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RÉPUBLIQUE FRANÇAISE

AUTORITÉ DES NORMES COMPTABLES
5, PLACE DES VINS DE FRANCE
75573 PARIS CÉDEX 12
Phone (+ 33 1) 53.44.28 53
Internet http://www.anc.gouv.fr/
Mel patrick.de-cambourg@anc.gouv.fr
Chairman

PDC N° 08/2019

Paris, February 11th, 2019

Mr Hans HOOGERVORST
IASB Chair
7 Westferry Circus, Canary Wharf
LONDON, UK, E14 4HD

Dear Hans,

Following our previous communications concerning IFRS 17, we are happy to share with you two additional documents: transition requirements and an example illustrating the application of the level of aggregation.

Many thanks to Darrel Scott for the ongoing dialogue on our concerns and potential solutions.

We remain at his disposal and at the disposal of the Board and Staff to follow up,

Yours sincerely, Kind regards.

Patrick de Cambourg

Patrick de CAMBOURG

IFRS 17 issues – Transition

Draft for discussion

1 Current IASB requirements and TRG conclusions

1.1 IFRS 17 requirements

1 IFRS 17.88: Unless paragraph 89 applies, an entity shall make an accounting policy choice between:

(a) including insurance finance income or expenses for the period in profit or loss; or

(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount determined by a systematic allocation of the expected total insurance finance income or expenses over the duration of the group of contracts, applying paragraphs B130–B133.

2 IFRS 17.89: For insurance contracts with direct participation features, for which the entity holds the underlying items, an entity shall make an accounting policy choice between:

(a) including insurance finance income or expenses for the period in profit or loss; or

(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount that eliminates accounting mismatches with income or expenses included in profit or loss on the underlying items held, applying paragraphs B134-B136.

3 IFRS 17.90: If an entity chooses the accounting policy set out in paragraph 88(b) or in paragraph 89(b), it shall include in other comprehensive income the difference between the insurance finance income or expenses measured on the basis set out in those paragraphs and the total insurance finance income or expenses for the period.

4 IFRS 17.91: If an entity transfers a group of insurance contracts or derecognises an insurance contract applying paragraph 77:

(a) it shall reclassify to profit or loss as a reclassification adjustment (see IAS 1 Presentation of Financial Statements) any remaining amounts for the group (or contract) that were previously recognised in other comprehensive income because the entity chose the accounting policy set out in paragraph 88(b).

(b) it shall not reclassify to profit or loss as a reclassification adjustment (see IAS 1) any remaining amounts for the group (or contract) that were previously recognised in other comprehensive income because the entity chose the accounting policy set out in paragraph 89(b).

5 IFRS 17.B93: When an entity acquires insurance contracts issued or reinsurance contracts held in a transfer of insurance contracts that do not form a business or in a business combination, the entity shall apply paragraphs 14–24 to identify the groups of contracts acquired, as if it had entered into the contracts on the date of the transaction.

6 IFRS 17.B115: To the extent that an entity meets the conditions in paragraph B116, it may choose not to recognise a change in the contractual service margin to reflect some or all of the changes in the effect of financial risk on the entity's share of the underlying items (see paragraph B112) or the fulfilment cash flows set out in paragraph B113(b).

7 IFRS 17.B116: To apply paragraph B115, an entity must have a previously documented risk-management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts and, in applying that objective and strategy:

(a) the entity uses a derivative to mitigate the financial risk arising from the insurance contracts.

(b) an economic offset exists between the insurance contracts and the derivative, ie the values of the insurance contracts and the derivative generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated. An entity shall not consider accounting measurement differences in assessing the economic offset.

(c) credit risk does not dominate the economic offset.

8 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.

9 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.

10 IFRS 17.C3: An entity shall apply IFRS 17 retrospectively unless impracticable, except that:

(a) an entity is not required to present the quantitative information required by paragraph 28(f) of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; and

(b) an entity shall not apply the option in paragraph B115 for periods before the date of initial application of IFRS 17.

11 IFRS 17.C5: If, and only if, it is impracticable for an entity to apply paragraph C3 for a group of insurance contracts, an entity shall apply the following approaches instead of applying paragraph C4(a):

(a) the modified retrospective approach in paragraphs C6–C19, subject to paragraph C6(a); or

(b) the fair value approach in paragraphs C20–C24.

12 IFRS 17.C6: The objective of the modified retrospective approach is to achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. Accordingly, in applying this approach, an entity shall:

(a) use reasonable and supportable information. If the entity cannot obtain reasonable and supportable information necessary to apply the modified retrospective approach, it shall apply the fair value approach.

(b) maximise the use of information that would have been used to apply a fully retrospective approach, but need only use information available without undue cost or effort.

13 IFRS 17.C7: Paragraphs C9–C19 set out permitted modifications to retrospective application in the following areas:

(a) assessments of insurance contracts or groups of insurance contracts that would have been made at the date of inception or initial recognition;

(b) amounts related to the contractual service margin or loss component for insurance contracts without direct participation features;

(c) amounts related to the contractual service margin or loss component for insurance contracts with direct participation features; and

(d) insurance finance income or expenses.

14 IFRS 17.C8: To achieve the objective of the modified retrospective approach, an entity is permitted to use each modification in paragraphs C9–C19 only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach

15 IFSR 17.C10: To the extent permitted by paragraph C8, an entity shall not apply paragraph 22 to divide groups into those that do not include contracts issued more than one year apart.

16 IFRS 17.C19: For groups of insurance contracts that do not include contracts issued more than one year apart:

(a) if an entity applies paragraph C13 to estimate the discount rates that applied at initial recognition (or subsequently), it shall also determine the discount rates specified in paragraphs B72(b)–B72(e) applying paragraph C13; and

(b) if an entity chooses to disaggregate insurance finance income or expenses between amounts included in profit or loss and amounts included in other comprehensive income, applying paragraphs 88(b) or 89(b), the entity needs to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date to apply paragraph 91(a) in future periods. The entity shall determine that cumulative difference:

(i) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B131—if the entity applies paragraph C13 to estimate the discount rates at initial recognition—using the discount rates that applied at the date of initial recognition, also applying paragraph C13;

(ii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B132—on the basis that the assumptions that relate to financial risk that applied at the date of initial recognition are those that apply on the transition date, ie as nil;

(iii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B133—if the entity applies paragraph C13 to estimate the discount rates at initial recognition (or subsequently)—using the discount rates that applied at the date of the incurred claim, also applying paragraph C13; and

(iv) for insurance contracts with direct participation features to which paragraph B134 applies—as equal to the cumulative amount recognised in other comprehensive income on the underlying items.

17 IFRS 17.C20: To apply the fair value approach, an entity shall determine the contractual service margin or loss component of the liability for remaining coverage at the transition date as the difference between the fair value of a group of insurance contracts at that date and the fulfilment cash flows measured at that date. In determining that fair value, an entity shall not apply paragraph 47 of IFRS 13 Fair Value Measurement (relating to demand features).

18 IFRS 17.C25: Notwithstanding the reference to the annual reporting period immediately preceding the date of initial application in paragraph C2(b), an entity may also present adjusted comparative information applying IFRS 17 for any earlier periods presented, but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, the reference to 'the beginning of the annual reporting period immediately

preceding the date of initial application' in paragraph C2(b) shall be read as 'the beginning of the earliest adjusted comparative period presented'.

19 IFRS 17. C31: An entity that applies paragraph C29 is not required to restate prior periods to reflect such changes in designations or classifications. The entity may restate prior periods only if it is possible without the use of hindsight. If an entity restates prior periods, the restated financial statements must reflect all the requirements of IFRS 9 for those affected financial assets. If an entity does not restate prior periods, the entity shall recognise, in the opening retained earnings (or other component of equity, as appropriate) at the date of initial application, any difference between:

(a) the previous carrying amount of those financial assets; and

(b) the carrying amount of those financial assets at the date of initial application.

20 IFRS 17.BC388: The Board concluded that providing restated comparative information for at least one reporting period was necessary because of the diversity of previous accounting and the extent of the changes introduced by IFRS 17. Because IFRS 17 only requires retrospective application on transition if practicable, and specifies simplified approaches when retrospective application is impracticable, the Board expects that determining the comparative amounts will not require significant incremental time and resources beyond those required to first apply IFRS 17. The Board set the effective date for IFRS 17 based on information given about the necessary time to prepare, in the knowledge that restated comparative information for one reporting period would be required.

21 IFRS 17.BC389: The requirement to restate comparative information for one reporting period is different from the transition requirements of IFRS 9, which did not require restatement of comparative amounts at transition to that Standard, including the fair value of financial instruments (and which did not allow restatement if doing so required the use of hindsight). However, the Board noted that different circumstances applied when it developed the transition requirements for IFRS 9, which were developed with the intention of minimising obstacles to voluntary application of IFRS 9 before its effective date. In addition, entities applying those transition requirements of IFRS 9 had all previously applied the same requirements, ie those in IAS 39. In contrast, the Board expects that most entities will apply IFRS 17 no earlier than the effective date and believes that the restatement of comparative amounts is particularly important, for the reasons given in paragraph BC388. Therefore, the Board decided not to provide relief from the restatement of comparative information to facilitate early application of IFRS 17.

22 IFRS 17.BC393: Paragraph B115 of IFRS 17 permits entities not to recognise a change in the contractual service margin for changes in fulfilment cash flows and the entity's share in the fair value returns on underlying items for which an entity uses derivatives to mitigate their financial risk. However, an entity applying this option is

required to document its risk management objective and the strategy for mitigating the risk before doing so. This documentation requirement is analogous to the documentation requirements for hedge accounting in IFRS 9. Consistent with the transition requirements for hedge accounting in IFRS 9, the Board concluded that retrospective application of the risk mitigation treatment would give rise to the risk of hindsight. In particular, the Board was concerned that documentation after the event could enable entities to choose the risk mitigation relationships to which it would apply this option, particularly because the application of this approach is optional. Consequently, IFRS 17, consistent with the transition requirements for hedge accounting in IFRS 9, requires prospective application of the risk mitigation option from the date of initial application of the Standard.

23 IFRS 9.7.2.1: An entity shall apply this Standard retrospectively, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, except as specified in paragraphs 7.2.4–7.2.26 and 7.2.28. This Standard shall not be applied to items that have already been derecognised at the date of initial application.

1.2 Current understanding of the accounting treatment

Selection of a transition methodology

24 On transition, IFRS 17.C3 requires to apply the full retrospective approach (FRA) unless impracticable. In the latter case, the entity may apply either the fair value approach (FVA) or the modified retrospective approach (MRA).

25 No specific provision is given relating to the FRA. By contrast, the MRA is providing some relief absent reasonable and supportable information to apply the FRA (IFRS 17.C06-IFRS 17.C19). Guidance is also provided on how to apply the FVA (IFRS 17.C20-IFRS 17.C24).

26 Considering that the FVA can only be applied upon the date of transition (IFRS 17.C20) and not in prior periods, a chosen approach appears to apply to the entirety of a given group of insurance contracts,e.g. mixed approaches would not be possible.

OCI option

27 As summarised by the staff in an agenda paper to the board (IASB 2019-02 AP 2C §20), when an entity chooses to disaggregate insurance finance income or expenses between profit or loss and OCI (IFRS 17.88(b)) in non-VFA contracts, it may be permitted or required to determine the cumulative amount of insurance finance income or expenses recognised in OCI at the transition date as nil in the following circumstances:

- (a) permitted when applying the FVA (IFRS 17.C24(b));
- (b) permitted when applying the MRA for groups of insurance contracts that include contracts issued more than one year apart (IFRS 17.C18(b)); and
- (c) required when applying the MRA for groups of insurance contracts that do not include contracts issued more than one year apart for insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders (IFRS 17.C19(b)(ii)).

Interaction with IFRS 9 – Comparative information in 2021

28 Insurers applying the IFRS 4 amendment may defer the IFRS 9 implementation until 1 January 2022.

29 On the first time application of IFRS 17 comparative year 2021 has to be restated (IFRS 17.C25, .BC388 and .BC389) except if IFRS 9 already applied (overlay approach) beforehand so that it may change its previous classification of (“redesignate”) financial instruments without restating prior periods (IFRS 17.C31).

30 By contrast, on the first time application of IFRS 9 comparative year 2021 has not to be restated (IFRS 17.BC 389).

31 If an entity however decides to restate the comparative year 2021:

- financial items that have not been derecognised at the date of initial application would have to be accounted for according to IFRS 9 (IFRS 9.7.2.1);
- financial items that have been derecognised at the date of initial application would need to continue to follow IAS 39 until the date of sale.

Interaction with IFRS 9 – Risk mitigation

32 IFRS 17.C3(b) specifically prohibits a retrospective application of the risk mitigation option for direct participating contracts.

33 IFRS 17.BC 393 justifies that “consistent with the transition requirements for hedge accounting in IFRS 9, the Board concluded that retrospective application of the risk mitigation treatment would give rise to the risk of hindsight. In particular, the Board was concerned that documentation after the event could enable entities to choose the risk mitigation relationships to which it would apply this option, particularly because the application of this approach is optional”.

2 Issue

34 The EFRAG case study has been the unique opportunity at this stage to test on a large basis the practicability of the transition requirements.

35 It raised issues of different natures:

- Operational difficulties in complying with the criteria for applying the three methodologies offered and in gathering data;
- Possible accounting mismatches created by certain requirements.

2.1 Operational difficulties

Selection of a transition methodology

36 Case studies report that the proposed transition methodologies better fit to certain situation. Accordingly:

	The methodology is expected to apply to group of contracts:
FRA	– where data are available (i.e. from 2018 on); – for which reasonable proxies can be made for the missing data based on European embedded value (EEV) or Solvency II information.
MRA	– where no data is available or out of scope of EEV or solvency II
FVA	– data required to perform MRA is not available; – expected CSM at transition is nil or negative: undue complexity of applying a retrospective approach since the recognised insurance

	contracts on transition only correspond to fulfilment cash-flows; – PAA, since no CSM assessment required on transition

37 Mixed transition approaches appear not applicable. However, for long term contracts a mix transition approach such as an initial FVA and a MRA from this date onward, would make the calculation of key data (CSM, LC, cumulative OCI on liabilities, acquisition cash to be recovered) on transition much easier and would also improve the relevance of the estimates.

38 On the other hand, users are concerned that depending on the transition methodology applied and assumptions retained upon transition, the measure of future performance could be significantly affected for a long period of time. Some are requesting a reduction of options.

39 We however support the view that different approaches allow for the most relevant and practicable solution to be applied in a context of major changes in the industry. In addition, many disclosures are required to provide information to users on estimates and judgments.

40 We support the application of retrospective approaches. In the insurance business, transactions are rarely performed on a quoted market so that fair value is difficult to gather and generally pertains to level 3 valuations that probably require as much judgment and assessments (and as few comparability) as applying a retrospective approach. We therefore do not consider that the fair value approach should take precedent on any retrospective approach.

41 Our understanding is that the FRA is very demanding. The concern has been raised that the simplifications introduced by the MRA may not result in much less efforts than the FRA. In order to facilitate a retrospective application rather than a prospective approach the MRA should therefore be as flexible as possible.

42 We concur with the principle set in IFRS 17.C6 that the modified retrospective approach aims at achieving "the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort".

43 In our view, requirements in IFRS 17.C9-C19 illustrate rather than restrict the modifications permitted.

44 We expect the practice to develop in this area (and the reference to "supportable information" invites to such a development). However, we think that either in the FRA or in the MRA, it would be very useful that the standard more clearly states how estimates (which might relax a too strict application) may be used in FRA before being considered as a departure requiring applying the MRA or the FVA. Questions on how to use "reasonable and supportable" information under the FRA or MRA are key, for instance when determining the initial value or when applying annual cohort requirements.

Contracts acquired through a business combination or a portfolio transfer before transition

45 According to IFRS 17.B93, accounting classification (VFA, General Model/BBA, PAA) has not to be made according to initial conditions (e.g. when the contract was issued) but on the date of the transaction (e.g. business combination or portfolio transfer).

46 Furthermore, contracts acquired in their settlement period before transition are treated as contracts providing coverage for the adverse development of claims, and revenue reflects the entire expected claims.

47 On transition, since no specific relief has been provided in the MRA nor in the VFA, these treatments would lead to a:

- Complex assessment of the accounting classification (BBA vs. VFA; BBA vs. PAA) depending on:
    - the date of transfer of a contract (compared with the date of issuance);
    - when a claim arose (whether before or after the transfer);
- possible distortion in the presentation or calculation of KPI (i.e. revenue on claims acquired).

Other transition issues

48 There is a common expectation that IFRS 4 amendment on IFRS 9 exemption will be further deferred by one year.

2.2 Possible accounting mismatches

49 Following 3 issues have been identified for possibly creating accounting mismatches:

- Prior OCI on liabilities can be removed to nil for indirect participating contracts;
- IFRS 9 provisions on financial instruments derecognised in prior year deter from restating comparative financial statement;
- Risk mitigation cannot be applied retrospectively.

OCI option for non VFA participating contracts under the MRA

50 For an entity that chooses to disaggregate insurance finance income or expenses between P&L and OCI in accordance with IFRS 17.88 (b), the MRA requirements indicate that the cumulative OCI relating to non-VFA contracts at the transition date should be assessed as nil under the assumption that the discount rate retained is the current rate at inception (IFRS 17.C19(b)(ii)).

51 From an economic standpoint, there is an issue in considering that a gain on changes in discount rate has not yet been recognised on the asset side (measured at amortised cost of FVOCI), whereas the insurance liability would be recognised on transition at a current value, e.g. implicitly considering that past losses on changes in discount rate have been recorded in the retained earnings.

52 Not considering any impact of the OCI carried forward on the liabilities could significantly impact the result of future periods and then undermine the credibility of the transition which is a higher risk than the risk of hindsight created by accepting to retrospectively calculate former FCF.

53 In our view, transition requirements should not only provide a solution to VFA contracts (as IFRS 17.C19(b)(iv) does) but more broadly to participating contracts (as defined in §B132) that are “directly” (i.e. with a clearly identified linkage) linked with assets without complying with all the VFA criteria set in §B101. This would allow for a more continuous accounting treatment of participating contracts preventing the “cliff effect” of VFA criteria.

54 We note that IFRS 17.116 assumes that there is a link between OCI on assets and liabilities upon transition, even for non VFA contracts.

55 For instance that linkage could be based on a “constructive obligation” not meeting the §B101 criteria or a reinsurance contract issued (such as “Prefon”).

56 In our view reference to a general pool of assets is possible. A pool of assets that would be smaller than the liability is probably not usual; it would however not disqualify but limit to that extent the OCI referred to upon transition.

57 The adjustment would only take into consideration the share in the referred assets that belongs to the policyholders (without considering the entity's share). Assessing that adjustment probably requires an estimation of historical flows / changes in the FCF in order to estimate the proper amount of OCI to be adjusted.

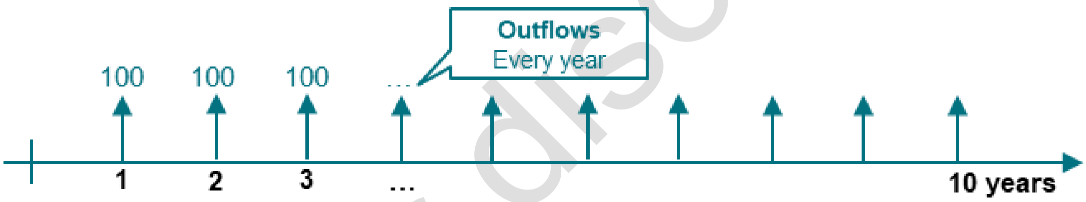
58 FCF could be discounted at the rate the entity is expecting to be committed to against its policyholders. Accordingly, accretion of the liability would reflect the returns transferred to policyholders. From an economic standpoint, the difference between that rate (estimated at transition date) and the current date on transition could be a proxy of what would have been put in OCI, be IFRS 17 applied from inception. The example below illustrates that alternative.

Illustrative example – prior OCI on indirect participating contracts

Assumptions

59 Assuming an indirect participating contract with :

– A fixed income portfolio backing liabilities with a book yield of 5 % (cumulative OCI on assets equal to 107)
– IFRS 17 current discount rate at transition date of 2.5 %
– Policyholders' participation rate of 80%
– Expected cash-outflows of 100 during 10 years (Inforce only, i.e. no New Business)



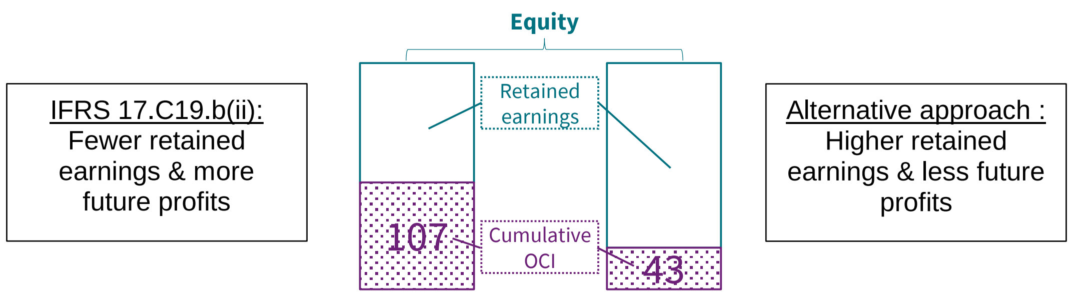
Amount of cumulative OCI at transition

60 Applying the simplification offered by the standard (IFRS 17.C19.b(ii)):

– Cumulative OCI on the asset side (107) results from the difference between the market value at 2.5% current rate (918) and the amortised cost of the asset applying the 5.0% discount rate at inception (811=100+100/(1,05^1)+…+100/(1,05^9))
– Cumulative OCI on liability is set to 0 at transition.
– Net cumulative OCI amounts to 107-0=107

61 Alternative approach: OCI with a "crediting rate" (expected rate of return to policyholders according to IFRS 17.B 134) amounting to 4 % (i.e. 5 %*80%).

– Cumulative OCI on the asset side (107)
– Cumulative OCI on liability (64) results from the outflows at 2.5% current rate subject to a crediting rate of 4%
– Net cumulative OCI then amounts to 43 (107 – 64).

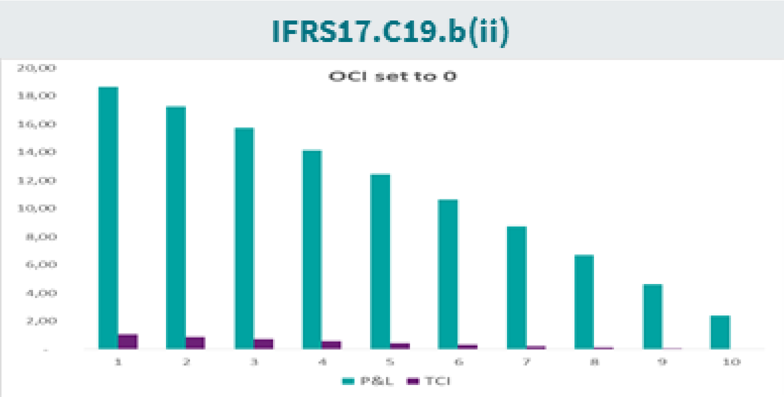


62 The amount of cumulative OCI at transition has:

- no impact on equity (but on the breakdown between OCI and retained earnings);
- a potential major impact on retained and future results.

Focus on the P&L

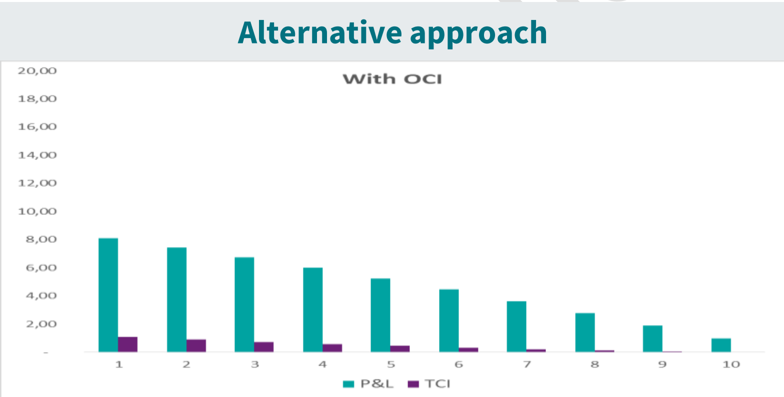
63 The comprehensive income (net result +OCI) remains unchanged.



64 The effective yield on the liability is the current discount rate (2.5 %). Since the effective yield is much lower than the book yield (5 %), the insurance finance expense will be low and the investment result high.

65 There is no allowance for past assets/liabilities interactions.

66 Future investment results are too high (above any economical vision)



67 The crediting rate amounts to 4 %. Since this effective yield is closer to the investment return (5 %), the insurance finance expense will be higher and the investment result lower.

68 The investment result is more in line with the expected financial margin (1 % in our example). In this example all the service provided is investment related result (e.g. no insurance coverage).

<u>Interaction with IFRS 9 – Comparative information in 2021</u>

69 Applying IFRS 9 provisions, an entity deciding to restate the comparative year 2021 will have to apply both standards (i) IAS 39 on financial instrument derecognised before transition and (ii) IFRS 9 on financial instrument that <u>have not</u> been derecognised before transition.

70 Restating the comparative period provides more relevant information, but applying both standards would be operationally burdensome and conceptually inconsistent so that it would deter preparers from choosing that option.

71 There is no conceptual reason for providing a relief on the retrospective application of IFRS 9 to financial instrument that have been derecognised before transition. It is a practical expedient that aimed at facilitating the transition on a standalone basis i.e. where no further collateral impact would arise. By contrast, when applied at the same time as IFRS 17, this provision leads to undue complexity when restating comparative year 2021.

Interaction with IFRS 9 – Risk mitigation

72 Hedging a financial asset (and more generally an underlying item) is addressed by IFRS 9 provisions, not by IFRS 17. For instance, an interest rate swap on a financial asset is integral part of the underlying items and thus is not dealt with in IFRS 17.

73 By contrast, risk mitigation in IFRS 17.B115 to IFRS 17.B118 addresses hedged items that do not belong to the underlying items.

74 For instance, guaranteed minimum death benefits (GMDB) in a unit-linked life insurance provides for the beneficiaries to an insurance contract a coverage in the case of (i) death of the policyholder where (ii) the decreased value of the underlying assets is such that it does not reach the guaranteed amount. In order to hedge its financial exposure (not the insurance exposure, which is part of the underlying items), the entity purchases a derivative (i.e. a put).

75 Changes in the fair value for the guaranteed amount to be paid upon death are reflected in the CSM (according to IFRS 17.45) whereas changes in the fair value of the derivative are recorded in the P&L (according to IFRS 9). Risk mitigation provisions in IFRS 17.B115 allows for recording in the P&L the financial risk's component of changes in the value of the guaranteed amount to be paid upon death instead of in the CSM and FCF, in order to match the corresponding changes in the derivatives.

76 Retrospectively apply such a hedge accounting would accordingly impact the CSM and the retained earnings.

77 IFRS 17.C3(b) specifically however prohibits a retrospective application of such a hedge accounting that may “give rise to the risk of hindsight” (IFRS 17.BC 393).

78 Not reflecting in the CSM such hedge accounting would however distort the historical CSM and may significantly impact the insurance result for years.

79 In our view, the documentation on the risk-management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts referred to in IFRS 17.B116 may already exist prior to the transition.

80 There is no conceptual reason for excluding the retrospective application of IFRS 17.B115 as long as the same documentation requirement apply. There is a higher risk to not provide a fair view in not considering any impact of risk mitigation carried forward than in accepting the risk of hindsight to carry forward existing risk mitigation instruments.

81 Moreover, hedging is a risk management technique derived from a corporate strategy and does not result from a deliberate choice. An overall consistency with information provided in other parts of the previous reports, such as description of the hedging strategy and its major impact, providing a clear distinction between instruments providing risk mitigation and the related contracts, and those that do not provide such a risk mitigation. In addition changes in the fair value of hedging instruments according to IFRS 7 add relevance and reliability to the information provided.

82 Moreover, the reference made in IFRS 17.C6 to “reasonable and supportable information available without undue cost or effort” should be a general principle ensuring an adequate financial information in the very specific and temporary situation of a transition.

83 Conversely, not recognise in the financial statement the effect of past hedging derivatives may have longstanding and significant impact on future result.

3 Suggested solution (tentative)

3.1 Suggested modifications relating to operational complexities –MRA

General

84 There is no need for a detailed guidance on how to apply the principle set in IFRS 17.C6, but examples may be useful.

85 We therefore suggest not restricting the requirements set in the transition but instead presenting them as illustrative example of the principle.

86 Consequently, when an entity:

– has no reasonable and supportable information available without undue cost or effort to apply the FRA,
– but has reasonable and supportable information available without undue cost or effort to modify the FRA in a way that would achieve “the closest outcome to retrospective application possible”,

the entity could use such modifications when applying the MRA, provided these additional modifications are duly disclosed in the notes.

87 For instance, applying a mixed approach on transition: full retrospective as long as reasonable and supportable information is available (i.e. for the last 10 years) and a FVA as initial value for the period before, when sufficient reasonable and supportable information is not available.

Suggested modifications

88 IFRS 17.C8: To achieve the objective of the modified retrospective approach, an entity is permitted to use ~~each~~ modifications such as the ones illustrated in paragraphs C9–C19 however only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach.

3.2 Suggested modifications relating to operational complexities – contracts acquired through a business combination or a portfolio transfer before transition

General

89 Introducing specific transition provisions (whatever the methodology retained) on the possibility to classify:

– groups of acquired contracts (BBA vs. VFA; BBA vs. PAA) as of the date of issuance instead of the date of transfer;
– as “liabilities for incurred claims” claims acquired in their settlement period before transition.

Suggested modifications

90 IFRS C5bis: On transition and regardless of the approach retained, an entity may depart from IFRS 17.B93 in applying the date when the contract was issued instead of the date of the transaction (e.g. business combination or portfolio transfer) to contracts acquired before transition.

3.3 Suggested modifications relating to possible accounting mismatches – OCI option

Alternative 1: setting OCI to zero is permitted

General

91 Setting OCI amounts to nil on transition is

- "permitted" by IFRS 17.C24(b) in the FVA and IFRS 17.C18(b) in the MRA when applying annual cohorts; and
- "required" by IFRS 17.C19(b) in the MRA when not applying annual cohorts.

92 The permission may be an application issue on transition, but it is mainly becomes a standard-setting issue when such adjustment is required.

93 A quick solution would be to remove the requirement and rather allow for setting the OCI to zero "on the basis that the assumptions that relate to financial risk that applied at the date of initial recognition are those that apply on the transition date".

Suggested modifications

94 IFRS 17.C19: For groups of insurance contracts that do not include contracts issued more than one year apart:

(a) if an entity applies paragraph C13 to estimate the discount rates that applied at initial recognition (or subsequently), it shall also determine the discount rates specified in paragraphs B72(b)–B72(e) applying paragraph C13; and

(b) if an entity chooses to disaggregate insurance finance income or expenses between amounts included in profit or loss and amounts included in other comprehensive income, applying paragraphs 88(b) or 89(b), the entity needs to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date to apply paragraph 91(a) in future periods. The entity shall determine that cumulative difference:

(i) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B131—if the entity applies paragraph C13 to estimate the discount rates at initial recognition—using the discount rates that applied at the date of initial recognition, also applying paragraph C13;

(ii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B132 — as nil if ~~on the basis that~~ the assumptions that relate to financial risk that applied at the date of initial recognition are those that apply on the transition date~~, ie as nil~~;

(iii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B133—if the entity applies paragraph C13 to estimate the discount rates at initial recognition (or subsequently)—using the discount rates that applied at the date of the incurred claim, also applying paragraph C13; and

(iv) for insurance contracts with direct participation features to which paragraph B134 applies—as equal to the cumulative amount recognised in other comprehensive income on the underlying items.

Alternative 2: using the rate the entity is expecting to be committed to

General

95 We suggest amending IFRS 17.C19(b) so that transition requirements address the cumulative amount of OCI carried forward on the liability for participating contracts (as defined in §B132) that are "directly" (i.e. with a clearly identified linkage) linked with assets without complying with all the VFA criteria set in §B101.

96 FCF should be discounted at the rate the entity is expecting to be committed to against its policyholders. Accordingly, accretion of the liability would reflect the returns transferred to policyholders. From an economic standpoint, the difference between that rate (estimated at transition date) and the current date on transition could be a proxy of what would have been put in OCI, be IFRS 17 applied from inception (as illustrated in the example in our paper).

Suggested modifications

97 IFRS 17.C19: For groups of insurance contracts that do not include contracts issued more than one year apart:

(a) if an entity applies paragraph C13 to estimate the discount rates that applied at initial recognition (or subsequently), it shall also determine the discount rates specified in paragraphs B72(b)–B72(e) applying paragraph C13; and

(b) if an entity chooses to disaggregate insurance finance income or expenses between amounts included in profit or loss and amounts included in other comprehensive income, applying paragraphs 88(b) or 89(b), the entity needs to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date to apply paragraph 91(a) in future periods. The entity shall determine that cumulative difference:

(i) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B131—if the entity applies paragraph C13 to estimate the discount rates at initial recognition—using the discount rates that applied at the date of initial recognition, also applying paragraph C13;

(ii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B132 and that refer to underlying assets but do not meet all the VFA criteria (in paragraph B101) — on the basis of the difference at transition date between the current rate and the rate based on which the entity expects to determine its commitment under the contract (paragraph 98); otherwise on the basis that the assumptions that relate to financial risk that applied at the date of initial recognition are those that apply on the transition date, ie as nil;

(iii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B133—if the entity applies paragraph C13 to estimate the discount rates at initial recognition (or subsequently)—using the discount rates that applied at the date of the incurred claim, also applying paragraph C13; and

(iv) for insurance contracts with direct participation features to which paragraph B134 applies—as equal to the cumulative amount recognised in other comprehensive income on the underlying items.

3.4 Suggested modifications relating to possible accounting mismatches – Interaction with IFRS 9 – Comparative information in 2021

General

98 We suggest making optional the exception introduced in IFRS 9.7.2.1 regarding financial instruments derecognised during the comparative period.

99 For consistency reasons, this should apply to all qualifying items and not on an item by item basis.

Suggested modifications

100 IFRS 9.7.2.1: An entity shall apply this Standard retrospectively, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, except as specified in paragraphs 7.2.4–7.2.26 and 7.2.28. An entity opts whether t~~T~~his Standard ~~shall~~ ~~not be~~ applie~~d~~s or not to all items that have already been derecognised at the date of initial application.

3.5 Suggested modifications relating to possible accounting mismatches – Interaction with IFRS 9 – Risk mitigation

General

101 We suggest removing the prohibition introduced in IFRS 17.C3(b) of a retrospective application of the risk mitigation provisions.

Suggested modifications

~~102~~ IFRS 17.C3: An entity shall apply IFRS 17 retrospectively unless impracticable, except that ~~:~~

~~(a)~~ an entity is not required to present the quantitative information required by paragraph 28(f) of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.~~; and~~

~~(b) an entity shall not apply the option in paragraph B115 for periods before the date of initial application of IFRS 17.~~

IFRS 17 issues – Example Level of Aggregation
Draft for discussion

1 Current IASB requirements and TRG conclusions

1.1 IFRS 17 requirements

1 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.

2 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.

3 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.

4 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.

5 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.

6 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.

7 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.

8 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.

9 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).

10 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.

11 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.

12 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.

13 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.

14 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 contacts 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.

15 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.

2 Assumptions

16 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

17 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.

18 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).

19 The premiums are assumed to be paid on January 1st 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;

20 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.

21 In future periods, notwithstanding this drop of market interest rate, everything happens as expected at inception.

22 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.

23 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.

3 In year Y:

3.1 Recognition of the first group of contracts

24 Upon receipt of the premium, the entity recognises the group of contracts issued in year Y.

25 The investment in bonds will provide a cash inflow of 10 000 x 1.05 ^ 5 = 12 763 in year 5 (Y+4).

26 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 x 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).

27 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.

28 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.		

3.2 At the end of year Y:

29 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		

30 As interest rate have fallen to 1%, the fair value of the bonds purchased in year Y has increased to 10 000 x 1.05 ^ 5 / 1.01 ^ 4 = 12 265.

31 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 %.

32 The liability for remaining coverage under IFRS 17 is the discounted value of the expected terminal payment which is 10 000 x 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).

33 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.

34 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.B132		

35 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
Bonds	10 500
Liability for remaining coverage	(11 748)
Contractual service margin	(414)
Net income	(103)
Other comprehensive income	1 765

Profit and loss statement	Year Y
Insurance revenue	103
Finance income (Bonds)	500
Insurance finance expenses	(500)
Net income	103

4 In year Y + 1:

4.1 Recognition of the second group of contracts

<u>Expected returns from the joint underlying assets</u>

36 The implicit rate of return in the fair value measurement of the reference portfolio of assets is 1%.

37 The expected returns from the overall portfolios of investments in bonds amounts to: 10 000 x (1.05 ^ 5 – 1) + 15 000 x (1.01 ^ 5 – 1) = 3 528

38 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.

<u>Entity's decision to allocate 2% of actual assets' return to each group</u>

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.

39 In the current case, that amount is equivalent to (80%@5%*10 000 on 4 years+80%@1%*15 000 on 5 years)=@2%*25 000 on 5 years.

40 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 x (1.02) ^ 4 = 11 257
- The expected terminal payment to group 2 (G 2) is expected to be 15 000 x (1.02) ^ 5 = 16 561
- Thus the expected returns to be passed to the policyholders amount to 1 257 + 1 561 = 2 819

41 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%).

42 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 x (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).

43 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 x 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.

4.2 Applying VFA with no transfer of FCF

44 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.

45 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”.

4.3 Applying VFA with transfer of FCF according to B68

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

47 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.

48 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).

49 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.

50 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 § 42) 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 § 45).

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.

4.4 At the end of year Y+1

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

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

52 The current market interest rate is flat at 1%. The fair value of the bonds held by the entity amounts to 10 000 x 1.05 ^ 5 / 1.01 ^ 3 + 15 000 x 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.

53 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		

54 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.

55 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.		

56 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		

57 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

58 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

5 At the end of year Y+2 and Y+3

59 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 x 5% + 15 150 x 1% = 703 ;
- In Y+3: 11 576 x 5% + 15 302 x 1% = 732.

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

61 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.

62 The entity computes the liability for remaining coverage:

63 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

64 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

65 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.

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

67 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).

68 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

69 The financial statements are as follows :

Balance sheet	Y+2	Y+3
Bonds	26 878	27 610
Liability for remaining coverage	(27 122)	(27 394)[1]
Contractual service margin	(312)	(178)
Net income	(138)	(141)
Retained earnings	(240)	(378)
Other comprehensive income	935	481

Profit and loss	Y+2	Y+3
Insurance revenue	138	141
Finance income	703	732
Insurance finance expense	(703)	(732)
Net income	138	141

6 At the end of year Y+4

70 Underlying assets:

- The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is 12 155 x 5% + 15 455 x 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 x 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.

71 The entity computes the liability for remaining coverage:

72 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 x 1.04 x 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.

73 At the end of year Y+4, the company has cash at hand up to 12 763 – 11 257 = 1 506

74 The opening balance of the liability for remaining coverage of group 1 was 12 104 = 12 225 / 1.01.

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[1] 27 394=15 290+12 104

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

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

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

77 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.

78 For group 2, the liability is 15 597 / 1.01^1 = 15 443 with an increase of 15 443 - 15 290 = 153.

79 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.

80 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.		

81 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

82 The financial statements are as follows :

Balance sheet	Y+4
Cash at hand	1 506
Bonds	15 609
Liability for remaining coverage	-16 410
Contractual service margin	- 41
Net income	-144
Retained earnings	-519
Other comprehensive income	0

Profit and loss statement	Y+4
Insurance revenue	144
Finance income (bonds)	762
Insurance finance expense	-762
Net income	144

7 At the end of year Y+5

83 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is 15 609 x 1% = 156. The change in the fair value of the bonds is also 156.

84 The bonds subscribed in year Y+1 reach their maturity and the entity receives the final inflow of 15 765.

85 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 x 1.02 ^ 5 = 16 561.

86 The balance of cash in hands amounts to 1 506 + 15 765 – 16 561 = 709

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

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

88 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

89 The financial statements are as follows:

Balance sheet	**Y+5**
Cash at hand	709
Bonds	0
Liability for remaining coverage	(4)
Contractual service margin	0
Net income	(43)
Retained earnings	(663)
Other comprehensive income	0

Profit and loss statement	**Y+5**
Insurance revenue	43
Finance income (bonds)	156
Insurance finance expense	(156)
Net income	43

8 Conclusion on the objectives of annual cohorts requirement

8.1 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 § 45).

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.

8.2 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 § 42);

- 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 § 50).

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 § 50).

As mentioned in § 33 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).

9 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

90 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 x 80% = 400. The collective reserve is therefore not credited. The total policyholders' account s balance is 10 400.

Year Y+1

91 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 x 2% + 15 000 x 2% = 508). The legal amount of profit sharing is 80% of the interest income that is 675 x 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

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

	Y+2	Y+3
Policyholders' accounts at opening	**25 908**	**26 426**
Interests credited (2%)	518	529
Policyholders' account at closing	**26 426**	**26 955**
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
Collective reserve on closing balance	**76**	**133**

Year Y+4

93 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 x 2% = 539). The legal amount of profit sharing is 80% of the interest income that is 762 x 80% = 610.

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

95 The accumulated policyholders' accounts balance is 26 954 + 539 – 11 257 = 16 236.

Year Y+5

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