



Thai General Insurance Association

IFRS 17 Insurance Contracts
Practical Guidance

Topic 6: Contractual Service Margin and
Coverage Unit; Onerous Contract

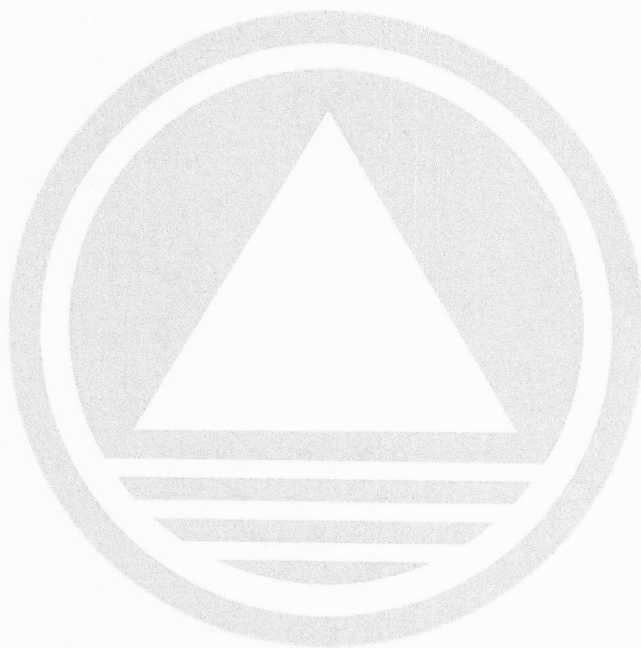
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Disclaimer

This is a Practical Guidance in the application of IFRS 17 Insurance Contracts and is by no means a financial reporting standards.

The IFRS is principles-based, therefore this Practical Guide aims to provide illustrative examples on how to apply the standards by IASB.

In the event of any conflict or inconsistency between the IFRS and the Practical Guidance, the IFRS shall prevail, and the accounting treatment should comply with the IFRS. Similarly, should the interpretation of the IFRS results in a contradicted conclusion from the example given in the Practical Guidance, the accounting treatment should observe IFRS.



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1.0 Executive Summary

This report is part of a series of study papers guiding non-life insurers' implementation of the new Thai Financial Reporting Standard 17 for Insurance Contracts ("TFRS 17"), which has a mandatory effective date of 1 January 2024 or later (1 year after IASB effective date for IFRS 17).

Contractual service margin (CSM), which applies only for contracts under the general measurement model, represents the unearned profit of a group of insurance or reinsurance contracts after allowing for future cash flows and an allowance for the cost of bearing non-financial risk.

The coverage unit allocates the contractual service margin between those units provided in the current reporting period and those to be provided in the future period. The Standard establishes principles, but not detailed requirements, in relation to coverage units. Some of the main considerations include:

- Expected coverage period – Consideration of potential cancellations;
- Quantity of benefits – A policyholder benefits from the entity standing ready to meet valid claims. It is determined from the policyholders' perspective, not the quantity of benefits expected to be incurred by the Company. The quantity of benefits from the policyholders' perspective is the sum insured (severity) of the claims, and the benefits expected to be incurred by the company is the severity multiplied by the frequency of it occurring.

A group of insurance contracts is considered onerous if the contractual service margin is negative i.e. there are future losses expected on the contract after including the allowance for the risk adjustment for non-financial risk. Loss component is defined as the amount of losses arising from onerous contracts. In the subsequent measurement, the concept of systematic allocation and sole allocation will be discussed. Similar to tracking the CSM, tracking the loss component is likely to be complex. An entity will need to develop its systems and processes to be capable of allocating these changes in estimates to the loss component. This not only impacts the amount of revenue recognised in each reporting period but also affects the carrying amount of the loss component at each reporting date as well as when/if it reverses and when/if a CSM arises.

CSM and loss component equivalence in reinsurance held are discussed in the reinsurance treatment topic.

The results of the assessment for the topic are discussed in sections below.

2.0 References

International Financial Reporting Standard 17

The following are references to the IFRS 17 referred to in this Practical Guidance:

Name of the IFRS17 Topics	Reference in IFRS 17 (Paragraph)
Contractual service margin	38, 43-46, B72, B96–B119
Coverage unit	B119
Fulfilment Cash Flows	24, 32-33, 35
Onerous contract	47-52, 57, 58, B95, B119D, B123, B124

24 An entity shall apply the recognition and measurement requirements of IFRS 17 to the groups of contracts determined by applying paragraphs 14–23. An entity shall establish the groups at initial recognition and add contracts to the groups applying paragraph 28. The entity shall not reassess the composition of the groups subsequently. To measure a group of contracts, an entity may estimate the fulfilment cash flows at a higher level of aggregation than the group or portfolio, provided the entity is able to include the appropriate fulfilment cash flows in the measurement of the group, applying paragraphs 32(a), 40(a)(i) and 40(b), by allocating such estimates to groups of contracts.

Measurement on initial recognition (paragraphs B36–B95F)

32 On initial recognition, an entity shall measure a group of insurance contracts at the total of:

- (a) the fulfilment cash flows, which comprise:
 - (i) estimates of future cash flows (paragraphs 33–35);
 - (ii) an adjustment to reflect the time value of money and the financial risks related to the future cash flows, to the extent that the financial risks are not included in the estimates of the future cash flows (paragraph 36); and
 - (iii) a risk adjustment for non-financial risk (paragraph 37).
- (b) the contractual service margin, measured applying paragraphs 38–39.

Estimates of future cash flows (paragraphs B36–B71)

33 An entity shall include in the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group (see paragraph 34). Applying paragraph 24, an entity may estimate the future cash flows at a higher level of aggregation and then allocate the resulting fulfilment cash flows to individual groups of contracts. The estimates of future cash flows shall:

- (a) incorporate, in an unbiased way, all reasonable and supportable information available without undue cost or effort about the amount, timing and uncertainty of those future cash flows (see paragraphs B37–B41). To do this, an entity shall estimate the expected value (ie the probability-weighted mean) of the full range of possible outcomes.
- (b) reflect the perspective of the entity, provided that the estimates of any relevant market variables are consistent with observable market prices for those variables (see paragraphs B42–B53).
- (c) be current—the estimates shall reflect conditions existing at the measurement date, including assumptions at that date about the future (see paragraphs B54–B60).
- (d) be explicit—the entity shall estimate the adjustment for nonfinancial risk separately from the other estimates (see paragraph B90). The entity also shall estimate the cash flows separately from the adjustment for the time value of money and financial risk, unless the most appropriate measurement technique combines these estimates (see paragraph B46).

35 An entity shall not recognise as a liability or as an asset any amounts relating to expected premiums or expected claims outside the boundary of the insurance contract. Such amounts relate to future insurance contracts.

Contractual service margin

38 The contractual service margin is a component of the asset or liability for the group of insurance contracts that represents the unearned profit the entity will recognise as it provides insurance contract services in the future. An entity shall measure the contractual service margin on initial recognition of a group of insurance contracts at an amount that, unless paragraph 47 (on onerous contracts) or paragraph B123A (on insurance revenue relating to paragraph 38(c)(ii)) applies, results in no income or expenses arising from:

- (a) the initial recognition of an amount for the fulfilment cash flows, measured by applying paragraphs 32–37;
- (b) any cash flows arising from the contracts in the group at that date;
- (c) the derecognition at the date of initial recognition of:
 - (i) any asset for insurance acquisition cash flows applying paragraph 28C; and
 - (ii) any other asset or liability previously recognised for cash flows related to the group of contracts as specified in paragraph B66A.

Contractual service margin (paragraphs B96–B119B)

43 The contractual service margin at the end of the reporting period represents the profit in the group of insurance contracts that has not yet been recognised in profit or loss because it relates to the future service to be provided under the contracts in the group.

44 For insurance contracts without direct participation features, the carrying amount of the contractual service margin of a group of contracts at the end of the reporting period equals the carrying amount at the start of the reporting period adjusted for:

- (a) the effect of any new contracts added to the group (see paragraph 28);
- (b) interest accreted on the carrying amount of the contractual service margin during the reporting period, measured at the discount rates specified in paragraph B72(b);
- (c) the changes in fulfilment cash flows relating to future service as specified in paragraphs B96–B100, except to the extent that:
 - (i) such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to a loss (see paragraph 48(a)); or
 - (ii) such decreases in the fulfilment cash flows are allocated to the loss component of the liability for remaining coverage applying paragraph 50(b).
- (d) the effect of any currency exchange differences on the contractual service margin; and
- (e) the amount recognised as insurance revenue because of the transfer of insurance contract services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period applying paragraph B119.

45 For insurance contracts with direct participation features (see paragraphs B101–B118), the carrying amount of the contractual service margin of a group of contracts at the end of the reporting period equals the carrying amount at the start of the reporting period adjusted for the amounts specified in subparagraphs (a)–(e) below. An entity is not required to identify these adjustments separately. Instead, a combined amount may be determined for some, or all, of the adjustments. The adjustments are:

- (a) the effect of any new contracts added to the group (see paragraph 28);
- (b) the change in the amount of the entity's share of the fair value of the underlying items (see paragraph B104(b)(i)), except to the extent that:
 - (i) paragraph B115 (on risk mitigation) applies;
 - (ii) the decrease in the amount of the entity's share of the fair value of the underlying items exceeds the carrying amount of the contractual service margin, giving rise to a loss (see paragraph 48); or
 - (iii) the increase in the amount of the entity's share of the fair value of the underlying items reverses the amount in (ii).
- (c) the changes in fulfilment cash flows relating to future service, as specified in paragraphs B101–B118, except to the extent that:
 - (i) paragraph B115 (on risk mitigation) applies;
 - (ii) such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to a loss (see paragraph 48); or
 - (iii) such decreases in the fulfilment cash flows are allocated to the loss component of the liability for remaining coverage applying paragraph 50(b).

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- (d) the effect of any currency exchange differences arising on the contractual service margin; and
- (e) the amount recognised as insurance revenue because of the transfer of insurance contract services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period applying paragraph B119.

46 Some changes in the contractual service margin offset changes in the fulfilment cash flows for the liability for remaining coverage, resulting in no change in the total carrying amount of the liability for remaining coverage. To the extent that changes in the contractual service margin do not offset changes in the fulfilment cash flows for the liability for remaining coverage, an entity shall recognise income and expenses for the changes, applying paragraph 41.

Onerous contracts

47 An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognised insurance acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow. Applying paragraph 16(a), an entity shall group such contracts separately from contracts that are not onerous. To the extent that paragraph 17 applies, an entity may identify the group of onerous contracts by measuring a set of contracts rather than individual contracts. An entity shall recognise a loss in profit or loss for the net outflow for the group of onerous contracts, resulting in the carrying amount of the liability for the group being equal to the fulfilment cash flows and the contractual service margin of the group being zero.

48 A group of insurance contracts becomes onerous (or more onerous) on subsequent measurement if the following amounts exceed the carrying amount of the contractual service margin:

- (a) unfavourable changes relating to future service in the fulfilment cash flows allocated to the group arising from changes in estimates of future cash flows and the risk adjustment for non-financial risk; and
- (b) for a group of insurance contracts with direct participation features, the decrease in the amount of the entity's share of the fair value of the underlying items.

Applying paragraphs 44(c)(i), 45(b)(ii) and 45(c)(ii), an entity shall recognise a loss in profit or loss to the extent of that excess.

49 An entity shall establish (or increase) a loss component of the liability for remaining coverage for an onerous group depicting the losses recognized applying paragraphs 47–48. The loss component determines the amounts that are presented in profit or loss as reversals of losses on onerous groups and are consequently excluded from the determination of insurance revenue.

50 After an entity has recognised a loss on an onerous group of insurance contracts, it shall allocate:

- (a) the subsequent changes in fulfilment cash flows of the liability for remaining coverage specified in paragraph 51 on a systematic basis between:
 - (i) the loss component of the liability for remaining coverage; and
 - (ii) the liability for remaining coverage, excluding the loss component.
- (b) solely to the loss component until that component is reduced to zero:
 - (i) any subsequent decrease relating to future service in fulfilment cash flows allocated to the group arising from changes in estimates of future cash flows and the risk adjustment for nonfinancial risk; and
 - (ii) any subsequent increases in the amount of the entity's share of the fair value of the underlying items.

Applying paragraphs 44(c)(ii), 45(b)(iii) and 45(c)(iii), an entity shall adjust the contractual service margin only for the excess of the decrease over the amount allocated to the loss component.

51 The subsequent changes in the fulfilment cash flows of the liability for remaining coverage to be allocated applying paragraph 50(a) are:

- (a) estimates of the present value of future cash flows for claims and expenses released from the liability for remaining coverage because of incurred insurance service expenses;
- (b) changes in the risk adjustment for non-financial risk recognised in profit or loss because of the release from risk; and
- (c) insurance finance income or expenses.

52 The systematic allocation required by paragraph 50(a) shall result in the total amounts allocated to the loss component in accordance with paragraphs 48–50 being equal to zero by the end of the coverage period of a group of contracts.

57 If at any time during the coverage period, facts and circumstances indicate that a group of insurance contracts is onerous, an entity shall calculate the difference between:

- (a) the carrying amount of the liability for remaining coverage determined applying paragraph 55; and
- (b) the fulfilment cash flows that relate to remaining coverage of the group, applying paragraphs 33–37 and B36–B92. However, if, in applying paragraph 59(b), the entity does not adjust the liability for incurred claims for the time value of money and the effect of financial risk, it shall not include in the fulfilment cash flows any such adjustment.

58 To the extent that the fulfilment cash flows described in paragraph 57(b) exceed the carrying amount described in paragraph 57(a), the entity shall recognise a loss in profit or loss and increase the liability for remaining coverage.

Discount rates (paragraph 36)

An entity shall use the following discount rates in applying IFRS 17:

- (a) to measure the fulfilment cash flows—current discount rates applying paragraph 36;
- (b) to determine the interest to accrete on the contractual service margin applying paragraph 44(b) for insurance contracts without direct participation features—discount rates determined at the date of initial recognition of a group of contracts, applying paragraph 36 to nominal cash flows that do not vary based on the returns on any underlying items;
- (c) to measure the changes to the contractual service margin applying paragraphs B96(a)–B96(b) and B96(d) for insurance contracts without direct participation features—discount rates applying paragraph 36 determined on initial recognition;
- (d) for groups of contracts applying the premium allocation approach that have a significant financing component, to adjust the carrying amount of the liability for remaining coverage applying paragraph 56— discount rates applying paragraph 36 determined on initial recognition;
- (e) if an entity chooses to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income (see paragraph 88), to determine the amount of the insurance finance income or expenses included in profit or loss:
 - (i) for groups of insurance contracts for which changes in assumptions that relate to financial risk do not have a substantial effect on the amounts paid to policyholders, applying paragraph B131—discount rates determined at the date of initial recognition of a group of contracts, applying paragraph 36 to nominal cash flows that do not vary based on the returns on any underlying items;
 - (ii) for groups of insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to policyholders, applying paragraph B132(a)(i)—discount rates that allocate the remaining revised expected finance income or expenses over the remaining duration of the group of contracts at a constant rate; and
 - (iii) for groups of contracts applying the premium allocation approach applying paragraphs 59(b) and B133—discount rates determined at the date of the incurred claim, applying paragraph 36 to nominal cash flows that do not vary based on the returns on any underlying items.

B95 Unless the premium allocation approach for the liability for remaining coverage in paragraphs 55–59 and 69–70A applies, on initial recognition the contractual service margin is calculated applying paragraph 38 for acquired insurance contracts issued and paragraph 65 for acquired reinsurance contracts held using the consideration received or paid for the contracts as a proxy for the premiums received or paid at the date of initial recognition.

Changes in the carrying amount of the contractual service margin for insurance contracts without direct participation features (paragraph 44)

B96 For insurance contracts without direct participation features, paragraph 44(c) requires an adjustment to the contractual service margin of a group of insurance contracts for changes in fulfilment cash flows that relate to future service. These changes comprise:

- (a) experience adjustments arising from premiums received in the period that relate to future service, and related cash flows such as insurance acquisition cash flows and premium-based taxes, measured at the discount rates specified in paragraph B72(c).
- (b) changes in estimates of the present value of the future cash flows in the liability for remaining coverage, except those described in paragraph B97(a), measured at the discount rates specified in paragraph B72(c).
- (c) differences between any investment component expected to become payable in the period and the actual investment component that becomes payable in the period. Those differences are determined by comparing (i) the actual investment component that becomes payable in the period with (ii) the payment in the period that was expected at the start of the period plus any insurance finance income or expenses related to that expected payment before it becomes payable.
- (ca) differences between any loan to a policyholder expected to become repayable in the period and the actual loan to a policyholder that becomes repayable in the period. Those differences are determined by comparing (i) the actual loan to a policyholder that becomes repayable in the period with (ii) the repayment in the period that was expected at the start of the period plus any insurance finance income or expenses related to that expected repayment before it becomes repayable.
- (d) changes in the risk adjustment for non-financial risk that relate to future service. An entity is not required to disaggregate the change in the risk adjustment for non-financial risk between (i) a change related to non-financial risk and (ii) the effect of the time value of money and changes in the time value of money. If an entity makes such a disaggregation, it shall adjust the contractual service margin for the change related to non-financial risk, measured at the discount rates specified in paragraph B72(c).

B97 An entity shall not adjust the contractual service margin for a group of insurance contracts without direct participation features for the following changes in fulfilment cash flows because they do not relate to future service:

- (a) the effect of the time value of money and changes in the time value of money and the effect of financial risk and changes in financial risk. These effects comprise:
 - (i) the effect, if any, on estimated future cash flows;
 - (ii) the effect, if disaggregated, on the risk adjustment for nonfinancial risk; and
 - (iii) the effect of a change in discount rate.
- (b) changes in estimates of fulfilment cash flows in the liability for incurred claims.
- (c) experience adjustments, except those described in paragraph B96(a).

B98 The terms of some insurance contracts without direct participation features give an entity discretion over the cash flows to be paid to policyholders. A change in the discretionary cash flows is regarded as relating to future service, and accordingly adjusts the contractual service margin. To determine how to identify a change in discretionary cash flows, an entity shall specify at inception of the contract the basis on which it expects to determine its commitment under the contract; for example, based on a fixed interest rate, or on returns that vary based on specified asset returns.

B99 An entity shall use that specification to distinguish between the effect of changes in assumptions that relate to financial risk on that commitment (which do not adjust the contractual service margin) and the effect of discretionary changes to that commitment (which adjust the contractual service margin).

B100 If an entity cannot specify at inception of the contract what it regards as its commitment under the contract and what it regards as discretionary, it shall regard its commitment to be the return implicit in the estimate of the fulfilment cash flows at inception of the contract, updated to reflect current assumptions that relate to financial risk.

Changes in the carrying amount of the contractual service margin for insurance contracts with direct participation features (paragraph 45)

B101 Insurance contracts with direct participation features are insurance contracts that are substantially investment-related service contracts under which an entity promises an investment return based on underlying items. Hence, they are defined as insurance contracts for which:

- (a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items (see paragraphs B105–B106);
- (b) the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items (see paragraph B107); and
- (c) the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items (see paragraph B107).

B102 An entity shall assess whether the conditions in paragraph B101 are met using its expectations at inception of the contract and shall not reassess the conditions afterwards, unless the contract is modified, applying paragraph 72.

B103 To the extent that insurance contracts in a group affect the cash flows to policyholders of contracts in other groups (see paragraphs B67–B71), an entity shall assess whether the conditions in paragraph B101 are met by considering the cash flows that the entity expects to pay the policyholders determined applying paragraphs B68–B70.

B104 The conditions in paragraph B101 ensure that insurance contracts with direct participation features are contracts under which the entity's obligation to the policyholder is the net of:

- (a) the obligation to pay the policyholder an amount equal to the fair value of the underlying items; and
- (b) a variable fee (see paragraphs B110–B118) that the entity will deduct from (a) in exchange for the future service provided by the insurance contract, comprising:
 - (i) the amount of the entity's share of the fair value of the underlying items; less
 - (ii) fulfilment cash flows that do not vary based on the returns on underlying items.

B105 A share referred to in paragraph B101(a) does not preclude the existence of the entity's discretion to vary the amounts paid to the policyholder. However, the link to the underlying items must be enforceable (see paragraph 2).

B106 The pool of underlying items referred to in paragraph B101(a) can comprise any items, for example a reference portfolio of assets, the net assets of the entity, or a specified subset of the net assets of the entity, as long as they are clearly identified by the contract. An entity need not hold the identified pool of underlying items. However, a clearly identified pool of underlying items does not exist when:

- (a) an entity can change the underlying items that determine the amount of the entity's obligation with retrospective effect; or
- (b) there are no underlying items identified, even if the policyholder could be provided with a return that generally reflects the entity's overall performance and expectations, or the performance and expectations of a subset of assets the entity holds. An example of such a return is a crediting rate or dividend payment set at the end of the period to which it relates. In this case, the obligation to the policyholder reflects the crediting rate or dividend amounts the entity has set, and does not reflect identified underlying items.

B107 Paragraph B101(b) requires that the entity expects a substantial share of the fair value returns on the underlying items will be paid to the policyholder and paragraph B101(c) requires that the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items. An entity shall:

- (a) interpret the term 'substantial' in both paragraphs in the context of the objective of insurance contracts with direct participation features being contracts under which the entity provides investment-related services and is compensated for the services by a fee that is determined by reference to the underlying items; and
- (b) assess the variability in the amounts in paragraphs B101(b) and B101(c):
 - (i) over the duration of the insurance contract; and
 - (ii) on a present value probability-weighted average basis, not a best or worst outcome basis (see paragraphs B37–B38).

B108 For example, if the entity expects to pay a substantial share of the fair value returns on underlying items, subject to a guarantee of a minimum return, there will be scenarios in which:

- (a) the cash flows that the entity expects to pay to the policyholder vary with the changes in the fair value of the underlying items because the guaranteed return and other cash flows that do not vary based on the returns on underlying items do not exceed the fair value return on the underlying items; and
- (b) the cash flows that the entity expects to pay to the policyholder do not vary with the changes in the fair value of the underlying items because the guaranteed return and other cash flows that do not vary based on the returns on underlying items exceed the fair value return on the underlying items.

The entity's assessment of the variability in paragraph B101(c) for this example will reflect a present value probability-weighted average of all these scenarios.

B109 Reinsurance contracts issued and reinsurance contracts held cannot be insurance contracts with direct participation features for the purposes of IFRS 17.

B110 For insurance contracts with direct participation features, the contractual service margin is adjusted to reflect the variable nature of the fee. Hence, changes in the amounts set out in paragraph B104 are treated as set out in paragraphs B111–B114.

B111 Changes in the obligation to pay the policyholder an amount equal to the fair value of the underlying items (paragraph B104(a)) do not relate to future service and do not adjust the contractual service margin.

B112 Changes in the amount of the entity's share of the fair value of the underlying items (paragraph B104(b)(i)) relate to future service and adjust the contractual service margin, applying paragraph 45(b).

B113 Changes in the fulfilment cash flows that do not vary based on the returns on underlying items (paragraph B104(b)(ii)) comprise:

- (a) changes in the fulfilment cash flows other than those specified in (b). An entity shall apply paragraphs B96–B97, consistent with insurance contracts without direct participation features, to determine to what extent they relate to future service and, applying paragraph 45(c), adjust the contractual service margin. All the adjustments are measured using current discount rates.
- (b) the change in the effect of the time value of money and financial risks not arising from the underlying items; for example, the effect of financial guarantees. These relate to future service and, applying paragraph 45(c), adjust the contractual service margin, except to the extent that paragraph B115 applies.

B114 An entity is not required to identify the adjustments to the contractual service margin required by paragraphs B112 and B113 separately. Instead, a combined amount may be determined for some or all of the adjustments.

Risk mitigation

B115 To the extent that an entity meets the conditions in paragraph B116, it may choose not to recognise a change in the contractual service margin to reflect some or all of the changes in the effect of the time value of money and financial risk on:

- (a) the amount of the entity's share of the underlying items (see paragraph B112) if the entity mitigates the effect of financial risk on that amount using derivatives or reinsurance contracts held; and
- (b) the fulfilment cash flows set out in paragraph B113(b) if the entity mitigates the effect of financial risk on those fulfilment cash flows using derivatives, non-derivative financial instruments measured at fair value through profit or loss, or reinsurance contracts held.

B116 To apply paragraph B115, an entity must have a previously documented risk management objective and strategy for mitigating financial risk as described in paragraph B115. In applying that objective and strategy:

- (a) an economic offset exists between the insurance contracts and the derivative, non-derivative financial instrument measured at fair value through profit or loss, or reinsurance contract held (ie the values of the insurance contracts and those risk mitigating items generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated). An entity shall not consider accounting measurement differences in assessing the economic offset.
- (b) credit risk does not dominate the economic offset.

B117 The entity shall determine the fulfilment cash flows in a group to which paragraph B115 applies in a consistent manner in each reporting period.

B117A If the entity mitigates the effect of financial risk using derivatives or nonderivative financial instruments measured at fair value through profit or loss, it shall include insurance finance income or expenses for the period arising from the application of paragraph B115 in profit or loss. If the entity mitigates the effect of financial risk using reinsurance contracts held, it shall apply the same accounting policy for the presentation of insurance finance income or expenses arising from the application of paragraph B115 as the entity applies to the reinsurance contracts held applying paragraphs 88 and 90.

B118 If, and only if, any of the conditions in paragraph B116 cease to be met an entity shall cease to apply paragraph B115 from that date. An entity shall not make any adjustment for changes previously recognised in profit or loss.

Recognition of the contractual service margin in profit or loss

B119 An amount of the contractual service margin for a group of insurance contracts is recognised in profit or loss in each period to reflect the insurance contract services provided under the group of insurance contracts in that period (see paragraphs 44(e), 45(e) and 66(e)). The amount is determined by:

- (a) identifying the coverage units in the group. The number of coverage units in a group is the quantity of insurance contract services provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage period.
- (b) allocating the contractual service margin at the end of the period (before recognising any amounts in profit or loss to reflect the insurance contract services provided in the period) equally to each coverage unit provided in the current period and expected to be provided in the future.
- (c) recognising in profit or loss the amount allocated to coverage units provided in the period.

B119D To apply paragraph 66A, an entity shall determine the adjustment to the contractual service margin of a group of reinsurance contracts held and the resulting income by multiplying:

- (a) the loss recognised on the underlying insurance contracts; and
- (b) the percentage of claims on the underlying insurance contracts the entity expects to recover from the group of reinsurance contracts held.

B123 Applying IFRS 15, when an entity provides services, it derecognises the performance obligation for those services and recognises revenue. Consistently, applying IFRS 17, when an entity provides services in a period, it reduces the liability for remaining coverage for the services provided and recognises insurance revenue. The reduction in the liability for remaining coverage that gives rise to insurance revenue excludes changes in the liability that do not relate to services expected to be covered by the consideration received by the entity. Those changes are:

- (a) changes that do not relate to services provided in the period, for example:
 - (i) changes resulting from cash inflows from premiums received;
 - (ii) changes that relate to investment components in the period;
 - (iia) changes resulting from cash flows from loans to policyholders;
 - (iii) changes that relate to transaction-based taxes collected on behalf of third parties (such as premium taxes, value added taxes and goods and services taxes) (see paragraph B65(i));
 - (iv) insurance finance income or expenses;
 - (v) insurance acquisition cash flows (see paragraph B125); and
 - (vi) derecognition of liabilities transferred to a third party.
- (b) changes that relate to services, but for which the entity does not expect consideration, ie increases and decreases in the loss component of the liability for remaining coverage (see paragraphs 47–52).

B124 Consequently, insurance revenue for the period can also be analysed as the total of the changes in the liability for remaining coverage in the period that relates to services for which the entity expects to receive consideration. Those changes are:

- (a) insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period), excluding:
 - (i) amounts allocated to the loss component of the liability for remaining coverage applying paragraph 51(a);
 - (ii) repayments of investment components;
 - (iii) amounts that relate to transaction-based taxes collected on behalf of third parties (such as premium taxes, value added taxes and goods and services taxes) (see paragraph B65(i));
 - (iv) insurance acquisition expenses (see paragraph B125); and
 - (v) the amount related to the risk adjustment for non-financial risk (see (b)).
- (b) the change in the risk adjustment for non-financial risk, excluding:
 - (i) changes included in insurance finance income or expenses applying paragraph 87;
 - (ii) changes that adjust the contractual service margin because they relate to future service applying paragraphs 44(c) and 45(c); and
 - (iii) amounts allocated to the loss component of the liability for remaining coverage applying paragraph 51(b).
- (c) the amount of the contractual service margin recognised in profit or loss in the period, applying paragraphs 44(e) and 45(e).
- (d) other amounts, if any, for example, experience adjustments for premium receipts other than those that relate to future service (see paragraph B96(a)).

3.0 Practical Guidance

3.1 Derecognition of Asset/Liability Recognized for Insurance Acquisition Cash Flows

An entity recognizes as an asset or liability for any insurance acquisition cash flows relating to a group of insurance contracts that it pays or receives before the group is recognized. These assets and liabilities are derecognized when the group of insurance contracts to which the cash flows are allocated is recognized, as part of determining the CSM on initial recognition. In the event the commission expenses are prepaid to agent before the initial recognition the IACF is an asset. In the event the reinsurance commission is received in advance before the initial recognition, the IACF is a liability.

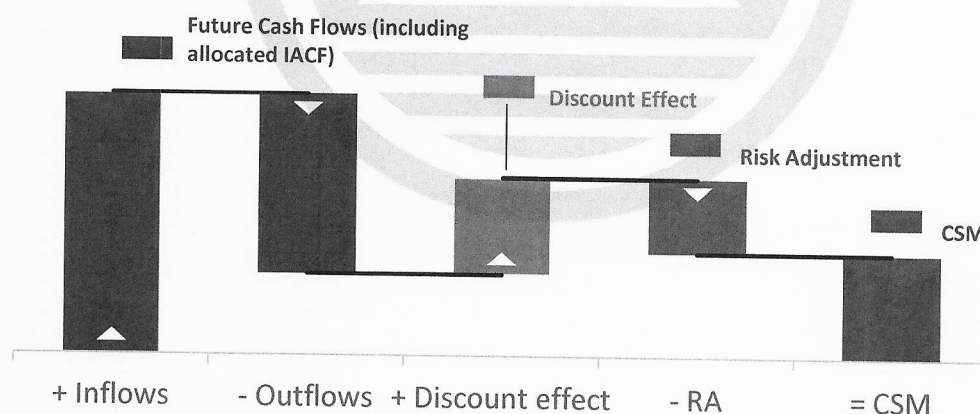
3.2 Initial Recognition

On initial recognition of a profitable group of insurance contracts, the CSM is equal to an opposite amount of the net inflow that arises from the following:

- Fulfilment cash flows (FCF = PVCF + RA)
- The derecognition of any asset or liability recognized for insurance acquisition cash flows.

If the sum of the previous elements result in a net outflow then this amount will be considered as the loss component of the liability for remaining coverage.

The CSM should be calculated for each group of insurance contracts measured under GMM as depicted in the diagram below.



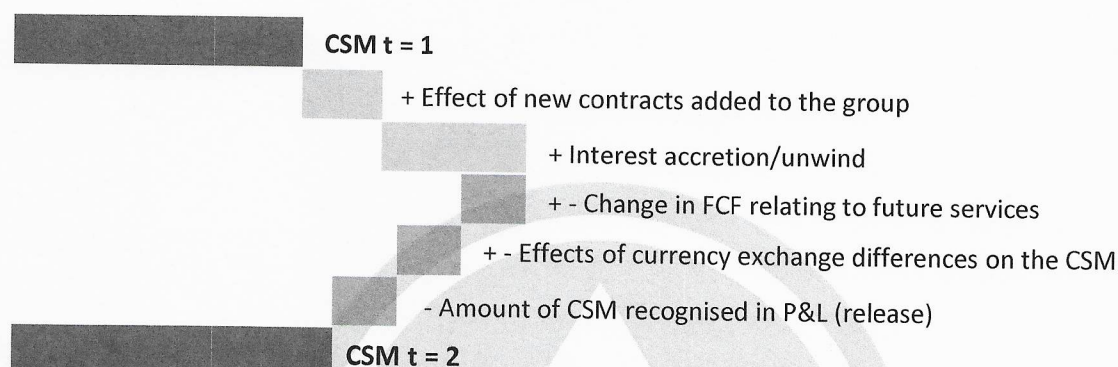
The CSM is a component of the asset or the liability for the group of insurance contracts that represents the unearned profit that the entity will recognize as it provides services in the future. Initial recognition has similar meaning to time zero of the projection of future cash flows.

3.3 Subsequent Measurement

At each reporting date the CSM should be updated mainly to reflect the changes in fulfilment cash flows related to future service, the financing effect and the profit as insurance services are provided in the period.

GMM Model

Therefore, in subsequent measurements, the carrying amount of the CSM of a group of contracts measured under GMM model is calculated as it follows:



The effect of the new contracts added to the group means that the CSM at initial recognition may increase to adjust the cumulative CSM. An entity shall include only CSM from the contracts issued by the end of the reporting period, but it can issue more contracts in the group after that time. Adding of new contracts to the existing group is limited by the requirement of not to include contracts issued more than one year apart in the same group.

To determine the discount rate is allowed to use weighted-average discount rates over the period which contracts in the group are issued. Thus, adding contracts to the group may result in a change in discount rates, hence it is also an effect of new contracts added to the group.

Interest accreted on the carrying amount of the CSM during the reporting period has to be calculated with the locked-in discount rates on the cumulative CSM determined in prior steps.

To determine the locked-in discount rates for interest accretion/unwind the entity may use weighted-average discount rates over the period when contracts are issued. The example of weights to be used for weighted-average discount rate calculation are coverage unit and GWP.

While fulfilment cash flows will be valued at current rates when OCI option is not applied, while the CSM unwind will be calculated at locked-in discount rates. If OCI option is applied then the rates used for fulfilment cash flows interest accretion will be the same than the ones used for CSM, the locked-in discount rates.

Change in fulfilment cash flows related with future services adjust the CSM. These changes may arise through:

- Experience adjustments (differences between the estimates at the beginning of the period and the corresponding actual cash flows) for premiums received in the period. While experience adjustments relating to cash outflows such as claims and expenses are to be recognised in P&L, experience adjustments arising from premiums received in the period relating to future service adjust the CSM.
- Changes in estimates of future cash flows. Only changes in estimates of future cash resulting from changes in non-financial assumptions should be considered
- Changes in the risk adjustment for non-financial risk that relate to future service could result from the release for the current period and systematic changes in the prospective risk estimation for future periods.
- Differences between actual and expected investment component. IFRS 17 requires any unexpected repayment of an investment component to adjust the contractual service margin. The CSM will also be adjusted for changes in future estimates of cash flows which will include (but not separately identify) the reduction in future repayments of investment components. Therefore, the net effect on the CSM comprises only the effect of a change in the timing of the repayment of the investment component.
- If a group of insurance contracts generate cash flows in foreign currency then the group is considered as a monetary item when applying IAS21. Therefore the CSM is also considered as a monetary item and it should be adjusted for the effect of any currency exchange differences. The CSM will be translated into functional currency at the spot exchange rate at the reporting date.

The amount of CSM recognized in the P&L as insurance revenue because of the transfer of services in the period is determined by allocating the CSM remaining at the end of the reporting period over the current and remaining coverage period. This amount is determined as follows:

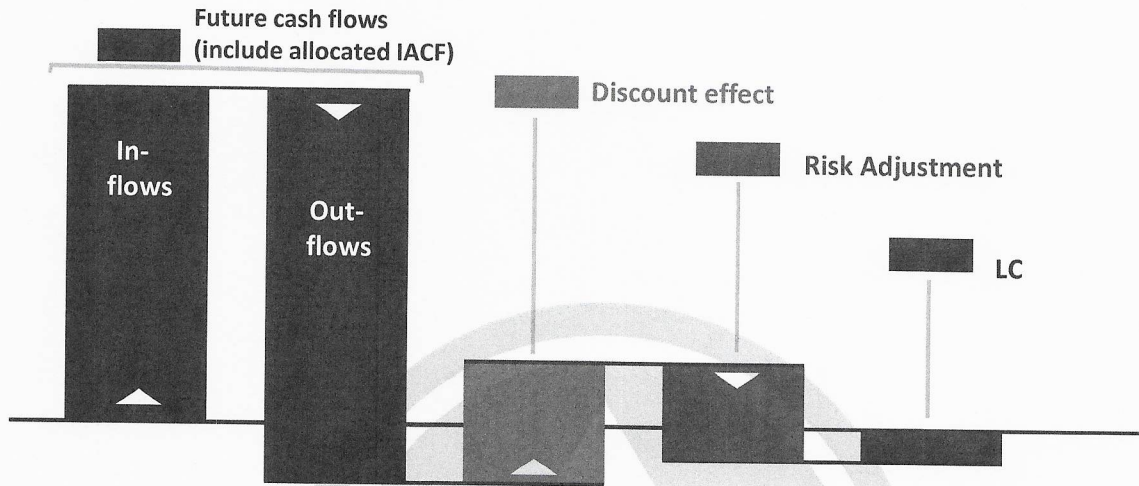
- Identifying the coverage units of the group of insurance contracts
- Allocating the CSM at the reporting date equally to coverage units provided in the current period and expected to be provided in the future
- Recognising in P&L the amount allocated to coverage units provided in the period

A GMM proxy model was attached in the Appendix section 1 to demonstrate how the CSM calculation could be done.

3.4 Loss Component

The Loss Component (LC) is a component of the liability for the group of insurance contracts that represents the loss the entity has recognized.

Contrarily to the CSM, the LC is directly recognized in the insurance service result. However, it is required to compute the LC for each period in order to follow the profitability of the contract and compute the revenue adjustment.



The LC should be calculated for each group of insurance contracts measured under GMM or PAA (onerous group). A group of insurance contract is onerous at the date of initial recognition if the followings result in a net outflow:

- Fulfilment cash flows ($FCF = PVCF + RA$)
- The derecognition of any asset or liability recognized for insurance acquisition cash flows
- Any cash flows arising from the contracts in the group at that date

In that case, a loss equal to the net outflow shall be recognized in insurance service expenses. Hence, at initial recognition of an onerous group of insurance contracts, the liability is equal to the FCF and the CSM is set to zero.

At each reporting date the LC after the systematic allocation, should be updated (sole allocation) to reflect the changes in fulfilment cash flows related to future service, the financing effect and the release from the LRC because of incurred insurance service expenses.

- Systematic allocation between fulfilment cash flows and loss component from (i) transfer from future service to current service, (ii) financing component, and (iii) change in risk adjustment;
- Decrease in the fulfilment cash flows and non-financial risks relating to the future service to the point that the loss component becomes zero;
- Changes in the fulfilment cash flows arising from changes in estimates of cash flows relating to future service, which may either lead to an increased loss component or a reversal of loss component (or result in a contractual service margin if the loss component is completely reversed).

Topic 6: Contractual Service Margin and Coverage Unit; Onerous Contract

For item a) above, Entity will base the systematic allocation between fulfilment cash flows and loss component on the proportion at the beginning of the period of the loss component of the liability for remaining coverage relative to the total estimate of the present value of the future cash outflows and the risk adjustment for non-financial risks.

This systematic allocation shall result in the total amount allocated to the loss component being equal to zero by the end of the coverage period of the group of insurance contracts.

The systematic allocation is performed using a ratio computed as

$$\frac{\text{Opening Loss Component}}{\text{RA LRC} + \text{Opening Present Value of Cash Outflows}}$$

- The opening present value of cash out flows include claims (gross of IC) and attributable expenses.
- This ratio is then applied to the movement of the LRC in order to compute the insurance finance expense allocation and the release of LC.
- The release of LC impacts the revenue but the effect is offset with the insurance service expenses in order to nullify the impact of insurance service result.
- Changes in FCF related with future services are the same changes that adjust the CSM.

A GMM proxy model was attached in the Appendix section 1 to demonstrate how the LC calculation could be done.

3.5 Coverage Unit

The Standard requires to identify and measure the coverage units of a group of contracts in way to establish the amount of CSM to be recognised in profit or loss for services provided in a period. In practice, the amount recognised in P&L each year is the amount of CSM before that recognition multiplied with a rate of release calculated at group of insurance contracts level

$$RateOfRelease_t = \frac{CU_t}{(\sum_{k \geq t}^n CU_k \times DiscountFactor_k)}$$

With:

- CU_t corresponds to the number of coverage units observed during the period t
- For $k \geq t$, CU_k corresponds to the number of coverage units expected to be provided for the period k
- $DiscountFactor_k$ reflect the time value of money (used if significant)
- n : The limit of the coverage period. For a group of contracts, the coverage period begins at the inception date of the first contract, and ends when the coverage period of all contracts in the group have expired.

The number of coverage units in a group of contracts during a period is the quantity of coverage provided by the contracts in the group of contracts during the period. The following elements shall be considered in the estimation of the coverage units of the contracts within the group of insurance contracts:

- The quantity of benefits should reflect the maximum level of the coverage defined within the contract
- When the maximum level of coverage cannot be used, the balance of the expected amount shall be used. For example, it can be the case when :
 - there are significant reasons which explain the variability of the level of the cover,
 - the maximum level is not directly available,
 - a seasonality or an intra-year effect have to be taken into account in the calculations
- The expected coverage duration of a contract shall take into account remaining coverage period and other policyholder's options (exercise rights in the contract).

Step 1: Analysis of service significance within the group of insurance contracts at the guarantee level

After the initial step of classification of the group of insurance contracts, it is necessary to analyse the significance of the components within the group of insurance contracts, in order to determine which of them have to be considered in the next step. This assessment leads to analyse the significance of the guarantees within each significant contract of the group of insurance contracts.

Note concerning non-modelled business:

A non-modelled business could be non-significant at the company level but significant at the group of contracts level.

Note concerning the granularity of calculations:

- According to the IFRS 17.B119 (a) : “The coverage units in a group of contracts is [...] determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration”
- In practice, the calculation of the quantity of benefits and the expected coverage duration of each significant guarantee within the group of contracts is necessary since an analysis of the contracts implies a study of the guarantees within the contracts.

Step 2: Expected coverage duration estimation

The expected coverage duration calculation depends on the conclusion of the previous step.

Insurance group of contracts without significant investment component

Following questions should be addressed:

- A. Are there any assumptions that lead the expected coverage period to vary significantly? (e.g. exercise of rights in the contract, claim, lapse, etc.)?

The expected coverage period is estimated on the basis of the table below:

A	Propositions
No	Contractual coverage period
Yes	Contractual coverage period, factoring in assumptions which lead it to vary

Group of contracts with both investment and insurance components

Following questions should be addressed:

- A. Are there any assumptions that lead the expected coverage period to vary (e.g. exercise of rights in the contract, claim, lapse, etc.)?
- B. Do both components have the same coverage period?
- C. Are insurance and investment components simultaneously significant?

The expected coverage duration is estimated on the basis of the table below:

A	B	C	Propositions
No	Yes	NA	Contractual coverage period of both components
Yes	Yes	Yes	Contractual coverage period of both components, factoring in assumptions which lead it to vary
No	No	Yes	Contractual coverage period for each component separately
Yes	No	Yes	Contractual coverage period for each component separately, factoring in assumptions which lead it to vary
No	No	No	Contractual coverage period for each component, excluding the non-significant component when relevant
Yes	NA	No	Contractual coverage period for each component, excluding the non-significant component when relevant, factoring in assumptions which lead it to vary

Step 3: quantity of benefits estimation

Insurance group of contracts without significant investment component

Following questions should be addressed:

- A. Is there a contractual maximum level of coverage available?
- B. Does the amount of the coverage vary significantly?
- C. Are there contractual elements which are deductibles (e.g., deposit, collateral on receivables...)?

The quantity of benefits is estimated on the basis of the table below:

A	B	C	Propositions
Yes	No	No	Contractual maximum guaranteed coverage
Yes	No	Yes	Contractual maximum guaranteed coverage less deductibles
No	Yes	No	Balance of expected covered amount taking into account the variability in the level of coverage provided
No	Yes	Yes	Balance of expected covered amount taking into account the variability in the level of coverage provided, less deductibles

Group of contracts with both investment and insurance components

Following questions should be addressed:

- A. Are insurance and investment components simultaneously significant?
- B. Is there a surrender option?
- C. Is it possible to allocate the CSM between the components?

The quantity of benefits is estimated on the basis of the table below:

A	B	C	Propositions
Yes	No	No	Reserve for: - Investment return service (e.g. mathematical reserve) - And the sum at risk related to insurance coverage (e.g. $\max[\text{sum insured} - \text{mathematical reserve}; 0]$)
Yes	Yes	No	- Policy's expected surrender value for the investment return service if different from the reserve - And reserve for sum at risk related to insurance coverage
No	NA	No	- During the investment period, reserve for the investment return services (e.g. mathematical reserve) - During the insurance service period, the level of insurance coverage service
NA	NA	Yes	Allocation of the CSM between the two components and projection of coverage units based on: - The reserve for the investment return service - The level of insurance coverage service

Step 4. Restrictions

For the coverage units' calculations, the following methods cannot be used:

- For an insurance contract without investment component, any methods where the quantity of benefits is impacted by the performance of any of the entity's assets.
- Methods that result in no allocation of the contractual service margin to periods in which the entity is providing services.
- Methods based on premiums, unless they are demonstrated to be reasonable proxies for the services provided by the entity in each period.
- Methods based on expected cash flows, unless they are demonstrated to be reasonable proxies for the services provided by the entity in each period

4.0 Frequently Asked Questions

4.1 CSM

Background

IFRS 17.44 (e)

For insurance contracts without direct participation features, the carrying amount of the contractual service margin of a group of contracts at the end of the reporting period equals the carrying amount at the start of the reporting period adjusted for:

- (e) the amount recognised as insurance revenue because of the transfer of services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period applying paragraph B119.

IFRS 17.B119 (b)

An amount of the contractual service margin for a group of insurance contracts is recognised in profit or loss in each period to reflect the insurance contract services provided under the group of insurance contracts in that period (see paragraphs 44(e), 45(e) and 66(e)). The amount is determined by:

- (b) allocating the contractual service margin at the end of the period (before recognising any amounts in profit or loss to reflect the insurance contract services provided in the period) equally to each coverage unit provided in the current period and expected to be provided in the future.

Question 1:

Should there be a release of CSM to profit or loss at the end of the reporting period in which there is a reversal of losses on a group of onerous contracts and the (re-)instatement of a CSM?

View A: Yes



View B: No

View C: It should be an accounting policy choice

Explanation

View A

In line with IFRS17.44(e) and IFRS 17.B119(b), at the end of the reporting period in which a CSM is (re-)instated after reversal of losses on an onerous group, the CSM should be allocated between coverage units over the current and remaining coverage periods. There should be a release of the CSM to profit or loss in the current period, to the extent it is allocated to coverage units in the current period.

Question 2:

Under view A of question 1, should there be any interest accretion of CSM for the current reporting period applying IFRS17.44(b)?

View A: Yes



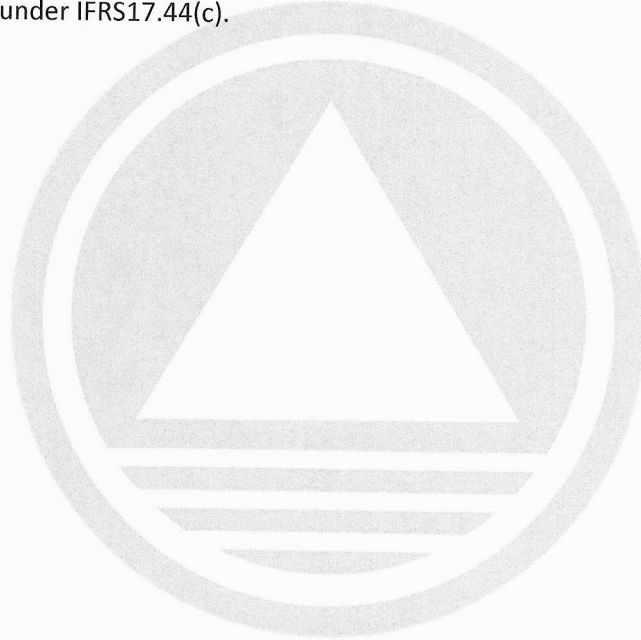
View B: No

View C: It should be an accounting policy choice

Explanation

View A

In line with IFRS17.44, the CSM interest accretion is adjusted under IFRS17.44(b) before the (re-) instatement of a CSM under IFRS17.44(c).



4.2 Loss Component

Question 1:

Which discount rates should be applied for the establishment of the LC and its subsequent adjustments?

View A: LIDR – Locked-in discount rate is used for the establishment of the LC and all adjustments (i.e. LC functions as a negative CSM). ☒

View B: Current – Current discount rate is used for the establishment of the LC and all adjustments (i.e. LC functions as an allocation of fulfilment cash flows). ☒

View C: Hybrid – Locked-in discount rates are used for establishment of the LC and 100% allocated adjustments while current rates are used for all other adjustments (i.e. a hybrid approach). ☒

Explanation

Any of the views presented is acceptable as long as the total LRC is measured using current discount rates.

Question 2:

Can coverage units be used as a basis for the systematic allocation of the LC under IFRS17. 50(a), 51(a) and 51(b)?

View A: ☒

Yes – Coverage units can be used as a basis.

View B:

No – Coverage units cannot be used as a basis.

Question 3:

If view A is acceptable in both questions 1 and 2, then do you agree that:

- an entity is permitted to fully apply a “CSM mirroring” approach to measuring the LC; and
- because the total LRC has to be measured following the FCF requirements, the LRC excluding the LC can be calculated as a balancing figure?

Explanation

Yes

Treating the LC as the inverse of the CSM comprises the calculations considered in questions 1 and 2. Accepting view A in both questions 1 and 2 means that both elements of an “inversed CSM” approach would be compliant with the requirements in IFRS 17 for LC. Under this approach, the LRC excluding the LC can be determined as a “balancing item”, being the difference between the total LRC (at current measurement) and the LC (an amount determined applying the requirements from View A in question 2).

Question 4:

If the answer to question 1 is the current rate for determining the amounts of LC changes in profit or loss, then when the CSM is re-established following a loss reversal event, what is the locked-in discount rate to be used for CSM interest accretion and for measuring the unlocking of CSM from that date?

View A: LIDR from initial recognition of the group of contracts



View B: Current rate as of the date the loss reversal occurred, newly locked in at that time

Explanation

View A

IFRS 17.B72(b)-(c) explicitly state that CSM interest accretion and changes which adjust CSM are done using the interest rate at initial recognition and this is the only rate that can be used for CSM interest rate accretion and to account for changes in FCF which adjust CSM. This includes the scenario when a new CSM has been recognised after a loss reversal event.

4.3 Investment Component – Actual vs Expected

Background

IFRS 17.B96

For insurance contracts without direct participation features, paragraph 44(c) requires an adjustment to the contractual service margin of a group of insurance contracts for changes in fulfilment cash flows that relate to future service. These changes comprise:

- a. experience adjustments arising from premiums received in the period that relate to future services, and related cash flows such as insurance acquisition cash flows and premium-based taxes, measured at the discount rates specified in paragraph B72(c);
- b. changes in estimates of the present value of the future cash flows in the liability for remaining coverage, except those described in paragraph B97(a), measured at the discount rates specified in paragraph B72(c);
- c. differences between any investment component expected to become payable in the period and the actual investment component that becomes payable in the period, measured at the discount rates specified in paragraph B72(c); and
- d. changes in the risk adjustment for non-financial risk that relate to future service. An entity is not required to disaggregate the change in the risk adjustment for non-financial risk between (i) a change related to non-finance changes in the time value of money and (ii) the effect of the time value of money. If an entity makes such a disaggregation, it shall adjust the contractual service margin for the change related to non-financial risk, measured at the discount rates specified in paragraph B72(c).

Question 1:

How should differences between expected and actual investment components be measured and treated when a claim is incurred?

View A: There are no differences between expected and actual investment components in a period (i.e. the expected investment components are always assumed to be the actual investment components).

View B: The expected and actual investment components should always be determined when a claim is incurred. ☒

View C: Actual investment components must always be determined when a claim is incurred, but the expected investment components may be estimated from the actual investment components, as a practical expedient.

View D: Actual investment components may be determined when a claim is incurred, and the expected investment components may be estimated from the actual investment components, or a practical expedient can be applied (the actual investment components may be estimated from the expected investment components, and the expected investment components may be determined when a claim is incurred). ☒

Explanation

View B/ View D

The expected and actual investment components should be determined when a claim is incurred. However, as a practical expedient, the expected investment components may be estimated from the actual investment components, or the actual investment components may be estimated from the expected investment components

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Question 2:

When applying paragraph B96(c) how should the time value of money be taken into account if the investment component is a fixed monetary amount?

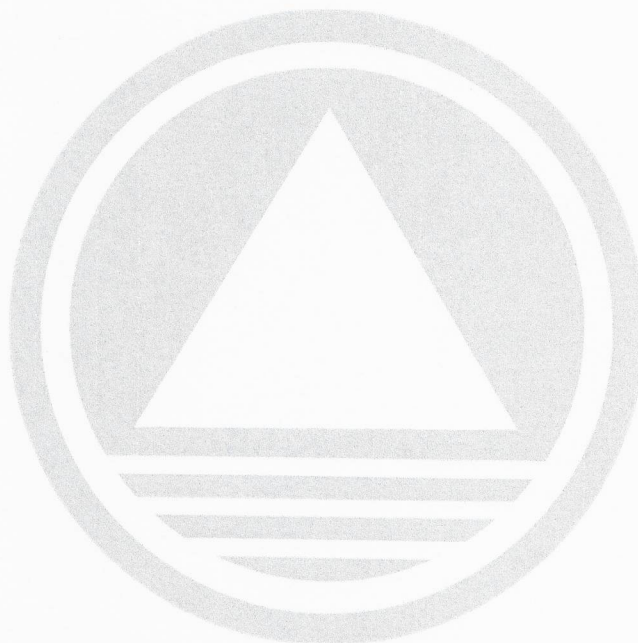
View A:

The measurement of the investment component should always have regard to the amount included in the fulfilment cash flows and so should take the time value of money into account.

View B:



If the measurement of an investment component is based on a fixed monetary amount identified in the contract, the time value of money should not be taken into account (i.e., the investment component should not be discounted).



4.4 FX Impact on CSM

Background

IFRS 17.44

For insurance contracts without direct participation features, the carrying amount of the contractual service margin of a group of contracts at the end of the reporting period equals the carrying amount at the start of the reporting period adjusted for:

- a. the effect of any new contracts added to the group (see paragraph 28);
- b. interest accreted on the carrying amount of the contractual service margin during the reporting period, measured at the discount rates specified in paragraph B72(b);
- c. the changes in fulfilment cash flows relating to future service as specified in paragraphs B96–B100, except to the extent that:
 - such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to a loss (see paragraph 48(a)); or
 - such decreases in the fulfilment cash flows are allocated to the loss component of the liability for remaining coverage applying paragraph 50(b).
- d. the effect of any currency exchange differences on the contractual service margin; and
- e. the amount recognised as insurance revenue because of the transfer of services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period applying paragraph B119.

Question 1:

Is an entity required to determine a 'CSM currency'?

View A: Yes



View B: No

Explanation

The requirements of IFRS 17 can result in a single unit of account (i.e. group of insurance contracts) including multiple contracts. To measure and present the foreign currency gains or losses (of IAS 21 and IFRS 17, including IFRS 17.44d and 45d) appropriately an entity would need to determine a single currency of the IFRS 17 unit of account. This single currency is the CSM currency.

Question 2:

What is the currency used when measuring the CSM of a group of insurance contracts with cash flows denominated in multiple currencies?

Explanation

Define a CSM currency for the group of contracts based on the predominant currency, which may be a different currency than the functional currency of the entity.

Question 3:

For calculating foreign exchange gains and losses on CSM, which approach do you agree with?

View A:

The CSM is retranslated at closing rates and any true up adjustment is treated as a foreign exchange gain or loss; or

View B:



The foreign exchange gain or loss is calculated before the CSM amortisation, meaning CSM amortisation must be translated at the closing rate.

Explanation

IFRS 17.44d requires currency translation from average rate to closing rate to be adjusted in CSM before release of CSM to insurance revenue is computed under IFRS 17.44e.

4.5 Coverage Units for Contractor's All Risks Product

Background

Contractors' all risks (CAR) insurance is an insurance policy that provides coverage for building and civil engineering works, machine erection, and third-party injury.

- Construction period : The liability of the insurers shall commence, after unloading of the property specified in the schedule at the contract site and shall expire on the date specified in the policy schedule.
- Maintenance period : The liability of the insurers during this period shall be limited to any loss or damage occasioned by the insured contractor(s) in the course of operations carried out for the purpose of complying with the obligations under the maintenance clause of the contract.

Relevant facts and circumstances surrounding the policy include:

- Pricing is standardized (i.e. CAR premium rates depend on project cost, sum insured, project nature)
- The policy provides two different coverages, each with a different coverage period:
 - Construction periods (between 2-3 years)
 - Maintenance periods (mostly 2 years)

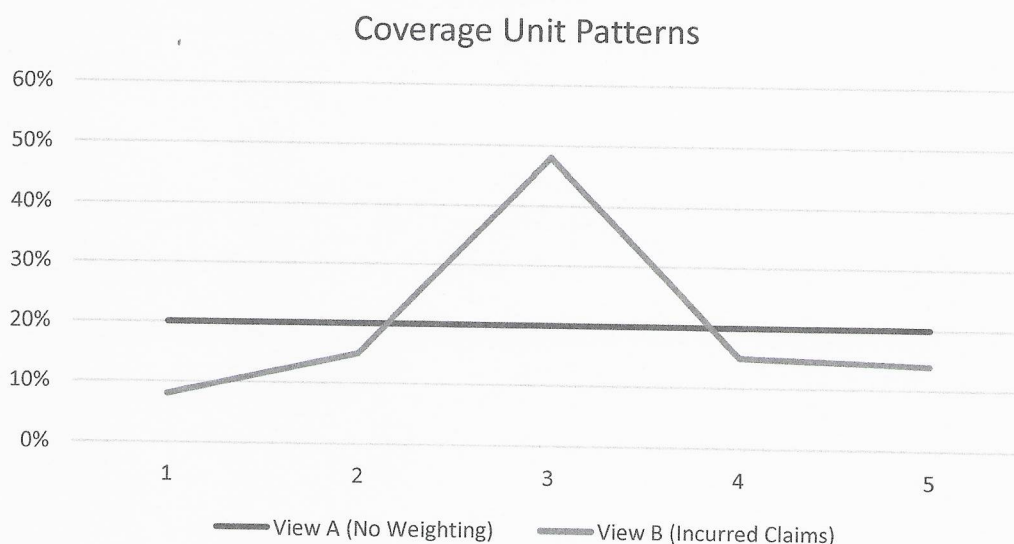
There are two related issues which are being considered by the entity when choosing the appropriate accounting estimates:

1. PAA : premium earning pattern; and
2. GMM : CSM recognition pattern and release of risk (if eligibility testing fails).

A further issue being considered is whether it would be appropriate for the entity to determine the probable maximum loss by policy year.

The graph below depicts:

- The revenue recognition pattern under IFRS 4 and the anticipated revenue recognition pattern under PAA (i.e. View A is also used for measuring incurred claims);
- Two possible CSM amortization (coverage unit patterns) under IFRS 17:
 - Straight-line over contract's coverage period (View A); and
 - Pattern of risk release over contract's coverage period (View B).



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Question 1 :

Which of the following methods for determining coverage units are acceptable under IFRS 17 for CSM allocation?

View A:

“Straight line” over the contract’s coverage period.

(For simplicity, the term “straight-line” is in reference to what, in practice, would be a marginally declining coverage limit because of lapse/expiry)

View B:

Based on pattern of risk exposure over each coverage’s relevant coverage period.

View C:



IFRS 17 is not prescriptive, both are permissible

Explanation

It is an accounting estimate, so it shall a discretion or judgement from company to company because no engineering project would be the same exactly in its pattern of risk and duration.

If a company chooses view B for its CSM allocation, it will be more difficult to pass the PAA eligibility because the pattern of LFRC run-off between PAA and GMM will be different.