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PDC N° 25/19

Paris, May 6<sup>th</sup>, 2019

Mr Hoogervorst  
IASB Chair  
7 Westferry Circus, Canary Wharf  
London, UK, E14 4HD

### March 2019 – IASB Meeting

Dear Mr Hoogervorst,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to comment the Board's discussion in March 2019 regarding IFRS 17 and more specifically Agenda Paper 2A.

We welcome the current discussions on the level of aggregation and are interested in contributing to the dialogue on that complex and sensitive part of the standard that raises concerns from our stakeholders. We have summarised our preliminary analyses in a paper and developed an example in order to illustrate our understanding of the standard's provisions. Based on that example, we concluded that, under the specific circumstances of an intergenerational mutualisation, applying annual cohorts would not be necessary and would deserve an exception. We were very interested in the example (§ 36-§ 45 and Appendix A) discussed at the IASB's March meeting, which is very similar to ours. Based on the same assumptions we concur with Board's conclusions to a certain extent but differ on others. We therefore draw up in this letter an analysis of the key points which, in our view, may explain the convergences as well as the divergences.

Please do not hesitate to contact us to further discuss that case,

Yours sincerely,

*Kind regards.*

*Patrick de Cambourg*

Patrick de CAMBOURG

**1 Recognition of onerous groups when the contracts' cash flows affect or are affected by cash flows to policyholders of other contracts**  
[IASB 2019-03 AP 2A.37-38]

- 1 We concur with the analysis laid down in § 38 of the March 2019 agenda paper 2A that when the contracts' cash flows affect or are affected by cash flows to policyholders of other contracts, IFRS 17 allows reflecting the intergenerational sharing of returns between cohorts.

**2 Concept of "fair value returns"**

- 2 The example of agenda paper 2A considers contracts whereby the policyholders receive 80% of the "fair value returns" from the underlying pool of assets with the entity having discretion over the timing and allocation across policyholders.
- 3 It is noteworthy that the example from the ANC about the level of aggregation considers contracts whereby the contractual minimum participation to policyholders is determined based on the "historical cost measurement" returns (i.e. measured based on historical costs in the statutory accounts) as required legally & contractually in the main European countries.
- 4 Accordingly, considering the theoretical case where all policyholders of a cohort would surrender their insurance contract at the same time, the leaving policyholders waive their right to possibly benefit from the unrealised accumulated changes in fair value of the underlying assets.
- 5 This does however not preclude that 80% of the fair value returns are paid to policyholders but nonetheless also depends on the discretionary assumptions / decisions made by management.

**3 Are the fair value changes of shared underlying items created by a group?**  
[IASB 2019-03 AP 2A.41]

- 6 IASB 2019-03 AP 2A.41 concludes that the increase in the entity's share in the fair value returns is *created* by the group of contracts (G 1 in the example).
- 7 In a mutualised pool of underlying items, the entity's share in the fair value of the underlying items stems from the overall portfolio, which includes all the items acquired from investing the premiums collected from all policyholders. As a consequence, there is no contractual link between any subset of the portfolio of underlying items and a group of contracts. Those underlying items belong to the community of policyholders without any group having individual rights on any subset of the overall portfolio. This is also illustrated by the fact that an insurer may decide to use the premiums received from the new business to indemnify the lapse of policyholders instead of selling assets.
- 8 For the purpose of measuring the CSM, IFRS 17.B 101(b)(i) and .B 112 implicitly require allocating the entity's share of the fair value of the underlying items to groups of contracts. However, this does not mean that the fair value returns are *created* by the groups.
- 9 Whenever a change in interest rate takes place when two or more cohorts already exist, the fair value gain from the pool of underlying items has to be allocated to the

groups. We have prepared an additional example describing that effect (see Appendix § 34-35).

- 10 In fact, considering that a change in the fair value of the assets acquired with the premium paid by a group solely belongs to this group would be equivalent to considering that the underlying items are ring-fenced on a cohort by cohort basis. This conclusion is contrary to the example's assumption that the returns on the underlying assets are shared between the groups.
- 11 In the example of agenda paper 2A, we do not think that the entity's share in the fair value of the underlying items is created by G 1 and should consequently be recognised over the coverage period of G 1 only. Instead, we believe that the entity's share of the fair value of the underlying items has been allocated to G 1 for measurement purpose but contractually stems from all policyholders taking into consideration the contractual intergenerational mutualisation.
- 12 Furthermore, as mentioned during the Board's discussion, we would like to highlight the operational complexity of applying IFRS 17 to such contracts as IFRS 17.B 68:
  - allows taking into account the fulfilment cash flows (FCF) allocated to groups of contracts already written (G 1 in the example) for the determination of the CSM of a newly underwritten cohort (G 2);
  - but does not reflect how FCF are expected to be allocated *between* the groups.
- 13 IFRS 17 implicitly requires tracking the part of the FCF included in the measurement of G 1, which will ultimately be paid to G 2. This therefore results in an artificial division of the FCF allocated to the groups into layers (depending on the group to which the payment is expected to be made) that *de facto* creates an additional level of disaggregation contradicting the objective of "an operational simplification given for cost benefit reasons" as highlighted in IFRS 17.BC137.
- 14 For instance in the example hereafter, from year Y+1 to Y+3 (see Appendix § 33 and § 42) the FCF of G 1 allocated to G 2 reflect the crediting rate of 4.1 % determined before the issuance of G 2 (i.e. expected final payments of 12 272, see Appendix § 19) even though the entity's expectation fell down to 3 % from year Y+1 onward.

#### **4 Does tracking the entity's share of the underlying item at group level provide meaningful information?**

[IASB 2019-03 AP 2A.43]

- 15 The example addresses the case where, in a context of low interest rates, the entity receives from newly issued G 2 contracts an initial premium that is sufficient to serve the contractual minimum of 80 % of the return from the underlying pool of assets.
- 16 Applying paragraph 41 of the March 2019 agenda paper 2A, the entity's share of the fair value of the underlying items is allocated to each group under the assumption that :
- 17 (i) insurance contracts are issued under current market conditions (regardless of the decision taken by the entity on previous groups) and
- 18 (ii) the underlying items purchased by investing the premium from the groups are segregated into ring-fenced fund backing specifically each group.
- 19 Arguably, this provides information as to whether adding such new business increases the overall share of the entity in the underlying pool of asset. However, the assumptions underlying such a calculation are contrary to the ones retained in the example, which assume mutualisation. And in fact, immediately after having been issued, G 2 is part of the mutualisation and the initial information provided by that CSM becomes obsolete.

- 20 Applying IFRS 17.B 68, the calculation of the CSM of G 2 is largely arbitrary as it depends on the amounts of discretionary cash flows initially assigned to G 1. We have prepared an additional example describing that effect (see Appendix § 27-29 and § 65-68). This highlights that the entity's share in the fair value returns allocated to G 2 depends on discretionary assumptions made in the periods *before* issuing G 2.
- 21 In addition, any change in the market rate or in the return rate to policyholders has to be allocated between the groups on a discretionary way that is not necessarily related with the original expected entity's share of the fair value returns (i.e. before mutualisation) of each group (see Appendix § 34-35). Accordingly, even if the initial CSM of G 2 were deemed valuable, it becomes obsolete after initial recognition because of the discretion left with regards to the allocation of subsequent changes in discretionary estimates.
- 22 In that context, we are struggling with the supposed informative value of the CSM of G 2 *alone* which appears largely artificial. Thus, we do not concur with the statement (IASB 2019-03 AP 2A.43) that removing the distinction of the CSM of both groups in that context "would lead to an unacceptable loss of useful information". We believe that, under these circumstances, the only relevant information about profitability is the cumulative CSM for both groups.
- 23 The CSM represents the expected profit to be recognised when the service will be rendered. It therefore relates to the evolution of groups (including upcoming new cohorts) rather than to initial conditions ignoring the other groups it is supposed to be mutualised with.

**5 Are separate annual cohorts necessary to prevent the CSM from being spread over a longer period than originally assessed?**

[IASB 2019-03 AP 2A.41 and .45]

- 24 We concur with the objective set by the board to ensure that the allocation of the CSM in the P&L cannot be indefinitely postponed. We however do not consider that separate annual cohorts are necessary to achieve this goal.
- 25 The additional example provided (see Appendix § 30 and 68) shows that by taking into account FCF from G 1 to G 2, the entity *duly* postpones a portion of G 1 CSM in a period that exceeds the initial G 1 coverage period. This is evidenced by a slight increase in the CSM due to the accretion effect by one year on that deferred part.
- 26 Further, we consider that adding new business to an existing group (in-Force) does not extend the portfolio duration indefinitely or make it "perpetual" since cash-flows attributable to the policyholders and the entity are permanently added and consumed. This mechanism is better and sufficiently reflected by the coverage units.
- 27 Therefore, we do not concur with the statement (IASB 2019-03 AP 2A.41 and .45) that "keeping the profit of the annual cohort separate is necessary to avoid deferring the recognition of profit beyond the coverage period of a group".

## **6 Overall conclusion**

- 28 Current IFRS 17 provisions (and especially IFRS 17.B67-B71) make it possible to reflect the intergenerational mutualisation, even if removing cohorts would probably better reflect the business practice as well as the contractual and legal situation.
- 29 Adding annual cohort in that context is however a very burdensome route to follow with no conceptual substance. The additional information provided does not prove to be useful but artificial.
- 30 In our view, such case has already been addressed by the board, as mentioned in IFRS 17.BC 138. We therefore suggest crystallising that exception in an amendment to annual cohorts in that specific context (see also our draft paper on the Level of Aggregation).

## Appendix: Example

### 1 Problem statement

- 1 An insurance company issues the following participating contracts:
  - In year Y: 10 contracts with an individual premium of 1 000
  - In year Y+1: 15 contracts with an individual premium of 1 000
- 2 The contracts share the returns of a common pool of assets segregated in a dedicated fund and are contractually entitled to a minimum of 80 % of the returns (determined based on the historical cost of the investments) from the pool, yet with the insurer's discretion as to the timing and allocation of the payments to individual policyholders. The contract duration is five years. Upon the contractual terms, policyholders are entitled to the account balance including the accumulated premiums and discretionary bonuses. Discretionary bonuses are set by management on a yearly basis and credited to policyholders' account. Afterwards, policyholders have an enforceable right to the payment of the bonus. For commercial reasons, management credits all policyholders' accounts using a single crediting rate (no distinction by year of subscription). Expected payment may exceed the contractual minimum of 80 % depending on market conditions and competitive pressure.
- 3 The contracts are investment contracts with discretionary participation features that fall under IFRS 17. The example assumes that they meet the criteria for the variable fee approach (IFRS 17.B 101).
- 4 The premiums are assumed to be paid on January 1<sup>st</sup> and immediately invested in zero-coupon bonds:
  - in year Y: 10 000 in bonds with a 5 year maturity and an interest rate of 5 % capitalised until maturity;
  - in year Y+1: 15 000 in bonds with a 5 year maturity and an interest rate of 3 % capitalised until maturity.
- 5 At the end of year Y, the market interest rate for bonds goes down to 3 %. For simplicity reason, yield curves are assumed to be flat.
- 6 At the end of year Y+1, the market interest rate for bonds goes down to 1 % and remains flat afterwards.
- 7 In future periods, notwithstanding the drop of market interest rate, everything happens as expected at inception.
- 8 The credit risk of the bonds is assumed to be negligible. The bonds are accounted for at amortised costs. Applying IFRS 17.B81 the entity determines the discount rate based on the yield curve implicit in the fair value measurement of the dedicated fund.
- 9 For simplicity reason, it is assumed that the company starts its activity in Y and has no other portfolios. Furthermore, the CSM is allocated to profit and loss based on the passage of time and no risk adjustment for non-financial risk is considered.

## 2 In year Y:

### 2.1 Recognition of the first group of contracts

- 10 Upon the receipt of the premium, the entity recognises the group of contracts issued in year Y.
- 11 The investment in bonds will provide a cash inflow of  $10\,000 \times 1.05^5 = 12\,763$  in year 5 (Y+4).
- 12 Because of market competition, the insurance company expects to make a final payout upon year Y+4 with an implicit yearly yield rate of 4.5 % for the policyholders. The final expected payment is therefore  $10\,000 \times 1.045^5 = 12\,462$ . The participation of the policyholders is therefore  $2\,462 / 2\,763 = 89\%$ , above the contractually guaranteed minimum, and the insurer's fee amounts to 301.
- 13 The dedicated portfolio of assets is considered as the reference portfolio for the determination of the discount rate. The bonds bear no credit risk and the entity decides to apply the option in IFRS 17.B81 not to adjust the reference portfolio's rate for differences in the liquidity characteristics. Therefore, the discount rate equals the rate of return implicit in the fair value of the dedicated portfolio of assets (top-down approach). At initial recognition the discounted value of the payment is  $12\,462 / 1.05^5 = 9\,764$ .
- 14 The initial CSM is therefore  $10\,000 - 9\,764 = 236$ .

### 2.2 At the end of year Y:

- 15 At the end of year Y the company's management decides to credit policyholders' account with a return of 4.5 %. The policyholders' account balance therefore becomes  $10\,000 \times 1.045 = 10\,450$ .
- 16 The bonds are accounted for at amortised cost, the entity records the interests earned over the period: 500.
- 17 As interest rate have fallen to 3 %, the fair value of the bonds purchased in year Y has increased to  $10\,000 \times 1.05^5 / 1.03^4 = 11\,340$ .
- 18 The discount rate for the determination of the liability for remaining coverage is updated to reflect the current market rate of returns implicit in the fair value measurement of the reference portfolio, which is 3 %.
- 19 Because of the drop in market interest rate, the entity now does not expect to pay back 88 % of the pool's expected yield anymore and thus reduces its estimates of discretionary benefits from 4.5 % to 4.1 %. The expected final payment is  $10\,000 \times 1.045 \times 1.041^4 = 12\,272$ . The expected participation of policyholders is 82 % of the yield from the pool of assets.
- 20 The liability for remaining coverage under IFRS 17 is the discounted value of the expected terminal payment which is  $10\,000 \times 1.045 \times 1.041^4 / 1.03^4 = 10\,904$ . The increase is  $10\,904 - 9\,764 = 1\,140$ .
- 21 Furthermore, as contracts are accounted for under the variable fee approach, the entity also updates the CSM by 200 up to the difference between:
- the change in the fair value of the underlying assets:  $11\,340 - 10\,000 = 1\,340$ .
  - the change in the liability for remaining coverage:  $9\,764 - 10\,904 = -1\,140$ .
- 22 In addition, as the entity holds the underlying items, it chooses to disaggregate the insurance finance income between profit and loss and OCI so as to eliminate the

mismatch with the assets carried at amortised costs. The difference is  $1\,140 + 200 - 500 = 840$ .

23 Finally, the entity allocates the contractual service margin to P&L:

New contracts issued (§ 14)	236
Change in the entity's share of the underlying items (§ 21)	200
Amounts before allocation to profit and loss	436
Allocation to profit and loss 1/5	-87
CSM at year end	349

Balance sheet	Year Y
Bonds (§ 16)	10 500
Liability for remaining coverage (§ 20)	(10 904)
Contractual service margin (§ 23)	(349)
Net income (§ 23)	(87)
Other comprehensive income (§ 22)	840

Profit and loss statement	Year Y
Insurance revenue (§ 23)	87
Finance income (Bonds) (§ 16)	500
Insurance finance expenses: -1 140 -200 +840	(500)
Net income	87

### 3 In year Y + 1:

#### 3.1 Recognition of the second group of contracts

- 24 The implicit rate of return in the fair value measurement of the reference portfolio of assets is 3 %.
- 25 The expected returns from the overall portfolios of investments in bonds amounts to:  $10\,000 \times (1.05^5 - 1) + 15\,000 \times (1.03^5 - 1) = 5\,152$ .
- 26 Considering the market conditions, the entity expects to credit policyholders' accounts with a single rate of 3 %.
- The expected terminal payment to group 1 (G 1) is therefore expected to be  $10\,450 \times (1.03)^4 = 11\,762$
  - The expected terminal payment to group 2 (G 2) is thus expected to be  $15\,000 \times (1.03)^5 = 17\,389$
  - Thus the expected returns to be passed to the policyholders amount to  $1\,762 + 2\,389 = 4\,151$ , that is 81 % of the total expected returns from the pool of assets.
- 27 Applying IFRS 17.B68 (b), the fulfilment cash flows included in the measurement of G 2 reflect the extent to which the contracts in the group cause the entity to be affected by expected cash flows.
- 28 In this example, the entity expects to pay 17 389 in year 5 to the policyholders of G 2, however, the measurement of G 1 already includes a  $12\,272 - 11\,762 = 510$  of payment allocated to G 2.
- 29 Applying IFRS 17.B68, the discounted fulfilment cash flows allocated to G 2 therefore amount to  $(17\,389 - 510) / 1.03^5 = 14\,560$ . The CSM amounts to 440.
- 30 The calculation of the CSM of G 2 upon initial recognition (440) reflects the fact that a payment of 510, which was previously allocated to the policyholders of G 1, is expected to be paid in year Y+5 to the policyholders of G 2. However, applying IFRS 17.B68, this



amount is allocated to G 1 and included in its discounted FCF up to  $510 / 1.03^4 = 453$ . As a consequence, the discounting effect due to the time lag between the expected payments to G 1 and G 2 ( $453 - 440 = 13$ ) adjusts the CSM of G 2.

The CSM of G 2 depends on the assumptions made on the whole mutualised population that (i) the crediting rate is 3 % and (ii) G 1 transfers 510 thanks to the pooling of assets' returns and applying IFRS 17.B 68. It is noteworthy that the amount of the CSM allocated to G 2 depends to a large extent on the discretionary assumptions made in past periods. This is illustrated in § 65-66 thereafter highlighting that whenever the discretionary benefits allocated to a group exceed the minimum contractual participation, the determination of the CSM of future groups is affected by the timing of the changes in discretionary assumptions.

### 3.2 At the end of year Y+1

31 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $10\,500 \times 5\% + 15\,000 \times 3\% = 975$ .

32 The current market interest rate falls to 1 %. The fair value of the bonds held by the entity amounts to  $10\,000 \times 1.05^5 / 1.01^3 + 15\,000 \times 1.03^5 / 1.01^4 = 12\,388 + 16\,710 = 29\,098$ . The fair value change is therefore  $29\,098 - 15\,000 - 11\,339 = 2\,759$ .

33 The entity computes the discounted fulfilment cash flows:

- For G 1, the liability is  $(11\,762 + 510) / 1.01^3 = 11\,911$  with an increase of  $11\,911 - 10\,903 = 1\,008$
- For G 2, the liability is  $(17\,389 - 510) / 1.01^4 = 16\,220$  with an increase of  $16\,220 - 14\,560 = 1\,660$ .

The total increase in the discounted fulfilment cash flows is therefore 2 668.

34 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is  $2\,759 - 2\,668 = 91$ .

IFRS 17 does not provide guidance in applying paragraphs B104 (b) (i) and B112 to groups of contracts that share in the same pool of underlying assets.

In this fact pattern, the changes in the fair value of the bonds cannot be specifically attributed to a cohort because policyholders do not have an individual right to the assets of the pool. Actually, the entity has not allocated discretionary bonuses to policyholders' accounts. As a consequence the fair value gain from the assets of the pool still belongs to the community of policyholders as a whole.

The entity therefore needs to determine an accounting policy to perform the allocation. In this example, it is *assumed* that the entity's share of the fair value of the underlying items is allocated proportionally to the increase in the discounted fulfilment cash flows allocated to each group.

35 According to its accounting policy, the entity thus allocates the entity's share of the fair value of the underlying items as follows:

- The amount allocated to G 1 is therefore  $91 \times 1\,008 / 2\,668 = 34$
- The amount allocated to G 2 is therefore  $91 \times 1\,660 / 2\,668 = 57$

The allocation policy applied affects the CSM of the cohorts. Given the lack of guidance in the standard, this challenges whether the information provided by the cohorts can lead to relevant and comparable information on profitability trends.

Actually, in the absence of a direct contractual relationship between the payments to individual policyholders and the returns on the underlying items, the annual cohort leads to an arbitrary allocation of mutualised discretionary benefits.

36 Then the entity applies IFRS 17.B134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore  $2\,668 + 91 - 975 = 1\,783$ .

37 Then the entity allocates CSM to P&L according to IFRS 17.B119

	G 1	G 2	Total
Opening balance	349		349
New contracts issued		440	440
Change in the entity's share of the underlying items	34	57	91
Amounts before allocation to profit and loss	383	497	880
Allocation to profit and loss 1 / 4 for G 1 and 1 / 5 for G 2	(96)	(99)	(195)
CSM at the end of year Y+1	287	398	685

38 The financial statements are as follows:

Balance sheet	Year Y+1	Profit and loss statement	Year Y+1
Bonds	26 475	Insurance revenue	195
Liability for remaining coverage	(28 131)	Finance income	975
Contractual service margin	(685)	Insurance finance expense	(975)
Net income	(195)		
Retained earnings	(87)		
Other comprehensive income	2 623	Net income	195

### 3.3 In years Y+2 and Y+3

39 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is:

- In Y+2:  $11\,025 \times 5\% + 15\,450 \times 3\% = 1\,015$  ;
- In Y+3:  $11\,576 \times 5\% + 15\,914 \times 3\% = 1\,056$ .

40 The current market interest rate is flat at 1 %. The fair value of the bonds held by the entity amounts to:

- In Y+2:  $10\,000 \times 1.05^5 / 1.01^2 + 15\,000 \times 1.03^5 / 1.01^3 = 12\,511 + 16\,878 = 29\,389$ ;
- In Y+3:  $10\,000 \times 1.05^5 / 1.01 + 15\,000 \times 1.03^5 / 1.01^2 = 29\,683$ .

41 The fair value changes of the bonds are therefore:

- In Y+2:  $29\,389 - 29\,098 = 291$ ;
- In Y+3:  $29\,683 - 29\,389 = 294$ .

42 The entity computes the discounted fulfilment cash flows

For G 1, the liability is:

- In Y+2:  $(11\,762 + 510) / 1.01^2 = 12\,030$  with an increase of  $12\,030 - 11\,911 = 119$
- In Y+3:  $(11\,762 + 510) / 1.01 = 12\,150$  with an increase of  $12\,150 - 12\,030 = 120$

For G 2, the liability is:

- In Y+2:  $(17\,389 - 510) / 1.01^3 = 16\,382$  with an increase of  $16\,382 - 16\,220 = 162$
- In Y+3:  $(17\,389 - 510) / 1.01^2 = 16\,546$  with an increase of  $16\,546 - 16\,382 = 164$ .

43 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is:

- In Y+2:  $291 - 119 - 162 = 10$   
Of which:  $10 \times 119 / (119 + 162) = 4$  allocated to G 1  
Of which:  $10 \times 162 / (119 + 162) = 6$  allocated to G 2
- In Y+3:  $294 - 120 - 164 = 10$ .  
Of which:  $10 \times 120 / (120 + 164) = 4$  allocated to G 1  
Of which:  $10 \times 164 / (120 + 164) = 6$  allocated to G 2

44 Then the entity applies IFRS 17.B134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore:

- In Y+2:  $119 + 162 + 10 - 1\,015 = (724)$ ;
- In Y+3:  $120 + 164 + 10 - 1\,056 = (762)$ .

45 Then the entity allocates the CSM to profit and loss according to IFRS 17.B119

	G 1	G 2	Total
Opening balance Y+1	287	397	685
Change in the entity's share of the underlying items	4	6	10
Allocation to profit and loss 1/3 for G 1 and 1/4 for G 2	(97)	(101)	(198)
CSM at the end of year Y+2	194	302	496
Change in the entity's share of the underlying items	4	6	10
Allocation to profit and loss 1/2 for G 1 and 1/3 for G 2	(99)	(103)	(202)
CSM at the end of year Y+3	99	205	304

46 The financial statements are as follows:

Balance sheet	Y+2	Y+3	Profit and loss	Y+2	Y+3
Bonds	27 490	28 546	Insurance revenue	198	202
Liability for remaining coverage	(28 412)	(28 697)	Finance income	1 015	1 056
Contractual service margin	(496)	(304)	Insurance finance expense	(1015)	(1 056)
Net income	(198)	(202)			
Retained earnings	(282)	(480)			
Other comprehensive income	1 899	1 137	Net income	198	202

### 3.4 In years Y+4

47 Underlying assets:

- The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $12\,155 \times 5\% + 16\,391 \times 3\% = 1\,099$ .
- The bonds subscribed in year Y reach their maturity and the entity receives the final inflow of 12 763.

- The fair value of the remaining bonds held by the entity amounts to  $15\,000 \times 1.03^5 / 1.01^1 = 17\,217$ .
- The change in fair value of the underlying assets is therefore  $(17\,217 + 12\,763) - 29\,683 = 297$ .

- 48 The contracts of G 1 reach their maturity. The entity makes its expected final payment of  $10\,000 \times 1.045 \times 1.03^4 = 11\,762$ . The change in the liability for remaining coverage for G 1 is therefore:

<b>Opening balance</b>	<b>12 151</b>
Unwind of the discount rate (1 %)	121
Terminal payment to policyholders of G 1	-11 762
<b>Closing balance – Residual amount allocated to G 2</b>	<b>510</b>

- 49 The entity applies IFRS 17.B71 and recognises a liability for the fulfilment cash flows allocated to G 2 up to 510.
- 50 At the end of year Y+5, the company has cash at hand up to  $12\,763 - 11\,762 = 1\,001$
- 51 The discounted fulfilment cash flow to G 2 amounts to  $(15\,000 \times 1.03^5 - 510) / 1.01 = 16\,712$ . The change amounts to  $16\,712 - 16\,546 = (165)$ .
- 52 Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is  $297 - 121 - 165 = 10$ , which is fully allocated to G 2.
- 53 Then the entity applies IFRS 17.B 134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore  $287 + 10 - 1\,099 = (803)$ .
- 54 Then the entity allocates the CSM to profit and loss according to IFRS 17.B119:

	<b>G 1</b>	<b>G 2</b>	<b>Total</b>
Opening balance	99	205	304
Change in the entity's share of the underlying items	0	10	10
Allocation to profit and loss 1 / 1 for G 1 and 1 / 2 for G 2	- 99	-108	-207
CSM at the end of Y+4	0	108	108

- 55 The financial statements are as follows:

<b>Balance sheet</b>	<b>Y+4</b>	<b>Profit and loss statement</b>	<b>Y+4</b>
Cash at hand	1 001	Insurance revenue	207
Bonds	16 883	Finance income (bonds)	1 099
Liability for remaining coverage	-17 222	Insurance finance expense	-1 099
Contractual service margin	- 108		
Net income	-207		
Retained earnings	-682		
Other comprehensive income	334	Net income	207

#### 4 At the end of year Y+5

- 56 The bonds are accounted for at amortised costs, the entity therefore records the interest rate for the period that is  $16\,883 \times 3\% = 506$ .
- 57 The bonds subscribed in year Y+1 reach their maturity and the entity receives the final inflow of 17 389. The change in the fair value of the bonds is  $17\,389 - 17\,217 = 172$ .

- 58 The contracts of G 2 reach their maturity. The entity makes its expected final payment of  $15\,000 \times 1.03^5 = 17\,389$ .
- 59 The balance of cash in hands amounts is therefore unchanged and amounts to 1 001.
- 60 The changes in the liability for remaining coverage amounts to  $17\,389 - 16\,712 - 511 = 167$ .
- 61 The CSM is adjusted by  $172 - 167 = 5$  to recorded the entity's share of the fair value changes.
- 62 The entity releases the contractual service margin to profit and loss:  $108 + 5 = 113$ .
- 63 Then the entity applies IFRS 17.B 134 and disaggregates its insurance finance expenses between profit and loss and OCI. The amount booked to OCI is therefore  $167 + 5 - 506 = (334)$ , which settles the balance of OCI.
- 64 The financial statements are as follows:

Balance sheet		Profit and loss statement	
	Y+5		Y+5
Cash at hand	1 001	Insurance revenue	113
Bonds	0	Finance income (bonds)	506
Liability for remaining coverage	0	Insurance finance expense	(506)
Contractual service margin	0		
Net income	(113)		
Retained earnings	(888)		
Other comprehensive income	0	Net income	113

## 5 Alternative case

- 65 § 19 indicates that, because of the drop in market interest rate, the entity discretionary changes its estimates of the crediting rate from 4.5 % to 4.1 % at the end of year Y. Accordingly, the expected participation of G 1 policyholders in the yield of the pool of assets decreases from 88 % down to 82 %. The expected final payment thus decreases from 12 462 to  $10\,000 \times 1.045 \times 1.041^4 = 12\,272$ .
- 66 Had that change in assumption not taken place at the end of Y, the expected final payment to G 1 would have remained at  $10\,000 \times 1.045^5 = 12\,462$ .
- 67 In that case, § 20-21 is changed as follows:
- At the end of year Y, the liability for remaining coverage under IFRS 17 is the discounted value of the expected terminal payment which is  $10\,000 \times 1.045^5 / 1.03^4 = 11\,072$ . The increase is  $11\,072 - 9\,764 = 1\,308$ .
  - Furthermore, as the contracts are accounted for under the variable fee approach, the entity also updates the CSM by **32** up to the difference between:
    - the change in the fair value of the underlying assets:  $11\,340 - 10\,000 = 1\,340$ .
    - the change in the liability for remaining coverage:  $9\,764 - 11\,072 = -1\,308$ .
- 68 Furthermore § 28-30 are changed as follows
- In year Y+1 upon the initial recognition of G 2, the entity expects to pay 17 389 in year 5 to the policyholders of G 2, however, the measurement of G 1 already includes a  $12\,462 - 11\,762 = 700$  of payment allocated to G 2.

- Applying IFRS 17.B68, the discounted fulfilment cash flows allocated to G 2 therefore amount to  $(17\,389 - 700) / 1.03^5 = 14\,396$ . The CSM amounts to **604**.
- The FCF allocated to G 1 include a payment of 700 to G 2 which results in discounted FCF of  $700 / 1.03^4 = 622$  allocated to G 1 whereas for the calculation of the CSM of G 2, this amount is discounted over 5 years:  $700 / 1.03^5 = 604$  with a difference of 18. This amount impacts the CSM of G 2.

69 Consequently § 33-35 are amended as follows:

- The entity computes the discounted fulfilment cash flows:
  - o For G 1, the liability is  $(11\,762 + 700) / 1.01^3 = 12\,095$  with an increase of  $12\,095 - 11\,072 = 1\,023$
  - o For G 2, the liability is  $(17\,389 - 700) / 1.01^4 = 16\,038$  with an increase of  $16\,038 - 14\,396 = 1\,642$ .

The total increase in the discounted fulfilment cash flows is therefore 2 665.
- Then the entity unlocks the CSM to record its share in the changes in the fair value of the underlying item that is  $2\,759 - 2\,665 = 94$ .
- According to its accounting policy, the entity thus allocates the entity's share of the fair value of the underlying items as follows:
  - o The amount allocated to G 1 is therefore  $94 \times 1\,023 / 2\,665 = 36$
  - o The amount allocated to G 2 is therefore  $94 \times 1\,642 / 2\,665 = 58$

70 The cumulative CSM of G 1 and G 2 has not significantly changed:

	Transfer: 510			Transfer: 700		
	G 1	G 2	Total	G 1	G 2	Total
New contracts issued in year Y	236		236	236		236
Change in the entity's share of the underlying items	200		200	32		32
Release to profit and loss (1/5)	-87		-87	-54		-54
Balance carried forward to year Y+1	349		349	214		214
Change in the entity's share of the underlying items	34	56	200	36	58	94
New contract issued in Y+1		440	440		604	604
CSM at the end of Y+1	383	497	<b>880</b>	250	662	<b>912</b>

By and large, the cumulative amount of CSM remains the same disregarding the discretionary assumptions made on the mutualised population in-Force (G 1) before the new business (G 2) has been issued. The difference in amount mainly results from the CSM released to profit and loss in year Y.