future periods, notwithstanding the drop of market interest rate, everything happens as expected at inception.
- 242 The credit risk of the bonds is assumed to be negligible. The bonds are accounted for at amortised costs. Applying IFRS 17.B81 the entity determines the discount rate based on the yield curve implicit in the fair value measurement of the dedicated fund.
- 243 For simplicity reason, it is assumed that the company starts its activity in Y and has no other portfolios. Furthermore, the CSM is allocated to profit and loss based on the passage of time and no risk adjustment for non-financial risk is considered.

## 5.2 In year Y:

### Recognition of the first group of contracts

- 244 Upon the receipt of the premium, the entity recognises the group of contracts issued in year Y.
- 245 The investment in bonds will provide a cash inflow of  $10\,000 \times 1.05^5 = 12\,763$  in year 5 (Y+4).
- 246 Because of market competition, the insurance company expects to make a final payout upon year Y+4 with an implicit yearly yield rate of 4.5 % for the policyholders. The final expected payment is therefore  $10\,000 \times 1.045^5 = 12\,462$ . The participation of the policyholders is therefore  $2\,462 / 2\,763 = 89\%$ , above the contractually guaranteed minimum, and the insurer's fee amounts to 301.
- 247 The dedicated portfolio of assets is considered as the reference portfolio for the determination of the discount rate. The bonds bear no credit risk and the entity decides to apply the option in IFRS 17.B81 not to adjust the reference portfolio's rate for differences in the liquidity characteristics. Therefore, the discount rate equals the rate of return implicit in the fair value of the dedicated portfolio of assets (top-down approach). At initial recognition the discounted value of the payment is  $12\,462 / 1.05^5 = 9\,764$ .
- 248 The initial CSM is therefore  $10\,000 - 9\,764 = 236$ .

### At the end of year Y:

- 249 At the end of year Y the company's management decides to credit policyholders' account with a return of 4.5 %. The policyholders' account balance therefore becomes  $10\,000 \times 1.045 = 10\,450$ .
- 250 The bonds are accounted for at amortised cost, the entity records the interests earned over the period: 500.
- 251 As interest rate have fallen to 3 %, the fair value of the bonds purchased in year Y has increased to  $10\,000 \times 1.05^5 / 1.03^4 = 11\,340$ .
- 252 The discount rate for the determination of the liability for remaining coverage is updated to reflect the current market rate of returns implicit in the fair value measurement of the reference portfolio, which is 3 %.
- 253 Because of the drop in market interest rate, the entity now does not expect to pay back 88 % of the pool's expected yield anymore and thus reduces its estimates of discretionary benefits from 4.5 % to 4.1 %. The expected final payment is  $10\,000 \times 1.045 \times 1.041^4 = 12\,272$ . The expected participation of policyholders is 82 % of the yield from the pool of assets.
- 254 The liability for remaining coverage under IFRS 17 is the discounted value of the expected terminal payment which is  $10\,000 \times 1.045 \times 1.041^4 / 1.03^4 = 10\,904$ . The increase is  $10\,904 - 9\,764 = 1\,140$ .
- 255 Furthermore, as contracts are accounted for under the variable fee approach, the entity also updates the CSM by 200 up to the difference between:
- the change in the fair value of the underlying assets:  $11\,340 - 10\,000 = 1\,340$ .
  - the change in the liability for remaining coverage:  $9\,764 - 10\,904 = -1\,140$ .
- 256 In addition, as the entity holds the underlying items, it chooses to disaggregate the insurance finance income between profit and loss and OCI so as to eliminate the

mismatch with the assets carried at amortised costs. The difference is  $1\,140 + 200 - 500 = 840$ .

257 Finally, the entity allocates the contractual service margin to P&L:

|  |     |
|--|-----|
| New contracts issued (§ 248)                                 | 236 |
| Change in the entity's share of the underlying items (§ 255) | 200 |
| Amounts before allocation to profit and loss                 | 436 |
| Allocation to profit and loss 1/5                            | -87 |
| CSM at year end  | 349 |

| Balance sheet                            | Year Y   | Profit and loss statement                    | Year Y |
|--|----------|--|--------|
| Bonds (§ 250)                            | 10 500   | Insurance revenue (§ 257)                    | 87     |
| Liability for remaining coverage (§ 254) | (10 904) | Finance income (Bonds) (§ 250)               | 500    |
| Contractual service margin (§ 257)       | (349)    | Insurance finance expenses: -1 140 -200 +840 | (500)  |
| Net income (§ 257)                       | (87)     |  |        |
| Other comprehensive income (§ 256)       | 840      | Net income                                   | 87     |

### 5.3 In year Y + 1:

#### Recognition of the second group of contracts

- 258 The implicit rate of return in the fair value measurement of the reference portfolio of assets is 3 %.
- 259 The expected returns from the overall portfolios of investments in bonds amounts to:  $10\,000 \times (1.05^5 - 1) + 15\,000 \times (1.03^5 - 1) = 5\,152$ .
- 260 Considering the market conditions, the entity expects to credit policyholders' accounts with a single rate of 3 %.
- The expected terminal payment to group 1 (G 1) is therefore expected to be  $10\,450 \times (1.03)^4 = 11\,762$
  - The expected terminal payment to group 2 (G 2) is thus expected to be  $15\,000 \times (1.03)^5 = 17\,389$
  - Thus the expected returns to be passed to the policyholders amount to  $1\,762 + 2\,389 = 4\,151$ , that is 81 % of the total expected returns from the pool of assets.
- 261 Applying IFRS 17.B68 (b), the fulfilment cash flows included in the measurement of G 2 reflect the extent to which the contracts in the group cause the entity to be affected by expected cash flows.
- 262 In this example, the entity expects to pay 17 389 in year 5 to the policyholders of G 2, however, the measurement of G 1 already includes a  $12\,272 - 11\,762 = 510$  of payment allocated to G 2.
- 263 Applying IFRS 17.B68, the discounted fulfilment cash flows allocated to G 2 therefore amount to  $(17\,389 - 510) / 1.03^5 = 14\,560$ . The CSM amounts to 440.
- 264 The calculation of the CSM of G 2 upon initial recognition (440) reflects the fact that a payment of 510, which was previously allocated to the policyholders of G 1, is expected to be paid in year Y+5 to the policyholders of G 2. However, applying IFRS 17.B68, this amount is allocated to G 1 and included in its discounted FCF up to

$510 / 1.03^4 = 453$ . As a consequence, the discounting effect due to the time lag between the expected payments to G 1 and G 2 ( $453 - 440 = 13$ ) adjusts the CSM of G 2.

The CSM of G 2 depends on the assumptions made on the whole mutualised population that (i) the crediting rate is 3 % and (ii) G 1 transfers 510 thanks to the pooling of assets' returns and applying IFRS 17.B 68. It is noteworthy that the amount of the CSM allocated to G 2 depends to a large extent on the discretionary assumptions made in past periods. This is illustrated in § 299-300 thereafter highlighting that whenever the discretionary benefits allocated to a group exceed the minimum contractual participation, the determination of the CSM of future groups is affected by the timing of the changes in discretionary assumptions.

At the end of year Y+1

265 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $10\,500 \times 5\% + 15\,000 \times 3\% = 975$ .

266 The current market interest rate falls to 1 %. The fair value of the bonds held by the entity amounts to  $10\,000 \times 1.05^5 / 1.01^3 + 15\,000 \times 1.03^5 / 1.01^4 = 12\,388 + 16\,710 = 29\,098$ . The fair value change is therefore  $29\,098 - 15\,000 - 11\,339 = 2\,759$ .

267 The entity computes the discounted fulfilment cash flows:

- For G 1, the liability is  $(11\,762 + 510) / 1.01^3 = 11\,911$  with an increase of  $11\,911 - 10\,903 = 1\,008$
- For G 2, the liability is  $(17\,389 - 510) / 1.01^4 = 16\,220$  with an increase of  $16\,220 - 14\,560 = 1\,660$ .

The total increase in the discounted fulfilment cash flows is therefore 2 668.

268 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is  $2\,759 - 2\,668 = 91$ .

IFRS 17 does not provide guidance in applying paragraphs B104 (b) (i) and B112 to groups of contracts that share in the same pool of underlying assets.

In this fact pattern, the changes in the fair value of the bonds cannot be specifically attributed to a cohort because policyholders do not have an individual right to the assets of the pool. Actually, the entity has not allocated discretionary bonuses to policyholders' accounts. As a consequence the fair value gain from the assets of the pool still belongs to the community of policyholders as a whole.

The entity therefore needs to determine an accounting policy to perform the allocation. In this example, it is *assumed* that the entity's share of the fair value of the underlying items is allocated proportionally to the increase in the discounted fulfilment cash flows allocated to each group.

269 According to its accounting policy, the entity thus allocates the entity's share of the fair value of the underlying items as follows:

- The amount allocated to G 1 is therefore  $91 \times 1\,008 / 2\,668 = 34$
- The amount allocated to G 2 is therefore  $91 \times 1\,660 / 2\,668 = 57$

The allocation policy applied affects the CSM of the cohorts. Given the lack of guidance in the standard, this challenges whether the information provided by the cohorts can lead to relevant and comparable information on profitability trends.



Actually, in the absence of a direct contractual relationship between the payments to individual policyholders and the returns on the underlying items, the annual cohort leads to an arbitrary allocation of mutualised discretionary benefits.

270 Then the entity applies IFRS 17.B134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore  $2\,668 + 91 - 975 = 1\,783$ .

271 Then the entity allocates CSM to P&L according to IFRS 17.B119

|   | G 1  | G 2  | Total |
|---|------|------|-------|
| Opening balance   | 349  |      | 349   |
| New contracts issued  |      | 440  | 440   |
| Change in the entity's share of the underlying items          | 34   | 57   | 91    |
| Amounts before allocation to profit and loss                  | 383  | 497  | 880   |
| Allocation to profit and loss 1 / 4 for G 1 and 1 / 5 for G 2 | (96) | (99) | (195) |
| CSM at the end of year Y+1                                    | 287  | 398  | 685   |

272 The financial statements are as follows:

| Balance sheet                    |  | Year Y+1 | Profit and loss statement |  | Year Y+1 |
|----------------------------------|--|----------|---------------------------|--|----------|
| Bonds                            |  | 26 475   | Insurance revenue         |  | 195      |
| Liability for remaining coverage |  | (28 131) | Finance income            |  | 975      |
| Contractual service margin       |  | (685)    | Insurance finance expense |  | (975)    |
| Net income                       |  | (195)    |                           |  |          |
| Retained earnings                |  | (87)     | Net income                |  | 195      |
| Other comprehensive income       |  | 2 623    |                           |  |          |

### In years Y+2 and Y+3

273 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is:

- In Y+2:  $11\,025 \times 5\% + 15\,450 \times 3\% = 1\,015$  ;
- In Y+3:  $11\,576 \times 5\% + 15\,914 \times 3\% = 1\,056$ .

274 The current market interest rate is flat at 1 %. The fair value of the bonds held by the entity amounts to:

- In Y+2:  $10\,000 \times 1.05^5 / 1.01^2 + 15\,000 \times 1.03^5 / 1.01^3 = 12\,511 + 16\,878 = 29\,389$ ;
- In Y+3:  $10\,000 \times 1.05^5 / 1.01 + 15\,000 \times 1.03^5 / 1.01^2 = 29\,683$ .

275 The fair value changes of the bonds are therefore:

- In Y+2:  $29\,389 - 29\,098 = 291$ ;
- In Y+3:  $29\,683 - 29\,389 = 294$ .

276 The entity computes the discounted fulfilment cash flows

For G 1, the liability is:

- In Y+2:  $(11\,762 + 510) / 1.01^2 = 12\,030$  with an increase of  $12\,030 - 11\,911 = 119$
- In Y+3:  $(11\,762 + 510) / 1.01 = 12\,150$  with an increase of  $12\,150 - 12\,030 = 120$

For G 2, the liability is:

- In Y+2:  $(17\,389 - 510) / 1.01^3 = 16\,382$  with an increase of  $16\,382 - 16\,220 = 162$
- In Y+3:  $(17\,389 - 510) / 1.01^2 = 16\,546$  with an increase of  $16\,546 - 16\,382 = 164$ .

277 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is:

- In Y+2:  $291 - 119 - 162 = 10$   
Of which:  $10 \times 119 / (119 + 162) = 4$  allocated to G 1  
Of which:  $10 \times 162 / (119 + 162) = 6$  allocated to G 2
- In Y+3:  $294 - 120 - 164 = 10$ .  
Of which:  $10 \times 120 / (120 + 164) = 4$  allocated to G 1  
Of which:  $10 \times 164 / (120 + 164) = 6$  allocated to G 2

278 Then the entity applies IFRS 17.B134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore:

- In Y+2:  $119 + 162 + 10 - 1\,015 = (724)$ ;
- In Y+3:  $120 + 164 + 10 - 1\,056 = (762)$ .

279 Then the entity allocates the CSM to profit and loss according to IFRS 17.B119

|   | G 1  | G 2   | Total |
|---|------|-------|-------|
| Opening balance Y+1                                       | 287  | 397   | 685   |
| Change in the entity's share of the underlying items      | 4    | 6     | 10    |
| Allocation to profit and loss 1/3 for G 1 and 1/4 for G 2 | (97) | (101) | (198) |
| CSM at the end of year Y+2                                | 194  | 302   | 496   |
| Change in the entity's share of the underlying items      | 4    | 6     | 10    |
| Allocation to profit and loss 1/2 for G 1 and 1/3 for G 2 | (99) | (103) | (202) |
| CSM at the end of year Y+3                                | 99   | 205   | 304   |

280 The financial statements are as follows:

| Balance sheet                    | Y+2      | Y+3      | Profit and loss           | Y+2    | Y+3     |
|----------------------------------|----------|----------|---------------------------|--------|---------|
| Bonds                            | 27 490   | 28 546   | Insurance revenue         | 198    | 202     |
| Liability for remaining coverage | (28 412) | (28 697) | Finance income            | 1 015  | 1 056   |
| Contractual service margin       | (496)    | (304)    | Insurance finance expense | (1015) | (1 056) |
| Net income                       | (198)    | (202)    |                           |        |         |
| Retained earnings                | (282)    | (480)    |                           |        |         |
| Other comprehensive income       | 1 899    | 1 137    | Net income                | 198    | 202     |

In years Y+4

281 Underlying assets:

- The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $12\,155 \times 5\% + 16\,391 \times 3\% = 1\,099$ .
- The bonds subscribed in year Y reach their maturity and the entity receives the final inflow of 12 763.

- The fair value of the remaining bonds held by the entity amounts to  $15\,000 \times 1.03^5 / 1.01^1 = 17\,217$ .
- The change in fair value of the underlying assets is therefore  $(17\,217 + 12\,763) - 29\,683 = 297$ .

282 The contracts of G 1 reach their maturity. The entity makes its expected final payment of  $10\,000 \times 1.045 \times 1.03^4 = 11\,762$ . The change in the liability for remaining coverage for G 1 is therefore:

|   |               |
|---|---------------|
| <b>Opening balance</b>                                    | <b>12 151</b> |
| Unwind of the discount rate (1 %)                         | 121           |
| Terminal payment to policyholders of G 1                  | -11 762       |
| <b>Closing balance – Residual amount allocated to G 2</b> | <b>510</b>    |

283 The entity applies IFRS 17.B71 and recognises a liability for the fulfilment cash flows allocated to G 2 up to 510.

284 At the end of year Y+5, the company has cash at hand up to  $12\,763 - 11\,762 = 1\,001$

285 The discounted fulfilment cash flow to G 2 amounts to  $(15\,000 \times 1.03^5 - 510) / 1.01 = 16\,712$ . The change amounts to  $16\,712 - 16\,546 = (165)$ .

286 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is  $297 - 121 - 165 = 10$ , which is fully allocated to G 2.

287 Then the entity applies IFRS 17.B 134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore  $287 + 10 - 1\,099 = (803)$ .

288 Then the entity allocates the CSM to profit and loss according to IFRS 17.B119:

|   | <b>G 1</b> | <b>G 2</b> | <b>Total</b> |
|---|------------|------------|--------------|
| Opening balance   | 99         | 205        | 304          |
| Change in the entity's share of the underlying items          | 0          | 10         | 10           |
| Allocation to profit and loss 1 / 1 for G 1 and 1 / 2 for G 2 | - 99       | -108       | -207         |
| CSM at the end of Y+4   | 0          | 108        | 108          |

289 The financial statements are as follows:

| <b>Balance sheet</b>             |  | <b>Y+4</b> | <b>Profit and loss statement</b> |  | <b>Y+4</b> |
|----------------------------------|--|------------|----------------------------------|--|------------|
| Cash at hand                     |  | 1 001      | Insurance revenue                |  | 207        |
| Bonds                            |  | 16 883     | Finance income (bonds)           |  | 1 099      |
| Liability for remaining coverage |  | -17 222    | Insurance finance expense        |  | -1 099     |
| Contractual service margin       |  | - 108      |                                  |  |            |
| Net income                       |  | -207       |                                  |  |            |
| Retained earnings                |  | -682       |                                  |  |            |
| Other comprehensive income       |  | 334        | Net income                       |  | 207        |

#### 5.4 At the end of year Y+5

290 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $16\,883 \times 3\% = 506$ .

- 291 The bonds subscribed in year Y+1 reach their maturity and the entity receives the final inflow of 17 389. The change in the fair value of the bonds is  $17\,389 - 17\,217 = 172$ .
- 292 The contracts of G 2 reach their maturity. The entity makes its expected final payment of  $15\,000 \times 1.03^5 = 17\,389$ .
- 293 The balance of cash in hands amounts is therefore unchanged and amounts to 1 001.
- 294 The changes in the liability for remaining coverage amounts to  $17\,389 - 16\,712 - 511 = 167$ .
- 295 The CSM is adjusted by  $172 - 167 = 5$  to recorded the entity's share of the fair value changes.
- 296 The entity releases the contractual service margin to profit and loss:  $108 + 5 = 113$ .
- 297 Then the entity applies IFRS 17.B 134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore  $167 + 5 - 506 = (334)$ , which settles the balance of OCI.
- 298 The financial statements are as follows:

| Balance sheet                    | Y+5   | Profit and loss statement | Y+5   |
|----------------------------------|-------|---------------------------|-------|
| Cash at hand                     | 1 001 | Insurance revenue         | 113   |
| Bonds                            | 0     | Finance income (bonds)    | 506   |
| Liability for remaining coverage | 0     | Insurance finance expense | (506) |
| Contractual service margin       | 0     |                           |       |
| Net income                       | (113) |                           |       |
| Retained earnings                | (888) |                           |       |
| Other comprehensive income       | 0     | Net income                | 113   |

### 5.5 Alternative case

- 299 § 253 indicates that, because of the drop in market interest rate, the entity discretionary changes its estimates of the crediting rate from 4.5 % to 4.1 % at the end of year Y. Accordingly, the expected participation of G 1 policyholders in the yield of the pool of assets decreases from 88 % down to 82 %. The expected final payment thus decreases from 12 462 to  $10\,000 \times 1.045 \times 1.041^4 = 12\,272$ .
- 300 Had that change in assumption not taken place at the end of Y, the expected final payment to G 1 would have remained at  $10\,000 \times 1.045^5 = 12\,462$ .
- 301 In that case, § 254-255 is changed as follows:
- At the end of year Y, the liability for remaining coverage under IFRS 17 is the discounted value of the expected terminal payment which is  $10\,000 \times 1.045^5 / 1.03^4 = 11\,072$ . The increase is  $11\,072 - 9\,764 = 1\,308$ .
  - Furthermore, as the contracts are accounted for under the variable fee approach, the entity also updates the CSM by **32** up to the difference between:
    - o the change in the fair value of the underlying assets:  $11\,340 - 10\,000 = 1\,340$ .
    - o the change in the liability for remaining coverage:  $9\,764 - 11\,072 = -1\,308$ .
- 302 Furthermore § 262-264 are changed as follows

- In year Y+1 upon the initial recognition of G 2, the entity expects to pay 17 389 in year 5 to the policyholders of G 2, however, the measurement of G 1 already includes a  $12\,462 - 11\,762 = 700$  of payment allocated to G 2.
- Applying IFRS 17.B68, the discounted fulfilment cash flows allocated to G 2 therefore amount to  $(17\,389 - 700) / 1.03^5 = 14\,396$ . The CSM amounts to **604**.
- The FCF allocated to G 1 include a payment of 700 to G 2 which results in discounted FCF of  $700 / 1.03^4 = 622$  allocated to G 1 whereas for the calculation of the CSM of G 2, this amount is discounted over 5 years:  $700 / 1.03^5 = 604$  with a difference of 18. This amount impacts the CSM of G 2.

303 Consequently § 267-269 are amended as follows:

- The entity computes the discounted fulfilment cash flows:
  - o For G 1, the liability is  $(11\,762 + 700) / 1.01^3 = 12\,095$  with an increase of  $12\,095 - 11\,072 = 1\,023$
  - o For G 2, the liability is  $(17\,389 - 700) / 1.01^4 = 16\,038$  with an increase of  $16\,038 - 14\,396 = 1\,642$ .
 The total increase in the discounted fulfilment cash flows is therefore 2 665.
- Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is  $2\,759 - 2\,665 = 94$ .
- According to its accounting policy, the entity thus allocates the entity's share of the fair value of the underlying items as follows:
  - o The amount allocated to G 1 is therefore  $94 \times 1\,023 / 2\,665 = 36$
  - o The amount allocated to G 2 is therefore  $94 \times 1\,642 / 2\,665 = 58$

304 The cumulative CSM of G 1 and G 2 has not significantly changed:

|  | Transfer: 510 |     |            | Transfer: 700 |     |            |
|--|---------------|-----|------------|---------------|-----|------------|
|  | G 1           | G 2 | Total      | G 1           | G 2 | Total      |
| New contracts issued in year Y                       | 236           |     | 236        | 236           |     | 236        |
| Change in the entity's share of the underlying items | 200           |     | 200        | 32            |     | 32         |
| Release to profit and loss (1/5)                     | -87           |     | -87        | -54           |     | -54        |
| Balance carried forward to year Y+1                  | 349           |     | 349        | 214           |     | 214        |
| Change in the entity's share of the underlying items | 34            | 56  | 200        | 36            | 58  | 94         |
| New contract issued in Y+1                           |               | 440 | 440        |               | 604 | 604        |
| CSM at the end of Y+1                                | 383           | 497 | <b>880</b> | 250           | 662 | <b>912</b> |

By and large, the cumulative amount of CSM remains the same disregarding the discretionary assumptions made on the mutualised population in-Force (G 1) before the new business (G 2) has been issued. The difference in amount mainly results from the CSM released to profit and loss in year Y.