International Financial Reporting Standards

Insurance Contracts Standard

Modifications to General model: variable fee contracts

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Topics

Modifications to the general model

The new insurance contracts Standard modifies the accounting model to provide additional accounting models for different types of contract.

- A variable fee approach for some contracts with participation features
- Accounting requirements for reinsurance contracts an entity holds, based on the general model
- Accounting requirements for investment contracts with discretionary participation features
- An optional simplified measurement approach for simpler insurance contracts, based on the unearned premium reserve approach used in many jurisdictions

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Modifications to the general model
Variable fee approach: Scope

- Scope of the variable fee approach
  - Policyholder participates in share of clearly identified pool of underlying items;
  - Entity expects to pay policyholder a substantial share of the returns from those underlying items;
  - Cash flows expected to vary substantially with underlying items
- Variable contracts outside the variable fee approach apply the general model

Modifications to the general model
Variable fee approach: Sensitivity

- Includes any contract which creates a contractual obligation linked to underlying items
  - Explicit contractual terms
  - Includes regulatory requirements
- However, measurement based on expected cash flows (not contractually-specified cash flows)
- Not dependent on holding of underlying assets
- Obligation need not be to current generation of policyholders

Modifications to the general model
Variable fee approach: Mechanics

- Measurement of obligation (both FCF and CSM) reflects change in fair value of all underlying items
- Fulfillment cash flow is calculated consistently with the general model
- Modify general model so that changes in the estimate of fee entity expects to earn are adjusted in CSM
  - Fee is equal to entity's expected share of returns on underlying items, less
  - any expected cash flows that do not vary with the underlying items.

Modifications to the general model
Variable fee approach: Risk mitigation

- Entity is permitted to recognise in profit or loss changes in value of guarantee (ie as in the general model) if:
  - Entity holds derivative instruments
  - consistent with entity’s risk management strategy;
  - economic offset exists between guarantee and derivative, and
  - credit risk does not dominate the economic offset
- Entity is required to:
  - document its risk management objective and strategy
  - discontinue prospectively when economic offset ceases
  - disclose the effect of changes in the value of the guarantee in the profit or loss for the period

Modifications to the general model
Variable fee approach: Allocation of CSM

- Release pattern consistent with general model
  - Basis of passage of time
  - Number of contracts in force
- Alternatives rejected:
  - Based only on investment services
  - What is the pattern for those services?
  - How to reflect two services and changes in magnitude in those services over time?

Contrast with general model
General model versus variable fee

	General model	Variable fee model
Cash flows	No difference	
Discount rate	No difference	
Risk margin	No difference	
CSM at inception	No difference	
Allocation of CSM	No difference	
Discretion	No difference	

Contrast with general model

General model versus variable fee

	General model	Variable fee model
CSM		
Subsequent Measurement (financial)	Changes in all financial assumptions in SCI	Changes in guarantees and shareholders share in CSM
- Except risk mitigated	Changes in all financial assumptions in SCI	Changes in sh/share in CSM
Subsequent (non financial)	No difference	
Accretion	Accreted at locked in rate	‘Effective’ accretion at current rate

Thank You


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expressions of
individual views
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