IASB/FASB Meeting
Week commencing 28 March 2011

IASB Agenda reference **1A**

Staff Paper

FASB Agenda reference **62A**

Topic **Considerations in unlocking the margin**

The paper provides background information for the boards to consider before deciding whether the residual or composite margin should be locked-in at inception (as the Exposure Draft *Insurance Contracts* and the FASB's Discussion Paper *Preliminary Views on Insurance Contracts* propose) or unlocked over the life of the contract. We do not intend to ask the boards for any decisions.

The content of this paper is exactly the same as agenda paper 5 for the Insurance Working Group meeting on 24th March 2011. Therefore board members may prefer to refer to their copy of IWG agenda paper 5 if they have already read that paper.

The staff will provide an addendum to this paper describing feedback received from the Insurance Working Group before the joint board meeting.

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

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What is this paper about?

1. The purpose of this paper is to discuss whether the residual or composite margin should be locked-in at inception (as the Exposure Draft *Insurance Contracts* and the FASB's Discussion Paper *Preliminary Views on Insurance Contracts* propose) or unlocked over the life of the contract.

2. The analysis in this paper applies equally to the residual and composite margin. For brevity, we refer solely to the margin in the rest of the paper when we do not need to distinguish between them.

3. This paper will not discuss the following other issues related to margins:

   (a) Whether to adopt a two margin approach (risk adjustment plus composite margin) as proposed in the IASB's ED or a one margin approach (composite margin) as proposed in the FASB's DP.

   (b) Whether the residual margin can become negative.

   (c) The aggregation level of the residual or composite margin for the purpose of amortisation (and potential unlocking).

   (d) The possible release pattern for the margins.

   (e) Accretion of interest on the margins.

4. Relevant decisions taken by the boards to date are set out in Appendix B.

Background

5. The Exposure Draft *Insurance Contracts* proposes that the measurement of an insurance liability should include a residual margin, calibrated as the difference between the present value of the expected cash flows plus a risk adjustment and the expected premium.

6. In contrast, in the FASB's preliminary views, the composite margin is calibrated to the difference between the present value of the expected cash flows (without a risk adjustment) and the expected premium. Risk and uncertainty would be reflected implicitly within a single composite margin rather than through a separate risk adjustment.

7. In both cases, the margin would be locked-in in at inception and allocated to future periods (although the pattern of allocation would be different between the residual and the composite margin because the composite margin covers risk and the residual margin does not). Appendix A provides extracts from the Basis for Conclusions to the ED that describe why the ED proposed allocation of the residual margin with no unlocking. Appendix B is a short summary of the Board discussions on residual and composite margin.

Overview of comments on the ED / DP

8. The Invitation to Comment to the ED/DP asked whether commentators agreed with the proposed methods of releasing the locked-in margin in profit or loss. There was no specific question on unlocking the margin.

9. Many commentators disagreed that the residual or composite margin should be fixed at inception of the contract and allocated in a systematic way over the coverage period (as proposed in the ED) or the period of coverage and claims payment (as the DP proposes). Those commentators challenged the reasoning for the lock-in and the consequence that any non-cash changes in the insurance liability after inception would be recognised immediately in profit or loss. Their reasons were that locking in the margin at inception:

(a) introduces an inconsistency between measurement on day one (no day one gain, but immediate day one loss) and the subsequent measurement.

(b) could lead to a situation in which an insurer recognises losses in a period, even though there are gains allocated from the release of the margin in the current and future periods. Many believe this effect is counterintuitive and will be difficult to explain to users. It also appears to be inconsistent with the proposals in ED *Revenue from Contracts with Customers*, which do not account for changes in estimates of cash flows arising from unsatisfied performance obligations unless a contract becomes onerous.

(c) might introduce an ability to influence profit for the period by manipulating assumption changes and some degree of subjectivity. Some are concerned that insurers might overstate the estimates of cash flows at inception with a subsequent benefit to profit or loss in later periods.

10. Some commentators would like to see the margin being remeasured every reporting date just like the other building blocks (cash flows, risk adjustment, discount rate). However, views amongst commentators were mixed on what the residual margin or the composite margin represents. Some stated that the margin would include amounts intended to recover all acquisition costs that are not incremental at a contract level[1], general overheads[2], risk of unknown uncertainties not identified and hence not captured by a risk adjustment (and, in the case of the composite margin, all risks), costs of infrastructure and IT, assumption errors, income taxes, other similar costs and the insurer's expected profit. (Paragraph BC125 of the Basis for Conclusions also included a list of items included in the residual margin)

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[1] At their 1-2 February meeting, the boards tentatively decided that the contract cash flows should include those acquisition costs that relate to a portfolio of insurance contracts, rather than only those that are incremental to the contract as proposed in the ED/DP.

[2] At their meeting in the week commencing 14 February, the boards tentatively decided that the cash flows used in measuring a portfolio of insurance contracts should include all costs that the insurer will incur directly in fulfilling the contracts in that portfolio, including costs that relate directly to the fulfilment of the contracts in the portfolio and costs that are directly attributable to contract activity as part of fulfilling that portfolio of contracts and that can be allocated to those portfolios

Staff analysis

Whether to unlock the margin

11. The first two issues regarding the margin are:

    (a) Can the residual or composite margin be remeasured (in the true sense of the word)? This requires a consideration of the nature of the residual and composite margin.

    (b) Should the margin be locked-in or unlocked?

True remeasurement of the residual or composite margin

12. The issue is whether the boards think that the margin is just a plug created to fill the gap between the present value of cash inflows and cash outflows (plus the risk margin in the IASB's ED) or whether the margin actually represents something. That something would include a blend of many different components that might or might not be possible to be distinguished. This raises the question whether the residual or composite margin could be remeasured (in the true sense of the word) or, if not, whether sufficient meaning could be assigned to the initial margin that would suggest it should be unlocked.

13. As noted in paragraph BC125 of the Basis for Conclusions, the ED/DP did not propose that an insurer should measure any of those factors separately, but sought a release pattern that corresponds in a reasonable way and at an acceptable cost to the pattern of the factors that generated those margins at inception. This reflects that if the margin is a blend of several components, it would be hard to remeasure these margins in aggregate, and it would also be very difficult to split such a margin into its components, distinguish them from each other and remeasure them individually. Furthermore, the staff thinks that any replication of the calculation of a margin after day one would have no intrinsic meaning (because it is defined as a calibration to the expected premium), and that any measurement would lack substance and would not lead to a faithful representation of the economics of the contract.

14. Many commentators noted that the major components of the residual or composite margin according to the ED or DP are non-incremental acquisition costs and overheads. The boards tentatively decided in their February and March 2011 meetings that acquisition costs and contract cash flows should be calculated on a portfolio level and include all costs that the insurer will incur and are directly attributable to acquiring and fulfilling that portfolio. (However the FASB would restrict acquisition costs to those relating to successful efforts only.) Those tentative decisions reduce, maybe significantly, the size of the residual or composite margin. The remainder of the margin would then include (besides profit) other components that are priced in the premium, such as general business risk and other overheads. It still does not seem to be feasible to remeasure such components of pricing considerations without an actual market transaction (the exact same contract cannot be written without hindsight on any day after inception).

15. Accordingly, in the staff's view, it would not be possible to remeasure the residual or composite margin.

Unlocking the margin

16. The arguments for and against unlocking the margin, without attempting to remeasure the margin according to its nature, but merely reflecting some or all changes that occurred in the other building blocks, can be summarised as two distinct positions:

    (a) The current measure of the liability is integral to understanding and reporting insurance contracts and therefore the reporting of changes to that liability needs the most emphasis. Accordingly all changes in estimates should be recognised in profit or loss. This was the view proposed in the ED/DP.

    (b) The pattern of recognition of revenue is integral to understanding and reporting insurance contracts and therefore the allocation of the margin needs the most emphasis. Accordingly, (some or all) changes in estimates should adjust the remaining margin, provided that this margin does not become negative.

17. Some believe that the most faithful representation of the insurance contract is the accuracy of the measurement of the insurance liability, and that that is achieved through the other building blocks. Those holding this view believe that information about changes in the measurement of the insurance liability provides relevant information to users about changes in circumstances for insurance contracts. Some of those with this view regard the residual margin, and to some extent the composite margin, as a plug that – conceptually – should be profit in its entirety on day one.

18. Those supporting this view argue:

    (a) unlocking would defer the recognition of changes in estimates of the value of the insurance contract liability to periods after the period in which they occur. Those changes in estimate depict economic changes in the cost of fulfilling the contract as those changes take place. Recognizing those changes in estimates in profit or loss in the period in which they occur provides more transparent, useful and relevant information about changes in the insurer's circumstances compared to spreading those changes and smoothing them over future periods.

    (b) unlocking would introduce a further level of complexity that would make it more difficult for users of financial statements to understand and that would add to the cost of applying the standard.

19. In addition, some note that the margin incorporates some allowances for some overheads and or unknown uncertainties and is a blend of many components that are not separately identifiable. As a result, any attempt to release the residual margin in a pattern that corresponds in a reasonable way to match the occurrence of the related expenses is inevitably arbitrary to some extent.

20. Accordingly, those with this view disagree that the residual margin should be unlocked and believe any gains or losses emerging from a change in the building blocks should be recognized in profit or loss in the period of the change.

21. Others place emphasis on the counterintuitive effect that results when changes in estimates are recognised in profit or loss, even though the measurement of the liability includes a profit margin.

22. Those with this view believe:

    (a) It would not be a faithful representation of the profit the insurer earns over time if an insurer recognises expense in one period only to reverse it in a later period through release of margin.

    (b) It is inconsistent to prohibit the recognition of gains at initial recognition on the basis of estimates, but require the subsequent recognition of gains on the basis of similar estimates.

    (c) If there is still a profit margin left, it is counterintuitive to account for losses that might or might not result in an actual payout.

    (d) In addition to profit, the margin includes allowance for general overheads, business risks and other uncertainties in the pricing of the contract (in the premium), even if not all these components are present. Accordingly it would be consistent with the boards' proposals in the revenue recognition project not to account for changes in the building blocks unless the contract becomes onerous (ie the margin becomes negative).

23. Accordingly, those with this view believe that the residual margin should be unlocked to depict profits and losses that emerge from the contract, rather than when estimates change. They indicate that this would be consistent with the revenue recognition approach to be adopted in other industries and suggest that reporting changes in estimates could be achieved by disclosing period-to-period changes in the margin.

Discussion question: Whether to unlock the residual margin
Should the residual or composite margin unlocked?

How to unlock the margin

24. If the boards were to unlock the margin, the next issue is how. There are different ways to unlock the margin. The two basic approaches are either to 'consume' the margin or to adjust the margin for both favourable and unfavourable changes, which will be called 'float' the margin in this paper.

Consuming the residual margin

25. 'Consuming' is a term used in this paper to describe an approach that reduces the margin to offset unfavourable changes in the carrying amount of the insurance liability. Consuming the margin could serve to solve the concerns and counterintuitive effects of the requirement to report losses while a profit margin remains. To serve that need, this approach would only be appropriate if the margin is adjusted for unfavourable changes until there is no margin left. Favourable changes would immediately flow through profit or loss. A variation of this approach would be to use favourable changes to build up the margin to its level at inception.

26. The staff agrees that consuming the margin up to the point where the margin becomes negative addresses the counterintuitive effects of presenting losses while allocating a profit margin at the same time. The staff, however, thinks that consuming the margin results in a presentation where favourable changes flow through profit or loss (as profits) and unfavourable changes are parked in the margin. Disclosures should be able to make this more transparent, but the staff thinks that the presentation of the contract's performance would be skewed. This particularly holds true if the margin is unlocked for some changes only, as there does not seem to be a conceptual reasoning why, eg favourable non-financial changes should be shown as profits, but unfavourable non-financial changes should adjust the margin.

Floating the residual or composite margin

27. Floating the residual or composite margin follows the view that the margin is 'something' and not just a plug to prevent day one gains. As remeasuring the margin in its true sense does not seem to be feasible, some suggest 'approximately' remeasuring the margin by adjusting the margin for

changes (both favourable and unfavourable) in the value of the other building blocks (cash flows, discounting, risk adjustment), without limiting the margin to the amount initially recognised (which is called 'floating' in this paper).

28. As discussed in paragraph 26, some argue that consuming the margin would result in a skewed presentation of the performance of the contract (consume the margin for unfavourable changes while presenting favourable changes as profit in profit or loss).

Adjust for which changes?

29. Approaches for deciding which changes would lead to unlocking of the residual or composite margin can be categorised as follows:

    (a) All changes (see paragraph 31).

    (b) Changes in financial inputs, such as changes in interest rates (see paragraphs 32-35).

    (c) Changes in non-financial inputs, such as changes in mortality and morbidity or frequency and severity (see paragraphs 35-37).

    (d) Changes in assumptions and estimates regarding the future, whilst the difference between the previously expected and current actuals would flow through profit or loss (see paragraphs 39-39).

All changes

30. If all changes in the building blocks are recorded in the residual margin, the visibility in profit or loss of the changes regarding the current period is diminished. Although all changes in the margin can be disclosed, the effect is not shown in profit or loss for the current period and therefore has no immediate impact, but is smoothed and deferred according to the allocation pattern of the margin. The staff thinks that adjusting the margin for all changes is counterproductive to the aim of achieving a current measurement of the insurance contracts that reflects the performance of the contract over time and in each individual period.

Financial inputs only

31. The rationale for limiting the adjustment of the margin to changes in financial inputs would be to absorb volatility arising from changes in, for example, interest rates. Some would say that especially long-term insurance contracts bear significant financial risk, in particular the risk of changes in interest rates. Those contracts therefore are sensitive to changes in interest rates, even though the overall performance of the contract remains unknown until the coverage period ends, which may well be in twenty or thirty year's time. Using the residual margin to absorb changes in interest rates and other financial inputs would dampen the volatility of the results in profit or loss of those contracts, but only to the extent that the changes consume the entire margin.

32. Further, adjusting the margin for changes in financial inputs would avoid accounting mismatches that arise when the assets backing the contracts are carried on a cost basis, because the cost basis is immune to changes in financial inputs. However, adjusting the margin for changes in financial inputs would equally create an accounting mismatch when the assets backing the contracts are carried at fair value.

33. The effect of adjusting changes in the discount rate against the residual margin would also mean that the interest expense due to the unwind of the discount stays the same and would in effect result in a locked-in discount rate for the statement of comprehensive income. This may also depend on whether the margin is discounted or not.

34. The staff does not agree with adjusting the margin for financial inputs only, mainly because it would introduce a potential accounting mismatch.

Non-financial inputs only

35. Limiting the adjustment to changes in non-financial inputs would make the measurement of the liability respond to changes in, for example, interest rates and so avoid any accounting mismatches arising when the assets backing the insurance contracts are carried at fair value.

36. Non-financial inputs can be seen as the drivers of insurance risk. That makes them extremely important for a faithful representation of the performance of the insurance contract. That could be one of the arguments in favour of recognising such changes in profit or loss, rather than parking those changes in the margin. On the other hand, those inputs often have a long-term perspective, they almost never have a quoted market price and some would say they do not fluctuate significantly over a short time period unless there is a significant change in the environment of the insured risk. One disadvantage of unlocking for some inputs only is inputs can have joint effects and separating them can be arbitrary.

37. In addition to that, staff thinks that the margin should only be adjusted for non-financial inputs in order to avoid accounting mismatches with changes in financial inputs reflected in the measurement of the asset side.

Estimated future changes only

38. The fourth approach, adjusting the margin for changes in assumptions and estimates regarding the future can be coupled with one of the other approaches (all changes, financial changes only, or non-financial changes only). The reasoning for this approach can be seen as an acknowledgment of the uncertainty of the insurance business because the difference between the previously expected estimates and the actual cash flows for that period would flow immediately through profit or loss whilst the changes to the future estimates of expectations and assumptions would adjust the residual or composite margin.

39. Many users are interested in the split between effects that arise in one period only and those that emerge in one period but also affect future periods. The staff thinks it would be most consistent with the measurement on day one (on day one, all estimates relate to future periods) to show changes that

affect the current period in profit or loss of that period, and adjust the residual margin for changes in estimates and assumptions that refer to future periods. Changes due to experience adjustments are recognised in the current period, those changes may or may not change the insurer's perception of assumptions and estimates about the future. If they change the assumptions and estimates about the future, those changes, from the staff's perspective, should adjust the residual margin. This approach would provide the transparency of showing changes that refer to the current period in profit or loss and ensure that changes that affect current period expenses and profits are not smoothed or deferred by allocating them to adjust the margin. Furthermore, estimates about the future would adjust the margin, in the same way that estimates about the future establish the margin on day one. Therefore, the same principle would apply to the measurement on day one and the measurement on day two.

Adjust prospectively or retrospectively?

40. Unlocking the residual or composite margin raises the question how the remaining residual margin should be allocated over the life of the contract. Some suggest that the margin should be adjusted retrospectively, which means that the margin would be adjusted as if that fact had been known at inception and accordingly spread over the whole life of the contract. Retrospective application means that the insurer would also be required to 'catch up' with the allocation already carried out in past periods. That seems to be quite complicated and burdensome.

41. Retrospective adjustment would be the natural approach to make the performance of the contract comparable to other contracts when the necessary information was gathered earlier. It is also more consistent with the measurement on day one. However, the retrospective adjustment and the cumulative effect may be impractical to apply. Some say it would be an immense effort to be forced to track back to inception and to anticipate subsequent changes to the margin. The other option would be to adjust the remaining margin prospectively over the remaining life of the contract.

42. The staff acknowledges cost-benefit considerations and thinks it is straightforward and serves the objective to adjust the margin for changes in assumptions and estimates if that adjustment is done on a prospective basis rather than on a retrospective basis. Some staff think that the cost of requiring a retrospective basis would not result in a significant benefit. Other staff think that it may be more important to have a conceptually clean approach and insurers should be able to adjust retrospectively.

Should the margin be able to become negative?

43. If the margin is adjusted for changes, it may well occur that the residual margin could become negative. The exposure draft and discussion paper propose that the residual or composite margin cannot be negative at initial recognition and cannot become negative subsequently. The Basis for Conclusions to the ED explains that "The residual margin is an allocation of part of the premium provided by the policyholder. Because it is an allocation, it cannot be negative, either at inception or subsequently." It follows that if the expected present value of the cash outflows (plus risk adjustment, in the case of the IASB's proposal) exceeds the expected present value of the cash inflows, the insurer would recognise that difference immediately in profit or loss as an expense.

44. At this stage, the staff concludes that the total of the margins (risk adjustment plus the residual margin; or composite margin only) should not become negative. The staff will analyse for the boards at a later date whether a residual margin can become negative.

Summary of staff views

45. Pending input from the working group, the staff is minded to recommend that (if the boards adopt unlocking) the boards should require that insurers:

    (a) unlock the residual or composite margin to reflect:

        (i) estimated future changes

        (ii) in assumptions about non-financial inputs

    (b) and to adjust the residual or composite margins

(i) prospectively

(ii) for favourable and unfavourable changes (‘float’ the margin).

46. In addition, the staff believes that:

(a) if the measurement of the liability includes a risk adjustment, the boards should prohibit the residual margin plus the risk adjustment from becoming negative; and

(b) if the measurement of the liability does not include a risk adjustment, the boards should prohibit the composite margin from becoming negative.

Discussion question
Do you agree with the staff’s tentative views in paragraphs 5 and 6? If not, would you rather: a) lock in the margin at inception (and allocate it over time)? b) adjust the margin for unfavourable changes only? Would you then rebuild the margin up to the initial amount when favourable changes occur? c) adjust for all changes? d) adjust for changes in financial inputs? e) adjust retrospectively? Would you then adjust the previous allocations as well? f) allow the residual margin plus the risk adjustment or composite margin to become negative?

Appendix A: Relevant basis for conclusions on the residual margin

This appendix sets *out the relevant extract of the Basis for Conclusions on the IASB's ED related to the release of the residual margin in profit or loss.*

Changes in the estimates of future cash flows

BC83 The Board concluded that an insurer should recognise the effect of changes in the estimates of cash flows immediately in profit or loss, rather than:

(a) in other comprehensive income (see paragraphs BC171–BC183 for a discussion of other comprehensive income), or

(b) by adjusting the residual margin, as discussed in the following paragraphs.

BC84 The Board considered whether the residual margin should be adjusted when there are changes in the estimates of financial market variables, such as discount rates and equity prices. If the assets backing insurance liabilities are measured at fair value, there would be an accounting mismatch if the residual margin were adjusted for those changes. Therefore, the Board proposes that changes in estimates of financial market variables should be recognised as income or expense. For the same reason, most respondents to the discussion paper agreed that such changes should be recognised as income or expense.

BC85 The Board considered the following approaches to accounting for changes in other estimates, for example mortality rates, lapse rates and expenses:

(a) The changes are recognised immediately in profit or loss and as an adjustment to the insurance liability. The residual margin is unchanged.

(b) The residual margin is adjusted for the changes, both increases and decreases, and the total liability remains unaffected. No expense is recognised.

BC86 Some believe that it would not be a faithful representation of the profit the insurer earns over the time if an insurer recognises income or expense in one

period only to reverse it in a later period. They further believe that reporting changes in estimates could be achieved by disclosing period-to-period changes in that margin. Accordingly, those holding this view believe that the residual margin should be adjusted for changes in estimates of non-financial variables. In addition, some believe it is inconsistent to prohibit the recognition of gains at initial recognition on the basis of estimates, but require the subsequent recognition of gains on the basis of similar estimates.

BC87 However, the Board concluded that a current measure of the insurance liability is integral to understanding and reporting insurance contracts. The immediate recognition of all changes in estimates provides important information to users about changes in circumstances for insurance contracts. The Board also concluded that the usefulness of that information is enhanced by presenting changes in estimates as separate items in profit or loss (see paragraphs BC157–BC188). In this respect, disclosure of the changes in estimates is not an adequate substitute for recognising those changes in profit or loss.

Release of residual margin (paragraph 50)

BC125 The residual margin could be viewed as an aggregation of several factors, including:

(a) compensation for the cost and effort of originating the contracts and assembling them into the portfolio.

(b) compensation for providing ancillary services that are not unbundled (and so are not treated as arising from a separate service contract within the scope of standards on revenue recognition).

(c) compensation for product development.

(d) additional returns if the insurer has significant pricing power, or conversely discounts if the insurer is seeking to build or maintain market power.

(e) the risk that the insurer might not satisfy its obligation to perform under the contract.

BC126 The draft IFRS does not propose that an insurer should measure any of those factors separately. Instead, the Board's objective is to seek a release pattern that corresponds in a reasonable way and at an acceptable cost to the pattern of the factors that generated those margins at initial recognition. Because those margins are a blend of various factors not separately identifiable, any such release pattern inevitably will be arbitrary to some extent. Because the risk adjustment reflects the risk in the contract, the Board thinks that risk should not drive the release pattern for the residual margin (unless risk is used as a convenient and reasonable proxy for another factor).

BC127 Instead, the Board proposes to determine the release pattern for the residual margin on the basis of an insurer's performance under the contract. Since insurance risk is present in every insurance contract and the insurance coverage from this type of risk represents a predominant factor for the performance under the insurance contract, the Board believes that the insurance coverage can be used as the basis for release across all types of contracts.

BC128 The Board believes that the factors implicitly included in the margin would no longer be relevant after the end of the coverage period. Therefore, the Board proposes that the residual margin should be recognised as income over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage, as follows:

(a) on the basis of passage of time, but

(b) on the basis of the expected timing of incurred claims and benefits, if that pattern differs significantly from the passage of time.

BC129 The draft IFRS proposes that the residual margin recognised in profit or loss for the period should be adjusted to reflect the portion of any contracts that are no longer in force at the end of the reporting period. This is consistent with recognising the residual margin over the coverage period of a contract. For similar reasons, no adjustment should be made if more contracts than expected are in force at the end of the period.

Appendix B: Board discussions on residual or composite margin

1. In their meeting in the week commencing 14 February 2011, the boards decided tentatively
   - (a) not to allow day one gains. This essentially means that the measurement model will still require a margin to calibrate the difference between expected cash inflows and expected cash outflows (plus a risk adjustment).
   - (b) that day one losses should be recognised immediately in profit or loss.
2. The boards also considered some examples how the unlocking of the margin could work (Agenda paper 3M/58M available from a link at http://www.ifrs.org/Current+Projects/IASB+Projects/Insurance+Contracts/Meeting+Summaries/IASB+FASB+February+2011.htm).
3. In their meetings before the working group meeting, the boards plan to consider the following topics related to the residual margin:
   - (a) Risk adjusted composite margin.
   - (b) Composite margin examples of run-off pattern.