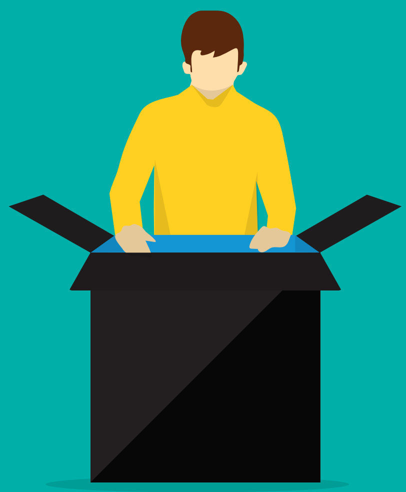
Opening the black box

Demystifying IFRS 4 Phase 2



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Foreword

The new accounting standard for insurers will represent a significant change for many insurance companies, both in terms of financial results and finance operating model. A core component of these changes are the presentations and disclosures — this publication aims to help insurers understand what is required and how they may implement them effectively.

The International Accounting Standard Board's (IASB's) replacement for IFRS 4 *Insurance Contracts* (IFRS 4) is approaching its final stages of development. Although the publication date of the forthcoming insurance contracts standard, IFRS 4 Phase 2 (IFRS 4 P2), is not yet known, the majority of its requirements have been tentatively agreed to by the IASB, including the detailed and complex presentation and disclosure requirements.

The new requirements will reshape the primary statements and change the disclosures in insurers' financial statements. Significant changes to the data gathered and maintained will be needed; as a result, this could be a complex exercise for many companies. In this report, we aim to unpack this complexity for the industry so that the implementation can be planned as efficiently as possible. Additionally, new IT systems can be planned for with greater confidence, building in the new requirements and future-proofing investment dollars.

We bring these requirements to life through illustrative examples in order to make more tangible the future requirements that insurers will face. We hope that insurers will gain a better understanding of the scale of change so that they can invest in the future with greater confidence, whether overhauling and modernizing systems and processes, or enhancing the effectiveness of their finance and actuarial functions to respond to evolving business challenges.

Users of insurance company financial statements can start to familiarize themselves with the new reporting framework for insurers and learn about the new measures and disclosures they will be presented with.

We have found this exercise to be very useful to gain a better understanding of the complexities of the forthcoming requirements, and provide a starting point to identify gaps in the data required for future financial reporting. In addition, we have developed a tool that links the presentation and disclosure requirements to detailed data requirements. This will be available to share and discuss with you, to support your efforts in assessing the impact of the changes.

We hope that this publication contributes to your understanding of the far-reaching implications of the forthcoming insurance contracts standard, and we look forward discussing its implications with you. We invite you to contact our specialists, or your usual contact at KPMG, to further these discussions. We would welcome your feedback as we move up the IFRS 4 P2 learning curve together.

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Executive summary

With the IASB getting closer to finalizing IFRS 4 P2, insurers will be keen to understand how the forthcoming insurance contracts standard will affect their financial statements, and how stakeholders may respond to the new information that will be presented. Although some disclosures, in particular those relating to the nature and extent of risks that arise from insurance contracts, will be carried forward from the existing standard, IFRS 4, there will be a number of new presentations and disclosures.

Developing these illustrative presentations and disclosures has demonstrated the complexity and intricacies of the forthcoming reporting requirements. Preparing and understanding numbers presented in a different format, using a new measurement model (or models), and with additional disclosures, will have a major impact on the insurance industry and those evaluating its performance. We also observed that the wording of the disclosure requirements contained in the 2013 Exposure Draft (ED or 2013 ED) is sometimes open to interpretation and is more complex, in practice, than it might seem, at first glance.

New performance measures will impact performance management in the future

The changes to measurement, presentation and disclosures introduced by IFRS 4 P2 will almost inevitably lead to changes in performance measurement. In developing these illustrative presentations and disclosures, we identified a number of sources of potentially new information that will be available to users of insurance company financial statements.

- The analyzes of movements will provide new and useful information about the drivers of changes in insurance contract assets and liabilities and the development of the risk adjustment (RA) and the contractual service margin (CSM) over the reporting period.
- The CSM (net of any losses) recognized on the initial recognition of contracts will provide a measure for the value added by new business that could in time replace existing performance measures computed using embedded value or regulatory-based measures.
- The RA and CSM included in the measurement of insurance contract assets and liabilities and the explanation of when the remaining CSM is expected to be recognized in profit or loss will provide valuable information about the quantum and timing of the recognition of future profits arising from existing business.

For contracts measured using the building block approach (BBA), insurance contract revenue is unlikely to become a key performance measure. For most life insurers, written premiums, which it will replace, are not widely used as a measure of performance. For short-duration contracts measured using the premium allocation approach (PAA), insurance contract revenue will be similar to earned premium and will, most likely, replace earned premium as a key performance measure. Written premiums will no longer be presented on the face of the statement of profit or loss and other comprehensive income (SOCI), and in time, might become less widely reported as a key performance measure.

A new way of working between finance and actuarial functions

Much of the information presented in the SOCI and the new disclosures, including insurance contract revenue, will be derived from analyzes that compare actual and expected cash flows, and the impact of changes in expected future cash flows, at a granular level. Although many insurers currently prepare similar analyzes as a means of validating and explaining profits arising from their insurance businesses, the results of these analyzes are not typically included in published IFRS financial statements. Actuaries and accountants will have to work closely together to produce the required information, which is likely to be of interest to investors and analysts.

Effective data management will be one of the keys to success

Most of the data required to perform the prospective cash flow calculations and movement analyzes is likely to be held in existing systems, although it might not currently be used in financial reporting.

However, obtaining the data needed to calculate the CSM and any interest recognized in other comprehensive income (OCI) at transition, on a retrospective basis, is likely to prove a greater challenge.

> "An important strategic dimension is to consider how stakeholders may respond to the new information that will be presented."
>
> **—Mary Trussell**
> Global Insurance Innovation Lead Partner
> KPMG in Canada

Making the data available in a reliable and controlled way, and at the appropriate level of detail, will be essential for quality reporting. Applying the forthcoming insurance contracts standard will create a new set of data items to be maintained, such as the CSM and the RA. This will typically require significant change and investment in systems and processes.

It will be important for insurers to fully understand and determine the financial information that will be presented and disclosed in their published financial statements before designing and developing systems and processes to meet the new reporting requirements.

Level of aggregation/ disaggregation is expected to be lower than in current reporting

The level of detail that is necessary to enable users of the financial statements to understand the nature, amount, timing and uncertainty of future cash flows that arise from insurance contracts will be an important judgment to make when presenting the disclosures. Insurers will be required to aggregate or disaggregate information so that useful information is not obscured by either the inclusion of a large amount of insignificant detail, or by the aggregation of items that have different characteristics.

Although insurers are required to make similar judgments when making the disclosures required by IFRS 4, many current disclosures (for example, reconciliations of changes in insurance contract liabilities) are typically made only at reporting entity level with little or no disaggregation. The IASB has stepped back from setting a minimum level for disaggregation (for example, by reportable segment). However, by including examples of bases for disaggregation that might be appropriate in the main body of the ED, it is signaling an expectation that the disclosures made under IFRS 4 P2 should perhaps include more disaggregated information than insurers are currently presenting under IFRS 4.

Differences with Solvency II will be fundamental in some areas

The impact of IFRS 4 P2 on an insurer's finance and actuarial processes will depend on a number of factors, such as its current reporting basis; the complexity and maturity of its business; whether it has recently undergone a major finance transformation; or the extent to which it has complex legacy systems. In Europe, insurers have made significant investments in new systems to comply with Solvency II, and many might expect that their newly developed systems and processes will require little additional development in order to meet the requirements of IFRS 4 P2.

However, there are some fundamental differences between IFRS 4 P2 and Solvency II. For example:

- the requirement to calculate and maintain a CSM, except where the PAA is used
- the need to allocate the RA at a more granular level
- the challenges of calculating the insurance contract revenue measure
- the need to analyze movements in fulfillment cash flows between those that will be presented in profit or loss, in OCI, or offset against the CSM.

For those companies that have not had to implement Solvency II, or do not currently measure insurance contracts using a building block approach, IFRS 4 P2 will typically pose an even greater implementation challenge.

What should insurers be doing now?

The IASB has tentatively agreed to allow a period of approximately 3 years after IFRS 4 P2 is issued. Many insurers, in particular those that will apply the BBA, will need to use all of this period given the complexity of the new requirements.

We believe it is important that you consider what you should be doing now and what you should defer until after the publication of the forthcoming insurance contracts standard. This thinking will be influenced by your current accounting regime; the extent to which you have implemented new regulatory frameworks, or capital models, that may be leveraged; the maturity of your finance function; and your strategic finance, actuarial and IT agenda. We believe it would be sensible to develop a clear understanding of how these components will interact, and use the time available before the issue of the forthcoming standard to draw up an implementation road map covering activities for the next 3 to 5 years.

> “Even if you have successfully implemented a modern solvency system (such as Solvency II in Europe), further action will be needed to address the new requirements.”
>
> —**Danny Clark**
> Global Insurance Accounting Change Lead
> KPMG in the UK

Illustrative presentations and disclosures

Basis of preparation

This publication presents an illustrative example SOCI and disclosures for an insurance entity that issues immediate (payout) annuities and term assurance contracts without participation features that are measured using the BBA. It cedes a portion of its insurance risk to reinsurers and chooses to present the effect of changes in discount rates and other market variables in OCI. The illustrative example SOCI and disclosures are populated with numbers. Numbers that appear in more than one of the presentations or disclosures are referenced using letters of the alphabet in order to provide as much clarity as possible on how the information provided in the different presentations and disclosures will interlink. We have not provided disaggregated disclosures for the two different product types, although, in practice, disaggregation might be appropriate.

The new disclosures illustrated in this document are as follows:

- movements in insurance contract assets and liabilities: analyzed by building block component (required by ED paragraph 76), including an analysis of new business (required by paragraph 81(b))
- movements in insurance contract assets and liabilities: analyzed between liabilities for remaining coverage and incurred claims (required by ED paragraph 74)
- inputs used in determining insurance contract revenue (required by ED paragraph 81(a))
- an analysis of insurance investment expense (required by ED paragraph 82 and IASB redeliberations on 18 March 2014 and 21 October 2015).

These disclosures will be required both for insurance contracts issued and reinsurance ceded. Separate movement analyzes will also be required for insurance contracts and reinsurance contracts issued. Comparative figures in respect of the previous period will be required for all amounts presented. In order to keep this publication concise, we have chosen not to present these disclosures or comparative information.

The illustrative SOCI and disclosures are accompanied by explanations of key items, as well as the insights that we gained from our analysis. Other disclosures that will be required but are not illustrated in this publication are described in Appendix A, page 24.

Our current interpretation of the presentation and disclosure requirements is based on the 2013 ED, supplemented by the IASB's subsequent redeliberations up to, and including, November 2015.

The new requirements are complex, and there are many different ways that the required information could be presented in insurers' published financial statements. In presenting the illustrative SOCI and disclosures, we have shaded (in green) the lines that would require separate presentation, either by IFRS 4 P2 or by other existing standards, unless immaterial. Non-mandatory lines could be combined, although they would be separately presented, if material.

Although the IASB substantially completed its redeliberations on the presentation and disclosure requirements at its meeting on 21 October 2015, further changes to these requirements may be made during the drafting stage and before the forthcoming standard is issued.

Contracts measured using the PAA and contracts with participation features

Although we have chosen to provide illustrative example presentations and disclosures for an insurance entity that issues contracts without participation features measured using the BBA, it is important to recognize that the same presentation and disclosure requirements will apply, with a few exceptions, to all insurance contracts.

Where different requirements will apply to contracts measured using the PAA, and to contracts with participation features, this is indicated.

Statement of profit or loss and other comprehensive income

What will remain the same?

The appearance of the SOCI will not change fundamentally under IFRS 4 P2, although the numbers presented will be very different. Insurers will continue to be subject to the requirements of paragraphs 81(a) to 87 of IAS 1 *Presentation of Financial Statements*, which prescribe the minimum information to be presented in the SOCI.

Amounts related to reinsurance ceded will continue to be separately presented from amounts related to direct insurance contracts.

What will change?

Written and earned premiums will be replaced by a new measure: insurance contract revenue. For most insurers, the separate presentation of insurance investment expense in respect of insurance contract assets and liabilities will also be new.

If an insurer chooses to use OCI to present the effect of changes in discount rates and other market variables, this will represent a change from most current presentations.

Presentation requirements

The presentation requirements in paragraphs 56 to 59 of the ED are as follows.

– An entity shall present revenue relating to the insurance contracts it issues in the statement of profit or loss and other comprehensive income. Insurance contract revenue shall depict the transfer of promised services arising from the insurance contract in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those services.
– An entity shall present incurred claims and other expenses relating to an insurance contract it issues in the statement of profit or loss and other comprehensive income.
– Insurance contract revenue and incurred claims presented in the statement of profit or loss and other comprehensive income shall exclude any investment components.
– An entity shall present the expense of purchasing reinsurance contracts held, excluding any investment components, in profit or loss as the entity receives reinsurance coverage and other services over the coverage period.

At its meeting on 25 April 2014, the IASB tentatively decided that an entity should be prohibited from presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue.

Table 1

Statement of profit or loss and other comprehensive income

In millions of euro	Ref	For the year ended 31 December 20XY Insurance contracts	20XY Reinsurance ceded	20XY Total
Insurance contract revenue/reinsurance expense	A	**14,210**	**(717)**	**13,493**
Claims incurred/reinsurer's share of claims incurred	B	(11,105)	569	(10,536)
Fulfillment expenses incurred	C	(793)	–	(793)
Other expenses incurred		(303)		(303)
Amortization of acquisition costs	D	(1,324)	–	(1,324)
Changes in estimates that do not adjust the contractual service margin	E	(53)	(3)	(56)
Adjustments to expected claims and expenses incurred for losses recognized on changes of estimates	F	114	4	118
Losses on initial recognition of insurance contracts/reinsurance ceded	G	(7)	–	(7)
Adjustments to expected claims and expenses incurred for losses recognized on initial recognition	H	76	–	76
Net gains on modification and derecognition of contracts	I	405	(20)	385
Underwriting result		**1,220**	**(167)**	**1,053**
Investment return				4,759
Insurance investment expense	J	(4,540)	182	(4,358)
Finance costs				(50)
Profit before tax				**1,404**
Income tax expense				(393)
Profit				**1,011**
Other comprehensive income				
Items that are or may be reclassified to profit or loss				
FVOCI financial assets				
Net change in fair value				(5,347)
Net amount reclassified to profit or loss				12
Insurance investment expense				
Net change in interest recognized in OCI	K	5,295	(220)	5,075
Net amount reclassified to profit or loss	L	(15)	5	(10)
Related tax				76
Other comprehensive income, net of tax				**(194)**
Total comprehensive income				**817**

The references in Tables 1 to 5 help the reader understand how data is linked and flows through the presentations and disclosures. For example, reference A against the insurance contract revenue line is linked to the analysis of revenue note found in Table 4 on page 18 of this publication, and the reference X in Table 2 is the sum of X1, X2 and X3 in Table 3.

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Insurance contract revenue

Insurers that measure some contracts using the BBA and others using the PAA will be able to present insurance contract revenue together in a single line, because insurance contract revenue will be measured using the same approach for all types of contract. In most current presentations, premium revenue for long-duration contracts is presented separately from premium revenue for short-duration contracts, because they are typically measured using different accounting policies. Although insurance contract revenue will be measured using the same general approach for all insurance contracts, there are some aspects of the measurement that will be different for contracts measured using the PAA approach and for contracts with participation features.

– *Contracts without participation features*

  For contracts without participation features measured using the BBA, insurance contract revenue will comprise the amount of the CSM recognized in profit or loss in the period, the change in the RA in the period, the directly attributable acquisition costs amortized in the period, and the latest estimates of claims and fulfillment expenses expected to be incurred in the period, excluding amounts that have previously been recognized as an expense in profit or loss. These components will not be derived from traditional accounting sources (such as the general ledger), but from an analysis of the movement in the insurance contract assets and liabilities. The amount recognized as insurance contract revenue over a contract's coverage period will generally be greater than the premiums received, because premiums are typically received before the related services are provided, and insurance contract revenue will include interest accreted from initial recognition on the expected future net fulfillment cash flows (comprising claims, fulfillment expenses, premiums and acquisition costs) and on the CSM.

– *Contracts measured using the PAA*

  The PAA may be used to simplify the measurement of the liability for the remaining coverage if doing so would produce a measurement that is a reasonable approximation to the measurement that would be produced using the BBA, or if the coverage period at initial recognition is one year or less. If the liability for the remaining coverage is measured using the PAA, the amount presented as insurance contract revenue over the coverage period would generally be lower than if the contract was measured using the BBA. For a contract measured using the PAA, the amount recognized as insurance contract revenue will not include accreted interest, so long as the period between the provision of each part of the coverage and the due date for the premium that relates to that part of the coverage is one year or less.

– *Contracts with participation features*

  Investment components are deducted from the latest estimate of expected claims when determining insurance contract revenue for contracts with participation features and are not included in the revenue measure. The IASB has not yet discussed whether it needs to make any modifications to how insurance contract revenue will be determined for contracts with direct participation features (see page 19).

Expenses

Insurance entities will need to analyze expenses incurred into three different categories on a retrospective basis:

– acquisition costs

– other expenses that relate directly to the fulfillment of insurance contracts

– expenses that cannot be included in either of the first two categories.

The basis of allocation required by IFRS 4 P2 is likely to be different from insurers' existing cost allocation methodology.

Acquisition costs are not included in profit or loss when incurred but are amortized over the coverage period. The amount presented as an expense in any period will be the same as the amount included in insurance contract revenue for the period.

Explanation of other items

Adjustments to expected claims and expenses incurred for losses recognized on changes in estimates and on initial recognition

If the expected fulfillment cash outflows (including the RA) exceed the expected fulfillment cash inflows, the difference is recognized immediately as an expense in the statement of profit or loss. This could occur on the initial recognition of a contract, or subsequently, when the CSM is insufficient to fully offset a change in the estimate of the remaining expected fulfillment cash flows. When an expected fulfillment cash outflow that had previously been recognized as an expense in profit or loss occurs, it is deducted from the claims and fulfillment expenses incurred in the period to avoid 'double counting'. The amount deducted from incurred claims and fulfillment expenses is also deducted from the expected claims and fulfillment expenses when determining insurance contract revenue for the period (see pages 18 and 19).

Presentation of insurance investment expense

Paragraph 82 of the ED requires interest accreted on insurance contracts to be disclosed in a way that highlights the relationship between the interest on insurance contracts and the investment return on related assets that the entity holds. This requirement is met by presenting the investment return on assets held and insurance investment expense on insurance contracts/ reinsurance ceded in adjacent lines below the underwriting result.

The effect of changes in discount rates and other market variables on the measurement of insurance contract assets and liabilities may be presented either in profit or loss or in OCI. The total insurance investment expense recognized in the SOCI in each period will be the same whichever approach is adopted.

If an entity elects to present the effect of changes in discount rates and other market variables in OCI for contracts without participation features, it should recognize:

- in profit or loss, the insurance investment expense that would be determined using the discount rates and other market variables that applied at the date that the contract was initially recognized
- in OCI, the movement in the difference between the carrying amount of the insurance contract measured using the discount rates and other market variables that applied at the reporting date, and at the date the contract was initially recognized.

The requirement to separately present insurance investment expense will represent an improvement in financial reporting. In most current presentations, this component is not separately presented from other movements in insurance contract assets and liabilities.

Net gains on modification and derecognition of contracts

In this illustrated presentation, the amounts presented in this line represent the amounts recognized in the statement of financial position, for contracts that lapsed during the period, immediately prior to their derecognition.

Contracts measured using the PAA

Presentation of the release of the RA

For contracts measured using the BBA, the release of the RA will be a component of insurance contract revenue. For contracts for which the liability for the remaining coverage is measured using the PAA, the release of the RA for incurred claims will not be a component of insurance contract revenue, because insurance contract revenue is not measured by reference to the fulfillment cash flows and the CSM.

We anticipate that most insurers using the PAA to measure the liability for remaining coverage will offset the release of the RA against claims incurred, because when a claim is incurred, the amount recognized as an expense in profit or loss would include the RA.

Presentation of insurance investment expense

If an entity chooses to present the effect of changes in discount rates and other market variables in OCI, the insurance investment expense recognized in profit or loss is determined using the discount rates that applied when the claim was incurred, and not the discount rates that applied on the date that the contract was initially recognized.

Movements in insurance contract assets and liabilities: analyzed by building block components

About this disclosure

This is the first of two illustrative disclosures in this publication that presents an analysis of movements in insurance contract assets and liabilities. This illustrative disclosure also includes the analysis of new business required by paragraph 81(b) of the 2013 ED.

Alternatively, this analysis could be presented in a separate table.

This disclosure will be of particular interest to users of financial statements because it provides information about the development of the RA and the CSM over the period.

Separate movement analyzes are required for direct insurance contracts and reinsurance contracts issued. A similar movement analysis is also required for reinsurance ceded assets and liabilities. These movement analyzes are not presented in these illustrative disclosures.

Table 2

Movements in insurance contract assets and liabilities: analyzed by building block components

								For the year ended 31 December 20XY
In millions of euro	**Ref**	**Expected PV of FCF**	**Risk Adj.**	**Ref**	**CSM**	**Ref**		**Total**
Opening insurance contract assets		(1,436)	34		124			(1,278)
Opening insurance contract liabilities		73,048	1,899		6,905			81,852
Net opening balance		**71,612**	**1,933**		**7,029**			**80,574**
New business								
Contracts that are not expected to be onerous at initial recognition:								
Expected present value of cash inflows		(18,233)	–		–			(18,233)
Acquisition costs		1,052	–		–			1,052
Claims Payable		15,082	–		–			15,082
Other fulfillment expenses		969	–		–			969
Expected present value of cash outflows		17,103	–		–			17,103
Risk adjustment		–	401		–			401
Contractual service margin		–	–		729			729
Total for contracts that are not expected to be onerous at initial recognition		**(1,130)**	**401**		**729**			–
Contracts that are expected to be onerous at initial recognition:								
Expected present value of cash inflows		(92)	–		–			(92)
Acquisition costs		8	–		–			8
Claims payable		84	–		–			84
Other fulfillment expenses		6	–		–			6
Expected present value of cash outflows		98	–		–			98
Risk adjustment		–	1		–			1
Losses recognized at initial recognition		**6**	**1**		–	G		**7**
Net movement—new business		**(1,124)**	**402**		**729**			**7**

Movements in insurance contract assets and liabilities: analyzed by building block components (continued)

In millions of euro	Ref	Expected PV of FCF	Risk Adj.	Ref	CSM	Ref	Total
							For the year ended 31 December 20XY
In-force business							
Premiums received		18,070	–		–	M	18,070
Claims paid		(11,161)	–		–	N	(11,161)
Experience adjustments—claims incurred		(279)	–		–	O	(279)
Acquisition costs paid		(1,015)	–		–	P	(1,015)
Other fulfillment expenses paid		(793)	–		–	C	(793)
Experience adjustments—acquisition costs and other fulfillment expenses incurred		(25)	–		–	Q	(25)
Accreted insurance investment expense	Y	4,466	–	Z	444	R	4,910
Changes in expected future cash flows adjusted against the CSM		(1,522)	(39)		1,388	S	(173)
Changes in expected future cash flows recognized in profit or loss		52	1		–	E	53
CSM recognized in period for services provided		–	–		(719)	T	(719)
Changes to the risk adjustment recognized in profit or loss		–	(155)		–	U	(155)
Modification and derecognition of contracts		(394)	(11)		–	I	(405)
Contracts acquired		1,450	21		365	V	1,836
Contracts transferred		(83)	(1)		(19)	W	(103)
Impact of changes in discount rates and other market variables		(5,477)	–		–	X	(5,477)
Net movement—in-force business		**3,289**	**(184)**		**1,459**		**4,564**
Net closing balance		**73,777**	**2,151**		**9,217**		**85,145**
Closing insurance contract assets		(1,476)	17		386		(1,073)
Closing insurance contract liabilities		75,253	2,134		8,831		86,218
Net closing balance		**73,777**	**2,151**		**9,217**		**85,145**

Disclosure requirements

Paragraph 76 of the ED requires an entity to disclose a separate reconciliation of the opening and closing balances of: (a) the expected present value of the future cash flows; (b) the risk adjustment; and (c) the contractual service margin.

Paragraph 78 of the ED requires the following, if applicable, to be separately identified in the reconciliation:

(a) premiums received for insurance contracts issued (or paid for reinsurance contracts held)

(b) claims paid for insurance contracts issued (or recovered under reinsurance contracts held)

(c) each of the amounts recognized in profit or loss in accordance with paragraph 60, if applicable

(d) gains and losses that arose on modification or derecognition of an insurance contract

(e) amounts that relate to contracts acquired from, or transferred to, other entities in portfolio transfers or business combinations

(f) any additional line items that may be needed to understand the change in the contract assets and the contract liabilities.

This illustrated disclosure also includes the information required by paragraph 81(b). This requires disclosure of the effect of the insurance contracts that are initially recognized in the statement of financial position in the period, showing separately, the effect of those contracts on:

(i) the expected present value of future cash outflows, showing separately the amount of the acquisition costs

(ii) the expected present value of future cash inflows

(iii) the risk adjustment

(iv) the contractual service margin.

This information could be provided in a separate disclosure rather than within this movement analysis.

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New performance measures

As presented, this movement analysis will provide useful information about both the CSM recognized, and losses recognized, on new business, and the development of the CSM and RA over the period, particularly if the information is presented on a disaggregated basis.

At its meeting on 21 October 2015, the IASB tentatively agreed to require a disclosure explaining when the entity expects to recognize the remaining CSM in profit or loss using appropriate time bands, or by using qualitative information. This will provide valuable information about the emergence of future profits. We have not included an example of this additional requirement in these illustrative disclosures.

These new performance measures might, over time, be expected to replace existing performance measures.

How should paragraph 78(c) of the ED be interpreted?

Paragraph 78(c) of the ED requires each of the amounts recognized in profit or loss in accordance with paragraph 60 to be separately presented, if applicable, in the illustrative analyzes of movements in insurance contract assets and liabilities.

The ED does not contain any guidance on how to determine the applicability of each of the items listed in paragraph 60 of the ED for inclusion in one or both of these movement analyzes. Our rationale for including each of these items in one, or both, of these movement analyzes is included in Appendix B, page 29.

Explanation of other items

Experience adjustments

There is no requirement to separately analyze experience adjustments between 'Claims incurred' and 'Acquisition costs and other fulfillment expenses incurred'. We have chosen to analyze these separately in this illustrative disclosure to make it easier for readers to compare the numbers in each of the illustrative disclosures and how they interlink.

Changes in expected future cash outflows/inflows: amounts adjusted against the CSM

Changes in estimates of the fulfillment cash flows that relate to future coverage and other future services are added to, or deducted from, the CSM, subject to the condition that the CSM should not be negative.

For a contract without participation features, the interest rate that applied at the date that the contract was initially recognized is used when calculating the change in present value of expected cash flows that offsets the CSM.

The insurance entity in this illustrative disclosure chooses to present the effect of changes in discount rates and other market variables in OCI, and so differences between the changes in present value calculated using the discount rates that applied on the date that contracts were initially recognized and the change in present value calculated using the current discount rates are recognized in OCI. This is the amount presented in the 'Total' column in this illustrative disclosure and in the third line of Table 5 on page 20.

At its meeting on 21 October 2015, the IASB tentatively agreed to require disclosure of changes in the fulfillment cash flows that adjust the CSM. This requirement is met by its separate presentation in this illustrative disclosure.

Modification and derecognition of contracts

There is no requirement to present gains and losses on modifications separately from gains and losses on the derecognition of contracts.

Impact of changes in discount rates and other market variables

It is possible that a change in discount rates and other market variables would cause a change in the value of the RA. Such changes that relate to future coverage and other services would be added to, or deducted from, the CSM, subject to the condition that the CSM should not be negative. Changes in the RA that relate to the coverage and other services provided in the current and past periods would be recognized in profit or loss. In this illustrative disclosure, we have chosen to present all changes in the RA (including those related to changes in discount rates and other market variables) that are recognized in profit or loss in the line 'Changes in the risk adjustment recognized in profit or loss'.

Reinsurance ceded

In the equivalent movement analysis for reinsurance ceded assets and liabilities, an additional line item will be required to present 'Changes in expected recoveries from reinsurers'.

Contracts measured using the PAA

This movement analysis is not required for liabilities for the remaining coverage measured using the PAA, because the measurement is not disaggregated into the separate components required by paragraph 76 of the ED. However, it would be required for contracts that are expected to be onerous and for the liability for incurred claims. The in-force business section of the analysis would include an additional line for the amounts recognized when claims are incurred. A number of other lines (such as acquisition costs paid and amounts adjusted against the CSM) would be redundant. For consistency with the analysis of new business, which other than for 'Contracts that are expected to be onerous at initial recognition' would also become redundant, the amounts recognized for claims payable could be presented separately from the amounts recognized for claims handling costs.

Contracts with direct participation features

The ED did not require this movement analysis to be presented for contracts with participation features to the extent that they were measured using the 'mirroring' approach. At its meeting on 21 October 2015, the IASB tentatively agreed that the 'mirroring' approach would no longer be permitted or required.

The IASB did not discuss whether this exemption might apply to contracts with direct participation features.

Movements in insurance contract assets and liabilities: analyzed between liabilities for remaining coverage and incurred claims

About this disclosure

This is the second of two illustrative disclosures in this publication that presents an analysis of movements in insurance contract assets and liabilities.

One of the main purposes of this movement analysis is to demonstrate that insurance contract revenue is the difference between the opening and closing carrying amounts of the liability for remaining coverage, excluding changes that do not relate to coverage or other services for which the entity expects to receive consideration.

This presentation is similar to the way that movements in non-life insurance contracts are often presented in financial statements prepared under IFRS 4. For life insurance contracts, the requirement to separately present and analyze movements in liabilities for onerous contracts will be a new requirement.

Separate movement analyzes are required for direct insurance contracts and reinsurance contracts issued. A similar movement analysis is also required for reinsurance ceded assets and liabilities. These movement analyzes are not presented in these illustrative disclosures.

Disclosure requirements

Paragraph 74 of the ED requires disclosure of reconciliations that show how the carrying amounts of insurance contracts that are in a liability position and insurance contracts that are in an asset position are affected by cash flows and income and expenses recognized in profit or loss and other comprehensive income. The reconciliations shall separately reconcile from the opening to the closing balances of:

(a) liabilities for the remaining coverage, excluding any amounts included in (b)

(b) liabilities for the remaining coverage that are attributable to amounts immediately recognized in profit or loss

(c) liabilities for any incurred claims.

Paragraph 75 of the ED requires disclosure of reconciliations that show how the aggregate carrying amounts of reinsurance contracts held in an asset position and reinsurance contracts held in a liability position are affected by cash flows and income and expense presented in profit or loss. The reconciliations shall separately reconcile from the opening to the closing balances of:

(a) the expected value of the recovery that relates to the remaining coverage, excluding the amounts included in (b)

(b) the expected value of the recovery that relates to the remaining coverage that is attributable to changes in estimates that are immediately recognized in profit or loss

(c) the expected value of the recovery that relates to any incurred claims that arise from the underlying insurance contract.

The information required by paragraph 75 of the ED is not presented in this illustrative disclosure.

Paragraph 78 of the ED also applies to this movement analysis (see 'Disclosure requirements' for the illustrative disclosure 'Movements in insurance contract assets and liabilities: analyzed by building block components' on page 10, and 'How should paragraph 78(c) of the ED be interpreted?' in Appendix B, page 29).

Table 3

Movements in insurance contract assets and liabilities: analyzed between liabilities for remaining coverage and incurred claims

In millions of euro	Ref	As at 31 December 20XY
Liabilities for remaining coverage excluding amounts immediately recognized in profit or loss		
Opening balance		**74,934**
Premiums received	M	18,070
Acquisition costs paid	P	(1,015)
Accretion of insurance investment expense	R1	4,567
Insurance contract revenue	A	(14,210)
Amortization of acquisition costs	D	1,324
Difference between the measurement of amounts that adjust the CSM using locked-in and current discount rates	S	(173)
Modification and derecognition of contracts	I1	(388)
Contracts acquired	V1	1,800
Contracts transferred	W1	(96)
Impact of changes in discount rates and other market variables	X1	(5,094)
Closing balance		**79,719**
Liabilities for remaining coverage attributable to amounts immediately recognized in profit or loss		
Opening balance		**3,223**
Losses recognized in profit or loss on initial recognition	G	7
Losses recognized in profit or loss in respect of changes in estimates	E	53
Accretion of insurance investment expense	R2	196
Adjustments to expected claims and expenses for losses previously recognized in profit or loss	F+H	(190)
Modification and derecognition of contracts	I2	(17)
Contracts acquired		–
Contracts transferred	W2	(4)
Impact of changes in discount rates and other market variables	X2	(219)
Closing balance		**3,049**
Liabilities for incurred claims		
Opening balance		**2,417**
Incurred claims	B	11,105
Accretion of insurance investment expense	R3	147
Adjustments to liabilities for incurred claims		–
Release of risk adjustment included in liability for incurred claims		–
Claims paid	N	(11,161)
Contracts acquired	V2	36
Contracts transferred	W3	(3)
Impact of changes in discount rates and other market variables	X3	(164)
Closing balance		**2,377**

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Separate reconciliations for insurance contracts that are in an asset position and a liability position

Paragraph 74 of the ED requires this movement analysis to show how the carrying amounts of insurance contracts that are in a liability position and insurance contracts that are in an asset position are affected by cash flows and income and expenses recognized in profit or loss and other comprehensive income. This would imply that separate movement analyzes should be presented for portfolios of insurance contracts that are in a liability position and portfolios of insurance contracts that are in an asset position. The same requirement is not specified for the disclosure of movements in insurance contract assets and liabilities analyzed by building block components required by paragraph 76 of the ED.

We have not provided separate movement analyzes for portfolios of insurance contracts that are in a net asset position and portfolios of insurance contracts that are in a net liability position in this illustrative disclosure, but present the required information on a net basis in a single disclosure. Providing separate movement analyzes for insurance contract portfolios that are in a net asset position and a net liability position would not provide more useful or relevant information for users of the financial statements, unless the appropriate level of disaggregation to meet the disclosure objective was the portfolio level. Whether an insurance contract portfolio is in a net asset or net liability position depends on the timing of the cash flows and not whether the portfolio is expected to be profitable or onerous, which the IASB appears to consider to be an important distinction.

Liabilities for remaining coverage

Liabilities for remaining coverage are presented in two sections in the table:

- Liabilities for remaining coverage excluding amounts immediately recognized in profit or loss; and
- Liabilities for remaining coverage attributable to amounts immediately recognized in profit or loss.

One of the main purposes of this disclosure is to present insurance contract revenue as the difference between the opening and closing carrying amounts of the liability for remaining coverage, excluding amounts immediately recognized in profit or loss, and changes that do not relate to coverage or other services for which the entity expects to receive consideration. Accordingly, insurance contract revenue is presented in a separate line in the table 'Liabilities for remaining coverage excluding amounts immediately recognized in profit or loss'.

If the expected cash outflows exceed the expected premium inflows, a contract is onerous and the difference is recognized immediately in profit or loss. Movements in onerous contracts are presented in the table 'Liabilities for remaining coverage attributable to amounts immediately recognized in profit or loss'.

Insurers will need to decide how they will determine which of the expected cash flows caused the contract to be onerous, so that when an expected cash flow occurs, they can determine if it should be presented as insurance contract revenue, in the first section of the table, or as an adjustment to expected claims and expenses for losses previously recognized in profit or loss, in the second section of the table.

Cash outflows may be expected to occur at different times (for example, contract expenses might occur on an ongoing basis but claims might only occur at a specific point in time). In the absence of guidance, preparers will presumably have an accounting policy choice of how to allocate the expected cash outflows.

The requirement to allocate expected cash outflows in this way adds complexity to an already complex model.

Losses recognized in profit or loss and adjustments to expected claims and expenses for losses previously recognized in profit or loss

There is no requirement to separately present losses recognized in profit or loss on initial recognition from losses recognized in profit or loss on changes of estimates, although we have chosen to do so in this illustrative disclosure to make it easier for readers to compare the numbers presented in each of the illustrative disclosures and how they interlink.

Favorable changes in estimates of future cash flows are recognized in profit or loss if they reverse losses previously recognized in profit or loss that relate to future coverage and other future services. In this illustrative disclosure, these reversals are included in the lines 'Losses recognized in profit or loss on initial recognition' and 'Losses recognized in profit or loss subsequent to initial recognition' so that the amounts are presented on a 'net' basis. An alternative approach would be to present these amounts on a 'gross' basis by including an additional line (or lines) in this movement analysis.

Liabilities for incurred claims

Many life insurers currently present liabilities for incurred claims as insurance payables separately from liabilities for the remaining coverage. Although these amounts are presented separately in this movement analysis, the balances will be combined and presented as insurance contract assets or liabilities in the statement of financial position.

In the same way, outstanding premiums will not be separately presented as insurance receivables but will be included in the liabilities for remaining coverage and presented as insurance contract liabilities.

Claims handling costs

Incurred claims and claims paid in 'Liabilities for incurred claims' include claims handling costs.

Reinsurance ceded

In the equivalent movement analysis for reinsurance ceded assets and liabilities, additional line items will be required in each section of the table to present 'Changes in expected recoveries from reinsurers'.

Contracts measured using the PAA

This movement analysis is required for all contracts. The lines 'Adjustments to liabilities for incurred claims' and 'Release of risk adjustment included in liabilities for incurred claims' in the section of the table 'Liabilities for incurred claims' are more likely to be used for non-life contracts. For most life insurance contracts, the amount payable will be known when a claim is notified and any liabilities recognized for claims incurred but not reported are not likely to be significant.

> “The days of separate accounting and actuarial silos are numbered. Accountants and actuaries will have to work together much more closely.”
>
> — **Jane Parker**
> Principal Advisor
> KPMG in the UK

Inputs used in determining insurance contract revenue

About this disclosure

This illustrative disclosure shows the separate components making up insurance contract revenue.

In this illustrated disclosure, we have chosen to group the components into three different categories: 'Margins released', 'Expected claims and fulfillment expenses' and 'Adjustments to expected claims and expenses for amounts previously recognized in profit or loss.' Other presentations are possible.

The inputs used in determining reinsurance expense (in respect of reinsurance ceded) must also be disclosed. This is not presented in this illustrative disclosure.

Table 4

Inputs used in determining insurance contract revenue

In millions of euro	Ref	For the year ended 31 December 20XY
Margins released		
Contractual service margin	T	719
Directly attributable acquisition costs	D	1,324
Risk adjustment	U	155
		2,198
Expected claims and fulfillment expenses		
Claims incurred	O+B	11,384
Fulfillment expenses incurred	C+Q	818
		12,202
Adjustment to expected claims and expenses for amounts previously recognized in profit or loss		
Losses recognized on changes in estimates	F	(114)
Losses recognized on initial recognition	H	(76)
		(190)
Insurance contract revenue		**14,210**
Insurance contract revenue—short-duration contracts		–
Total insurance contract revenue	A	**14,210**

Disclosure requirements

Paragraph 81(a) of the ED requires disclosure of the following inputs that are used when determining the insurance contract revenue that is recognized in the period:

(i) the expected cash outflows for the period, excluding investment components

(ii) the acquisition costs that are allocated to the period

(iii) the change in risk adjustment in the period

(iv) the amount of the contractual service margin recognized in the period.

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Adjustments to expected claims and expenses for amounts previously recognized in profit or loss

Insurance contract revenue is intended to depict the transfer of promised services in an amount that reflects the consideration that the entity expects to receive in exchange for those services (i.e. the premiums receivable). Accordingly, the extent to which the expected cash outflows exceed the expected cash inflows is not recognized in insurance contract revenue.

When an expected claim or fulfillment expense is incurred that is attributable to an expense previously recognized in profit or loss, an adjustment is made to remove that expected claim or fulfillment expense from the latest estimates of the expected claims and fulfillment expenses included in insurance contract revenue.

There is no requirement to separately present the expected claims and fulfillment expenses or to separately analyze the adjustments for amounts previously recognized in profit or loss between losses recognized on initial recognition and losses recognized on changes in estimates. However, we have adopted this approach in this illustrative disclosure to make it easier for readers to compare the numbers presented in each of the illustrative disclosures and how they interlink.

Contracts measured using the PAA

This disclosure is not required for insurance contracts measured using the PAA, because for these contracts, insurance contract revenue is not determined by reference to the building block components. Accordingly, if an insurer measures some of its contracts using the BBA, and others using the PAA, the total insurance contract revenue presented in this disclosure would not equal the amount of insurance contract revenue presented in the SOCI. An additional line for insurance contract revenue for short-duration contracts measured using the PAA has been included in this illustrative disclosure so that the total amount of insurance contract revenue presented would be the same as the amount of insurance contract revenue presented in the SOCI.

Contracts with participation features

For contracts with participation features, investment components would be deducted from the claims and fulfillment expenses expected to be incurred in the period.

Although there would be a need to identify the investment components in both the actual and expected claims amounts, this might be relatively straightforward for some contracts (for example, unit-linked contracts), because for these contracts, the investment component would typically be separately identified in the expected cash outflows and in the calculation of the claims paid.

"The transition effort for the forthcoming standard will be greater in Asia as there has been little or no focus on Solvency II type calculations."

— **Erik Bleekrode**
Partner, Insurance Accounting Change
KPMG in Hong Kong

For other contracts with participation features, the identification of investment components in the actual and expected claims might not be straightforward.

There would be no need to separate out investment components in expected premiums or premiums received for the purposes of calculating insurance contract revenue. Insurance contract revenue is determined by reference to expected claims and fulfillment expenses, and not expected premiums received.

The IASB has not yet discussed how insurance contract revenue for contracts with direct participation features will be determined. The variable fees recognized in the CSM will represent profits to be earned over the coverage period, but the extent to which the CSM recognized in profit or loss in each period will be grossed up for incurred claims and expenses, when presenting insurance contract revenue, is not clear. For many contracts with direct participation features, the variable fees will be determined on a net basis and any gross up might be arbitrary.

Analysis of insurance investment expense

About this disclosure

Entities may choose to present the effect of changes in discount rates and other market variables either in profit or loss or in OCI. The choice is made on a portfolio by portfolio basis.

The main purpose of this disclosure is to enable comparisons to be made whichever approach is adopted by requiring all entities to disclose the same information about the insurance investment expense recognized in the SOCI. The amount of insurance investment expense recognized in the SOCI in any given period will be the same whichever approach for presenting the effect of changes in discount rates and other market variables is adopted.

Separate analyzes will be required for insurance contracts and for reinsurance ceded. This illustrative disclosure presents only the analysis of insurance investment expense for insurance contracts.

Table 5

Analysis of insurance investment expense included in profit or loss and other comprehensive income

In millions of euro	**Ref**	**For the year ended 31 December 20XY**
Insurance investment expense accreted on expected future cash flows using current discount rates	Y	4,466
Effect of changes in discount rates and other market variables	X	(5,477)
Difference between measurement of amounts that adjust the CSM using the discount rates that applied at the initial recognition of insurance contracts and current discount rates	S	(173)
Insurance investment expense accreted on the CSM	Z	444
Total insurance investment expense recognized in profit or loss and other comprehensive income		**(740)**

Analysis of insurance investment expense between amounts recognized in profit or loss and other comprehensive income

Amounts recognized in profit or loss		
Insurance investment expense accreted at the discount rates that applied at the initial recognition of insurance contracts		4,555
Amount reclassified from other comprehensive income		(15)
	J	4,540
Amounts recognized in other comprehensive income		
Movement in OCI before amounts reclassified to profit or loss	K	(5,295)
Amount reclassified to profit or loss	L	15
		(5,280)
Total insurance investment expense recognized in profit or loss and other comprehensive income		**(740)**

Disclosure requirements

At its meetings on 18 March 2014 and 21 October 2015, the IASB tentatively decided that an entity should disclose the following information.

(a) For all portfolios of insurance contracts, an analysis of total interest expense included in total comprehensive income disaggregated at a minimum into:

  (i) the amount of interest accretion determined using current discount rates

  (ii) the effect on the measurement of the insurance contract of changes in discount rates in the period

  (iii) the difference between the present value of changes in expected cash flows that adjust the CSM in a reporting period when measured using discount rates that applied on initial recognition of insurance contracts, and the present value of changes in expected cash flows that adjust the contractual service margin when measured at current rates.

(b) An explanation of the method that an entity uses to calculate the cost information presented in profit or loss. We have not included an illustrative example of this disclosure in this publication.

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Analysis of insurance investment expense included in profit or loss and OCI

For the purposes of this disclosure, an entity might assume that the change in the current discount rate(s) over a reporting period takes place at the end of the reporting period. Entities generally would be expected to apply the same approach consistently from year to year.

Unlocking the CSM

Differences between current and previous estimates of the present value of cash flows related to future coverage and other future services are added to, or deducted from, the CSM, subject to the condition that the CSM should not be negative. For contracts without participation features, the discount rates that applied on the initial recognition of the insurance contracts is used to calculate the change in the present value of expected future cash flows that is added to, or deducted from, the CSM.

Because the change in the expected present value of fulfillment cash flows is determined using current discount rates, and the amounts added to, or deducted from, the CSM, are determined using the rates that applied on the initial recognition of the insurance contracts, the two amounts will differ if the current discount rates are different from the discount rates that applied on the initial recognition of the insurance contracts.

For contracts for which changes in the discount rate are recognized in OCI, the difference will be a component of the amount recognized in OCI. For contracts for which changes in the discount rate are recognized in profit or loss, the difference will be recognized in profit or loss.

Insurance investment expense accreted on the CSM

For contracts without participation features, insurance investment expense is accreted on the CSM using the discount rates that applied on the initial recognition of the contracts. Although there is no specific requirement to present the insurance investment expense accreted on the CSM in this disclosure, its inclusion would be necessary for the total interest expense analyzed in this disclosure to agree with the total insurance investment expense recognized in the SOCI.

Data requirements

Although an entity may choose to recognize the effect of changes in discount rates and other market variables in profit or loss, it would still need to maintain records of the discount rates that applied at the inception of its insurance contracts without participation features, because this information would be needed to calculate the insurance investment expense accreted on the CSM, and to determine the amount by which the CSM is adjusted when there are changes in the estimates of future cash flows related to future coverage and other future services.

Analysis of insurance investment expense between amounts recognized in profit or loss and OCI

Paragraph 65 of the ED states that when an entity derecognizes insurance contracts, any remaining amount of interest relating to those contracts that was previously recognized in OCI shall be reclassified to profit or loss as a reclassification adjustment (as defined in IAS 1 *Presentation of Financial Statements*).

Although there is no requirement to present insurance investment expense analyzed between amounts recognized in profit or loss and OCI, we have presented this analysis in our illustrative disclosure to make it easier for readers to understand the amounts presented as insurance investment expense in the illustrative SOCI.

Contracts measured using the PAA

For contracts for which the liability for the remaining coverage is measured using the PAA only the first two lines in this illustrative disclosure would be presented.

Contracts with direct participation features

In a paper prepared for the October 2015 board meeting, the IASB staff observed that analyzing insurance investment expense into the effect of changes in discount rates and other changes would provide limited information for contracts to which the current book yield approach could be applied and proposed that this disclosure should not be required for such contracts. However, the board was not asked to vote on this proposal.

> “Implementing IFRS 4 Phase 2 will not just be a finance systems change but, fundamentally, an opportunity for CFOs to rethink their operating model and how they might restructure to reduce costs and inefficiencies.”
>
> **— David Holliday**
> Senior Manager
> KPMG in the UK

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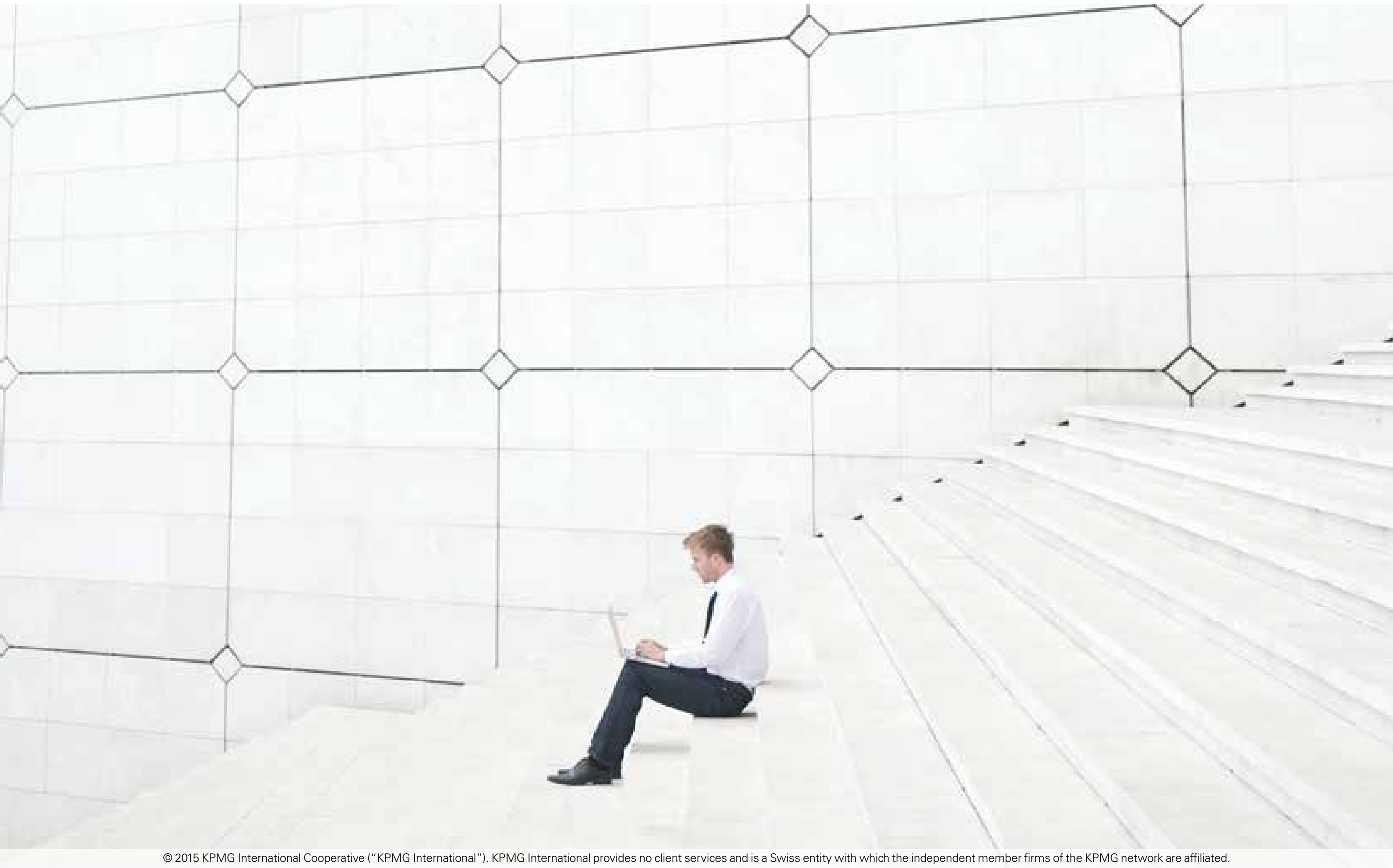
We hope that our illustrative presentations and disclosures have helped you develop your understanding of the complexity and consequences of the forthcoming insurance contracts standard. Wherever you are in your current thinking or planning for the implementation, we would be extremely happy to speak with you, hear your thoughts and feedback, and jointly continue the journey into the IFRS 4 Phase 2 world.



Appendix A

Summary of the disclosure requirements in the forthcoming insurance contracts standard

Explanation of recognized amounts

The illustrative disclosure requirements included in this publication are derived from paragraphs 73 to 82 of the 2013 ED, which are intended to provide additional information about the amounts recognized in the statement of financial position and statement of profit or loss and other comprehensive income. A summary of these requirements, and the different requirements that will apply to contracts measured using the different measurement approaches, is provided in the table below.

The disclosure requirements that are illustrated in this publication are in blue.

ED paragraph number		BBA	PAA	Contracts with participating features	
	Explanation of recognized amounts			**Direct**	**Other**
73	Present the reconciliations required by paragraphs 74 to 76 separately for insurance contracts and reinsurance contracts[1]	Yes	Yes	Yes	Yes
74 & 75	Movements in insurance contract assets and liabilities: analyzed between liabilities for remaining coverage and incurred claims	Yes	Yes	Yes	Yes
76 & 77	Movements in insurance contract assets and liabilities: analyzed by building block components	Yes	No	Yes[2]	Yes
Oct 2015 Board Meeting	An explanation of when the remaining CSM is expected to be recognized in profit or loss	Yes	No	Yes	N/A
78	Items that should be separately presented in the reconciliations required by paragraphs 74 and 76, if applicable	As above	As above	As above	As above
79	Deleted at Oct 2015 board meeting	N/A	N/A	N/A	N/A
80	Deleted at Oct 2015 board meeting[3]	N/A	N/A	N/A	N/A
81(a)	Inputs used in determining insurance contract revenue	Yes	No	Yes	Yes
81(b)	Analysis of new business	Yes	No	Yes	Yes
82	Analysis of insurance investment expense	Yes	Yes	Yes[4]	Yes
Sep 2015 Board Meeting	Information about changes between the effective yield approach and the current period book yield approach (and vice versa)	N/A	N/A	Yes	Yes

ED paragraph number		BBA	PAA	Contracts with participating features	
	Explanation of recognized amounts			**Direct**	**Other**
Oct 2015 Board Meeting	The amount of the guarantees recognized in profit or loss for the period for contracts measured using the variable fee approach where changes in the guarantee are recognized in profit or loss.	N/A	N/A	Yes	N/A
Oct 2015 Board Meeting	A reconciliation of the accumulated balance of OCI for financial assets measured at FVOCI that are designated at the date of transition as relating to insurance contracts for which the accumulated balance of OCI was set to zero under the simplified transition approach.	N/A	N/A	N/A	Yes

[1] Paragraph 73 requires the reconciliations required by paragraphs 74 to 76 to be presented separately for insurance contracts and reinsurance contracts.

The disclosures in paragraphs 74 to 82 apply to the explanation of recognized amounts. Since recognized amounts relating to portfolios of insurance contracts must be presented separately from amounts relating to portfolios of reinsurance contracts held in the statement of financial position (paragraphs 54 and 55), and income or expense from reinsurance contracts held must not be offset against the expense or income from insurance contracts in the SOCI (paragraph 63), this would imply that all of the disclosures required by paragraphs 74 to 82 should be made separately for direct insurance contracts and reinsurance contracts held.

[2] The ED did not require this movement analysis to be presented for participating contracts to the extent that they were measured using the 'mirroring' approach. At its meeting on 21 October 2015, the IASB tentatively agreed that the 'mirroring' approach would no longer be permitted or required.

The IASB did not discuss whether the exemption that would have applied to the extent that participating contracts were measured using the mirroring approach would apply to direct participation contracts.

[3] This disclosure was required for contracts measured using the mirroring approach. At its meeting on 21 October 2015, the IASB tentatively agreed that the 'mirroring' approach would no longer be permitted or required.

[4] In a paper prepared for the October 2015 board meeting, the IASB staff has observed that this disclosure would provide limited information for contracts to which the current book yield approach could be applied and proposed that this disclosure should not be required for such contracts. However, the board has not yet been asked to vote on this proposal.

Significant judgments in applying the forthcoming standard

The disclosure requirements in paragraphs 83 to 85 of the ED will apply to all types of contracts. Insurers will need to consider the disclosure objective in paragraph 71 when determining the extent to which these disclosures would need to be disaggregated (for example, by type of contract or measurement approach) to enable users of financial statements to understand the nature, amount, timing and uncertainty of future cash flows that arise from contracts within the scope of the forthcoming insurance contracts standard.

The disclosures required by paragraphs 83 to 85 relate to significant judgments made in applying the forthcoming standard. Many of these disclosure requirements will be new.

ED paragraph number	**Significant judgments in applying the forthcoming standard**
83	Judgments made in applying the [draft] standard. At a minimum: (a) the methods used to measure insurance contracts and the processes for estimating the inputs to those methods (b) to the extent not covered in (a), the methods and inputs that are used to estimate: (i) the risk adjustment; (ii) discount rates; (iii) the pattern of recognition of the contractual service margin; and (iv) investment components (c) the effect of changes in the methods and inputs that are used to measure insurance contracts, separately showing the effect of each change that has a material effect on the financial statements, together with an explanation of the reason for each change.
84	If the entity uses a technique other than the confidence level technique for determining the risk adjustment, a translation of the result of that technique into a confidence level.
85	The yield curve (or range of yield curves) that is used to discount the cash flows that do not depend on the returns from underlying items.
Oct 2015 Board Meeting	When an entity chooses to disaggregate insurance investment expense into an amount presented in profit or loss and an amount presented in OCI, an explanation of the method that an entity uses to calculate the cost information presented in profit or loss.

Nature and extent of risks that arise from insurance contracts

The disclosures required by paragraphs 87 to 95 of the ED, concerning the nature and extent of risks that arise from insurance contracts, are substantially the same as the requirements contained in IFRS 4.

	Nature and extent of risks that arise from insurance contracts
87	(a) the exposures to risks and how they arise (b) objectives, policies and processes for managing risks that arise from insurance contracts and the methods that are used to manage those risks (c) any changes in (a) or (b) from the previous period.
88	Information about the effect of each regulatory framework in which the entity operates (for example, minimum capital requirements or required interest rate guarantees).
89	Information about insurance risk on a gross basis and a net basis, before and after risk mitigation (for example, by reinsurance), including information about: (a) sensitivity to the insurance risk in relation to its effect on profit or loss and equity (b) concentrations of insurance risk.
90	Claims development tables other than for claims that are typically settled within one year.
91	For each type of risk, other than insurance risk, that arises from insurance contracts: (a) summary quantitative information about its exposure to that risk at the end of the reporting period, based on the information that was provided internally to the key management personnel, and information about the risk management techniques and methodologies that are applied (b) concentrations of risk if not apparent from other disclosures.
92	For credit risk that arises from insurance contracts issued and reinsurance contracts held: (a) the amount that best represents the maximum exposure to credit risk at the end of the reporting period; and (b) information about the credit quality of reinsurance contract assets.
93	With regard to liquidity risk: (a) a description of how liquidity risk that results from insurance liabilities is managed; (b) the amounts that are payable on demand, in a way that highlights the relationship between such amounts and the carrying amount of the related contracts; and (c) a maturity analysis that shows, at a minimum, the net cash flows that result from recognized insurance contracts for each of the first 5 years after the reporting date, and in aggregate beyond the first 5 years, other than for the liability for remaining coverage for contracts measured using the PAA.
94	For market risk that arises from embedded derivatives that are contained in a host insurance contract and not separated: (a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss, other comprehensive income, and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date (b) an explanation of the methods and the main inputs that were used in preparing the sensitivity analysis (c) changes from the previous period in the methods and inputs that were used and the reasons for such changes.
95	Information about the entity's exposure to risk during the reporting period if this differs from the entity's exposure to risk at the end of the period.

Transition

The disclosures required by paragraphs C7 to C10 of the ED will be required when an entity first adopts the forthcoming insurance contracts standard, in addition to the disclosures required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

<table>
<tr><th></th><th>Transition</th></tr>
<tr><td>C7</td><td>If the forthcoming standard has been early adopted.</td></tr>
<tr><td>C8 and Oct 2015 Board Meeting</td><td>For each period presented for which there are contracts that were measured at transition:
(a) the earliest date of initial recognition of the portfolios for which the forthcoming standard has been applied retrospectively; and
(b) the disclosures required by paragraphs 83 to 85 separately for portfolios measured at transition using simplified approaches. At a minimum, an entity shall provide those disclosures for:
(i) the CSM, including a description of the extent to which the entity used information that is not objective in determining that margin; and
(ii) the discount rates that applied at the date of initial recognition.</td></tr>
<tr><td>C9</td><td>Partial exemption from disclosing previously unpublished information about claims development required by paragraph 90.</td></tr>
<tr><td>C10</td><td>Exemption from the requirement in IAS 8.28(f) to present the adjustment made to each financial statement line item that is affected by the adoption of the forthcoming standard.</td></tr>
<tr><td>Oct 2015 Board Meeting</td><td>(a) when an entity applies the transition relief for the assessment of the business model for managing financial assets, the entity's policy for designating financial assets to which that transition relief is applied
(b) when the classification and measurement of financial assets changes as a result of applying any of the transition reliefs in the forthcoming insurance contracts standard, information about: the measurement categories and carrying amounts of those financial assets before and after applying the forthcoming insurance contracts standard; the amounts previously designated under the fair value option that are no longer so designated; and qualitative information about how the entity applied the transition provisions in the forthcoming insurance contracts standard to those financial assets whose classification has changed.</td></tr>
</table>

Appendix B

How should paragraph 78(c) of the ED be interpreted?

Paragraph 78(c) of the 2013 ED requires each of the amounts recognized in profit or loss in accordance with paragraph 60 to be disclosed, if applicable, in the movement analyzes required by paragraphs 74 and 76.

The movement analysis required by paragraph 74 is primarily intended to demonstrate how insurance contract revenue can be derived from the movement in the liability for the remaining coverage. The primary purpose of the movement analysis required by paragraph 76 is to demonstrate changes in the separate components of the building block measurement model.

The items listed in paragraph 60 and their treatment in our illustrative disclosures are as follows.

	Movements in insurance contract assets and liabilities	
Items listed in paragraph 60 recognized in profit or loss	*Analyzed by building block components*	*Analyzed between liabilities for remaining coverage and incurred claims*
Losses at initial recognition of insurance contracts	Yes	Yes
Changes in the risk adjustment	Yes	No[1]
Change in the contractual service margin that reflects the transfer of services in the period	Yes	No[1]
Changes in estimates of future cash flows that do not adjust the contractual service margin[2]	Yes	Yes
Differences between actual cash flows that occurred during the period and previous estimates of those cash flows (experience adjustments)	Yes	No

(continued from page 29)

	Movements in insurance contract assets and liabilities	
Items listed in paragraph 60 recognized in profit or loss	*Analyzed by building block components*	*Analyzed between liabilities for remaining coverage and incurred claims*
Changes in the carrying amount of onerous contracts recognized using the PAA	No	Yes
Changes in the credit standing of the issuer of reinsurance contracts held	Yes[3]	Yes[3]
Interest expense on insurance contract liabilities determined using the discount rates that applied at the date of initial recognition	No[4]	No[4]

[1] One of the main purposes of this movement analysis is to demonstrate how insurance contract revenue can be derived from the movement in the liability for the remaining coverage, and not to present movements in the components of the building block measurement model. This is the primary purpose of the other movement analysis. If insurance contract revenue was analyzed into its constituent parts in this movement analysis this might obscure the main purpose of the disclosure.

[2] At its meeting on 21 October 2015, the IASB tentatively agreed to also require disclosure of changes in estimates of the fulfillment cash flows that adjust the CSM. These changes are presented in our illustrative disclosure of movements in insurance contract assets and liabilities analyzed by building block components. It is not separately presented in our illustrative disclosure of movements in insurance contract assets and liabilities analyzed between liabilities for the remaining coverage and incurred claims, because movements in the CSM are not separately analyzed in this disclosure.

[3] In our illustrative disclosures, we have assumed there are no changes in the credit standing of the issuers of reinsurance contracts held.

[4] Insurance investment expense determined using the discount rates that applied at the date of initial recognition is relevant only for the purpose of presenting insurance investment expense in profit or loss using a cost measurement basis. It is not relevant when measuring insurance contract assets and liabilities, because insurance contract assets and liabilities are measured using current discount rates. We present insurance investment expense accreted using current discount rates, and the impact of changes in discount rates and other market variables, in both movement analyzes, to enable these movements to be easily compared with the amounts presented in the disclosure 'Analysis of insurance investment expense' on page 20.

Appendix C

Glossary

Term	Description
Acquisition costs	Directly attributable costs of selling, underwriting and initiating an insurance contract that can be allocated on a rational and consistent basis to individual portfolios of insurance contracts.
Building block approach (BBA)	The general measurement approach for an insurance contract in the forthcoming insurance contract standard, comprising the fulfillment cash flows and the CSM.
Contractual service margin (CSM)	A component of the BBA representing the unearned profit that the entity recognizes as it provides services under an insurance contract.
Current book yield approach	A term used to describe the cost measurement basis used for contracts with direct participation features, and for which the entity holds the underlying items, to determine the insurance investment expense recognized in profit or loss if an entity chooses to present the impact of changes in discount rates and other market variables in OCI.
Contract with direct participation features	A contract with participation features for which: (a) the contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items; (b) the entity expects to pay to the policyholder an amount equal to a substantial share of the returns from the underlying items; and (c) a substantial proportion of the cash flows that the entity expects to pay to the policyholder should be expected to vary with the cash flows from the underlying items.
Contract with participation features	A contract for which changes in market variables affect the nominal amounts payable to the holder of the contract.
Contract without participation features	A contract for which changes in market variables do not affect the nominal amounts payable to the holder of the contract.
Effective yield approach	A term used to describe any cost measurement basis, other than the current book yield approach, used to determine the insurance investment expense recognized in profit or loss if an entity chooses to present the impact of changes in discount rates and other market variables in OCI.
Exposure Draft (ED or 2013 ED)	ED/2013/7 Insurance Contracts, a revision of ED 2010/8.
Fair value through comprehensive income (FVOCI)	One of the permitted classifications for financial assets in IFRS 9 *Financial Instruments* (issued July 2014). Gains and losses arising on a FVOCI financial asset (except for interest revenue calculated using the effective interest method, expected credit losses and reversals, and foreign exchange gains and losses) are recognized in OCI until the financial asset is derecognized or reclassified.
Fulfillment cash flows	An explicit, unbiased and probability-weighted estimate (i.e. expected value) of the present value of the future cash outflows less the present value of the future cash inflows that will arise as the entity fulfills an insurance contract, including a RA.

Term	Description
Insurance contract	In this publication, an insurance contract is defined as a contract that will fall within the scope of IFRS 4 P2. This includes investment contracts with discretionary participation features.
Insurance investment expense	The expense recognized in the SOCI reflecting changes in the measurement of insurance contract assets and liabilities due to the effect of the passage of time, and the impact of changes in discount rates and other market variables on the time value of money and the nominal amounts of the fulfillments cash flows.
Investment contract with a discretionary participation feature	A financial instrument that provides a particular investor with the contractual right to receive, as a supplement to an amount that is not subject to the discretion of the issuer, additional amounts: (a) that are likely to be a significant portion of the total contractual benefits; (b) whose amount or timing is contractually at the discretion of the issuer; and (c) that are contractually based on: (i) the returns from a specified pool of insurance contracts or a specified type of insurance contract; (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or (iii) the profit or loss of the entity or fund that issues the contract.
International Accounting Standards Board (IASB)	The IASB is the independent standard-setting body of the IFRS Foundation (the legal entity under which the IASB operates).
International Financial Reporting Standards (IFRS)	The IFRS is a single set of accounting standards, developed and maintained by the IASB, with the intention of those standards being capable of being applied on a globally consistent basis.
IFRS 4 *Insurance Contracts* (IFRS 4)	The IASB's current financial reporting standard for insurance contracts issued in March 2004.
IFRS 4 Phase 2 (IFRS 4 P2)	The IASB's forthcoming financial reporting standard for insurance contracts that will replace IFRS 4.
Insurance contract revenue	The transfer of promised services arising from an insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services.
Investment component	The amounts that an insurance contract requires the issuer to repay to a policyholder even if an insured event does not occur.
Liability for incurred claims	The obligation that an entity has to investigate, and pay claims for, insured events that have already occurred, including incurred claims for events that have occurred but for which claims have not been reported.
Liability for remaining coverage	An entity's obligation to pay valid claims that arise under existing insurance contracts for insured events that have not yet occurred (i.e. the obligation that relates to the unexpired portion of the coverage period).
Mirroring approach	An approach proposed in the 2013 ED for insurance contracts that would measure the fulfillment cash flows expected to vary directly with returns on underlying items, by reference to the carrying amount of the underlying items, if a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items.

Term	Description
Modification and derecognition of contracts	A contract modification occurs when the parties to a contract agree on a change to the terms of the contract. An insurance contract is derecognized when the obligation specified in the contract is discharged, cancelled or expired. A derecognition of a contract occurs whenever there is a contract modification.
Onerous contract	An onerous contract is a contract where after the entity is bound by the terms of the contract, the sum of fulfillment cash flows and any pre-coverage cash flows is greater than zero.
Other comprehensive income (OCI)	OCI comprises items of income and expense (including reclassification adjustments) that are not recognized in profit or loss, as required or permitted by IFRS.
Pre-coverage cash flows	Cash flows paid or received before an insurance contract is recognized that relate directly to the acquisition or the fulfillment of the portfolio of insurance contracts that will contain the insurance contract.
Premium allocation approach (PAA)	A simplified measurement for the liability for the remaining coverage that, at initial recognition, measures the carrying amount of the liability for the remaining coverage as: (i) the premium, if any, received at initial recognition; (ii) less any payments that relate to acquisition costs; (iii) plus (or minus) any pre-coverage cash flows; (iv) plus any liability for onerous contracts.
Reinsurance contract	An insurance contract issued by one insurer (the reinsurer) to compensate another insurer (the cedant) for losses on one or more contracts issued by the cedant.
Reinsurance contract ceded or held	An insurance contract issued by another entity (the 'reinsurer') to compensate the issuer of an insurance contract (the 'cedant') for claims arising from one or more insurance contracts that are issued by the cedant.
Risk adjustment (RA)	A component of the BBA representing the compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfills an insurance contract.
Solvency II	A legislative program to be implemented in all 28 member states of the European Union (EU), effective from 1 January 2016, that will introduce a new, harmonized EU-wide insurance regulatory regime.
Statement of profit or loss and other comprehensive income (SOCI)	One of the components of a complete set of IFRS financial statements that presents items of income and expense that are required by IFRS to be presented either in profit or loss or OCI.
Variable fee approach	The measurement approach applied to contracts with direct participation features under which the issuer's obligation to the contract holder is considered to be the net of: (a) the obligation to pay the policyholder an amount equal to 100% of the fair value of the 'underlying items'. The underlying items are referenced assets, or a pool of assets and liabilities, on which the obligation is based; and (b) a variable fee that the entity deducts in exchange for the services provided by the insurance contract.

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