

STAFF PAPER

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IASB Meeting

Project	Insurance contracts		
Paper topic	Changes in the carrying amount of the contractual service margin for insurance contracts without direct participation features		
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Purpose of this paper

1. This paper considers whether the insurance contract Standard should give further guidance on changes in the carrying amount of the contractual service margin for insurance contracts without direct participation features, ie under the general model.

Staff recommendations

2. The staff recommends that the insurance contract Standard should provide guidance on what changes in the fulfilment cash flows relate to future service, and hence adjust the contractual service margin, and what changes relate to current and past service, and hence do not adjust the contractual service margin. The proposed revised text is set out in Appendix A.

Staff analysis

3. Under the general model, the contractual service margin is adjusted for changes in the fulfilment cash flows that relate to future service. The 2013 Exposure Draft included some guidance on what changes related to future service, and what changes related to current or past service (see Appendix A). During the staff discussions on the level of aggregation (see Agenda paper 2A); it has

become apparent that the guidance is not always clear. The problem is that the guidance in the ED describes some specific cases, but does not set out a general approach, beyond the overall objective.

4. The working draft included expanded guidance on the issue (see Appendix A), but subsequent staff discussions and comments on the working draft demonstrate that guidance also failed to lead to a clear common understanding of what changes would adjust the contractual service margin.
5. Appendix A includes revised proposed text on the distinction. The staff does not think that the text changes the substance of the requirements in the 2013 ED, which the Board confirmed in March 2014 (Agenda Paper 2A). In particular we do not think it changes the objective of distinguishing changes relating to future service from changes relating to current or past service. However, we think it provides a clearer structure to how that distinction should be made.
6. One aspect of the revised wording that may be regarded as an exception to the objective of distinguishing changes relating to future service from changes relating to current or past service, is when an event gives rise to an experience adjustment that causes a change in estimates of future cash flows. Following the objective may indicate that two effects (the experience adjustment and the change in future estimates) should not be combined. However, the staff thinks that recognising a gain or a loss in the current period knowing that there will be a consequential loss or gain in the future would not give a faithful representation of the single event. The proposed wording is consistent with the examples discussed in March 2014 Agenda Paper 2A.

Question 1. Changes in the carrying amount of the contractual service margin under the general model

Does the Board agree with the revised guidance set out in Appendix A?

Appendix A: Text on changes in the fulfilment cash flows that adjust the contractual service margin

2013 ED

Changes in current estimates of cash flows (paragraphs 30–31)

- B68 Paragraph 30 requires an adjustment to the remaining amount of the contractual service margin for a difference between the current and previous estimates of the cash flows that relate to future coverage and other future services. Accordingly:
- (a) the contractual service margin is not adjusted for changes in estimates of incurred claims, because these claims relate to past coverage. Such changes are recognised immediately in profit or loss.
 - (b) the contractual service margin is adjusted for experience differences that relate to future coverage; for example, if they relate to premiums for future coverage. The entity adjusts the margin for both the change in premiums and any resulting changes in future outflows.
 - (c) the contractual service margin is not adjusted for a delay or acceleration of repayments of investment components if the change in timing did not affect the cash flows relating to future services. For example, if an entity estimates that there will be a lower repayment in one period because of a corresponding higher repayment in a future period, the change in timing does not affect the cash flows relating to future periods. The contractual service margin is adjusted only for any net effect on the contractual service margin of the delay or acceleration.
 - (d) the contractual service margin is not adjusted for changes in estimates of cash flows that depend on investment returns if those changes arise as a result of changes in the value of the underlying items. Such changes do not relate to services provided under the contract.
 - (e) the contractual service margin is adjusted for changes in estimates of cash flows that are expected to vary directly with returns on underlying items only if those cash flows relate to future services under the insurance contract. For example, changes in cash flows relating to asset management services that are provided under a contract relate to future services under the insurance contract. Gains or losses on the underlying items do not relate to unearned profit from future services from the insurance contract and are recognised in accordance with the Standards relevant to the underlying items.

Working draft

Changes in the carrying amount of the contractual service margin for insurance contracts without direct participation features

- B1. For insurance contracts without direct participation features, paragraph 29b requires an adjustment to the contractual service margin for changes in estimates of the present value of future cash flows that relate to future coverage or other future services.
- B2. The contractual service margin is not adjusted for a change in the present value of future cash flows caused by changes in financial assumptions (being the effect, if any, on estimated future cash flows and the effect of a change in discount rate) because changes in financial assumptions are not regarded as related to future coverage service.
- B3. Changes in estimates of the cash flows (other than those caused by changes in financial assumptions) comprise differences between actual cash flows and expected cash flows in the period, and changes in estimates of future cash flows. Both can relate to future service or to current and past service, depending on the event that gives rise to the change in estimate. If an event causes both a difference between actual cash flows and expected cash flows in the period and a change in estimates of future cash flows, the combined effect of both is treated as relating to future service if there is any effect

relating to future service. If not, the combined effect is treated as relating to current and past service. Hence:

- a. the contractual service margin is not adjusted for changes in estimates of incurred claims, because these claims relate to past coverage.
- b. the contractual service margin is not adjusted for changes relating to contracts that lapse in the period, because those changes cannot relate to future service.
- c. the contractual service margin is adjusted for changes in estimates relating to contracts that were expected to lapse in the period but did not, because those changes must relate to future service. These changes include differences between actual premiums and claims in the period and previous estimates of those premiums and claims, and changes in estimates of future premiums and claims.
- d. for contracts that were not expected to, and did not, lapse in the period, the contractual service margin:
 - i. is not adjusted for differences between premiums received in the period and previous estimates of those premiums that have no effect on future premiums
 - ii. is adjusted for changes in estimates of future premiums, and differences between actual claims in the period and previous estimates that have an effect on future claims
 - iii. is not adjusted for differences between actual claims in the period and previous estimates of those claims that have no effect on estimates of future claims;
 - iv. is adjusted for changes in estimates of future claims, and differences between actual claims in the period and previous estimates that have an effect on future claims
- e. is not adjusted for a delay or acceleration of repayments of investment components if the change in timing did not affect the cash flows relating to future services. For example, if an entity estimates that there will be a lower repayment in one period because of a corresponding higher repayment in a future period, the change in timing does not affect the cash flows relating to future periods. The contractual service margin is adjusted only for any net effect on the contractual service margin of the delay or acceleration.

Proposed revised text

Changes in the carrying amount of the contractual service margin for insurance contracts without direct participation features

- B1. For insurance contracts without direct participation features, paragraph 29.b requires an adjustment to the contractual service margin for experience adjustments¹ and changes in estimates of the present value of future cash flows that relate to future coverage or other services.
- B2. The contractual service margin is not adjusted for an experience adjustment or a change in the present value of future cash flows caused by changes in financial assumptions (being the effect, if any, on estimated future cash flows and the effect of a change in discount rate) because changes in financial assumptions are not regarded as related to future service.
- B3. To identify whether experience adjustments and changes in estimates of future cash flows relate to future coverage or other service, in general an entity shall regard experience adjustments as relating to current or past services and changes in estimates of future cash flows as relating to future services. However, circumstances where this does not apply include:
 - a. the following changes in the liability for remaining coverage:

¹ Experience adjustments are defined in IAS 19 as ‘the effects of differences between previous actuarial assumptions and what has actually happened’. The staff plan to amend this definition by deleting the term ‘actuarial’ so it can apply to both IAS 19 and IFRS XX.

- i. experience adjustments arising from premiums paid in the period that relate to future services. These experience adjustments relate to future service; and
 - ii. the effect of events that result in an experience adjustment that causes a change in estimate of future cash flows. The combined effect is regarded as relating to future service. Hence, for example, the contractual service margin is adjusted for any net effect of any delay or acceleration in repayments of investment components; and
- b. changes in estimates of incurred claims, which relate to current or past services.