STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	Quantity of the Benefits Provided under a Group of Annuity Contracts (IFRS 17)	
Paper topic	Initial consideration	
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the recognition of profit applying IFRS 17 *Insurance Contracts*. Applying IFRS 17, an entity includes unearned profit in the measurement of insurance contracts and recognises it as revenue as the entity provides services. The submission asks how to determine the services provided under a group of annuity contracts in each period and, more specifically, how to determine the quantity of benefits provided under each contract in the group.

2. At its February 2022 meeting, we provided the Committee with an overview of the applicable IFRS 17 requirements and other background information.

3. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

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Structure of the paper

4. This paper includes the following:

   (a) background information (paragraphs 6–12);

   (b) outreach (paragraphs 13–14);

   (c) IFRS 17 requirements (paragraphs 15–18);

   (d) analysis of the question asked in the submission (paragraphs 19–42); and

   (e) analysis of whether to add a standard-setting project to the work plan (paragraphs 43–46).

5. There are two appendices to the paper:

   (a) Appendix A—proposed wording of the tentative agenda decision; and

   (b) Appendix B—submission.

Background information

Fact pattern

6. Appendix B[1] to this paper reproduces the submission, including details about the fact pattern. The submission asks about a group of identical immediate annuity contracts. For each annuity contract in the group, the main facts considered in our analysis are that the policyholder:

   (a) pays the premium upfront and has no right to cancel the contract or seek a refund;

   (b) is entitled to a constant annual benefit starting from inception of the contract for as long as the policyholder survives; and

   (c) receives no other service under the contract (that is, the only service is insurance coverage for survival).

[1] The submission's page numbers do not follow the numbering of the paper. The page numbers are from 2–34. We use the submission's page numbers when we refer to the submission in the paper.

7. This is a simple fact pattern reflecting the main conditions of a life-contingent immediate annuity contract. In practice, fact patterns may include other conditions that an entity would need to analyse, in addition to the analysis in this paper, when determining the quantity of the benefits provided under the contract.

The question

8. Applying IFRS 17, the measurement of a group of insurance contracts includes a contractual service margin, which reflects the unearned profit in that group of contracts. An entity will recognise the contractual service margin in profit or loss as it provides insurance contract services to the policyholders in the group.

9. To achieve the principle of reflecting the insurance contract services provided under a group of insurance contracts, IFRS 17 requires an entity to identify the '**coverage units**'. The number of coverage units in a group is determined by considering for each contract the **quantity of the benefits** provided under the contract and its **expected coverage period**. To determine the amount of the contractual service margin to recognise in the current period, an entity allocates the contractual service margin equally to each coverage unit provided in the current period and expected to be provided in the future.

10. The submission asks how an entity determines the **quantity of the benefits** provided under each contract in the group of annuity contracts.

11. The submission sets out two approaches and asks whether both approaches meet the principle in IFRS 17 of reflecting the insurance contract services provided under a group of insurance contracts. The approaches identify the quantity of the benefits provided in each period as being reflected by:

    (a) Approach A—the constant annual benefit, that is, the claim amount payable for the period; and

    (b) Approach B—the present value of the current and future benefits, that is, the balance of all claim amounts expected to be payable over the duration of the contract.

12. The submission also analyses the implications of the two approaches for a group of deferred annuity contracts (that is, a group of annuity contracts under which the policyholder is entitled to a constant annual benefit starting from a specified date after contract inception for as long as the policyholder survives) and other types of insurance contracts. This paper focuses on the group of immediate annuity contracts (see paragraph 6) but also extends the analysis to a group of deferred annuity contracts.

Outreach

13. For some submissions, we perform outreach to understand whether the matter has widespread effect and has, or is expected to have, a material effect on those affected.

14. We did not perform outreach on this submission because sufficient understanding of the widespread effect of the matter was obtained from the evidence referred to in the submission and from discussions with stakeholders. The submitter:

    (a) gathered publicly available information about the prevalence and size of the UK annuity market (see pages 3–4 of the submission); and

    (b) highlighted that the matter could have wider implications for deferred annuity contracts and other types of insurance contracts (see pages 15–19 of the submission).

IFRS 17 requirements

15. Paragraphs 43 and 44 of IFRS 17 state:

> 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) ….

(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.

16. Paragraph B119 of IFRS 17 states (emphasis added):

> 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.

17. Appendix A to IFRS 17 defines insurance contract services as (emphasis added):

> The following services that an entity provides to a policyholder of an insurance contract:
>
> (a) coverage for an insured event (**insurance coverage**);
>
> (b) for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service); and
>
> (c) for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service).

18. Appendix A to IFRS 17 also defines the liability for incurred claims and the liability for remaining coverage as (emphasis added):

> **Liability for incurred claims**
>
> An entity's obligation to:
>
> (a) **investigate and pay valid claims for insured events** that have already occurred, including events that have occurred but for which claims have not been reported, and incurred insurance expenses; and...
>
> **Liability for remaining coverage**
>
> An entity's obligation to:
>
> (a) **investigate and pay valid claims under existing insurance contracts for insured events** that have not yet occurred (ie the obligation that relates to the unexpired portion of the **insurance coverage**); and…

Analysis of the question asked in the submission

19. As noted above, in determining the amount of the contractual service margin to recognise in profit or loss, an entity is required to identify the coverage units in a group of insurance contracts (paragraph B119(a) of IFRS 17). Identifying those coverage units could be described in three steps:

(a) Step 1—identify the insurance contract services to be provided under the group of contracts;

(b) Step 2—consider the expected coverage period of each contract in the group; and

(c) Step 3—consider the quantity of the benefits provided under each contract in the group.

20. For the group of annuity contracts described in the submission:

    (a) Step 1—no analysis is required. The submission specifies that the entity provides only one insurance contract service under the group of insurance contracts—insurance coverage for survival[2].

    (b) Step 2—both approaches described in the submission identify the same expected coverage period for each contract in the group, reflecting the entity's expectations of when death will occur.

    (c) Step 3—the submission focuses on this step and asks how to determine the quantity of the benefits provided under each annuity contract in the group.

21. IFRS 17 does not prescribe a method for determining the quantity of the benefits provided under a group of insurance contracts. Instead, an entity must use a method that meets the principle of reflecting the insurance contract services provided in each period. Different methods may achieve the principle depending on the fact pattern.

22. The submission presents two possible methods (Approach A and Approach B). Our analysis considers the arguments presented in the submission for and against both approaches to conclude on whether each approach would meet the principle and requirements in paragraph B119 of IFRS 17.

23. To illustrate the two approaches in the paragraphs below, we use the following example:

Illustrative example

- An entity issues 10 identical immediate annuity contracts at the beginning of year 1 and recognises the contracts as a group of insurance contracts.
- The entity provides only insurance coverage under the group of contracts.
- Under each contract, each policyholder pays the premium upfront and receives a constant benefit of CU100 each year until death.
- The entity expects that 1 policyholder will die at the end of each year resulting in a total coverage period for the group of contracts of 10 years.
- The contractual service margin at initial recognition is CU200.

[2]If the entity were to provide both insurance coverage and investment-return service under the group of contracts, it is required to develop (and then to disclose) an approach to determine the relative weighting of the benefits provided by each service when allocating the contractual service margin (see paragraph 117(c)(v) of IFRS 17).

- The entity discounts the expected future cash flows and coverage units for the time value of money at an annual discount rate of 3%[3].
- The example ignores the risk-adjustment for non-financial risk because the submission focuses only on the recognition of the contractual service margin in profit or loss.

The entity measures the expected future cash outflows for each year as follows:

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Surviving policyholders	10	9	8	7	6	5	4	3	2	1
Opening balance	4,899	4,046	3,268	2,566	1,943	1,401	943	571	288	97
Interest 3%	147	122	98	77	58	42	28	17	9	3
Claims in year	(1,000)	(900)	(800)	(700)	(600)	(500)	(400)	(300)	(200)	(100)
Closing balance	**4,046**	**3,268**	**2,566**	**1,943**	**1,401**	**943**	**571**	**288**	**97**	**0**

24. When in the following paragraphs we use this example to illustrate the approaches, we have assumed that everything turns out as the entity expected at contract inception.

25. Our analysis is structured as follows:

    (a) Approach A—the claim amount payable for the period:

        (i) illustration of approach (paragraphs 26–28);

        (ii) staff analysis (paragraphs 29–34); and

        (iii) staff conclusion (paragraph 35).

    (b) Approach B—the balance of all claim amounts expected to be payable over the duration of the contract:

        (i) illustration of approach (paragraphs 36–39);

        (ii) staff analysis (paragraphs 40–41); and

[3] Paragraph BC282 of the Basis for Conclusions on IFRS 17 states: 'IFRS 17 does not specify whether an entity should consider the time value of money in determining [how to allocate the contractual service margin equally to the coverage units provided in the period and the expected remaining coverage units] and consequently does not specify whether that equal allocation should reflect the timing of the expected provision of the coverage units. The Board concluded that should be a matter of judgement by an entity.'

(iii) staff conclusion (paragraph 42).

Approach A—claim amount payable for the period

Illustration of approach

26. Under Approach A, in applying paragraph B119(a) of IFRS 17 an entity identifies the coverage units in a group of insurance contracts by considering for each contract:

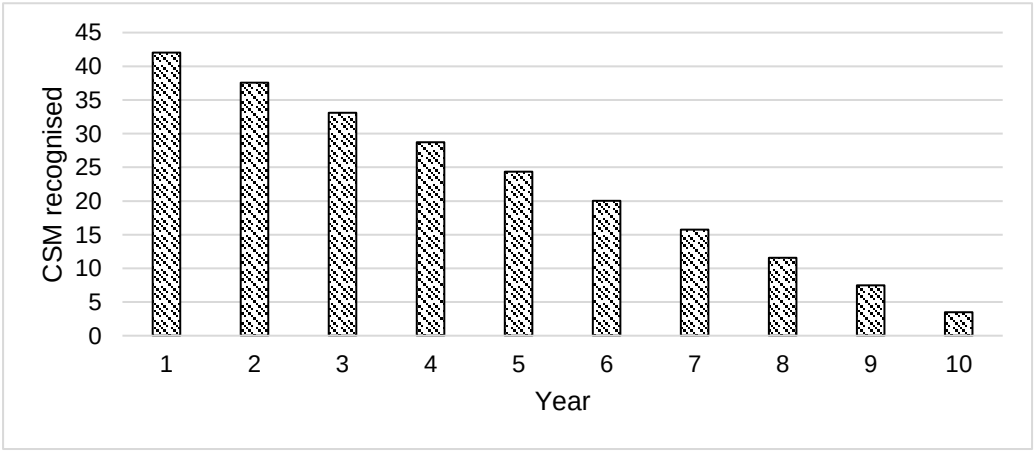
(a) the quantity of the benefits provided, reflected by the constant annual benefit of CU100 provided under each of the 10 contracts for each year the policyholder survives; and

(b) the expected coverage period, reflecting that—due to death—coverage is expected to end for one contract at the end of each of the 10 years.

27. If the entity were to assume that all 10 policyholders would survive for exactly 10 years, the total coverage units in each of the 10 years would be the same (that is, the coverage units would reflect benefits provided of CU100 x 10 contracts in each year).

28. Considering both the constant annual benefit (the quantity of the benefits of insurance coverage provided under each contract) and the expectation that the number of contracts in the group will decline (the expected coverage period for each contract), Approach A results in the following pattern of recognition of the contractual service margin of CU200 in profit or loss:

Approach A



Staff analysis

29. The submission puts forward arguments that the claim amount payable for each period under Approach A is appropriate in determining the quantity of the benefits of insurance coverage provided because:

    (a) it is the maximum amount that a policyholder could validly claim in each period if the insured event (survival) occurs (paragraphs 30–32); and

    (b) the claim amount payable for a period is the only amount that the policyholder has access to in that period (and therefore the only amount that the policyholder is benefitting from in that period), even though the entity has accepted insurance risk from contract inception for the remainder of the policyholder's life (paragraphs 33–34).

30. Appendix A to IFRS 17 defines, among other items, the liability for incurred claims and the liability for remaining coverage. Both of those definitions describe insurance coverage as '**an entity's obligation to investigate and pay valid claims for insured events**'.

31. Under the terms of the immediate annuity contracts described in the submission (and illustrated in paragraph 23 of this paper), survival of the policyholders in year 1:

    (a) obliges the entity to pay the valid claims of CU1,000 (CU100 x 10 contracts); and

    (b) does not oblige the entity to pay claims for years 2–10. Rather, the terms of the contract specify that the future annual benefits to be provided to the policyholder are contingent on survival of the policyholder in future periods.

32. The description of insurance coverage in IFRS 17 indicates that in determining the quantity of the benefits of insurance coverage provided in the current period an entity considers (a) the periods in which it has an obligation to pay a valid claim if an insured event occurs, and (b) the amount of the valid claim if the claim is made. The quantity of the benefits to be provided in future periods is the sum of the quantity of the benefits for each future period, calculated in the same way as the benefits for the current period.

33. Paragraphs BC140 and BC141 of the Basis for Conclusions on IFRS 17 explain that under an insurance contract, an entity can accept insurance risk before it is obliged to perform the insurance coverage service. The application of Approach A to a group of deferred annuity contracts—as illustrated in the submission—results in an entity recognising an amount of the contractual service margin in profit or loss for insurance coverage provided only once the policyholder is entitled to receive the constant annual benefit. That is, an entity would recognise no amount of the contractual service margin in profit or loss for insurance coverage before the policyholder is entitled to receive the constant annual payments (the deferral phase) because, during this period, the entity has no obligation to investigate and pay valid claims even though it has accepted insurance risk from contract inception.

34. The submission explains that some stakeholders view Approach A as an inappropriate method because it 'attributes no benefits to insured events which enhance the expected total lifetime benefits to the policyholder in periods that do not trigger an immediate payment' (see page 9 of the submission). Those stakeholders explain that this element of service has 'commercial substance to the policyholder and reflects the stand-ready obligation from the insurer to the policyholder throughout the coverage period.' We agree that, for the purpose of recognising the contractual service margin in profit or loss, Approach A does not reflect within the quantity of benefits the uncertainty about survival transferred from the policyholder to the entity. However, we disagree with the view that this means Approach A does not meet the principle in paragraph B119 of IFRS 17 for recognising the contractual service margin in profit or loss. We agree that uncertainty of survival (insurance risk) is a key feature of an insurance contract, and the transfer of this risk to the entity is a benefit to the policyholder for which the entity charges compensation. That is why, applying IFRS 17, an entity recognises a risk adjustment for non-financial risk representing the margin the entity charges for bearing insurance risk. An entity recognises this margin for bearing insurance risk in profit or loss separately from the contractual service margin and as the entity is released from that risk. As explained in paragraph BC279(a) of the Basis for Conclusions on IFRS 17, the release from risk is already reflected in the risk adjustment for non-financial risk and is irrelevant to the

satisfaction of an entity's performance obligation. (See also the discussion in section B of the table in paragraph 41 of this paper.)

Staff conclusion

35. We conclude that Approach A meets the principle in paragraph B119 of IFRS 17 to reflect the insurance coverage provided under a group of annuity contracts in each period. This measure of the quantity of the benefits:

(a) assigns a quantity of benefits only to periods in which the entity has an obligation to investigate and pay valid claims (for example, only to the period when the policyholder is entitled to receive the constant annual benefit under a deferred annuity contract); and

(b) aligns the quantity of benefits with the amount of the valid claim that is a constant amount in each year.

Approach B—balance of all claim amounts expected to be payable over the duration of the contract

Illustration of approach

36. Under Approach B, in applying paragraph B119(a) of IFRS 17 an entity identifies the coverage units in a group of insurance contracts by considering for each contract:

(a) the quantity of the benefits provided, determined based on the claim amount payable in the current period plus the present value of all claim amounts expected to be payable in future periods; and

(b) the expected coverage period, reflecting that—due to death—coverage is expected to end for one contract at the end of each of the 10 years.

37. Therefore, under Approach B an entity determines the quantity of the benefits provided in each period based on the balance of the present value of the expected cash flows as follows, using year 1 and year 2 as examples:

(a) at the end of year 1:

(i) the benefits provided to policyholders in year 1 are reflected by the balance of the present value of the expected future cash flows of 4,899; and

(ii) the benefits expected to be provided in the future are reflected by the present value of all the balances of the present value of the expected future cash flows for years 2–10. That amount plus the benefit provided in year 1 is 18,747. The calculation can be illustrated as follows:

Year	1	2	3	4	5	6	7	8	9	10
Opening balance	4,899	4,046	3,268	2,566	1,943	1,401	943	571	288	97
18,747	← discounted at 3% p.a.									

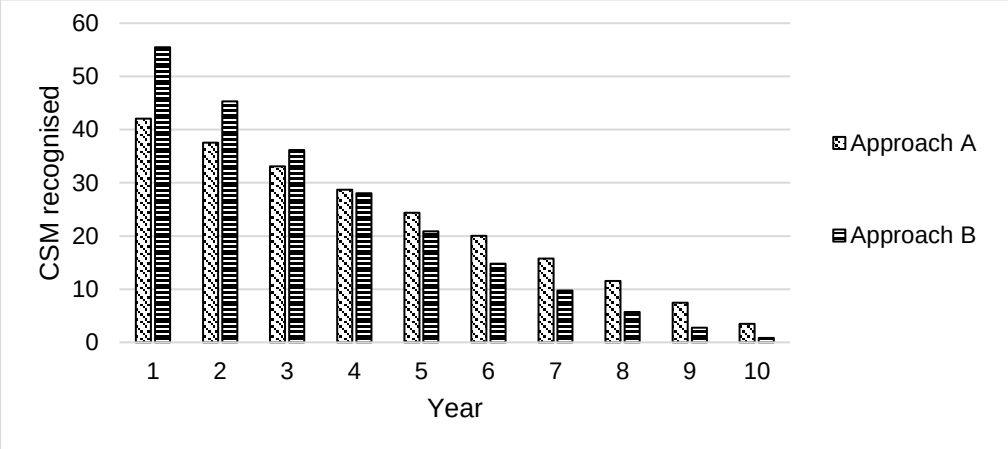
(b) at the end of year 2:

(i) the benefits provided to policyholders in year 2 are reflected by the balance of the present value of the expected future cash flows of 4,046; and

(ii) the benefits expected to be provided in the future are reflected by the present value of all the balances of the present value of the expected future cash flows for years 3–10. That amount plus the benefit provided in year 2 is 14,263.

38. Considering the probability of survival and discounting at 3%, Approach B results in the following pattern of recognition of the contractual service margin of CU200 in profit or loss compared to Approach A:

Approach B compared to Approach A



39. Approach B results in a steeper decline in the amount of the contractual service margin recognised in profit or loss when compared to Approach A. This is because Approach A reflects a **constant quantity of benefits** provided in each period, whereas Approach B reflects a **declining quantity of benefits** provided in each period.

Staff analysis

40. The submission puts forward arguments that the quantity of the benefits of insurance coverage provided under Approach B reflects:

(a) that survival in a period also entitles the policyholder to continued access to insurance coverage in future periods;

(b) the service of accepting insurance risk;

(c) the pricing of annuity contracts;

(d) the benefit lost if the policyholder were to die;

(e) the margin the entity charges for investment management expenses; and

(f) the view that the insured event in an annuity contract is one continuous event rather than a series of discrete insured events.

41. The analysis in the following table considers each argument in turn in the context of assessing whether Approach B would meet the principle in paragraph B119 of IFRS 17 to reflect the insurance coverage provided under the group of annuity contracts:

A. Approach B reflects that survival in a period also entitles the policyholder to continued access to insurance coverage in future periods
The submission puts forward an argument that the benefits provided to the policyholder in the current period as a result of survival in that period is both the claim payable for surviving in the period (CU100) and the continued right to receive payments until death. Applying this view, the quantity of the benefits is higher in earlier periods than in later periods because the continued right to receive

payments is related to a longer expected remaining coverage period in earlier periods compared to later periods.

Staff analysis:

We agree that the benefits to the policyholder over the coverage period is the continued right to receive payments until death. Paragraph B119(b) of IFRS 17 requires an entity to identify the portion of the benefits provided to the policyholder in the current period and the portion expected to be provided in the future. We are not persuaded by the view that, as a result of surviving in the current period, the policyholder **benefits in the current period** from the continued right to insurance coverage (the entity's obligation to investigate and pay valid claims for insured events) in future periods. The right to insurance coverage in future periods is created by the contractual terms of the contract and is contingent on survival in each period. The policyholder therefore benefits from the right to make a valid claim in future periods only when it survives in those future periods.

Therefore, in our view this is not a valid argument to support Approach B.

B. Approach B reflects the service of accepting insurance risk

The submission puts forward an argument that the declining quantity of the benefits in Approach B reflects the insured risk under the contract, which reduces over the coverage period. Proponents of Approach B think an approach based on a constant annual benefit, such as Approach A, fails to recognise that the policyholder has exchanged premiums for insurance against the risk of surviving for an unexpected period.

Approach B notes that the transfer of insurance risk is a key service that differentiates a life-contingent annuity (as described in the submission) from a fixed-term annuity.

Staff analysis:

We agree that uncertainty (insurance risk) is a key feature of an insurance contract, and the transfer of this risk to the entity is a benefit to the policyholder for which the entity charges compensation. That is why, applying IFRS 17, an entity

recognises a risk adjustment for non-financial risk representing the margin the entity charges for bearing insurance risk.

Paragraph B87 of IFRS 17 explains that the risk adjustment for non-financial risk measures the compensation that an entity would require to make it indifferent between:

(a) fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and

(b) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contracts.

Accordingly, IFRS 17 requires an entity to reflect in full—in the risk adjustment for non-financial risk—the difference between a fixed term annuity and a life-contingent annuity with an expected duration equal to the fixed term.

The contractual service margin is the margin an entity charges for its services **in addition to** the amount it charges for bearing the risk of uncertainty. An entity does not reflect the pattern of release from risk in the pattern of the recognition of the contractual service margin.

Therefore, in our view this is not a valid argument to support Approach B.

C. Approach B reflects the pricing of annuity contracts

The submission puts forward an argument that the declining pattern of the amount of the contractual service margin recognised in profit or loss under Approach B aligns with the price policyholders are willing to pay for service. A younger policyholder would be expected to place a higher value (reflected by a higher contractual service margin) on the service provided than an older policyholder, because of the greater uncertainty about how long they will survive at contract inception.

Staff analysis:

We agree that a younger policyholder would be expected to pay more for a life-contingent annuity contract than an older policyholder because:

(a) there is greater uncertainty about how long the policyholder will survive; and

(b) the younger the policyholder at contract inception, the longer the expected coverage period.

Regarding (a), as discussed in the previous section of this table IFRS 17 requires an entity to reflect in full—in the risk adjustment for non-financial risk—the compensation charged under the insurance contract for the uncertainty about how long the policyholder will survive. The release from risk (the recognition of the risk adjustment in profit or loss) will reflect the higher release of uncertainty in earlier years compared to later years.

Regarding (b), a younger policyholder pays more than an older policyholder because the remaining coverage period is expected to be longer; the younger policyholder therefore expects to receive benefits under the annuity contract for a longer period of time. This does not mean that the benefit it receives in earlier years is greater than the benefit it will receive in later years.

Therefore, in our view this is not a valid argument to support Approach B.

D. Approach B reflects the benefit lost if the policyholder were to die

The submission puts forward an argument that the benefit lost if the policyholder were to die in the current period is a factor to consider when determining the quantity of the benefits provided in the current period as a result of surviving.

Staff analysis:

We disagree with this view. The benefit lost to the policyholder in the event of death represents the quantity of the benefits of the insurance coverage for the entire remaining expected coverage period; it is not a measure of the benefits attributable to only one period of insurance coverage.

E. Approach B reflects the margin the entity charges for investment management expenses

The submission puts forward an argument that the declining quantity of the benefits in Approach B reflects the costs of investment activity the entity incurs, which may

be higher in earlier years than in later years because of the larger outstanding balance of expected future payments under the group of annuity contracts.

Staff analysis:

In our view, consideration of the entity's costs of investment activity is irrelevant when determining the quantity of the benefits provided to the policyholder in each period in the fact pattern described in the submission. In that fact pattern, the only insurance contract service provided under the group of annuity contracts is insurance coverage.

An entity invests and manages the premiums it has collected so that it can pay the constant annual benefit it has promised to policyholders until death. The entity may incur higher costs for its investment activities in earlier periods compared to later periods. However, this does not mean that the insurance coverage benefits provided to the policyholder are greater in earlier years compared to later years. In each period, the policyholder receives CU100 for survival as specified in the contract.

Therefore, in our view this is not a valid argument to support Approach B.

F. Approach B reflects the view that the insured event in an annuity contract is one continuous event rather than a series of discrete insured events

The submission says a key distinction between Approach A and Approach B is that Approach A views an annuity contract as a series of insured events (survival each year) whereas Approach B views an annuity contract as one continuous insured event (survival until death). Approach B therefore views an annuity contract as a wasting asset to the policyholder, for which the benefits of continued access declines over time as does the uncertainty about how long they will survive.

Staff analysis:

Paragraphs BC36 of the Basis for Conclusions on IFRS 17 explains, when considering the principle from IFRS 15 *Revenue from Contracts with Customers* on identifying performance obligations, the IASB concluded that the coverage and services provided over the whole duration of the contract would generally be treated as a single performance obligation that is satisfied over time. In our view, whilst the

distinction between the two approaches explained in the submission is helpful to understand the perspectives of proponents of each approach, the distinction does not change the nature of insurance coverage as a performance obligation satisfied over time.

Regardless of whether an entity views the insurance coverage as a series of distinct insurance contract services provided over time or as a single performance obligation satisfied over time, the measure of progress at the end of year 1 is required to reflect the insurance coverage provided in year 1 and the liability for remaining coverage at the end of year 1 is required to reflect the insurance coverage the entity expects to provide in the future.

Therefore, in our view this is not a valid argument to support Approach B.

Staff conclusion

42. Considering the analysis in the table above, we conclude that Approach B does not meet the principle in paragraph B119 of IFRS 17 to reflect the insurance coverage provided under a group of annuity contracts as described in the submission. This measure of the quantity of the benefits:

(a) assigns a quantity of the benefits to periods in which the entity has no obligation to investigate and pay valid claims (for example, to the period before the policyholder is entitled to receive the constant annual benefit of a deferred annuity contract), although it has accepted insurance risk; and

(b) misrepresents the quantity of the benefits provided in a period by considering claim amounts the policyholder can access and benefit from only in future periods.

Question 1 for the Committee

1. Does the Committee agree with our analysis of the application of the requirements in IFRS 17, outlined in paragraphs 19–42 of this paper?

Whether to add a standard-setting project to the work plan

Staff analysis and conclusion

43. Paragraph 5.16 of the IFRS Foundation *Due Process Handbook* states that the Committee decides to add a standard-setting project to the work plan only if, among other things, it is necessary to add or change requirements in IFRS Accounting Standards to improve financial reporting, that is, the principles and requirements in IFRS Accounting Standards do not provide an adequate basis for an entity to determine the required accounting.

44. Based on our analysis in paragraphs 19–42, we conclude that this criterion is not satisfied—the principles and requirements in IFRS 17 provide an adequate basis for an entity to determine the quantity of the benefits provided under each contract in a group of annuity contracts.

Staff recommendation

45. For the reason described in paragraph 44, we recommend that the Committee not add a standard-setting project to the work plan. We recommend that the Committee instead publish a tentative agenda decision that sets out the applicable requirements in IFRS 17 and explains how an entity determines the quantity of the benefits provided under the group of annuity contracts described in the submission. In our view, the tentative agenda decision would be helpful in explaining how to 'walk through' the applicable requirements.

46. Appendix A to this paper sets out the proposed wording of the tentative agenda decision. In our view, the proposed tentative agenda decision (including the explanatory material contained within it) would not add or change requirements in IFRS Accounting Standards.[4]

[4] Paragraph 8.4 of the *Due Process Handbook* states: 'Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.'

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision in Appendix A to this paper?

Appendix A—proposed wording of the tentative agenda decision

Quantity of the benefits provided under a group of annuity contracts (IFRS 17 *Insurance Contracts*)

The Committee received a request about how to identify, applying paragraph B119(a) of IFRS 17, the quantity of the benefits provided under a group of immediate annuity contracts. The policyholder in each contract:

a. pays the premium upfront and has no right to cancel the contract or seek a refund;

b. receives a constant annual benefit starting from inception of the contract for as long as the policyholder survives; and

c. receives no other services under the contract (insurance coverage for survival is the only service).

The request also described a group of deferred annuity contracts under which the policyholder receives a constant annual benefit starting from a specified date after the inception of the contract for as long as the policyholder survives.

The request sets out two methods of determining the quantity of the benefits provided in each period as:

a. the constant annual benefit, that is, the claim amount payable for the period; and

b. the present value of the current and future benefits, that is, the balance of all claim amounts expected to be payable over the duration of the contract.

Application of paragraph B119 of IFRS 17

Paragraph B119 of IFRS 17 requires an entity to recognise an amount of the contractual service margin in profit or loss in each period ‘to reflect the insurance contract services provided under the group of insurance contracts in that period’. To determine the amount of the contractual service margin to recognise in profit or loss in each period, paragraph B119 of IFRS 17 requires an entity to:

a. identify the coverage units in the group of insurance contracts, determined ‘by considering for each contract the quantity of the benefits provided under a contract and its expected coverage period’ (paragraph B119(a)); and

b. allocate the contractual service margin at the end of the period equally to each coverage unit provided in the current period and expected to be provide in the future (paragraph B119(b)).

In applying paragraph B119(a) of IFRS 17, an entity therefore:

a. identifies the insurance contract services to be provided under the group of contracts. In the fact pattern described in the request, insurance coverage for survival is the only insurance contract service provided under the group of contracts;

b. considers the expected coverage period for each contract in the group. For the fact pattern described in the request, the expected coverage period would reflect the entity's expectations of how long the policyholder will survive; and

c. considers the quantity of the benefits provided under each contract in the group.

IFRS 17 does not prescribe a method for determining the quantity of the benefits provided under a contract. Instead, an entity is required to use a method that meets the principle in paragraph B119 of reflecting the insurance contract services provided in each period. Different methods may achieve that principle depending on the fact pattern.

The definitions of the liability for incurred claims and the liability for remaining coverage in Appendix A to IFRS 17 describe insurance coverage as 'an entity's obligation to investigate and pay valid claims for insured events.' Paragraphs BC140 and BC141 of the Basis for Conclusions on IFRS 17 explain that an entity can accept insurance risk before it is obliged to perform the insurance coverage service. In determining the quantity of the benefits of insurance coverage provided under a contract, an entity therefore considers (a) the periods in which it has an obligation to pay a valid claim if an insured event occurs; and (b) the amount of the valid claim if the claim is made.

The Committee observed that, under the contractual terms of the annuity contracts described in the request, survival of the policyholder (the insured event) in each year—from when the policyholder is entitled to receive the constant annual benefit—obliges the entity to pay the annual benefit (the amount of the valid claim) for that year. Survival in one year does not oblige the entity to pay amounts that compensate the policyholder for surviving in future years; that is, claim amounts payable to policyholders in future years are contingent on the policyholder surviving in those future years.

The Committee's conclusions

The Committee concluded that determining the quantity of the benefits provided under each annuity contract described in the request as:

a. the claim amount payable for each period meets the principle in paragraph B119 of IFRS 17 of reflecting the insurance coverage provided in each period by:

   (i) assigning a quantity of the benefits only to periods for which the entity has an obligation to investigate and pay valid claims for the insured event (survival of the policyholder); and

   (ii) aligning the quantity of benefits provided in a period with the amount of the valid claim that is a constant amount in each period.

b. the balance of all claim amounts expected to be payable over the duration of the contract does not meet the principle in paragraph B119 of IFRS 17 of reflecting the insurance coverage provided in each period because it:

   (i) assigns a quantity of the benefits to periods for which the entity has no obligation to investigate and pay valid claims for the insured event; and

   (ii) misrepresents the quantity of benefits provided in a period by considering claim amounts the policyholder can access and benefit from only in future periods.

The request asked only about the recognition of the contractual service margin in profit or loss. For the annuity contracts described in the request, the entity accepts insurance risk related to the uncertainty about how long the policyholder will survive. The Committee noted that the entity would apply other requirements in IFRS 17 to recognise in profit or loss—separately from the contractual service margin—the risk adjustment for non-financial risk, representing the entity's compensation for bearing insurance risk. The Committee did not discuss those other requirements.

The Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an issuer of a group of annuity contracts as described in the request to determine for each contract the quantity of the benefits provided under a contract. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—submission

B1. We have reproduced the submission below. The submission's page numbers do not follow the numbering of the paper. The page numbers are from 2–34. We use the submission's page numbers when we refer to the submission in the paper.

Application of IFRS 17 to the interpretation of service and CSM amortisation methods for UK life-contingent annuities

EXECUTIVE SUMMARY

This paper seeks views from the IASB regarding the interpretation of IFRS 17 with respect to the service provided by a life contingent annuity and the application of IFRS 17 principles for recognising that service through the release of the contractual service margin ('CSM'). The paper presents two possible interpretations and seeks views on whether both are acceptable interpretations of the principles of IFRS 17.

The ICAEW is particularly interested in the question because annuities are by far the most significant source of growth for business presented in accordance with IFRS 17 for UK life insurers. The method for releasing the CSM is fundamental to the recognition of revenue under IFRS 17 for these contracts. There are concerns from some commentators that revenue recognition will not reflect the commercial model for annuities, which has led to the development of one of the approaches described in this paper.

Under IFRS 4, most entities have recognised a gain when annuities have been issued, a practice which is prohibited under IFRS 17. The degree of initial gain recognised under IFRS 4 depends on several factors, including the level of prudence applied by the entity to the measurement of the liability. It should be noted that neither of the approaches described in this paper results in an initial gain and the fulfilment cash flows are measured consistently under both approaches. In both interpretations, the CSM is released over the lifetime of the contract.

The differences in interpretation relate to different views on the service that is provided and this in turn results in a difference in the approach to releasing the CSM and revenue recognition. Some consider that service is represented by the benefits and commitments made by the insurer to the policyholder as described in the policyholder documentation described in section 2 of this paper. Others consider the payments made to the policyholder are the relevant measure of service under IFRS 17.

The paper seeks to establish the technical requirements in IFRS 17 that support the principle of recognition of CSM in line with service provided to policyholders. It also references the various papers prepared by the IASB staff for the TRG related to the CSM.

It then presents the two interpretations, together with an example and some analysis from the proponents of the two interpretations. It also includes a section on the relevance to deferred annuities. It also notes there may be other contracts which have similar features to annuities and considers whether both interpretations also result in an appropriate pattern of CSM recognition for these contracts.

1. THE UK ANNUITY MARKET AND WHY THIS ISSUE IS PREVALENT IN THE UK

Within the UK insurance market, annuity contracts, specifically the bulk purchase annuity market is the main growth area for life insurance business within the scope of IFRS 17. Bulk purchase annuities (BPAs) is the term used to refer to defined benefit pension schemes which are parcelled up and sold to large insurers to manage the risk such that the beneficiaries of the scheme receive their pension payments when they fall due for as long as they live. This enables UK employers with significant pension liabilities to pass the liability for paying pensions to insurers who will contract to manage the risk on behalf of the trustees of the pension scheme. The fact that a BPA contract transfers the risk associated with defined benefit pension scheme liabilities means there are typically complex and varying terms with the contract, all of which are transferred to the insurer to manage. This has a positive impact on UK economic growth as it enables businesses to de-risk their balance sheet by passing the management of pension liabilities to the insurance industry and focus on growing their business. Transactions during 2020 totalled c£30bn and are forecast to average over £40bn a year up to 2030. Almost £150bn has been written by eight market participants over the period 2009 to mid-2020.

Given the prevalence and the long duration of annuities, particularly BPAs where a typical annual cohort of contracts will take up to 70 years before all the profit is recognised, the CSM amortisation profile significantly impacts the timing of profit recognition under IFRS 17.

Below is a summary of estimated financial information on the size of the UK annuity market:

Individual annuities

The individual annuity market is mature and in recent years has declined, due largely to pensions freedoms introduced by the 2014 Pensions Reform Act. For example, in a 2018 report, PwC noted that new individual annuities sold in the UK declined by 78% between 2013 and 2016. Nevertheless, due to the size of the back book, this remains a major business. FCA information shows that new business was provided by roughly 20 entities, though business is now concentrated in only five main insurance groups. Assets under management backing annuity liabilities amount to some £300 billion.

Bulk purchase annuities

By contrast, the BPA business is increasing in significance and is the main growth area within the UK insurance market. BPA transactions amounted to £31.6bn in 2020, as reported by PensionAge, and Hymans Robertson report that almost £150bn BPA business has been written by eight market participants in the period 2009 to 2020. Hymans Robertson forecast BPA transactions to average around £40bn per year up to 2030. Although declining after 2030, their forecast shows continued high levels of BPA transactions up to 2040 (average over £20bn p.a.).

The level of transactions is driven by pension schemes' de-risking strategies and buy-outs resulting from sponsor insolvencies. Annuities are long term business, with typical duration of a single annual cohort of immediate annuities being 40 years. For BPA cohorts which typically include deferred annuities the duration of an annual cohort is typically 70 years. Average duration in the BPA market is longer, as members are typically younger and a significant proportion of lives insured are in the deferred phase (ie, in the phase before retirement).

Discussions by the UK Endorsement Board with standard setters in Canada and Australia and our review of EFRAG's Final Endorsement Advice indicate that the allocation of CSM for annuities is a particular UK concern. It was not a focus area for EFRAG and is not a significant topic of current debate in Canada or Australia, although we understand annuities are prevalent in those markets. These jurisdictions are seeing an increase in BPAs, though not on the scale observed in the UK.

The service provided by a life contingent annuity contract

Since pension freedom was introduced in the UK in 2015, individual policyholders are able to choose from several options at retirement. All of them, except for annuities, are investment options that could result in the policyholder running out of money if they live longer than expected. The uncertain future event that creates insurance risk in an annuity contract is the uncertainty over how long the policyholder will survive. The benefit of an annuity is that it provides a guaranteed income for life, however long that life is. Therefore, in opting for an annuity when alternative investment options are available, the policyholder is choosing to buy protection against the uncertainty of how long they will survive, ie, the benefit to the policyholder is longevity protection.

A review of policyholder documentation and UK Financial Conduct Authority guidance sets out the key terms of a life contingent annuity contract, which are:

- A promise to pay the policyholder a guaranteed income for the rest of their life;
- The choice to include payment of income to a dependent when the policyholder dies;
- The fact that this is a once-and-for-all decision for the individual policyholder regarding their future income needs for the remainder of their life, subject to any guarantees[1] (typically 5 or 10 years) explicitly stated in the contract;
- There is no possibility to cancel or surrender the contract and there is no return of premium on death.

Individual annuities and bulk purchase annuity contracts

The service provided by an individual annuity contract is consistent with the service provided by bulk purchase annuity contracts, where the policyholder is a pension scheme trustee that transfers the whole or tranches of its pension liabilities to an insurer. The statement of facts provided to the policyholder states that the product is designed to de-risk a pension scheme by purchasing cover for longevity, investment and inflation risk. ie, the benefit of the annuity to those trustees is laying off the risks around investment, inflation and longevity that could otherwise impact their ability to meet the future income stream obligation to their pensioners. The investment risk and inflation risk are both financial risks, it is the transfer of the longevity risk that makes annuity contracts insurance contracts.

Bulk purchase annuities may include a deferral of payments where they include pension scheme members who are yet to retire. The benefit to the trustees of insurance is present in this deferred phase and will also reflect options the policyholder has in terms of how benefits will be realised (eg, transfer out / lump sum benefits etc).

[1] Contracts may contain a feature that will pay out a fixed amount if the policyholder dies during a specified period at the start of the pay-out phase.

2. TECHNICAL REQUIREMENTS OF IFRS 17

Under IFRS 17, an amount of the CSM for a group of insurance contracts is recognised in profit or loss in each period to reflect the profit earned for insurance contract services provided under the group of insurance contracts in that period. The amount is determined by reference to the coverage units in the group, which are defined as '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'.

The appendix provides more information about how the CSM is recognised in profit or loss, including relevant references from the standard, the basis for conclusions and TRG papers.

3. IMPLEMENTATION QUESTION AND ANALYSIS OF APPROACHES

Background

The method for releasing the CSM for annuities has been a key question In the UK market, given their importance to insurers issuing these contracts. This included considering the deferred phase prior to the issue of the amendments to the standard in June 2020, which included changes related to the recognition of an investment return service and the inclusion of expenses incurred to enhance benefits.

The ICAEW has also been considering the application of IFRS 17 in the context of life-contingent immediate annuity contracts. Two views have developed regarding the interpretation of the services provided in each period to the policyholder and the resulting approach to release the CSM to reflect the service provided.

The first method of CSM allocation, presented as Approach A in this paper, is consistent with the IASB staff comments provided in example 12 in the agenda paper 5 of the May 2018 TRG meeting. The second method, presented as Approach B in this paper, was not considered in example 12 and hence we would like to obtain more clarity as to whether it also represents a permissible interpretation of the principles of IFRS 17.

Implementation question

Are both Approach A and Approach B permissible interpretations of IFRS 17 to support the principle in IFRS 17 to release the CSM in line with the service provided to the policyholder?

Fact pattern

The following fact pattern and example forms the basis of the analysis of the two approaches.
A life-contingent immediate annuity contract is issued at the beginning of Year 1 that pays out a fixed periodic (annual) benefit of currency units (CU) 1,000 each year until the annuitant dies.
Key characteristics of the contract which are relevant for the analysis are:

- The contract provides the policyholder with a guaranteed income for life.
- Payment of the premium is a once and for all decision, after the cooling off period of 90 days - there is no opportunity for the policyholder to seek any refund of premium.
- On death of the policyholder all payments cease, and the insurer has no further obligation under the contract including to return any premium.
- The periodic annuity benefit payments are made annually in advance; if the policyholder dies part way through a period there will be no attempt to recover any portion of the last payment made.
- Inflation is ignored, for simplicity.
- The contract provides an immediate annuity, so there is no deferral or accumulation period before the annuity starts. The amount of the annuity payments is determined based on the amount of premium paid.
- There is no guarantee period where the policyholder's dependants would continue to receive income from the annuity even if the policyholder dies.
- The contract can provide other services e.g., death benefit, protection for spouses and dependents, but these are ignored for simplicity.

Analysis of views

Approach A – The CSM allocation is determined based on the periodic benefit payable in each period that services are provided.

Under this method, the periodic benefit payable represents the quantity of benefits provided under the contract for each discrete insured event (policyholder's survival to the point of payment of a claim) and reflects both the maximum amount that a policyholder could validly claim in each period if an insured event occurs and the maximum contractual cover in each period.

Proponents of this approach believe that an annuity contract has a series of insured events, being survival to future points in time that valid claims can be made by the policyholder under the contract. A key feature of the contract is that the policyholder needs to remain alive up to each point in time in order to claim from the insurer the contractually agreed annuity payment (e.g., survive in year 1 to receive the annuity payment at the start of year 2, the same for year 2 and so on for the duration of the policyholder's life). Consequently, the insurance coverage and the service provided to the policyholder in each period is represented by the periodic payments that the policyholder receives for surviving each period. These periodic annuity payments are consistent with the notion of the maximum amount that a policyholder could validly claim in each period if an insured event occurs and the maximum contractual cover in each period because the policyholder would not have access to any other amounts in the period that the insured event occurred beyond the periodic annuity pay-out.

The interpretation that the periodic annuity benefit payable represents an acceptable method to determine the quantity of services provided in each period for a life-contingent annuity contract was supported by the IASB Staff view reported in example 12 in the May 2018 TRG paper (Agenda Paper 05, par.B46(b)).

Example 1 – Illustration of Approach A

The application of the CSM allocation approach under Approach A can be illustrated in the following example. Consider an annuity with an annual benefit of CU1,000 in a group with an expected duration of 40 years. The probability of survival for each period is depicted in the tables below (and in more details in the spreadsheet attached in the appendix) and the discount rate is 3% for the whole duration. CSM is assumed to be CU100 at initial recognition which is the start of year 1. In both example 1 and 2, the coverage units are discounted for the time value of money.

Approach A - Periodic benefit payable method

Year(s)[1]	1	2	3	4	5	6-10	11-15	16-20	21-30	31-40	
Annual Payment	1,000	1,000	1,000	1,000	1,000	5,000	5,000	5,000	10,000	10,000	
Discount Factor[2]	97.1%	94.3%	91.5%	88.8%	86.3%	79.0%	68.2%	58.8%	47.2%	35.1%	
Probability of Survival[3]	99.0%	97.9%	96.7%	95.4%	94.0%	89.0%	77.9%	62.8%	34.6%	5.9%	
PV of Annual Payments	14,786	14,210	13,628	13,040	12,449	53,289	38,544	24,905	19,399	1,844	
(A) Current service	990	979	967	954	940	4,449	3,894	3,139	3,459	587	
(B) Current + future service	14,786	14,210	13,628	13,040	12,449	53,289	38,544	24,905	19,399	1,844	
CSM amortisation factor [(A)/(B)][4]	6.7%	6.9%	7.1%	7.3%	7.6%	8.4%	10.2%	12.7%	19.3%	45.5%	
Opening CSM	100.0	96.1	92.2	88.2	84.2	80.2	60.0	40.7	23.9	3.7	*Total*
Interest accretion	3.0	2.9	2.8	2.6	2.5	10.8	7.8	5.1	3.9	0.4	*42*
CSM Amortisation[5]	-6.9	-6.8	-6.7	-6.6	-6.6	-31.0	-27.1	-21.9	-24.1	-4.1	*-142*
Closing CSM	96.1	92.2	88.2	84.2	80.2	60.0	40.7	23.9	3.7	0.0	

Notes:

[1] Information for years 6-20 is presented in buckets of 5 years. Information for years 21-40 is presented in buckets of 10 years as the financial impact of the CSM amortisation considerably reduces in the second half of the annuity pay-out period.

[2] The discount factor from year 6 onwards reflects the average discount factor for the respective periods.

[3] The probability of survival from year 6 onwards reflects average probability for the respective periods.

[4] The CSM amortisation factor from year 6 onwards reflects the average CSM amortisation factor for the respective periods.

[5] The CSM amortisation for the year buckets presented after Year 5 reflects the sum of the CSM amortisation for each year within the period band applying the CSM amortisation factor in each respective year.

The example does not show the risk adjustment or premiums for simplicity.

Following the requirements in IFRS 17 B119 paras a) to c):

1. Identifying the coverage units. In this example, the quantity of insurance contract services is 14,786, which is the expected value of the amount to be paid to policyholders of the group over its duration. It is the present value of the annual payments of 1,000 per year for 40 years, adjusted for expected deaths each period. This equates to coverage units of 14,786 also.
2. Allocate the CSM at the end of the period equally to each coverage unit provided in the current period and expected to be provided in the future. So, for period 1, 990 coverage units are provided (being the annual payment of 1,000 adjusted for expected survival in the period of 99%) in the period and there are 13,786 left to be provided.
3. Recognise in P&L, the amount allocated to coverage units in the period. So, for period 1, the CSM amortisation is 990 divided by 14,786 multiplied by 103 (being the starting CSM with interest accreted for one year at 3%) = 6.9.

This method equates the quantity of insurance contract services in the accounting period to the amounts that are paid in the period. Thus, the quantity of benefits agrees to the present value of the total expected amount that will be paid to the policyholders in the group of contracts. This method is consistent with the concepts that coverage units are linked to the maximum amount payable in the period (that is 1,000 multiplied by the probability of survival in the example above) and the amount that may be claimed in the period (again being 1,000 multiplied by the probability of survival).

The above method of CSM amortisation is consistent with how proponents of Approach A perceive the service delivered in each period under the contract, which is considered to reflect a series of insured events and coverage for each insured event is provided in each period in which a valid claim can be made. Hence linking the coverage units to the payments is consistent with the transfer of services in the period being equivalent to the annuity payments the policyholder receives.

The quantity of benefits (and the coverage units) for each contract is the sum of the annuity payments that are expected to be paid to the policyholder. A consequence of this method is that the amount of CSM amortised in a period equates to the proportion of the total payments that is received by the policyholders in that period, after allowing for the probability of survival.

This approach is believed to be consistent with the IASB Staff Approach As presented in Example 12 in the May 2018 TRG paper.

Proponents of Approach B believe this interpretation is consequential of how the proponents of Approach A perceive the insured event and the emergence of service as a series of discrete

insured events and coverages as opposed to the survival risk being continuous throughout the contract. They would therefore argue that Approach A attributes no benefits to insured events which enhance the expected total lifetime benefits to the policyholder in periods that do not trigger an immediate payment. This element of service has commercial substance to the policyholder and reflects the stand-ready obligation from the insurer to the policyholder throughout the coverage period.

They believe the interpretation under Approach A fails to recognise the fact that the policyholder has exchanged premiums for insurance against the risk of surviving for an unexpected period of time and the value the policyholder continues to obtain from the contract as long as the policyholder lives is continued insurance against the risk of their savings pot not lasting during retirement

They believe there is commercial substance in this service and that this service is clearly perceived by the policyholder by the continued access to the future stream of annuity payments that would cover the survival risk over their lifetime. The periodic annuity benefit fails to accurately capture that transfer of service in the form of continuous insurance coverage to the policyholder for as long as they survive their contract.

Approach B – The service in a period is based on the value to the policyholder of surviving to the end of the period which includes both the annuity payment in the period as well as the continued access to receive a continuous stream of future payments for as long as the policyholder survives aligned to the description within policyholder documentation as set out in section 2.

This reflects the insured risk under the contract (i.e. the risk of living longer than expected or longer than the policyholder's savings lasts and the policyholder having insufficient funds to cover their living costs for the remainder of their life).The CSM allocation is determined based on a quantity of benefits that is represented by the present value of all future payments under the contract and is consistent with the method based on expected cash flows noted in the May 2018 TRG meeting. Proponents of Approach B believe that the policyholder is seeking to achieve financial security for the remainder of their life.

The development of Approach B has arisen as financial analysis of the impact of IFRS 17 has developed through the implementation process and identified that CSM allocation based on Approach A results in a very significant deferral of CSM recognition that is not evident from simple examples. In particular the simpler Approach A (based on annuity payments each period) does not reflect the key service which differentiates a life contingent annuity (the promise to pay for an uncertain period until the policyholder's death) from a fixed term annuity (the promise to pay for a fixed period). This does not reflect the commercial substance as market evidence supports the fact that policyholders pay an additional amount for the life contingent service.

Application of Approach B aligns to the commercial substance observed in the UK's market for annuity contracts which is directly linked to how market participants price annuities. If the CSM release profile is derived in a way which is not aligned with these economic principles, then over time the amount of CSM diverges from that which would be measured based on market values (as observed in the active BPA market) or new customer pricing principles. For example, if we assume 2 customers aged 75 with otherwise identical risk profiles and all other assumptions are consistent,

then compare the present value of CSM if one took out the policy 10 years ago, amortised according to approach A, with the CSM for the other who takes out a new contract aged 75, the CSM post amortisation would be significantly greater for the existing customer than for the new customer. If alternatively, we use approach B then the CSM of the existing and new customers are aligned. Proponents of Approach B believe that the cash flow-based Approach A is not representative of economics and would result in a material overstatement of the CSM for many decades. It would generate a material divergence between the commercial substance of annuity business written and what is reflected in the IFRS 17 balance sheet.

Proponents of Approach B believe that the insurance contract service provided to the policyholder over the life of the contract is a guaranteed income (stream of payments) until their death. The service transferred in each period reflects survival in the period plus the entitlement to ongoing coverage for survival in future periods for the expected duration of the policyholder's life. The benefit provided to the policyholder is the continued right to receive payments this period and in future periods until death as a result of the insured event which is survival.

Therefore, proponents of Approach B think that the amount that can be validly claimed in the period represents part payment of an overall uncertain future claim and so an approach that views the maximum contractual cover in a period, eg, an annual period, as one year's worth of the sum of the payments the policyholder can expect to receive over the term of the contract (ie, the expected duration until their death) better reflects the services provided in the period. This approach was not considered by the TRG during its discussions in May 2018, however it is consistent with the method described in the May 2018 IASB TRG meeting summary paragraph 35 (h)(v):

> '(v) methods based on expected cash flows. However, methods that result in no allocation of the contractual service margin to periods in which the entity is standing ready to meet valid claims do not meet the objective.'

In contrast with Approach A, proponents of Approach B see the insured event as continuous throughout the contract rather than a series of discrete, independent insured events and so in their view the coverage period and service delivery is continuous spanning from the first period the policyholder is entitled to start receiving payments and ends on death of the policyholder when the insurer's obligations cease.

Proponents of Approach B believe the definition of service in this approach is consistent with the technical requirements of IFRS 17.B119, the definition of insurance contract services and coverage period in appendix A as well as IFRS 17.BC222, because in their view the policyholder continues to receive ongoing coverage in the period for the insured event under the contract, their survival, for the current and future periods for as long as they may live.

Applying the definitions of insurance contract services and insured event in Appendix A of IFRS 17, the insurer in a life-contingent annuity contract in its pay-out period provides insurance coverage for ***an insured event*** (risk that the policyholder lives longer than their pot of savings last), not a series of insured events, and so the transfer of services under the contract should be reflective of that insurance. Otherwise said, by surviving one more period the policyholder continues to receive ongoing protection under the contract for that period and beyond and this is not accurately reflected by equating the transfer of service with the annuity periodical pay-out only.

Another way to try and perceive the service provided to the policyholder of a life-contingent annuity is by distinguishing between the services provided under a fixed term (non-life contingent) annuity and a life contingent annuity:

- For a fixed term annuity contract the only benefit is the payment each period.
- For a life-contingent annuity, the benefit is the entitlement to a payment in the period and retention of cover for the remainder of the policyholder's expected life.

Some proponents of Approach B would also consider how the policyholder perceives the service they receive under the contract by looking at what is the value lost versus what is the value obtained by the policyholder if the insured event (survival) did not occur/occur. In the event of death, the policyholder will not receive the annuity payment for the period and the entitlement to any future annuity payments from the end of that period (and the inception pricing approach will allocate a proportion of those expected benefits from those that die to the benefits of those that survive). Consequently, they think that this should be factored into the determination of the quantity of benefits provided under the contract.

Proponents of Approach B believe that the commercial substance of the contracts also includes a margin on investment management expenses because investment activity is a necessary activity to enhance benefits from insurance coverage and this is reflected in the pricing and delivery of services to policyholders. This margin is recognised appropriately under approach B but would result in a deferral of recognition compared to the costs of delivering this activity under approach A.

Example 2 – Illustration of Approach B

Example 2 below illustrates the application of Approach B in the same fact pattern as illustrated for example 1 above.

Approach B - Present value of the benefits provided

Year(s)[1]	1	2	3	4	5	6-10	11-15	16-20	21-30	31-40	
Annual Payment	1,000	1,000	1,000	1,000	1,000	5,000	5,000	5,000	10,000	10,000	
Discount Factor[2]	97.1%	94.3%	91.5%	88.8%	86.3%	79.0%	68.2%	58.8%	47.2%	35.1%	
Probability of Survival[3]	99.0%	97.9%	96.7%	95.4%	94.0%	89.0%	77.9%	62.8%	34.6%	5.9%	
PV of Annual Payments	14,786	14,210	13,628	13,040	12,449	53,289	38,544	24,905	19,399	1,844	
(A) Current service	14,786	14,210	13,628	13,040	12,449	53,289	38,544	24,905	19,399	1,844	
(B) Current + future service	160,811	150,406	140,282	130,453	120,935	473,691	289,259	154,246	90,312	5,141	
CSM amortisation factor [(A)/(B)][4]	9.2%	9.4%	9.7%	10.0%	10.3%	11.3%	13.4%	16.3%	23.5%	51.3%	
Opening CSM	100.0	93.5	87.2	81.1	75.2	69.5	44.2	24.9	11.8	1.1	*Total*
Interest accretion	3.0	2.8	2.6	2.4	2.3	8.8	5.4	2.9	1.7	0.1	*32*
CSM Amortisation[5]	-9.5	-9.1	-8.7	-8.4	-8.0	-34.1	-24.7	-16.0	-12.4	-1.2	*-132*
Closing CSM	93.5	87.2	81.1	75.2	69.5	44.2	24.9	11.8	1.1	0.0	

Notes:

[1] Information for years 6-20 is presented in buckets of 5 years. Information for years 21-40 is presented in buckets of 10 years as the financial impact of the CSM amortisation considerably reduces in the second half of the annuity pay-out period.

[2] The discount factor from year 6 onwards reflects the average discount factor for the respective periods.

[3] The probability of survival from year 6 onwards reflects average probability for the respective periods.

[4] The CSM amortisation factor from year 6 onwards reflects the average CSM amortisation factor for the respective periods.

[5] The CSM amortisation for the year buckets presented after Year 5 reflects the sum of the CSM amortisation for each year within the period band applying the CSM amortisation factor in each respective year. The total CSM amortised of 132 is less than the 142 in Approach A. This results from the relatively slower revenue recognition under Approach A, which means that more interest is accreted on the CSM balance than under Approach B.

	Difference between Approach A and B									
Interest accretion (B-A)	0.0	-0.1	-0.1	-0.2	-0.3	-2.0	-2.4	-2.2	-2.3	-0.3
CSM Amortisation (B-A)	-2.6	-2.3	-2.0	-1.7	-1.4	-3.1	2.4	5.9	11.7	2.9
Net profit (B-A)	-2.6	-2.4	-2.1	-1.9	-1.7	-5.1	0.0	3.7	9.4	2.6

Under Approach B, the CSM is released using the following method:

1. The coverage units are the sum of the present value of the annual payments at the end of each period. So, at the start of year 1, total coverage units are 160,811. The present value of the annual payments is calculated consistently with Approach A (the present value of the annual payments of 1,000 per year for the number of remaining years, adjusted for expected deaths each period).
2. The service provided in the period is represented by the present value of the future annual payments to be made to policyholders in the group. So, for period 1, 14,786 coverage units are provided in the period out of the total of 160,811.
3. Recognise in P&L the amount allocated to coverage units in the period. So, for period 1, the CSM amortisation is 14,786 divided by 160,811 multiplied by 103 (being the starting CSM with interest accreted for one year at 3%) = 9.5.

The approach illustrated in Example 2 is consistent with how proponents of Approach B perceive the delivery of service under the contract in each period. As explained above, the service provided to the policyholder against the risk of longevity is continuous reflecting cover for survival for an unexpected period of time. Hence the service provided is the cash paid in the period plus the protection which ensures access to future payments for the expected duration of the contract. The quantity of benefits provided in each period reflects the service associated with protection of their future income needs (a stand ready obligation on the part of the insurer) and the amount of cash received. It also reflects the fact that the annuity is a wasting asset to the policyholder, meaning that the benefit of continued access to it falls over time as does the uncertainty surrounding the ultimate outcome to the policyholder.

Proponents of Approach B consider the determination of coverage units should be based on the maximum contractual cover in the period and they believe that the present value of the total annuity claim over the life of the contract is a way of determining this.

Proponents of Approach B believe the approach presents more fairly the service provided and aligns with the amount the policyholder is prepared to pay for the service in a competitive market that exists in the UK. This is demonstrable post the pensions freedom legislation that means policyholders only chose an annuity if they particularly want the service that includes protection of income for the rest of their life. The value of this service is not linear across the expected duration of the contract. A younger policyholder would be expected to place a higher value on an annuity for the rest of their life, and hence a higher value on the service provided, because of the greater uncertainty around how long they will live for at that time. Therefore, the service provided by an annuity is much greater to the policyholder at younger ages. As the policyholder continues to live, the uncertainty surrounding their life expectancy begins to reduce and therefore the service provided to them by an annuity reduces from i) less variation around the number of remaining

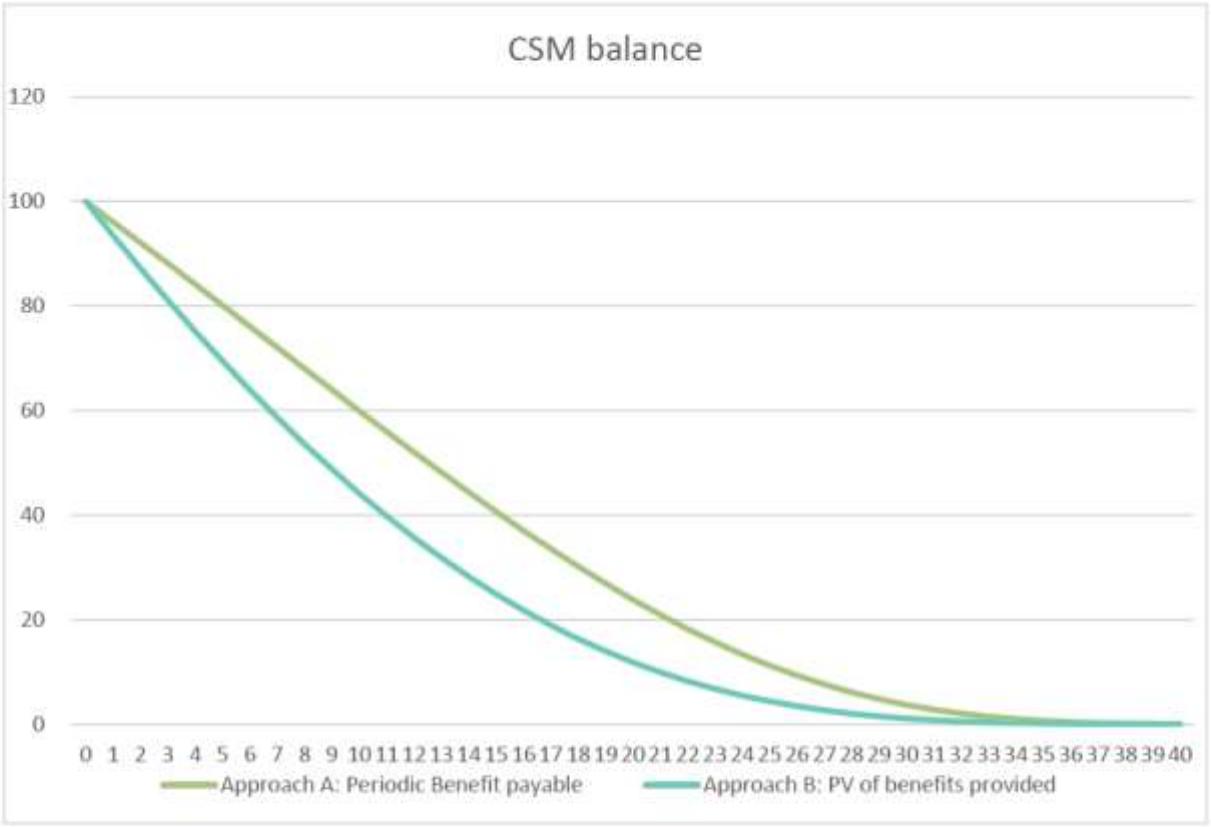
payments, and ii) fewer expected payments. It is therefore rational that the CSM profile follows this pattern, which it would not using a cash flow-based approach. This is reflected in the commercial substance of contracts sold. Proponents of Approach B have tested the level of risk adjustment and note that the margin in excess of the risk adjustment (calibrated to the compensation charged for bearing risk) is greater in the early years.

Proponents of Approach A note that Approach B takes into account in the quantity of benefits for the determination of coverage units amounts that are in excess of what 'the entity expects the policyholder to be paid in each period if an insured event occurs' and this is contrary to the analysis provided by the IASB staff in response to example 12 in the May 2018 TRG meeting. While the continued access to potential future annuity payments from surviving in a given period has value, there is no transfer of that value in the form of insurance coverage beyond the periodic annuity payment because the policyholder cannot validly claim or monetise any other amounts before the occurrence of those future insured events. If no insured event can take place during the period, then no insurance coverage is provided in that period, even if the insurer is bearing insurance risk. While the entity is standing ready to pay a decreasing amount from period to period, the stand-ready obligation that is relevant for service transferred in the period is the amount the entity is standing ready to pay in the period, not the amount it is standing ready to pay in future periods. They note that the sum-of-the-digits method in Approach B systematically allocates more revenue to earlier periods of a group than later periods of a group. This implies that policyholders are receiving more service in earlier periods than later periods. They question why this results in a fair reflection of the benefits received in the period.

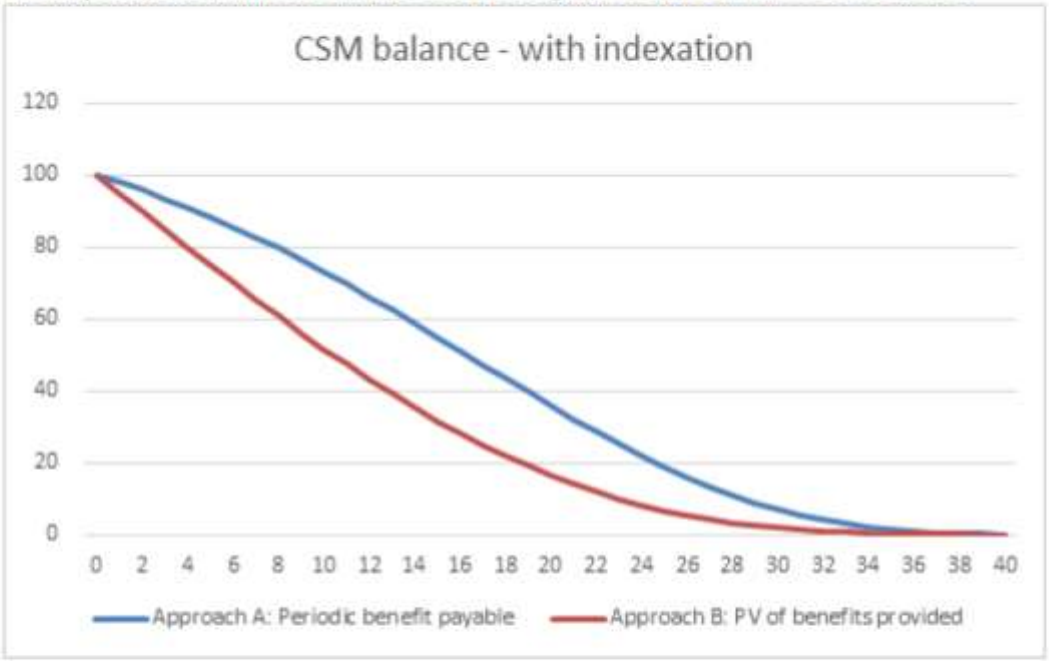
Proponents of Approach A also believe that there is a distinction to be made between what reflects a transfer of insurance risk, including the period under which the insurer is bearing that risk, and the provision of insurance coverage. The fact that the entity continues to bear the risk for the potential future insured events at the end of a reporting period is represented by its stand-ready obligation (e.g., the entity's obligation to pay valid claims when a policyholder remains alive in years 2,3, etc.) but it does not mean that any coverage for those potential future events is provided in a previous period (eg, year 1). Proponents of Approach A note that as described in BC222 the CSM 'represents the margin the entity has charged for the services it provides in addition to bearing risk. The expected margin charged for bearing risk is represented by the risk adjustment for non-financial risk.'

Illustrations of the development of the CSM balance under the two approaches

The following graph illustrates the difference in the CSM balance run-off for all years under the two approaches:



If benefit inflation is included at 3% which is common and a key service in many annuity contracts the impact is to further slow the CSM recognition on both bases as follows:



4. APPLICATION OF APPROACH A AND APPROACH B TO DEFERRED ANNUITIES

The IASB amended IFRS 17 (June 2020) to permit an investment-return service following industry concerns that without this permitted service there would be no CSM earned over the deferred period of a deferred annuity, partially arising from an interpretation of TRG Example 13. If Approach A is applied to deferred annuities then, as the IASB indicated in its discussions, there would be no insurance contract service until the annuity vests and becomes payable to the policyholder as there is no benefits in the deferred period.

In the example of the immediate annuity contract outlined above proponents of Approach B see the insured event as continuous throughout the contract rather than a series of discrete insured events and so in their view the coverage period and insuranceservice delivery is continuous spanning from the first period the policyholder is entitled to start receiving payments and ends on death of the policyholder when the insurer's obligations cease. In a deferred annuity contract the first benefit payment will only be due after retirement but as these future amounts are expected to be paid proponents of Approach B would argue that the coverage period for the insurance contract is from inception of the contract, not just on retirement. Approach B would therefore result in CSM being earned over the deferred period of a deferred annuity as there would be insurance coverage in this period.

The investment return service incorporated into the standard remains distinct from the service, irrespective of how that service is measured. The fact that the amended standard would allow for the recognition of CSM for the investment return service during the period prior to retirement does not prevent insurance contract services also being recognised in this period.

5. POTENTIAL CONSEQUENCES FROM THE APPLICATION OF APPROACH A AND APPROACH B TO OTHER CONTRACTS

This section considers how the principles in the two approaches may apply to several types of insurance contracts. It is not intended to be an exhaustive list, nor to provide definitive conclusions on the amortisation of the CSM for these contracts, but to highlight that the principles put forward in this paper should also be considered for contracts other than annuities. The different views on how the principle of service is interpreted means there are different views on how Approach B would be applied. Proponents of Approach A believe there is a risk that the principles of Approach B could lead to unintended consequences that may result in changes to CSM recognition for other contracts, while proponents of view B believe the IFRS 17 principle of recognition of CSM in line with service provided is sufficiently clear such that this would also result in appropriate revenue recognition for other products with similar features to annuity contracts.

Product	Approach A	Approach B
Pure endowment A pure endowment pays out if, and only if, the policyholder is alive at a specified future date. Consider the following example: – Policyholder pays a premium as at 1 January 2021 – The contract pays out if the policyholder is alive on 1 January 2031 – There is a CSM of 50 and a risk adjustment of 20.	A key feature of Approach A is that the coverage units for a period are limited to the amount of benefits that can be received during that period. In the case of a pure endowment there is no possibility to receive any benefits in the periods prior to the claim date and therefore no coverage units are released before the claim date. Consequently, for the example above, no CSM would be released until 1 January 2031, at which point the whole CSM (50) is released. It should also be noted that any changes in the risk adjustment would adjust the CSM and would not be recognised in profit or loss until 1 January 2031 in accordance with IFRS 17.B96(d).	An alternative perspective, which is aligned to the logic of Approach B, is that service is transferred prior to the claim date. The coverage period may be seen as the whole period prior to the claim date and the insured events are the survival for each period prior to the claim date. The present value of the future payment increases each period which represents the service that has been transferred during that period.
Forward purchase of fixed rate annuity – policyholder right to cancel Consider a forward contract to buy an annuity in the future at a fixed rate. The premium is	The IASB staff noted they did not think an insured event can happen in the period before the annuity payments start. Consequently, under Approach A, no release of the CSM would be recognised in the	Proponents of both approaches are not aware of this type of contract being available in the market as it is a nil cost guaranteed annuity option. It is effectively an option against the insurer in case of economic

payable when the annuity is purchased. If the policyholder dies or cancels the contract before the date the annuity can be purchased they receive no benefit. This was example 13 included in the paper for the May 2018 TRG meeting. **For this example, assume the forward contract is entered into on 1 January 2022 and the premium and annuity payments start on 1 January 2031.**	period from 1 January 2022 to 1 January 2031 because there is no insured event in these periods.	or longevity changes and therefore would be unlikely in reality. Proponents of Approach B agree that no insured event has occurred with such contracts until annuity payments start since the annuity contract has been pre-agreed at a fixed price. Their view is that this is different from a traditional annuity contract where survival in a period is increasing your right to future expected cashflows. Some consider that the contract may not meet the recognition criteria of IFRS 17 until 1 January 2031 when the premium is received. They note that the staff paper concluded that the insurer bears risk from the date the contract is issued. Some are concerned there is a risk that the principles of Approach B would result in insurance coverage in the period from 1 January 2022 to 1 January 2031. This is because, on survival to the end of each year before the annuity starts, the policyholder remains entitled to the potential future annuity payments, and so there would be an insurance event and service from the date the forward contract is entered into.
Endowment assurance Consider a participating contract where a sum assured is paid out on survival for the length of the contract or in the event of death during the contract period. Amounts are	Approach A seems to be consistent with the IASB staff's comments that in principle, the coverage units should be determined by the insurance benefit only, ie, excluding the surrender or maturity value.	Under Approach B, on survival to the end of each year prior to the end of the contract, the policyholder remains entitled to the potential future maturity payments (which with expected future bonuses are higher than the current death benefits).

added as bonuses throughout the contract to increase the sum assured during the contract. This is example 15 included in the paper for the May 2018 TRG meeting.	That is, the benefit is the amount the entity is standing ready to pay if the insured event (death) occurred in that accounting period.	This would mean that the benefit for the service would be the present value of the expected future maturity payment.
(Re)insurance contracts where the premium is paid prior to the contract coverage period In many cases, contracts may be concluded prior to the contract coverage start date. For example, a contract may be entered into on 1 November 2021, which entitles the policyholder to make claims during a period from 1 January 2022 to 31 December 2024. In this case, the policy inception date is 1 November 2021 and the premium is fixed at this date.	Under Approach A, no CSM would be recognised during the period from 1 November 2021 to 31 December 2021 because no claims payments could be made during this period. The entity is only standing ready to pay claims between 1 January 2022 and 31 December 2024.	Some are concerned that applying Approach B to this this scenario, the coverage period would start on 1 November 2021 and service would be recognised from that point, reflecting the entitlement to future benefits the policyholder has during this period. Others believe that there is no such read across from Approach B since there is no insured service provided prior to 31 December 2021 as no claim can be made prior to that date. This contrasts with an annuity contract where Approach B is on the basis of an service being provided at the start of the contract, since deaths can occur from that point and will impact the claims payments made in later periods.
Reinsurance of deferred annuities Consider a quota share reinsurance contract that reinsures the longevity risk on a group of deferred annuities. The underlying contracts are currently all in the deferred period, with the pay-out period beginning on 1 January 2031. The underlying deferred annuities provide an investment return service as	Under Approach A, the deferred annuities would only provide an investment return service during the deferred period and service during the pay-out period. The reinsurance contract coverage period would begin on 1 January 2031 and thus none of the reinsurance CSM would be recognised until 1 January 2031.	Under Approach B, insurance coverage would be provided over the whole duration of the group of deferred annuities and also for the reinsurance contract held. Hence, the CSM for the reinsurance contract held would be amortised in the period up to and after 1 January 2031.

part of the insurance contact services. The reinsurance contract does not provide an investment return service. Claims under the reinsurance contract are only made during the pay-out period of the underlying contracts.		
Income protection Consider an income protection contract that provides monthly payments to the policyholder during periods of unemployment or illness. The contract term is selected by the policyholder and can be anywhere between 12 months until retirement. The contract is paid for by monthly premiums. The contract pays out for the whole duration of the claim, which could be until retirement. The TRG discussed in Sept 2018 that the obligation to pay the claim once policyholder is unemployed or ill could be seen as part of the liability for remaining cover (LFRC) or liability for incurred claims. It is assumed that the obligation to continue to pay claims is seen as part of LFRC	Under Approach A, the benefits are the amount that can be claimed during each period.	Under Approach B, the benefits are not limited to the amounts that can be paid in each period. The benefits in the period would therefore include the entitlement to make continuing claims under the policies in future periods.

APPENDIX: TECHNICAL REFERENCES AND ANALYSIS

Included in this section are:

1. Analysis of the technical requirements of IFRS 17
2. Extracts from IFRS 17
3. Extracts from IFRS 17 Basis for Conclusions
4. Extracts from Agenda Paper 5 from the May 2018 TRG
5. Extracts from IASB meeting summary for Agenda Paper 5 from the May 2018 TRG
6. Extracts from Agenda paper 5 from the Feb 2018 TRG
7. Extracts from IASB meeting summary for Agenda paper 5 from the Feb 2018 TRG
8. Extracts from IASB papers on the introduction of the investment-return service

1. Analysis of the technical requirements of IFRS 17

Under IFRS 17, an amount of the contractual service margin ('CSM') for a group of insurance contracts is recognised in profit or loss in each period to reflect the profit earned for insurance contract services provided under the group of insurance contracts in that period. The amount is determined by reference to the coverage units in the group, which are defined as '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'.

The coverage period is the period during which the entity provides insurance contract services. This period includes the insurance contract services that relate to all premiums within the boundary of the insurance contract. Insurance contract services under the general model are defined as insurance coverage ('coverage for an insured event') and investment-return service. An insured event is 'an uncertain future event covered by an insurance contract that creates insurance risk'. The criteria for identifying where an investment-return service may exist are set out in paragraph B119B of the standard.

The IASB amended IFRS 17 in June 2020 to permit an investment-return service following concerns that without this permitted service there would be no CSM earned over the deferred period of a deferred annuity. In addition the IASB recognised that investment activities enhance benefits from insurance coverage irrespective of whether the criteria for an investment return service are met and therefore required that the fulfilment cash flows include investment management expenses if the entity performs investment activities to enhance the benefits from insurance coverage. (Paragraph B65 (ka) (i)). This appendix contains extracts from (1) IASB Board January 2019 (Paper 2E); and (2) IASB Basis for Conclusions relating to the Amendment in respect of investment-return services.

Para 44(e) of IFRS 17 states that the carrying amount of the CSM at the end of the reporting period is adjusted for the amount recognised as insurance revenue because of the transfer of insurance contract services in the period. The recognition of the CSM is through the transfer of service to the policyholder.

Para B119 of IFRS 17 states the amount of insurance contract services provided is determined by 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. The transfer of service to the policyholder is identified through the determination of coverage units. The coverage units reflect the quantity of the benefits provided and the expected coverage period.

Bearing insurance risk is not synonymous with providing insurance coverage. As described in BC222, the CSM "represents the margin the entity has charged for the services it provides in addition to bearing risk. The expected margin charged for bearing risk is represented by the risk adjustment for non-financial risk". The definitions of insurance contract services and coverage period in the standard clarify that insurance coverage is provided for an insured event (defined as an uncertain future event covered by an insurance contract that creates insurance risk). If no insured event can take place during the period, then no insurance coverage is provided in that period - even if the insurer is bearing insurance risk.

This distinction between bearing risk and providing insurance coverage is further clarified within paragraphs BC140 -BC142, which describe the Board's rationale for delaying recognition from the time the entity is on-risk until to the start of the coverage period.

TRG Discussion

Given that the standard does not have a lot of guidance on coverage units, this was a topic that was raised with the Transition Resource Group ('TRG'). The TRG is a public forum for stakeholders to follow the discussion of questions raised on implementation and to inform the IASB to determine what, if any, action is needed to address the questions raised. Whilst the TRG discussions are relevant, the standard as written is paramount to the consideration of compliance.

The topic of coverage units was initially discussed in the February 2018 meeting of the TRG. In that meeting a paper was discussed which included an example of a life contingent pay out annuity (Example 4). The paper included the IASB Staff View but the meeting agreed that the topic of coverage units in its broadest sense needed to come back for further discussion including consideration of insurance contracts with investment components.

The topic of coverage units was then discussed in the May 2018 meeting of the TRG. In the summary of the TRG discussion it is noted that TRG members 'observed that IFRS 17 established a principle (to reflect the services provided in a period under a group of insurance contracts), not detailed requirements… and the determination of coverage units is not an accounting policy choice but involves judgement and estimates to best achieve the principle of reflecting the services provided in each period. Those judgements and estimates should be applied systematically and rationally.'

This appendix contains the relevant extracts from the TRG staff paper and the summary of the discussion. Paragraph 30(e) of the TRG paper states that 'a policyholder benefits from the entity standing ready to meet valid claims, not just from making a claim if an insured event occurs. The quantity of benefits provided therefore depends on the amounts that can be claimed by the policyholder'. Paragraph 30(f) notes that:
'Possible methods include the use of:

i. the maximum contractual cover in each period; and

ii. the amount the entity expects the policyholder to be able to validly claim in each period if an insured event occurs.'

The TRG staff paper included a number of example contracts. Example 12 in the paper was a life contingent annuity. In the staff comments in the paper the staff noted that the quantity of benefits is the fixed monthly amount payable. As noted above, Example 13 was a forward purchase of a fixed rate annuity, and the staff noted their view that 'the coverage period does not start until the date the annuity starts'.

Paragraph 9 of the May 2018 TRG paper states that:

'a) coverage units reflect the likelihood of insured events occurring only to the extent that they affect the expected duration of contracts in the group; and

b) coverage units do not reflect the likelihood of insurance events occurring to the extent that they affect the amount expected to be claimed in the period'

In addition, the following principles were noted in paragraph 35 of the IASB meeting summary:

'd) determining the quantity of benefits provided under a contract requires an entity to consider the benefits expected to be received by the policyholder, not the costs of providing those benefits expected to be incurred by the entity

e) a policyholder benefits from the entity standing ready to meet valid claims, not just from making a claim if an insured event occurs. The quantity of benefits provided therefore relates to the amounts that can be claimed by the policyholder.'

The TRG noted (per paragraph 35(h) in the IASB meeting summary) a number of methods which might achieve the objective if they are reasonable proxies for the services provided under the group of insurance contracts in each period:

i. a straight-line allocation over the passage of time, but reflecting the number of contracts in a group.

ii. a method based on the maximum contractual cover in each period.

iii. a method based on the amount the entity expects the policyholder to be able to validly claim in each period if an insured event occurs.

iv. methods based on premiums. However, premiums will not be reasonable proxies when comparing services across periods if they are receivable in different periods to those in which services are provided, or reflect different probabilities of claims for the same type of insured event in different periods rather than different levels of service of standing ready to meet claims. Additionally, premiums will not be reasonable proxies when comparing contracts in a group if the premiums reflect different levels of profitability in contracts. The level of profitability in a contract does not affect the services provided by the contract.

v. methods based on expected cash flows. However, methods that result in no allocation of the contractual service margin to periods in which the entity is standing ready to meet valid claims do not meet the objective.

Notwithstanding the above examples, the TRG noted (per paragraph 35(g) in the IASB meeting summary) that IFRS 17 does not specify a particular method or methods to determine the quantity of benefits and so different methods may achieve the objective of reflecting the services provided in each period, depending on facts and circumstances.

2. IFRS 17 - Standard

Para 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 future services to be provided under the contracts in the group.'

Para 44(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.'

Para B65: Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, including cash flows for which the entity has discretion over the amount or timing. The cash flows within the boundary include:

...

(ka) costs the entity will incur:

i. performing investment activity, to the extent the entity performs that activity to enhance benefits from insurance coverage for policyholders. Investment activities enhance benefits from insurance coverage if the entity performs those activities expecting to generate an investment return from which policyholders will benefit if an insured event occurs.
ii. providing investment-return service to policyholders of insurance contracts without direct participation features (see paragraph B119B).
iii. providing investment-related service to policyholders of insurance contracts with direct participation features.

Para 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.'

Para B119B

Insurance contracts without direct participation features may provide an investment-return service if, and only if:

a) an investment component exists, or the policyholder has a right to withdraw an amount;
b) the entity expects the investment component or amount the policyholder has a right to withdraw to include an investment return (an investment return could be below zero, for example, in a negative interest rate environment); and

c) the entity expects to perform investment activity to generate that investment return.

Appendix A - definitions

cov Coverage period - The period during which the entity provides insurance contract services. This period includes the insurance contract services that relate to all premiums within the boundary of the insurance contract.

Insur Insurance contract services - The following services that an entity provides to a policyholder of an insurance contract:

a) coverage for an insured event (insurance coverage);
b) for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service); and
c) for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service).

I Insured event - An uncertain future event covered by an insurance contract that creates insurance risk.

3. IFRS 17 - Basis for Conclusions

Para BC140-BC142:

'BC140 The Board considered whether an entity should recognise the obligations and associated benefits arising from a group of insurance contracts from the time at which it accepts risk. Doing so would be consistent with the aspects of IFRS 17 that focus on measuring the obligations accepted by the entity. However, such an approach would differ from that required for revenue contracts within the scope of IFRS 15, which focuses on measuring performance. Under IFRS 15, an entity recognises no rights or obligations until one party has performed under the contract. That model would be consistent with the aspects of IFRS 17 that focus on measuring performance.

BC141 Further, some stakeholders were concerned that a requirement to recognise the group of insurance contracts from the time the entity accepts risk would mean that the entity would need to track and account for the group even before the coverage period begins. Those expressing that view stated that accounting for the group of insurance contracts before the coverage period begins would require system changes whose high costs outweigh the benefits of doing so, particularly because the amount recognised before the coverage period begins might be immaterial, or even nil. In the view of these respondents, even if amounts recognised before the coverage period begins are insignificant, requiring an entity to account for groups of insurance contracts in the pre-coverage period would impose on the entity the requirement to track groups to demonstrate that the amounts are insignificant.

BC142 The Board was sympathetic to those concerns. Accordingly, the Board adopted an approach that combines aspects of both approaches set out in paragraph BC140 by requiring that an entity recognise a group of insurance contracts from the earliest of:

a) the beginning of the coverage period of the group of contracts;
b) the date on which the first payment from a policyholder in the group becomes due; or
c) for a group of onerous contracts, when the group becomes onerous.'

...

Para BC222:
'BC222 The key service provided by insurance contracts is insurance coverage, but contracts may also provide investment-related or other services. The measurement of a group of insurance contracts at initial recognition includes a contractual service margin, which represents the margin the entity has charged for the services it provides in addition to bearing risk. The expected margin charged for bearing risk is represented by the risk adjustment for non-financial risk (see paragraphs BC206–BC214).'

Para BC283:
'BC283 Consistent with the requirements in IFRS 15, the settlement of a liability is not considered to be a service provided by the entity, Thus, the recognition period for the contractual service margin is the coverage period over which the entity provides the coverage promised in the insurance contract, rather than the period over which the liability is expected to be settled. The margin the entity recognises for bearing risk is recognised in profit or loss as the entity is released from risk in both the coverage period and the settlement period.'

4. Agenda Paper 5 from the May 2018 TRG

Para 9:
'At the February 2018 meeting, TRG members discussed the analysis of the submission in Agenda Paper 5 from that meeting and observed that:

a) coverage units reflect the likelihood of insured events occurring only to the extent that they affect the expected duration of contracts in the group; and
b) coverage units do not reflect the likelihood of insurance events occurring to the extent that they affect the amount expected to be claimed in the period.'

...

Para 20:
'the objective in IFRS 17 for the allocation of the contractual service margin is to reflect the services provided in the period. The staff think the determination of coverage units to achieve this objective is not an accounting policy choice but involves judgement and estimates to best reflect the provision of service. That judgement and estimates should be determined systematically and rationally. The disclosure requirements of paragraph 125 of IAS 1 Presentation of Financial Statements apply.'

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Para 30:
'The staff observe:

a) paragraph B119 of IFRS 17 requires that '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 services provided under the group of insurance contracts in that period'.
b) because the objective is to reflect the service provided in each period, different levels of service across periods should be reflected.

c) paragraph B119(a) of IFRS 17 requires an entity to determine the services provided by the group considering for each contract the quantity of benefits provided under a contract and its expected coverage duration.
d) determining the quantity of benefits provided under a contract requires an entity to consider the benefits expected to be received by the policyholder, not the costs of providing those benefits expected to be incurred by the entity.
e) a policyholder benefits from the entity standing ready to meet valid claims, not just from making a claim if an insured event occurs. The quantity of benefits provided therefore depends on the amounts that can be claimed by the policyholder. The entity is standing ready to meet those claims. The amount that a policyholder can claim affects the benefit of being able to make a claim. The probability of a policyholder making a claim does not affect the benefit of it being able to make a claim.
f) IFRS 17 does not specify a particular method or methods to determine the quantity of benefits. Therefore, different methods can be used to determine the quantity of benefits as long as they achieve the objective of reflecting the service provided in each period. Judgement needs to be applied to determine the method that best reflects the service provided. Possible methods include the use of:
    i. the maximum contractual cover in each period; and
    ii. the amount the entity expects the policyholder to be able to validly claim in each period if an insured event occurs.
g) The following methods would not meet the objective:
    i. for an insurance contract without an investment component, methods in which the quantity of benefits is affected by the performance of any of the entity's assets. The quantity of benefits provided under an insurance contract without an investment component depends solely on the service provided (see paragraphs 31–43 of this paper for a discussion of insurance contracts with investment components).
    ii. methods that result in no allocation of the contractual service margin to periods in which the entity is standing ready to meet valid claims.
    iii. methods based on premiums, unless they can be demonstrated to be reasonable proxies for the services provided by the entity in each period. For example, premiums will not be a reasonable proxy when comparing service across periods if they are receivable in different periods to those in which services are provided, or reflect different probabilities of claims in different periods rather than different levels of service of standing ready to meet claims. Additionally, premiums will not be a reasonable proxy when comparing contracts in a group if the premiums reflect different levels of profitability in contracts or different probabilities of claims rather than different levels of the service of standing ready to meet claims. The level of profitability in a contract does not affect the services provided by the contract.
    iv. methods based on expected cash flows, unless they can be demonstrated to be reasonable proxies for the services provided by the entity in each period. For example, expected cash flows will not be a reasonable proxy if they reflect different probabilities of claims rather than different levels of the service of standing ready to meet claims.

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Para B.10-B.13:
Example 3—Mortgage loss cover:

B.10 Example: a contract provides cover for five years for default losses on a mortgage, after recovering the value of the property on which the mortgage is secured. The balance of the mortgage will decline because of contractually scheduled payments and cannot be increased.

B.11 No comments were made about the expected coverage duration.

B.12 Methods suggested for determining the quantity of benefits:

a) contractual balance of mortgage; and
b) the amount for which the policyholder has the ability to make a valid claim, ie the contractual balance of the mortgage, less the expected value of the property.

B.13 Staff comments:

a) the staff think the expected coverage duration is the five years during which cover is provided, adjusted for any expectations of lapses.
b) for determining the quantity of benefits, the staff think either method suggested could be valid. Method B.12(a) is the maximum contractual cover and method B.12(b) is the amount the entity expects the policyholder to be able to make a valid claim for if the insured event occurs.

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Para B.44-B.49:
Example 12—Life contingent annuity:

B.44 Example: a life contingent pay out annuity pays a fixed monthly amount of CU10 each period until the annuitant dies.

B.45 Combined comments on the expected coverage duration and the quantity of benefits:

a) there is a constant level of benefits provided over the life of the annuitant. The contractual service margin would be amortised straight line over the remaining expected life of the annuitant. That is the quantity of benefit is 10 per year, and the coverage duration is the length of time until there is zero probability of making a payment to the policyholder (40 years).
b) the contract is a series of individual promises to pay a fixed amount at a future point in time if the annuitant is alive at that point in time. The cumulative coverage units in the first period are the total expected dates a payment will be made. The second period cumulative coverage units would be one less coverage unit as a coverage unit expired with the reaching of the first promise to pay at a point in time. That is the quantity of benefit and coverage duration are determined together by multiplying the face amount by the probability of making payment in each year (not the probability weighted cash flow).
c) the coverage units are determined by the quantity of benefits and the expected duration. The quantity of benefits is a constant benefit of 10 per year. The expected duration is the probability-weighted average duration of the contract.

B.46 Staff comments:

a) the staff think the expected coverage duration is the probability-weighted average expected duration of the contract. The expected coverage duration is reassessed each period (same as Approach B.45(c)).

b) the staff think the quantity of benefits is the fixed monthly amount of CU10 (same as Approach B.45(c)).
c) the staff do not agree with Approach B.45(a) because it does not reflect the expected duration of the contract. The staff do not agree with Approach B.45(b) because it requires an entity to split a contract into multiple individual contracts. It also does not seem to require reassessment of the expected coverage duration.

Example 13—Forward purchase of fixed rate annuity

B.47 Example: forward contract to buy an annuity in the future at a fixed rate. The premium is payable when the annuity is bought. If the policyholder dies, or cancels the contract, before the date the annuity can be purchased, the policyholder receives no benefit.

B.48 Comments on the coverage period:
a) the entity bears insurance risk from the date the forward contract is issued. Hence, the coverage period starts at that date.
b) the entity bears insurance risk from the date the forward contract is issued, but the coverage period does not start until the date the annuity starts. The insured event is that the policyholder lives long enough to receive payments under the annuity.

B.49 Staff comments: The staff think Approach B.48(b) is valid. The staff do not think an insured event can happen in the period before the annuity starts.

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Example 15—Endowment policy

C.6 Example: the entity has issued conventional participating insurance with the following features:
a) the policyholder pays a regular level premium to the insurance entity.
b) in return, the policyholder receives:
    i. insurance coverage, payable upon death of the life insured, of a specified sum insured; and
    ii. a share of the investment returns from an underlying pool of assets to which the policy refers.
c) the investment returns are allocated to the policyholder through bonuses that are added to the policy's sum insured.
d) the insurance entity may allocate 'reversionary bonuses' (ie an annual incremental addition to the sum insured) or 'terminal bonuses' (ie an amount in addition to the sum insured and reversionary bonuses that is payable to the policyholder upon maturity or death).
e) there are three ways in which the policy can terminate. The policyholder could:
    i. die. In this case the sum insured including all reversionary bonuses accumulated at the time of death and the terminal bonus would be payable.
    ii. survive and reach the maturity date of the policy. In this case the maturity value consisting of the sum insured, all reversionary bonuses accumulated at maturity and the terminal bonus would be payable.
    iii. voluntarily surrender their policy before the maturity date. In this case, a surrender value would be payable to the policyholder.

The surrender value is generally based on a set schedule such that the surrender value is low in the early years of the policy and increases with policy duration. At maturity, the surrender value equals the maturity value.

A key point of these contracts is that the insurance component of the policy dominates at early durations and the investment component dominates at later durations as the policyholder accumulates investment returns.

C.7 No comments were made about the expected coverage duration (there is insurance risk until maturity of the contract because
the surrender value is always lower than the amount payable on death).

C.8 The following methods were suggested for determining the quantity of benefits:

a) coverage units are determined by reference to the amount payable on death, which reflects the quantity of benefits for both insurance and investment services provided by the entity; and
b) coverage units are determined by reference to the difference between the amount payable on death and the surrender value, which reflects the quantity of benefits only for the services provided by the entity.

C.9 Staff comments:

a) for both VFA and general model contracts, the staff think the expected coverage duration is the expected duration of the contract, including expectations of surrender.
b) for the quantity of benefits, the staff think the analysis differs for VFA and general model contracts:
    i. if the contract falls within the scope of the VFA, the coverage units should be determined reflecting the benefits to the policyholder of the services and the investment-related services. One method of doing this would be by using the amount payable on death (ie including the surrender value). (Same as method in C.8(a)).
    ii. if the contract does not fall within the scope of the VFA, the contract provides only services for the purpose of applying IFRS 17. In principle, the coverage units should be determined by the insurance benefit only, ie excluding the surrender value. (Same as method C.8(b)). However, IFRS 17 does not require entities to separately identify investment components before a claim is incurred, because of the difficulties in doing so.3 Therefore, the staff think that determining the quantity of benefits by excluding the surrender value is a possible approach if an entity has reasonable and supportable information to do so. If the entity does not have such reasonable and supportable information, it will need to use its judgement to determine the quantity of benefits.

5. IASB meeting summary for Agenda Paper 5 from the May 2018 TRG

Para 31:
Paragraphs 32-35 summarise the TRG discussions on the determination of coverage units to reflect the service provided under a group of contracts. Paragraphs 36–39 summarise the TRG discussions on whether the services provided include investment-related services.

How to determine coverage units to reflect the services provided under a group of contracts

Para 32:
TRG members discussed the analysis in Agenda Paper 5. They observed that IFRS 17 established a principle (to reflect the services provided in a period under a group of insurance contracts), not detailed requirements, and that it would not be possible to develop detailed requirements that would apply appropriately to the wide variety of insurance products existing globally.

Para 33:
TRG members also observed the determination of coverage units is not an accounting policy choice but involves judgement and estimates to best achieve the principle of reflecting the services provided in each period. Those judgements and estimates should be applied systematically and rationally.

Para 34:
TRG members noted the analysis of the examples in Agenda Paper 5 depends on the fact patterns in that paper, and would not necessarily apply to other fact patterns. In addition, which method would best reflect the services provided in each period would be a matter of judgement based on facts and circumstances.

Para 35:
In considering how to achieve the principle, TRG members observed:

a) the period in which an entity bears insurance risk is not necessarily the same as the insurance coverage period.
b) expectations of lapses of contracts are included in the determination of coverage units because they affect the expected duration of the coverage. Consistently, coverage units reflect the likelihood of insured events occurring to the extent that they affect the expected duration of coverage for contracts in the group.
c) because the objective is to reflect the services provided in each period, different levels of service across periods should be reflected in the determination of coverage units.
d) determining the quantity of benefits provided under a contract requires an entity to consider the benefits expected to be received by the policyholder, not the costs of providing those benefits expected to be incurred by the entity.
e) a policyholder benefits from the entity standing ready to meet valid claims, not just from making a claim if an insured event occurs. The quantity of benefits provided therefore relates to the amounts that can be claimed by the policyholder.
f) different probabilities of an insured event occurring in different periods do not affect the benefit provided in those periods of the entity standing ready to meet valid claims for that insured event. Different probabilities of different types of insured events occurring might affect the benefit provided by the entity standing ready to meet valid claims for the different types of insured events.
g) IFRS 17 does not specify a particular method or methods to determine the quantity of benefits. Different methods may achieve the objective of reflecting the services provided in each period, depending on facts and circumstances.
h) The following methods might achieve the objective if they are reasonable proxies for the services provided under the group of insurance contracts in each period:
    i. a straight-line allocation over the passage of time, but reflecting the number of contracts in a group.
    ii. a method based on the maximum contractual cover in each period.

iii. a method based on the amount the entity expects the policyholder to be able to validly claim in each period if an insured event occurs.
iv. methods based on premiums. However, premiums will not be reasonable proxies when comparing services across periods if they are receivable in different periods to those in which services are provided, or reflect different probabilities of claims for the same type of insured event in different periods rather than different levels of service of standing ready to meet claims. Additionally, premiums will not be reasonable proxies when comparing contracts in a group if the premiums reflect different levels of profitability in contracts. The level of profitability in a contract does not affect the services provided by the contract.
v. methods based on expected cash flows. However, methods that result in no allocation of the contractual service margin to periods in which the entity is standing ready to meet valid claims do not meet the objective.

6. Agenda paper 5 from Feb 2018 TRG

Example 4–Life contingent pay out annuity
A18. A life contingent pay out annuity pays a fixed monthly amount of CU10 each period until the annuitant dies.

A19. What is the quantity of benefits provided under the contract in each period?

A20. Approach A: There is a constant level of benefits provided over the life of the annuitant. The contractual service margin would be amortized straight line over the remaining expected life of the annuitant. That is the quantity of benefit is 10 per year, and the coverage duration is the length of time until there is zero probability of making a payment to the policyholder = 40 years. This results in 400 coverage units being provided over the entire contract. The amount of amortisation of the contractual service margin in each year is then calculated as: (opening contractual service margin + interest accretion) * (coverage units in current year / total coverage units in current and all future years).

A21. Approach B: The contract is a series of individual promises to pay a fixed amount at a future point in in time if the annuitant is alive at that point in time. The cumulative coverage units in the first period are the total expected dates a payment will be made. The second period cumulative coverage units would be one less coverage unit as a coverage unit expired with the reaching of the first promise to pay at a point in time. That is the quantity of benefit and coverage duration are determined together by multiplying the face amount by the 2 probability of making payment in each year (not the probability weighted cash flow).

A22. View C: Either approach is acceptable under IFRS 17

A23. Staff View: The coverage units are determined by the quantity of benefits and the expected duration. The quantity of benefits is a constant benefit of 10 per year. The expected duration is the probability-weighted average duration of the contract. (The staff does not think any of views A-C give the same result as this). The staff also observes that the expected duration, and hence coverage units, should be reassessed at each reporting date.

7. IASB meeting summary for Agenda paper 5 from Feb 2018 TRG meeting

Determining the quantity of benefits for identifying coverage units (Agenda Paper 5)

21. Coverage units establish the amount of the contractual service margin to be recognised in profit or loss for services provided in a period. Agenda Paper 5 addresses a submission received about how to determine the coverage units of a group of insurance contracts with no investment component. Insurance contracts with investment components will be discussed at a later meeting.

22. TRG members discussed the analysis in Agenda Paper 5 and observed that:

a) coverage units reflect the likelihood of insured events occurring only to the extent that they affect the expected duration of contracts in the group; and
b) coverage units do not reflect the likelihood of insurance events occurring to the extent that they affect the amount expected to be claimed in the period.

23. TRG members discussed the extent to which the determination of coverage units should reflect variability across periods in the level of cover provided by contracts in the group based on the narrow scope fact patterns presented. However, they observed that a view could not be reached before they also considered a wider scope including insurance contracts with investment components. Accordingly, the staff will bring a paper to a later TRG meeting that will address the determination of coverage units for contracts with investment components and will also develop further:

a) the use of the maximum level of cover and the expected level of cover in periods. For example, the TRG considered a contract that provides cover for fire damage up to CU50m per year on a five year construction project. The value of the property covered is expected to increase over the 5 years. The maximum level of cover is the contract CU50m limit. The expected level of cover is the increasing value on which the entity is exposed to insurance risk.
b) the balance to be struck between high-level principles and specific guidance, given the wide variety of insurance products that need to be considered.

24. TRG members agreed to send in their comments on the examples in Agenda Paper 5 by the end of February to help the development of the next paper.

8. Extracts from IASB papers on the introduction of the investment-return service

A. IASB Board January 2019 (Paper 2E)

15. Some of those stakeholders noted that without amending IFRS 17 to reflect investment-related services in determining coverage units for contracts accounted for applying the general model, the application of the requirements would result in unintended consequences. For example

a) contracts that provide insurance coverage that ends significantly before the investment-related services would result in a front-end revenue recognition; and
b) deferred annuity contracts with an account balance accumulating in the period before the annuity payments start could result in back-end revenue recognition if insurance coverage is provided only during the annuity periods.

...

33. In contrast, deferred annuities are often given as an example of when restricting coverage units to the period in which insurance coverage is provided is a problem. Looking at the cases in which there is no investment component in such contracts as described in paragraph 31(b) of this paper:

a) if there is a payment on death in the accumulation phase, there is insurance coverage in the accumulation phase which will be included in the determination of coverage units. Hence, there should not be a problem in terms of the period over which the contractual service margin is recognised in profit or loss.
b) if there is no payment on death in the accumulation phase, the staff think it is appropriate not to regard the contract as providing investment services: if the policyholder dies in the accumulation phase, the beneficiary receives no benefit from the investment. Any investment benefit arises only if the policyholder survives to receive the annuity. Hence the staff think it is appropriate to recognise the contractual service margin over the insurance coverage period only.

B. IASB Basis for Conclusions relating to the Amendment to IFRS 17 Exposure Draft (May 2019)

BC54 A question submitted to the Transition Resource Group for IFRS 17 indicated that it would be useful to clarify that an entity is required to consider investment-related service when determining coverage units for insurance contracts with direct participation features. Transition Resource Group members thought coverage units for contracts with direct participation features should include investment-related service because those contracts are substantially investment-related service contracts. However, Transition Resource Group members held different views on whether IFRS 17 requires, permits or prohibits such an approach. Hence, the Board decided to clarify that such an approach is required.

BC55 After deciding to clarify the requirements for insurance contracts with direct participation features, the Board considered feedback from some Transition Resource Group members and other stakeholders that the requirements should be changed for some insurance contracts without direct participation features. Those stakeholders explained that the requirement to recognise the contractual service margin considering only insurance coverage would fail to faithfully represent the entity's financial performance across periods, in particular when:

a) a contract provides insurance coverage that ends before the policyholder ceases to earn investment returns; or
b) a deferred annuity contract with an accumulating account balance provides insurance coverage only during the annuity period.

BC56 The Board noted arguments that some insurance contracts without direct participation features provide policyholders with a return that depends on underlying items, similar to insurance contracts with direct participation features. Although these contracts do not meet the conditions to be within the scope of the variable fee approach, the Board was persuaded that some such contracts provide an investment service because the contract includes an investment component or the policyholder has a right to withdraw an amount from the entity that is expected to include an investment return. Such a service is referred to in the proposed amendments as an investment-return service. The Board was persuaded that, particularly for contracts that have an insurance coverage period that differs from the period in which the policyholder benefits from such a service, recognising the contractual service margin in profit or loss considering both the insurance coverage and an investment-return service provides useful information to users of financial statements.

C. IASB Basis for Conclusions relating to the Amendment to IFRS 17 (June 2020)

BC283B The Board was persuaded that some insurance contracts without direct participation features provide an investment-return service (see paragraph BC283A(a)). Recognising the contractual service margin considering both insurance coverage and an investment-return service will provide useful information to users of financial statements, particularly for contracts that have an insurance coverage period that differs from the period in which the policyholder benefits from an investment-return service.