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Project	**Insurance Contracts**		
Paper topic	Cover note		
CONTACT(S)	Andrea Pryde	apryde@ifrs.org	+44 (0)20 7246 6957
	Milena Lacheta	mlacheta@ifrs.org	+44 (0)20 7246 6494

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Introduction

1. This cover note accompanies:

   (a) Agenda Paper 2A *Adaptations for insurance contracts that provide policyholders with investment returns: Background and scope;*

   (b) Agenda Paper 2B *Adaptations for insurance contracts that provide policyholders with investment returns: Proposed accounting for CSM and OCI; and*

   (c) Agenda Paper 2C *Adaptations for insurance contracts that provide policyholders with investment returns: Recognition of contractual service margin in profit or loss*.

2. The staff is not asking for decisions at this meeting.

3. This cover note also provides:

   (a) an overview of the progress on the Insurance Contracts project in paragraphs 4-12;

   (b) a summary of the European CFO Forum proposal presented during November 2014 education session in paragraph 13;

   (c) an overview of the tentative decisions made in the redeliberations phase in 2014 and 2015 in Appendix A; and

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

(d) the response of the European CFO Forum to follow up questions from that education session in Appendix B.

Summary of progress on the Insurance Contracts project

4. At present, IFRS has no comprehensive standard that deals with the accounting for insurance contracts. IFRS 4, published in 2004, is an interim Standard that provides disclosure requirements, but permits a wide range of practices and includes a 'temporary exemption'. That temporary exemption explicitly states that an entity does not need to ensure that its accounting policies are relevant to the economic decision-making needs of users of financial statements, or that those accounting policies are reliable. This means that:

   (a) entities account for insurance contracts using different accounting models that evolved in each jurisdiction according to the products and regulations prevalent in that jurisdiction; and

   (b) users of financial statements are not provided with all the information they need to understand the financial statements of entities that issue insurance contracts, or to make meaningful comparisons between entities.

5. The IASB's proposals are intended to improve financial reporting by providing more transparent, comparable information about:

   (a) the effect of the insurance contracts an entity issues on the entity's financial performance;

   (b) the way an entity makes profits or loss through underwriting risks and investing premiums from customers; and

   (c) the nature and extent of risks that an entity is exposed to as a result of issuing insurance contracts.

6. Since January 2014, the IASB has been deliberating issues raised in its third consultation document, a revised Exposure Draft issued in June 2013. The 2013 Exposure Draft *Insurance Contracts* builds on the proposals previously set out in:

(a) the Discussion Paper *Preliminary Views on Insurance Contracts*, published in May 2007, which explained the IASB's initial views on insurance contracts; and

(b) the Exposure Draft *Insurance Contracts*, published in July 2010, which developed those initial views into a draft Standard.

7. The 2013 Exposure Draft sought input on only five proposals, but contained a complete draft of the proposed Standard on insurance contracts so that interested parties could consider the proposals in context. The reason for seeking limited input was to avoid revisiting issues that the IASB had previously rejected or reconsider consequences it has previously considered. The IASB also sought input on whether the costs of implementing the proposed Standard would be justified by the benefits of the information provided overall.

8. As at the beginning of 2015, the IASB is nearing the end of its project on insurance contracts. In its deliberations, the IASB has sought to balance many diverse views and develop an approach that provides useful financial information and that can be applied in all jurisdictions that apply IFRS.

9. So far, the IASB has completed its discussions on the model for insurance contracts without participation features. The IASB also made tentative decisions on some issues that were not targeted in the 2013 Exposure Draft.

10. However, the IASB has not made any tentative decisions on the application of the general model to contracts with participation features. Instead, the IASB has held several education sessions during which the IASB directed the staff in developing proposals for the application of the general model to contracts with participation features.

11. From those education sessions, the staff have identified three key issues that the proposals for contracts with participation features must address:

(a) If and how the contractual service margin should be adjusted to reflect changes in entity's share of underlying items. This is discussed in Agenda Paper 2A.

(b) How to determine interest expense in profit or loss. This is discussed in Agenda Paper 2B.

(c) How the amounts in the contractual service margin should be allocated to the profit or loss as the entity provides services to the policyholder This is discussed in Agenda Paper 2C.

12. During one of those education sessions, in November 2014, representatives of the European CFO Forum presented an alternative proposal they had put to the IASB for accounting for contracts with participation features. That proposal is described fully in Agenda paper 2 *Insurance Contracts: Cover note* of the November 20134 IASB meeting, and summarised in paragraph 13.

Summary of the proposal from the European CFO Forum

13. The CFO Forum have proposed a single measurement basis based on a single yield curve applied to all the cash flows in the contract, and options and guarantees to be treated in the same way as for other changes in fulfilment cash flows. As part of that model, the CFO Forum propose the following.

Reporting changes in the entity's share of returns on underlying items

(a) The contractual service margin represents all of the profits to be earned in the future from the provision of services under the participating contract. The CSM is unlocked for non-financial assumptions and financial assumptions, including those which are impacted by the change in value of the underlying assets and reinvestment assumptions.

Pattern for allocating the contractual service margin to profit or loss

(b) The CSM should be recognised in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of services that are provided under the contract. Therefore, the driver for the release of the CSM in the income statement is the nature of the services provided under the participating contract. Participating contracts oblige the entity to provide investment management services in addition to insurance coverage.

Presentation of interest expense in profit or loss

(c) A current portfolio book yield is used so that the interest expense on the liability is determined consistently with the investment return recognised in P&L on the underlying assets.

(d) An entity should be able to elect to present the effect of changes in the discount rate in OCI or in profit or loss as an accounting policy choice.

Scope

(e) The alternative proposal would apply to all contracts which provide policyholders with a right to receive, as a supplement to the guaranteed benefits, a variable return, either contractually or at the discretion of the issue. The variable return could be based upon one or more of the following:

(i) The performance of a specified pool of contracts or a specified type of contract;

(ii) Realised and/or unrealised investment returns on a specified pool of assets; or

(iii) The profit or loss of the company, fund or other entity that issues the contract.

(f) As the book yield and the fully unlocked CSM interact with each other, the same scope is required.

14. After the November 2015 education session, the staff sent follow-up questions that staff and Board members had identified relating to the CFO Forum's proposals. The CFO Forum's response to those questions is reproduced in Appendix B.

15. Agenda Papers 2B and 2C compare, at a high level, the staff proposals with the European CFO Forum approach.

Next steps

16. At this meeting, the IASB will continue to hold education sessions to consider the three issues outlined in paragraph 11.

17. The staff expect to continue discussions on contracts with participation features in the coming months. After the deliberations on the model for contracts with participation features have been completed, the staff expect to consider the mandatory effective date of the new insurance contracts Standard. Accordingly, the staff expect that the new Standard will not be published before the end of 2015.

Appendix A: Tentative decisions to date

A1. The following table presents a summary of tentative decisions made in the redeliberations phase in 2014 and 2015:

	Tentative decisions	Change from 2013 Exposure Draft
1	***Targeted issue: Unlocking the contractual service margin*** (a) Differences between the current and previous estimates of the present value of expected cash flows and the risk adjustment related to future coverage and other future services should be added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative. (b) Differences between the current and previous estimates of the present value of cash flows and the risk adjustment that do not relate to future coverage and other future services should be recognised immediately in profit or loss. (c) Favourable changes in estimates that arise after losses were previously recognised in profit or loss should be recognised in profit or loss to the extent that they reverse losses that related to coverage and other services to be provided in the future. (d) An entity should use the locked-in rate at inception of the contract for accreting interest and for determining the change in the present value of expected cash flows that offsets the contractual service margin.	The 2013 Exposure Draft would: • recognise all changes in estimates of risk adjustment immediately in profit or loss. • rebuild the contractual service margin from zero without first reversing previously recognised losses in the profit or loss.
2	***Targeted issue: Presentation of interest expense in the Statement of Comprehensive***	The 2013 Exposure Draft proposed

<table>
<tr><th></th><th>Tentative decisions</th><th>Change from 2013 Exposure Draft</th></tr>
<tr><td></td><td>Income
(a) An entity should choose to present the effect of changes in discount rates in profit or loss, or in other comprehensive income as its accounting policy and should apply that accounting policy to all contracts within a portfolio
(b) If the entity chooses to present the effect of changes in discount rates in other comprehensive income, the entity should:
(i) Recognise in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised; and
(ii) Recognise in other comprehensive income, the differences between the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date and the carrying amount of the insurance contract was initially recognised.
(iii) Disclose an analysis of total interest expense included in total comprehensive income disaggregated at a minimum to:
1. interest accretion at the discount rate that applied at initial recognition of insurance contracts reported in profit or loss for the period; and
2. the movement in other comprehensive income for the period.
(c) An entity should disaggregate total interest expense included in total</td><td>that the effect of changes in discount rates should be required to be presented in OCI.</td></tr>
</table>

	Tentative decisions	Change from 2013 Exposure Draft
	comprehensive income to: (i) the amount of interest accretion determined using current discount rates; (ii) the effect on the measurement of the insurance contract of changes in discount rates in the period; and (iii) the difference between the present value of changes in expected cash flows that adjust the contractual service margin in a reporting period when measured using discount rates that applied on initial recognition of insurance contracts, and the present value of changes in expected cash flows that adjust the contractual service margin when measured at current rates. (d) For contracts without participation features, an entity should use the locked-in rate at inception of the contract for accreting interest and for determining the change in the present value of expected cash flows that offsets the contractual service margin. (e) An entity should apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to changes in accounting policy relating to the presentation of the effect of changes in discount rates.	
3	***Targeted issue: Insurance contracts revenue*** (a) An entity should present insurance contract revenue and expense in the statement of comprehensive income, as proposed in paragraphs 56–59 and B88–B91 of the	The 2013 Exposure Draft did not explicitly prohibit presenting premium information in the

	Tentative decisions	Change from 2013 Exposure Draft
	2013 Exposure Draft; and (b) An entity should disclose the following: (i) a reconciliation that separately reconciles the opening and closing balances of the components of the insurance contract asset or liability (paragraph 76 of the 2013 Exposure Draft); (ii) a reconciliation from the premiums received in the period to the insurance contract revenue in the period (paragraph 79 of the 2013 Exposure Draft); (iii) the inputs used when determining the insurance contract revenue that is recognised in the period (paragraph 81(a) of the 2013 Exposure Draft); and (iv) the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position (paragraph 81(b) of the 2013 Exposure Draft). (c) An entity should be prohibited from presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue.	statement of comprehensive income if that information is not consistent with commonly understood notions of revenue.
4	**Targeted issue: Transition** **(for contracts without participation features)** (a) an entity should apply the Standard retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors unless impracticable; and	For contracts without participation features: • Simplified the practical expedients when retrospective application in accordance with

<table>
<tr><th>Tentative decisions</th><th>Change from 2013 Exposure Draft</th></tr>
<tr><td>(b) if retrospective application of the Standard is impracticable, an entity should apply the simplified approach proposed in paragraphs C5 and C6 of the 2013 Exposure Draft with the following modification: instead of estimating the risk adjustment at the date of initial recognition as the risk adjustment at the beginning of the earliest period presented, an entity should estimate the risk adjustment at the date of initial recognition by adjusting the risk adjustment at the beginning of the earliest period presented by the assumed release of the risk before the beginning of the earliest period presented. The assumed release of risk should be determined by reference to release of risk for similar insurance contracts that the entity issues at the beginning of the earliest period presented.

(c) if the simplified approach described in paragraph (b) above is impracticable, an entity should:

(i) determine the contractual service margin at the beginning of the earliest period presented as the difference between the fair value of the insurance contract at that date and the fulfilment cash flows measured at that date; and

(ii) determine interest expense in profit or loss, and the related amount of other comprehensive income accumulated in equity, by estimating the discount rate at the date of initial recognition using the method in the simplified approach proposed in paragraph C6(c) and (d) the 2013 Exposure Draft.

(d) for each period presented for which there are contracts that were measured in accordance with the simplified approach or the fair value approach, an entity</td><td>IAS 8 is impracticable.

• In addition, added a way for the entity to estimate the contractual service margin on transition when neither retrospective application nor the simplified approach are impracticable.

For initial application of the new standard after implementation of IFRS 9, the 2013 Exposure Draft did not allow or require an entity to reassess the business model for financial assets at the date of initial application of the new insurance contracts Standard.</td></tr>
</table>

Tentative decisions	Change from 2013 Exposure Draft
should disclose the information proposed in paragraph C8 of the 2013 Exposure Draft (ie the disclosures for contracts for which retrospective application is impracticable) separately for: (i) contracts measured using the simplified approach; and (ii) contracts measured using the fair value approach. **(On initial application of the new insurance contracts Standard after implementation of IFRS 9 Financial Instruments)** (a) An entity is permitted to newly designate financial assets under the fair value option as measured at fair value through profit or loss to eliminate (or significantly reduce) an accounting mismatch according to paragraph 4.1.5 of IFRS 9; (b) An entity is required to revoke previous fair value option designations for financial assets if the accounting mismatch that led to the previous designation according to paragraph 4.1.5 of IFRS 9 no longer exists; and (c) An entity is permitted to newly designate an investment in an equity instrument as measured at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9 and is permitted to revoke previous designations. (d) To provide further transition relief to permit or require an entity to reassess the business model for financial assets at the date of initial application of the new insurance contracts Standard. This reassessment would be based on the conditions for assessing the business model in paragraphs 4.1.2(a) or 4.1.2A(a) of IFRS 9 and the	

	Tentative decisions	Change from 2013 Exposure Draft
	facts and circumstances that exist at the date of the first application of the new insurance contracts Standard.	
5	***Non-targeted issue: Level of aggregation and portfolio definition*** (a) Clarify that the objective of the proposed insurance contracts Standard is to provide principles for the measurement of an individual insurance contract, but that in applying the Standard an entity could aggregate insurance contracts provided that it meets that objective. (b) Amend the definition of a portfolio of insurance contracts to be: "insurance contracts that provide coverage for similar risks and are managed together as a single pool". (c) Add guidance to explain that in determining the contractual service margin or loss at initial recognition, an entity should not aggregate onerous contracts with profit-making contracts. An entity should consider the facts and circumstances to determine whether a contract is onerous at initial recognition.	The definition of a portfolio in the 2013 Exposure Draft is modified to eliminate the reference to "priced similarly relative to the risk taken on". The definition of portfolio now applies more narrowly than the 2013 Exposure Draft. Added additional guidance and clarification
6	***Non-targeted issue: Discount rate for long-term contracts when there is little or no observable market data*** (a) Confirm the principle that the discount rates used to adjust the cash flows in an insurance contract for the time value of money should be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract.	Added clarification of how the principle should be applied in determining discount rates for insurance contracts.

	Tentative decisions	Change from 2013 Exposure Draft
	(b) Provide additional application guidance that, in determining those discount rates, an entity should use judgement to: (i) ensure that appropriate adjustments are made to observable inputs to accommodate any differences between observed transactions and the insurance contracts being measured. (ii) develop any unobservable inputs using the best information available in the circumstances, while remaining consistent with the objective of reflecting how market participants assess those inputs. Accordingly any unobservable inputs should not contradict any available and relevant market data.	
7	***Non-targeted issue: Asymmetric treatment of contractual service margin between insurance contracts issued and reinsurance contracts held*** (a) After inception, an entity should recognise in profit or loss any changes in estimates of fulfilment cash flows for a reinsurance contract that an entity holds when those changes arise as a result of changes in estimates of fulfilment cash flows for an underlying direct insurance contract that are recognised immediately in profit or loss.	The 2013 Exposure Draft proposed that, for a reinsurance contract that an entity holds, all changes in estimates of fulfilment cash flows relating to future service should be recognised and offset to the contractual service margin
8	***Non-targeted issue: Allocation of the contractual service margin to the profit or loss*** ***(for contracts without participation features)*** (a) Confirm the principle in the 2013 Exposure Draft that an entity should recognise the remaining contractual service margin in profit or loss over the coverage period	The 2013 Exposure Draft stated only that an entity should recognise the remaining contractual service margin in profit or loss over the coverage period in the systematic way that

	Tentative decisions	Change from 2013 Exposure Draft
	in the systematic way that best reflects the remaining transfer of the services that are provided under an insurance contract. (b) Clarify that, for contracts without participation features, the service represented by the contractual service margin is insurance coverage that: (i) is provided on the basis of the passage of time; and (ii) reflects the expected number of contracts in force.	best reflects the remaining transfer of the services that are provided under an insurance contract.
9	***Non-targeted issue: Significant insurance risk*** (a) Clarify the guidance in paragraph B19 of the 2013 Exposure Draft that significant insurance risk only occurs when there is a possibility that an issuer will incur a loss on a present value basis.	The 2013 Exposure Draft referred more specifically to the need for a scenario with commercial substance in which the present value of the net cash outflows can exceed the present value of the premiums.
10	***Non-targeted issue: Portfolio transfers and business combinations*** (a) Clarify the requirements for the contracts acquired through a portfolio transfer or a business combination in paragraphs 43-45 of the 2013 Exposure Draft, that such contracts should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or business combination.	Clarification of requirements in the 2013 Exposure Draft to avoid difference in interpretation.
11	***Non-targeted issue: Fixed fee service contracts*** (a) Entities should be permitted, but not required, to apply the revenue recognition	The 2013 Exposure Draft excluded all fixed fee service contracts from

	Tentative decisions	Change from 2013 Exposure Draft
	Standard to the fixed-fee service contracts that meet the criteria stated in paragraph 7(e) of the 2013 Exposure Draft.	its scope.
12	***Non-targeted issue: Premium-allocation approach*** (a) Clarify that when an entity applies the premium-allocation approach to account for an insurance contract, it should recognise insurance contract revenue in profit or loss: (i) on the basis of the passage of time; but (ii) if the expected pattern of release of risk differs significantly from the passage of time, then on the basis of expected timing of incurred claims and benefits. (b) When an entity applies the premium-allocation approach to contracts for which the entity: (i) discounts the liability for incurred claims; and (ii) chooses to present the effect of changes in discount rates in OCI; the interest expense in profit or loss for the liability for incurred claims should be determined using the discount rate that is locked in at the date the liability for incurred claims is recognised. This tentative decision also applies to the presentation of interest expense for any onerous contract liability that is recognised when the entity applies the premium-allocation approach.	The 2013 Exposure Draft required that an entity should allocate the expected premium receipts as insurance contract revenue to each accounting period in the systematic way that best reflects the transfer of services that are provided under the contract. The 2013 Exposure Draft required that interest expense on insurance liabilities should be determined using the discount rates that applied at the date that the contract was initially recognised.

	Tentative decisions	Change from 2013 Exposure Draft
13	***Non-targeted Issues that will not be addressed*** (a) In April 2014 the IASB tentatively decided not to consider in future meetings other non-targeted issues, including those relating to: (i) disclosures; (ii) combination of insurance contracts; (iii) contract boundary for specific contracts; (iv) unbundling—lapse together criteria; (v) treatment of ceding commissions; (vi) discount rate—top-down and bottom-up approaches; (vii) tax included in the measurement; and (viii) combining the contractual service margin with other comprehensive income.	None

Appendix C: Response of the European CFO Forum to follow up questions from the November 2014 education session

A2. The following pages contain the response of the European CFO Forum to follow up questions that staff and Board members had identified relating to the CFO Forum's proposals presented during an education session in November 2014.

Appendix: Responses to the IASB Questions

IASB question	Proposed response
What amounts adjust the margin? (paragraphs 54-72) *The CFO Forum proposes that there should be full unlocking of the CSM for all assumption changes that impact expected future profits, including financial assumptions which are impacted by the change in value of the underlying assets and reinvestment assumptions.*	
1. The proposals rely on the identification of underlying items. We have questions about what the underlying items are:	
a. An insurance contract could be index-linked. If the insurer invests in assets that are not the index, are the underlying assets: i. the index; ii. the assets purchased that are not the index, if they are purchased with the intent of replicating the index; or iii. the assets purchased that are not the index, if they are not purchased with the intent of replicating the index, for example to generate additional returns for the insurer?	For index-linked contracts within the scope of the Alternative Proposal, the underlying assets for these policies are the assets actually held by the insurer to back these policies. If the assets actually held are not exactly the same as the reference index, this would not impact the "underlying assets": these are always the assets actually held by the insurer. However, the determination of the fulfilment cash flows will continue to be based on the amounts that are actually allocated to policyholders, which will reference to the relevant assets for the participation (irrespective of the assets actually held). This difference fairly represents the economic mismatch that results from investing in assets different from the reference assets.
b. When contracts are backed by general funds (ie not segregated pool of assets), are these considered to be within the proposal, and if so, what are the underlying items?	If these contracts meet the criteria set out in the CFO Forum Paper presented to the IASB in November 2014, then these contracts would be considered within the Alternative Proposal. Accordingly, the model would apply to contracts that are backed by general funds such as universal life type contracts. This also holds true if a pool of underlying items back several portfolios. In such cases, the underlying assets would be those assets identified by the insurer as backing these policies. As noted in the November 2014 paper: *69. For participating contracts there is a pool of underlying assets which are used to determine the fulfilment cash flows on day one. These assets are also used for determination of the day one CSM and the subsequent unlocking of the CSM. Adjusting the CSM will refer to this existing information about which underlying items relate to the contract. When benefits to policyholders are asset dependent, (expected) returns on these assets have to be used for a traceable cash flow projection. Typically, insurers hold these assets on their books (often they are required by regulation). The assets used to determine the unlocking of the CSM are the same as those that are used for the projection of the fulfilment cash flows. For some types of participating contracts the*

Appendix: Responses to the IASB Questions

IASB question	Proposed response
	underlying assets may be mixed with assets from other insurance contracts (for example in general account portfolios). It is not necessary for assets to be legally ring-fenced for the insurer to identify the relevant underlying assets. Insurers usually separately track returns attributable to policyholders and such information will already be required for determination of the fulfilment cash flows.
c. If an entity uses derivatives to hedge the interest rate exposure from participating contracts, but the policyholder does not participate in the gains and losses on the derivatives (eg the regulator does not allow the derivative to be part of segregated pool), should the derivative be considered to be part of the underlying items?	If derivatives are not part of the pool of underlying items in which the policyholder shares in returns, but are held by the insurer in the context of its risk management, the CFO Forum believes that these derivatives should be deemed to form part of the underlying items. This is because these derivatives are an integral part of the asset liability management of the insurer and impact the (expected) profit of the insurer and, therefore, should equally impact the accounting for OCI and the CSM. Deeming such risk management instruments as underlying items allows the instruments to be considered consistently with derivatives providing the same economic relationship but already considered to be part of the underlying assets. While these instruments may not meet the current criteria defining underlying items, following this approach would lead to a more consistent treatment of economically similar situations and most importantly, reflect the reality of how insurers manage risk. In order to address potential IASB concerns that the Alternative Proposal would implicitly allow an insurer being inappropriately able to apply hedge accounting without restriction, The CFO Forum would be open to discussing additional guidelines to be applied before being able to include risk management derivatives in the underlying items. These additional guidelines could be based on the IASB's hedging designation and documentation guidelines in IFRS 9 and could include the following formal designation and documentation criteria: • Risk management objective and strategy • The risk item (a liability or portion of a liability that exposes the insurer to risk) • Risk management instrument(s) used to manage the exposure to risk • Nature of the risk being managed • Description of the accounting mismatch being addressed We note that IFRS 9 hedge accounting can and will be applied when possible but that, given the nature of insurance risk, this will not be sufficiently possible and, therefore, the impact of derivatives must be addressed (also) in IFRS 4 as set out above. By considering hedging derivatives as part of the underlying items, as described above, accounting mismatches would be avoided in most instances.
2. Assuming the entity has discretion to change the amounts credited/paid to the policyholder, the entity may choose in some periods to credit amounts to the	The CSM is the expected future profits on the portfolio as at the reporting date. When the amounts credited or paid to policyholders were to impact those expected future profits then the CSM should be updated to reflect this current assumptions.

Appendix: Responses to the IASB Questions

IASB question	Proposed response
policyholder that exceed the returns earned on the underlying items held in those periods. Should changes in these expected amounts adjust the margin and why?	
3. How would an entity distinguish between changes in value of underlying items that are: a. earned for past/current services, and therefore should be recognised in profit or loss; and b. earned for services to be delivered in the future and should therefore be adjusted against the margin? In other words, how does an entity distinguish between future changes and 'experience gains and losses'?	Under the Alternative proposal, all changes in value of underlying items are reflected in the CSM to the extent that these affect the expected profitability of the contract. Subsequently, the CSM is then recognised in the P&L for the current period in line with the provision of services. Whilst this would require a distinction between services rendered and future services, this would need to be ascertained for the IASB's proposals as well as for the Alternative Proposal. Fortunately, Insurers already currently distinguish between experience variances and changes in future expectations in their embedded value reporting and/or in their GAAP reporting. We would expect insurers to continue to utilise this consistent methodology.
4. At the November education session, the CFO Forum representatives indicated that applying the alternate model would result in a different balance sheet liability, and consequently different equity value, dependent on what presentation choice an entity made in regard to using or not using OCI. The consequence is that the choice of OCI is both a presentation and a measurement choice. a. Was this the intent of the CFO Forum? b. Do you believe that this is consistent with a single insurance contracts model, or is this in fact the creation of a second model, with different outcomes? c. Given this change in measurement outcome, the IASB's objective of retaining consistency of balance sheet measurement will no longer be achieved. Consequently, it would likely be necessary for the IASB to more clearly define which presentation/measurement model is applicable in specified circumstances. Have you considered how this can be achieved?	A different balance sheet liability and equity balance may be appropriate depending on the insurer's business model but as we understand the IASB is concerned that the CSM (and therefore the equity/liabilities balance) would differ for the same insurance product under these two approaches, we believe this would be resolved with the change explained below. We believe that there may be misinterpretations on the number, type and significance of the differences in equity/liabilities between those using or not using OCI. We believe that, under the application of the Alternative Proposal that aside from the potential movement in TVOG (see response to question #9), the main difference in equity/liabilities may result from the different interest accretion rates for the CSM (book yield versus current rate). For this potential difference the CFO Forum proposes that the CSM be treated consistently with the elements or components of the other insurance liabilities on the balance sheet and be re-measured for balance sheet purposes at the current rate. Under the FVOCI approach, the difference arising from using the current rate and the book yield is recognised in OCI. Re-measuring the CSM using the current rate will reduce the differences between the CSM under the FVPL and FVOCI approaches. Although this may significantly reduce the net balance reported in OCI, the use of OCI remains a critical element of the Alternative Proposal. Furthermore, the use of OCI will also be a critical element to maintain consistency with the accounting for non-participating contracts. Under these proposals, the different classifications for the underlying assets accounted for under IFRS 9 will

Appendix: Responses to the IASB Questions

IASB question	Proposed response
	not impact the CSM balance. If the CSM should become negative then the OCI movements related to the CSM should be recycled to P&L in addition to the negative CSM balance.
5. The term reinvestment assumption or reinvestment risk appears throughout the document. It is unclear what these terms mean. In a participating contract, the policyholder participates in reinvestment risk to the extent of its participation. Therefore, presumably reinvestment risk only exists on a net basis to the extent that the insurer has retained the risk, either through the shareholders' share of returns, or because of the guarantees. Does reinvestment risk refer to this retained risk?	Reinvestment risk refers to the full risk of having to reinvest in assets when the liability duration is longer than the duration of existing assets. The asset returns at that time will likely be different to those on existing assets and, therefore, the insurer is exposed to risk and needs to set an assumption for the expected investment return upon reinvestment. Part of this risk is assumed by the policyholder through the participation mechanism. The remainder is borne by the shareholder.
6. The IASB's objective for the unit of account for the proposed insurance contracts standard is to provide principles for the measurement of an individual insurance contract. However, in applying the standard, an entity could aggregate insurance contracts provided that it meets that objective. A key feature of that objective is that the CSM relating to a contract is fully recognised in profit or loss when the contract has been fulfilled. The IASB's intent is that the accounting would show when one group of contracts are loss-making, and another group of contracts are profitable. Paragraphs 58-59 of the paper state that the CSM should be determined at a portfolio level. Paragraph 58 further makes the statement that if the margin was exhausted, further losses would be presented in profit or loss. However, it was apparent from answers provided to our questions that, for example, if an entity had written contracts before 2008 and those contracts are now loss-	The Alternative Proposal's definition of a portfolio includes groups of contracts which share risk characteristics and are managed in the same way by the insurer. For participating contracts, this includes policies which also pool investments and the return on these assets is shared amongst current policyholders, future policyholders and shareholders. Insurance contracts are managed by the insurer through the concept of pooling of risk and returns at a portfolio level. These portfolios often include natural offsetting of risks within the portfolio. Companies may also economically hedge exposures at a portfolio level, rather than at a contract by contract level. Further, many participating contracts include features where the policyholder's investment is pooled with the investments of other policyholders in the portfolio and the return on the underlying assets is shared. The mechanism for this pooling of returns is often determined by the nature of the contract terms, the structure of the company and the regulations applying to the contract. When policyholders enter into the contract, it will usually be set out in the terms of the policy that the policyholder's money will be combined with the money of other policyholders and this combined pool of funds invested in the underlying investments. Often the pool of assets will combine funds from previous policyholders in addition to current policyholders. The policyholder receives its participation from a share in

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making, those losses could be offset with the CSM for new contracts written since 2008. Do you agree this would be the case? When will the CSM be fully released to profit or loss? How would you define portfolio?	the overall return of the undivided assets. This profit sharing is inter-generational between policyholders which results in sharing of past and current returns together with current and future policyholders. This intergenerational sharing also exists for policies where the insurer has discretion over the returns to credit to the policyholder, the insurer distributes these returns between contracts over different generations. As a result, returns on the assets at a point in time are pooled with earlier or expected future profits from previous or subsequent policyholders, thus providing a more consistent return to policyholders year on year. The determination of the cash flows and the assumptions used in measuring the insurance contract liability for such policies will be at a portfolio level, reflecting the nature and economics of the way the policies are managed. It would be inconsistent to measure the CSM from these products as a lower level. The policyholder does not receive its share in the returns until the point that the profits are determined for each policyholder from the overall return from the pool of investments. Similarly, the shareholder receives its compensation in the same form as the policyholder when the sharing of profits is determined. This means that the shareholders' compensation follows the same inter-generational sharing, where losses from one year can be offset with profits from future years under the terms of the contracts in the portfolio. This broader portfolio interpretation of the IASB's definition of a portfolio would also result in a consistent interpretation and application of the unit of account in determining cash flows, best estimate liability, CSM and other aspects of the insurance contracts. While the portfolio is open for the addition of future policies in future periods, the portfolio utilised to calculate best estimate liability, CSM, etc. will only include actual policies in force at the measurement date; it will not include future policies. Thus, this portfolio definition will not affect the contracts boundaries. The CSM expires in line with the transfer of services relating to the policies existing at the time of valuation. Consideration has been given to the treatment of CSM generated by new business, that is, business written since the last reporting date. Whilst such CSM on new business would already be separately disclosed under the proposals presented in the November meeting, it has been suggested that for new business CSM should be considered separately. Where this CSM is positive, this CSM on the new business polices is added to the CSM on the existing portfolio (assuming the appropriate portfolio-defining characteristics have been met). If, after establishing the appropriate unit of account (as discussed above) the new business CSM is negative this loss could be recognised immediately in the P&L in the period in which it was written. Once the negative day 1 CSM for this new business has been recognised in profit or loss, these policies would then be added to the existing portfolio (for which they qualify) with a zero CSM. Any subsequent gains or losses will be included in the calculation of the CSM for the wider portfolio.

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	This mechanism for recognising these negative CSM new contracts, by portfolio by reporting period, is more complex (conceptually and in processes required to track these contracts) and is not consistent with the principle of mutualisation and pooling of risk, but the CFO Forum is willing to discuss this potential interpretation to address the IASB's concerns about losses on new business. Furthermore, CSM note disclosures in our Alternative Proposal would disclose the movements in the CSM balance during the period which would include the amount of CSM added for new policies and the amount of CSM released for services rendered/expired contracts.
7. Do entities currently switch assets between reference portfolios, or between general portfolios and reference portfolios? If they do, is this done on a prospective basis, or a retrospective basis?	This practice does not occur frequently. If this does take place it should be accounted for on a prospective basis. Furthermore, in many jurisdictions, switching assets between reference portfolios or between reference portfolios and a general account will be subject to regulatory restrictions.
8. Is there a difference between (a) CSM being remeasured and (b) the CSM closing balance as the opening balance plus or minus the accretion of interest, adjustments and allocation? If so, what? And when?	Following the appropriate CSM allocation under the Alternative Proposal, there would be no difference between a) and b). The closing balance reflects the expected unearned profit on the contracts. The movement in the period reflects the recalculation of the expected unearned profit and the provision of service(s) in the period.
Options and Guarantees	
9. The proposal states that options and guarantees that are embedded in the insurance contract are treated consistently with other elements of the insurance liability. Where would the changes in the embedded options and guarantees be recognised (eg profit or loss, OCI or the margin)? At the November education session, it was apparent that the CFO Forum representatives had differences in views and would like to understand the different views.	Options and guarantees embedded in an insurance contract are comprised of two components: intrinsic value and the time value of the option and guarantee (TVOG). The value of all options and guarantees are considered in the determination of the BEL as are all other elements of the insurance liability. With regards to changes in TVOG, there is a strong consensus that they should not be mandatorily recorded in profit or loss. The CFO Forum has also agreed that TVOG changes should be reported consistently in one location but this location cannot be finalised until the discussion over the related issues have been resolved (eg. unit of account, how and for what the CSM may be unlocked, etc.).

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	In discussions as to where TVOG changes should be recorded, the following was noted with regards to reporting TVOG in OCI or CSM:

TVOG changes in:	Observations
CSM	Would treat TVOG changes consistent with the intrinsic value and other elements of the liability measurement. However, unknowns regarding how CSM unlocking and unit of account will be applied by the IASB means this approach may or may not result in meaningful performance reporting.
OCI	TVOG changes are considered to be “temporary noise” and are consistently reported in OCI much like changes in discount rates. However, while P&L reporting may be improved, this approach results in volatility in shareholders’ equity and is not considered appropriate for the FVPL approach.

IASB question	Proposed response
10. How would the changes in embedded options and guarantees be measured?	All options and guarantees would be reflected in the balance sheet at current fulfilment value.
11. What information would be provided in the primary financial statements when the entity expects the guarantees will be in the money?	The value of all options and guarantees, including both intrinsic value and time value, is reflected in the balance sheet at current fulfilment value. As a result, the Alternative Proposal ensures that all changes in the value of options and guarantees are fully transparent.

How does an entity determine how much of the CSM is allocated in period? (paragraphs 73-89)

The CFO Forum proposals would allocate the CSM in a way that reflects the service provided by a contract.

IASB question	Proposed response
12. What constitutes service in a participating contract? The paper mentions only insurance and investment management service. Are any of the following service: a. Provision of a guaranteed minimum return? b. The returns from a financial instrument embedded in a contract that includes service?	As noted in the November paper presented at the IASB Board meeting: 56. We believe that the determination of the CSM on day one under the Alternative Proposal is consistent with the general approach under the 2013 ED. On subsequent measurement, in the Alternative Proposal the CSM is unlocked in a manner that ensures it is measured consistently with the day one calculation. As such, we believe that the Alternative Approach’s subsequent measurement is consistent with the 2013 ED’s day one calculation instead of the 2013 ED’s subsequent measurement basis. 74. For non-participating contracts the main services include insurance coverage and

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	administering the contract. For participating contracts, the additional service provided is asset management services because the policyholder benefits from investment returns realised by the insurer based on their premiums. Participating contracts therefore oblige the entity to provide asset management services in addition to insurance coverage and administering the contract. As such, these factors are considered in the Day 1 calculation, to maintain consistency, they would continue to be measured in CSM for all subsequent periods. Asset management services, as noted in November paper, are a main service provided under participating contracts. We believe the asset management services provided under participating contracts are comprised of a package of several components, including the initial investment itself, holding and selling assets, asset-liability management and provision of guaranteed minimum returns.
13. At the November education session, the CFO Forum representatives indicated that the allocation of the contractual service margin should not be on a predominant component basis, but should reflect the different weights of different drivers of service. What guidance could be added to ensure that there is comparability between similar service delivered by different contracts and by different entities?	The Alternative Proposal does not alter the drivers of services set out in the IASB's Exposure Draft. If additional guidance is required, the CFO Forum would be open to discussing potential additional guidance which may include the weighting of significant drivers of the services as well as practical expedients such as applying a predominant driver when all other service drivers are not significant.
Scope (paragraphs 104-113)	
14. How would you interpret the phrase "substantial share of total return on underlying items"? Is this to be considered: a. Over the whole of the contract life? b. On an expected basis? c. On another basis?	The Alternative Proposal considers, at inception, the assessment of policyholder participation in underlying items to be over the whole life on an expected basis.
15. Would the CFO Forum's proposed model apply to contracts in which the entity credits amounts to policyholders and the amounts credited are determined	Yes, the Alternative Proposal would apply in such situations. Insurers already identify assets underlying portfolios and thus would continue to utilise this identified

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IASB question	Proposed response
based on the entity's general funds, but subject to the entity's discretion. Does the answer change if the same underlying items back several portfolios? [Refer to question b]	underlying pool of assets in the calculations.
16. Paragraph 22 suggests that participating contracts include contracts backed with assets that the entity does not hold. It was unclear during the discussions at the November Board meeting whether this was the intention of the paragraph. Is it in fact the case that this proposal includes contracts backed with assets the entity does not hold?	While insurers generally hold the reference assets for the participating contract, there may be situations where the insurer does not hold these exact same reference assets. In such situations, where the participating contract meets the criteria for the Alternative Proposal, they would still be subject to the Alternative Proposal. As noted in our response to Question 1a, the underlying assets for policies are the assets actually held by the insurer to back these policies. If the assets actually held are not exactly the same as the reference assets, this would not impact the "underlying assets": these are always the assets actually held by the insurer. However, the determination of the fulfilment cash flows will continue to be based on the amounts that are actually allocated to policyholders, which will reference to the relevant assets for the participation (irrespective of the assets actually held).
17. When an entity invests in assets other than the assets used as a basis for the promise to the policyholder, there could be a difference in CSM determined on day 1, because of the difference between the rate used to project the return on the invested assets and the rate used to discount the liability cash flows (which would reflect the promised return only). Do you agree this would be the case? How do you explain the day 1 difference? In this circumstance, and assuming the insurer has some choice as which assets are held to back the liability (but has elected an ALM strategic outside of that choice), how would the asset values, and changes therein, be determined?	The rate used to discount the liability is determined as described in the response to Question #21 which would be the current rate (derived either top down or bottom up, reflecting the risk free rate and illiquidity). We would not expect a significant difference between this rate and the rate used to project the rate of return at the inception of a contract. A day one difference between current rate at inception and book yield will be present where existing assets are used to back new policies, this will result in a day 1 OCI. This is inherently a result of the mutualisation effect between generations of policyholders and, therefore, this difference should be explained rather than eliminated on inception. We do note that this OCI on the liability would be compensated by OCI on the asset portfolio.
18. In some parts of the world, interest rates have fallen significantly since some insurance contracts were written, and this means that market returns are not expected to increase above the minimum guaranteed rate for the remaining duration of the contracts. In such	As is the case under the current IFRS 4, once a contract has been assessed as an insurance contract, it is not re-assessed at subsequent measurement dates even if the level of insurance risk has changed. Likewise, for contracts under the Alternative Proposal, once an insurance contract is included in the Alternative Proposal, it is not assessed at subsequent measurement dates to determine if it still meets the scope requirements.

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IASB question	Proposed response
cases, the amounts paid to the policyholder are no longer expected to vary with underlying items. Should such contracts still be accounted for using the model for participating contracts? Why?	The measurement of such contract would be reflected in the accounting provisions set out in the Alternative Proposal.
Presentation of interest expense in profit or loss	
19. There is no mention in the paper of risk-neutral valuations of the fulfilment cash flows, in which a risk-neutral curve is used to discount risk-neutral cash flows. What is the book yield when risk-neutral valuation is used? Does it result in a different amount than if real-world valuation is used?	The book yield would represent the interest rate on the underlying debt instruments, adjusted for both expected and unexpected credit risk. The credit risk adjustment in the book yield would be the same as the credit risk adjustment that is applied in the determination of the current interest rate used for determining the insurance liabilities in the balance sheet. This current rate could be determined using the top down or bottom up approach.
20. For bonds accounted for at amortised cost and FVOCI, how is impairment loss accounted for in the book yield?	As noted above, the CFO Forum would clarify that the Alternative Proposal's book yield is the yield on existing assets adjusted for impairment risk by adjusting for expected and unexpected credit losses. This is the same method employed to determine the current rate used in liability measurement. Any actual impairments recognised in accordance with IFRS 9. This may result in some differences between the impairments (credit losses) recognised in the measurement of the financial instrument and those recognised in the book yield rate for the liability. We believe that this difference is an inherent consequence of the accounting requirements in IFRS 9.
21. How is the book yield calculated when: a. the general fund assets back both participating and non-participating contracts? b. The policyholder participates in the overall profit or loss of the entity issuing the contract?	See our response for Question #20 above with regards to how the book yield is proposed to be calculated using the same method employed to determine the current rate used in liability measurement. In determining the underlying assets to calculate this book yield, for participating contracts, there is a pool of underlying assets which are used to determine the fulfilment cash flows at contract inception and on subsequent measurement. Determination of the book yield will refer to this existing information about which underlying items relate to the contract. When benefits to the policyholders are asset dependent, expected returns on these assets already have to be used for a traceable cash flow projection. We note that for some types of participating contracts the underlying assets may be mixed with assets from other insurance contracts (for example in general account portfolios) or the profit or loss of the entity issuing the contract. It is not necessary for assets to be legally ring-fenced for the insurer to identify the relevant underlying assets. Insurers usually separately track returns attributable to policyholders and such information will already be required for determination of the fulfilment cash flows

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IASB question	Proposed response
	On the basis of simplicity the current discount rate should be used as a practical expedient for all non-debt securities
22. The CFO Forum paper acknowledges that there may be a day-one effect from applying book yield. Could you explain how this effect would be accounted for?	As noted in question 17 above, a day one difference between current rate at inception and book yield will be present where existing assets are used to back new policies, this will result in a day 1 OCI. This is inherently a result of the mutualisation effect between generations of policyholders and, therefore, this difference should be explained rather than eliminated on inception. It should be noted that the existing assets that are used to back new policies would also have an existing OCI that would compensate the day-1 OCI on the liability.
23. Given that the book yield approach would not result in accounting mismatches between assets carried at FVPL and insurance liabilities, what would be the benefit of permitting an accounting policy choice between presenting the effects of changes in discount rate in profit or loss or OCI?	The CFO Forum strongly believes that there must be a choice between presenting the effects of changes in discount rate in P&L or in OCI. This option is needed for several reasons; for example, some assets are not reported at FVPL. For example, in some territories, assets may be managed on a cost basis. When assets are accounted for at amortised cost or FVOCI, the OCI option is needed. Furthermore, for some products, it may be most appropriate to report short term fluctuations in interest rates in OCI in order to produce meaningful performance reporting in the P&L and reflect how the assets are managed. Thus, even if net income and shareholders' equity are the same under the FVPL and FVOCI approaches, the individual components are presented differently, which provides relevant information on how the business and assets/liabilities are managed.
24. Given that the net effect of changes in interest rates on the shareholders' share would be adjusted against the contractual service margin in the CFO Forum proposals, what would be the advantage of permitting an accounting policy choice between presenting the effects of changes in discount rate in profit or loss or OCI?	See response in #23 above.
25. At the November education session, some CFO Forum representatives suggested that a loss recognition test would be necessary or desirable. Is this the view of the	We believe that there is a misunderstanding here. The CFO Forum does not propose a loss recognition test as is currently required in IFRS 4. Such test would not be relevant under the Alternative Proposal.

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IASB question	Proposed response
CFO Forum, and if so, how would such a test be constructed?	However, we do agree that a CSM that has become negative at the portfolio level must be recognised in the P&L (including the recycling of any related OCI under the FVOCI approach). This ensures that losses are recognised when appropriate and is sometimes referred to as an alternative loss recognition test. In addition, consideration has been given to the treatment of CSM generated by new business, that is, business written since the last reporting date. The new business CSM should be determined separately. Where this CSM is positive, this CSM on the new business polices is added to the CSM on the existing portfolio (assuming the appropriate portfolio-defining characteristics have been met). Also as noted in our November paper, the CSM on new business would be disclosed in the rollforward of the CSM. Where the new business CSM is negative, this loss could be recognised immediately in the P&L in the period in which it was written. Once the negative day 1 CSM for this new business has been recognised in profit or loss, these policies would then be added to the existing portfolio (for which they qualify) with a zero CSM. Any subsequent gains or losses will be included in the calculation of the CSM for the wider portfolio.