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Project	**Amendments to IFRS 17 *Insurance Contracts***		
Paper topic	Recognition of the contractual service margin in profit or loss in the general model		
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Purpose

1. This paper discusses the requirements in IFRS 17 *Insurance Contracts* for the recognition of the contractual service margin in profit or loss for contracts without direct participation features (ie contracts to which the general model applies).

Summary of staff recommendations

2. The staff recommend the International Accounting Standards Board (Board):
   (a) amend IFRS 17 so that in the general model the contractual service margin is allocated on the basis of coverage units that are determined by considering both insurance coverage and any investment return service;[1]
   (b) amend IFRS 17 to establish that an investment return service can exist only when an insurance contract includes an investment component;
   (c) amend IFRS 17 to require an entity to use judgement applied consistently in deciding whether to include an investment return service when determining coverage units, and not provide an objective or criteria for that determination;
   (d) amend IFRS 17 to establish that the period of investment return services should be regarded as ending when the entity has made all investment

[1] The staff will consider in drafting whether to replace the term 'coverage units' with 'service units'.

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component payments to the policyholder of the contract, ie not including payments to future policyholders;

(e) amend IFRS 17 to require the assessments of the relative weighting of the benefits provided by insurance coverage and investment return services and their pattern of delivery to be made on a systematic and rational basis;

(f) confirm that, applying IFRS 17, cash flows relating to fulfilling the investment return service are included in the measurement of the insurance contract;

(g) does not change the requirements in IFRS 17 relating to which changes in fulfilment cash flows adjust the contractual service margin in the general model; and

(h) amend IFRS 17 to establish that the one year eligibility criterion for the premium allocation approach (PAA) should be assessed by considering insurance coverage and an investment return service, if any.

Structure of the paper

3. This paper provides:

(a) an overview of the requirements in IFRS 17 (paragraphs 4–7 of this paper);

(b) a summary of the Board's rationale for setting those requirements, including an overview of the Board's previous discussions (paragraphs 8–12 of this paper);

(c) an overview of the concerns and implementation challenges expressed since IFRS 17 was issued (paragraphs 13–15 of this paper);

(d) the staff analysis (paragraphs 16–54 of this paper); and

(e) the staff recommendations and questions for Board members (paragraphs 55–57 of this paper).

IFRS 17 requirements

4. The contractual service margin is the unearned profit in a group of insurance contracts. It forms part of the liability for remaining coverage and is initially measured as the amount that results in no gain being recognised on initial recognition of a group of insurance contracts. After initial recognition, in the general model the contractual service margin is:
   (a) adjusted for the accretion of interest and changes in estimates of cash flows relating to future service; and
   (b) recognised in profit or loss to reflect the entity's provision of service under the contract.
5. The recognition of the contractual service margin in profit or loss is determined by allocating the balance of the contractual service margin at the end of the reporting period to coverage units provided in the current period and expected to be provided in the future. The amount allocated to coverage units provided in the current period is recognised in profit or loss.
6. The number of coverage units in a group of contracts is determined by considering for each contract in the group, the quantity of benefits provided under the contracts and its expected coverage duration.
7. Applying the general model, the quantity of benefits includes only insurance coverage and the contractual service margin is recognised only over the period during which the entity provides coverage for insured events. Applying the variable fee approach, the Board tentatively decided at its June 2018 meeting to propose an annual improvement to clarify that coverage units should be determined by considering both insurance coverage and investment-related services.[2]

Board's rationale

8. In determining coverage units, IFRS 17 requires an entity to assess the services provided to the policyholder. The Board acknowledges that some insurance contracts

[2] Agenda Paper 2B of the June 2018 Board meeting

provide services other than insurance coverage. Paragraph BC222 of the Basis for Conclusions on IFRS 17 explains that the key service provided by insurance contracts is insurance coverage, but contracts may also provide investment-related or other services. However, paragraph BC279 of the Basis for Conclusions on IFRS 17 observes that insurance coverage is the defining service provided by insurance contracts. The focus in these statements on insurance coverage reflects the fact that contracts are in the scope of IFRS 17 because they provide insurance coverage.

9. Hence, for general model contracts, the Board decided that useful information is provided by recognising the contractual service margin in profit or loss over the period in which insurance coverage is provided. Not considering any other service is a simplification, but doing so avoids complexity and subjective or arbitrary allocations, and reflects the key service of insurance.

10. The Board decided a different approach to reflect the effect of investment-related services was appropriate only for those contracts that fall within the scope of the variable fee approach. In contrast to contracts applying the general model, IFRS 17 acknowledges that variable fee approach contracts 'are substantially investment-related service contracts'. As discussed in Agenda Paper 2C for the December 2018 Board meeting, this perspective is fundamental to the requirements of the variable fee approach and to its scope, which was carefully considered during its development.

11. IFRS 17 uses the scope of the variable fee approach to identify insurance contracts that provide investment-related services to an extent that justifies a modified approach to their measurement. In these contracts, the obligation to the policyholder can be regarded as a promise to return the underlying items, including any returns generated, to the policyholder after deducting a variable fee. The entity is promising an investment return based on underlying items, in effect providing an asset management service.

12. The measurement is modified so that changes in the entity's share of the underlying items adjust the contractual service margin. At the June 2018 Board meeting, the Board tentatively decided to clarify that the determination of coverage units should be determined by considering both insurance coverage and investment-related services, to make the modified measurement internally consistent.

Concerns and implementation challenges expressed since IFRS 17 was issued

13. Some stakeholders agree that there is an economic distinction between insurance contracts without direct participation features (to which the general model applies) and insurance contracts with direct participation features (to which the variable fee approach applies). Those stakeholders agree with the outcome of IFRS 17 that:

    (a) for contracts to which the general model applies, the quantity of benefits includes only insurance coverage and the contractual service margin is recognised only over the period during which the entity provides coverage for insured events; and

    (b) for contracts to which the variable fee approach applies, the quantity of benefits includes investment-related services and the coverage period includes periods in which the entity provides investment-related services.

14. Other stakeholders disagree. They think that some insurance contracts that are not direct participating contracts provide investment-related services or other services and those services should be reflected in the coverage units applied for the contractual service margin allocation of those contracts. They observe that the contractual service margin is determined based on all the expected cash flows discounted at a current market-consistent rate.[3] Hence it includes the effect of any difference between the expected return on an investment component promised to a policyholder and the market rate for such returns. They think it would be consistent with that calculation to recognise the contractual service margin in profit or loss over the period that difference arises.

15. Some of those stakeholders noted that without amending IFRS 17 to reflect investment-related services in determining coverage units for contracts accounted for applying the general model, the application of the requirements would result in unintended consequences. For example:

[3] It also includes the effect of the risk adjustment for non-financial risk.

(a) contracts that provide insurance coverage that ends significantly before the investment-related services would result in a front-end revenue recognition; and

(b) deferred annuity contracts with an account balance accumulating in the period before the annuity payments start could result in back-end revenue recognition if insurance coverage is provided only during the annuity periods.

Staff analysis

16. The staff analysis is structured as follows:

(a) identification of a service related to investment returns for insurance contracts without direct participation features;

(b) consequences of determining coverage units based on the identification of such a service; and

(c) alternative approach based on any service provided (ie not just insurance coverage and a service related to investment returns).

17. The staff use the following example from a submission to the Transition Resource Group for IFRS 17 (TRG) to illustrate the analysis given below.[4]

> Example: an investment contract matures in year 10 and pays the customer the account value at maturity. The account value is determined as the premiums received plus the return on underlying items less 1%. The contract also includes a death benefit that varies depending on which year in the 10 year period the death occurs. Specifically, if the customer dies during the 1–5 year period, the customer's beneficiary would receive a death benefit that is the higher of 110 per cent of the premium paid or the accumulated account value (assume the death benefit for years 1–5 results in significant insurance risk). However, if the customer dies in years 6 to 10 the customer's beneficiary only gets the account value. There is no surrender penalty.

18. Applying IFRS 17:

(a) if the contract falls within the scope of the variable fee approach:

[4] Example 14 in Appendix C of Agenda Paper 5 of the May 2018 TRG meeting.

(i) the contract provides insurance and investment-related services. The coverage period for total services is 10 years.

(ii) the coverage units should be determined reflecting the benefits to the policyholder of the insurance coverage and the investment-related services. Determining the amount and pattern of the insurance and investment-related services is a matter of judgement. Methods that rely solely on the amount of the investment component or solely on the death benefit would not be a faithful representation of the provision of services.

(b) if the contract does not fall within the scope of the variable fee approach, only insurance coverage is considered for the purpose of determining coverage units applying IFRS 17. The coverage period for those services is the first five years. In years 6–10, the policyholder can make no valid insurance claim and receives no insurance coverage from the entity. Hence, coverage units are determined using the insurance benefits that exist only in the coverage period of years 1-5.

Identification of a service related to investment returns for insurance contracts without direct participation features

19. Many insurance contracts include an investment component,[5] whereby a policyholder pays amounts to the insurer which will be repaid (often plus a return) even if an insured event does not occur. IFRS 17 distinguishes between such contracts, depending on whether they include direct participation features.

20. For insurance contracts with direct participation features, IFRS 17 treats the investment component as an investment in a specific pool of assets that the entity manages on behalf of the policyholders. In effect, all the returns on the assets flow to the policyholder, except for a fee that the entity retains. The entity receives this fee substantially[6] for a service that is regarded as equivalent to an asset management

[5] Any references to an investment component in this paper are to investment components that cannot be separated from the insurance contract applying paragraph 11 of IFRS 17.

[6] The fee also covers the insurance coverage.

service.[7] The definition of an insurance contract with direct participation features identifies contracts for which such a depiction of the services provided and related fee provides useful information.

21. Applying IFRS 17 to insurance contracts without direct participation features, the investment component is regarded in the same way as any other investment made in an entity, for example investments made by bond holders. The policyholder gets its investment plus a return on its investment, and no service related to the investment component is separately identified.

22. Using the example in paragraph 17 of this paper, suppose the expected rate of return on the underlying items is 5%. The fulfilment cash flows will include cash flows to the policyholder giving them a return of 4%. The discount rate reflecting the uncertainty of the cash flows for the return of 4% would be the expected market return of 5%.[8] Suppose the policyholder pays a premium of 100 and the entity expects the investment component to exist for 10 years with a lump sum payment at the end of the 10 years. The expected value of the lump sum would be 100 x 1.04^{10} =148. The fulfilment cash flows for the investment component would be 148 discounted at the market rate on the underlying items of 1.05, ie 91, giving a contractual service margin of 9.[9]

23. Ignoring for simplicity any cash flows arising from the insurance component, applying the general model in IFRS 17 the entity would recognise the interest expense at the market rate of 5% equal to 57 over the 10 years, and profit of 9 over the 5 years in which insurance coverage is provided.[10] The spread of 1% (the profit of 9) is regarded as payment for the insurance coverage.

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[7] This perspective of the fee applies regardless of whether or not the entity holds the assets (the underlying items).

[8] Applying IFRS 17 the discount rate would not be exactly 5% because of the spread. That effect has been ignored in this example for simplicity.

[9] The fulfilment cash flows would also include cash flows, risk adjustment and an adjustment to the discount rate for the insurance component. It may not be possible to identify separately the amount of the fulfilment cash flows that relates to the insurance component and the amount described here as relating to the investment component.

[10] Applying IFRS 17 the amount of the contractual service margin would be increased by interest accreted at a risk-free rate. That amount would depend on the risk-free rate and the pattern of recognition of the contractual

24. The staff compared the IFRS 17 accounting with that applying IFRS 9 *Financial Instruments* to a financial liability issued by the entity with the characteristics of the example in paragraph 17 without the insurance component. The IFRS 9 accounting will depend on the characteristics of the cash flows of the liability that depend on the underlying assets. For example, if the underlying assets are equity assets, it is likely that the liability would either be measured at fair value or include an embedded derivative that would be measured at fair value. Hence, the spread would not be recognised evenly over time but if the initial assumptions were ultimately realised, the value of the 1% spread would have been recognised cumulatively as the fair value of the liability or embedded derivative changes over time over the life of the liability.

25. The staff continue to think there is a difference between:

    (a) insurance contracts with direct participation features—for which the entity is regarded as providing a service equivalent to asset management; and

    (b) insurance contracts without direct participation features—for which the entity is providing a return that reflects the uncertainty of the cash flows to be repaid to the policyholder, just like any financial liability.

26. However, the staff acknowledge that many stakeholders do not think useful information is provided for contracts that have an insurance coverage period that differs from the period in which the policyholder gets return on an investment component if the total profit is recognised over only the insurance coverage period. The staff also acknowledge that applying IFRS 9 would likely result in the recognition of any spread between market rates and the rate payable to an investor (the entity's profit) over the period the investor receives a return.

27. The staff think it is possible to justify the recognition of the contractual service margin over a period that includes the period in which the policyholder gets a return, even when this extends beyond the period when insurance coverage is provided, on the grounds that the entity is providing a service in that period. The service is not an asset management service because the entity is not managing assets on behalf of the policyholders. Rather it is providing the policyholder with access to an investment

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service margin over the five-year period, Dr interest expense, Cr CSM. That amount has been ignored in this example for simplicity.

return that would not otherwise be available to the policyholder because of the amounts invested, liquidity, complexity and expertise. The staff use the term ‘investment return service’ for this service.

28. The staff think there is a balance on whether including an investment return service when determining coverage units results in useful information because:

    (a) doing so could provide relevant information about the services the entity regards itself as providing to the policyholder; but

    (b) doing so also introduces greater subjectivity and potentially less comparability between entities.

29. To assess where that balance lies, the staff investigated the consequences of including an investment return service in determining coverage units.

Consequences of determining coverage units based on the identification of such a service

30. The staff have identified a number of consequential questions relating to the determination of coverage units based on insurance coverage and an investment return service:

    (a) circumstances in which the investment return service exists;

    (b) subjectivity in weighting of services;

    (c) cash flows in the contract boundary;

    (d) subsequent adjustments to the contractual service margin; and

    (e) eligibility for the premium allocation approach.

Circumstances in which the service exists

31. The staff considered when an investment return service should be regarded as existing. First, the staff considered insurance contracts with no investment components. An investment component exists only if amounts are paid to

policyholders in all circumstances, including the contract lapsing. [11] Examples of contracts without investment components include:

(a) car insurance contracts with no rebates;

(b) deferred annuities with at least one of the following features:

(i) no surrender value in the accumulation phase;

(ii) no payment on death in the accumulation phase; or

(iii) no guaranteed payments in the annuity phase.

(c) a contract that provides an annuity if a policyholder becomes disabled. The amount of the annuity is linked to the returns on a pool of assets. The entity treats the payment of the annuity after an insured disability event as a liability for incurred claims.[12] There is no investment component because there is no amount paid to the policyholder in all circumstances, for example if there is no claim.

32. Stakeholders have not raised problems relating to an investment return service for the type of contract described in paragraph 31(a) of this paper.

33. In contrast, deferred annuities are often given as an example of when restricting coverage units to the period in which insurance coverage is provided is a problem. Looking at the cases in which there is no investment component in such contracts as described in paragraph 31(b) of this paper:

(a) if there is a payment on death in the accumulation phase, there is insurance coverage in the accumulation phase which will be included in the determination of coverage units. Hence, there should not be a problem in terms

[11] IFRS 17 requires identification of the amount of an investment component only when a payment is made to a policyholder. But it is always clear whether or not the contract includes an investment component, even if the amount cannot be identified in advance.

[12] At its September 2018 meeting, TRG members observed an entity would use its judgement to develop an accounting policy on whether the provision of an annuity consequent to a disability claim involved the provision of insurance coverage, ie whether the liability for the annuity payments would be regarded as a liability for incurred claims or a liability for remaining coverage.

of the period over which the contractual service margin is recognised in profit or loss.

(b) if there is no payment on death in the accumulation phase, the staff think it is appropriate not to regard the contract as providing investment services: if the policyholder dies in the accumulation phase, the beneficiary receives no benefit from the investment. Any investment benefit arises only if the policyholder survives to receive the annuity. Hence the staff think it is appropriate to recognise the contractual service margin over the insurance coverage period only.

34. The staff think the reasoning in paragraph 33(b) of this paper also applies to the annuity payments after a disability claim described in paragraph 31(c) of this paper: the policyholder only benefits from the investment returns if the policyholder becomes disabled. Hence, the entity is not providing an investment return service beyond the insurance coverage service.

35. The staff therefore think that an entity should consider investment return services only when an insurance contract includes an investment component.

36. The staff then considered whether an investment return service always exists when there is an investment component. The staff observed that in some contracts, the entity does not provide an investment return service, for example when the entity provides only custodial services in relation to the investment component or when the investment component is included solely to facilitate insurance coverage, such as the inclusion of a no claims bonus in some insurance contracts. The staff think it is a matter of judgement for the entity to determine whether it provides an investment return service in addition to insurance coverage. That judgement should be applied consistently to similar contracts.

37. The staff considered whether it would be helpful to:

(a) set specific criteria for when an entity should include an investment return service in the determination of coverage units. For example, whether the

promised return needs to be variable, or different from market rates, or greater than zero;

(b) set an objective of considering an investment return service only when it is expected that the policyholder will identify an investment benefit in addition to the insurance coverage in the contract, rather than the investment component being included solely to facilitate the provision of insurance coverage. Examples of investment components when the policyholder might not identify an investment benefit could be a no claims bonus or fixed surrender value, where the entity does not perform significant activities to meet its obligation to pay the investment component; and/or

(c) state that if changes in financial assumptions do not have a substantial effect on the amounts paid to the policyholder, then any investment service could be regarded as minimal and hence disregarded. This criterion is used in paragraphs B131–B132 of IFRS 17 to determine what amounts should be included in profit or loss when an entity uses the option in IFRS 17 to include some insurance finance income and expenses in other comprehensive income. The objective of paragraphs B131–B132 of IFRS 17 is to identify an amount effectively equivalent to an amortised cost amount applying IFRS 9. In doing this, the paragraphs effectively distinguish between contracts that provide a fixed return and contracts that provide a variable return.

38. The staff acknowledge that setting criteria or an objective could help with consistent application of any amendment to IFRS 17 in relation to investment return services and comparability of results. However, the staff think that it is not possible to identify strict criteria for when an investment return service exists. For example, the staff think that in some economic conditions a promise of a fixed return could involve as much service as the promise of a variable return. The staff also think that it would be difficult to develop an objective that is clear and applicable in all circumstances. Further, the staff note that any criteria or objective for identifying when an entity

provides an investment return service will add complexity for users, preparers and auditors in understanding and applying the criteria or objective.

39. The staff think it is unlikely that any benefits of consistent application or comparability of results would outweigh the costs of the added complexity created by criteria or an objective developed at this time.

40. Finally, the staff considered insurance contracts under which some investment component payments are expected to be paid to future policyholders rather than the current policyholder.[13] Does the entity provide a service during the period in which payments are expected to be made to future policyholders?[14]

41. The staff think that the contractual service margin should be regarded as the amount a policyholder pays for services that *it* receives, not for services to future policyholders. Also, the staff think that from a practical perspective, tracking the contractual service margin across periods in which payments are expected to be made would be complex and probably arbitrary. The staff therefore recommend that the period of investment return service is regarded as ending when all investment component payments to the policyholder of the contract have been made, without considering payments to future policyholders.

Subjectivity in weighting of services

42. Including an investment return service in addition to insurance coverage services in the determination of coverage units adds subjectivity and complexity to that determination. An entity would have to assess the relative weighting of the benefits of the investment return service and the insurance coverage services, and the pattern of delivery of these services.

43. An entity is already required to make similar assessments for contracts under the variable fee approach, and for contracts applying the general model which provide more than one type of insurance coverage. As noted in Agenda Paper 2B for the June

[13] Payments can be expected to be made to future policyholders when an entity is obliged to pay amounts based on the returns on underlying items, but has discretion over the timing of such payments. An entity may retain some returns in a good period to be able to pay out more in future periods with lower returns. All the expected payments are included in the fulfilment cash flows, regardless of to whom they are expected to be made.

[14] This question also applies to the recognition of the contractual service margin for groups of insurance contracts with direct participation features, as does the proposed staff solution in paragraph 41 of this paper.

2018 Board meeting in relation to the variable fee approach, practice will develop as IFRS 17 is implemented. The staff observe similar assessments are required in applying IFRS 15 *Revenue from Contracts with Customers* and guidance in that Standard considers potential or actual transaction prices services had they been offered on a standalone basis. The staff note that in practice, a similar type of analysis may be helpful in identifying whether an investment return service exists and the relative benefits for the policyholder. However, the staff do not recommend developing further guidance in IFRS 17 on how to make such assessments at this time, for the same reasons set out in paragraph 38–39 of this paper in relation to criteria or an objective for when an investment return service exists. Instead, the staff recommend requiring the assessments to be made on a systematic and rational basis, consistent with TRG members observations on the determination of insurance coverage units.[15]

44. The staff observe the pattern in which services are provided is a significant judgment in measuring groups of insurance contracts, which IFRS 17 requires to be disclosed. Also, IFRS 17 specifically requires extensive disclosure of changes in the contractual service margin and an explanation of when it expects to recognise in profit or loss the contractual service margin remaining at the end of a period. The staff think these disclosures will facilitate users' understanding of the entity's approach to recognising the contractual service margin.

Cash flows in contract boundary

45. Some stakeholders have questioned whether the costs of managing assets that form underlying items for insurance contracts can be included in the fulfilment cash flows for the contracts, both for variable fee contracts and for general model contracts.

46. The staff observe that IFRS 17 includes in the fulfilment cash flows those cash flows that relate directly to the fulfilment of the contract, including an allocation of fixed and variable overheads directly attributable to fulfilling insurance contracts. For variable fee contracts, where the policyholder is regarded as investing in assets that the entity manages on its behalf, it follows that the asset management costs should be regarded as part of the costs of fulfilling the contracts. Hence, they will be included in

[15] Summary of the TRG meeting held on 2 May 2018.

the fulfilment cash flows. Further, the staff think that to the extent that an entity includes an investment return service for general model contracts in the determination of coverage units, it should also include cash flows related to the fulfilment of that service in the fulfilment cash flows.

Subsequent adjustments to the contractual service margin

47. Paragraph 4 of this paper explains that after initial recognition the contractual service margin is adjusted for changes in fulfilment cash flows that relate to future service. In the general model, all changes in financial assumptions are regarded as relating to the current period, not to future service. In contrast, applying the variable fee approach, some changes in financial assumptions are regarded as relating to future service.

48. The staff considered whether extending the type of service that determines coverage units in the general model would have any implications for the sort of changes in fulfilment cash flows that are regarded as relating to future service in that model. For example, should some changes in financial assumptions be regarded as relating to future service, similar to the variable fee approach?

49. There are two aspects of contracts under the variable fee approach that result in differences between the variable fee approach and the general model. The first is the type of service provided under the contract, as discussed in paragraphs 19–21 of this paper. The second is the nature of the fee that compensates the entity for that service, which is the entity's share of the change in the fair value of the underlying items less the fulfilment cash flows that do not vary depending on the returns on underlying items.[16] It is the second aspect, the nature of the fee, that causes the contractual service margin to be remeasured for changes in the fair value of the underlying item. Other effects of changes in financial assumptions adjust the contractual service margin in the variable fee approach because it is not possible to separate them from the change in fair value of the underlying items. The extension of the type of service used to determine coverage units in the general model does not change the nature of

[16] IFRS 17 paragraph B104.

the fee in those contracts. Hence, there is no need to change the treatment of the effects of changes in financial assumptions.

Eligibility for the premium allocation approach

50. Insurance contracts are eligible to use a simplified approach, the PAA, if:
    (a) the entity reasonably expects that the simplified approach would produce a measurement of the liability for remaining coverage for a group of insurance contracts that would not differ materially from the one that would be produced applying the core requirements of IFRS 17; or
    (b) the coverage period of each contract in the group is one year or less.

51. Including an investment return service may increase the reporting periods in which the entity is regarded as providing service and the reporting periods in which the contractual service margin exists. It will therefore increase the reporting periods in which the liability for remaining coverage exists, affecting the first criterion for the PAA (paragraph 50(a) of this paper). The staff think it would be consistent to also specify that the coverage period referred to in the second criterion would also include the period in which the entity provides an investment return service. This would mean that an entity would need to assess whether insurance contracts with investment components provide such a service, and could potentially reduce the number of contracts eligible for the PAA.

Alternative approach based on any services

52. Some stakeholders suggested IFRS 17 should require the recognition of the contractual service margin in profit or loss to be determined based on services provided under the contract. An entity would then use its judgement to decide what services were provided.

53. These stakeholders observed that their specific concerns related to investment-related services rather than any other types of service.

54. The staff think the recognition of the contractual service margin in profit or loss is a fundamental aspect of the depiction of the performance of groups of insurance contracts. As discussed in paragraphs 42–44 of this paper, the staff acknowledge that

there is inevitable subjectivity in determining the pattern of provision of service. Given the feedback identifying the two key services provided by insurance contracts without direct participation features as insurance coverage and an investment return service, the staff think using these services as the basis for the recognition of the contractual service margin will provide useful information, without introducing more subjectivity by allowing for other services.

Staff recommendations and questions for Board members

55. As noted in paragraph 28 of this paper, the staff think there is a balance on whether including an investment return service when determining coverage units results in useful information because:
    (a) doing so could provide relevant information about the services the entity regards itself as providing to the policyholder; but
    (b) doing so also introduces greater subjectivity and potentially less comparability between entities.
56. The staff are persuaded by feedback that the benefits of 55(a) outweigh the costs of 55(b), because of the extensive disclosures required around the contractual service margin. Including an investment return service in the determination of coverage units also could reduce the differences between the general model and the variable fee approach because it would reduce differences in the pattern of recognition of the contractual service margin in profit or loss.
57. The staff acknowledge that any change to the requirements on the recognition of the contractual service margin in profit or loss have the potential to disrupt implementation—the calculation of the contractual service margin is an important part of any system for implementing IFRS 17. Further, a large number of insurance contracts have investment components, so this change could have a widespread effect. On the other hand, some entities may judge that investment return services should not be considered in the determination of coverage units. On balance, the staff think the

potential disruption could be justified given the stakeholder feedback about the lack of useful information given by the existing requirements in IFRS 17.

Questions for Board members
1—Do you agree the Board amend IFRS 17 so that in the general model the contractual service margin should be allocated on the basis of coverage units that are determined by considering both insurance coverage and any investment return service? (See paragraphs 19–28 and 55–57 of this paper)
2—Do you agree the Board amend IFRS 17 to establish that an investment return service exists only when an insurance contract includes an investment component? (See paragraphs 31–35 of this paper)
3—Do you agree the Board amend IFRS 17 to require an entity to use judgement applied consistently in deciding whether to include an investment return service when determining coverage units and the Board should not provide an objective or criteria for that determination? (See paragraphs 36–39 of this paper)
4—Do you agree the Board amend IFRS 17 to establish that the period of investment return services should be regarded as ending when the entity has made all investment component payments to the policyholder of the contract, ie not including payments to future policyholders? (See paragraphs 38–41 of this paper)
5—Do you agree the Board amend IFRS 17 to require the assessment of the relative weighting of the benefits provided by the insurance coverage and investment return service and their pattern of delivery to be made on a systematic and rational basis? (See paragraphs 42–44 of this paper)
6—Do you agree the Board confirm that, applying IFRS 17, cash flows relating to fulfilling the investment return service are included in the measurement of the insurance contract? (See paragraphs 45–46 of this paper)
7—Do you agree the Board does not change the requirements in IFRS 17 relating to which changes in fulfilment cash flows adjust the contractual service margin in the general model (See paragraphs 47–49 of this paper)
8—Do you agree the Board amend IFRS 17 to establish that the one year eligibility criterion for the PAA should be assessed by considering insurance coverage and an investment return service, if any? (See paragraphs 50–51 of this paper)