IFRS

STAFF PAPER

March 2019

IASB® meeting

Project	**Amendments to IFRS 17 *Insurance Contracts***		
Paper topic	Level of aggregation—History of the Board's decisions and stakeholder feedback		
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Purpose

1. This paper is part of a set of papers on the level of aggregation requirements in IFRS 17 *Insurance Contracts*. It sets out the history of the decisions of the International Accounting Standards Board (Board) and stakeholder feedback.

2. The other papers in the set are:

   (a) AP2A *Level of aggregation—Stakeholder concerns, implementation challenges and staff analysis*; and

   (b) AP2B *Level of aggregation—IFRS 17 requirements and Board's rationale*.

Structure of the paper

3. This paper provides an overview of:

   (a) 2010 Exposure Draft *Insurance Contracts* and stakeholder feedback (paragraphs 5−7 of this paper);

   (b) 2013 Exposure Draft *Insurance Contracts* and stakeholder feedback (paragraphs 8−11 of this paper);

   (c) towards the draft IFRS 17 for external review and final IFRS 17 (paragraphs 12−20 of this paper):

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(i) annual cohorts; and

(ii) annual cohorts and mutualisation.

4. Appendix A to this paper provides extracts of the relevant sections in the 2010 Exposure Draft, 2013 Exposure Draft and 2016 draft IFRS 17 used for external testing.

2010 Exposure Draft and stakeholder feedback

5. In the 2010 Exposure Draft, the Board defined a portfolio of insurance contracts as 'insurance contracts that are subject to broadly similar risks and managed together as a single pool'.

6. On level of aggregation for measurement, the Board proposed:

   (a) the risk adjustment be measured at the portfolio level; and

   (b) the residual margin (contractual service margin) be measured at a lower level—the portfolio split into groups based on similar dates of inception and similar coverage periods. The Board also proposed that the residual margin recognised in profit or loss in each period be adjusted to reflect when fewer contracts than expected were in force at the end of a period, so that amounts related to contracts no longer in force would go to profit or loss immediately.

7. Stakeholder feedback:

   (a) most respondents thought that the definition of a portfolio could be subject to different interpretations of 'similar risks' and 'managed together', resulting in aggregation of very different contracts.

   (b) many respondents suggested that the Standard should have a single level of aggregation and that this single level of aggregation should be the portfolio. In addition:

      (i) some respondents did not agree with the proposed level of aggregation for measuring the risk adjustment, because it restricted the diversification benefits to only those within a portfolio and not between

portfolios. Those respondents stated that this proposal was inconsistent with the way in which they price contracts and manage their business.

(ii) some respondents did not see the need to restrict the level of aggregation for the release of the contractual service margin to a level lower than portfolio, because in some circumstances using a higher level of aggregation would provide the same information at lower cost.

2013 Exposure Draft and stakeholder feedback

8. In response to stakeholder feedback that the definition of a portfolio of insurance contracts included in 2010 Exposure Draft could be subject to different interpretations, the Board proposed a narrower definition of a portfolio of insurance contracts. That definition would be 'a group of insurance contracts that provide coverage for similar risks and that are priced similarly relative to the risk taken on and are managed together as a single pool'.

9. In response to stakeholder feedback that there should be a single level of aggregation, the Board proposed that the level of aggregation for both the measurement of expected cash flows and the contractual service margin should be the portfolio of insurance contracts. The Board noted that the level of aggregation should not make a difference for the measurement of expected cash flows. However, the Board did not specify a level of aggregation for recognising the contractual service margin. Instead, the Board provided an objective that the contractual service margin should be recognised in profit or loss at a level of aggregation such that once the coverage period of the insurance contract has ended, the related contractual service margin has been fully recognised. The Board noted that, in practice, this may result in a smaller unit of account than the portfolio that entities would generally use to manage contracts and may require entities to group together contracts that have similar contract inception dates, coverage periods and service profiles.

10. In response to stakeholder feedback that the measurement of the risk adjustment should not be restricted to the portfolio level, the Board proposed that the risk adjustment is measured incorporating diversification benefits to the extent that the

entity considers those benefits in setting the amount of compensation it requires to bear risk.

11. Stakeholder feedback:

(a) some respondents were unclear about how to interpret the requirement that contracts within a portfolio should be priced similarly relative to the risk taken on. Some of those respondents also said that this could result in a level of aggregation that was excessively narrow and burdensome.

(b) some respondents struggled to understand the reasons for the proposals for the level of aggregation that was to be used to account for different components of insurance contracts.

(c) some respondents were not sure how to measure an insurance contract by applying different levels of aggregation to the measurement of its components. They held the view that applying different levels of aggregation to measure different components of the insurance liability will create unnecessary complexity and an operational burden.

(d) some respondents were concerned that the 2013 Exposure Draft would require them to apply a level of aggregation that is lower than the level at which they manage their business. In particular, respondents were concerned that the requirements in paragraph B37(d) of the 2013 Exposure Draft relating to the release of the contractual service margin, and the requirement in the definition of an insurance contract that contracts should be priced similarly relative to the risk taken on, would require a lower level of aggregation than they currently use.

(e) some respondents would prefer a single level of aggregation throughout the Standard, while others ask for clarification of the principle, improved consistency of drafting and additional guidance on the application of the portfolio definition.

(f) some respondents suggested grouping insurance contracts in a portfolio that have been issued within the same annual reporting period or grouping insurance contracts that have a similar inception date.

Towards the draft IFRS 17 for external review and final IFRS 17

12. In response to feedback on the 2013 Exposure Draft, the Board decided to discuss whether any clarification or additional application guidance was needed for the level of aggregation requirements.

13. As a result of those discussions, the Board proposed in the draft of IFRS 17 for external review that:

    (a) the definition of a portfolio of insurance contracts is a group of insurance contracts subject to similar risks and managed together as a single pool.

    (b) an entity is required to measure individual insurance contracts on initial recognition to determine what group they belong to. Those groups comprise contracts that on initial recognition have:

        (i) future cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions; and

        (ii) similar expected profitability. Similar profitability means similar contractual service margin as a percentage of the total expected revenue. As a practical expedient, an entity may instead assess whether the contracts have a similar expected return on premiums, ie the contractual service margin as a percentage of expected premiums.

    (c) an amount of the contractual service margin is recognised in the statement of profit or loss to reflect the service provided under the contract. In determining that amount, the objective is to allocate the contractual service margin for a group of contracts remaining (before any allocation) at the end of the reporting period over the coverage provided in the current period and expected remaining future coverage to be provided, on the basis of the passage of time. The allocation shall be based on coverage units, reflecting the expected duration and size of the contracts in the group.

14. Those proposed requirements reflected the Board's tentative conclusions that:

    (a) groups of contracts that have a greater risk of being onerous should not be grouped with groups of contracts that have a lower risk of being onerous;

    (b) the contractual service margin should be allocated to periods in a way that reflects the service provided by the contracts; and

    (c) the contractual service margin for the group should reflect the number and size of the contracts within the group that still have coverage to provide.

15. Feedback received from external review test participants:

    (a) test participants expected that applying draft IFRS 17 could result in a very high number of groups. Specifically, they interpreted grouping by 'similar profitability' as requiring an excessively large number of groups at a level of granularity that might not provide useful information. This response was exacerbated by the fact that participants were unclear on what might be considered 'dissimilar'.

    (b) test participants said that the application of draft IFRS 17 would generally:

        (i) result in a more granular level of aggregation that entities previously used;

        (ii) be different from the way that many entities currently assess profitability or track contracts; and

        (iii) impose significant cost and complexity due to data storage requirements and granularity of analysis.

    (c) although the primary concerns about granularity were often identified as being operational, there was also a concern that the requirements in draft IFRS 17 would result in entities reporting losses on some contracts and profits on other contracts when participants thought there was no economic loss or gain.

16. In response to this feedback, the Board wanted to achieve an outcome that was less granular than draft IFRS 17 while still requiring information to be provided to users of financial statements that is consistent with the Board's conclusions in paragraph 14 of

this paper. To achieve this, the Board tentatively concluded to require a portfolio to be divided into a minimum of three 'profitability buckets' by:

(a) requiring that entities identify any onerous contracts at inception and group them separately from contracts that are not onerous at inception;

(b) requiring that entities measure insurance contacts that are not onerous at inception by dividing portfolios, at a minimum, into two groups—a group of contracts that have no significant risk of becoming onerous and a group of other profitable contracts;

(c) providing guidance that:

  (i) an entity should assess the risk of the contracts in the group becoming onerous in a manner consistent with how the entity's internal reporting provides information about changes in estimates;

  (ii) an entity should assess whether there is no significant risk of the contracts in the group becoming onerous, based on the sensitivity of the fulfilment cash flows to changes in estimates which, if they occurred, would result in the contracts becoming onerous; and

  (iii) an entity is permitted to divide portfolios into more than two groups. For example, an entity may choose to divide the portfolios into more groups if the entity's internal reporting provides information that distinguishes at a more granular level the different risks of contracts becoming onerous.

Annual cohorts

17. At the same time, the Board observed that because this approach was designed to reduce the overall granularity resulting from the 'similar profitability' requirement, it may not provide as much information in the financial statements as would have been provided by the requirements in draft IFRS 17. For example, an unexpectedly large change in estimates may have otherwise caused some contracts to become onerous, however because those contracts could now be grouped with other contracts which are more profitable, this may no longer occur—reflecting the move in focus away from

'similar profitability'. Applying draft IFRS 17, grouping contracts by similar profitability would mean that those different effects would have been reflected in the measurement of the insurance contract and hence in the financial statements. In contrast, grouping profitable contracts into those that are more resilient and those that are less resilient would ensure that losses would be reported on contracts that are less resilient, but would not provide as much information about how quickly different contracts became onerous or the effect of any reversal in changes of estimates. Some of that information would, however, be available in the disclosures through the change in the contractual service margin.

18. The Board concluded that the objective for the allocation of the contractual service margin could be achieved to an acceptable degree if, for each of the profitability buckets, an entity was restricted to grouping contracts that are issued within the same year. This would achieve the benefits of the reduced operational burden that results from removing the requirement for entities to group contracts according to similar profitability while still retaining the outcome the Board desires for the allocation of the contractual service margin. Like the previous 'similar profitability' proposal in the draft IFRS 17, requiring annual cohorts would ensure that changes in profitability over time are more likely to be apparent because profits on contracts are allocated over a finite period, compared to open profitability buckets in which profits on contracts could be allocated over an infinite period.

Annual cohorts and mutualisation

19. The Board considered the effect on mutualised contracts of the requirement to restrict groups to contracts that are issued within one year. Contracts are mutualised if some policyholders have subordinated their claims to those of other policyholders, thereby reducing the direct exposure of the insurer to the collective risk of the group.[1]

20. The Board considered whether applying annual cohorts to contracts that are *fully*[2] mutualised might result in a loss because an annual group is regarded as onerous even

[1] Note that the Board decided not to use the term 'mutualisation' in IFRS 17 because different stakeholders have different definitions for this term.

[2] ie 100% risk shared between policyholders

though the combined mutualised group (the portfolio) is profitable. The Board concluded that, because the measurement and allocation of cash flows to groups consider the effect of mutualisation (so for example, cash flows are allocated across annual cohorts to reflect mutualisation), applying IFRS 17 to fully mutualised contracts would result in the same outcome with and without annual cohorts. The Board considered whether to add an exception to annual cohorts for fully mutualised contracts, but concluded that to do so would add complexity, and create risk that the boundary would not be robust or appropriate in all circumstances. Instead, the Board explained in paragraph BC138 of the Basis for Conclusions on IFRS 17 that it may not be necessary for an entity to apply annual cohorts to achieve the same accounting outcome in some circumstances.

Appendix A— Extracts of the relevant sections in the 2010 Exposure Draft, 2013 Exposure Draft and 2016 draft IFRS 17 used for external testing

2010 Exposure Draft

The Exposure Draft

50 **An insurer shall recognise the residual margin determined at initial recognition as income in profit or loss over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage, as follows:**

- **(a) on the basis of the 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.**

(…)

52 (…) Once the coverage period has ended, the residual margin is zero; hence, after that point the contract shall be measured as the present value of the fulfilment cash flows.

53 If fewer contracts are in force at the end of a period than was expected at the beginning of the period, the amount of the residual margin recognised in profit or loss during the period shall include an adjustment to eliminate from the residual margin at the end of the reporting period the portion relating to contracts that are no longer in force. If more contracts are in force at the end of a period than was expected at the beginning of the period, the insurer shall not increase the residual margin.

Definitions

portfolio of insurance contracts	**Insurance contracts** that are subject to broadly similar risks and managed together as a single pool.

Basis for conclusions

Level of aggregation for the residual margin

BC130 Paragraph BC120 explains that the risk adjustment should be determined at a portfolio of contracts level that groups together contracts subject to similar circumstances (ie contracts that are subject to similar risks and are managed together as a pool). However, because the residual margin is released over the coverage period, it is necessary to adopt a different level

of aggregation for residual margins that group together only those contracts within the portfolio that have similar coverage periods. For that reason, the Board concluded that residual margins should be determined at a level that aggregates insurance contracts into a portfolio and, within each portfolio, by similar date of inception of the contract and by similar coverage period. An alternative would be to determine the release of the residual margin at an individual contract level, but the Board concluded that would be impracticable.

2013 Exposure Draft

The Exposure Draft

Contractual service margin

28 **Unless the portfolio of insurance contracts that includes the contract is onerous at initial recognition, an entity shall measure the contractual service margin recognised at initial recognition in accordance with paragraph 18(b) at an amount that is equal and opposite to the sum of:**

- **(a) the amount of the fulfilment cash flows for the insurance contract at initial recognition; and**
- **(b) any pre-coverage cash flows.**

Subsequent measurement

29 **Unless paragraphs 35–40 apply, the carrying amount of an insurance contract at the end of each reporting period shall be the sum of:**

- **(a) the fulfilment cash flows at that date, measured in accordance with paragraphs 19–27, B36–B67 and B69–B82; and**
- **(b) the remaining amount of the contractual service margin at that date.**

30 The remaining amount of the contractual service margin at the end of the reporting period is the carrying amount at the start of the reporting period:

- (a) plus the interest accreted on the carrying amount of the contractual service margin during the reporting period to reflect the time value of money (the interest accreted is calculated using the discount rates specified in paragraph 25 that applied when the contract was initially recognised);
- (b) minus the amount recognised in accordance with paragraph 32 for services that were provided in the period;

(c) plus a favourable difference between the current and previous estimates of the present value of future cash flows, if those future cash flows relate to future coverage and other future services (see paragraph B68);

(d) minus an unfavourable change in the future cash flows:

  (i) if the change arises from a difference between the current and previous estimate of the present value of future cash flows that relate to future coverage and other future services; and

  (ii) to the extent that the contractual service margin is sufficient to absorb an unfavourable change. The contractual service margin shall not be negative.

31 An entity shall recognise in profit or loss any changes in the future cash flows that, in accordance with paragraph 30, do not adjust the contractual service margin (see paragraph B68).

32 An entity shall recognise the remaining contractual service margin in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract.

Definitions

portfolio of insurance contracts	A group of **insurance contracts** that: (a) provide coverage for similar risks and that are priced similarly relative to the risk taken on; and (b) are managed together as a single pool.

Application guidance

Level of measurement (paragraph 22)

B36 The expected (probability-weighted) cash flows from a portfolio of insurance contracts equals the sum of the expected cash flows of the individual contracts. Consequently, the level of aggregation for measurement should not affect the expected present values of future cash flows.

B37 However, from a practical point of view, it may be easier to make estimates in aggregate for a portfolio rather than for individual insurance contracts. For example, incurred but not reported (IBNR) estimates are typically made for a portfolio as a whole. If expenses are incurred at the portfolio level but not at an individual insurance contract level, it may be easier, and perhaps even necessary, to estimate them at an aggregate level. Accordingly, this [draft] Standard requires that entities measure an insurance contract using:

(a) expected cash flows assessed at the level of a portfolio of insurance contracts (see paragraph 22);

(b) a risk adjustment measured by incorporating diversification benefits to the extent that the entity considers those benefits in setting the amount of compensation it requires to bear risk (see paragraphs B76–B77);

(c) the contractual service margin at initial recognition at the level of a portfolio of insurance contracts, consistent with the cash flows (see paragraph 28); and

(d) the amount of contractual service margin recognised in profit or loss at a level of aggregation such that once the coverage period of the insurance contract has ended, the related contractual service margin has been fully recognised in profit or loss (see paragraph 32).

B38 However, the expected value of estimates made at the portfolio level reflects the expected value of the equivalent estimates of those amounts attributed to the individual contracts. In principle, this should be no different from making expected value estimates for individual insurance contracts and then aggregating the results for the portfolio of those contracts.

Basis for conclusions

Level of aggregation (paragraph 32)

BCA113 This Exposure Draft specifies that an entity should aggregate insurance contracts into a portfolio of insurance contracts when determining the contractual service margin. However, it does not specify the level of aggregation for recognising the contractual service margin in profit or loss. The IASB proposes that when entities recognise the contractual service margin they should use a level of aggregation that ensures that the contractual service margin is recognised in line with the pattern of services provided under the contracts to which they relate. This would mean that when the coverage period of each contract has ended, the contractual service margin relating to that contract should be fully recognised. In practice, this may result in a smaller unit of account than the portfolio that entities would generally use to manage contracts, and may require entities to group together contracts that have similar contract inception dates, coverage periods and service profiles. Another approach would be to determine the recognition of the contractual service margin at an individual contract level, but the IASB concluded that requiring that approach in all circumstances might be onerous.

2016 draft IFRS 17 used for external testing

36 **Having determined the measurement of individual contracts on initial recognition, an entity shall aggregate contracts into groups to determine whether to recognise a loss for a group of contracts and to measure the contractual service margin after initial recognition. Those groups comprise contracts that on initial recognition have:**

(a) **future cash flows the entity expects will respond similarly in terms of amount and timing to changes in key assumptions; and**

(b) **similar expected profitability. Unless paragraphs 50-54 apply, similar profitability means similar contractual service margin as a percentage of the total expected revenue. As a practical expedient, an entity may instead assess whether the contracts have a similar expected return on premiums, ie the contractual service margin as a percentage of expected premiums.**

B107 An amount of the contractual service margin is recognised in the statement of profit or loss to reflect the service provided under the contract. In determining that amount, the objective is to allocate the contractual service margin for a group of contracts remaining (before any allocation) at the end of the reporting period over the coverage provided in the current period and expected remaining future coverage to be provided, on the basis of the passage of time. The allocation shall be based on coverage units, reflecting the expected duration and size of the contracts in the group.