

# Insurance contracts with participation and other features

IFRS 17 *Insurance Contracts*  
Part 1: measurement of fulfilment cash flows

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## This webcast

July 2018 Insurance contracts with participation and other features

## Previous webcasts

March 2018 Recognising the CSM in profit or loss  
January 2018 Level of aggregation  
2017 See appendix A for all IFRS 17 webcasts published in 2017



**Further information:**

go.ifrs.org/IFRS-17-implementation and  
IFRS 17 webcasts YouTube playlist:  
<https://www.youtube.com/playlist?list=PLrLeeuMbuaUeLNX7Qoqlq7Oh3csegFwYn>  
IFRS 17 Effects Analysis available at <http://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-effects-analysis.pdf>  
IFRS 17 Project Summary available at <http://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-project-summary.pdf>  
IFRS 17 Feedback Statement available at <http://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-feedback-statement.pdf>

- Part 1 – Explanation of features and measurement of fulfilment cash flows:
  1. Payments to policyholders that vary with returns on underlying items through participation features
  2. Financial options and guarantees
  3. Discretion over timing or amount of cash flows
  4. Cash flows affecting or affected by other insurance contracts
- Part 2 – Measurement of the contractual service margin
  - Including criteria for variable fee approach

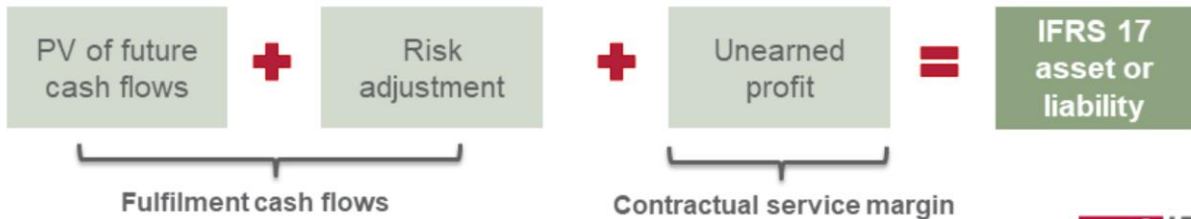
**Further information:**

Webcast *Part 2* at [go.ifrs.org/IFRS-17-implementation](https://go.ifrs.org/IFRS-17-implementation) and IFRS 17 YouTube playlist:  
<https://www.youtube.com/playlist?list=PLrLeeuMbuaUeLNX7Qoqlq7Oh3csegFwYn>

# Reminder: IFRS 17 core requirements

4

- All insurance contracts measured as the sum of:
  - **Fulfilment cash flows (FCF)**
    1. Present value (PV) of probability-weighted expected cash flows—reflects financial risk
    2. Plus an explicit risk adjustment for non-financial risk (eg insurance)
  - **Contractual service margin (CSM)**
    3. The unearned profit from the contracts



## Further information:

IFRS 17 paragraph 32

IFRS 17 Appendix A definitions:

- Contractual service margin
- Risk adjustment for non-financial risk
- Fulfilment cash flows
- Financial risk

Basis for Conclusions on IFRS 17 paragraphs BC16-BC21

Webcast *Core requirements: measurement essentials of IFRS 17*

at [go.ifrs.org/IFRS-17-implementation](https://go.ifrs.org/IFRS-17-implementation) and

IFRS 17 YouTube playlist:

<https://www.youtube.com/playlist?list=PLrLeeuMbuaUeLNX7Qoqlq7Oh3csegFwYn>

## Reminder: IFRS 17 contracts

5

- A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law.
- Consider all substantive rights and obligations, whether they arise from a contract, law or regulation. Disregard terms that have no commercial substance

Contracts can be:

Written



Oral



Implied by the  
entity's customary  
business practices



S

### Further information:

IFRS 17 paragraph 2

Basis for Conclusions on IFRS 17 paragraph BC69

# 1. Payments to policyholders that vary with returns on underlying items

6



- Payments to policyholders may vary with returns on underlying items through participation features

# Contracts with participation and other features

7

*Insurance contracts with participation features may have some or all of these other features:*

2 Financial options and guarantees

3 Discretionary cash flows

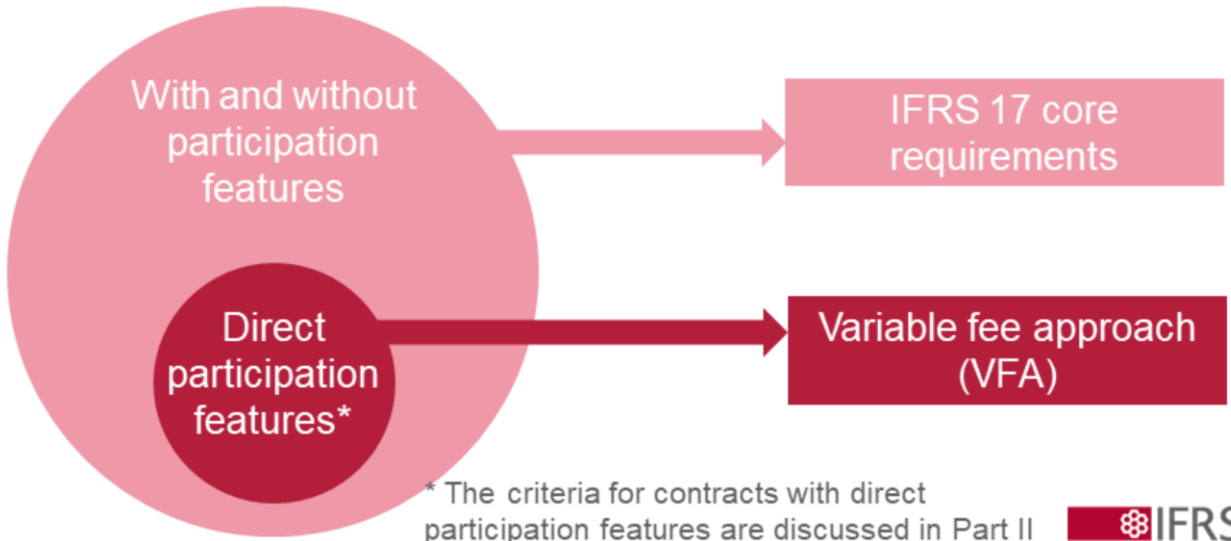
4 Cash flows that affect or are affected by other insurance contracts

Other features

# Participation: What?

8

Insurance contracts:



## Further information:

IFRS 17 Appendix A definition:

- Insurance contract with direct participation features

Basis for Conclusions on IFRS 17 paragraph BC227



## Core requirements vs VFA

9

- Only difference is in subsequent measurement of CSM:

	Fulfilment cash flows		CSM*
	PV of future cash flows	Risk Adjustment	
Initial recognition	Same requirements	Same requirements	Same requirements
Subsequently	Same requirements	Same requirements	Different requirements



\* Discussed in part II of the webcast

### Further information:

Basis for Conclusions on IFRS 17 paragraphs BC227 and BC240-241

# 1. Participation: Effect on FCF

10

- Effect on measurement of present value of future cash flows:
  - Reflect the extent cash flows vary with returns on underlying items
  - Cash flows that vary based on the returns on financial underlying items are:
    - discounted at rates that reflect that variability; or
    - adjusted for the effect of the variability and discounted at a rate that reflects that adjustment



## **Further information:**

IFRS 17 paragraphs 33, 36, B65, B44-B48 and B74-B78

Basis for Conclusions on IFRS 17 paragraphs BC201 and BC204-BC205

## 2. Financial options and guarantees: What?

11

### Option

For example, a policyholder's right to change a financial benefit to another type of financial benefit under potentially favourable terms

### Guarantee

For example, cash flows to the policyholder are subject to a guaranteed minimum annual return

- Reminder—apply IFRS 9 *Financial Instruments* to determine whether, and if so, how an embedded derivative is required to be separated



### Further information:

IFRS 17 paragraphs 10 and 11(a)

Basis for Conclusions on IFRS 17 paragraphs BC98-BC107 and BC114

## 2. Financial options and guarantees: Effect on FCF

12

- Effect on measurement of present value of future cash flows\*:
  - Reflect the current value of options and guarantees consistent with observable market variables:
    - intrinsic value and time value
  - Judgement is required to determine the appropriate technique
    - example technique: stochastic modelling

\* If required **not** to be separated from the insurance contract



### Further information:

IFRS 17 paragraphs 33, 36 and B36-B41, B44-B48, B74-B77

Basis for Conclusions on IFRS 17 paragraphs BC152 and BC202-BC205

### 3. Discretion: What?

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- The entity's discretion to vary cash flows to policyholders
  - timing and/or amount
- Examples:
  - the entity may vary the extent to which policyholders participate in the returns from underlying items
  - the entity may change the timing of payments of the policyholders' share of returns through 'bonus' mechanisms



**Further information:**

IFRS 17 paragraphs B65, B69, and B98-B100

Basis for Conclusions on IFRS 17 paragraphs BC167-BC170, BC237

### 3. Discretion: Effect on FCF

14

- Contract boundary determined by substantive rights and obligations
- Measurement of group of insurance contracts:
  - present value of all future cash flows within contract boundaries:
    - probability-weighted cash flows for the full range of possible outcomes
    - include the effect of the entity's expectation of discretionary cash flows



#### **Further information:**

IFRS 17 paragraphs B65, B69, and B98-B100

Basis for Conclusions on IFRS 17 paragraphs BC167-BC170 and BC237

## 4. Cash flows affecting or affected by other contracts: What?

15

- Cash flows of insurance contracts that affect other insurance contracts or are affected by other insurance contracts
  - policyholders share the returns on the same specified pool of underlying items and
  - some policyholders are required to bear a reduction in their share of the return because of guaranteed payments to other policyholders



### **Further information:**

IFRS 17 paragraphs B67 and B68

Basis for Conclusions on IFRS 17 paragraphs BC171-BC174

## 4. Cash flows affecting or affected by other contracts: effect on FCF

16

- Effect on measurement of present value of future cash flows:
  - Reflect the extent to which contracts in the group cause the entity to be affected by expected cash flows:
    - to policyholders in that group; or
    - to policyholders in another group



### **Further information:**

IFRS 17 paragraphs B67 and B68

Basis for Conclusions on IFRS 17 paragraphs BC171-BC174



## 4. Cash flows affecting or affected by other contracts: effect on FCF

17

- Accordingly present value of future cash flows for a group:
  - a) Include payments arising from terms of existing contracts in the group to policyholders of contracts in other groups\*
  - b) Exclude payments to policyholders in the group that applying a) have been already included in another group
- Simplified example in Appendix B to these slides

\* Payments can be to existing and/or future policyholders



### **Further information:**

IFRS 17 paragraphs B68 and B69

Basis for Conclusions on IFRS 17 paragraphs BC171-BC174

## 4. Cash flows affecting or affected by other contracts: effect on FCF

18

- Different practical approaches can be used to determine the present value of future cash flows
- As an example, an entity could:
  - identify the change in the underlying items and resulting change in the fulfilment cash flows at higher level of aggregation (eg portfolio)
  - allocate the effect of such changes to each group on a systematic and rational basis
- An entity need not continue the FCF allocation to groups when coverage has been provided for all affected contracts



### **Further information:**

IFRS 17 paragraphs B70 and B71

Basis for Conclusions on IFRS 17 paragraphs BC171-BC174

- The features discussed in this webinar could have an effect on the risk adjustment for non-financial risk
- As a reminder, the risk adjustment for non-financial risk:
  - is the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk

### **Further information:**

IFRS 17 paragraphs 37 and B86-B90

IFRS 17 Appendix A definitions:

- Risk adjustment for non-financial risk
- Financial risk

Basis for Conclusions on IFRS 17 paragraphs BC206-BC212

- Part 1 – Explanation and effect on fulfilment cash flows measurement:
  1. Payments to policyholders that vary with returns on underlying items through participation features
  2. Financial options and guarantees
  3. Discretion
  4. Cash flows affecting other contracts
- Part 2 – Effect on contractual service margin
  - Including criteria for variable fee approach

**Further information:**

Webcast *Part 2* at [go.ifrs.org/IFRS-17-implementation](https://go.ifrs.org/IFRS-17-implementation) and IFRS 17 YouTube playlist:  
<https://www.youtube.com/playlist?list=PLrLeeuMbuaUeLNX7Qoqlq7Oh3csegFwYn>

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# Appendix A: Other IFRS 17 webcasts

## Previous webcasts

May 2017	Introducing IFRS 17
May 2017	Understanding IFRS 17
June 2017	Core requirements: scope of IFRS 17
July 2017	Core requirements: measurement essentials of IFRS 17
August 2017	Simplified accounting for contracts with short coverage periods
September 2017	Reinsurance contracts held
November 2017	Core requirements: Recognition and derecognition
December 2017	Transition to IFRS 17



**Further information:**

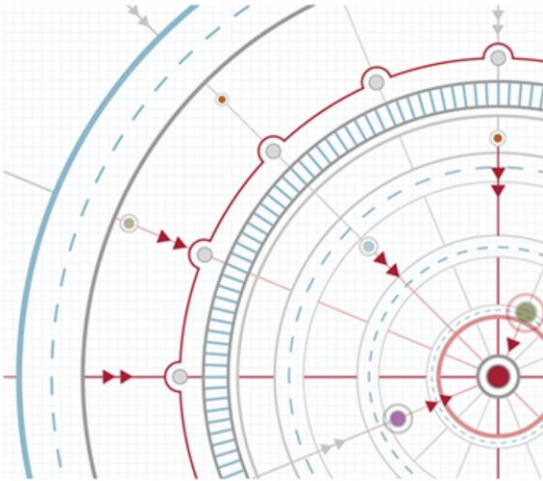
go.ifrs.org/IFRS-17-implementation and  
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<https://www.youtube.com/playlist?list=PLrLeeuMbuaUeLNX7Qoqlq7Oh3csegFwYn>  
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IFRS 17 Project Summary available at <http://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-project-summary.pdf>  
IFRS 17 Feedback Statement available at <http://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-feedback-statement.pdf>

# Appendix B : Accounting for insurance contracts

Reflecting contracts affecting cash flows of other contracts

**Example**  
Future payments to policyholders of Group A are expected to be reduced from a share in the returns on underlying items of CU350 to CU250 because of payments of a guaranteed amount to policyholders in Group B

Group A		Group B	
Share in returns on underlying items	CU350	Share in returns on underlying items	CU100
Reduction in payments because of guarantee to policyholders in Group B	(CU100)	Increase in payments because of guarantee to policyholders in Group B	CU100
Payments to policyholders in Group A	CU250	Payments to policyholders in Group B	CU200
Reflected in fulfilment cash flows	CU350	Reflected in fulfilment cash flows	CU100



# Insurance contracts with participation and other features

Part 2: measurement effect on the contractual service margin

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- Insurance contracts with one or more of the following features:
  1. Payments to policyholders that vary with returns on underlying items through participation features
  2. Financial options and guarantees
  3. Discretion
  4. Cash flows affecting other contracts
- Part 1 – Explanation and effect on fulfilment cash flow measurement
- Part 2 –Effect on contractual service margin
  1. General model
  2. Variable fee approach, including criteria for its scope

**Further information:**

Webcast *Part 1* at [go.ifrs.org/IFRS-17-implementation](https://go.ifrs.org/IFRS-17-implementation) and IFRS 17 YouTube playlist:  
<https://www.youtube.com/playlist?list=PLrLeeuMbuaUeLNX7Qoqlq7Oh3csegFwYn>

## Reminder: IFRS 17 contracts

3

- A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law.
- Consider all substantive rights and obligations, whether they arise from a contract, law or regulation. Disregard terms that have no commercial substance

Contracts can be:

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Oral



Implied by the  
entity's customary  
business practices



S

### Further information:

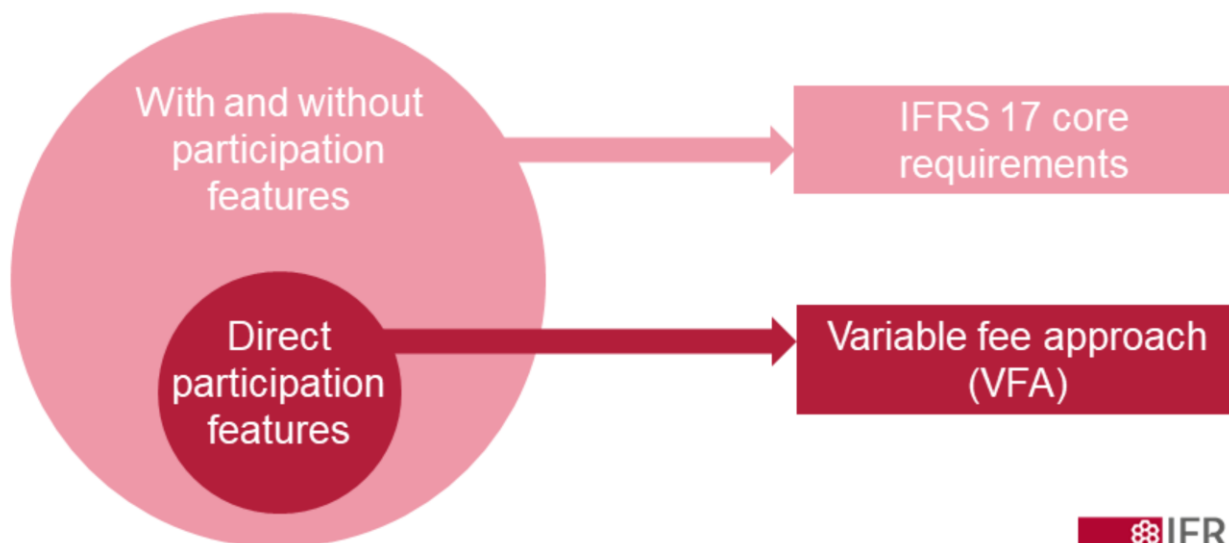
IFRS 17 paragraph 2

Basis for Conclusions on IFRS 17 paragraph BC69

# Reminder: IFRS 17 requirements for contracts with participation features

4

Insurance contracts:



## Further information:

IFRS 17 Appendix A definition:

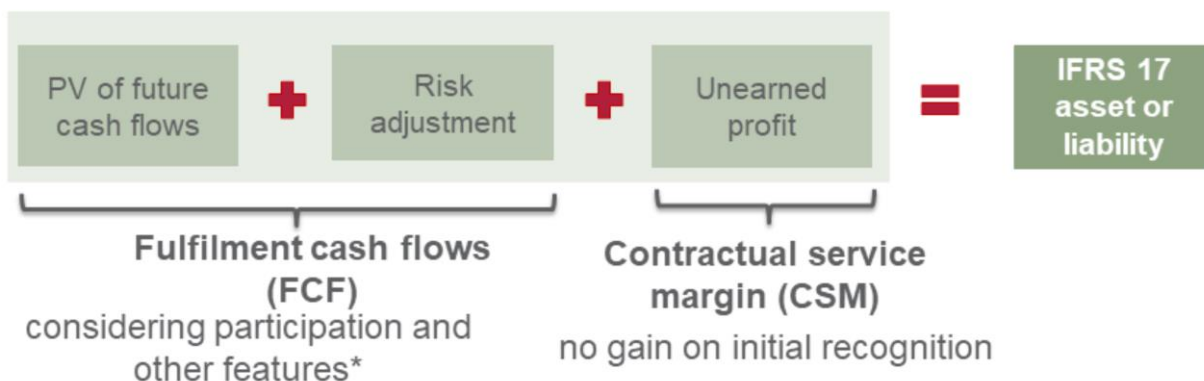
- Insurance contract with direct participation features
- Basis for Conclusions on IFRS 17 paragraph BC227

# Participation and other features— effect on CSM: IFRS 17 core requirements

# Reminder: IFRS 17 core requirements— measurement

6

- Same measurement requirements as contracts without participation features



\* The effect of these features on the FCF is discussed in part 1 of the webcast



## Further information:

IFRS 17 paragraph 32

IFRS 17 Appendix A definitions:

- Contractual service margin
- Risk adjustment for non-financial risk
- Fulfilment cash flows
- Financial risk

Basis for Conclusions on IFRS 17 paragraphs BC16-BC21

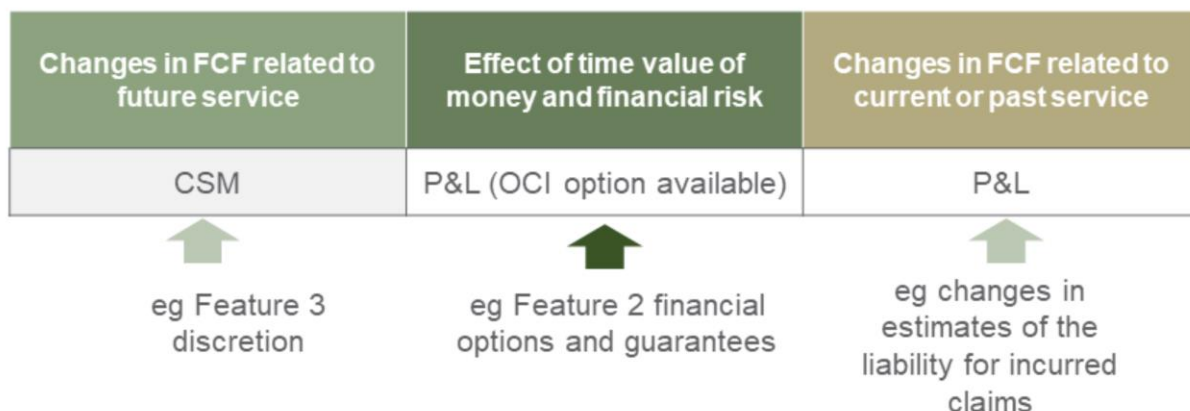
Webcast *Core requirements: measurement essentials of IFRS 17*

at [go.ifrs.org/IFRS-17-implementation](https://go.ifrs.org/IFRS-17-implementation) and IFRS 17 YouTube playlist:

<https://www.youtube.com/playlist?list=PLrLeeUMbuaUeLNX7Qoqlq7Oh3csegFwYn>

## Reminder: IFRS 17 core requirements— subsequent changes in the CSM

7



- Accordingly changes arising from participation features and financial options and guarantees do not adjust the CSM to the extent that they relate to time value of money and/or financial risk



### Further information:

IFRS 17 paragraphs 44 and B96-B100

Basis for Conclusions on IFRS 17 paragraphs BC227-BC231

## Feature 3: Discretionary cash flows

8

- A change in discretionary cash flows is related to future service
- A change in the effect of assumptions that relate to financial risk is not related to future service
- To determine changes in discretionary cash flows:
  - a) specify at inception the basis on which the entity expects to determine its commitment
  - b) if cannot specify a), the entity's commitment is assumed to be the return implicit in the estimated fulfilment cash flows, updated to reflect current assumptions for financial risk



### **Further information:**

IFRS 17 paragraphs 4 and B98-B100

Basis for Conclusions on IFRS 17 paragraphs BC237

# Insurance contracts with direct participation features: Variable fee approach

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## **Further information:**

IFRS 17 paragraph 32

IFRS 17 Appendix A definitions:

- Contractual service margin
- Risk adjustment for non-financial risk
- Fulfilment cash flows
- Financial risk

Basis for Conclusions on IFRS 17 paragraphs BC16-BC21



## Variable fee approach criteria

10

- Criteria for insurance contracts with direct participation features:
  - a) Contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items;
  - b) The entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and
  - c) The entity expects a substantial proportion of any changes in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items
- Reinsurance contracts and reinsurance contracts held are prohibited from applying this approach



### Further information:

IFRS 17 B101-B108

IFRS 17 Appendix A definition:

- Insurance contract with direct participation features

Basis for Conclusions on IFRS 17 paragraphs BC238, BC246, BC248 and BC249

## Variable fee approach criteria

11

- When is a contract assessed against the variable fee approach criteria?

Inception

Subsequently

↑  
Assess against  
VFA criteria\*  
(see slides 12-17)

↑  
Do not reassess after  
inception *unless* there is  
a specified modification

\*considering all features of the contract eg whether the contract's cash flows affect or are affected by cash flows to other policyholders



### Further information:

IFRS 17 paragraphs 45, 72 and B101-B103

Webcast IFRS 17 *Core requirements: Recognition and derecognition* at

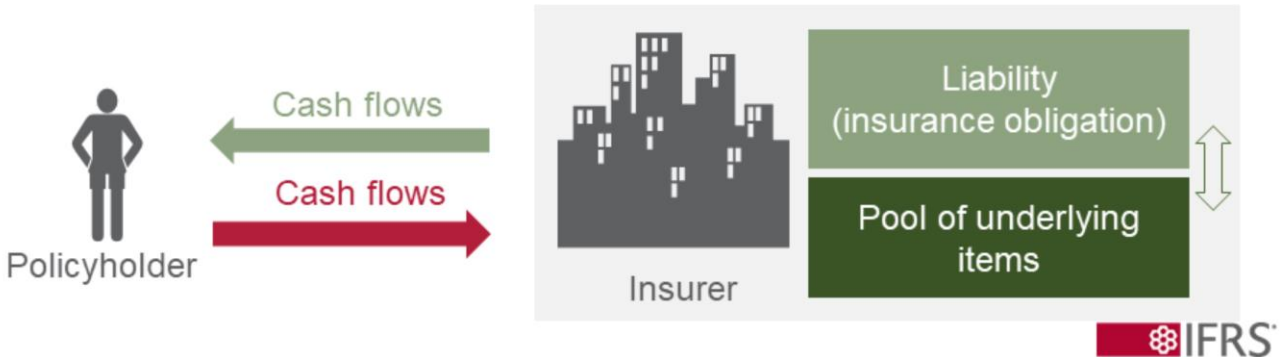
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<https://www.youtube.com/playlist?list=PLrLeeuMbuaUeLNX7Qoqlq7Oh3csegFwYn>

## Variable fee approach criterion a)

12

- Contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items
  - Discretionary cash flows do not preclude such a share
  - Enforceable link to underlying items



### Further information:

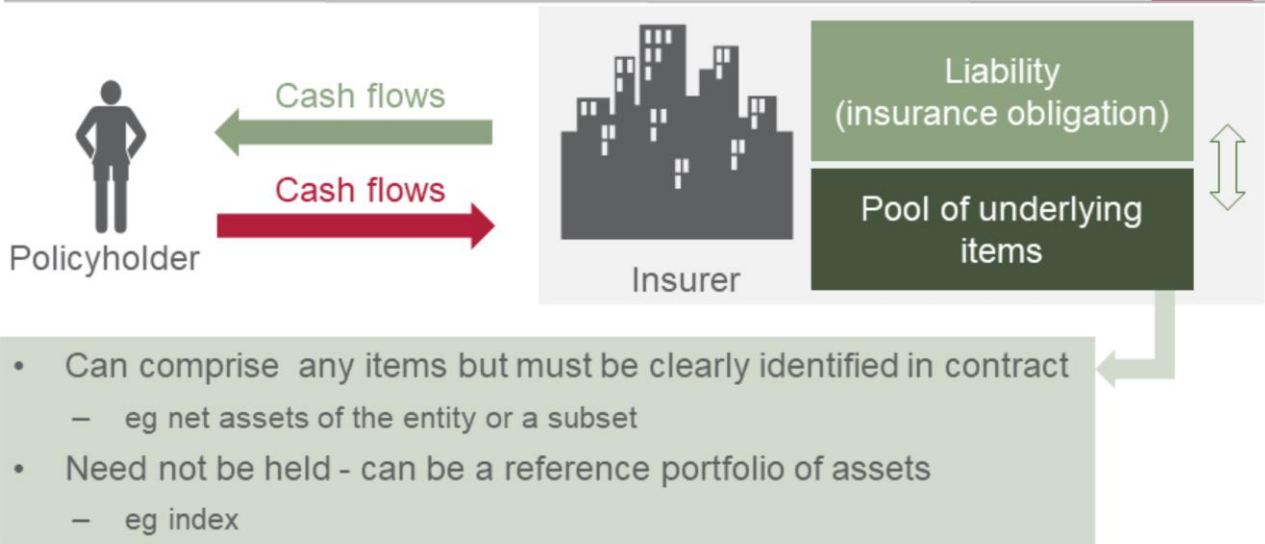
IFRS 17 paragraphs 2 and B105

IFRS 17 Appendix A definition:

- Insurance contract with direct participation features

## Variable fee approach criterion a)

13



### Further information:

IFRS 17 paragraph B106

IFRS 17 Appendix A definition:

- Insurance contract with direct participation features

## Variable fee approach criterion a)

14

- Criterion a) not met if any of the following are applicable:
  - The underlying items determining the amount of entity's obligation can be changed with retrospective effect
  - No pool of underlying items is identified in the contract
    - eg past practice that policyholders receive a return that reflected the entity's (or a subset of assets) performance is not evidence by itself that there are underlying items identified in contract



### Further information:

IFRS 17 paragraph B106

IFRS 17 Appendix A definition:

- Insurance contract with direct participation features

## Variable fee approach criteria b) and c)

15

- The entity:
  - b) expects to pay an amount equal to a substantial share of the fair value returns on underlying items and
  - c) expects a substantial proportion of any change in the amounts to be paid to vary with the change in fair value of underlying items
- Contracts with the following features are not precluded from meeting these criteria:
  - a minimum guarantee return
  - a return that is based on amortised cost of underlying items\*

\* discussed at February 2018 IFRS 17 TRG meeting



### Further information:

IFRS 17 paragraph B107

IFRS 17 Appendix A definition:

- Insurance contract with direct participation features

## Variable fee approach criteria b) and c)

16

- For criteria b) and c):
  - Interpret ‘substantial’ in the context of the objective:
    - provision of investment-related services and
    - a fee to compensate for that service determined by reference to underlying items
  - Assess variability in amounts:
    - over the duration of insurance contracts
    - on a present value probability weighted average basis



### **Further information:**

IFRS 17 paragraph B107

IFRS 17 Appendix A definition:

- Insurance contract with direct participation features

## Core requirements vs VFA

17

- Only difference is in subsequent measurement of CSM:

	Fulfilment cash flows		CSM
	PV of future cash flows	Risk Adjustment	
Initial recognition	Same requirements	Same requirements	Same requirements
Subsequently	Same requirements	Same requirements	Different requirements



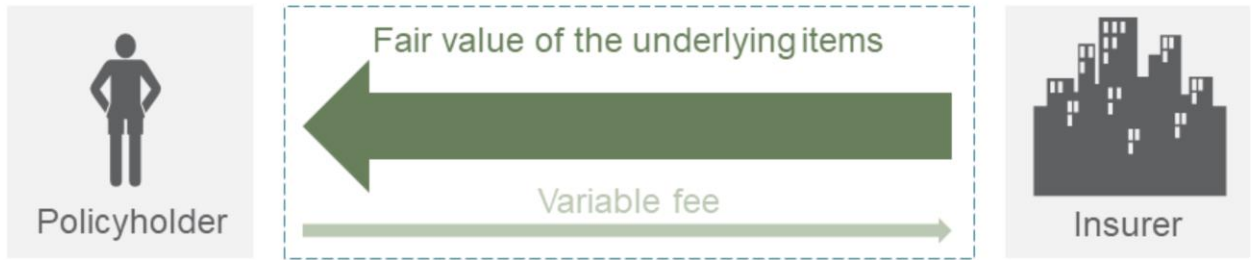
### Further information:

Basis for Conclusions on IFRS 17 paragraphs BC227 and BC240-241



## VFA – Day 1 obligation to the policyholder

18



On Day 1, the entity's obligation to the policyholder (ie fulfilment cash flows) is equal to the fair value of the underlying items less a variable fee

The variable fee is deducted in exchange for future services to be provided and comprises:

- the entity's share of the fair value of the underlying items less
- any changes in the fulfilment cash flows that are not based on the returns on the underlying items

### Further information:

IFRS 17 paragraph B104

Basis for Conclusions on IFRS 17 paragraphs BC

## VFA: Subsequent measurement of CSM

19

- Changes that adjust the CSM are the net of changes in:
    - a) fair value of underlying items
    - b) fulfilment cash flows—liability for remaining coverage
- \* see appendix for simple example



### **Further information:**

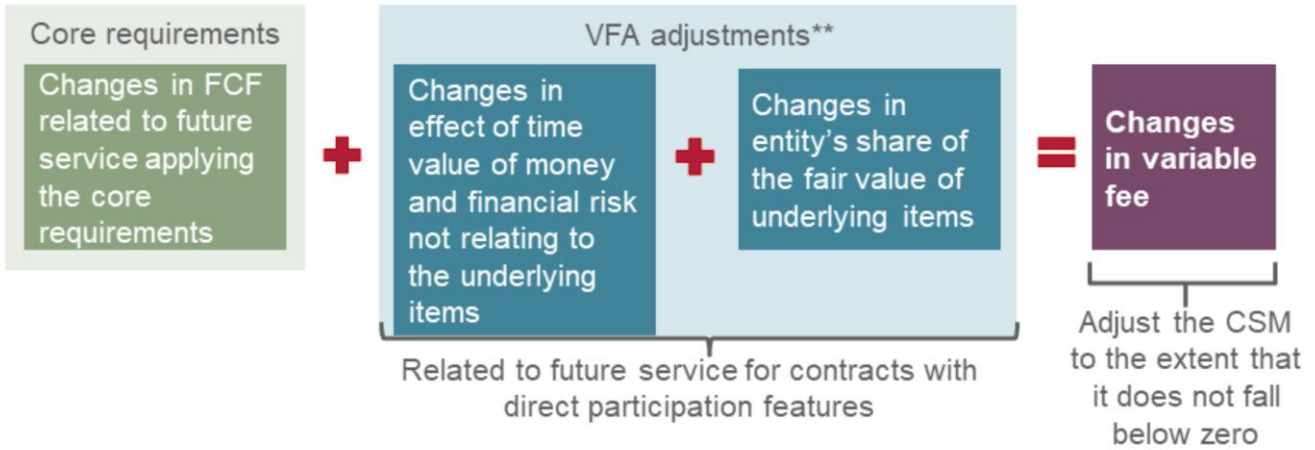
IFRS 17 paragraph B114

Basis for Conclusions on IFRS 17 paragraphs BC243

## VFA: Subsequent measurement of CSM

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- Subsequently, the CSM is adjusted for changes in the variable fee:



\*\* An entity could choose to recognise some or all of changes in the effect of financial risk in profit or loss if specified risk mitigation conditions are met (slide 26)



### Further information:

IFRS 17 paragraphs B110-B113 and B115

Basis for Conclusions on IFRS 17 paragraphs BC239-BC241

# VFA: risk mitigation

21

	FCF related to future service	Effect of time value of money and financial risk	FCF related to current or past service eg liability for incurred claims	Entity's share of the fair value of underlying items
<b>IFRS 17 core requirements</b>	CSM	P&L	P&L	Not applicable
<b>VFA – without risk mitigation</b>	CSM	CSM*	P&L	CSM
<b>VFA – to the extent that mitigation is applied</b>	CSM	P&L**	P&L	Does not adjust CSM

\* Only those FCF that do not vary based on returns to underlying items

\*\* Change in IFRS 17 fulfilment cash flows, not fair value measurement



## Further information:

IFRS 17 Paragraphs B115-B118

Basis for Conclusions on IFRS 17 paragraphs BC53-BC55 and BC250-BC256

## VFA: risk mitigation conditions

22

Financial  
risk



a) Insurance  
contracts  
with direct  
participation  
features

b)  
Derivatives

An entity must have a previously documented risk-management objective and strategy and:

- uses derivatives to mitigate financial risks in those insurance contracts
- economic offset exists between a) and b)—ie their values generally move in opposite directions because they respond in a similar way to changes in the risk being mitigated.
- the economic offset is not dominated by credit risk



### Further information:

IFRS 17 paragraph B116

Basis for Conclusions on IFRS 17 paragraph BC255

## VFA: risk mitigation application

23

Entity chooses to apply and determines which fulfilment cash flows in the group to apply it to

Apply risk mitigation consistently in each reporting period

Cease to apply risk mitigation\*

Risk mitigation conditions are met

Risk mitigation conditions are no longer met



\* periods before are not adjusted

### Further information:

IFRS 17 paragraph B115-B118

- On transition to IFRS 17, this option
  - can be applied on the date of initial application of IFRS 17
  - cannot be applied to periods before the date of initial application

**Further information:**

IFRS 17 paragraph C3(b)

Basis for Conclusions on IFRS 17 paragraph BC393

## Recognition of CSM in profit or loss: VFA contracts

25

- The CSM for a group of insurance contracts is recognised in profit or loss (P/L) over the coverage period:
  - Allocate the CSM to the coverage units and recognise in P/L the amount allocated to coverage units provided in the period
- Coverage units determined by quantity of benefits and expected coverage period. For insurance contracts with direct participation features:
  - Benefits are insurance coverage and investment-related services
  - Coverage period includes periods of insurance and investment-related services
    - Board proposed clarification of the inclusion of investment-related service period at the June 2018 Board meeting



### Further information:

IFRS 17 paragraphs 45(e) and B119

Basis for Conclusions of IFRS 17 paragraphs BC220, BC221 and BC279-BC283

Agenda Paper 2B June 2018



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## Appendix: VFA simplified example

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- Fact pattern – a group of insurance contracts with direct participation features
  - Between initial recognition and the end of period 1:
    - The fair value of the underlying items increases from CU1,000 to CU1,135. Change of CU135
    - The fulfilment cash flows—liability for remaining coverage\* are remeasured from CU795 to CU900. Change of CU105

\* All fulfilment cash flows (both those that vary based on returns on underlying items and those that do not)



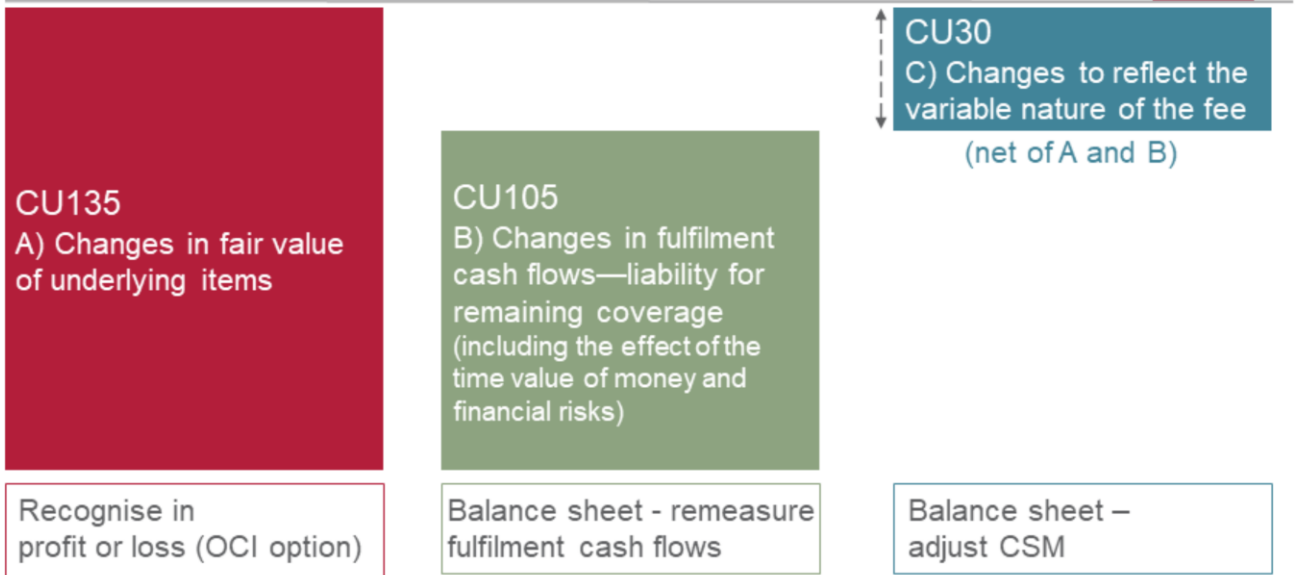
### Further information:

IFRS 17 paragraph B114

Basis for Conclusions on IFRS 17 paragraphs BC243

## Appendix: VFA simplified example

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### Further information:

IFRS 17 paragraphs B110-B114

Illustrative Examples on IFRS 17 *Example 9—Measurement on initial recognition and subsequently of groups of insurance contracts with direct participation features*