

International Financial Reporting Standards

Insurance Contracts Standard Modifications to General model: variable fee contracts

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1. The need for change and the history of the project
2. What is an insurance contract
3. Initial measurement of insurance contracts
4. Subsequent measurement of insurance contracts
5. **Modifications to General model: variable fee approach**
6. Other modifications to the General model
7. Presentation and disclosure
8. Applying the standard for the first time

Modifications to the general model

The new insurance contracts Standard **modifies the accounting model** to provide additional accounting models for different types of contract.

- A variable fee approach for some contracts with **participation features**
- Accounting requirements for **reinsurance contracts** an entity holds, based on the general model
- Accounting requirements for **investment contracts** with discretionary participation features
- An optional simplified measurement approach for **simpler insurance contracts**, based on the unearned premium reserve approach used in many jurisdictions

Modifications to the general model

Variable fee approach: Scope

- **Scope** of the variable fee approach
 - Policyholder **participates** in share of clearly identified pool of **underlying items**;
 - Entity expects to pay **policyholder a substantial share** of the returns from those underlying items;
 - **Cash flows expected to vary substantially** with underlying items
- Variable contracts outside the variable fee approach **apply the general model**

Modifications to the general model

Variable fee approach: Sensitivity

- Includes any contract which creates a **contractual obligation** linked to underlying items
 - **Explicit** contractual terms
 - **Includes regulatory** requirements
- However, measurement based on **expected cash flows** (not contractually-specified cash flows)
- **Not dependent on holding** of underlying assets
- Obligation **need not be to current generation** of policyholders

Modifications to the general model

Variable fee approach: Mechanics

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- Measurement of **obligation** (both FCF and CSM) **reflects** change in **fair value of all underlying items**
- **Fulfillment cash flow is calculated consistently** with the general model
- Modify general model so that changes in the estimate of fee entity expects to earn **are adjusted in CSM**
 - Fee is equal to entity's expected share of returns on underlying items, less
 - any expected cash flows that do not vary with the underlying items.

Modifications to the general model

Variable fee approach: Risk mitigation

- Entity is permitted to **recognise in profit or loss** changes in value of **guarantee** (ie as in the general model) if:
 - Entity holds derivative instruments
 - consistent with entity's risk management strategy;
 - economic offset exists between guarantee and derivative, and
 - credit risk does not dominate the economic offset
- Entity is required to:
 - document its risk management objective and strategy
 - discontinue prospectively when economic offset ceases
 - disclose the effect of changes in the value of the guarantee in the profit or loss for the period

Modifications to the general model

Variable fee approach: Allocation of CSM

- Release **pattern consistent with general model**
 - Basis of **passage of time**
 - Number of **contracts in force**
- Alternatives rejected:
 - Based only on investment services
 - What is the pattern for those services?
 - How to reflect two services and changes in magnitude in those services over time?

Contrast with general model

General model versus variable fee

	General model	Variable fee model
Cash flows		No difference
Discount rate		No difference
Risk margin		No difference
CSM at inception		No difference
Allocation of CSM		No difference
Discretion		No difference

Contrast with general model

General model versus variable fee

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	General model	Variable fee model
CSM		
Subsequent Measurement (financial)	Changes in all financial assumptions in SCI	Changes in guarantees and shareholders share in CSM
- Except risk mitigated	Changes in all financial assumptions in SCI	Changes in sh/share in CSM
Subsequent (non financial)	No difference	
Accretion	Accreted at locked in rate	'Effective' accretion at current rate

Thank You

