STAFF PAPER

June 2014

REG IASB Meeting

Project	Insurance contracts
Paper topic	Non-targeted issues: Level of aggregation

CONTACT(S)	Andrea Pryde	apryde@ifrs.org	+44 (0)20 7246 6491
	Milena Lacheta	mlacheta@ifrs.org	+44 (0)20 7246 6494
	Izabela Ruta	iruta@ifrs.org	+44 (0)20 7246 6957

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose of paper

1. During its meeting in April 2014, the IASB agreed to discuss seven issues that had been raised in the comment letters but were outside the five areas that were targeted for input in the IASB's 2013 Exposure Draft *Insurance Contracts* (the 2013 ED). This paper discusses one of those issues, namely whether any clarification or additional application guidance is needed regarding the level of aggregation for measurement as proposed in the 2013 ED.

Why does the IASB need to address this issue?

2. The 2013 ED did not prescribe a single level of aggregation to be used for recognition and measurement throughout the Standard. Instead, the 2013 ED set principles for the measurement of particular components of an insurance contract and indicated the levels of aggregation that would be needed for an entity to meet those principles. Many constituents were unsure how to apply the different levels of aggregation and consequently asked for clarification and additional guidance. Constituents also commented that the reference to pricing that was added to the definition of a portfolio in the 2013 ED was unclear and could result in a level of aggregation that was excessively narrow and burdensome.

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

Staff recommendation

3. The staff recommend that the IASB should:

   (a) clarify that the objective of the proposed insurance contracts Standard is to provide principles for the measurement of an individual insurance contract, but that in applying the standard an entity could aggregate insurance contracts provided that it does in a way that meets that objective.

   (b) amend the definition of a portfolio of insurance contracts to read:

   "insurance contracts that provide coverage for similar risks and are managed together as a single pool".

   (c) add guidance to the proposed Standard that:

      (i) in determining the contractual service margin or loss at initial recognition, an entity should not combine onerous contracts with profit-making contracts. An entity should consider the facts and circumstances to determine whether a contract is onerous at initial recognition, i.e. whether the sum of the fulfilment cash flows and any pre-coverage cash flows determined for the contract is greater than zero;

      (ii) in determining the contractual service margin at subsequent measurement an entity could combine contracts that have similar:

         1. release patterns;
         2. absolute amounts of contractual service margin at initial recognition; and
         3. inception dates and coverage periods.

   (d) clarify that, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity should select and apply its accounting policies consistently for similar contracts, taking into consideration the portfolio in which the contract is included and the related assets that the entity holds.

Overview of this paper

4. This paper comprises:

   (a) background information, which summarises the proposals in the 2013 ED and the feedback received in the comment letters (paragraphs 5-10).

   (b) staff analysis, which:

      (i) describes the 2013 ED proposals for the level of aggregation of insurance contracts that would be consistent with the objective for measurement of an insurance contract and considers whether changes are needed (paragraphs 11-33); and

      (ii) proposes, in the light of the IASB's March 2014 decision on presenting the effect of changes in the discount rate in other comprehensive income, additional requirements for when an entity selects the accounting policy to apply to portfolios of insurance contracts (paragraphs 34-38).

   (c) Appendix A, which contains relevant extracts from the 2013 ED and the Basis for Conclusions.

Background information

The 2010 ED

5. The 2010 Exposure Draft Insurance Contracts (the 2010 ED) proposed to define a portfolio of insurance contracts as:

> "insurance contracts that are subject to broadly similar risks and managed together as a single pool."

6. Furthermore, the 2010 ED proposed that entities should:

   (a) measure expected cash flows and the risk adjustment at portfolio level; and

(b) measure any expected gain (contractual service margin) or loss at a lower level of aggregation[1] at initial recognition and on subsequent release of the contractual service margin to profit or loss.

7. Most respondents thought that the definition of a portfolio could be subject to different interpretations of "similar risks" and "managed together", resulting in aggregation of very different contracts. Many respondents suggested that the Standard should have a single level of aggregation and that this single level of aggregation should be the portfolio. In addition:

(a) Some respondents did not agree with the proposed level of aggregation for measuring the risk adjustment, because it restricted the diversification benefits to only those within a portfolio and not between portfolios. Those respondents stated that this proposal was inconsistent with the way in which they price contracts and manage their business.

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

The 2013 ED

8. In response to that feedback, the 2013 ED proposed that an entity should measure expected cash flows and the contractual service margin or initial loss at portfolio level. At the same time, the IASB proposed to modify the definition of a portfolio to include a requirement that contracts in a portfolio should be priced similarly relative to the risks taken on. The reference to pricing was added to ensure that contracts with similar risks and different expectations of profitability would not be combined in the same portfolio. It also precludes an entity from regrouping contracts to avoid recognising losses in subsequent periods (because pricing is established at contract inception). The definition of a portfolio in the 2013 ED is thus:

" A group of insurance contracts that:

[1] This level of aggregation is sometimes referred to as a cohort, and aggregates contracts within a portfolio by similar dates of inception and similar coverage periods.

a) provide coverage for similar risks and that are priced similarly relative to the risk taken on; and

b) are managed together as a single pool."

9. In addition, in response to constituents' comments, the 2013 ED proposed that an entity should:

   (a) measure the risk adjustment in a way that incorporates diversification benefits to the extent that the entity considers such benefits when estimating the compensation for bearing the risk. This is consistent with the definition of the risk adjustment as the compensation the entity requires for bearing risk; and

   (b) aggregate contracts for the purpose of the release of the contractual service margin in a way that ensures that when the coverage period of each contract has ended, the contractual service margin relating to that contract is fully recognised.

10. Most of the comments received on the 2013 ED relating to the definition of a portfolio and to the level of aggregation were sent by preparers of financial statements and regulatory or standard-setting bodies, mostly from Europe and the United States. The main issues were:

    (a) Respondents were unclear about how to interpret the requirement that contracts within a portfolio should be priced similarly relative to the risk taken on.

    (b) Respondents struggled to understand the reasons for the 2013 ED proposals for the level of aggregation that was to be used to account for different components of insurance contracts.

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

    (d) Respondents were concerned that the 2013 ED would requires them to apply a level of aggregation that is lower than the level at which they

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

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

Staff analysis

The measurement principle for an insurance contract

11. This section:

(a) explains the 2013 ED proposals for the level of aggregation of insurance contracts that would be consistent with the objective for measurement of an insurance contract.

(b) demonstrates that different levels of aggregation are needed for different components of measurement to meet the objective of accounting for an individual contract.

(c) considers whether the requirement in the 2013 ED that contracts in a portfolio should be priced similarly relative to the risk taken on should be retained.

12. Although entities manage, and often measure, contracts on a portfolio basis, the contractual rights and obligations arise from individual contracts. Consequently, the objective of 2013 ED is to provide principles for the measurement of an individual insurance contract that the entity issues.

13. However, as acknowledged in paragraph B37 of the 2013 ED, it may be practical or necessary for entities to measure different components of an insurance contract using different levels of aggregation. This is because:

(a) some inputs exist only at an aggregate level and need to be allocated to the individual contract the entity aims to measure. For example, the

measurement of an insurance contract includes an allocation of costs that are incurred on an aggregate level which need to be allocated to individual contracts.

(b) measuring insurance contracts using a higher level of aggregation (for example, a cohort or a portfolio) reduces the operational burden and complexity of calculations on an individual contract level. For example, assessing the expected value of the claims arising due to an insurance contract is more easily achieved by considering the level of claims in a portfolio of contracts, rather than for an individual contract.

14. As a default, the 2013 ED used the portfolio to specify this higher level of aggregation, because this is the level that would currently be used in practice. However, difficulties arise because:

(a) The IASB's definition of a portfolio may be different from the way that the term is used currently in practice. Our fieldwork indicated that there are significant differences in the way in which entities group contracts into portfolios.

(b) Different levels of aggregation could be appropriate to meet the IASB's objectives for measuring the different components of insurance contracts.

15. The following paragraphs consider the extent to which an entity could aggregate insurance contracts and still achieve the objective of measuring an individual insurance contract, taking into consideration the following components of the measurement of an insurance contract:

(a) at initial recognition:

(i) cash flows;

(ii) risk adjustment; and

(iii) contractual service margin/loss (onerous contract).

(b) in subsequent periods:

(i) changes in estimates that adjust the contractual service margin; and

(ii) allocation of the contractual service margin to profit or loss.

Cash flows

16. The 2013 ED requires that the estimates of cash flows used to determine the fulfilment cash flows should include all cash inflows and cash outflows that relate directly to the fulfilment of the portfolio of contracts. Paragraphs B66 and B67 of the 2013 ED explain which cash flows relate directly to the fulfilment of the contract. Those cash flows include cash flows that are directly attributable to portfolios of insurance contracts, even if they cannot be attributed directly to individual insurance contracts in a portfolio; for example, acquisition costs. Those cash flows also include overhead costs that are incurred at an entity level but can be directly attributable to portfolios of insurance contracts. Such cash flows are assessed on a probability-weighted basis, as explained in paragraph B38 of the 2013 ED:

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

17. Thus, the definition of a portfolio does not determine the level of aggregation for cash flow measurement, but is used only to identify whether costs, including those that are determined at a higher level of aggregation than the portfolio, are permitted to be included in the fulfilment cash flows on an expected value basis. In other words, the level of aggregation is not relevant to the measurement of the cash flows.

Risk adjustment

18. The risk adjustment is defined as the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract. Consequently, the risk adjustment is assessed from an entity-specific perspective, and should reflect all factors (including diversification benefits) considered by the entity in determining the compensation required. The effect of diversification benefits is in effect allocated to insurance contracts. As a result, the definition of a portfolio is not relevant to assessing the risk adjustment. Furthermore, it is not possible to define a portfolio in a way that

would capture the appropriate cash flows to include in the fulfilment cash flows and the appropriate diversification benefits to be reflected in the risk adjustment that is used to adjust those cash flows to reflect the effect of uncertainty about their amount and timing.

Contractual service margin (or loss) at initial recognition

19. At initial recognition, an insurance contract is expected to be either profitable or loss-making. When a contract is profitable, an entity eliminates any initial gain by recognising a contractual service margin. When a contract is loss-making, an entity recognises any initial loss immediately in profit or loss. The 2013 ED proposed in paragraph 12 that when a contract is loss-making an entity should recognise an insurance contract before the coverage period begins when a contract is onerous. To test if a contract is onerous, paragraph 15 of the 2013 ED requires an entity to consider if any facts and circumstances indicate that the portfolio of contracts that will contain the contract is onerous.

20. Both the contractual service margin and loss are determined directly from the calculation of the fulfilment cash flows. Consequently, the contractual service margin (or loss) for each contract incorporates an allocation of costs determined at a portfolio level, and a risk adjustment determined on an entity-specific level of aggregation.

21. The level of aggregation used for determining the contractual service margin can determine the extent to which an entity recognises losses in profit or loss, both at initial recognition and subsequently. This is because the aggregation of insurance contracts results in the averaging of the contractual service margins allocated to each contract. Thus, combining a contract that might have had an initial loss with a contract with a higher positive contractual service margin could result in both contracts showing an averaged, but nevertheless positive, contractual service margin. Similarly, combining contracts with different degrees of expected profitability in a portfolio would result in each contract having an averaged contractual service margin. This may not make a significant difference at initial recognition, because the measurement of the sum of the combined contracts would include the sum of their combined contractual service margins. However, on subsequent measurement, there could be differences in the ability of the

contractual service margin for each contract to absorb unfavourable changes in estimates (resilience) compared to an averaged contractual service margin (see paragraphs 27-29).

22. The 2013 ED specified that an entity should aggregate insurance contracts into a portfolio of contracts when determining the contractual service margin. Consequently, the definition of a portfolio is used to determine when losses would be recognised in profit or loss. The staff note that without the additional requirement that contracts within a portfolio should be priced similarly relative to the risk taken on, the definition of an insurance contract would already prevent an entity from combining contracts that have different risks and that are not managed together. The additional requirement that contracts in a portfolio should be priced similarly to the risk taken on was intended to ensure that an entity would not combine similar contracts with different degrees of expected profitability and thus avoid recognising losses that would otherwise be recognised at initial recognition or subsequent measurement. However, the staff note that the reference to pricing seems excessively restrictive for the initial recognition of the contractual service margin (because, as noted in paragraph 21, at initial recognition it only matters whether loss-making contracts are combined with profit-making contracts, and not if contracts of different profitability are combined) while it does not fully address the issues relating to the subsequent measurement of the contractual service margin (as described in paragraphs 23-29).

Subsequent measurement of the contractual service margin

23. After initial recognition, the amount of the contractual service margin changes because:

    (a) it is recognised in the profit or loss as profit according to the pattern of the services provided; and

    (b) it is adjusted by changes in expected cash flows and changes in risk adjustment that relate to future coverage (often referred to as unlocking).[2]

[2] Interest is also accreted on the contractual service margin to reflect the time value of money. However, accretion has no dependence on the level of aggregation.

Recognition in profit or loss

24. The 2013 ED proposes that an entity should recognise the remaining contractual service margin in profit or loss in a systematic way that best reflects the remaining transfer of services that are provided under the contract. For contracts with no participating features, the IASB decided in May 2014 that the transfer of services covered by the contractual service margin is provided on the basis of the passage of time. The Basis for Conclusions in the 2013 ED noted that the draft Standard did not specify the level of aggregation for recognising the contractual service margin in profit or loss, but stated that an entity would need to ensure that the contractual service margin for each contract should be fully recognised when the coverage period of each contract has ended.

25. The staff think that an entity would be able to aggregate insurance contracts and still achieve this objective, provided the following conditions are met:

    (a) The contractual service margin of the contracts should have a similar release pattern. This condition would not apply to contracts that do not have participating features because their release pattern is based only on the passage of time. However, if the IASB decides there should be different release patterns for contracts with participating features, aggregating insurance contracts with different durations and different starting points would not meet the objective in paragraph 24. This is because the proportion of release of the contractual service margin would differ across different stages of the contract's life. For example, if the services provided are increasing over time, the proportion of release of the margin for contracts that are at the beginning of the coverage period would be higher than for contracts that are towards the end of the coverage period.

    (b) The absolute amounts of the contractual service margin for each contract should be similar. If they are not similar, the entity should incorporate the effect of lapses. In other words, aggregating insurance contracts with different absolute levels of contractual service margins would not meet the objective in paragraph 24, unless the entity separately incorporates the effect of lapses. This is because an entity should recognise in profit or loss

more contractual service margin when a contract with a large contractual service margin lapses, compared to when a contract with a smaller contractual service margin lapses.

(c) The period over which the contractual service margin is expected to be recognised should be similar. In determining that period, the entity should take into account the expected termination of the contracts (because of either expiry or cancellation). This is because the contractual service margin should be recognised in a way that ensures that when the contract is finished, the whole margin should be recognised in profit or loss.

26. Because the definition of a portfolio does not address the release pattern, the absolute size and the recognition period of the contractual service margin, it does not contribute to ensuring that the entity meets the objective of full recognition of the contractual service margin for each contract by the time the coverage period of each contract has ended. The staff believe that incorporating these factors in the definition of a portfolio would be unduly restrictive.

Adjusting the contractual service margin for changes in estimates

27. As noted in paragraph 23(b), after initial recognition, an entity adjusts the margin for changes in estimates of cash flows and risk adjustment that relate to future services. The staff note that the revised estimates of the expected cash flows and risk adjustment are made on the same basis as described in paragraphs 16-18 for initial recognition and should be allocated to the contracts to which they relate. Because the margin cannot be negative, an entity recognises a loss in profit or loss to the extent the margin is insufficient to absorb unfavourable changes in estimates.

28. As a consequence, the remaining amount of the margin at the measurement date affects the margin's ability to absorb subsequent unfavourable changes in estimates. Accordingly, if the entity combines different amounts of contractual service margins, either at initial recognition or subsequently, losses that ought to be reported because the margin is exhausted on a contract might be averaged with contracts that have sufficient margin to absorb unfavourable changes in estimates. Consequently, an entity should be able to aggregate contracts within a portfolio only if the following conditions are met:

(a) The contracts should have similar inception dates. As noted in the paragraph 24, the IASB proposed that entities should recognise the contractual service margin for contracts with no participating features based on the passage of time. This means that the remaining contractual service margin decreases over time which decreases the ability to absorb unfavourable changes in estimates.

(b) The amount of the contractual service margin released in each period is the same, which would mean that the factors described in paragraph 25 are relevant.

29. The staff believe that, as for the recognition of the contractual service margin, the definition of a portfolio does not contribute to ensuring that the entity meets the objective of recognising subsequent losses if the margin is not enough to absorb the unfavourable changes in estimates. This is because the definition of a portfolio does not refer to the inception date of the contracts or the factors described in paragraph 25.

Staff recommendations

30. In summary, the staff believe that:

(a) The objective of the insurance contracts Standard is to provide principles for measurement of an individual insurance contract that the entity issues.

(b) The measurement of an insurance contract incorporates on an expected value basis the fact that claims are expected to arise on some contracts, but not on others. Consequently, as a practical expedient, an entity may need to aggregate insurance contracts to measure them.

(c) Different levels of aggregation may be appropriate for different components of measurement to achieve the objective.

(d) The proposed Standard should clarify the factors an entity needs to consider in determining the extent to which an entity could aggregate insurance contracts and still achieve the objective of measuring an individual insurance contract.

31. The staff also note that the definition of a portfolio was used in 2013 ED for the following purposes:

    (a) establishing the cash flows that should be used in the determination of the fulfilment cash flows (as described in paragraph 17); and

    (b) determining which contracts may be aggregated at initial recognition and thus determining when losses would be recognised in profit or loss (as described in paragraph 22).

32. However, the staff note the following concerns that arise from the additional requirement that contracts in a portfolio should be priced similarly relative to the risk taken on:

    (a) It caused confusion for some constituents because they were not sure how to interpret and apply this requirement (as described in paragraph 10(a)).

    (b) It would be excessively restrictive for achieving the objective of ensuring that an entity would not combine loss making contracts with profitable contracts (as described in paragraph 22);

    (c) It does not fully address issues relating to the subsequent measurement of the contractual service margin, because it does not contribute to ensuring that the entity meets the objectives:

        (i) that the contractual service margin should be recognised in a way that ensures that when the contract is finished, the whole margin should be recognised in profit or loss (as described in paragraph 26); and

        (ii) that, when the unfavourable changes in expectations occur, the entity should recognise a loss if the contractual service margin is exhausted (as described in paragraph 28).

33. Accordingly, the staff recommend that the IASB should remove the reference to pricing in the definition of a portfolio. However, to meet the objectives in paragraphs 26 and 29, the staff propose that the IASB should provide guidance that:

        (i) in determining the contractual service margin or loss at initial recognition, an entity should not combine onerous contracts with

profit-making contracts. An entity should consider the facts and circumstances to determine whether a contract is onerous at initial recognition, i.e. whether the sum of the fulfilment cash flows and any pre-coverage cash flows determined for the contract is greater than zero;

(b) in determining the contractual service margin at subsequent measurement an entity could combine contracts that have similar:

(i) release patterns;

(ii) absolute amounts of the contractual service margin at initial recognition; and

(iii) inception dates and coverage periods.

Question 1 – Level of aggregation

(a) Does the IASB agree to clarify that the objective of the proposed insurance contract standard is to provide principles for the measurement of an individual insurance contract, but that in applying the standard, an entity could aggregate insurance contracts provided that it meets that objective?

(b) Does the IASB agree to amend the definition of a portfolio of insurance contracts to read:

> "insurance contracts that provide coverage for similar risks and are managed together as a single pool"?

(c) Does the IASB agree to specify that:

(i) in determining the contractual service margin or loss at initial recognition, an entity should not combine onerous contracts with profit-making contracts. An entity should consider the facts and circumstances to determine whether a contract is onerous at initial recognition, i.e. whether the sum of the fulfilment cash flows and any pre-coverage cash flows determined for the contract is greater than zero;

(ii) in determining the contractual service margin at subsequent measurement an entity could combine contracts that have similar:

1. release patterns;
2. absolute amounts of the contractual service margin at initial recognition; and
3. inception dates and coverage periods.

Selecting an accounting policy for presenting the effect of changes in the discount rate

34. In March 2014 the IASB tentatively decided that an entity should choose to present the effect of changes in discount rates in profit or loss or in other comprehensive income as its accounting policy and should apply that accounting policy to all contracts within a portfolio, subject to developing guidance that entities should apply the same accounting policy to groups of similar portfolios.[3]

35. The IASB's concern was that entities would elect different accounting policies for very similar portfolios in order to achieve a favourable accounting result. This concern arises because of comments in the feedback to the 2013 ED that the proposed definition of a portfolio would mean that an entity could choose to start a new portfolio in each year, and to apply a new accounting policy choice to that year's contracts.

36. The staff believe that the application of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, which governs accounting policy choice, would prevent the situation described in paragraph 35. Paragraph 13 of IAS 8 requires an entity to choose its accounting policy at inception as follows:

> "an entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless IFRS specifically requires or permits categorisation of items for which different policies may be appropriate. If an IFRS requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category."

37. Thus, the staff believe that the requirements in IAS 8 that an entity should use the same accounting policy for similar transactions, other events and conditions should already prevent an entity from creating a different portfolio in order to apply different accounting policies to similar contracts. (This would also apply when an entity changes its accounting policy: the staff plan to consider the

---

[3] The IASB also asked that the staff to develop guidance that would provide rigour about when entities could change accounting policies, based on the requirements for changing accounting policy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The staff will consider this guidance in a future meeting.

circumstances in which an entity may change accounting policy at a future meeting.)

38. The staff considered a concern that IAS 8 would preclude an entity from applying different accounting policies to two similar portfolios of insurance contracts that are backed by different types of assets. However, the staff believe that the mix of assets that back a given portfolio of insurance contracts should be considered as a condition that characterises the contracts in that portfolio. Accordingly, the staff think that no additional guidance is needed in the insurance contracts standard, other than a reference to paragraph 13 of IAS 8. In the staff's view this could be clarified by stating:

> In accordance with IAS 8, an entity shall select and apply its accounting policies consistently for similar contracts, considering the portfolio the contract is included in and the related assets that the entity holds.

Question 2 – Selecting an accounting policy for presenting the effect of changes in discount rates

Does the IASB agree that, in accordance with IAS 8, an entity should select and apply its accounting policies consistently for similar contracts, taking into consideration the portfolio in which the contract is included and the related assets that the entity holds?

Appendix A: Relevant excerpts from the 2013 Exposure Draft *Insurance Contracts* and Basis for Conclusions

Recognition

12 **An entity shall recognise an insurance contract that it issues from the earliest of the following:**

(a) **the beginning of the *coverage period*;**

(b) **the date on which the first payment from the policyholder becomes due; and**

(c) **if applicable, the date on which the *portfolio of insurance contracts* to which the contract will belong is onerous.**

13 **An entity shall recognise any *pre-coverage cash flows* as they occur as part of the portfolio that will contain the contract to which they relate.**

14 (…)

15 An entity needs to assess whether a contract is onerous when facts and circumstances indicate that the portfolio of contracts that will contain the contract is onerous. A portfolio of insurance contracts is onerous if, after the entity is bound by the terms of the contract, the sum of the *fulfilment cash flows* and any pre-coverage cash flows is greater than zero. Any excess of this sum over zero shall be recognised in profit or loss as an expense.

Measurement (paragraphs B36–B87)

Future cash flows (paragraphs B39–B67)

22 **The estimates of cash flows used to determine the fulfilment cash flows shall include all cash inflows and cash outflows that relate directly to the fulfilment of the portfolio of contracts. Those estimates shall:**

(…)

(c) **incorporate, in an unbiased way, all of the available information about the amount, timing and uncertainty of all of the cash inflows and cash outflows that are expected to arise as the entity fulfils the insurance contracts in the portfolio (see paragraph B54);**

(d) **be current (ie the estimates shall reflect all of the available information at the measurement date) (see paragraphs B55–B61); and**

(e) **include the cash flows within the boundary of each contract in the portfolio (see paragraphs 23–24 and B62–B67).**

Contractual service margin

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

(a) **the amount of the fulfilment cash flows for the insurance contract at initial recognition; and**

(b) **any pre-coverage cash flows.**

Subsequent measurement

(…)

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

Defined terms

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

Application guidance

Level of measurement (paragraph 22)

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

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

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

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

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

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

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

Basis for Conclusions to the 2013 ED

Level of aggregation (paragraph 32)

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