

Basis for Conclusions on
IFRS 17 Insurance Contracts

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Basis for Conclusions on IFRS 17 *Insurance Contracts*

This Basis for Conclusions accompanies, but is not part of, IFRS 17. It summarises the considerations of the International Accounting Standards Board (the Board) in developing IFRS 17. Individual Board members gave greater weight to some factors than to others. The Board also published an Effects Analysis which describes the likely costs and benefits of IFRS 17.

The need to change previous accounting and history of the project

BC1 The previous IFRS Standard on insurance contracts, IFRS 4 *Insurance Contracts*, allowed entities to use a wide variety of accounting practices for insurance contracts, reflecting national accounting requirements and variations in those requirements. The differences in accounting treatment across jurisdictions and products made it difficult for investors and analysts to understand and compare insurers' results. Most stakeholders, including insurers, agreed on the need for a common global insurance accounting standard even though opinions varied as to what it should be. Long-duration and complex insurance risks are difficult to reflect in the measurement of insurance contracts. In addition, insurance contracts are not typically traded in markets and may include a significant investment component, posing further measurement challenges. Some previous insurance accounting practices permitted under IFRS 4 did not adequately reflect the true underlying financial positions or performance arising from these insurance contracts. To address these issues, the Board undertook a project to make insurers' financial statements more useful and insurance accounting practices consistent across jurisdictions. IFRS 17 completes this project.

History of the project

BC2 The Board's predecessor organisation, the International Accounting Standards Committee, began a project on insurance contracts in 1997. The Board was created in 2001 and included an insurance project in its initial work plan. Because it was not feasible to complete the project in time for the many entities that would adopt IFRS Standards in 2005, the Board split the project into two phases.

BC3 The Board completed Phase I in 2004 by issuing IFRS 4, which:

- (a) made limited improvements to then existing accounting practices for insurance contracts; and
- (b) required an entity to disclose information about insurance contracts.

BC4 However, the Board had always intended to replace IFRS 4 because it permits a wide range of practices. In particular, IFRS 4 included a 'temporary exemption' that explicitly stated that an entity need not ensure that its accounting policies are relevant to the economic decision-making needs of users of financial statements or that such accounting policies are reliable. As a result, there was wide diversity in the financial reporting of insurance contracts across entities applying IFRS Standards, and within some entities' financial statements. In addition, some of that financial reporting did not provide useful information about those contracts to users of financial statements.

BC5 IFRS 17 is the outcome of the second phase of the Board's project. It is a comprehensive Standard for accounting for insurance contracts. It is the result of the proposals set out in the following consultation documents previously published by the Board:

- (a) the 2007 Discussion Paper, which set out the Board's preliminary views on the main components of an accounting model for an entity's rights and obligations (assets and liabilities) arising from an insurance contract. The Board received 162 comment letters about those preliminary views.
- (b) the 2010 Exposure Draft of proposals for a Standard on insurance contracts. The Board received 251 comment letters about the proposals.
- (c) the 2013 Exposure Draft of revised proposals on targeted aspects of the proposed Standard. The Board received 194 comment letters about the proposals.

BC6 When developing IFRS 17, the Board consulted with multiple stakeholders over many years. In addition to considering comment letters on the 2007 Discussion Paper, the 2010 Exposure Draft and the 2013 Exposure Draft, the Board developed IFRS 17 after considering:

- (a) input from the Insurance Working Group, a group of senior financial executives of insurers, analysts, actuaries, auditors and regulators established in 2004;
- (b) four rounds of field work conducted in 2009, 2011, 2013 and 2016, which helped the Board to better understand some of the practical challenges of applying the proposed insurance model; and
- (c) more than 900 meetings with individuals and with groups of users and preparers of financial statements, actuaries, auditors, regulators and others to test proposals and to understand affected parties' concerns about the 2010 and 2013 Exposure Drafts.

The need for a new approach

- BC7 The Board considered whether the following approaches could be used to account for insurance contracts:
- (a) applying generally applicable IFRS Standards (see paragraphs BC9–BC12); and
 - (b) selecting an existing model for accounting for insurance contracts (see paragraphs BC13–BC15).
- BC8 The paragraphs that follow explain why the Board rejected these approaches and developed a new Standard for insurance contracts.

Applying generally applicable IFRS Standards

- BC9 Insurance contracts are excluded from the scope of many existing IFRS Standards that might otherwise apply to such contracts, including Standards on:
- (a) revenue (see IFRS 15 *Revenue from Contracts with Customers*);
 - (b) liabilities (see IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*); and
 - (c) financial instruments (see IFRS 9 *Financial Instruments* and IAS 32 *Financial Instruments: Presentation*).
- BC10 If the Board extended the scope of existing IFRS Standards to include insurance contracts, an entity would need to:
- (a) identify service components and investment components within each premium that it receives. The Board decided that it would be difficult for an entity to routinely separate components of an insurance contract, and setting requirements to do so would result in complexity. Such separation would also ignore interdependencies between components, with the result that the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition.
 - (b) account for the service component in applying IFRS 15. As noted in paragraph BC26(a), the Board decided that the results of IFRS 17 are broadly consistent with those of IFRS 15, subject to requiring additional remeasurement. But the Board also decided that:
 - (i) the specific requirements of IFRS 17 are necessary to determine how to account for particular aspects of insurance contracts.
 - (ii) the additional remeasurement is necessary to give relevant information; for example, information about the financial aspects of insurance contracts that are more significant for many insurance contracts than for contracts in the scope of IFRS 15. In particular, when applying IFRS 17, changes in financial assumptions will be recognised earlier for some insurance contracts than they would be when applying IFRS 15.
 - (c) account for its liability for incurred claims in applying IAS 37. IAS 37 would require the measurement of the liability to reflect current estimates of cash flows and a current market-based discount rate, which would reflect risks specific to the liability. This measurement would be broadly consistent with the requirements in IFRS 17 for the measurement of the liability for incurred claims.
 - (d) apply the financial instruments Standards to the investment component. If an entity accounted for the investment components of an insurance contract in the same way it accounts for other financial liabilities, it would, consistent with IFRS 17, not recognise principal deposited as revenue and would account separately for embedded options and guarantees when so required by IFRS 9. However, it would also:
 - (i) measure the investment components at fair value through profit or loss or at amortised cost, as applicable. The Board decided that measuring all interrelated cash flows using

the same current value measurement required by IFRS 17 provides more useful information.

- (ii) measure the investment components so that the fair value of the investment component would be no less than the amount payable on demand, discounted from the first date the payment could be required (the deposit floor). This is discussed in paragraphs BC165–BC166.
- (iii) recognise, for investment components measured at fair value through profit or loss, the costs of originating contracts as an expense when incurred, with no corresponding gain at inception. For investment components measured at amortised cost, incremental transaction costs relating to the investment component would reduce the initial carrying amount of that liability. The treatment of insurance acquisition cash flows applying IFRS 17 is discussed in paragraphs BC175–BC184.

BC11 Overall, applying generally applicable IFRS Standards would provide useful information for users of financial statements and would be relatively easy to apply to insurance contracts for which there is no significant variability in outcomes and no significant investment component. This is because, in those cases, the issues arising with IFRS 15 and IFRS 9 discussed above would not occur. However, simply applying generally applicable Standards would be difficult and would produce information of limited relevance for other types of insurance contracts. In contrast, the model required by IFRS 17 can be applied to all types of insurance contracts.

BC12 Although the Board has rejected an approach that requires routine separation of components of an insurance contract, IFRS 17 requires some components of an insurance contract to be separated if the cash flows attributable to the individual components are distinct. In those cases, the problems created by interdependencies are less significant. The requirements for separating and measuring non-insurance components of an insurance contract are discussed in paragraphs BC98–BC114.

Selecting an existing model

BC13 Some stakeholders, mainly from the United States (US), suggested that the Board develop an approach based on existing US generally accepted accounting practices (US GAAP) for insurance contracts. The Board rejected this suggestion because such an approach would be based on the type of entity issuing the contract and on numerous standards developed at different times. In addition, although US GAAP is widely used as a basis for accounting for insurance contracts, it was developed in the context of US insurance products and the US regulatory environment. Further, when IFRS 17 was developed, the US Financial Accounting Standards Board was working on a project to improve, simplify and enhance the financial reporting requirements for long-term insurance contracts issued by entities applying US GAAP.

BC14 The Board also decided that it would be inappropriate to account for insurance contracts using other national insurance accounting models because many such models:

- (a) do not use current estimates of all cash flows;
- (b) require no explicit risk measurement, even though risk is the essence of insurance;
- (c) fail to reflect the time value or the intrinsic value of some or all embedded options and guarantees, or else they measure time value or intrinsic value in a way that is inconsistent with current market prices;
- (d) lack global acceptance; and
- (e) present an entity's financial performance, particularly for life insurance, in a manner difficult for users of financial statements to understand.

BC15 The Board considered whether regulatory requirements already being used by insurers could form the basis of the requirements in IFRS 17 for financial reporting purposes. However, the Board noted that:

- (a) although some regulatory requirements require current market-consistent measurement of future cash flows, their focus is on solvency, and they do not consider reporting of financial performance. Hence, for example, the measurement required by Solvency II, a regulation adopted by the European Union, is broadly consistent with the measurement of the fulfilment cash flows required by IFRS 17. However, Solvency II does not consider the determination or reporting of an entity's financial performance over time, which under IFRS 17 is achieved through the contractual service margin.
- (b) regulatory requirements may include simplifications and practical expedients that are appropriate in the context of the regulatory regime in which they were developed, but which may not be appropriate in an international financial reporting environment.

- (c) regulatory reporting frequently includes jurisdiction-specific requirements, which accommodate issues specific to that jurisdiction, including policy objectives.

Overview of the approach taken in the Standard

- BC16 IFRS 17 reflects the Board's view that an insurance contract combines features of both a financial instrument and a service contract. In addition, many insurance contracts generate cash flows with substantial variability over a long period. To provide useful information about these features, the Board developed an approach that:
- (a) combines current measurement of the future cash flows with the recognition of profit over the period that services are provided under the contract (see paragraphs BC18–BC26);
 - (b) presents insurance service results (including presentation of insurance revenue) separately from insurance finance income or expenses (see paragraphs BC27–BC37); and
 - (c) requires an entity to make an accounting policy choice at a portfolio level of whether to recognise all insurance finance income or expenses in profit or loss or to recognise some of that income or expenses in other comprehensive income (see paragraphs BC38–BC49).
- BC17 The Board developed this approach rather than a fair value model. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (see IFRS 13 *Fair Value Measurement*). However, many stakeholders suggested that such an approach places too much emphasis on hypothetical transactions that rarely happen. Therefore, IFRS 17 requires an entity to measure insurance contracts in a way that reflects the fact that entities generally fulfil insurance contracts directly over time by providing services to policyholders, rather than by transferring the contracts to a third party.

Measurement of insurance contracts and recognition of profit

- BC18 An insurance contract typically combines features of a financial instrument and a service contract in such a way that those components are interrelated. Hence, the Board concluded that entities should not unbundle the components and account for them separately, except as discussed in paragraphs BC98–BC114. Instead, the Board developed requirements to account for both the financial and service components without unbundling them. Measurement at current value is consistent with the requirements for comparable financial instruments. Recognising profit at the same time services are provided is consistent with IFRS 15. Therefore, IFRS 17 requires an entity to measure insurance contracts at:
- (a) a current risk-adjusted present value that incorporates all reasonable and supportable information available without undue cost or effort about the future cash flows, in a way that is consistent with observable market information (the fulfilment cash flows (see paragraphs BC19–BC20)); and
 - (b) an amount representing the unearned profit in the contracts relating to services still to be provided (the contractual service margin (see paragraphs BC21–BC26)).

Fulfilment cash flows (paragraphs 33–37 of IFRS 17)

- BC19 The current value of the fulfilment cash flows allocated to a group of insurance contracts includes:
- (a) a current, unbiased estimate of the future cash flows expected to fulfil the insurance contracts. The estimate of future cash flows reflects the perspective of the entity, provided that the estimates of any relevant market variables are consistent with the observable market prices for those variables (see paragraphs BC147–BC184).
 - (b) an adjustment for the time value of money and the financial risks associated with the future cash flows, to the extent that the financial risks are not included in the estimate of the future cash flows. For example, if the cash flows being discounted are an estimate of the probability-weighted average (the mean), that mean itself does not include an adjustment for risk, and any financial risk (ie uncertainty relating to financial risk on whether the ultimate cash flows will equal the mean) will be included in the discount rate (a risk-adjusted rate). If, in contrast, the cash flows being discounted are an estimate of the mean with an adjustment to reflect uncertainty related to financial risk, the discount rate will be a rate that reflects only the time value of money (ie not adjusted for risk). The discount rates are consistent with observable current market prices for instruments whose cash flow characteristics are consistent with the estimates of the cash flows of the insurance contracts. The discount rates also exclude the effects of any factors that influence

observable market prices but are not relevant to the estimates of the cash flows of the insurance contracts (see paragraphs BC185–BC205).

- (c) an adjustment for the effects of non-financial risk, referred to as a risk adjustment for non-financial risk. The risk adjustment for non-financial risk is defined as the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk (see paragraphs BC206–BC217).

BC20 The underlying objective of the Board’s approach to the measurement of the fulfilment cash flows is to achieve consistent measurement with current market information when possible. That market-consistent measurement includes any options and guarantees embedded in the insurance contracts. The Board decided that the use of a market-consistent current value measurement model for the fulfilment cash flows is desirable because it provides the most relevant information about:

- (a) fulfilment cash flows, by incorporating all reasonable and supportable information available without undue cost or effort on a timely basis; and, hence,
- (b) changes in the fulfilment cash flows, including changes in the economic value of options and guarantees embedded in insurance contracts. This means that there is no need for a separate liability adequacy test.

Contractual service margin on initial recognition (paragraphs 38 and 47 of IFRS 17)

BC21 On initial recognition, the contractual service margin is an amount that reflects the excess of the consideration charged for a group of insurance contracts over the risk-adjusted expected present value of the cash outflows expected to fulfil the group of contracts and any insurance acquisition cash flows incurred before the recognition of the group of contracts. It depicts the profit that the entity expects to earn by providing the services promised under the contracts in the group over the duration of the coverage of the group. Accordingly, IFRS 17 does not permit the entity to recognise that excess as a gain on initial recognition, but instead requires the entity to recognise that gain as the entity satisfies its obligation to provide services over the coverage period. However, if a group of contracts is onerous on initial recognition, IFRS 17 requires an entity to recognise a loss immediately (see paragraph BC284). Accordingly, if a group of contracts is onerous on initial recognition, no contractual service margin would be recognised. This reflects the Board’s view that the carrying amount of a group of insurance contracts should reflect the obligation of the entity to provide future service, and that amount should be at least equal to the fulfilment cash flows. This is consistent with the approach to the recognition of profits and losses on contracts with customers required in IFRS 15.

Subsequent measurement and recognition of profit (paragraphs 40–46 of IFRS 17)

BC22 After initial recognition, IFRS 17 requires the measurement of the fulfilment cash flows to reflect estimates based on current assumptions, for the reasons set out in paragraphs BC20 and BC155.

BC23 After initial recognition, IFRS 17 also requires an entity to recognise specified changes in the contractual service margin for a group of insurance contracts. These changes depict changes in the future profit to be earned from providing services under the contracts, and include:

- (a) changes in the estimates of the fulfilment cash flows that relate to future service (see paragraphs BC222–BC269);
- (b) the effect of the time value of money on the contractual service margin (see paragraphs BC270–BC276) and, for insurance contracts with direct participation features, changes in the entity’s share of the underlying items (see paragraphs BC238–BC263);
- (c) the effect of changes in foreign currency exchange rates on the contractual service margin (see paragraphs BC277–BC278); and
- (d) the profit earned in the period from providing services (see paragraphs BC279–BC283).

BC24 Although the service and financial components of an insurance contract are not separated for measurement on initial recognition, the Board decided that changes in the carrying amount of the insurance contract have different information value, depending on the nature of the change. As a result of the combined treatment of the changes in the fulfilment cash flows and the changes in the contractual service margin:

- (a) changes in estimates that relate to future service only affect the measurement of the total liability¹ to the extent they make a group of insurance contracts onerous (except as described in paragraph BC275);
 - (b) changes in estimates relating to current period and past period service are recognised in profit or loss (see paragraphs BC224(c) and BC232–BC236); and
 - (c) changes in estimates arising from assumptions that relate to financial risks, including the effects of changes in discount rates, are recognised in profit or loss, or profit or loss and other comprehensive income, in the period in which the change occurs (except for some such changes for insurance contracts with direct participation features (see paragraphs BC238–BC247)).
- BC25 The total carrying amount of a group of insurance contracts (ie the fulfilment cash flows plus the contractual service margin) can be regarded as having the following components:
- (a) a liability for remaining coverage, being the portion of the fulfilment cash flows that relates to coverage that will be provided under the contracts in future periods, plus the remaining contractual service margin, if any; and
 - (b) a liability for incurred claims, being the fulfilment cash flows for claims and expenses already incurred but not yet paid.
- BC26 Overall, the measurement required by IFRS 17 results in:
- (a) the measurement of the liability for remaining coverage and the resulting profit and revenue recognition being broadly consistent with IFRS 15, except that:
 - (i) for insurance contracts without direct participation features—the measurement is updated for changes in financial assumptions; and
 - (ii) for insurance contracts with direct participation features—the measurement is updated for changes in the fair value of the items in which the entity and the policyholder participate; and
 - (b) the component relating to incurred claims being measured broadly consistently with IAS 37.

Presentation of insurance revenue (paragraphs 83, 85 and B120–B127 of IFRS 17)

- BC27 The determination of revenue under previous insurance accounting practices varied across jurisdictions and often resulted in the presentation of revenue amounts that could not be easily compared with the information reported by other entities, either in the insurance industry or in other industries. Two common factors that resulted in this lack of comparability were:
- (a) the accounting of deposits as revenue; and
 - (b) the recognition of revenue on a cash basis.
- BC28 In contrast, IFRS 17 requires entities to present revenue for insurance contracts determined in a way that is broadly consistent with the general principles in IFRS 15. Consistent with that Standard, an entity depicts revenue for the transfer of promised coverage and other services at an amount that reflects the consideration to which the entity expects to be entitled in exchange for the services. This means that the entity:
- (a) excludes from insurance revenue any investment components; and
 - (b) recognises insurance revenue in each period as it satisfies the performance obligations in the insurance contracts.
- BC29 IFRS 17, consistent with IFRS 15, requires that the statement of financial position reports the asset or liability for a group of insurance contracts, and the statement(s) of financial performance reports the progress towards satisfaction of the performance obligations in the contracts:
- (a) IFRS 15 establishes the amount of revenue to be recognised each period and adjusts the contract asset or contract liability at the start of the period by the amount of revenue recognised to measure the contract asset or contract liability at the end of the period; and
 - (b) IFRS 17 requires a measurement model that establishes the carrying amount of the asset or liability for the group of insurance contracts at the start and end of the reporting period. The amount of insurance revenue presented is determined by reference to these two measurements.

¹

Insurance contracts can be assets or liabilities depending on the timing of their cash flows. For simplicity, this Basis generally describes the carrying amount as a liability.

- BC30 The Board decided that determining insurance revenue in this way makes the financial statements of entities that issue insurance contracts more understandable and more comparable with other entities. It also increases comparability among entities that issue insurance contracts. Both this approach and the simpler premium allocation approach (see paragraphs BC288–BC295) allocate customer consideration in a way that reflects the transfer of services provided under the contract. As a result, the insurance revenue presented for contracts accounted for using the general requirements in IFRS 17 can be meaningfully combined with the insurance revenue for contracts accounted for using the premium allocation approach. Many users of financial statements use measures of revenue to provide information about the volume of business and gross performance.
- BC31 The Board considered the view that lack of comparability between the presentation of insurance results and revenue amounts reported by entities in other sectors would not be a significant disadvantage to users of financial statements of entities that issue insurance contracts. In the view of some, users of financial statements do not typically compare the results of entities that issue insurance contracts with those of other entities. Instead, they argue that many users of financial statements that specialise in the insurance sector rely on the disaggregated information in the notes to the financial statements. Therefore, those who held this view expected users of financial statements to derive little value from the information reported in the statement(s) of financial performance because:
- (a) the accounting models for life insurance contracts, unlike those for other transactions, typically measure the profit from insurance contracts directly through the changes in the insurance contract liability. In contrast, the profit from other transactions is measured as the difference between revenue and expenses.
 - (b) measures of total premiums that include both revenue and investment components are considered by some to be the most meaningful measure of gross performance and growth for insurance contracts. Such measures give information about the total increase in assets under management. However, those with this view accept that this measure is inconsistent with usual concepts of revenue and therefore accept that this information should not be presented in the statement(s) of financial performance. Applying IFRS 17, this would instead be reported in the notes to the financial statements and elsewhere.
- BC32 The Board rejected this view. The Board hopes that the changes brought in by IFRS 17 will enable a wider range of users to understand financial statements of entities that issue insurance contracts and compare them with financial statements of other entities. Alternative approaches to the presentation of revenue considered but also rejected by the Board are discussed in paragraphs BC332–BC339.

Excluding investment components from insurance revenue and incurred claims (paragraph 85 of IFRS 17)

- BC33 An investment component is an amount that the insurance contract requires the entity to repay to the policyholder even if an insured event does not occur. Such obligations, if not included within an insurance contract, would be measured and presented in accordance with IFRS 9. The Board decided that when an investment component is interrelated with the insurance components in an insurance contract, it is appropriate to measure both the investment component and the insurance component in accordance with IFRS 17, for the reasons set out in paragraphs BC10(a) and BC108. However, the Board decided that it would not faithfully represent the similarities between financial instruments within the scope of IFRS 9 and investment components embedded in insurance contracts within the scope of IFRS 17 if an entity were to present the receipts and repayments of such investment components as insurance revenue and incurred claims. To do so would be equivalent to a bank recognising a deposit as revenue and its repayment as an expense. Accordingly, the requirements of the Standard exclude such investment components from insurance revenue and incurred claims.
- BC34 To achieve this without separating the investment component for measurement purposes, the Board decided to identify the investment components only at the time revenue and incurred claims are recognised, and to exclude the amounts so identified. In doing this, the Board considered defining the investment component as (a) the amount that the contract requires to be repaid when no insured event occurs, rather than (b) the amount that would be repaid even if an insured event does not occur. For example, if the entity pays the higher of an account balance and a fixed amount in the event of a policyholder's death, using the definition in (a) the whole of the payment that results from the policyholder's death would be regarded as relating to the insurance component rather than to the investment component. Using the definition in (a) has the practical advantage that an entity would need to identify cash flows relating to an investment component only if it made a payment in the absence of an insured event. However, the Board decided that defining an investment component in this way does not faithfully represent the fact that the amount accumulated in the account balance through deposits by the policyholder is paid to the policyholder in all circumstances,

including in the event of the policyholder's death. In the Board's view, the insurance benefit is the additional amount that the entity would be required to pay if an insured event occurs.

Recognising revenue as the entity satisfies its performance obligations (paragraphs 83 and B120–B127 of IFRS 17)

- BC35 The Board noted the inherent challenges for some insurance contracts in identifying and measuring progress in satisfying the performance obligations during the period; for example, for stop-loss contracts and for contracts that include financial guarantees. However, the liability for remaining coverage represents the obligation to provide coverage for a future period and other services needed to fulfil the contract. As a result, recognising insurance revenue to the extent of a reduction in the liability for remaining coverage, adjusted to eliminate changes that do not relate to the satisfaction of the performance obligation, would faithfully represent the entity's performance in providing services. The adjustments to the liability for remaining coverage exclude from total insurance revenue the part of the change in the liability for remaining coverage that does not relate to cash flows expected to generate revenue; for example, insurance finance income or expenses, and losses on groups of onerous contracts. These adjustments ensure that the total insurance revenue presented over the duration of the group of insurance contracts is the same as the premiums received for services, adjusted for a financing component.
- BC36 The Board considered whether each period's coverage should be treated as a separate performance obligation or whether the coverage for the entire contract should be regarded as a single performance obligation that would be satisfied over time. When considering the principle from IFRS 15, the Board concluded that the obligation to provide coverage in any particular part of the entire coverage period would generally not be a separate performance obligation, and the coverage and services provided over the whole duration of the contract would generally be treated as a single performance obligation that is satisfied over time. Hence, a change in the pattern of expected cash flows results in the entity updating its measure of progress and adjusting the amount of revenue recognised accordingly. That approach is also consistent with the requirements in IFRS 17 to adjust the contractual service margin for changes in estimates of cash flows relating to future service (see paragraphs BC222–BC226).
- BC37 A consequence of the decision to measure the satisfaction of the entity's performance obligations in each period using the change in the measurement of the liability for remaining coverage during each period is that insurance revenue will be recognised partly on the basis of the expected claims and benefits. Some expressed concern about this and hence questioned whether the service provided by an insurance contract was adequately represented by the change in the measurement of an entity's obligation. Rather, they thought that revenue (the gross amount) ought to be determined independently of changes in the obligation (the net amount). One way of doing this would be to use time-based methods for measuring progress, such as those typically used for other contracts. However, the Board concluded that time-based methods of allocating premiums would not reflect the fact that the value of the services provided in each period may differ. Instead, the Board noted that the amount reported as the liability for remaining coverage represents the value of the obligation to provide services. The Board therefore concluded that the reduction in the liability for remaining coverage is a reasonable representation of the value of the performance obligation to provide services that was satisfied in the period. The reduction in the liability for remaining coverage includes an allocation of the contractual service margin to reflect the services provided in the period. That allocation reflects the quantity of benefits provided and duration of contracts in a group. The other changes in the liability for remaining coverage that represent revenue for the period are measured using current assumptions. The total change in the liability for remaining coverage that represents revenue therefore faithfully represents the amount of insurance revenue that the entity is entitled to.

Presentation of insurance finance income or expenses (paragraphs 87–92 and B128–B136 of IFRS 17)

- BC38 Insurance finance income or expenses comprise the changes in the carrying amount of the asset or liability for a group of insurance contracts arising from:
- (a) the effect of the time value of money and changes in the time value of money; and
 - (b) the effect of financial risks and changes in financial risks; but
 - (c) excluding any such effects for groups of insurance contracts with direct participation features that would normally adjust the contractual service margin but do not do so because the group of insurance contracts is onerous. These effects are recognised as part of the insurance service result, for the reasons given in paragraph BC247.

- BC39 The definition of financial risk in IFRS 17 is unchanged from that in IFRS 4. To provide clarity on the treatment of assumptions about inflation when applying IFRS 17, the Board decided to specify that for the purposes of IFRS 17:
- (a) assumptions about inflation based on an index of prices or rates or on prices of assets with inflation-linked returns are financial assumptions; and
 - (b) assumptions about inflation based on an entity's expectation of specific price changes are non-financial assumptions.
- BC40 The Board has not considered whether this specification would be appropriate outside the context of IFRS 17.
- BC41 Consistent with the requirement in IAS 1 *Presentation of Financial Statements* to present finance costs separately, an entity is required to present insurance finance income or expenses separately from the insurance service result. Doing so provides useful information about different aspects of the entity's performance.
- BC42 IFRS 17 requires entities to make an accounting policy choice for each portfolio on how to present insurance finance income or expenses. Such income or expenses for a portfolio of insurance contracts is either all included in profit or loss or is disaggregated between profit or loss and other comprehensive income. If disaggregated, the amount in profit or loss is based on a systematic allocation of the expected total finance income or expenses over the duration of the groups of insurance contracts in the portfolio. The systematic allocation is based on the characteristics of the insurance contracts, without reference to factors that do not affect the cash flows expected to arise under the contracts. For example, the allocation of the insurance finance income or expenses should be based on expected recognised returns on assets only if those expected recognised returns affect the cash flows of the contracts. (In specific circumstances, an amount that eliminates accounting mismatches is included in profit or loss rather than an amount based on a systematic allocation (see paragraph BC48)).
- BC43 The Board decided to allow entities to choose an accounting policy for the presentation of insurance finance income or expenses to balance the sometimes competing demands of understandability and comparability. By allowing an accounting policy choice, the Board:
- (a) acknowledges that it could be appropriate for an entity to disaggregate the effect of changes in assumptions that relate to financial risks between profit or loss and other comprehensive income by presenting the insurance finance income or expenses in profit or loss using a systematic allocation based on the characteristics of the insurance contract;
 - (b) but also:
 - (i) acknowledges that an inherent feature of such a systematic allocation in profit or loss is that accounting mismatches are likely to arise; hence, an accounting policy choice allows entities to avoid such mismatches by permitting them to present the insurance finance income or expenses using a current measurement basis; and
 - (ii) allows entities to avoid the costs and complexity of using other comprehensive income when the benefits of doing so do not outweigh those costs (because permitting entities to present the total insurance finance income or expenses in a period in profit or loss allows entities to avoid additional calculations to derive separate amounts to be presented in profit or loss and other comprehensive income).
- BC44 The Board noted that, in selecting an accounting policy, entities would need to apply judgement regarding the policy's relative benefits and costs. The Board decided to require entities to make the accounting policy choice for each portfolio because a key factor in making the choice will be what assets the entity regards as backing the insurance contracts. The Board received feedback that many entities regard the choice of strategies for assets backing insurance contracts to be driven by the differences between portfolios of insurance contracts. Hence, an entity might hold financial assets measured at fair value through other comprehensive income for one portfolio, and for another portfolio, hold financial assets measured at fair value through profit or loss. Accordingly, an option applied to portfolios of insurance contracts would allow entities to reduce accounting mismatches. The Board concluded that even if it were to allow an accounting policy choice, entities within the same jurisdiction are likely to remain comparable because they are likely to issue similar products and adopt similar asset strategies for those products. Thus, the entities are likely to make similar accounting policy choices.
- BC45 Alternative approaches to the presentation of insurance finance income or expenses considered but rejected by the Board are discussed in paragraphs BC340–BC342.

Basis of disaggregation (paragraphs B129–B136 of IFRS 17)

- BC46 Allowing an accounting policy choice on whether to present in profit or loss insurance finance income or expenses using a systematic allocation raises the question of what constitutes a systematic allocation.
- BC47 The Board considered a cost-based presentation approach and discussed various practical methods of determining a cost measurement basis for the insurance finance income or expenses. However, the Board concluded that some potentially appropriate approaches, such as some projected crediting methods, could not be described as cost measurements. Instead, the Board decided to set an objective for disaggregating the insurance finance income or expenses of a systematic allocation based on the characteristics of the insurance contracts. The Board considered whether this disaggregation objective alone would be sufficient, given the variety of contracts and the need to tailor more specific requirements to the features of different contracts. However, the Board concluded that a lack of prescribed methods might result in a lack of comparable information. Therefore the Board set out constraints on how a systematic allocation should be determined in paragraphs B130–B133 of IFRS 17.
- BC48 An inherent feature of any systematic allocation of insurance finance income or expenses based on the characteristics of a group of insurance contracts is potential accounting mismatches between the insurance contracts and the finance income or expenses on assets held by the entity. The only way of completely eliminating such accounting mismatches for all insurance contracts would be to measure both the insurance contracts and the assets using the same measure of current value and to include all finance income or expenses in profit or loss. The Board rejected such an approach for the reasons set out in paragraph BC340. However, for insurance contracts for which there can be no economic mismatch with the assets held, it is possible to eliminate accounting mismatches between the insurance contracts and the assets in a different way, by using the current period book yield. The current period book yield is the change in the carrying amount of assets regarded as backing the insurance contracts, recognised in profit or loss for the period. The Board concluded that this approach is appropriate only for groups of insurance contracts for which there can be no economic mismatch with the assets held; ie groups of insurance contracts with direct participation features as defined in IFRS 17 if the entity holds the underlying items. The Board concluded this approach is inappropriate for other insurance contracts for the reasons set out in paragraph BC342.
- BC49 If an entity fulfils its obligations under the contracts in the group, the systematic allocation required by IFRS 17 means that the cumulative amount recognised in other comprehensive income over the duration of the group equals zero. To achieve this outcome if an entity transfers a group of insurance contracts before the fulfilment of all the contracts in the group, IFRS 17 requires that the cumulative amount recognised in other comprehensive income by the date of the transfer should be reclassified to profit or loss at the date of the transfer. The Board considered whether the same requirement should apply to groups of insurance contracts to which the current period book yield applies. However, the Board noted that the cumulative amount recognised in other comprehensive income over the duration of a group that is not transferred will not necessarily equal zero under the current period book yield. The Board concluded that to achieve the objective of the current period book yield, which is to eliminate accounting mismatches between the insurance contracts and the assets held, no amounts should be reclassified from other comprehensive income to profit or loss on a transfer of a group beyond any such amounts arising because of the change in carrying amount of the assets recognised in profit or loss in the period of the transfer.

Pervasive issues

- BC50 In developing the approach outlined in paragraph BC16, the Board considered the following pervasive issues:
- (a) the level of aggregation;
 - (b) accounting mismatches; and
 - (c) the complexity of the Standard.

The level of aggregation

- BC51 An entity's rights and obligations arise from individual contracts with policyholders. However, a fundamental aspect of much insurance activity is that the entity issues a large number of similar contracts knowing that some will result in claims and others will not. The large number of contracts reduces the risk that the outcome across all the contracts will differ from that expected by the entity. This aspect of insurance activity, combined with the requirements of IFRS 17 that require different timing of recognition of gains and losses (for example losses on onerous contracts are recognised earlier than gains on profitable

contracts), means that the level of aggregation at which contracts are recognised and measured is an important factor in the representation of an entity's financial performance.

- BC52 In reaching a decision on the level of aggregation, the Board balanced the loss of information inevitably caused by the aggregation of contracts with the usefulness of the resulting information in depicting the financial performance of an entity's insurance activities and with the operational burden of collecting the information (see paragraphs BC115–BC139).

Accounting mismatches

- BC53 The Board decided to set the scope of IFRS 17 as insurance contracts rather than insurance entities for the reasons set out in paragraphs BC63–BC64. The Board was aware that the development of an accounting model for insurance contracts would inevitably result in possible accounting mismatches because of the different basis of accounting for assets and liabilities in other Standards. Nonetheless the Board has minimised the extent of accounting mismatch, when possible, while recognising this limitation. Particular consideration was given to potential or perceived accounting mismatches arising from:

- (a) the presentation of insurance finance income or expenses (see paragraphs BC38–BC49);
- (b) risk mitigation activities (see paragraphs BC54–BC55);
- (c) the measurement of underlying items for insurance contracts with direct participation features (see paragraph BC56); and
- (d) reinsurance (see paragraph BC298).

- BC54 Some stakeholders noted that the approach to accounting for risk mitigation activities in IFRS 17 does not fully eliminate accounting mismatches. In particular:

- (a) some requested that the Board create a hedge accounting solution for insurance contracts without direct participation features;
- (b) some noted that the Board is researching a model for dynamic risk management, and suggested aligning the projects; and
- (c) some noted that the application of the risk mitigation requirements on a prospective basis would not eliminate accounting mismatches for relationships that started before the date of initial application.

- BC55 The Board's decisions on risk mitigation techniques related to insurance contracts with direct participation features reduce the accounting mismatches that were introduced by the variable fee approach by providing an option to align the overall effect of the variable fee approach more closely to the model for other insurance contracts (see paragraphs BC250–BC256). However, the Board concluded that it would not be appropriate to develop a bespoke solution for all hedging activities for insurance contracts, noting that such a solution should form part of a broader project. The Board did not want to delay the publication of IFRS 17 pending finalisation of that broader project. The Board also concluded that a prospective basis was necessary for the application of the risk mitigation requirements on transition, for the reasons set out in paragraph BC393.

- BC56 Insurance contracts with direct participation features are measured by reference to the fair value of the underlying items (see paragraphs BC238–BC249). This measurement reflects the investment-related nature of the contracts. Applying IFRS Standards, many underlying items will also be measured at fair value. The Board also decided to amend some IFRS Standards to enable additional underlying items to be measured at fair value (see paragraph BC65(c)). However, there could still be underlying items that cannot be measured at fair value applying IFRS Standards; for example, other insurance contracts or net assets of a subsidiary. The Board noted that all such mismatches would be eliminated only if all assets and liabilities were recognised and measured at fair value.

Complexity of the Standard

- BC57 The Board acknowledges that the following important aspects of IFRS 17 add complexity to the Standard, compared with the original proposals in the 2007 Discussion Paper:

- (a) the existence and treatment of the contractual service margin, including:
 - (i) recognising it as profit over the coverage period of the contracts (see paragraph BC59);
 - (ii) adjusting it for changes in estimates of cash flows relating to future service, with different requirements for different types of insurance contracts (see paragraph BC60); and

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- (iii) the consequent need for a specified level of aggregation (see paragraphs BC51–BC52).
 - (b) the statement(s) of financial performance presentation, including:
 - (i) the presentation of revenue on a basis consistent with IFRS 15 (see paragraph BC61); and
 - (ii) the option to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income (see paragraph BC62).
- BC58 For each aspect, the Board was persuaded by stakeholder feedback that the requirements in IFRS 17 are necessary to provide useful information about insurance contracts issued by an entity.
- BC59 The recognition of the contractual service margin as profit over the coverage period, rather than as a gain immediately on initial recognition of the group of insurance contracts, adds complexity for preparers because they will need to track and allocate the contractual service margin. This method of recognising the contractual service margin also may add complexity for users of financial statements because of the need to understand the amounts recognised in the statement of financial position and in the statement(s) of financial performance. However, the Board concluded that recognition of the profit in the group of insurance contracts over the coverage period is necessary to represent faithfully an entity's financial performance over the coverage period.
- BC60 The requirement to adjust the contractual service margin for changes in estimates relating to future service increases complexity for both users and preparers of financial statements. For users of financial statements, complexity may arise from the need to understand how gains and losses arising from events of previous years affect current-year profit or loss. For preparers of financial statements, complexity arises from the need to identify the changes in estimates of future cash flows that adjust the contractual service margin separately from changes in estimates that do not adjust the contractual service margin. For both, a particular source of complexity arises from the distinction between changes in estimates relating to future service and changes relating to past service. That distinction may be subjective and may vary according to when the entity makes the change in estimate. An entity adjusts the contractual service margin for a change in estimates of cash flows that is made before the cash flows occur. In contrast, the entity recognises an experience adjustment in profit or loss and does not adjust the contractual service margin if there is no change in estimate before the cash flows occur. However, in the light of the feedback received, the Board concluded that adjusting the contractual service margin for changes in future service provides relevant information about the unearned profit in the group of insurance contracts and is consistent with the approach in IFRS 15 (see paragraphs BC222–BC224).
- BC61 The requirement to present insurance revenue in the financial statements increases complexity for preparers because entities must identify investment components and exclude them from insurance revenue and from incurred claims presented in the statement of profit or loss. Some preparers expressed concern about the operational challenges of compliance. However, the Board decided that these potential challenges are outweighed by the following benefits of the requirements:
 - (a) distinguishing insurance revenue from investment components provides significant benefits for users of financial statements. For example, many users have indicated that if entities reported investment components as revenue, they would overstate revenue and could distort performance measures such as combined ratios. Such reporting would also hamper comparability between insurers and entities in other industries.
 - (b) measuring insurance revenue to depict the consideration the entity expects to receive in exchange for providing services would increase consistency between the measurement and presentation of insurance revenue and the revenue from other types of contracts with customers within the scope of IFRS 15. Such a measurement would reduce the complexity of financial statements overall.
- BC62 Requiring an entity to make an accounting policy choice on how to present insurance finance income or expenses introduces complexity for both preparers of financial statements, who have to assess what choice to make, and for users of financial statements who have to understand what choice has been made and its implications on the amounts presented. The Board had proposed requiring insurance finance income or expenses to be disaggregated between profit or loss and other comprehensive income. However, the Board was persuaded that the balance between the costs and benefits of such disaggregation will vary significantly across entities depending on the type of insurance contracts that they issue and the information that the users of their financial statements find most useful. The Board therefore concluded that it should leave the assessment of that balance to be made by the entity.

Scope of the Standard and definition of insurance contracts (paragraphs 3–8 and B2–B30 of IFRS 17)

- BC63 Some argued that IFRS 17 should deal with all aspects of financial reporting by entities that issue insurance contracts to ensure that the financial reporting is internally consistent. They noted that regulatory requirements often cover all aspects of an entity's insurance business, as do some national accounting requirements. However, the Board decided that IFRS 17 should apply only to insurance contracts and should be applicable to all entities holding those contracts. The Board decided to base its approach on the type of activity rather than on the type of the entity because:
- (a) a robust definition of an insurer that could be applied consistently from country to country would be difficult to create;
 - (b) entities that might meet the definition frequently have major activities in other areas as well as in insurance, and would need to determine how and to what extent these non-insurance activities would be accounted for in a manner similar to insurance activities or in a manner similar to how other entities account for their non-insurance activities;
 - (c) if an entity that issues insurance contracts accounted for a transaction in one way and an entity that does not issue insurance contracts accounted for the same transaction in a different way, comparability across entities would be reduced.
- BC64 Accordingly, IFRS 17 applies to all insurance contracts (as defined in IFRS 17) throughout the duration of those contracts, regardless of the type of entity issuing the contracts.
- BC65 IFRS 17 generally does not set requirements for the other assets and liabilities of entities that issue insurance contracts, because those assets and liabilities fall within the scope of other IFRS Standards. However, IFRS 17 provides the following exceptions:
- (a) it applies to investment contracts with discretionary participation features, provided that the issuer also issues insurance contracts. In the Board's view, applying the requirements in IFRS 17 provides more relevant information about such contracts than would be provided by applying other Standards. The Board also noted that investment contracts with discretionary participation features are almost exclusively issued by entities that issue insurance contracts (see paragraphs BC82–BC86).
 - (b) it applies to financial guarantee contracts provided they meet the definition of insurance contracts in IFRS 17, the entity has previously asserted that it regards such contracts as insurance contracts and the entity has used accounting that is applicable to insurance contracts for such financial guarantee contracts. The Board noted that it has previously heard incompatible views on the appropriate accounting model for financial guarantee contracts and does not view work in this area as a high priority (see paragraphs BC91–BC94).
 - (c) it amends other IFRS Standards (see Appendix D of IFRS 17) to permit an entity to recognise its own shares as assets and to measure such assets, own debt and owner-occupied property at fair value when held in an investment fund that provides investors with benefits determined by units in the fund or when an entity holds the investment as an underlying item for insurance contracts with direct participation features. The Board decided that for many contracts that specify a link to returns on underlying items, those underlying items include a mix of assets that are almost all measured at fair value through profit or loss. Measurement of own shares, own debt and owner-occupied property at fair value through profit or loss would be consistent with the measurement of the majority of the underlying assets and would prevent accounting mismatches.
- BC66 IFRS 17 does not set requirements for insurance contracts held by policyholders, other than reinsurance contracts held. Other IFRS Standards include requirements that may apply to some aspects of such contracts. For example, IAS 37 sets requirements for reimbursements from insurance contracts held that provide cover for expenditure required to settle a provision and IAS 16 *Property, Plant and Equipment* sets requirements for some aspects of reimbursement under an insurance contract held that provides coverage for the impairment or loss of property, plant and equipment. Furthermore, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specifies a hierarchy that an entity should use when developing an accounting policy if no IFRS Standard applies specifically to an item. Accordingly, the Board did not view work on policyholder accounting as a high priority.

Definition of an insurance contract (paragraph 6, Appendix A and paragraphs B2–B30 of IFRS 17)

- BC67 The definition of an insurance contract determines which contracts are within the scope of IFRS 17 and outside the scope of other IFRS Standards. The definition of an insurance contract in IFRS 17 is the same as the definition in IFRS 4, with clarifications to the related guidance in Appendix B of IFRS 4 to require that:
- (a) an insurer should consider the time value of money in assessing whether the additional benefits payable in any scenario are significant (see paragraph B20 of IFRS 17 and paragraph BC78); and
 - (b) a contract does not transfer significant insurance risk if there is no scenario with commercial substance in which the insurer can suffer a loss on a present value basis (see paragraph B19 of IFRS 17 and paragraph BC78).
- BC68 The following aspects of the definition of an insurance contract are discussed below:
- (a) the definition of a contract (see paragraphs BC69–BC70);
 - (b) the insurance risk (see paragraphs BC71–BC72);
 - (c) the insurable interest (see paragraphs BC73–BC75);
 - (d) the quantity of insurance risk (see paragraphs BC76–BC80); and
 - (e) the expiry of insurance-contingent rights and obligations (see paragraph BC81).

Definition of a contract (paragraph 2 of IFRS 17)

- BC69 IFRS 17 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations, and explains that contracts can be written, oral or implied by an entity's business practices. IFRS 17 also requires an entity to consider all its substantive rights and obligations, whether they arise from contract, law or regulation. Thus, when referring to contractual terms the effects of law and regulation are also considered. These requirements are consistent with IFRS 15. They apply when an entity considers how to classify a contract and when assessing the substantive rights and obligations for determining the boundary of a contract. However, in measuring a group of insurance contracts, IFRS 17 requires an entity to include estimates of future cash flows that are at the discretion of the entity and hence may not be enforceable. The Board's reasons for requiring such cash flows to be included in the measurement are set out in paragraphs BC167–BC169.
- BC70 IFRS 17 is consistent with the Board's principle set out in the 2015 Exposure Draft of *The Conceptual Framework* that contracts should be combined as necessary to report their substance.

Insurance risk (Appendix A and paragraphs B7–B25 of IFRS 17)

- BC71 The definition of an insurance contract in IFRS 17 focuses on the feature unique to insurance contracts—insurance risk.
- BC72 Some contracts have the legal form of insurance contracts but do not transfer significant insurance risk to the issuer. IFRS 17 does not treat such contracts as insurance contracts even though the contracts are traditionally described as insurance contracts and may be subject to regulation by insurance supervisors. Similarly, some contracts may contain significant insurance risk and therefore may meet the definition of insurance contracts in IFRS 17, even though they do not have the legal form of insurance contracts. Thus, IFRS 17 adopts a definition of an insurance contract that reflects the contract's economic substance and not merely its legal form.

Insurable interest (paragraphs B7–B16 of IFRS 17)

- BC73 The definition of an insurance contract reflects the risk the entity accepts from the policyholders by agreeing to compensate the policyholders if they are adversely affected by an uncertain event (paragraph B12 of IFRS 17). The notion that the uncertain event must have an adverse effect on the policyholder is known as 'insurable interest'.
- BC74 The Board considered whether it should eliminate the notion of insurable interest and replace it with the notion that insurance involves assembling risks into a pool in which they can be managed together. Some argued that doing so would appropriately include the following within the scope of the Standard:

- (a) contracts that require payment if a specified uncertain future event occurs, causing economic exposure similar to insurance contracts, whether the other party has an insurable interest or not; and
- (b) some contracts used as insurance that do not include a notion of insurable interest, for example, weather derivatives.

BC75 However, the Board decided to retain the notion of insurable interest because without the reference to ‘adverse effect’, the definition might have captured any prepaid contract to provide services with uncertain costs. Such a definition would have extended the meaning of the term ‘insurance contract’ beyond its traditional meaning, which the Board did not want to do. The notion of insurable interest is also needed to avoid including gambling in the definition of insurance. Furthermore, it is a principle-based distinction, particularly between insurance contracts and contracts used for hedging.

Quantity of insurance risk (paragraphs B17–B25 of IFRS 17)

BC76 Paragraphs B17–B25 of IFRS 17 discuss how much insurance risk must be present before a contract qualifies as an insurance contract.

BC77 In developing this material, the Board considered the criteria in US GAAP for a contract to be treated as an insurance contract, which includes the notion that there should be a ‘reasonable possibility’ of a ‘significant loss’. The Board observed that some practitioners use the following guideline when applying US GAAP: a reasonable possibility of a significant loss is at least a 10 per cent probability of a loss of at least 10 per cent of premium.

BC78 However, quantitative guidance risks creating an arbitrary dividing line that results in different accounting treatments for similar transactions that fall marginally on different sides of the line. Quantitative guidance also creates opportunities for accounting arbitrage by encouraging transactions that fall marginally on one side of the line or the other. For these reasons, IFRS 17 does not include quantitative guidance. Instead, noting the criteria applied in US GAAP, the Board decided to add the requirement that a contract transfers insurance risk only if there is a scenario with commercial substance in which the issuer has a possibility of a loss on a present value basis.

BC79 The Board also considered whether it should define the significance of insurance risk by referring to materiality, which the *Conceptual Framework for Financial Reporting* describes as follows:

Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.

However, a single contract, or even a single book of similar contracts, would rarely generate a material loss in relation to the financial statements as a whole. Although entities manage contracts by portfolios, the contractual rights and obligations arise from individual contracts. Consequently, IFRS 17 defines the significance of insurance risk in relation to individual contracts (see paragraph B22 of IFRS 17).

BC80 The Board also rejected the notion of defining the significance of insurance risk by expressing the expected (ie probability-weighted) average of the present values of the adverse outcomes as a proportion of the expected present value of all outcomes, or as a proportion of the premium. This notion had some intuitive appeal because it would include both amount and probability. However, such a definition would have meant that a contract could start as a financial liability and become an insurance contract as time passes or probabilities are reassessed. In the Board’s view, it would be too burdensome to require an entity to continuously monitor whether a contract meets the definition of an insurance contract over its duration. Instead, the Board adopted an approach that requires the decision about whether a contract is an insurance contract to be made once only, at contract inception (unless the terms of the contract are modified). The requirements in paragraphs B18–B24 of IFRS 17 focus on whether insured events could cause an entity to pay additional amounts, judged on a contract-by-contract basis. Further, paragraph B25 of IFRS 17 states that an insurance contract remains an insurance contract until all rights and obligations expire.

Expiry of insurance-contingent rights and obligations

BC81 Some stakeholders suggested that a contract should not be accounted for as an insurance contract if the insurance-contingent rights and obligations expire after a very short time. IFRS 17 addresses aspects of this issue: paragraph B18 of IFRS 17 explains the need to ignore scenarios that lack commercial substance and paragraph B21(b) of IFRS 17 notes that there is no significant transfer of pre-existing risk in some contracts that waive surrender penalties on death.

Investment contracts with discretionary participation features (paragraphs 4(b) and 71 of IFRS 17)

- BC82 The Board decided that issuers of investment contracts with discretionary participation features should apply IFRS 17 to those contracts provided that the issuer also issues insurance contracts. Because investment contracts with discretionary participation features do not transfer insurance risk, the requirements of IFRS 17 are modified for such contracts.
- BC83 Although investment contracts with discretionary participation features do not meet the definition of insurance contracts, the advantages of treating them the same as insurance contracts rather than as financial instruments when they are issued by entities that issue insurance contracts are that:
- (a) investment contracts with discretionary participation features and insurance contracts that specify a link to returns on underlying items are sometimes linked to the same underlying pool of assets. Sometimes investment contracts with discretionary participation features share in the performance of insurance contracts. Using the same accounting for both types of contracts will produce more useful information for users of financial statements because it enhances comparability within an entity. It also simplifies the accounting for those contracts. For example, some cash flow distributions to participating policyholders are made in aggregate both for insurance contracts that specify a link to returns on underlying items and for investment contracts with discretionary participation features. This makes it challenging to apply different accounting models to different parts of that aggregate participation.
 - (b) both of these types of contract often have characteristics, such as long maturities, recurring premiums and high acquisition cash flows that are more commonly found in insurance contracts than in most other financial instruments. The Board developed the model for insurance contracts specifically to generate useful information about contracts containing such features.
 - (c) if investment contracts with discretionary participation features were not accounted for by applying IFRS 17, some of the discretionary participation features might be separated into an equity component in accordance with the Board's existing requirements for financial instruments. Splitting these contracts into components with different accounting treatments would cause the same problems that would arise if insurance contracts were separated (see paragraph BC10(a)). Also, in the Board's view, the accounting model it has developed for insurance contracts, including the treatment of discretionary cash flows (see paragraphs BC167–BC170), is more appropriate than using any other model for these types of contracts.
- BC84 Accordingly, the Board decided that entities that issue insurance contracts should apply IFRS 17 to account for investment contracts with discretionary participation features.
- BC85 The Board considered whether IFRS 17 should be applied to all investment contracts with discretionary participation features regardless of whether they are issued by an entity that also issues insurance contracts. However, the Board was concerned that for the few entities that did not issue insurance contracts the costs of implementing IFRS 17 would outweigh the benefits.
- BC86 Because investment contracts with discretionary participation features transfer no significant insurance risk, IFRS 17 made the following modifications to the general requirements for insurance contracts (see paragraph 71 of IFRS 17) for these contracts:
- (a) the date of initial recognition is the date the entity becomes party to the contract, because there is no pre-coverage period and hence the practical concerns noted in paragraph BC141 do not arise;
 - (b) the contract boundary principle builds on the defining characteristic, namely the presence of the discretionary participation features, rather than on the existence of insurance risk; and
 - (c) the requirement for the recognition of the contractual service margin in profit or loss refers to the pattern of the provision of investment related services.

Scope exclusions (paragraphs 7–8 of IFRS 17)

- BC87 The scope of IFRS 17 excludes various items that may meet the definition of insurance contracts, such as:
- (a) warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer (see paragraphs BC89–BC90).
 - (b) employers' assets and liabilities that arise from employee benefit plans, and retirement benefit obligations reported by defined benefit retirement plans (see IAS 19 *Employee Benefits*, IFRS 2 *Share-based Payment* and IAS 26 *Accounting and Reporting by Retirement Benefit Plans*).

- (c) contractual rights or contractual obligations contingent on the future use of, or right to use, a non-financial item (see IFRS 15, IFRS 16 *Leases* and IAS 38 *Intangible Assets*).
- (d) residual value guarantees provided by the manufacturer, dealer or retailer and lessees' residual value guarantees embedded in a lease (see IFRS 15 and IFRS 16). However, stand-alone residual value guarantees that transfer insurance risk are not addressed by other IFRS Standards and are within the scope of IFRS 17.
- (e) some financial guarantee contracts (see paragraphs BC91–BC94).
- (f) contingent consideration payable or receivable in a business combination (see IFRS 3 *Business Combinations*).
- (g) insurance contracts in which the entity is the policyholder, unless those contracts are reinsurance contracts (see paragraph BC66).

BC88 IFRS 17 also allows an entity a choice of applying IFRS 17 or IFRS 15 to some fixed-fee service contracts (see paragraphs BC95–BC97).

Product warranties (paragraphs 7(a) and B26(g) of IFRS 17)

BC89 IFRS 17 includes the scope exclusion previously included in IFRS 4 for warranties provided by the manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer. Such warranties might provide a customer with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications, or they might provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

BC90 Such warranties meet the definition of an insurance contract. However, the Board decided to exclude them from the scope of IFRS 17. The Board noted that, if IFRS 17 were to apply, entities would generally apply the premium allocation approach to such contracts, which would result in accounting similar to that which would result from applying IFRS 15. Further, in the Board's view, accounting for such contracts in the same way as other contracts with customers would provide comparable information for the users of financial statements for the entities that issue such contracts. Hence, the Board concluded that changing the existing accounting for these contracts would impose costs and disruption for no significant benefit.

Financial guarantee contracts (paragraph 7(e) of IFRS 17)

BC91 IFRS Standards define a financial guarantee contract as a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. These contracts transfer credit risk and may have various legal forms, such as a guarantee, some types of letters of credit, a credit default contract or an insurance contract.

BC92 Some view all contracts that transfer credit risk as financial instruments. However, a precondition for a payment in the contracts described in paragraph BC91 is that the holder has suffered a loss—a distinguishing feature of insurance contracts. The Board heard two incompatible views on the appropriate accounting model for financial guarantee contracts:

- (a) financial guarantee contracts meet the definition of an insurance contract because the issuer of the contract agrees to compensate the holder when an uncertain future event (ie default) occurs that would adversely affect the holder. Consequently, an entity should account for financial guarantee contracts in the same way as other insurance contracts.
- (b) financial guarantee contracts are economically similar to other credit-related contracts within the scope of IFRS 9. Similar accounting should apply to similar contracts. As a result, an entity should account for financial guarantee contracts in the same way as other financial instruments.

BC93 IFRS 4 included an option that permitted an issuer of a financial guarantee contract to account for it as if it were an insurance contract, if the issuer had previously asserted that it regards the contract as an insurance contract. This option had been intended as a temporary solution, pending the publication of IFRS 17. However, although the terms of the option may appear to be imprecise, in the vast majority of cases the accounting choice for financial guarantee contracts is clear and no implementation problems appear to have been identified in practice. Therefore, the Board decided to carry forward to IFRS 17 the option to account for a financial guarantee contract as if it were an insurance contract, without any substantive changes, because the option has worked in practice and results in consistent accounting for economically similar contracts issued by the same entity. The Board did not view it as a high priority to address the inconsistency that results from accounting for financial guarantee contracts differently depending on the issuer.

- BC94 Some credit-related contracts lack the precondition for payment that the holder has suffered a loss. An example of such a contract is one that requires payments in response to changes in a specified credit rating or credit index. The Board concluded that those contracts are derivatives and do not meet the definition of an insurance contract. Therefore, such contracts will continue to be accounted for as derivatives. The Board noted that these contracts were outside the scope of the policy choice in IFRS 4 carried forward in IFRS 17, so continuing to account for them as derivatives would not create further diversity.

Fixed-fee service contracts (paragraphs 8 and B6 of IFRS 17)

- BC95 A fixed-fee service contract is a contract in which the level of service depends on an uncertain event. Examples include roadside assistance programmes and maintenance contracts in which the service provider agrees to repair specified equipment after a malfunction. Such contracts meet the definition of an insurance contract because:
- (a) it is uncertain whether, or when, assistance or a repair will be needed;
 - (b) the owner is adversely affected by the occurrence; and
 - (c) the service provider compensates the owner if assistance or repair is needed.
- BC96 Fixed-fee service contracts meet the definition of an insurance contract. However, the Board originally proposed to exclude from the scope of IFRS 17 fixed-fee service contracts whose primary purpose is the provision of service. Instead, entities would have been required to apply IFRS 15 to those contracts. The Board noted that, if IFRS 17 were to apply, entities would generally apply the premium allocation approach to such contracts, which would result in accounting similar to that which would result from applying IFRS 15. Further, the Board decided the practice of accounting for these contracts in the same way as other contracts with customers would provide useful information for the users of financial statements for the entities that issue such contracts. Hence, the Board thought that changing the accounting for these contracts would impose costs and disruption for no significant benefit.
- BC97 However, some stakeholders noted some entities issue both fixed-fee service contracts and other insurance contracts. For example, some entities issue both roadside assistance contracts and insurance contracts for damage arising from accidents. The Board decided to allow entities a choice of whether to apply IFRS 17 or IFRS 15 to fixed-fee service contracts to enable such entities to account for both types of contract in the same way.

Separating components from an insurance contract (paragraphs 10–13 and B31–B35 of IFRS 17)

- BC98 Insurance contracts create rights and obligations that work together to generate cash inflows and cash outflows. Some insurance contracts may:
- (a) contain embedded derivatives that, if bifurcated, would be within the scope of IFRS 9;
 - (b) contain investment components that, if they were provided under separate contracts, would be within the scope of IFRS 9; or
 - (c) provide goods and non-insurance services that, if they were provided under separate contracts, would be within the scope of IFRS 15.
- BC99 Separating such non-insurance components from an insurance contract can improve comparability. Accounting for such components using other applicable IFRS Standards makes them more comparable to similar contracts that are issued as separate contracts, and allows users of financial statements to better compare the risks undertaken by entities in different businesses or industries.
- BC100 However, separating components also has limitations. Separating a single contract into components could result in complex accounting that does not provide useful information for interdependent cash flows attributable to the components. Furthermore, when cash flows are interdependent, separating the cash flows for each component can be arbitrary, particularly if the contract includes cross-subsidies between components or discounts. Also, as noted in paragraph BC10(a), when separation ignores interdependencies between components, the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition.
- BC101 The Board originally proposed that an entity separate a component not closely related to the insurance coverage specified in the contract and identified some common examples of such components. The term ‘closely related’ is used in IFRS 9 in the criteria that determine whether embedded derivatives must be bifurcated. However, stakeholders indicated that some were unsure how to interpret the term closely related

for non-insurance components embedded in insurance contracts. The Board noted that the principles for separating embedded derivatives were long-established in IFRS 9 (and previously in IAS 39 *Financial Instruments: Recognition and Measurement*). However, IFRS 17 clarifies the principles for the separation of other non-insurance components from an insurance contract based on the principles developed in IFRS 15.

BC102 Hence, IFRS 17 includes requirements for the separation of the following non-insurance components:

- (a) embedded derivatives (see paragraphs BC104–BC107);
- (b) investment components (see paragraphs BC108–BC109); and
- (c) goods and non-insurance services (see paragraphs BC110–BC113).

BC103 The criteria for separating such non-insurance components from insurance components differ to reflect the different characteristics of the non-insurance components. This is consistent with applying different accounting models to the equivalent contracts accounted for on a stand-alone basis.

Embedded derivatives (paragraph 11(a) of IFRS 17)

BC104 When applying IFRS 9 (and previously IAS 39) entities are required to account separately for some derivatives embedded in hybrid contracts. The Board noted that accounting separately for some embedded derivatives in hybrid contracts:

- (a) ensures that contractual rights and obligations that create similar risk exposures are treated alike whether or not they are embedded in a non-derivative host contract.
- (b) counters the possibility that entities might seek to avoid the requirement to measure derivatives at fair value through profit or loss by embedding a derivative in a non-derivative host contract. In the Board's view, fair value through profit or loss is the only measurement basis that provides relevant information about derivatives. If derivatives were measured at cost or at fair value through other comprehensive income, their role in reducing or increasing risk would not be visible. In addition, the value of derivatives often changes disproportionately in response to market movements and fair value is the measurement basis that best captures such non-linear responses to changes in risk. That information is essential to communicate the nature of the rights and obligations inherent in derivatives to users of financial statements.

BC105 IFRS 4 confirmed that the requirements of IAS 39 for embedded derivatives apply to derivatives embedded in insurance contracts. The Board has updated this requirement in IFRS 17 so that an entity applies IFRS 9 to determine whether a contract includes an embedded derivative to be separated and, if so, how entities account for that derivative. The Board's approach is consistent with the approach it has taken with hybrid contracts other than hybrid financial assets. This results in the following changes from the requirements of IFRS 4:

- (a) IFRS 4 did not require the separation of an embedded derivative from the host contract if the contract and the embedded derivative are so interdependent that an entity cannot measure the derivative separately. By applying IFRS 9 to determine whether a contract includes an embedded derivative to be separated, the Board replaced this option with a prohibition from separating such closely related embedded derivatives from the host contract. The Board concluded that when embedded derivatives are closely related to the host insurance contract, the benefits of separating those embedded derivatives fail to outweigh the costs. Applying the measurement requirements of IFRS 17, such embedded derivatives are measured using current market-consistent information; and
- (b) IFRS 17 removes the statement in IFRS 4 that an entity is not required to separate specified surrender options in an insurance contract. Instead, the entity applies the requirements in IFRS 9 to decide whether it needs to separate a surrender option.

BC106 Some respondents suggested that separating embedded derivatives from insurance contracts introduces excessive complexity with little additional benefit.

BC107 The Board agreed that when embedded derivatives are closely related to the host insurance contract, the benefits of separating those embedded derivatives do not outweigh the costs. However, the Board decided that those benefits would exceed the costs when the embedded derivatives are not closely related to the host insurance contract. Previous practice indicates that the costs of separating such embedded derivatives from host insurance contracts would not be excessive.

Investment components (paragraphs 11(b) and B31–B32 of IFRS 17)

- BC108 An investment component is the amount an insurance contract requires the entity to repay to the policyholder even if an insured event does not occur. Many insurance contracts have an implicit or explicit investment component that would, if it were a separate financial instrument, be within the scope of IFRS 9. As explained in paragraph BC10(a), the Board decided that it would be difficult to routinely separate such investment components from insurance contracts. Accordingly, IFRS 17 requires an entity to:
- (a) separate only any distinct investment components from insurance contracts. An investment component is distinct if the cash flows of the insurance contract are not highly interrelated with the cash flows from the investment component. Separating such components does not create the problems noted in paragraph BC10(a).
 - (b) account for all investment components with cash flows that are highly interrelated with the insurance contract by applying IFRS 17, but, as explained in paragraphs BC33–BC34, eliminate any investment components from insurance revenue and insurance service expenses reported in accordance with paragraph 85 of IFRS 17.
- BC109 IFRS 17 requires the cash flows allocated to a separated investment component to be measured on a stand-alone basis as if the entity had issued that investment contract separately. This requirement is consistent with the objective of separation, which is to account for a separated component the way stand-alone contracts with similar characteristics are accounted for. The Board concluded that, in all cases, entities would be able to measure the stand-alone value for an investment component by applying IFRS 9.

Goods and non-insurance services (paragraphs 12 and B33–B35 of IFRS 17)

- BC110 In principle, an entity should use similar principles to those in IFRS 15 to separate performance obligations to provide goods and non-insurance services from the host contract, regardless of whether the host contract is within the scope of IFRS 17 or of IFRS 15. Accordingly, IFRS 17 requires entities to separate only the goods and services that are distinct from the provision of insurance coverage, consistent with the separation criteria in IFRS 15.
- BC111 Consistent with IFRS 15, IFRS 17 requires an entity to allocate the cash inflows of an insurance contract between the host insurance contract and the distinct good or non-insurance service, based on the stand-alone selling price of the components. In the Board's view, in most cases, entities would be able to determine an observable stand-alone selling price for the goods or services bundled in an insurance contract if those components meet the separation criteria.
- BC112 However, if the stand-alone selling price were not directly observable, an entity would need to estimate the stand-alone selling prices of each component to allocate the transaction price. This might be the case if the entity does not sell the insurance and the goods or services components separately, or if the consideration charged for the two components together differs from the stand-alone selling prices because the entity charges more or less for the bundled contract than the sum of the prices for each component. Applying IFRS 15, any discounts and cross-subsidies are allocated to components proportionately or on the basis of observable evidence. In the Board's view, this approach ensures that the allocation of cross-subsidies and discounts/supplements reflects the economics of the separated components.
- BC113 IFRS 17 requires that cash outflows should be allocated to their related component, and that cash outflows not clearly related to one of the components should be systematically and rationally allocated between components. Insurance acquisition cash flows and some fulfilment cash flows relating to overhead costs do not clearly relate to one of the components. A systematic and rational allocation of such cash flows is consistent with the requirements in IFRS 17 for allocating acquisition and fulfilment cash flows that cover more than one group of insurance contracts to the individual groups of contracts, and is also consistent with the requirements in other IFRS Standards for allocating the costs of production—the requirements in IFRS 15 and IAS 2 *Inventories*, for example.

Prohibition on separating non-insurance components when not required (paragraph 13 of IFRS 17)

- BC114 The Board considered whether to permit an entity to separate a non-insurance component when not required to do so by IFRS 17; for example, some investment components with interrelated cash flows, such as policy

loans. Such components may have been separated when applying previous accounting practices. However, the Board concluded that it would not be possible to separate in a non-arbitrary way a component that is not distinct from the insurance contract nor would such a result be desirable. Permitting an entity to separate such components would mean that the entity measures the components in the contract on an arbitrary basis. The Board also noted that when separation ignores interdependencies between insurance and non-insurance components, the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition. That would reduce the comparability of the financial statements across entities.

Level of aggregation of insurance contracts (paragraphs 14–24 of IFRS 17)

Background

- BC115 A key issue in developing the measurement requirements for the contractual service margin in IFRS 17 was the level of aggregation of insurance contracts to which the requirements should be applied. Some aspects of the adjustments to the carrying amount of the contractual service margin result in gains being treated differently from losses or changes in estimates relating to current and past service being treated differently from changes in estimates relating to future service (see paragraphs BC21–BC24). These different treatments mean that the accounting result depends on the level of aggregation at which the adjustments are made, because amounts that would offset each other within the measurement of a group of insurance contracts would be treated differently (and hence not offset each other) if contracts were measured individually.
- BC116 For example, suppose an entity issued a group of identical contracts expecting that there would be more claims from some of the contracts than others, but not knowing which contracts would be the ones with more claims. Subsequently it becomes apparent which contracts are likely to give rise to claims and which are not, and the number of contracts in each category is as expected. If the contracts were measured individually, the expected claims may cause the contracts for which they are likely to arise to become onerous, with an equal and opposite reduction in the fulfilment cash flows of the other contracts. The entity would recognise a loss for the onerous contracts immediately in profit or loss and an increase in the contractual service margin for the other contracts. That increase in the contractual service margin would not be recognised immediately in profit or loss but instead would be recognised over the current and future coverage period. In contrast, if the contracts were measured as one group, there would be no loss for a group of onerous contracts or increase in the contractual service margin to be recognised.
- BC117 This issue does not arise in the measurement of the fulfilment cash flows. The fulfilment cash flows include all changes in estimates, regardless of whether they are gains or losses or they relate to past, current or future service. Hence, IFRS 17 allows an entity to estimate the fulfilment cash flows at whatever level of aggregation is most appropriate from a practical perspective. All that is necessary is that the entity is able to allocate such estimates to groups of insurance contracts so that the resulting fulfilment cash flows of the group comply with requirements of IFRS 17.
- BC118 For the contractual service margin, the Board considered whether contracts should be measured individually despite the resulting lack of offsetting. Doing so would be consistent with the general requirements in IFRS 9 and IFRS 15 and would reflect the fact that the entity's rights and obligations arise from individual contracts with policyholders. Measuring contracts individually would also provide a clear measurement objective. However, the Board decided that such an approach would not provide useful information about insurance activities, which often rely on an entity issuing a number of similar contracts to reduce risk. The Board concluded, therefore, that the contractual service margin should be measured at a group level.

Characteristics of a group

- BC119 Once the Board had decided that the contractual service margin should be measured for a group, the Board considered what that group level should be. The Board considered whether it could draw on requirements for groups set by insurance regulators. However, as noted in paragraph BC15, regulatory requirements focus on solvency not on reporting financial performance. The decisions about grouping in IFRS 17 were driven by considerations about reporting profits and losses in appropriate reporting periods. For example, in some cases the entity issues two groups of insurance contracts expecting that, on average, the contracts in one group will be more profitable than the contracts in the other group. In such cases, the Board decided, in principle, there should be no offsetting between the two groups of insurance contracts because that

offsetting could result in a loss of useful information. In particular, the Board noted that the less profitable group of contracts would have a lesser ability to withstand unfavourable changes in estimates and might become onerous before the more profitable group would do so. The Board regards information about onerous contracts as useful information about an entity's decisions on pricing contracts and about future cash flows, and wanted this information to be reported on a timely basis. The Board did not want this information to be obscured by offsetting onerous contracts in one group with profitable contracts in another.

- BC120 The level of aggregation is also relevant to the recognition of the contractual service margin in profit or loss. Paragraph BC279 explains that, following the Board's principle for the allocation of the contractual service margin, an entity should systematically recognise the remaining contractual service margin in profit or loss over the current and remaining coverage period to reflect the remaining transfer of services to be provided by the insurance contracts.
- BC121 In many cases, the coverage period of individual contracts in a group will differ from the average coverage period for the group. When this is the case, measuring the contracts on:
- (a) an individual basis would mean that the contractual service margin associated with contracts with a shorter than average coverage period would be fully recognised in profit or loss over that shorter period;
 - (b) a group basis would mean that the contractual service margin associated with contracts with a shorter than average coverage period would not be fully recognised in profit or loss over that shorter period.
- BC122 Thus, measuring the contracts as a group creates the risk that the contractual service margin for a group might fail to reflect the profit relating to the coverage remaining in the group, unless the entity tracked the allocation of the contractual service margin separately for groups of insurance contracts:
- (a) that have similar expected profitability, on initial recognition, and for which the amount and timing of cash flows are expected to respond in similar ways to key drivers of risk. In principle, this condition would ensure the contractual service margin of a particularly profitable individual contract within a group is not carried forward after the individual contract has expired.
 - (b) that have coverage periods that were expected to end at a similar time. In principle, this condition would ensure the contractual service margin of an individual contract that expired was not carried forward after the contract had expired.
- BC123 The Board concluded that it was necessary to strike a balance between the loss of information discussed in paragraphs BC119 and BC121–BC122, and the need for useful information about the insurance activity as discussed in paragraphs BC118 and BC120. The Board:
- (a) did not want entities to depict one type of contract as cross-subsidised by a different type of contract, but also did not want to recognise losses for claims developing as expected within a group of similar contracts; and
 - (b) did not want the contractual service margin of an expired contract to exist as part of the average contractual service margin of a group long after the coverage provided by the contract ended, but also did not want to recognise a disproportionate amount of contractual service margin for contracts lapsing as expected within a group of similar contracts.
- BC124 The Board concluded that the balance described above could be achieved in principle by:
- (a) requiring contracts in a group to have future cash flows the entity expects will respond similarly in amount and timing to changes in key assumptions—meaning that losses on insurance contracts for one type of insurance risk would not be offset by gains on insurance contracts for a different type of risk, and would provide useful information about the performance of contracts insuring different types of risk.
 - (b) requiring contracts in a group to have similar expected profitability—meaning that loss-making contracts could not be grouped with profitable contracts, whether at initial recognition or if changes in conditions make a previously profitable group loss-making. Hence, such a requirement would provide information about loss-making groups of insurance contracts.
 - (c) requiring groups not be reassessed after initial recognition.
- BC125 The Board also noted that, in principle, it would be possible to meet the objective of the recognition of the contractual service margin in profit or loss discussed in paragraph BC120 either by grouping only contracts with a similar size of contractual service margin and the same remaining coverage period, or by reflecting the different duration and profitability of the contracts within the group in the allocation of the contractual service margin.

Practical considerations

- BC126 The Board noted that entities could interpret the approach described in paragraphs BC124–BC125 as requiring an excessively large number of groups that may provide insufficiently useful information to justify the operational burden that would be imposed by extensive disaggregation of portfolios. Accordingly, the Board sought a balance to reflect profit and potential losses in the statement of financial performance in appropriate periods and the operational burden.
- BC127 To achieve that balance, the Board concluded that an entity should be required to identify portfolios of contracts subject to similar risks and managed together, and to divide a portfolio into, at a minimum, groups of:
- (a) contracts that are onerous at initial recognition, if any;
 - (b) contracts that are not onerous at initial recognition and that have no significant possibility of becoming onerous subsequently, if any; and
 - (c) all other contracts, if any.
- BC128 The same principle of grouping applies to insurance contracts to which the premium allocation approach applies and to reinsurance contracts held, but the wording is adapted to reflect their specific characteristics.
- BC129 The objective of the requirement to identify contracts that are onerous at initial recognition is to identify contracts that are onerous measured as individual contracts. An entity typically issues individual contracts and it is the characteristics of the individual contracts that determine how they should be grouped. However, the Board concluded this does not mean that the contracts must be measured individually. If an entity can determine using reasonable and supportable information that a set of contracts will all be in the same group, then the entity can measure that set to determine whether the contracts are onerous or not, because there will be no offsetting effects in the measurement of the set. The same principle applies to the identification of contracts that are not onerous at initial recognition and that have no significant possibility of becoming onerous subsequently—the objective is to identify such contracts at an individual contract level, but this objective can be achieved by assessing a set of contracts if the entity can conclude using reasonable and supportable information that the contracts in the set will all be in the same group.
- BC130 To identify whether contracts (or sets of contracts) are onerous at initial recognition, an entity measures the contracts (or sets of contracts) applying the measurement requirements of IFRS 17. The Board decided that to assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous subsequently, an entity should use the information provided by its internal reporting system but need not gather additional information. The Board concluded that such information would provide a sufficient basis for making this assessment and that it would not be necessary to impose costs of gathering additional information. Some stakeholders nonetheless expressed the view that separating contracts that have no significant possibility of becoming onerous from other contracts that are not onerous was burdensome and unnecessary. The Board, however, concluded that in the absence of such a requirement, should the likelihood of losses increase, IFRS 17 would fail to require timely recognition of contracts that become onerous.
- BC131 In some jurisdictions, law or regulation specifically constrains the entity’s practical ability to set a different price or level of benefits for contracts or policyholders with different characteristics. The Board considered whether to give an exemption from dividing contracts into separate groups if the only reason that they would fall into different groups specified in paragraph BC127 is because of such constraints. In general, the Board seeks to minimise exemptions because they increase complexity for both users of financial statements and preparers and may have unintended consequences for future standard-setting activities. Further, providing an exemption for accounting for economic differences caused by the effect of law or regulation on pricing may create an undesirable precedent, given that such effects are not restricted to insurance contracts. However, the notion of grouping contracts to determine the profit or losses recognised is a specific feature of the requirements in IFRS 17. In deciding the appropriate grouping of contracts, the Board sought to balance the need to group contracts to reflect the economics of issuing insurance contracts against grouping at too high a level, which would reduce the usefulness of information produced (see paragraph BC123).
- BC132 The Board concluded it would not provide useful information to group separately contracts that an entity is required by specific law or regulation to group together for determining the pricing or level of benefits. All market participants in that jurisdiction will be constrained in the same way, particularly if such entities are unable to refuse to provide insurance coverage solely on the basis of differences in that characteristic.
- BC133 The Board considered whether to extend further any exemption from including contracts in separate groups, because it can be difficult to define when an entity’s action is constrained by law or regulation and any distinction drawn by the Board could be considered arbitrary. The following situations could be considered

economically similar to the situation in which an entity chooses to issue contracts in a jurisdiction where the law or regulation explicitly prohibits (or limits) the consideration of a specific characteristic in pricing the contract:

- (a) the entity sets the price for contracts without considering differences in a specific characteristic because it thinks using that characteristic in pricing may result in a law or regulation prohibiting the use of that specified characteristic in the future or because doing so is likely to fulfil a public policy objective. These practices are sometimes termed ‘self-regulatory practices’.
- (b) the entity sets the price for contracts without considering differences in a specific characteristic because the law or regulation in a neighbouring jurisdiction explicitly prohibits consideration of differences in that specific characteristic.
- (c) the entity sets the price for contracts without considering differences in a specific characteristic because using differences in that specific characteristic may have a negative effect on the entity’s brand and reputation.

BC134 However, the Board decided that in these circumstances a difference in the likelihood of a contract being or becoming onerous is an important economic difference between groups of insurance contracts. Grouping contracts that have different likelihoods of becoming onerous reduces the information provided to users of financial statements. Hence, the exemption in IFRS 17 applies only when law or regulation specifically constrains the entity’s practical ability to set a different price or level of benefits for policyholders with different characteristics.

BC135 Despite the development of an approach designed to respond to the practical concerns raised by stakeholders, some continued to argue that the level of aggregation set out in paragraph BC127 might lead to excessive granularity that is, in their view, contrary to the essence of the insurance business. These stakeholders do not think that contracts that have been priced on the same basis by the entity should be in different groups. The Board noted that applying IFRS 17, an entity would not be expected under normal circumstances to group separately contracts priced on the same basis by the entity. This is because:

- (a) groups are determined on the basis of information available to the entity at initial recognition of the contracts, which will be at their inception if they are onerous at inception. In that case, the information that is used to determine the groups will be the same information that is available to the entity for pricing purposes. If contracts are onerous at inception, that will generally be the result of an intentional pricing strategy (and is likely to be relatively infrequent). If contracts are not onerous at inception, the date of initial recognition may be later than inception (see paragraphs BC140–BC144). Hence, the information used for determining the groups may differ from the information that had been available for pricing purposes. However, the difference between the information available at inception and initial recognition will often not be significant and stakeholders had indicated that always determining groups at inception (ie measuring the contracts at inception) would be unduly costly for little benefit (see paragraph BC141).
- (b) IFRS 17 provides an exception for circumstances in which law or regulation specifically constrains the entity’s practical ability to set a different price or level of benefits for contracts or policyholders with different characteristics.

BC136 The Board noted that the decisions outlined in paragraph BC127 could lead to perpetual open portfolios. The Board was concerned that this could lead to a loss of information about the development of profitability over time, could result in the contractual service margin persisting beyond the duration of contracts in the group, and consequently could result in profits not being recognised in the correct periods. Consequently, in addition to dividing contracts into the groups specified in paragraph BC127, the Board decided to prohibit entities from including contracts issued more than one year apart in the same group. The Board observed that such grouping was important to ensure that trends in the profitability of a portfolio of contracts were reflected in the financial statements on a timely basis.

BC137 The Board considered whether there were any alternatives to using a one-year issuing period to constrain the duration of groups. However, the Board considered that any principle-based approach that satisfied the Board’s objective would require the reintroduction of a test for similar profitability, which as set out in paragraph BC126, was rejected as being operationally burdensome. The Board acknowledged that using a one-year issuing period was an operational simplification given for cost-benefit reasons.

BC138 The Board considered whether prohibiting groups from including contracts issued more than one year apart would create an artificial divide for contracts with cash flows that affect or are affected by cash flows to policyholders of contracts in another group. Some stakeholders asserted that such a division would distort the reported result of those contracts and would be operationally burdensome. However, the Board concluded that applying the requirements of IFRS 17 to determine the fulfilment cash flows for groups of such contracts provides an appropriate depiction of the results of such contracts (see paragraphs BC171–BC174). The Board acknowledged that, for contracts that fully share risks, the groups together will give the

same results as a single combined risk-sharing portfolio, and therefore considered whether IFRS 17 should give an exception to the requirement to restrict groups to include only contracts issued within one year. However, the Board concluded that setting the boundary for such an exception would add complexity to IFRS 17 and create the risk that the boundary would not be robust or appropriate in all circumstances. Hence, IFRS 17 does not include such an exception. Nonetheless, the Board noted that the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. Therefore it may not be necessary for an entity to restrict groups in this way to achieve the same accounting outcome in some circumstances.

BC139 Once an entity has established a group of insurance contracts, it becomes the unit of account to which the entity applies the requirements of IFRS 17. However, as noted above, an entity will typically enter into transactions for individual contracts. IFRS 17 therefore includes requirements that specify how to recognise groups that include contracts issued in more than one reporting period, and how to derecognise contracts from within a group.

Recognition (paragraphs 25–28 of IFRS 17)

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

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

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

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

BC143 Typically, the first premium is due at the start of the coverage period and the entity recognises the group of insurance contracts at that point. In the Board's view:

- (a) the rationale described in paragraph BC141 for not recognising a group of insurance contracts in the pre-coverage period—ie tracking information before the coverage period begins does not generate benefits that outweigh costs—applies only to contracts before payments are due; and
- (b) the benefits of reporting insurance contracts that are onerous in the pre-coverage period outweigh the costs of recognising the contracts.

BC144 In some cases, changes in circumstances make a group of insurance contracts onerous before coverage begins. The Board decided that entities should recognise such onerous groups in the pre-coverage period. However, IFRS 17 requires onerous groups to be recognised only when facts and circumstances indicate that a group of insurance contracts is onerous. That approach ensures that entities recognise adverse changes in circumstances without the need to track groups before the coverage period begins.

BC145 The costs of originating insurance contracts are often incurred before the coverage period begins. As discussed in paragraph BC176, the Board concluded that an entity should not recognise such costs as separate assets. Instead, IFRS 17 requires such costs to be recognised as part of the cash flows of the group of insurance contracts once it qualifies for initial recognition. The Board observed that, in effect, entities will recognise groups from the date that the insurance acquisition cash flows are incurred. However, although an asset or liability is recognised from that date, entities do not need to update assumptions until

the date the group qualifies for initial recognition and they are required only to determine the contractual service margin at that later date.

Measurement of fulfilment cash flows (paragraphs 29–37 and B36–B92 of IFRS 17)

BC146 As explained in paragraphs BC19–BC20, IFRS 17 requires an entity to measure the fulfilment cash flows at a risk-adjusted present value. The sections below discuss the measurement of the fulfilment cash flows, in particular:

- (a) how an entity estimates the expected value of cash flows (see paragraphs BC147–BC157);
- (b) which cash flows should be included in the expected value of cash flows (see paragraphs BC158–BC184);
- (c) how the cash flows are adjusted to reflect the time value of money and the financial risks, to the extent that the financial risks are not included in the estimates of future cash flows (see paragraphs BC185–BC205); and
- (d) how the cash flows are adjusted to depict the effects of non-financial risk (see paragraphs BC206–BC217).

Estimates of future cash flows (paragraphs 33–35 and B36–B71 of IFRS 17)

BC147 This section discusses the requirements of IFRS 17 relating to how an entity estimates the future cash flows, including:

- (a) the unbiased use of all reasonable and supportable information available without undue cost or effort (see paragraphs BC148–BC152);
- (b) estimates that are consistent with available market information (see paragraphs BC153–BC154);
- (c) current estimates at the reporting date (see paragraphs BC155–BC156); and
- (d) explicit estimates (see paragraph BC157).

Unbiased use of all reasonable and supportable information available without undue cost or effort (paragraphs 33(a) and B37–B41 of IFRS 17)

BC148 Because insurance contracts transfer risk, the cash flows generated by insurance contracts are uncertain. Some argue that the measurement of insurance contracts should use a single estimate of the cash flows, for example, the most likely outcome or an outcome that is likely to prove ‘sufficient’ at an implicit or explicit level of confidence. However, the Board decided that a measure of insurance contracts is most useful if it captures information about the full range of possible outcomes and their probabilities.

BC149 Consequently, the Board concluded that the measurement of insurance contracts should start with an estimate of the expected present value of the cash flows generated by the contracts. The expected present value is the probability-weighted mean of the present value of the possible cash flows. The Board also noted that, because IFRS 17 sets the measurement requirement as the probability-weighted mean of the present value of the possible cash flows, when an entity determines that amount, estimates of the probabilities associated with each cash flow scenario should be unbiased. In other words, the estimates should not be biased by the intention of attaining a predetermined result or inducing particular behaviour. A lack of bias is important because biased financial reporting information cannot faithfully represent economic phenomena. A lack of bias requires that estimates of cash flows and the associated probabilities should be neither conservative nor optimistic.

BC150 In principle, determining an expected present value involves the following steps:

- (a) identifying each possible scenario;
- (b) measuring the present value of the cash flows in that scenario—paragraphs BC185–BC205 discuss the discount rate; and
- (c) estimating the probability of that scenario occurring.

Consistent with the approach taken in IFRS 9, the Board decided to specify that an entity should use reasonable and supportable information available without undue cost or effort in determining an expected present value.

- BC151 An expected present value is not a forecast of a particular outcome. Consequently, differences between the ultimate outcome and the previous estimate of expected value are not ‘errors’ or ‘failures’. The expected value is a summary that incorporates all foreseeable outcomes. When one or more of those outcomes do not occur, that does not invalidate the previous estimate of the expected value.
- BC152 Many insurance contracts contain significant embedded options and guarantees. Many previous insurance accounting models attributed no value to embedded options or guarantees that lack ‘intrinsic value’ (ie when they were ‘out of the money’). However, such embedded options and guarantees also have a time value because they could be ‘in the money’ at expiry. To the extent that those options and guarantees remain embedded in the insurance contract (see paragraphs BC104–BC107), the expected present value of future cash flows is an estimate based on all possible outcomes about cash flows. IFRS 17 also requires the measurement to include the effect of financial risk, either in the estimates of future cash flows or in the discount rate. The measurement approach in IFRS 17, therefore, incorporates both the intrinsic value and the time value of embedded options and guarantees. The use of the IFRS 17 approach will mean that the measurement of any options and guarantees included in the insurance contracts is consistent with observable market variables (see paragraph B48 of IFRS 17). The Board concluded that this measurement approach provides the most relevant information about embedded options and guarantees.

Estimates that are consistent with available market information (paragraphs 33(b) and B42–B53 of IFRS 17)

- BC153 The Board decided that measurements are more relevant, have less measurement uncertainty, and are more understandable if they are consistent with observed market prices, because such measurements:
- (a) involve less subjectivity than measurements that use entity-specific expectations that differ from market consensus;
 - (b) reflect all evidence available to market participants; and
 - (c) are developed using a common and publicly accessible benchmark that users of financial statements can understand more easily than information developed using a private, internal benchmark.
- BC154 This view has the following consequences:
- (a) an entity is required to use observable current market variables, such as interest rates, as direct inputs without adjustment when possible; and
 - (b) when variables cannot be observed in, or derived directly from, market prices, the estimates should not contradict current market variables. For example, estimated probabilities for inflation scenarios should not contradict probabilities implied by market interest rates.

Current estimates at the reporting date (paragraphs 33(c) and B54–B60 of IFRS 17)

- BC155 The Board concluded that estimates of cash flows should be based on current information, updated at the end of every reporting period. Insurance measurement models before IFRS 17 often required entities to make estimates at initial recognition and to use the same estimates throughout the duration of the contract, without updating to include information that became available later in the duration of the contract. However, the Board concluded that using current estimates:
- (a) gives more relevant information about the entity’s contractual obligations and rights by better reflecting information about the amounts, timing and uncertainty of the cash flows generated by those obligations and rights. Because of the uncertainty associated with insurance contract liabilities and the long duration of many insurance contracts, current information reflecting the amount, timing and uncertainty of cash flows is particularly relevant for users of financial statements.
 - (b) incorporates all reasonable and supportable information available without undue cost or effort in the measurement, thus avoiding the need for a separate test to ensure that the liability is not understated (sometimes known as a ‘liability adequacy test’). Any liability adequacy test is likely to involve some arbitrary components. For example, any specified timing for such a test would inevitably be arbitrary, unless current information were required at each reporting date.

- (c) is broadly consistent with other IFRS Standards for provisions (IAS 37) and financial liabilities (IFRS 9). That is, for liabilities with characteristics similar to insurance contract liabilities, both IAS 37 and IFRS 9 would require measurements based on current estimates of future cash flows.

BC156 The Board noted that IAS 37 includes in the measurement of liabilities the effect of possible new legislation only when the legislation is virtually certain to be enacted, and that IAS 12 *Income Taxes* includes in the measurement of income taxes only changes in legislation that are substantively enacted. Consistent with these Standards, the Board concluded that an entity should include the effect of possible changes in legislation on future cash flows only when the change in legislation is substantively enacted.

Explicit estimates (paragraphs 33(d) and B46 of IFRS 17)

BC157 The Board concluded that explicit estimates of cash flows, which require an entity to consider actively whether circumstances have changed, result in more useful information about the entity's obligations to policyholders than estimates that combine cash flows with either the risk adjustment for non-financial risk or the adjustment to reflect the time value of money and financial risks. Explicit estimates also reduce the possibility that the entity does not identify some changes in circumstances. However, IFRS 17 allows an exception to the requirement to use explicit estimates of cash flows separate from the adjustment to reflect the time value of money and financial risks. This exception applies if the entity uses the fair value of a replicating portfolio of assets to measure some of the cash flows that arise from insurance contracts, which will combine the cash flows and the adjustment to reflect the time value of money and financial risks. The fair value of a replicating portfolio of assets reflects both the expected present value of the cash flows from the portfolio of assets and the risk associated with those cash flows (see paragraph B46 of IFRS 17).

The cash flows used to measure insurance contracts (paragraphs 34–35 and B61–B71 of IFRS 17)

BC158 This section discusses which cash flows should be included in the expected value of cash flows, including:

- (a) cash flows that arise from future premiums (see paragraphs BC159–BC164);
- (b) deposit floors (see paragraphs BC165–BC166);
- (c) cash flows over which the entity has discretion (see paragraphs BC167–BC170);
- (d) cash flows that affect or are affected by cash flows to policyholders of other contracts (see paragraphs BC171–BC174); and
- (e) insurance acquisition cash flows (see paragraphs BC175–BC184).

Cash flows that arise from future premiums (paragraphs 34–35 and B61–B66 of IFRS 17)

BC159 The measurement of a group of insurance contracts includes all the cash flows expected to result from the contracts in the group, reflecting estimates of policyholder behaviour. Thus, to identify the future cash flows that will arise as the entity fulfils its obligations, it is necessary to draw a contract boundary that distinguishes whether future premiums, and the resulting benefits and claims, arise from:

- (a) existing insurance contracts. If so, those future premiums, and the resulting benefits and claims, are included in the measurement of the group of insurance contracts; or
- (b) future insurance contracts. If so, those future premiums, and the resulting benefits and claims, are not included in the measurement of the group of existing insurance contracts.

BC160 The essence of a contract is that it binds one or both of the parties. If both parties are bound equally, the boundary of the contract is generally clear. Similarly, if neither party is bound, it is clear that no genuine contract exists. Thus:

- (a) the outer limit of the existing contract is the point at which the entity is no longer required to provide coverage and the policyholder has no right of renewal. Beyond that outer limit, neither party is bound.
- (b) the entity is no longer bound by the existing contract at the point at which the contract confers on the entity the practical ability to reassess the risk presented by a policyholder and, as a result, the right to set a price that fully reflects that risk. Thus, any cash flows arising beyond that point occur beyond the boundary of the existing contract and relate to a future contract, not to the existing contract.

- BC161 However, if an entity has the practical ability to reassess the risk presented by a policyholder, but does not have the right to set a price that fully reflects the reassessed risk, the contract still binds the entity. Thus, that point would lie within the boundary of the existing contract, unless the restriction on the entity's ability to reprice the contract is so minimal that it is expected to have no commercial substance (ie the restriction has no discernible effect on the economics of the transaction). In the Board's view, a restriction with no commercial substance does not bind the entity.
- BC162 However, it may be more difficult to decide the contract boundary if the contract binds one party more tightly than the other. For example:
- (a) an entity may price a contract so that the premiums charged in early periods subsidise the premiums charged in later periods, even if the contract states that each premium relates to an equivalent period of coverage. This would be the case if the contract charges level premiums and the risks covered by the contract increase with time. The Board concluded that the premiums charged in later periods would be within the boundary of the contract because, after the first period of coverage, the policyholder has obtained something of value, namely the ability to continue coverage at a level price despite increasing risk.
 - (b) an insurance contract might bind the entity, but not the policyholder, by requiring the entity to continue to accept premiums and provide coverage but permitting the policyholder to stop paying premiums, although possibly incurring a penalty. In the Board's view, the premiums the entity is required to accept and the resulting coverage it is required to provide fall within the boundary of the contract.
 - (c) an insurance contract may permit an entity to reprice the contract on the basis of general market experience (for example, mortality experience), without permitting the entity to reassess the individual policyholder's risk profile (for example, the policyholder's health). In this case, the insurance contract binds the entity by requiring it to provide the policyholder with something of value: continuing insurance coverage without the need to undergo underwriting again. Although the terms of the contract are such that the policyholder has a benefit in renewing the contract, and thus the entity expects that renewals will occur, the contract does not require the policyholder to renew the contract. The Board originally decided that ignoring the entity's expectation of renewals would not reflect the economic circumstances created by the contract for the entity. Consequently, the Board originally proposed that if the entity can reprice an existing contract for general but not individual-specific changes in policyholders' risk profiles, the cash flows resulting from the renewals repriced in this way lie within the boundaries of the existing contract.
- BC163 Many stakeholders suggested that the original proposal in paragraph BC162(c) resulted in some cash flows for which the entity was not bound being included within the boundary of some contracts. Even when an entity is prevented from repricing an existing contract using an individual policyholder's risk assessment, the entity may nonetheless be able to reprice a portfolio to which the contract belongs with the result that the price charged for the portfolio as a whole fully reflects the risk of the portfolio. As a result, these stakeholders argued that in such cases the entity is no longer bound by the existing portfolio of contracts and that any cash flows that arise beyond that repricing point should be considered to be beyond the boundary of the existing contract. To the extent that an entity would not be able to charge a price that fully reflects the risks of the portfolio as a whole, it would be bound by the existing contract. The Board was persuaded by this view and modified the contract boundary so that such cash flows are considered to be outside the contract boundary, provided the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods subsequent to the reassessment date.
- BC164 Because the entity updates the measurement of the group of insurance contracts to which the individual contract belongs and, hence, the portfolio of contracts in each reporting period, the assessment of the contract boundary is made in each reporting period. For example, in one reporting period an entity may decide that a renewal premium for a portfolio of contracts is outside the contract boundary because the restriction on the entity's ability to reprice the contract has no commercial substance. However, if circumstances change so that the same restrictions on the entity's ability to reprice the portfolio take on commercial substance, the entity may conclude that future renewal premiums for that portfolio of contracts are within the boundary of the contract.

Deposit floors

- BC165 The Board also addressed how deposit floors are considered when measuring insurance contracts. The 'deposit floor' is a term used to describe the following requirement in paragraph 47 of IFRS 13:

The fair value of a financial liability with a demand feature (eg a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

BC166 If a deposit floor were to be applied when measuring insurance contracts, the resulting measurement would ignore all scenarios other than those involving the exercise of policyholder options in the way that is least favourable to the entity. Such a requirement would contradict the principle that an entity should incorporate in the measurement of an insurance contract future cash flows on a probability-weighted basis. Consequently, IFRS 17 does not require or allow the application of a deposit floor when measuring insurance contracts. This applies both to the general measurement requirements of IFRS 17 and when IFRS 17 requires the use of fair value (see paragraphs BC327 and BC385). However, paragraph 132(c) of IFRS 17 requires entities to disclose the amount payable on demand in a way that highlights the relationship between such amounts and the carrying amount of the related contracts.

Cash flows over which the entity has discretion (paragraph B65 of IFRS 17)

BC167 Some insurance contracts give policyholders the right to share in the returns on specified underlying items. In some cases, the contract gives the entity discretion over the resulting payments to the policyholders, either in their timing or in their amount. Such discretion is usually subject to some constraint, including constraints in law or regulation and market competition.

BC168 IFRS 17 requires the measurement of a group of insurance contracts to include an unbiased estimate of the expected cash outflows from the contracts. The expected cash outflows include outflows over which the entity has discretion. The Board decided to require this because:

- (a) it can be difficult to determine whether an entity is making payments because it believes that it is obliged to do so, rather than for some other reason that does not justify the recognition of a stand-alone liability. Those reasons could be to maintain the entity's competitive position or because the entity believes it is under some moral pressure. Thus, it could be difficult to make a reasonable estimate of the level of distribution that would ultimately be enforceable in the unlikely event that an entity asserts that its discretion to pay or withhold amounts to policyholders is unfettered.
- (b) even if it were possible to make a reasonable estimate of non-discretionary cash flows, users of financial statements would not benefit from knowing how much might be enforceable in the highly unlikely event that an entity tried to avoid paying amounts to policyholders of insurance contracts when the entity and its policyholders currently expect that such benefits will be paid. That amount does not provide relevant information about the amount, timing and uncertainty of future cash flows. On the other hand, users of financial statements would want to know:
 - (i) how much of the cash flows will be unavailable to investors because the entity expects to pay them to policyholders. The requirements in IFRS 17 convey that information by including those cash flows in the measurement of the liability.
 - (ii) how much of the risk in the contracts is borne by the policyholders through the participation mechanism and how much by the shareholders. This information is conveyed by the required disclosures about risk.

BC169 The Board considered whether payments that are subject to the entity's discretion meet the definition of a liability in the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*). The contract, when considered as a whole, clearly meets the *Conceptual Framework's* definition of a liability. Some components, if viewed in isolation, may not meet the definition of a liability. However, in the Board's view, including such components in the measurement of insurance contracts would generate more useful information for users of financial statements.

BC170 The Board considered whether to provide specific guidance on amounts that have accumulated over many decades in participating funds and whose 'ownership' may not be attributable definitively between shareholders and policyholders. It concluded that it would not. In principle, IFRS 17 requires an entity to estimate the cash flows in each scenario. If that requires difficult judgements or involves unusual levels of uncertainty, an entity would consider those matters in deciding what disclosures it must provide to satisfy the disclosure objective in IFRS 17.

Cash flows that affect or are affected by cash flows to policyholders of other contracts (paragraphs B67–B71 in IFRS 17)

BC171 Sometimes insurance contracts in one group affect the cash flows to policyholders of contracts in a different group. This effect is sometimes called 'mutualisation'. However, that term is used in practice to refer to a variety of effects, ranging from the effects of specific contractual terms to general risk diversification. Consequently, the Board decided not to use the term but instead to include in IFRS 17 requirements that ensure the fulfilment cash flows of any group are determined in a way that does not distort the contractual

service margin, taking into account the extent to which the cash flows of different groups affect each other. Hence the fulfilment cash flows for a group:

- (a) include payments arising from the terms of existing contracts to policyholders of contracts in other groups, regardless of whether those payments are expected to be made to current or future policyholders; and
- (b) exclude payments to policyholders in the group that, applying (a), have been included in the fulfilment cash flows of another group.

BC172 The reference to future policyholders is necessary because sometimes the terms of an existing contract are such that the entity is obliged to pay to policyholders amounts based on underlying items, but with discretion over the timing of the payments. That means that some of the amounts based on underlying items may be paid to policyholders of contracts that will be issued in the future that share in the returns on the same underlying items, rather than to existing policyholders. From the entity's perspective, the terms of the existing contract require it to pay the amounts, even though it does not yet know when or to whom it will make the payments.

BC173 The Board considered whether it was necessary to amend the requirements in IFRS 17 relating to the determination of the contractual service margin for insurance contracts with cash flows that affect or are affected by cash flows to policyholders of contracts in another group. The Board concluded that it was not necessary because the fulfilment cash flows allocated to a group described in paragraph BC171 result in the contractual service margin of a group appropriately reflecting the future profit expected to be earned from the contracts in the group, including any expected effect on that future profit caused by other contracts.

BC174 The Board also considered whether it was necessary to amend the requirements in IFRS 17 restricting contracts in a group to those issued more than one year apart, but concluded that it was not necessary (see paragraph BC138).

Insurance acquisition cash flows (paragraphs B65(e) and B125 of IFRS 17)

BC175 Entities often incur significant costs to sell, underwrite and start new insurance contracts. These costs are commonly referred to as 'insurance acquisition cash flows'. Insurance contracts are generally priced to recover those costs through premiums or through surrender charges, or both.

Measurement approach

BC176 The measurement approach required in IFRS 17 represents a change from many previous accounting models that measure insurance contract liabilities initially at the amount of the premiums received, with deferral of insurance acquisition cash flows. Such models treat insurance acquisition cash flows as a representation of the cost of a recognisable asset, which, depending on the model, might be described as a contract asset or a customer relationship intangible asset. The Board concluded that such an asset either does not exist, if the entity recovers insurance acquisition cash flows from premiums already received, or relates to future cash flows that are included in the measurement of the contract. The Board noted that an entity typically charges the policyholder a price the entity regards as sufficient to compensate it for undertaking the obligation to pay for insured losses and for the cost of originating the contracts. Thus, a faithful representation of the remaining obligation to pay for insured losses should not include the part of the premium intended to compensate for the cost of originating the contracts.

BC177 Consequently, the Board concluded that an entity should recognise insurance acquisition cash flows as an expense, and should recognise an amount of revenue equal to the portion of the premium that relates to recovering its insurance acquisition cash flows. IFRS 17 achieves this by requiring that the cash flows for a group of insurance contracts include the insurance acquisition cash outflows or inflows associated with the group of contracts (including amounts received or to be received by the entity to acquire new insurance contracts). This approach reduces the contractual service margin on initial recognition of the group of insurance contracts and has the advantage that the insurance acquisition cash flows are treated the same as other cash flows incurred in fulfilling contracts.

BC178 In many cases, insurance acquisition cash flows occur at the beginning of the coverage period of a group of insurance contracts, before any coverage or other service has been provided. Because insurance revenue is recognised in the same pattern as changes in the liability for remaining coverage, this would mean that some of the insurance revenue would be recognised when the insurance acquisition cash flows are paid, often at the beginning of the coverage period.

BC179 The Board was concerned that recognising insurance revenue at the beginning of the coverage period would be inconsistent with the principles in IFRS 15 because, at the beginning of the coverage period, the entity

has not satisfied any of the obligations to the policyholder under the contract. In contrast, IFRS 15 requires an entity to recognise as revenue the consideration received from the customer as it satisfies its performance obligations under the contract. Accordingly, the Board decided to include an exception in IFRS 17 for the treatment of insurance acquisition cash flows so that the premium related to insurance acquisition cash flows is not recognised as revenue when the insurance acquisition cash flows occur, but is separately identified and recognised over the coverage period. IFRS 17 also requires the insurance acquisition cash flows to be recognised as an expense over the same period.

BC180 The requirement to recognise insurance acquisition cash flows as an expense over the coverage period differs from recognising an asset or an explicit or implicit reduction in the carrying amount of the group of insurance contracts. At all times, the liability for the group is measured as the sum of the fulfilment cash flows, including any expected future insurance acquisition cash flows, and the contractual service margin. Because the contractual service margin cannot be less than zero, the entity need not test separately whether it will recover the insurance acquisition cash flows that have occurred but have not yet been recognised as an expense. The measurement model captures any lack of recoverability automatically by remeasuring the fulfilment cash flows.

Insurance acquisition cash flows included in measurement

BC181 The Board considered whether only insurance acquisition cash flows that are incremental at a contract level should be included in the measurement of an insurance contract. Those cash flows can be clearly identified as relating specifically to the contract. Including cash flows that relate to more than one contract requires a more subjective judgement to identify which cash flows to include.

BC182 However, the Board noted that:

(a) including only insurance acquisition cash flows that are incremental at a contract level would mean that entities would recognise different contractual service margins and expenses depending on the way they structure their acquisition activities. For example, there would be different liabilities reported if the entity had an internal sales department rather than outsourcing sales to external agents. In the Board's view, differences in the structure of insurance acquisition activities would not necessarily reflect economic differences between insurance contracts issued by the entities.

(b) an entity typically prices insurance contracts to recover not only incremental costs, but also other direct costs and a proportion of indirect costs incurred in originating insurance contracts—such as costs of underwriting, medical tests and inspection, and issuing the policy. The entity measures and manages these costs for the portfolio, rather than for the individual contract. Accordingly, including insurance acquisition cash flows that are incremental at the portfolio level in the fulfilment cash flows of the insurance contracts would be consistent with identification of other cash flows that are included in the measurement of the contracts.

BC183 The Board also considered whether to restrict insurance acquisition cash flows to be included in the measurement of a group of insurance contracts to those cash flows related directly to the successful acquisition of new or renewed insurance contracts. The approach in IFRS 17 to the measurement of a group of insurance contracts is to estimate the profit expected to be generated over the duration of the group. In this context, excluding some insurance acquisition cash flows that relate to issuing a portfolio of contracts would result in an understatement of the fulfilment cash flows and an overstatement of the contractual service margins of groups in the portfolio. In addition, the Board wanted to avoid measuring liabilities and expenses at different amounts depending on how an entity structures its insurance acquisition activities, as described in paragraph BC182(a).

BC184 The Board also noted that the measurement approach in IFRS 17 automatically recognises as an immediate expense any insurance acquisition cash flows that cannot be recovered from the cash flows of the portfolio of contracts, because such cash flows reduce the contractual service margin below zero and must therefore be recognised as an expense. Hence, no amount can be recognised in the statement of financial position for insurance acquisition cash flows that are not recoverable.

Discount rates (paragraphs 36 and B72–B85 of IFRS 17)

BC185 This section discusses:

(a) whether the measurement of all insurance contracts should be discounted (see paragraphs BC186–BC191);

- (b) current, market-consistent estimates of the time value of money and financial risks, to the extent not included in the estimates of future cash flows (see paragraph BC192);
- (c) the approach taken in respect of liquidity and own credit risk factors in determining the discount rate for a group of insurance contracts (see paragraphs BC193–BC197);
- (d) disclosure of the yield curve (see paragraph BC198); and
- (e) reflecting dependence on underlying items in the discount rate (see paragraphs BC199–BC205).

Discounting for all insurance contracts (paragraphs 36 and B72 of IFRS 17)

- BC186 An amount payable tomorrow has a value different from that of the same amount payable in 10 years' time. In other words, money has a time value. The Board concluded that the measurement of all insurance contracts should reflect the effect of the timing of cash flows, because such a measure gives more relevant information about the entity's financial position.
- BC187 When applying some previous accounting practices, entities did not discount their non-life (property and casualty) insurance contract liabilities. Some suggested that measuring non-life insurance contracts at a discounted amount would produce information that is less reliable (ie has more measurement uncertainty) than measuring it at its undiscounted amount because non-life insurance contracts are more uncertain than life insurance contracts with respect to:
- (a) whether the insured event will occur, whereas the insured event in some life insurance contracts is certain to occur unless the policy lapses;
 - (b) the amount of the future payment that would be required if an insured event occurs, whereas the future payment obligation is generally specified in, or readily determinable from, a life insurance contract; and
 - (c) the timing of any future payments required when the insured event occurs, whereas the timing of future payments in a life insurance contract is typically more predictable.
- BC188 These uncertainties mean that the cash flows for many non-life insurance contracts have greater variability than do the cash flows for many life insurance contracts. Some stakeholders argued that estimating the timing of payments and calculating a discount rate would introduce additional subjectivity into the measurement of insurance contracts and that this could reduce comparability and permit earnings management. Furthermore, these stakeholders stated that the benefits of presenting a discounted measure of non-life insurance contracts might not justify the costs of preparing that measure. These stakeholders stated that the timing of cash flows and the resulting interest is an essential component of the pricing and profitability of life insurance contracts, but is less relevant for non-life insurance contracts for which the stakeholders viewed underwriting results as the most critical component of pricing and profitability.
- BC189 These arguments did not persuade the Board. Measuring a group of insurance contracts using undiscounted cash flows would fail to represent faithfully the entity's financial position and would be less relevant to users of financial statements than a measurement that includes the discounted amounts. The Board also concluded that discount rates and the amount and timing of future cash flows can generally be estimated without excessive measurement uncertainty at a reasonable cost. Absolute precision is unattainable, but it is also unnecessary. The Board is of the view that the measurement uncertainty caused by discounting does not outweigh the additional relevance of the resulting measurement of the entity's obligations. Furthermore, many entities have experience in discounting, both to support investment decisions and to measure items for which other IFRS Standards require discounting, such as financial instruments, employee benefit obligations and long-term non-financial liabilities. Additionally, the Board has learned that, for internal managerial purposes, some insurance entities discount some of their non-life insurance portfolios or groups of insurance contracts.
- BC190 Some stakeholders suggested that measuring non-life insurance contracts at undiscounted amounts that ignore future inflation could provide a reasonable approximation of the value of the liability, especially for short-tail liabilities, at less cost and with less complexity than measuring such contracts at explicitly discounted amounts. However, this approach of implicitly discounting the liability makes the unrealistic assumption that two variables (claim inflation and the effect of timing) will more or less offset each other in every case. As this is unlikely, the Board concluded that financial reporting will be improved if entities estimate those effects separately.
- BC191 As discussed in paragraphs BC292(a) and BC294, for contracts to which the entity applies the simpler premium allocation approach, the Board decided that an entity need not reflect the effects of discounting in some cases in which those effects would be generally expected to be insignificant.

Current, market-consistent discount rates (paragraphs 36 and B74–B85 of IFRS 17)

BC192 Paragraphs BC20 and BC146–BC156 describe the Board’s reasoning for using current, market-consistent estimates of cash flows. That reasoning also applies to the discount rate for those cash flows. Accordingly, IFRS 17 requires entities to discount cash flows using current, market-consistent discount rates that reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts.

Factors to include in the discount rate (paragraphs B78–B85 of IFRS 17)

Liquidity

BC193 Discussions of the time value of money often use the notion of risk-free rates. Many entities use highly liquid, high-quality bonds as a proxy for risk-free rates. However, the holder can often sell such bonds in the market at short notice without incurring significant costs or affecting the market price. This means that the holder of such bonds effectively holds two things:

- (a) a holding in an underlying non-tradable investment, paying a higher return than the observed return on the traded bond; and
- (b) an embedded option to sell the investment to a market participant, for which the holder pays an implicit premium through a reduction in the overall return.

In contrast, for many insurance contracts, the entity cannot be forced to make payments earlier than the occurrence of insured events, or dates specified in the contract.

BC194 The Board concluded that, in principle, the discount rate for a group of insurance contracts should reflect the liquidity characteristics of the items being measured. Thus, the discount rate should equal the return on the underlying non-tradable investment (see paragraph BC193(a)), because the entity cannot sell or put the contract liability without significant cost. There should be no deduction in the rate for the implicit premium for the embedded put option, because no such put option is present in the liability.

BC195 The Board concluded that it is not appropriate in a principle-based approach:

- (a) to ignore the liquidity characteristics of the item being measured, or to use an arbitrary benchmark (for example, high-quality corporate bonds) as an attempt to develop a practical proxy for measuring the specific liquidity characteristics of the item being measured; or
- (b) to provide detailed guidance on how to estimate liquidity adjustments.

BC196 However, in response to feedback suggesting that it may be difficult to determine a liquidity premium in isolation, the Board observed that in estimating liquidity adjustments, an entity could apply either of the following:

- (a) a ‘bottom-up’ approach based on highly liquid, high-quality bonds, adjusted to include a premium for the illiquidity.
- (b) a ‘top-down’ approach based on the expected returns of a reference portfolio, adjusted to eliminate factors that are not relevant to the liability, for example market and credit risk. The Board expects a reference portfolio will typically have liquidity characteristics closer to the liquidity characteristics of the group of insurance contracts than highly liquid, high-quality bonds. Because of the difficulty in assessing liquidity premiums, the Board decided that in applying a top-down approach an entity need not make an adjustment for any remaining differences in liquidity characteristics between the reference portfolio and the insurance contracts.

Own credit risk (paragraph 31 of IFRS 17)

BC197 IFRS 17 requires an entity to disregard its own credit risk when measuring the fulfilment cash flows. Some stakeholders expressed the view that information about own credit risk relating to a liability that must be fulfilled by the issuer, and about gains and losses arising from changes in the issuer’s own credit risk, is not relevant for users of financial statements. The Board concluded that including the effect of a change in the entity’s own non-performance risk in the measurement of an insurance contract liability would not provide useful information. The Board considered concerns that excluding own credit risk could lead to accounting mismatches, because the fair value of the assets viewed as backing insurance contracts includes changes in

credit risk on those assets, while the measurement of a group of insurance contracts would exclude changes in the credit risk of the group of contracts. In the Board's view, such mismatches will often be economic in nature, because the credit risk associated with the insurance contracts differs from the credit risk of the assets held by the entity.

Disclosure of yield curve (paragraph 120 of IFRS 17)

BC198 Paragraphs B80 and B81 of IFRS 17 note that the different approaches the Board allows for determining the discount rate could give rise to different rates. Accordingly, the Board decided that an entity should disclose the yield curve or range of yield curves used to discount cash flows that do not vary based on returns on underlying items to supplement the requirement in paragraph 117 of IFRS 17 that an entity disclose the methods and inputs that are used to estimate the discount rates. The Board decided that disclosure of the yield curves used will allow users of financial statements to understand how those yield curves might differ from entity to entity.

Reflecting dependence on assets in the discount rate (see paragraphs 36 and B74–B85 of IFRS 17)

BC199 Some previous accounting approaches applied discount rates to insurance contract liabilities derived from the expected return on assets viewed as backing the liabilities, even when the cash flows arising from the liability do not vary based on the cash flows of the underlying items. Proponents of such approaches stated that doing so:

- (a) prevents losses arising at initial recognition for groups of insurance contracts that are expected to be profitable overall and so reflects the most likely outcome of the insurance activity as a whole, taking into consideration the underwriting and investment functions together.
- (b) prevents the volatility that would arise if short-term fluctuations in asset spreads affect the measurement of the assets, but not the measurement of the liabilities. Because an entity holds those assets for the long term to fulfil its obligations under the insurance contracts it has issued, some say that those fluctuations make it more difficult for users of financial statements to assess an entity's long-term performance.

BC200 However, the Board did not agree with these views. The Board decided that recognising a loss at contract inception is appropriate if the amount paid by the policyholder is insufficient to cover the expected present value of the policyholder's benefits and claims as well as to compensate the entity for bearing the risk that the benefits might ultimately exceed the expected premiums. Further, the Board noted that, to the extent that market spreads affect assets and insurance contracts differently, useful information is provided about economic mismatches, particularly about duration mismatches.

BC201 The Board rejected the application of an asset-based discount rate when the cash flows from the group of insurance contracts do not vary based on returns on assets, because those rates are unrelated to the cash flows. The objective of the discount rate is to adjust estimated future cash flows for the time value of money and for financial risks (for example, the liquidity risk), to the extent that they are not included in the estimated cash flows, in a way that captures the characteristics of the contract. To capture the characteristics of the contract:

- (a) to the extent that the cash flows from assets (or other underlying items) affect the cash flows that arise from the liability, the appropriate discount rate should reflect the dependence on the underlying items; and
- (b) to the extent that the cash flows that arise from the contracts are expected not to vary with returns on underlying items, the appropriate discount rate should exclude any factors that influence the underlying items that are irrelevant to the contracts. Such factors include risks that are not present in the contracts but are present in the financial instrument for which the market prices are observed. Thus, the discount rate should not capture all of the characteristics of those assets, even if the entity views those assets as backing those contracts.

BC202 Some view the cash flows that result from a guarantee embedded in an insurance contract as:

- (a) variable in scenarios in which the guarantee amount is lower than the proportion of returns on underlying items promised to the policyholder; and
- (b) fixed in scenarios in which the guaranteed amount is higher than the proportion of returns on underlying items promised to the policyholder.

- BC203 However, the cash flows resulting from the guarantees do not vary directly with returns on underlying items because they are not expected to vary directly with such returns in all scenarios. Accordingly, an asset-based discount rate (from assets with variable returns) would be inappropriate for such cash flows.
- BC204 The Board noted that a link between cash flows and underlying items could be captured by using replicating portfolio techniques, or portfolio techniques that have similar outcomes (see paragraphs B46–B48 of IFRS 17). A replicating portfolio is a theoretical portfolio of assets providing cash flows that exactly match the cash flows from the liability in all scenarios. If such a portfolio exists, the appropriate discount rate(s) for the replicating portfolio would also be the appropriate discount rate(s) for the liability. If a replicating portfolio existed and could be measured directly, there would be no need to determine separately the cash flows and the discount rate for the part of the liability replicated by that portfolio. The measurements of the replicating portfolio and the replicated cash flows arising from the contracts would be identical.
- BC205 However, the Board also noted that using a replicating portfolio technique might require splitting the cash flows of the insurance contracts into those that match the cash flows from the asset portfolio and those that do not. As discussed in paragraph BC261, many stakeholders argued that it is impossible to split the cash flows in this way. Hence, IFRS 17 permits, but does not require, the use of a replicating portfolio technique and allows other approaches, such as risk-neutral modelling.

Risk adjustment for non-financial risk (paragraphs 37 and B86–B92 of IFRS 17)

- BC206 IFRS 17 requires entities to depict the risk that is inherent in insurance contracts by including a risk adjustment for non-financial risk in the measurement of those contracts. The risk adjustment for non-financial risk directly measures the non-financial risk in the contract.
- BC207 This section discusses:
- (a) the reasons for including a risk adjustment for non-financial risk in the measurement of a group of insurance contracts (see paragraphs BC208–BC212);
 - (b) the techniques for estimating the risk adjustment for non-financial risk (see paragraphs BC213–BC214); and
 - (c) the requirement to disclose a confidence level equivalent (see paragraphs BC215–BC217).

Reasons for including a risk adjustment for non-financial risk in the measurement of insurance contracts (paragraphs 37 and B86–B89 of IFRS 17)

- BC208 IFRS 17 requires the risk adjustment for non-financial risk to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.
- BC209 In developing the objective of the risk adjustment for non-financial risk, the Board concluded that a risk adjustment for non-financial risk should not represent:
- (a) the compensation that a market participant would require for bearing the non-financial risk that is associated with the contract. As noted in paragraph BC17, the measurement model is not intended to measure the current exit value or fair value, which reflects the transfer of the liability to a market participant. Consequently, the risk adjustment for non-financial risk should be determined as the amount of compensation that the entity—not a market participant—would require.
 - (b) an amount that would provide a high degree of certainty that the entity would be able to fulfil the contract. Although such an amount might be appropriate for some regulatory purposes, it is not compatible with the Board’s objective of providing information that will help users of financial statements make decisions about providing resources to the entity.
- BC210 The Board considered arguments that it not include a risk adjustment for non-financial risk in the fulfilment cash flows because:
- (a) no single well-defined approach exists for developing risk adjustments for non-financial risks that would meet the objective described in paragraph BC208 and provide consistency and comparability of results.
 - (b) some techniques are difficult to explain to users of financial statements and, for some techniques, it may be difficult to provide clear disclosures that would give users of financial statements an insight into the measure of the risk adjustment for non-financial risk that results from the technique.

- (c) it is impossible to assess retrospectively whether a particular adjustment was reasonable, although preparers of financial statements may, in time, develop tools that help them to assess whether the amount of a risk adjustment for non-financial risk is appropriate for a given fact pattern. Over time, an entity may be able to assess whether subsequent outcomes are in line with its previous estimates of probability distributions. However, it would be difficult for the entity to assess whether, for example, a decision to set a confidence level at a particular percentile was appropriate.
- (d) developing systems to determine risk adjustments for non-financial risk will involve cost, and some stakeholders doubt whether the benefits of such systems will be sufficient to justify that cost.
- (e) the inclusion of an explicitly measured risk adjustment for non-financial risk in identifying a loss on initial recognition is inconsistent with IFRS 15.
- (f) if the remeasurement of the risk adjustment for non-financial risk for an existing group of insurance contracts results in a loss, that loss will reverse in later periods as the entity is released from that risk. Reporting a loss followed by an expected reversal of that loss may confuse some users of financial statements.
- (g) the risk adjustment for non-financial risk could be used to introduce bias into the measurement of an insurance contract.

BC211 However, even given some of the limitations noted above, IFRS 17 requires a separate risk adjustment for non-financial risk because the Board decided that such an adjustment:

- (a) will result in an explicit measurement of the non-financial risk that will provide a clearer insight into the insurance contracts. In particular, it distinguishes risk-generating liabilities from risk-free liabilities. It will convey useful information to users of financial statements about the entity's view of the economic burden imposed by the non-financial risk associated with the entity's insurance contracts.
- (b) will result in a profit recognition pattern that reflects both the profit recognised by bearing risk and the profit recognised by providing services. As a result, the profit recognition pattern is more sensitive to the economic drivers of the contract.
- (c) will faithfully represent circumstances in which the entity has charged insufficient premiums for bearing the risk that the claims might ultimately exceed expected premiums.
- (d) will report changes in estimates of risk promptly and in an understandable way.

BC212 IFRS 17 requires entities to consider the risk adjustment for non-financial risk separately from the adjustment for the time value of money and financial risks. The Board observed that some previous accounting models combined these two adjustments by using discount rates adjusted for non-financial risk. However, the Board concluded that combining the two adjustments is inappropriate unless the risk is directly proportional to both the amount of the liability and the remaining time to maturity. Insurance contract liabilities often do not have these characteristics. For example, the average risk in a group of claims liabilities may rise over time because more complex claims incurred may take longer to resolve. Similarly, lapse risk may affect cash inflows more than it affects cash outflows. A single risk-adjusted discount rate is unlikely to capture such differences in risk. The Board therefore decided to require a separate risk adjustment for non-financial risk.

Techniques for measuring risk adjustments for non-financial risk (paragraphs B90–B92 of IFRS 17)

BC213 The Board decided a principle-based approach for measuring the risk adjustment for non-financial risk, rather than identifying specific techniques, would be consistent with the Board's approach on how to determine a similar risk adjustment for non-financial risk in IFRS 13. Furthermore, the Board concluded that:

- (a) limiting the number of risk adjustment techniques would conflict with the Board's desire to set principle-based IFRS Standards. In particular situations, some techniques may be more applicable, or may be easier to implement, and it would not be practicable for an IFRS Standard to specify in detail every situation in which particular techniques would be appropriate. Furthermore, techniques may evolve over time. Specifying particular techniques might prevent an entity from improving its techniques.
- (b) the objective of the risk adjustment for non-financial risk is to reflect the entity's perception of the economic burden of its non-financial risks. Specifying a level of aggregation for determining

the risk adjustment for non-financial risk that was inconsistent with the entity's view of the burden of non-financial risk would contradict the objective of reflecting the entity's perception in the risk adjustment for non-financial risk.

- BC214 As a result, IFRS 17 states only the principle that the risk adjustment for non-financial risk should be the compensation the entity requires for bearing the uncertainty arising from non-financial risk that is inherent in the cash flows that arise as the entity fulfils the group of insurance contracts. Accordingly, the risk adjustment for non-financial risk reflects any diversification benefit the entity considers when determining the amount of compensation it requires for bearing that uncertainty.

Confidence level disclosure (paragraph 119 of IFRS 17)

- BC215 An important difference between IFRS 17 and IFRS 13 is that the risk adjustment for non-financial risk in IFRS 17 relies on an entity's own perception of its degree of risk aversion, rather than on a market participant's perception. This could result in entities determining different risk adjustments for non-financial risk for similar groups of insurance contracts. Accordingly, to allow users of financial statements to understand how the entity-specific assessment of risk aversion might differ from entity to entity, IFRS 17 requires entities to disclose the confidence level to which the risk adjustment for non-financial risk corresponds.
- BC216 The Board acknowledges concerns that disclosure of the confidence level would be burdensome to prepare and may not provide information that is directly comparable. However, the Board did not identify any other approaches that would provide quantitative disclosure that would allow users of financial statements to compare the risk adjustments for non-financial risk using a consistent methodology across entities. In particular, the Board noted that this objective would not be achieved by:
- (a) disclosing the range of values of key inputs used to measure the risk adjustment for non-financial risk from a market participant's perspective; or
 - (b) providing information about the relative magnitude of the risk adjustment for non-financial risk compared to total insurance contract liabilities.
- BC217 The Board also considered whether a different technique, such as the cost of capital approach, should be used as the basis for comparison. Although the usefulness of the confidence level technique diminishes when the probability distribution is not statistically normal, which is often the case for insurance contracts, the cost of capital approach would be more complicated to calculate than would the confidence level disclosure. Also, the confidence level technique has the benefit of being relatively easy to communicate to users of financial statements and relatively easy to understand. The Board expects that many entities will have the information necessary to apply the cost of capital technique because that information will be required to comply with local regulatory requirements. However, the Board decided not to impose the more onerous requirements on entities when a simpler approach would be sufficient.

Measurement of the contractual service margin (paragraphs 38, 43–46 and B96–B119 of IFRS 17)

- BC218 The contractual service margin depicts the unearned profit the entity expects to generate from a group of insurance contracts (see paragraph BC21). The contractual service margin is determined on initial recognition of a group as the amount that eliminates any gains arising at that time. Subsequent adjustments to the carrying amount of the contractual service margin and its recognition in profit or loss determine how profit and revenue are recognised over the coverage period of the group.
- BC219 The contractual service margin cannot depict unearned losses. Instead, IFRS 17 requires an entity to recognise a loss in profit or loss for any excess of the expected present value of the future cash outflows above the expected present value of the future cash inflows, adjusted for risk (see paragraphs BC284–BC287 on losses on onerous contracts).
- BC220 IFRS 17 requires the carrying amount of the contractual service margin to be adjusted for (see paragraphs 44 and 45 of IFRS 17):
- (a) changes in estimates of the future unearned profit (see paragraphs BC222–BC269);
 - (b) insurance finance income or expenses (see paragraphs BC270–BC276); and
 - (c) currency exchange differences (see paragraphs BC277–BC278).

BC221 The resulting carrying amount at the end of the reporting period is allocated over the current and future periods, and the amount relating to the current period is recognised in profit or loss (see paragraphs BC279–BC283).

Changes in estimates of the future unearned profit (paragraphs 44, 45 and B96–B118 of IFRS 17)

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

BC223 IFRS 17 requires an entity to measure the contractual service margin, on initial recognition of the group of insurance contracts, as the difference between the expected present value of cash inflows and the expected present value of cash outflows, after adjusting for uncertainty and any cash flows received or paid before or on initial recognition. IFRS 17 also requires an entity to update the measurement of the contractual service margin for changes in estimates of the fulfilment cash flows relating to future service, for the following reasons:

- (a) changes in estimates of the fulfilment cash flows relating to future service affect the future profitability of the group of insurance contracts. Thus, adjusting the contractual service margin to reflect these changes provides more relevant information about the remaining unearned profit in the group of insurance contracts after initial recognition than not adjusting the contractual service margin. Paragraphs BC227–BC237 discuss which changes in estimates relate to future service for insurance contracts without direct participation features, and paragraphs BC238–BC256 discuss which changes relate to future service for insurance contracts with direct participation features.
- (b) increased consistency between measurement at initial recognition and subsequent measurement. If the contractual service margin were not adjusted for changes in estimates relating to future service, the estimates made at initial recognition would determine the contractual service margin, but changes in those estimates thereafter would not.

BC224 Having concluded that changes in estimates of the fulfilment cash flows relating to future service should adjust the contractual service margin, the Board further decided that:

- (a) it would not limit the amount by which the contractual service margin could be increased. Favourable changes in estimates—whether lower than expected cash outflows, higher than expected cash inflows or reductions in the risk adjustment for non-financial risk—increase the profit that the entity will recognise from the group.
- (b) the contractual service margin cannot be negative for a group of insurance contracts issued. Therefore, once the contractual service margin is reduced to zero, expected losses arising from the group will be recognised immediately in profit or loss. Any excess of the increase in the fulfilment cash flows over the contractual service margin means the group is expected to be onerous (ie loss-making) rather than profit-making in the future. Such losses are recognised as an increase in the liability and corresponding expense in the period.
- (c) only changes in estimates of fulfilment cash flows relating to future service result in an adjustment to the contractual service margin. Consistent with viewing the contractual service margin as unearned future profit, changes that relate to current or past periods do not affect the contractual service margin. Paragraphs BC227–BC247 discuss which changes in estimates relate to future service.
- (d) changes in estimates of fulfilment cash flows relating to future service include changes in the risk adjustment for non-financial risk that relate to future service.
- (e) adjustments to the contractual service margin are recognised prospectively using the latest estimates of the fulfilment cash flows. Except in the case of onerous groups of insurance contracts as explained in (b), any changes are recognised in profit or loss when the contractual service margin is recognised over the current period and the coverage period remaining after the adjustments are made. Revisions in estimates that adjust the contractual service margin result in a transfer between the components of the insurance contract liability, with no change in the total carrying amount of the liability. Therefore, the total insurance contract liability is remeasured for changes in estimates of expected cash flows only if there is an unfavourable change relating to future service that exceeds the remaining balance of the contractual service margin, ie if the group of insurance contracts becomes onerous. This remeasurement requirement is consistent with the

measurement of contract liabilities under IFRS 15, which also does not remeasure performance obligations based on changes in estimates of future cash flows unless a contract is onerous.

Other approaches considered but rejected

Not adjusting the contractual service margin for subsequent changes in the future cash flows and risk adjustment for non-financial risk

- BC225 The Board originally proposed that the contractual service margin recognised at initial recognition should not be adjusted subsequently to reflect the effects of changes in the estimates of the fulfilment cash flows. The reasons underlying that view were that:
- (a) changes in estimates during a reporting period are economic changes in the cost of fulfilling a group of insurance contracts in that period, even when they relate to future service. Recognising changes in estimates immediately in profit or loss would provide relevant information about changes in circumstances for insurance contracts.
 - (b) the contractual service margin represents an obligation to provide services that is separate from the obligation to make the payments required to fulfil the contracts. Changes in the estimates of the payments required to fulfil the contracts do not increase or decrease the obligation to provide services and consequently do not adjust the measurement of that obligation.
 - (c) there would be accounting mismatches for changes in the estimates of financial market variables, such as discount rates and equity prices, if the assets that back insurance contract liabilities were measured at fair value through profit or loss and the contractual service margin was adjusted for those changes rather than being recognised in profit or loss.
- BC226 However, many stakeholders stated that the measurement of the insurance contract liability would not provide relevant information about the unearned profit that would be recognised over the remaining coverage period if the contractual service margin were not adjusted to reflect changes in estimates made after initial recognition. Those with this view argued that it would be inconsistent to prohibit the recognition of gains on initial recognition, but then to require the subsequent recognition of gains on the basis of changes in estimates made immediately after initial recognition. The Board, persuaded by these views, accordingly decided to adjust the contractual service margin for changes in estimates of fulfilment cash flows that relate to future service.

Insurance contracts without direct participation features (paragraphs 44 and B96–B100 of IFRS 17)

- BC227 In determining which changes in estimates relate to future service, IFRS 17 distinguishes two types of insurance contracts: those without direct participation features and those with direct participation features. Insurance contracts with direct participation features are discussed in paragraphs BC238–BC269.

Time value of money and changes in assumptions relating to financial risk (paragraph B97(a) of IFRS 17)

- BC228 For insurance contracts without direct participation features, the Board concluded that changes in the effects of the time value of money and financial risk do not affect the amount of unearned profit. This is the case even if the payments to policyholders vary with returns on underlying items through a participation mechanism, for the reasons set out in paragraphs BC229–BC231. Accordingly, the entity does not adjust the contractual service margin to reflect the effects of changes in these assumptions.
- BC229 For insurance contracts without direct participation features, the underwriting result is regarded as the difference between the amount of premiums the entity charges (less any investment component) and the payments the entity makes because of the occurrence of the insured event. The insurance finance result reflects the interest arising on the group of insurance contracts because of the passage of time and the effect of changes in assumptions relating to financial risk. The statement(s) of financial performance also reflect gains and losses from the investments in which the premiums are invested. Such gains and losses would be recognised in profit or loss according to other applicable IFRS Standards.
- BC230 Thus, for insurance contracts without direct participation features, the entity's profit from financing activities arises from the difference between:

- (a) the gains (or losses) from the investments; and
 - (b) the change in the insurance contract liability depicted by the insurance finance income or expenses including the gains (or losses) the entity passes to the policyholder through any indirect participation mechanism.
- BC231 This approach to determining profit from financing activities reflects the separate accounting for the investment portfolio and the group of insurance contracts, regardless of any participation mechanism in the insurance contracts, consistent with the following:
- (a) the entity controls the cash flows of the investments, even when the entity is required to act in a fiduciary capacity for the policyholder.
 - (b) in most cases, an entity would be unlikely to have a legally enforceable right to set off the insurance contract liability with the investment portfolio, even if the investment portfolio were to be invested in assets that exactly match the entity's obligation, because the entity retains the obligation to pay the policyholders the amounts that are determined on the basis of the investments in the portfolio, irrespective of the entity's investment strategy.

Experience adjustments and changes in assumptions that do not relate to financial risk (Appendix A and paragraphs B96–B97 of IFRS 17)

- BC232 The Board decided that all changes in estimates of the liability for incurred claims relate to current or past service because they relate to coverage in previous periods.
- BC233 The Board defined experience adjustments as (a) differences between the premium receipts (and related cash flows) that were expected to happen in the period and the actual cash flows or (b) differences between incurred claims and expenses that were expected to happen in the period and the actual amounts incurred. The Board decided that for the liability for remaining coverage, in general, it was reasonable to assume that experience adjustments relate to current or past service. In contrast, changes in estimates of future cash flows in general can be assumed to relate to future service. The Board noted that experience adjustments relating to premiums received for future coverage relate to future service and are an exception to this general rule.
- BC234 The Board considered whether to establish a further exception to the general rule, for situations in which an experience adjustment directly causes a change in the estimates of the future cash flows. In some such cases, the experience adjustment and the change in the estimates of the future cash flows largely offset and adjusting the contractual service margin for only one effect might not seem an appropriate depiction of the single event. However, in other cases, the experience adjustment and the change in the estimates of the future cash flows do not offset each other and recognising the experience adjustment in profit or loss in the current period while adjusting the contractual service margin for the change in the estimates of the future cash flows appropriately depicts both effects. The Board concluded that not establishing any further exceptions to the general rule described in paragraph BC233 gave an appropriate result in most cases and avoided excessively complex requirements.
- BC235 The Board also considered the treatment of investment components. The Board did not regard as useful information, for example, the recognition of a gain for a delay in repaying an investment component accompanied by a loss that adjusts the contractual service margin for the expected later repayment. Acceleration or delay in repayments of investment components only gives rise to a gain or loss for the entity to the extent that the amount of the repayment is affected by its timing. Also, IFRS 17 does not require an entity to determine the amount of an investment component until a claim is incurred (see paragraph BC34). Accordingly, when a claim is incurred, IFRS 17 requires an entity to determine how much of that claim is an investment component, and whether it was expected to become payable that period. IFRS 17 requires any unexpected repayment of an investment component to adjust the contractual service margin. The contractual service margin will also be adjusted for changes in future estimates of cash flows which will include (but not separately identify) the reduction in future repayments of investment components. This achieves the desired result of the net effect on the contractual service margin being the effect of the change in timing of the repayment of the investment component.
- BC236 Requiring the contractual service margin to be adjusted for changes in estimates of the fulfilment cash flows but not for experience adjustments has the consequence that the accounting depends on the timing of a reporting date. To avoid IAS 34 *Interim Financial Reporting* being interpreted as requiring the recalculation of previously reported amounts, the Board decided that IFRS 17 should specifically prohibit entities from changing the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period.

Discretionary cash flows (paragraphs B98–B100 of IFRS 17)

- BC237 Insurance contracts without direct participation features often give rise to cash flows to policyholders over which the entity has some discretion regarding the amount or timing (see paragraphs BC167–BC170). IFRS 17 requires an entity to distinguish between the effect of changes in assumptions that relate to financial risks (which do not adjust the contractual service margin) and the effect of changes in discretion (which do adjust the contractual service margin). The Board noted that there are potentially many ways in which an entity could make that distinction. To ensure a consistent approach, the Board decided to require an entity to specify at the inception of a contract the basis on which it expects to determine its commitment under the contract, for example, based on a fixed interest rate, or on returns that vary based on specified asset returns.

Insurance contracts with direct participation features (the variable fee approach) (paragraphs 45 and B101–B118 of IFRS 17)

- BC238 Insurance contracts with direct participation features are insurance contracts for which, on inception:
- (a) the contractual terms specify that the policyholder participates in a 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 fair value returns from the underlying items; and
 - (c) the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items.
- BC239 The Board views these contracts as creating an obligation to pay policyholders an amount equal in value to specified underlying items, minus a variable fee for service. That fee is an amount equal to the entity's share of the fair value of the underlying items minus any expected cash flows that do not vary directly with the underlying items.
- BC240 IFRS 17 requires the contractual service margin for insurance contracts with direct participation features to be updated for more changes than those affecting the contractual service margin for other insurance contracts. In addition to the adjustments made for other insurance contracts, the contractual service margin for insurance contracts with direct participation features is also adjusted for the effect of changes in:
- (a) the entity's share of the underlying items; and
 - (b) financial risks other than those arising from the underlying items, for example the effect of financial guarantees.
- BC241 The Board decided that these differences are necessary to give a faithful representation of the different nature of the fee in these contracts. As explained in paragraphs BC228–BC231, the Board concluded that for many insurance contracts it is appropriate to depict the gains and losses on any investment portfolio related to the contracts in the same way as gains and losses on an investment portfolio unrelated to insurance contracts. However, the Board also considered a contrasting view that, for some contracts, the returns to the entity from a pool of underlying items should be viewed as the compensation that the entity charges the policyholder for service provided by the insurance contract, rather than as a share of returns from an unrelated investment. Under this contrasting view, changes in the estimate of the entity's share of returns are regarded as a change in the entity's compensation for the contract. Such changes in the entity's compensation should be recognised over the periods in which the entity provides the service promised in the contract, in the same way that changes in the estimates of the costs of providing the contract are recognised.
- BC242 In support of this view, the Board also noted that any benefit the entity receives from its share of the pool of underlying items can be regarded as a consequence of the entity holding those items to provide benefits to the policyholder. In addition, the Board also observed that the entity is often constrained when exercising its control over the underlying items because:
- (a) the quantum of underlying items is determined entirely by the premiums paid by the policyholder;
 - (b) the entity is usually expected to manage the policyholder's invested premiums for the benefit of the policyholders, acting for them in a fiduciary capacity; and
 - (c) some aspects of the entity's management of the underlying items might be specified in the contract.
- BC243 Because of these features, some believe that, in some cases, the entity's interest in the underlying items is not, in substance, the equivalent of a direct holding in assets, but is equivalent to a variable fee the entity charges the policyholder, expressed as a share of the fair value of the underlying items. When applying this view:

- (a) the entity's obligation to the policyholder is considered to be the net of:
 - (i) the obligation to pay the policyholder an amount equal to the fair value of the underlying items; and
 - (ii) a variable fee that the entity deducts in exchange for the services provided by the insurance contract.
- (b) changes in the estimate of the obligation to pay the policyholder an amount equal to the fair value of the underlying items would be recognised in profit or loss or other comprehensive income, just as would changes in the fair value of most underlying items.
- (c) changes in the estimate of the variable fee for future service and changes in estimates of the cash flows relating to future service would be accounted for consistently. Accordingly, changes in the entity's share of the underlying items would adjust the contractual service margin so that the changes would be recognised in profit or loss over the coverage period.
- (d) the financial statements of the entity report a net investment return only to the extent that the return on the assets the entity holds (if measured at fair value through profit or loss) do not match the returns on the promised underlying items.

BC244 The Board concluded that returns to the entity from underlying items should be viewed as part of the compensation the entity charges the policyholder for service provided by the insurance contract, rather than as a share of returns from an unrelated investment, in a narrow set of circumstances in which the policyholders directly participate in a share of the returns on the underlying items. In such cases, the fact that the fee for the contract is determined by reference to a share of the returns on the underlying items is incidental to its nature as a fee. The Board concluded, therefore, that depicting the gains and losses on the entity's share of the underlying items as part of a variable fee for service faithfully represents the nature of the contractual arrangement.

BC245 The Board then considered how to specify when the entity's share of underlying items is viewed as part of the variable fee for service. The Board decided the underlying items do not need to be a portfolio of financial assets. They can comprise items such as the net assets of the entity or a subsidiary within the group that is the reporting entity. The Board also decided that all the following conditions need to be met:

- (a) the contract specifies a determinable fee. For this to be the case, the contract needs to specify that the policyholder participates in a share of a clearly identified pool of underlying items. Without a determinable fee, which can be expressed as a percentage of portfolio returns or portfolio asset values rather than only as a monetary amount, the share of returns on the underlying items the entity retains would be entirely at the discretion of the entity, and, in the Board's view, this would not be consistent with that amount being equivalent to a fee.
- (b) the entity's primary obligation is to pay to the policyholder an amount equal to the fair value of the underlying items. For this to be the case:
 - (i) the entity should expect to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items. It would not be a faithful representation to depict an obligation to pay an amount equal to the fair value of the underlying items if the policyholder does not expect to receive a substantial part of the fair value returns on the underlying items.
 - (ii) the entity should expect a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items. It would not be a faithful representation to depict an obligation to pay an amount equal to the fair value of the underlying items if the entity were not to expect changes in the amount to be paid to vary with the change in fair value of the underlying items.

BC246 The Board used these conditions to define insurance contracts with direct participation features as described in paragraph BC238. The Board also decided that the entity need not hold the underlying items, because the measurement of insurance contracts should not depend on what assets the entity holds. The Board extended the adjustments to the contractual service margin as described in paragraphs BC239–BC240 to reflect the view that the entity's share of underlying items is part of the variable fee for service. In such cases, variability in the fee is driven by changes in assumptions relating to financial risk. Therefore, the Board decided that it is also appropriate to regard as part of the fee the effect of changes in assumptions relating to financial risk on the fulfilment cash flows that do not vary based on returns on the underlying items.

BC247 Hence, the additional adjustments to the contractual service margin described in paragraph BC246 are caused by changes in assumptions related to financial risk. However, the contractual service margin is adjusted only to the extent that it does not become negative. Beyond that, the changes in assumptions cause a gain or loss to be recognised in the statement(s) of financial performance. The Board considered whether

such gains and losses should be included as losses on groups of onerous contracts in insurance service result or as insurance finance income or expenses. The Board concluded that the former provided information that was consistent with the treatment of such changes as being part of the variable fee for service.

- BC248 For reinsurance contracts an entity holds, the entity and the reinsurer do not share in the returns on underlying items, and so the criteria in paragraph BC238 are not met, even if the underlying insurance contracts issued are insurance contracts with direct participation features. The Board considered whether it should modify the scope of the variable fee approach to include reinsurance contracts held, if the underlying insurance contracts issued are insurance contracts with direct participation features. But such an approach would be inconsistent with the Board's view that a reinsurance contract held should be accounted for separately from the underlying contracts issued.
- BC249 Although some types of reinsurance contracts issued might meet the criteria in paragraph BC238, the Board decided that reinsurance contracts issued are not eligible for the variable fee approach. This is because the view that the returns to the entity from a pool of underlying items should be viewed as part of the compensation that the entity charges the policyholder for the service provided by the insurance contract (see paragraph BC241) does not apply to reinsurance contracts issued.

Effect of risk mitigation (paragraphs B115–B118 of IFRS 17)

- BC250 Amounts payable to policyholders create risks for an entity, particularly if the amounts payable are independent of the amounts that the entity receives from investments; for example, if the insurance contract includes guarantees. An entity is also at risk from possible changes in its share of the fair value returns on underlying items. An entity may purchase derivatives to mitigate such risks. When applying IFRS 9, such derivatives are measured at fair value.
- BC251 For contracts without direct participation features, the contractual service margin is not adjusted for the changes in fulfilment cash flows the derivatives are intended to mitigate. Hence, both the change in the carrying amount of fulfilment cash flows and the change in the value of the derivative will be recognised in the statement(s) of financial performance. If the entity chooses to recognise all insurance finance income or expenses in profit or loss, there will be no accounting mismatch between the recognition of the change in the value of the derivative and the recognition of the change in the carrying amount of the insurance contract.
- BC252 However, for contracts with direct participation features the contractual service margin would be adjusted for the changes in the fulfilment cash flows, including changes that the derivatives are intended to mitigate. Consequently, the change in the value of the derivative would be recognised in profit or loss, but, unless the group of insurance contracts was onerous, there would be no equivalent change in the carrying amount to recognise, creating an accounting mismatch.
- BC253 A similar accounting mismatch arises if the entity uses derivatives to mitigate risk arising from its share of the fair value return on underlying items.
- BC254 The Board concluded that, to avoid such accounting mismatches created by the variable fee approach, an entity should be allowed not to adjust the contractual service margin for the changes in the fulfilment cash flows and the entity's share in the fair value return on the underlying items that the derivatives are intended to mitigate.
- BC255 Such an option reduces the comparability of the measurement of insurance contracts because the contractual service margin will be adjusted by a different amount depending on whether, and the extent to which, an entity chooses to apply this approach. To limit the reduction in comparability, the Board decided that an entity may make this choice only to the extent that, in accordance with a previously documented risk management objective and strategy for using derivatives to mitigate financial market risk arising from those fulfilment cash flows:
- (a) the entity uses a derivative to mitigate the financial risk arising from the group of insurance contracts.
 - (b) an economic offset exists between the group of insurance contracts and the derivative, ie the values of the group of insurance contracts and the derivative generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated. An entity does not consider accounting measurement differences in assessing the economic offset.
 - (c) credit risk does not dominate the economic offset.
- BC256 The Board considered an alternative approach to reducing accounting mismatches arising from such derivatives. This approach would have allowed an entity to recognise in profit or loss the change in fair value of a hypothetical derivative that matches the critical terms of the specified fulfilment cash flows or the entity's share of the fair value return on the underlying items. This might have resulted in a greater

reduction in accounting mismatches, because a fair value measurement would have been used in profit or loss for both the ‘hedged’ fulfilment cash flows and the ‘hedging’ derivative, relative to the measurement being used for the fulfilment cash flows under IFRS 17. However, the Board concluded that such an approach would involve too much additional complexity.

Complexity

- BC257 Treating insurance contracts with direct participation features differently from insurance contracts without direct participation features adds complexity for preparers and users of financial statements. Preparers have to determine the category in which their insurance contracts belong, and users need to understand the implications of the different accounting requirements. The Board noted that the measurement of the fulfilment cash flows is the same for both types of contract, and the differences are limited to the treatment of the contractual service margin. The Board was persuaded that those differences are necessary to provide a faithful representation of the different nature of the types of contract.

Other approaches considered but rejected

Adjusting the contractual service margin by changes in the carrying amount of underlying items for all contracts

- BC258 Some stakeholders advocated adjusting the contractual service margin for changes in the carrying amount of underlying items whenever the insurance contracts require the amounts paid to policyholders to vary with returns on underlying items. However, the Board rejected that broad application of the variable fee concept, after deciding that it is useful only for insurance contracts that are substantially investment-related service contracts.

A ‘mirroring’ approach

- BC259 In the 2013 Exposure Draft, the Board proposed a ‘mirroring approach’ for the measurement and presentation of contracts that require an entity to hold underlying items and that specify a link to returns on those underlying items. The essence of the mirroring approach was that, to the extent that an entity expects to settle fulfilment cash flows payable to policyholders with assets or other underlying items it holds, the entity would measure those fulfilment cash flows just as it measures the underlying items. Similarly, an entity would recognise changes in fulfilment cash flows subject to the mirroring approach (those that are expected to vary directly with returns on underlying items) in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of the underlying items. All other cash flows would be measured using the general requirements.
- BC260 Mirroring would have eliminated accounting, but not economic, mismatches between the cash flows from an insurance contract and underlying items when the terms of the contract mean that the entity will not suffer any economic mismatches. However, not all cash flows in an insurance contract will vary directly with returns on underlying items.
- BC261 Many stakeholders endorsed the Board’s intention to eliminate accounting mismatches for some participating contracts. However, many criticised the Board’s approach as being unduly complex and questioned whether the proposals could be made workable. In particular, many stakeholders stated that it would be difficult for entities to separate and measure separately the different components of the insurance contract. Some suggested that any decomposition of interrelated cash flows would be arbitrary and that separate measurement would lead to different valuations of an insurance contract depending on arbitrary decisions.
- BC262 Many stakeholders were also concerned because the mirroring proposals would mean that the measurement outcome for some participating contracts would differ markedly from the measurement outcome for other insurance contracts based on only subtle differences in the characteristics of the contracts. In addition, some preparers and regulators were concerned that when the underlying items are measured at cost, the carrying value of the insurance contract would not be a current value. As a result, mirroring would widen the difference between the liability measured for financial reporting purposes and the liability recognised for regulatory purposes.
- BC263 Given this feedback, the Board rejected the mirroring approach and developed the variable fee approach instead.

Insurers that are mutual entities

- BC264 Some stakeholders supported the mirroring approach particularly for insurers that are mutual entities. They argued that mirroring was necessary for such insurers because the effect of accounting mismatches between assets that cannot be measured at fair value and fulfilment cash flows measured at current value can have a particularly significant effect on their reported financial position and financial performance.
- BC265 A defining feature of an insurer that is a mutual entity is that the most residual interest of the entity is due to a policyholder and not a shareholder. When applying IFRS 17, payments to policyholders form part of the fulfilment cash flows regardless of whether those payments are expected to be made to current or future policyholders. Thus, the fulfilment cash flows of an insurer that is a mutual entity generally include the rights of policyholders to the whole of any surplus of assets over liabilities. This means that, for an insurer that is a mutual entity, there should, in principle, normally be no equity remaining and no net comprehensive income reported in any accounting period.
- BC266 However, there may be accounting mismatches between the measurement of insurance contracts and the measurement of the other net assets of an insurer that is a mutual entity. Insurance contracts are measured at current value, which, for an insurer that is a mutual entity, incorporates information about the fair value of the other assets and liabilities of the entity. Many of these other assets and liabilities are not required to be measured at fair value in applying IFRS Standards; for example, amortised cost financial assets, deferred tax balances, goodwill in subsidiaries and pension scheme surpluses and deficits. Furthermore, the carrying amounts of assets that are not measured at fair value are more likely to be measured at a value lower rather than higher than fair value because of requirements to recognise impairments.
- BC267 Hence, when liabilities are measured in applying IFRS 17, insurers that are mutual entities might report liabilities greater than recognised assets in their financial statements, even though those entities are solvent for regulatory purposes and economically have no equity (rather than negative equity). To prevent insurers that are mutual entities from reporting negative equity, some stakeholders suggested that the mirroring approach be retained for such entities to eliminate or reduce the effect of accounting mismatches.
- BC268 However, the Board noted that one consequence of retaining the mirroring approach for insurers that are mutual entities would be that an identical insurance contract would be measured on a different basis only because it was issued by an insurer that is a mutual entity. Comparability across entities is enhanced if economically similar products are accounted for in a similar way regardless of the legal form of the entity holding or issuing the product. In addition, the Board noted that applying the mirroring approach would mean that part of the fulfilment cash flows of an insurer that is a mutual entity would not be measured at current value, which was a major concern about the mirroring approach for some regulators (see paragraph BC262). Hence, the Board concluded that it should not retain the mirroring approach for insurers that are mutual entities.
- BC269 The Board noted that to provide useful information about its financial position and financial performance, an insurer that is a mutual entity can distinguish:
- (a) in the statement of financial position, the liability attributable to policyholders in their capacity as policyholders from the liability attributable to policyholders with the most residual interest in the entity; and
 - (b) in the statement(s) of financial performance, the income or expenses attributable to policyholders in their capacity as policyholders before determination of the amounts attributable to policyholders with the most residual interest in the entity.

Insurance finance income or expenses on the contractual service margin (paragraphs 44(b) and 45(b) of IFRS 17)

- BC270 IFRS 17 requires an entity to adjust the contractual service margin for a financing effect. The contractual service margin is one part of an overall measure of insurance contracts, and including in it a financing effect is consistent with the measurement of the other part (the fulfilment cash flows), which is adjusted for the time value of money and the effect of financial risks. Some argued that the contractual service margin should not be adjusted for a financing effect on the grounds of simplicity and because they view the contractual service margin as being a deferred credit rather than a representation of a component of an obligation. However, adjusting the contractual service margin for a financing effect is consistent with IFRS 15.
- BC271 The way in which a financing effect is included in the contractual service margin differs between insurance contracts without direct participation features and insurance contracts with direct participation features.

- BC272 For insurance contracts without direct participation features, IFRS 17 requires an entity to calculate interest on the contractual service margin. In the Board’s view, on initial recognition the contractual service margin can be viewed as an allocation of part of the transaction price, which is the consideration paid or payable by the policyholder. Calculating interest on the contractual service margin is consistent with IFRS 15, which requires an entity to adjust the promised consideration to reflect the time value of money if the contract has a significant financing component. As a result of that adjustment, the transaction price would reflect the amount the customer would pay in cash for the promised good or service when they receive the good or service. Consequently, an entity would recognise revenue at an amount that corresponds to the cash selling price of the good or service, with the effects of the financing presented separately from revenue (as interest expense or interest income).
- BC273 Because the contractual service margin is measured at initial recognition of the group of insurance contracts, the Board decided that the interest rate used to accrete interest on the contractual service margin for insurance contracts without direct participation features should be locked in at initial recognition and not adjusted subsequently. The Board also decided, for the sake of simplicity, that the rate should be a rate applicable to nominal cash flows that do not vary based on asset returns. Locking in the rate is consistent with the determination of the contractual service margin on initial recognition and making no adjustments for changes in assumptions relating to financial risk.
- BC274 Some stakeholders argued that interest should be accreted at a current rate on the grounds that the current rate would be consistent with the measurement of the fulfilment cash flows. Also, a locked-in rate requires information about historical rates that would not otherwise be needed for entities not using the option to include insurance finance income or expenses in profit or loss using a systematic allocation (see paragraphs BC42–BC44). However, the Board noted that accreting interest on the contractual service margin for an accounting period at a current rate differs from measuring cash flows at a current rate. The contractual service margin does not represent future cash flows; it represents the unearned profit in the contract, measured at the point of initial recognition and adjusted only for specified amounts. For insurance contracts without direct participation features, the contractual service margin is not adjusted (remeasured) for changes in interest rates for the reasons set out in paragraphs BC228–BC231. Accreting interest for a period at a current rate without also remeasuring the contractual service margin at the start of the period would create an internally inconsistent measurement of the contractual service margin.
- BC275 For insurance contracts without direct participation features, IFRS 17 requires the contractual service margin to be adjusted for changes in estimates of future cash flows that relate to future service. When measuring the fulfilment cash flows, these changes in estimates are measured consistently with all other aspects of the fulfilment cash flows using a current discount rate. However, the contractual service margin is determined using the discount rate that applies on initial recognition. To make the contractual service margin internally consistent, the Board decided that the adjustments for changes in estimates of future cash flows also need to be measured at the rate that applied on initial recognition. This leads to a difference between the change in the fulfilment cash flows and the adjustment to the contractual service margin—the difference between the change in the future cash flows measured at a current rate and the change in the future cash flows measured at the rate that had applied on initial recognition. That difference gives rise to a gain or loss that is included in profit or loss or other comprehensive income, depending on the accounting policy choice an entity makes for the presentation of insurance finance income or expenses.
- BC276 For insurance contracts with direct participation features, IFRS 17 requires an entity to remeasure the contractual service margin for the entity’s share in the change in the fair value of the underlying items. The remeasurement of the contractual service margin reflects current rates and changes in the value of the consideration received. Remeasuring the contractual service margin in this way is consistent with the view that the entity is earning a variable fee from the contract—the amount it deducts from its obligation to return the value of underlying items to the policyholder (see paragraphs BC238–BC247). A consequence of this is that insurance revenue includes changes in the entity’s share in the change in the fair value of the underlying items. As set out in paragraphs B121–B124 of IFRS 17, insurance revenue includes the amount of contractual service margin allocated to the period for services provided in the period. The allocation of the contractual service margin amount is based on the remeasured contractual service margin. Insurance revenue for the period is therefore also based on that remeasured amount. The Board decided this appropriately reflects the variable nature of the fee for such contracts.

Foreign currency (paragraph 30 of IFRS 17)

- BC277 When applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*, the fulfilment cash flows are clearly monetary items. However, the contractual service margin component might be classified as non-monetary because it is similar to prepayments for goods and services. The Board decided that it would be simpler to treat all components of the measurement of an insurance contract denominated in a single currency as either monetary or non-monetary. Because the measurement in IFRS 17 is largely based on

estimates of future cash flows, the Board concluded that it is more appropriate to view an insurance contract as a whole as a monetary item.

- BC278 Accordingly, IFRS 17 requires an insurance contract to be treated as a monetary item for foreign currency translation in applying IAS 21. This applies for both the fulfilment cash flows and the contractual service margin. The Board's conclusion that the insurance contract is a monetary item does not change if an entity measures a group of insurance contracts using the simplified approach for the measurement of the liability for remaining coverage.

Recognition in profit or loss (paragraphs 44(e), 45(e) and B119 of IFRS 17)

- BC279 As discussed in paragraph BC21, the Board views the contractual service margin as depicting the unearned profit for coverage and other services provided over the coverage period. Insurance coverage is the defining service provided by insurance contracts. The Board noted that an entity provides this service over the whole of the coverage period, and not just when it incurs a claim. Consequently, IFRS 17 requires the contractual service margin to be recognised over the coverage period in a pattern that reflects the provision of coverage as required by the contract. To achieve this, the contractual service margin for a group of insurance contracts remaining (before any allocation) at the end of the reporting period is allocated over the coverage provided in the current period and expected remaining future coverage, on the basis of coverage units, reflecting the expected duration and quantity of benefits provided by contracts in the group. The Board considered whether:
- (a) the contractual service margin should be allocated based on the pattern of expected cash flows or on the change in the risk adjustment for non-financial risk caused by the release of risk. However, the Board decided the pattern of expected cash flows and the release of the risk adjustment for non-financial risk are not relevant factors in determining the satisfaction of the performance obligation of the entity. They are already included in the measurement of the fulfilment cash flows and do not need to be considered in the allocation of the contractual service margin. Hence, the Board concluded that coverage units better reflect the provision of insurance coverage.
 - (b) the contractual service margin should be allocated before any adjustments made because of changes in fulfilment cash flows that relate to future service. However, the Board concluded that allocating the amount of the contractual service margin adjusted for the most up-to-date assumptions provides the most relevant information about the profit earned from service provided in the period and the profit to be earned in the future from future service.
- BC280 The Board considered whether the allocation of the contractual service margin based on coverage units would result in profit being recognised too early for insurance contracts with fees determined based on the returns on underlying items. For such contracts, IFRS 17 requires the contractual service margin to be determined based on the total expected fee over the duration of the contracts, including expectations of an increase in the fee because of an increase in underlying items arising from investment returns and additional policyholder contributions over time. The Board rejected the view that the allocation based on coverage units results in premature profit recognition. The Board noted that the investment component of such contracts is accounted for as part of the insurance contract only when the cash flows from the investment component and from insurance and other services are highly interrelated and hence cannot be accounted for as distinct components. In such circumstances, the entity provides multiple services in return for an expected fee based on the expected duration of contracts, and the Board concluded the entity should recognise that fee over the coverage period as the insurance services are provided, not when the returns on the underlying items occur.
- BC281 The Board also considered a proposal to constrain the amount of contractual service margin recognised in an accounting period just as IFRS 15 constrains the recognition of revenue. The approach would have constrained the cumulative amount of the contractual service margin that the entity recognised in profit or loss to the amount to which the entity is reasonably assured to be entitled. However, in the Board's view, it would be inconsistent with other aspects of IFRS 17 to constrain the amount of contractual service margin on a 'reasonably assured' basis. IFRS 17 requires a current measurement model based on a probability-weighted average of all possible scenarios and the contractual service margin depicts a current view of the unearned profit relating to services consistent with that measurement model.
- BC282 IFRS 17 requires the contractual service margin remaining at the end of the reporting period to be allocated equally to the coverage units provided in the period and the expected remaining coverage units. IFRS 17 does not specify whether an entity should consider the time value of money in determining that equal allocation and consequently does not specify whether that equal allocation should reflect the timing of the

expected provision of the coverage units. The Board concluded that should be a matter of judgement by an entity.

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

Onerous contracts (paragraphs 47–52 of IFRS 17)

- BC284 The contractual service margin represents the unearned profit arising from a group of insurance contracts. IFRS 17 prohibits the contractual service margin from becoming negative (except in relation to reinsurance contracts held) because the Board decided that expected losses on groups of insurance contracts should be recognised immediately in profit or loss. Doing so provides timely information about loss-making groups of insurance contracts, and is consistent with the recognition of losses for onerous contracts in accordance with IFRS 15 and IAS 37.
- BC285 After an entity recognises a loss for a group of onerous contracts, there may subsequently be favourable changes in the estimates of the fulfilment cash flows relating to future service. The Board considered whether such changes should be recognised in profit or loss to the extent that they reverse previously recognised losses or whether the changes should adjust, or rebuild, the contractual service margin. In the 2013 Exposure Draft, the Board proposed that the changes adjust the contractual service margin, rather than being recognised in profit or loss, because of the complexity in assessing the extent to which the favourable changes reverse previous losses. However, some stakeholders stated that it would be counterintuitive to rebuild a contractual service margin for future profit from contracts that were considered loss-making overall.
- BC286 The Board noted that, under the proposals in the 2013 Exposure Draft, the determination of insurance revenue required entities to exclude losses for groups of onerous contracts (see paragraph BC35). Subsequent changes in the fulfilment cash flows that relate to the losses for groups of onerous contracts would also need to be excluded from insurance revenue, otherwise insurance revenue would be understated or overstated. Hence, the Board decided that some tracking of the loss component of the liability for remaining coverage would be needed. Further, the Board concluded that the complexity added by requiring this tracking was outweighed by the benefits of the more faithful representation of performance that would be provided to users of financial statements if the effect of favourable changes were recognised in profit or loss to the extent that they reverse losses previously recognised in profit or loss. Accordingly, IFRS 17 requires that, to the extent that favourable changes in the estimates of the fulfilment cash flows relating to future service reverse losses previously recognised in profit or loss, the changes should also be recognised in profit or loss.
- BC287 The Board considered whether to require specific methods to track the loss component, but concluded that any such methods would be inherently arbitrary. The Board therefore decided to require an entity to make a systematic allocation of changes in the fulfilment cash flows for the liability for remaining coverage that could be regarded as affecting either the loss component or the rest of the liability.

Premium allocation approach (paragraphs 53–59 of IFRS 17)

- BC288 IFRS 17 allows an entity to simplify the measurement of some groups of insurance contracts by applying a premium allocation approach.
- BC289 The premium allocation approach permitted in IFRS 17 is similar to the customer consideration approach in IFRS 15. In the premium allocation approach, the initial measurement of the liability equals the premium received, and unless the group of insurance contracts is onerous, the entity does not identify explicitly the components otherwise used in IFRS 17 to build the measurement of the insurance contract, ie the estimate of future cash flows, the time value of money and the effects of risk. Nevertheless, that initial measurement can be described as containing the components that build the measurement of the group of insurance contracts implicitly, as follows:
- (a) an estimate of the future cash flows, made at initial recognition;
 - (b) the effect of the time value of money and of financial risks, measured at initial recognition;
 - (c) the effect of non-financial risk, measured at initial recognition; and

- (d) a contractual service margin, if any, measured at initial recognition.
- BC290 Subsequently, the liability for remaining coverage is recognised over the coverage period on the basis of the passage of time unless the expected pattern of release from risk differs significantly from the passage of time, in which case it is recognised based on the expected timing of incurred claims and benefits.
- BC291 The Board decided that an entity should be permitted, but not required, to apply the premium allocation approach when that approach provides a reasonable approximation to the general requirements of IFRS 17. The Board views the premium allocation approach as a simplification of those general requirements. To simplify its application, the Board also decided to provide guidance that an entity could assume, without further investigation, that the approach provides a reasonable approximation of the general requirements of IFRS 17 if the coverage period of each contract in the group is one year or less.
- BC292 To keep the approach simple, the Board decided that entities:
- (a) should accrete interest on the liability for remaining coverage only for groups of insurance contracts that have a significant financing component. When the period between premiums being due and the provision of coverage is one year or less, the group is deemed not to have a significant financing component.
 - (b) need to assess whether groups of insurance contracts are onerous only when facts and circumstances indicate that a group of insurance contracts has become onerous.
 - (c) are permitted to recognise all insurance acquisition cash flows as an expense when incurred for groups of insurance contracts each with a coverage period of one year or less.
- BC293 The premium allocation approach measures the group of insurance contracts using estimates made at initial recognition and does not update those estimates in the measurement of the liability for remaining coverage unless the group is or becomes onerous. Accordingly, IFRS 17 requires that entities, when accreting interest on the liability for remaining coverage, set the discount rate when the group is initially recognised.
- BC294 IFRS 17 also allows a simplification for the measurement of the liability for incurred claims—an entity need not discount claims that are expected to be paid within one year. The Board concluded that no other simplifications were needed for the measurement of the liability for incurred claims because it comprises only the fulfilment cash flows for settling the incurred claims and expenses, with no contractual service margin. However, in considering how to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income (see paragraphs BC42–BC44), the Board considered requiring the interest expense for the liability for incurred claims to be measured using either:
- (a) the discount rate at initial recognition of the contract; or
 - (b) the discount rate at the date the claims included in the liability for incurred claims occur.
- BC295 In the 2013 Exposure Draft, the Board proposed using the discount rate at initial recognition to achieve consistency with the measurement of the liability for remaining coverage. However, both preparers and users of financial statements expressed the view that using the discount rate at the date the claim was incurred would be less complex than using the rate at the inception of the contract. The liability for incurred claims is zero when the group of insurance contracts is initially recognised and the entity may not have determined a discount rate at that time. The Board concluded that the premium allocation approach, which was developed as a simplification, should not burden entities by creating high costs and operational complexity. Consequently, IFRS 17 requires that entities measure the interest expense for the liability for incurred claims using the rate that applied when the liability for incurred claims was initially recognised, rather than when the group of insurance contracts was initially recognised.

Reinsurance contracts (paragraphs 60–70 of IFRS 17)

- BC296 A reinsurance contract is a type of insurance contract. The Board identified no reason to apply different requirements to reinsurance contracts from those applied to other insurance contracts an entity issues. Consequently, IFRS 17 requires entities that issue reinsurance contracts to use the same recognition and measurement approach as they use for other insurance contracts.
- BC297 Although both an issuer of direct insurance contracts and a reinsurer of those contracts will measure their contractual rights and obligations on the same basis, in practice they will not necessarily arrive at the same amount. Differences between the estimates for the reinsurance contract and the underlying contracts may arise because the issuer of the underlying insurance contracts and the reinsurer may base estimates on access to different information; they may also make different adjustments for diversification effects.
- BC298 IFRS 17 also applies to reinsurance contracts held by an entity (ie in which the entity is the policyholder). IFRS 17 requires a reinsurance contract held to be accounted for separately from the underlying insurance

contracts to which it relates. This is because an entity that holds a reinsurance contract does not normally have a right to reduce the amounts it owes to the underlying policyholder by amounts it expects to receive from the reinsurer. The Board acknowledged that separate accounting for the reinsurance contracts and their underlying insurance contracts might create mismatches that some regard as purely accounting, for example on the timing of recognition (see paragraphs BC304–BC305), the measurement of the reinsurance contracts (see paragraphs BC310–BC312) and the recognition of profit (see paragraph BC313). However, the Board concluded that accounting for a reinsurance contract held separately from the underlying insurance contracts gives a faithful representation of the entity's rights and obligations and the related income and expenses from both contracts.

- BC299 The amount an entity pays for reinsurance coverage consists of premiums the entity pays minus any amounts paid by the reinsurer to the entity to compensate the entity for expenses it incurs, such as underwriting or acquisition expenses (often referred to as 'ceding commissions'). The amount paid for reinsurance coverage by the entity can be viewed as payment for the following:
- (a) the reinsurer's share of the expected present value of the cash flows generated by the underlying insurance contract(s). That amount includes an adjustment for the risk that the reinsurer may dispute coverage or fail to satisfy its obligations under the reinsurance contract held.
 - (b) a contractual service margin that makes the initial measurement of the reinsurance asset equal to the premium paid. This margin depends on the pricing of the reinsurance contract held and, consequently, may differ from the contractual service margin arising for the underlying insurance contract(s).
- BC300 When estimating cash flows and the associated adjustments for the financial risk and the time value of money arising from reinsurance contracts held, the entity would use assumptions consistent with those it uses for the underlying contracts. As a result, the cash flows used to measure the reinsurance contracts held would reflect the extent to which those cash flows depend on the cash flows of the contracts they cover.
- BC301 Consistent with the requirements for the measurement of insurance contracts an entity issues, the entity also may apply the premium allocation approach to simplify the measurement of reinsurance contracts held, provided that the resulting measurement is a reasonable approximation of the results that would be obtained by applying the general requirements of IFRS 17. The entity may also apply the premium allocation approach if the coverage period of each reinsurance contract held in the group is one year or less. Because groups of reinsurance contracts are separate from the groups of underlying insurance contracts, the assessment of whether a group of reinsurance contracts meets conditions for applying the premium allocation approach may differ from the assessment of whether the group(s) of underlying insurance contracts meet(s) those conditions.
- BC302 IFRS 17 modifies the requirements for reinsurance contracts held to reflect the fact that:
- (a) groups of reinsurance contracts held are generally assets, rather than liabilities; and
 - (b) entities holding reinsurance contracts generally pay a margin to the reinsurer as an implicit part of the premium, rather than making profits from the reinsurance contracts.
- BC303 The following paragraphs discuss aspects of the general principles in IFRS 17 in relation to groups of reinsurance contracts held:
- (a) recognition for groups of reinsurance contracts held (see paragraphs BC304–BC305);
 - (b) derecognition (see paragraph BC306);
 - (c) cash flows (see paragraphs BC307–BC309); and
 - (d) contractual service margin (see paragraphs BC310–BC315).

Recognition for groups of reinsurance contracts held (paragraph 62 of IFRS 17)

- BC304 Many reinsurance arrangements are designed to cover the claims incurred under underlying insurance contracts written during a specified period. In some cases, the reinsurance contract held covers the losses of separate contracts on a proportionate basis. In other cases, the reinsurance contract held covers aggregate losses from a group of underlying contracts that exceed a specified amount.
- BC305 The Board decided to simplify the application of the principle that a contract should be recognised from the date the entity is exposed to risk for reinsurance contracts as follows:
- (a) when the group of reinsurance contracts held covers the loss of a group of insurance contracts on a proportionate basis, the group of reinsurance contracts held is recognised at the later of the

beginning of the coverage period of the group of reinsurance contracts held or the initial recognition of any underlying contracts. This means that the entity will not recognise the group of reinsurance contracts until it has recognised at least one of the underlying contracts.

- (b) when the group of reinsurance contracts held covers aggregate losses arising from a group of insurance contracts over a specified amount, the group of reinsurance contracts held is recognised when the coverage period of the group of reinsurance contracts begins. In these contracts the entity benefits from coverage—in case the underlying losses exceed the threshold—from the beginning of the group of reinsurance contracts held because such losses accumulate throughout the coverage period.

Derecognition of underlying contracts (paragraphs 74–75 of IFRS 17)

- BC306 An entity does not derecognise an insurance contract until the contractual obligations are extinguished by discharge, cancellation or expiry (or on specified modifications of the contract). A reinsurance contract held typically protects the entity from the effects of some defined losses on the underlying group of insurance contracts, but does not eliminate the entity's responsibility for fulfilling its obligations under those contracts. It follows that the entity typically would not derecognise the related underlying insurance contracts upon entering into a reinsurance contract.

Cash flows in reinsurance contracts held (paragraph 63 of IFRS 17)

- BC307 As required by paragraph 63 of IFRS 17, cash flows for a group of reinsurance contracts held should be estimated using assumptions that are consistent with those used for the group(s) of underlying insurance contracts. In addition, IFRS 17 requires entities to reflect expected credit losses in the measurement of the fulfilment cash flows. This is discussed in paragraphs BC308–BC309.
- BC308 An entity holding reinsurance contracts faces the risk that the reinsurer may default, or may dispute whether a valid claim exists for an insured event. IFRS 17 requires the estimates of expected credit losses to be based on expected values. Hence, estimates of the amounts and timing of cash flows are probability-weighted outcomes after calculating the effect of credit losses.
- BC309 IFRS 17 prohibits changes in expected credit losses adjusting the contractual service margin. In the Board's view, differences in expected credit losses do not relate to future service. Accordingly, any changes in expected credit losses are economic events that the Board decided should be reflected as gains and losses in profit or loss when they occur. This would result in consistent accounting for expected credit losses between reinsurance contracts held and purchased, and originated credit-impaired financial assets accounted for in accordance with IFRS 9.

Gains and losses on buying reinsurance (paragraph 65 of IFRS 17)

- BC310 The amount paid by the entity to buy reinsurance contracts would typically exceed the expected present value of cash flows generated by the reinsurance contracts held, plus the risk adjustment for non-financial risk. Thus, a debit contractual service margin, which represents the net expense of purchasing reinsurance, would typically be recognised on the initial recognition of a group of reinsurance contracts held. The Board considered whether the contractual service margin of the group of reinsurance contracts held could be a credit if, as happens in rare cases, the amount paid by the entity is less than the expected present value of cash flows plus the risk adjustment for non-financial risk. Such a credit contractual service margin would represent a net gain on purchasing reinsurance. The most likely causes of such a net gain would be either of the following:
- (a) an overstatement of the underlying insurance contract(s). An entity would evaluate this by reviewing the measurement of the underlying insurance contract(s).
- (b) favourable pricing by the reinsurer; for example, as a result of diversification benefits that are not available to the entity.
- BC311 The Board originally proposed that entities should recognise a gain when such a negative difference arose. The Board proposed this for symmetry with the model for the underlying group of insurance contracts and for consistency with the Board's conclusion that the contractual service margin for the underlying group of insurance contracts should not be negative. However, IFRS 17 requires entities to instead recognise the

negative difference over the coverage period of the group of reinsurance contracts held. The Board was persuaded by the view that the apparent gain at initial recognition represents a reduction in the cost of purchasing reinsurance, and that it would be appropriate for an entity to recognise that reduction in cost over the coverage period as services are received.

- BC312 The Board also decided that the net expense of purchasing reinsurance should be recognised over the coverage period as services are received unless the reinsurance covers events that have already occurred. For such reinsurance contracts held, the Board concluded that entities should recognise the whole of the net expense at initial recognition, to be consistent with the treatment of the net expense of purchasing reinsurance before an insured event has occurred. The Board acknowledged that this approach does not treat the coverage period of the reinsurance contract consistently with the view that for some insurance contracts the insured event is the discovery of a loss during the term of the contract, if that loss arises from an event that had occurred before the inception of the contract. However, the Board concluded that consistency of the treatment of the net expense across all reinsurance contracts held would result in more relevant information.
- BC313 The Board considered the view that the amount of the contractual service margin included in the measurement of the group of reinsurance contracts held should be proportional to the contractual service margin on the group of underlying contracts instead of being measured separately by reference to the reinsurance premium. Under this approach, any difference between the amount recognised for the group of underlying insurance contracts and the reinsurance premium would be recognised in profit or loss when the group of reinsurance contracts held is initially recognised. This approach would depict a gain or loss equal to the shortfall or excess of the reinsurance premium the entity pays to the reinsurer above or below the premium that the entity receives from the policyholder. Thereafter, unearned profit from the group of underlying contracts would be offset by an equal and opposite expense for the reinsurance premium. However, in the Board's view, measuring the group of reinsurance contracts held on the basis of the premium the entity receives for the underlying contracts when that premium does not directly affect the cash flows arising from the group of reinsurance contracts held would be contrary to viewing the group of reinsurance contracts held and the underlying contracts as separate contracts. Such a measurement approach would also not reflect the economics of the group of reinsurance contracts the entity holds—that the expense of purchasing the group of reinsurance contracts (that should be recognised over the coverage period) equals the whole of the consideration paid for the group of reinsurance contracts.
- BC314 For the measurement of the group of insurance contracts the entity issues, IFRS 17 specifies that the contractual service margin can never be negative. IFRS 17 does not include a limit on the amount by which the contractual service margin of a group of reinsurance contracts held could be adjusted as a result of changes in estimates of cash flows. In the Board's view, the contractual service margin for a group of reinsurance contracts held is different from that for a group of insurance contracts issued—the contractual service margin for the group of reinsurance contracts held depicts the expense the entity incurs when purchasing reinsurance coverage rather than the profit it will make by providing services under the insurance contract. Accordingly, the Board placed no limit on the amount of the adjustment to the contractual service margin for the group of reinsurance contracts held, subject to the amount of premium paid to the reinsurer.
- BC315 The Board considered the situation that arises when the underlying group of insurance contracts becomes onerous after initial recognition because of adverse changes in estimates of fulfilment cash flows relating to future service. In such a situation, the entity recognises a loss on the group of underlying insurance contracts. The Board concluded that corresponding changes in cash inflows from a group of reinsurance contracts held should not adjust the contractual service margin of the group of reinsurance contracts held, with the result that the entity recognises no net effect of the loss and gain in the profit or loss for the period. This means that, to the extent that the change in the fulfilment cash flows of the group of underlying contracts is matched with a change in fulfilment cash flows on the group of reinsurance contracts held, there is no net effect on profit or loss.

Modification and derecognition (paragraphs 72–77 of IFRS 17)

- BC316 Paragraph B25 of IFRS 17 states that a contract that qualifies as an insurance contract remains an insurance contract until all rights and obligations are extinguished. An obligation is extinguished when it has expired or has been discharged or cancelled. However, in some cases, an entity may modify the terms of an existing contract in a way that would have significantly changed the accounting of the contract if the new terms had always existed. IFRS 17 specifies different requirements for these and other modifications. In some cases, insurance contract modifications will result in derecognising the insurance contract.

Modifications that would have resulted in significantly different accounting for the contract (paragraphs 72, 76 and 77 of IFRS 17)

- BC317 A modification of an insurance contract amends the original terms and conditions of the contract (for example, extending or shortening the coverage period or increasing the benefits in return for higher premiums). It differs from a change arising from either party to the contract exercising a right that is part of the original terms and conditions of the contract. If an insurance contract modification meets specific criteria (see paragraph 72 of IFRS 17), the contract is modified in a way that would have significantly changed the accounting of the contract had the new terms always existed. IFRS 17 therefore requires the original contract to be derecognised and a new contract based on the modified terms to be recognised. The consideration for the new contract (ie the implicit premium) is deemed to be the price the entity would have charged the policyholder had it entered into a contract with equivalent terms at the date of the modification. That deemed consideration determines:
- (a) the adjustment to the contractual service margin of the group to which the existing contract belonged on derecognition of the existing contract; and
 - (b) the contractual service margin for the new contract.
- BC318 The Board concluded that modifications to contracts that trigger derecognition should be measured using the premium the entity would have charged had it entered into a contract with equivalent terms as the modified contract at the date of the contract modification. Such an approach measures the modified contract consistently with the measurement of other insurance contract liabilities.
- BC319 The Board considered whether the contractual service margin of the group to which the existing contract belonged should be adjusted for the gain or loss arising on the derecognition of the existing contract and recognition of the modified contract (paragraph BC317(a)). The alternative (not adjusting the contractual service margin) would result in a gain or loss in profit or loss. However, the Board concluded that: (a) not adjusting the contractual service margin of the group from which the existing contract is derecognised; and (b) establishing the contractual service margin for the group that includes the new modified contract based on the premiums that would have been charged for that new contract would result in the contractual service margin of the two groups double-counting the future profit to be earned from the contract. Hence, the Board decided that the contractual service margin of the group from which the existing contract has been derecognised should be adjusted.

Modifications that would not have resulted in significantly different accounting for the contract (paragraph 73 of IFRS 17)

- BC320 The Board decided that all modifications that would not have resulted in significantly different accounting for the contract should be accounted for in the same way as changes in estimates of fulfilment cash flows. Doing so results in symmetrical accounting for contract modifications that eliminate rights and obligations and for contract modifications that add rights and obligations. This reduces the potential for accounting arbitrage through contract modification.

Derecognition (paragraphs 74–75 of IFRS 17)

- BC321 IFRS 17 requires an entity to derecognise an insurance contract liability from its statement of financial position only when it is extinguished or modified in the way discussed in paragraph BC317. An insurance contract is extinguished when the obligation specified in the insurance contract expires or is discharged or cancelled. This requirement is consistent with requirements in other IFRS Standards, including the derecognition requirements for financial liabilities in IFRS 9. The requirement also provides symmetrical treatment for the recognition and derecognition of insurance contracts.
- BC322 The Board considered concerns that an entity might not know whether a liability has been extinguished because claims are sometimes reported years after the end of the coverage period. It also considered concerns that an entity might be unable to derecognise those liabilities. Some argued that, in some cases, the delayed derecognition would result in unreasonable and unduly burdensome accounting. In the Board's view, ignoring contractual obligations that remain in existence and that can generate valid claims would not give a faithful representation of an entity's financial position. However, the Board expects that when the entity has no information to suggest there are unasserted claims on a contract with an expired coverage period, the entity would measure the insurance contract liability at a very low amount. Accordingly, there may be little practical difference between recognising an insurance liability measured at a very low amount and derecognising the liability.

Transfers of insurance contracts and business combinations (paragraphs 39 and B93–B95 of IFRS 17)

- BC323 IFRS 17 requires an entity to treat the consideration for insurance contracts acquired in a transfer of insurance contracts or a business combination, including contracts in their settlement period, as a proxy for premiums received. This means that the entity determines the contractual service margin, in accordance with the general requirements of IFRS 17, in a way that reflects the consideration paid for the contracts.
- BC324 Thus, when applying paragraph B95 of IFRS 17, the entity determines the contractual service margin or loss component of the liability for remaining coverage at initial recognition for a group of insurance contracts acquired in a transfer of insurance contracts or a business combination using the consideration received or paid for the contracts as a proxy for premiums received. There is no contractual service margin if a group of insurance contracts issued is onerous. In those cases, the amount by which the group is onerous is recognised:
- (a) immediately as an expense in profit or loss for a transfer of insurance contracts, in the same way as for insurance contracts that the entity issues.
 - (b) as an adjustment to the initial measurement of goodwill or gain from a bargain purchase, for a business combination. Although this requires a new measurement exception to the principle of fair value measurement in IFRS 3, similar exceptions are contained in that Standard for other cases in which liabilities, such as pension liabilities, are measured on a current value basis that is not fair value.
- BC325 The requirements described in paragraphs BC323–BC324 mean that an entity will recognise insurance contracts it acquires in a transfer of insurance contracts or a business combination at the amount of the fulfilment cash flows rather than at the amount of the consideration (which equals the fair value in a business combination) when:
- (a) the insurance contracts are in a liability position at the date of the transfer or business combination and the fulfilment cash flows are higher than the fair value; or
 - (b) the insurance contracts are in an asset position at the date of the transfer or business combination and the fulfilment cash flows are lower than the fair value.
- BC326 The Board considered how the amount of the fulfilment cash flows could differ as described in paragraph BC325 from the amount of the consideration received, ie the fair value. For transfers of insurance contracts, the most likely cause of the difference is that the fair value would include the risk of non-performance by the entity. The Board concluded that, for contracts in a liability position acquired in a transfer, the immediate recognition of a loss faithfully represents the entity's assumption of an obligation it expects to fulfil but for which it received a lower price because of the risk that it might not be able to fulfil the obligation.
- BC327 For a business combination, the Board concluded that the most likely reason that fulfilment cash flows differ from the fair value is that the acquirer may have been willing to pay more for the contracts because of other synergies that might arise as the contracts are fulfilled. Consequently, the recognition of that difference as an adjustment to the gain on the business combination or goodwill is consistent with the accounting for similar effects in a business combination. The Board decided to clarify that in determining fair value of a group of insurance contracts, an entity should not apply the concept of a deposit floor set out in IFRS 13 (see paragraphs BC165–BC166).

Presentation in the statement of financial position and statement(s) of financial performance (paragraphs 78–92 and B120–B136 of IFRS 17)

- BC328 IFRS 17 requires an entity to present the combination of rights and obligations arising from a group of insurance contracts as a single insurance contract asset or liability in the statement of financial position. This requirement is consistent with the measurement of a group of insurance contracts as a package of cash inflows and cash outflows. Consistent with the requirement in IAS 1 that an entity not offset assets and liabilities, IFRS 17 prohibits entities from offsetting groups of insurance contracts in an asset position with groups of insurance contracts in a liability position.
- BC329 IFRS 17 amended IAS 1, which specifies the line items that are required to be presented in the statement of financial position, to require an entity to present separately groups of insurance contracts issued and groups of reinsurance contracts held. The Board concluded that such contracts are sufficiently distinct to warrant separate presentation in the statement of financial position.

- BC330 Paragraphs BC27–BC37 discuss the presentation of insurance revenue and paragraphs BC38–BC49 discuss the presentation of insurance finance income and expenses. The Board considered and rejected:
- (a) other approaches to the presentation of insurance revenue, including:
 - (i) the summarised-margin approach; and
 - (ii) premium approaches; and
 - (b) other approaches to the presentation of insurance finance income and expenses:
 - (i) include all insurance finance income or expenses in profit or loss; and
 - (ii) use the current period book yield for all contracts.

Presentation of insurance revenue

- BC331 As noted in paragraph BC61, some complexity in the requirements of IFRS 17 arises from the need to eliminate investment components from insurance revenue. Investment components may be more significant in some contracts than in others. For example, significant investment components exist in many long-term life insurance contracts and in some large long-term or bespoke non-life insurance or reinsurance contracts. Some argued that any attempt to distinguish between investment components that have not been separated and the premium charged for insurance and other services would be arbitrary and complex to apply.
- BC332 The Board considered an approach that avoided this issue: a ‘summarised-margin approach’ in profit or loss. This approach would have applied to most insurance contracts with a coverage period of more than one year. The summarised-margin approach would have been operationally less complex than any presentation that provides a gross performance measure in profit or loss. This is because the summarised-margin approach would not have distinguished between investment components and premiums for services provided. Further, the Board would not have needed an exception for the treatment of insurance acquisition cash flows (see paragraphs BC175–BC180) to avoid a situation in which an entity recognises insurance revenue before the coverage has been provided.
- BC333 Nonetheless, the summarised-margin approach would have been a significant change from previous practice because it would have precluded presenting revenue-type line items in profit or loss. Furthermore:
- (a) the summarised-margin approach would not have provided relevant information about the extent to which an entity provides services under an insurance contract because it would not have presented any amounts as revenue or expenses in profit or loss.
 - (b) the summarised-margin approach, as with other substitutes for revenue that are unique to insurance contracts, would have reduced the comparability between the financial reporting for insurance contracts and the financial reporting for other contracts.
 - (c) many of those who report, use and quote financial measures expect such financial measures to include a measure of gross performance. If IFRS 17 did not require the presentation of an amount that is measured using principles that are applicable to revenue from contracts with customers, preparers and users of financial statements might substitute other inconsistently calculated measures for them.
- BC334 Accordingly, the Board rejected the summarised-margin approach.
- BC335 The Board also considered two approaches for the presentation of insurance revenue that were often used in previous practice:
- (a) a written-premium approach, which allocates the total expected insurance revenue to the period in which the contracts are initially recognised (written). At the same time, an expense is presented for the total expected claims and expenses relating to those contracts.
 - (b) a premiums-due approach, which allocates the total expected insurance revenue to the periods in which the premiums become unconditionally due to the entity, whether or not the premiums are collected in that period. At the same time, the entity recognises expenses which must be reconciled to the incurred claims (see paragraphs BC343–BC344).
- BC336 A written-premium approach would have provided information about new business during the period, including the expected present value of the amounts to be received and the obligations assumed. The Board rejected this approach because the premiums, claims and expenses presented in profit or loss are not measured by applying commonly understood notions of revenue and expenses. In particular, the revenue is recognised before the entity has performed a service and the claims and expenses are recognised before they have been incurred.

- BC337 Many entities that issue long-duration insurance contracts previously applied a premiums-due approach in profit or loss. A premiums-due approach would have:
- (a) provided information about the additional premiums for services to which the entity has an unconditional right; and
 - (b) provided a measure of growth and a denominator for claims and expenses ratios that is objective, sufficient for that purpose and simpler to provide than insurance revenue.
- BC338 However, the Board rejected this approach because:
- (a) the gross performance measure presented using a premiums-due approach would be inconsistent with commonly understood concepts of revenue and would be likely to mislead non-specialist users of financial statements. In particular, in a premiums-due approach:
 - (i) revenue would typically be recognised before the entity has performed the corresponding service.
 - (ii) the amounts presented as revenue and claims, benefits and expenses would vary depending on when a contract requires payment of the premium. For example, if a premium is due at the start of the contract, then all revenue and expenses are presented in the period the contract is issued. If the premium is instead due annually, the revenue and expenses would be presented at that point in each year. Thus, revenue and expenses may not indicate when the entity performs the service.
 - (b) the premiums-due approach typically reports amounts billed in the period and includes in expenses an amount representing the premiums expected to relate to claims in the future. The Board decided that reporting claims and expenses when incurred would provide useful information to users of financial statements, as discussed in paragraphs BC343–BC344. As noted in paragraph BC344, when revenue is measured using a premium approach, the incurred claims must be reconciled to the amount of expenses presented in the period and a balancing figure must be presented in profit or loss. Feedback from users of financial statements suggested that this balancing figure is difficult for users to interpret when analysing insurers' performance in the period.
- BC339 Although the Board rejected a premiums-due approach for the reasons given above, it noted that some of the information provided by a premiums-due approach could be useful. Hence IFRS 17 requires disclosure of other measures of gross performance (see paragraphs BC358–BC362).

Presentation of insurance finance income or expenses

- BC340 The Board considered requiring entities to include all insurance finance income or expenses in profit or loss. This would prevent accounting mismatches with finance income from assets measured at fair value through profit or loss, and could also reduce the complexity inherent in disaggregating changes in the liability. However, many stakeholders expressed concern that gains and losses from underwriting and investing activities would be obscured by more volatile gains and losses arising from changes in the current discount rate applied to the cash flows in insurance contracts. In addition, many preparers of financial statements expressed concern that they would be forced to measure their financial assets at fair value through profit or loss to avoid accounting mismatches. These preparers noted that the Board has indicated that amortised cost and fair value through other comprehensive income are appropriate measures for financial assets in some circumstances and that IFRS 9 would generally require an entity to measure financial liabilities at amortised cost. Accordingly, these preparers say that the volatility in profit or loss that would result from a current value measurement of insurance contracts would impair the faithful representation of their financial performance and users of financial statements would face difficulties in comparing insurers with entities that have no significant insurance contracts. The Board was not persuaded that entities that issue insurance contracts would be disadvantaged if insurance contracts were to be measured at current value. However, the Board was persuaded that users of financial statements may find that, for some contracts, the presentation of insurance finance income or expenses based on a systematic allocation in profit or loss would be more useful than the presentation of total insurance finance income or expenses in profit or loss.
- BC341 The Board also considered requiring all insurance finance income or expenses to be included in profit or loss with separate presentation of some or all such income or expenses. Such presentation would provide disaggregated information about the effects of changes in insurance contract assets and liabilities in profit or loss. However, the Board rejected this approach for the same reasons given in paragraph BC340 and also because it would introduce operational complexity similar to that discussed in paragraph BC43(b)(ii).

- BC342 The Board also considered requiring a current period book yield for all insurance contracts. The current period book yield is the change in the carrying amount of assets regarded as backing the insurance contracts that is recognised in profit or loss for the period. The Board rejected this approach, except as discussed in paragraph BC48, because recognising insurance finance income or expenses in profit or loss measured using a discount rate that has no relationship to the rate that is used to measure the group of insurance contracts does not provide useful information. In addition, it may be difficult in some circumstances to identify the assets that are held by the entities to back insurance contract liabilities.

Recognition of incurred claims (paragraph 84 of IFRS 17)

- BC343 Reporting claims and expenses (other than insurance acquisition expenses) when incurred is consistent with the reporting of expenses for other types of contracts and, the Board decided, provides useful information to users of financial statements.
- BC344 Reporting claims and expenses in this way is only possible when insurance revenue is measured using changes in the liability for remaining coverage as a measure of progress towards satisfying an obligation. When insurance revenue is measured in any other way, the incurred claims must be reconciled to the amount of expenses that is presented in the period. This is because both insurance revenue and incurred claims and benefits are measures of changes in the liability for the group of insurance contracts relating to coverage in the period.

Reinsurance contracts held (paragraphs 78, 82 and 86 of IFRS 17)

- BC345 The Board noted that assets for reinsurance contracts held and liabilities for the underlying insurance contracts would rarely meet the criteria established by IAS 32 for offsetting financial assets against financial liabilities. Rather than incorporating those criteria in IFRS 17, the Board decided that it was simpler to prohibit an entity from offsetting reinsurance contract assets held against related insurance contract liabilities.
- BC346 Consistent with the prohibition on offsetting reinsurance contracts assets against insurance contract liabilities, IFRS 17 requires an entity to present income or expenses from reinsurance contracts held separately from expenses or income from insurance contracts issued. However, IFRS 17 allows an entity to present income or expenses from reinsurance contracts held either as a single net amount or as separate amounts recovered from the reinsurer and an allocation of the premiums paid. If it presents separate amounts, IFRS 17 requires the entity to treat:
- (a) cash flows contingent on the claims or benefits in the underlying contracts, including ceding commissions, as part of the claims that are expected to be reimbursed under the reinsurance contracts held, unless those cash flows need to be accounted for as investment components. In the Board's view, the economic effect of changes in those cash flows is equivalent to the effect of reimbursing a different amount of claims than expected.
 - (b) ceding commissions that are not contingent on claims of the underlying contracts as a reduction of the premiums to be paid to the reinsurer. The economic effect of such ceding commissions is equivalent to the effect of charging a lower premium with no ceding commission.

Disclosure (paragraphs 93–132 of IFRS 17)

- BC347 The Board decided that an entity should disclose information that gives a basis for users of financial statements to assess the effect that contracts within the scope of IFRS 17 have on the entity's financial position, financial performance and cash flows. To achieve this disclosure objective, information is needed about the amounts recognised in the financial statements, the significant judgements and changes in judgements made when applying IFRS 17, and the nature and extent of risks that arise from contracts within the scope of IFRS 17. The disclosure objective is supplemented with some specific disclosure requirements designed to help the entity satisfy this objective. By specifying the objective of the disclosures, the Board aims to ensure that entities provide the information that is most relevant for their circumstances and to emphasise the importance of communication to users of financial statements rather than compliance with detailed and prescriptive disclosure requirements. In situations in which the information provided to meet the specific disclosure requirements is not sufficient to meet the disclosure objective, paragraph 94 of IFRS 17 requires the entity to disclose additional information necessary to achieve that objective.
- BC348 The Board used the disclosure requirements in IFRS 4, including the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* that are incorporated in IFRS 4 by cross-reference, as a basis for the

requirements in IFRS 17. This is because stakeholders have indicated that such disclosures provide useful information to users of financial statements for understanding the amount, timing and uncertainty of future cash flows from insurance contracts. The disclosure requirements brought forward from IFRS 4 include information about:

- (a) significant judgements in applying the Standard, including an explanation of methods used to measure contracts within the scope of the Standard, the processes for estimating the inputs to those methods, and any changes in those methods and processes (see paragraph 117 of IFRS 17); and
- (b) the nature and extent of risks that arise from insurance contracts, including:
 - (i) the exposures to insurance risk and each type of financial risk and how they arise, and the entity's objectives, policies and processes for managing the risk and the methods used to measure those risks (see paragraphs 121–125 of IFRS 17);
 - (ii) concentrations of risk (see paragraph 127 of IFRS 17);
 - (iii) sensitivities to insurance risk and each type of market risk (see paragraphs 128–129 of IFRS 17);
 - (iv) information about claims development (see paragraph 130 of IFRS 17);
 - (v) information about credit risk arising from insurance contracts, including the credit quality of reinsurance contracts held (see paragraph 131 of IFRS 17); and
 - (vi) information about liquidity risk arising from insurance contracts (see paragraph 132 of IFRS 17).

BC349 In addition, when developing IFRS 17 the Board identified key items it views as critical to understanding the financial statements of entities issuing insurance contracts, in the light of the requirement to update the measurement of insurance contracts at each reporting date. The Board therefore decided that entities should disclose the following items:

- (a) reconciliations from the opening to closing balances for each of:
 - (i) changes in insurance contract liabilities (or assets), analysed to provide information about the determination of insurance revenue and the linkage between amounts in the statements of financial position and financial performance (see paragraph 100 of IFRS 17); and
 - (ii) changes in insurance contract liabilities (or assets), analysed to provide information about the measurement model (see paragraph 101 of IFRS 17).

These reconciliations are discussed in paragraphs BC350–BC356.

- (b) an analysis of insurance revenue (see paragraph 106 of IFRS 17 and paragraphs BC352–BC353).
- (c) information about the initial recognition of insurance contracts in the statement of financial position (see paragraphs 107–108 of IFRS 17 and paragraphs BC358–BC362).
- (d) an explanation of when the entity expects to recognise the contractual service margin remaining at the end of the reporting period in profit or loss (see paragraph 109 of IFRS 17 and paragraph BC363).
- (e) an explanation of the total amount of insurance finance income or expenses in the reporting period (see paragraph 110 of IFRS 17 and paragraphs BC364–BC366) and the composition and fair value of underlying items for contracts with direct participation features (see paragraph 111 of IFRS 17 and paragraphs BC238–BC247).
- (f) to the extent not already included in meeting the requirements in paragraph 117(a) of IFRS 17, information about the entity's approach to determine (see paragraph 117(c) of IFRS 17):
 - (i) how to distinguish changes in estimates of future cash flows arising from the exercise of discretion from other changes in estimates of future cash flows (see paragraph BC237);
 - (ii) the risk adjustment for non-financial risk (see paragraphs BC213–BC217);
 - (iii) discount rates (see paragraphs BC193–BC205); and
 - (iv) investment components (see paragraphs BC33–BC34).
- (g) the confidence level used to determine the risk adjustment for non-financial risk (see paragraph 119 of IFRS 17 and paragraphs BC215–BC217).

- (h) information about the yield curves used to discount cash flows that do not vary based on the returns on underlying items (see paragraph 120 of IFRS 17 and paragraph BC198).
- (i) information about the effect of the regulatory framework in which the entity operates (see paragraph 126 of IFRS 17 and paragraphs BC369–BC371).

Explanation of recognised amounts (paragraphs 97–116 of IFRS 17)

Reconciliation of components of the insurance contract liability (paragraphs 98–105 of IFRS 17)

- BC350 IFRS 17 requires an entity to disaggregate the insurance contract liability into components as follows (see paragraph 40 of IFRS 17):
- (a) the liability for remaining coverage, excluding the amounts in (b) below. For liabilities measured using the premium allocation approach, this is the unearned premium, less any unamortised insurance acquisition cash flows.
 - (b) the loss component of the liability for remaining coverage (see paragraph 49 of IFRS 17). For liabilities measured using the premium allocation approach, this is the additional liability for onerous contracts (see paragraph 58 of IFRS 17).
 - (c) the liability for incurred claims.
- BC351 IFRS 17 requires entities to disclose a reconciliation from the opening to the closing balance separately for each of the components listed in paragraph BC350 and separately for insurance contracts issued and reinsurance contracts held, to explain how insurance revenue is determined, and to show how the amounts in the statements of financial position and financial performance are linked.
- BC352 The Board noted that insurance revenue can also be analysed as the total of the changes in the liability for remaining coverage in the period that relate to coverage or other services for which the entity expects to receive consideration. Those changes include insurance service expenses incurred in the period, the change in the risk adjustment for non-financial risk and the amount of the contractual service margin allocated to the period.
- BC353 The Board concluded that requiring such an analysis of insurance revenue recognised in the period provides useful information about the drivers of insurance revenue and assists users of financial statements to understand how insurance revenue relates to more familiar metrics.
- BC354 In addition, the Board decided that, except for insurance contracts to which an entity applies the premium allocation approach described in paragraphs 53–59 or 69–70 of IFRS 17, the entity must disclose a reconciliation as set out in paragraph 101 of IFRS 17 that shows the sources of profit for the period, by separately reconciling from the opening to the closing balances:
- (a) the estimates of the present value of the future cash flows;
 - (b) the risk adjustment for non-financial risk; and
 - (c) the contractual service margin.
- BC355 The Board concluded that a reconciliation showing sources of profit would provide useful information for users of financial statements. Furthermore, in the Board's view, information about changes in the components used in the measurement of insurance contracts will be important in the light of the Board's decision to adjust the contractual service margin for the effects of changes in estimates of fulfilment cash flows relating to future service (see paragraphs 44(c) and 45(c) of IFRS 17). That decision means that those effects do not appear directly in the statement(s) of financial performance.
- BC356 As noted in paragraphs BC350 and BC354, entities are required to disclose two reconciliations from the opening to the closing carrying amounts in the statement of financial position, except for insurance contracts to which the premium allocation approach described in paragraphs 53–59 or 69–70 of IFRS 17 has been applied. The Board decided to require both reconciliations because feedback received from stakeholders generally indicated that the information required in each reconciliation will be useful. The Board considered the costs and benefits of requiring both reconciliations and concluded that the benefits of providing such information outweigh the costs of preparing two reconciliations. The Board noted that, in some cases, it may be possible to combine the information required into one reconciliation.

Insurance revenue (paragraph 85 of IFRS 17)

- BC357 IAS 1 requires an entity to present additional line items in the statement(s) of financial performance when such a presentation is relevant to an understanding of the entity's financial performance. However, IFRS 17 prohibits an entity from presenting information about premiums in profit or loss if that information is inconsistent with insurance revenue determined applying IFRS 17. Given the varied amounts presented under previous insurance accounting practices (see paragraphs BC335–BC339), the Board decided to prohibit entities from presenting information about premiums that is inconsistent with insurance revenue in additional line items in the statement(s) of financial performance.

The effect of new contracts initially recognised in the period (paragraphs 107 and 108 of IFRS 17)

- BC358 The Board considered arguments that it would be useful for entities to disclose information about the effect of new contracts initially recognised in the period. Such information differs from revenue. A measure of insurance revenue by itself provides only part of the information users of financial statements seek, and is not intended to measure an entity's insurance contracts business growth or shrinkage. In particular, many users of financial statements find information about the amount, and profitability, of new business written in each period to be important when assessing an entity's future prospects.
- BC359 As noted in paragraphs BC28–BC29, the purpose of insurance revenue is to measure the consideration to which an entity expects to be entitled in exchange for services provided in the period. This consideration may differ from premiums from new contracts generated or cash collected. The Board noted, therefore, that the use of accruals-based accounting for any contract initiated in advance of services provided (ie any contract for which the performance obligation is not satisfied in the period in which the contract is written) can result in revenue increasing even if the volume of new contracts issued decreased. The Board noted that this effect is not unique to insurance contracts and sought to identify other ways to provide useful information regarding an entity's growth.
- BC360 The Board agreed that information about the effect of new contracts initially recognised in the period would provide useful information for users of financial statements. In particular, information about the contractual service margin, and the risk adjustment for non-financial risk initially recognised in the period, would provide useful information about the profitability of new contracts issued in the period. Accordingly, unless the entity applies the premium allocation approach described in paragraphs 53–59 or 69–70 of IFRS 17, paragraph 107 of IFRS 17 requires an entity to disclose the effect of new contracts initially recognised in the period, showing separately their effect on:
- (a) the estimates of the present value of future cash flows;
 - (b) the risk adjustment for non-financial risk; and
 - (c) the contractual service margin.
- BC361 The estimates of the present value of future cash flows are further disaggregated into estimates of the present value of future cash outflows, showing separately the amount of insurance acquisition cash flows, and estimates of the present value of future cash inflows. The separate disclosure of the estimates of the present value of future cash inflows, including any investment components:
- (a) provides useful information about the volume of sales that supplements the insurance revenue presented in the statement(s) of financial performance; and
 - (b) allows users of financial statements to compare the volume of business written in prior years with the volume of contracts written in the current year.
- BC362 New contracts initially recognised in the period might include contracts issued by the entity and contracts acquired from other entities in transfers of insurance contracts or business combinations. IFRS 17 requires an entity to disclose separately the effects of new contracts initially recognised in the period that are acquired from other entities in transfers of insurance contracts or business combinations, so that the separate effects on future profitability and insurance revenue from contracts issued and acquired in the period is provided to users of financial statements. IFRS 17 also requires an entity to disclose separately the effect of new contracts initially recognised in the period that are onerous.

Recognition of the contractual service margin (paragraph 109 of IFRS 17)

- BC363 Many stakeholders suggested they would like to know when the contractual margin is expected to be recognised in profit or loss in future periods, because this information would be helpful in assessing future

profitability. The Board agreed this information would be useful to users of financial statements. IFRS 17 requires entities to disclose when they expect to recognise the contractual service margin remaining at the end of the reporting period in profit or loss, either quantitatively, in appropriate time bands, or by providing qualitative information.

Insurance finance income or expenses (paragraphs 110–113 and 118 of IFRS 17)

- BC364 Insurance finance income or expenses are expected to have a significant effect on the performance of an insurer, particularly if it issues long-duration contracts. IFRS 17 allows an entity to choose how to present insurance finance income or expenses; therefore, the Board concluded it is important for an entity to disclose or explain:
- (a) the total amount of its insurance finance income or expenses in each period;
 - (b) the basis for any disaggregation of the total between amounts recognised in profit or loss and other comprehensive income; and
 - (c) the relationship between insurance finance income or expenses and investment income on the related assets the entity holds.
- BC365 For contracts with direct participation features, IFRS 17 allows an entity to choose how to recognise changes in the effect of financial risk (for example, the value of financial guarantees embedded in a group of insurance contracts or the entity's share of the underlying items), if the entity uses a derivative to mitigate the financial risk, and the criteria in paragraph B116 of IFRS 17 are met. Such changes may be recognised either in profit or loss, or by adjusting the contractual service margin. Recognising the lack of comparability that this accounting policy choice creates, the Board decided to require an entity that chooses to recognise such changes in profit or loss to disclose the effect of that choice on the adjustment to the contractual service margin in the current period.
- BC366 For contracts with direct participation features, an entity choosing to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income might change the basis on which it determines the amounts to be included in profit or loss from a systematic allocation to the current period book yield (see paragraph BC48), or vice versa. A change of basis is required if the entity becomes eligible, or ceases to be eligible, to apply the current period book yield because it starts to hold, or ceases to hold, the underlying items for a group of insurance contracts. In such cases, IFRS 17 requires an entity to include in a specified way in profit or loss the accumulated amount previously recognised in other comprehensive income. The Board requires the specified method to prevent an entity from including or excluding gains and losses permanently in profit or loss simply by choosing to buy or sell underlying items. The Board also decided to require entities to disclose, in the period the change in basis occurs:
- (a) the reason why the entity changed the basis of disaggregation;
 - (b) the amount of any adjustment for each financial statement line item affected; and
 - (c) the carrying amount of the groups of insurance contracts to which the change applied.

Disclosures that the Board considered but did not include in IFRS 17

Reconciliation of premium receipts to insurance revenue

- BC367 The Board originally proposed that an entity reconcile the insurance revenue to the premium receipts in each period because it wanted entities to explain how insurance revenue differs from previously familiar metrics. However, the Board found that such information will be provided in the reconciliation of the insurance contract balance required by paragraph 100 of IFRS 17. Hence, a separate reconciliation, while permissible, is not required. Paragraphs BC27–BC37 and BC337–BC339 explain why IFRS 17 prohibits the use of premiums-due as a measure of insurance revenue.

Measurement uncertainty analysis

- BC368 The Board originally proposed the disclosure of an analysis of the measurement uncertainty in the inputs that have a material effect on the measurement. This would have been similar to the disclosure for unobservable inputs in fair value measurement considered by the Board when developing IFRS 13 (as

described in paragraphs BC202–BC210 of the Basis for Conclusions on IFRS 13). When finalising IFRS 13, the Board decided not to require such a disclosure for unobservable inputs in IFRS 13 because of concerns about costs relative to benefits, but instead required more quantitative information about the inputs as well as narrative information about how those inputs influence the measurement (as described in paragraphs BC188–BC195 and BC206–BC208 of the Basis for Conclusions on IFRS 13). Accordingly, consistent with its decision for IFRS 13, the Board did not include such a disclosure requirement in IFRS 17.

Regulatory capital

- BC369 IFRS 17 requires an entity to disclose information about the effect of the regulatory frameworks in which it operates; for example, minimum capital requirements or required interest rate guarantees (see paragraph 126 of IFRS 17). Many users of financial statements indicated a desire for additional disclosures that would help them to understand and analyse those effects; in particular:
- (a) information about how much regulatory capital an entity needs to hold for the new contracts written in the period, and when that capital will cease to be required; and
 - (b) information about the amount of equity generated in a reporting period that is not needed to service the regulatory capital requirements. That amount is sometimes referred to as ‘free cash flow’.
- BC370 Disclosure of the regulatory capital required could provide users of financial statements with information about:
- (a) the entity’s profitability, ongoing capital needs and, thus, financial flexibility;
 - (b) an entity’s capacity to write new business in future periods, because the excess over regulatory capital held is available to support future new business; and
 - (c) improved understanding of the financial position, financial performance and cash flows during the reporting period.
- BC371 However, entities that issue insurance contracts are not the only entities that operate in a regulated environment. Such disclosures might be useful for all entities operating in a regulated environment. The Board was concerned about developing such disclosures in isolation in a project on accounting for insurance contracts that would go beyond the existing requirements in paragraphs 134–136 of IAS 1. Accordingly, the Board decided to limit the disclosures about regulation to those set out in paragraph 126 of IFRS 17.

Applying the Standard for the first time (Appendix C of IFRS 17)

- BC372 IFRS 17 includes specific requirements for applying the Standard for the first time. An entity is therefore required to apply the IFRS 17 transition requirements instead of the general requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. In the light of the diversity in previous insurance accounting practices and the long duration of many types of insurance contracts, the Board decided that retrospective application of IFRS 17 provides the most useful information to users of financial statements by allowing comparisons between contracts written before and after the date of initial application of the Standard. Consistent with IAS 8, which requires retrospective application of a new accounting policy except when it would be impracticable, the Board concluded that entities should apply IFRS 17 retrospectively (see paragraphs BC374–BC378) and should be allowed to use alternatives only when retrospective application of IFRS 17 is impracticable.
- BC373 The Board developed two alternative transition methods that may be used when retrospective application is impracticable (see paragraphs BC379–BC384 for the alternative transition method referred to as the ‘modified retrospective approach’ and paragraphs BC385–BC386 for the alternative transition method referred to as the ‘fair value approach’). The Board decided to permit an entity to choose between the modified retrospective approach and the fair value approach if the entity cannot apply IFRS 17 retrospectively. The Board acknowledged a choice of transition methods results in a lack of comparability of transition amounts but concluded it was appropriate for the following reasons. The objective of the modified retrospective approach is to achieve the closest outcome to a retrospective application of the Standard. The Board noted that the similarity between a modified retrospective approach and a full retrospective application would depend on the amount of reasonable and supportable information available to an entity. If an entity has relatively little reasonable and supportable information available, and, therefore,

would need to use many of the permitted modifications, the cost of the modified retrospective approach might exceed the benefits.

Retrospective application (paragraphs C3–C5 of IFRS 17)

BC374 To apply IFRS 17 retrospectively, at the transition date an entity is required to:

- (a) recognise and measure each group of insurance contracts as if IFRS 17 had always applied;
- (b) derecognise any existing balances that would not exist had IFRS 17 always applied; and
- (c) recognise any resulting net difference in equity.

Consistent with retrospective application, the Board noted that an entity would need not only to adjust the measurement of its insurance contracts when first applying the Standard but also to eliminate any items such as deferred acquisition costs and some intangible assets that relate solely to existing contracts. The requirement to recognise any resulting net differences in equity means that no adjustment is made to the carrying amount of goodwill from any previous business combinations.

BC375 The measurement model in IFRS 17 comprises two components:

- (a) a direct measurement, which is based on estimates of the present value of future cash flows and an explicit risk adjustment for non-financial risk; and
- (b) a contractual service margin, which is measured on initial recognition of the group of insurance contracts, then adjusted for subsequent changes in estimates relating to future service and adjusted for subsequent changes in estimates relating to future services and a financing component and recognised in profit or loss over the coverage period.

BC376 The Board identified no specific transition problems for the introduction of the direct measurement component of the insurance contracts, other than in the assessments made on initial recognition described in paragraphs BC381–BC382. That measurement reflects only circumstances at the measurement date. Consequently, provided an entity has sufficient lead time to set up the necessary systems, performing that direct measurement at the transition date will be no more difficult than performing it at a later date.

BC377 Measuring the remaining amount of the contractual service margin at the transition date, and the information needed for presentation in the statement(s) of financial performance in subsequent periods, is more challenging. These amounts reflect a revision of estimates for all periods after the initial recognition of the group of insurance contracts.

BC378 The Board concluded that measuring the following amounts needed for retrospective application would often be impracticable:

- (a) the estimates of cash flows at the date of initial recognition;
- (b) the risk adjustment for non-financial risk at the date of initial recognition;
- (c) the changes in estimates that would have been recognised in profit or loss for each accounting period because they did not relate to future service, and the extent to which changes in the fulfilment cash flows would have been allocated to the loss component;
- (d) the discount rates at the date of initial recognition; and
- (e) the effect of changes in discount rates on estimates of future cash flows for contracts for which changes in financial assumptions have a substantial effect on the amounts paid to policyholders.

The Board therefore developed two transition methods entities are allowed to use for groups of insurance contracts for which retrospective application of IFRS 17 would be impracticable.

Modified retrospective approach (paragraphs C6–C19 of IFRS 17)

BC379 Although many entities may not have sufficient information for retrospective application of IFRS 17, the Board was told that, in many cases, entities may have much of the information needed, and that some entities may face only a small number of limitations on retrospective application. In such situations, the Board concluded that more comparable information about insurance contracts could result if an entity were permitted to modify retrospective application only when needed because it lacked information to apply a fully retrospective approach. Furthermore, the Board concluded that an entity should:

- (a) use the minimum modifications necessary for achieving the closest outcome to retrospective application that is possible using reasonable and supportable information; and

- (b) be prohibited from disregarding any reasonable and supportable information that could be used in the retrospective application of IFRS 17 if that information is available without undue cost or effort.

BC380 The Board decided to specify some modifications that could be applied if retrospective application as defined in IAS 8 is impracticable, to address the issues noted in paragraph BC378. Those modifications are permitted only to the extent necessary because an entity does not have reasonable and supportable information to apply the retrospective approach. Those modifications:

- (a) simplify the information necessary for an entity to make assessments about insurance contracts or groups of insurance contracts that would be made at the date of inception or initial recognition (see paragraphs BC381–BC382).
- (b) simplify how an entity determines amounts related to the contractual service margin (see paragraph BC383).
- (c) simplify how an entity determines the information necessary to determine insurance revenue (see paragraph BC383).
- (d) permit an entity to determine insurance finance income and expenses included in profit or loss using the discount rates at the transition date if an entity chooses to disaggregate insurance finance income or expenses into an amount included in profit or loss and an amount included in other comprehensive income. In addition, the modification provides an expedient for determining the amount of the accumulated balance in equity relating to insurance finance income and expenses (see paragraph BC384).

Assessments made at inception or initial recognition of insurance contracts (paragraphs C9–C10 of IFRS 17)

BC381 IFRS 17 requires some assessments to be made at the inception or initial recognition of a contract, in particular:

- (a) whether a contract is eligible for the variable fee approach;
- (b) how to group contracts; and
- (c) how to determine the effect of discretion on estimated cash flows for contracts subject to the general model.

BC382 The Board concluded that often it would be impracticable for entities to make such assessments using assumptions at the date of inception or initial recognition. Such assessments might be impossible without the use of hindsight (ie making an assumption of what an entity would have expected in the past). The need for hindsight could be avoided if the assessments were made at the transition date instead of at the date of inception or initial recognition of the contract. However, the Board noted that assessing contracts only at the transition date could impose grouping for entities that is significantly different from an assessment as at the date of the inception or initial recognition of the contract. Accordingly, the Board decided that entities should be allowed to make the assessments either:

- (a) at the date of inception or initial recognition of a contract, if such assessments could be made based on reasonable and supportable evidence for what the entity would have determined given the terms of the contract and the market conditions at that time; or
- (b) at the transition date.

Determining amounts relating to the contractual service margin and insurance revenue (paragraphs C11–C17 of IFRS 17)

BC383 In many cases, the estimates described in paragraph BC378 can be determined only using hindsight, which would mean that the entity would not be able to apply IFRS 17 retrospectively. Accordingly, the Board decided that it would specify modifications that could be used for making those estimates. Those modifications:

- (a) avoid the need for entities to measure the changes in estimates that would have been recognised in profit or loss because they did not relate to future service, or to assess the extent to which such changes in estimates had been reversed as claims were incurred;
- (b) provide an objective way for entities to estimate what the risk adjustment for non-financial risk would have been at the date of initial recognition;

- (c) provide a way for entities to estimate the discount rates at the date of initial recognition; and
- (d) provide guidance on how an entity should determine how much of the estimated contractual service margin on initial recognition should remain at the date of transition.

Determining insurance finance income and expenses (paragraphs C18 and C19 of IFRS 17)

BC384 If an entity chooses to include some insurance finance income or expenses in other comprehensive income, applying IFRS 17 retrospectively, the entity would need to track historical information and make assessments about the allocation of amounts from other comprehensive income to profit or loss in each period to determine the accumulated balance recognised in other comprehensive income. This information would be particularly difficult to determine if, consistent with paragraph C10 of IFRS 17, the entity included within a group insurance contracts issued more than one year apart. Accordingly, the Board decided to provide modifications that would enable an entity to determine those amounts at the transition date.

Fair value approach (paragraphs C20–C24 of IFRS 17)

BC385 The Board noted that in some cases an entity might not have reasonable and supportable information available without undue cost or effort to apply the modified retrospective approach. Accordingly, the Board specified that in such cases, an entity must apply a fair value approach in which the contractual service margin at the transition date is determined as the difference between the fulfilment cash flows and the fair value of the group of insurance contracts, determined in accordance with IFRS 13. The Board also decided to allow the use of the fair value approach whenever retrospective application is impracticable (see paragraph BC373). The Board decided to clarify that in determining fair value of a group of insurance contracts, an entity should not apply the concept of a deposit floor (see paragraphs BC165–BC166).

BC386 The fair value approach also permits the same modifications as the modified retrospective approach relating to:

- (a) assessments about insurance contracts or groups of insurance contracts that would be made at the date of inception or initial recognition; and
- (b) determining the discount rates and the effect of changes in discount rates necessary to determine insurance finance income and expenses.

Comparative information (paragraphs C25–C28 of IFRS 17)

BC387 IFRS 17 requires entities to present comparative information, applying the requirements of IFRS 17 for the period immediately before the date of initial application of IFRS 17, to provide the most useful information to users of financial statements by allowing comparisons among entities and using trend information. However, if an entity presents comparative information for earlier periods, that comparative information need not be restated applying the requirements of IFRS 17.

BC388 The Board concluded that providing restated comparative information for at least one reporting period was necessary because of the diversity of previous accounting and the extent of the changes introduced by IFRS 17. Because IFRS 17 only requires retrospective application on transition if practicable, and specifies simplified approaches when retrospective application is impracticable, the Board expects that determining the comparative amounts will not require significant incremental time and resources beyond those required to first apply IFRS 17. The Board set the effective date for IFRS 17 based on information given about the necessary time to prepare, in the knowledge that restated comparative information for one reporting period would be required.

BC389 The requirement to restate comparative information for one reporting period is different from the transition requirements of IFRS 9, which did not require restatement of comparative amounts at transition to that Standard, including the fair value of financial instruments (and which did not allow restatement if doing so required the use of hindsight). However, the Board noted that different circumstances applied when it developed the transition requirements for IFRS 9, which were developed with the intention of minimising obstacles to voluntary application of IFRS 9 before its effective date. In addition, entities applying those transition requirements of IFRS 9 had all previously applied the same requirements, ie those in IAS 39. In contrast, the Board expects that most entities will apply IFRS 17 no earlier than the effective date and believes that the restatement of comparative amounts is particularly important, for the reasons given in

paragraph BC388. Therefore, the Board decided not to provide relief from the restatement of comparative information to facilitate early application of IFRS 17.

Other transition issues

Contracts derecognised before the transition date

- BC390 The Board decided that it would not provide a simplification for contracts that have been derecognised before the transition date. The Board noted that reflecting the effect of contracts derecognised before the transition date on the remaining contractual service margin was necessary to provide a faithful representation of the remaining profit of the group of insurance contracts. Furthermore, although entities may have difficulty obtaining details of cash flows for all contracts that have been derecognised, the Board concluded that an entity would be able to make estimates and extrapolations using reasonable and supportable information to enable the effect of derecognised contracts to be determined. Finally, the Board observed that when an entity is not able to make such estimates and extrapolations, the fair value approach would be available.

Level of aggregation (paragraphs C9(a) and C10 of IFRS 17)

- BC391 To apply the Standard retrospectively, an entity needs to determine the group of insurance contracts to which individual contracts would have belonged on initial recognition. The Standard requires entities to group only contracts written within one year.
- BC392 The Board noted that it may not always be practicable for entities to group contracts written in the same one-year period retrospectively. Accordingly, the Board decided to provide a transition relief so that entities would not need to divide contracts into groups of contracts that were written within one year. In addition, entities are allowed to accrete and adjust the resulting contractual service margin after transition using the discount rates at the transition date. Furthermore, the Board decided that entities that choose to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income in accordance with paragraphs 88(b) and 89(b) of IFRS 17 should be permitted to determine insurance finance income or expenses included in profit or loss using the discount rates at the transition date. Although this results in a different accumulated balance in equity compared with the amount that would result from a full retrospective approach, and hence different insurance finance income or expenses in profit or loss in the future, the Board concluded that users of financial statements could be alerted to these differences through disclosures.

Derivatives used to mitigate financial risk (paragraph C3(b) of IFRS 17)

- BC393 Paragraph B115 of IFRS 17 permits entities not to recognise a change in the contractual service margin for changes in fulfilment cash flows and the entity's share in the fair value returns on underlying items for which an entity uses derivatives to mitigate their financial risk. However, an entity applying this option is required to document its risk management objective and the strategy for mitigating the risk before doing so. This documentation requirement is analogous to the documentation requirements for hedge accounting in IFRS 9. Consistent with the transition requirements for hedge accounting in IFRS 9, the Board concluded that retrospective application of the risk mitigation treatment would give rise to the risk of hindsight. In particular, the Board was concerned that documentation after the event could enable entities to choose the risk mitigation relationships to which it would apply this option, particularly because the application of this approach is optional. Consequently, IFRS 17, consistent with the transition requirements for hedge accounting in IFRS 9, requires prospective application of the risk mitigation option from the date of initial application of the Standard.

Redesignation of financial assets (paragraphs C29–C33 of IFRS 17)

- BC394 When first applying IFRS 17, an entity will either:
- (a) have already applied IFRS 9; or
 - (b) also be applying IFRS 9 for the first time.
- BC395 IFRS 9 includes requirements for the classification of financial assets. IFRS 9 also includes an option on the date of initial application of IFRS 9 for entities to designate financial assets as measured at fair value through profit or loss when doing so mitigates an accounting mismatch (the fair value option). An entity

applying both IFRS 9 and IFRS 17 for the first time will be able to assess financial asset classifications, elections and designations while, at the same time, assessing the implications of the requirements of IFRS 17.

- BC396 The Board considered whether an entity that has previously applied IFRS 9 when it first applies IFRS 17 should be permitted to revisit its IFRS 9 financial asset classifications, elections and designations. IFRS 9 determines classification based on the contractual cash flow characteristics of a financial asset and the business model in which it is held. After IFRS 9 is applied, changes in classification can only occur when an entity's business model changes; the Board expects such changes to be infrequent. In addition, IFRS 9 does not usually permit either subsequent redesignation under the fair value option or subsequent redesignation of equity instruments into, or out of, the category of equity instruments at fair value through other comprehensive income after initial recognition.
- BC397 The interaction between the classification of financial assets and the presentation of changes in the insurance contract liability could create accounting mismatches in profit or loss. New accounting mismatches could arise on first applying IFRS 17 if an entity were unable to reconsider the classification of financial assets that were classified at an earlier date in accordance with IFRS 9. The Board concluded that entities should be able to designate financial assets using the fair value option on first applying IFRS 17 to the same extent that they would have been able to do so when first applying IFRS 9. In addition, the Board decided that, following earlier application of IFRS 9, an entity should be permitted to newly elect to use other comprehensive income to recognise changes in the fair value of some or all equity investments that are not held for trading, or to revoke such an election. The criterion for this classification option does not refer to accounting mismatches, so the Board decided that entities should be able to reconsider this election regardless of whether there is an effect on accounting mismatches when IFRS 17 is applied. Even though accounting mismatches do not determine the availability of this classification option, the Board noted that in practice entities may consider accounting mismatches when deciding whether to apply the option.
- BC398 A major factor in the classification of financial assets in accordance with IFRS 9 is an entity's business model. The application of IFRS 17 would not of itself have been likely to have resulted in a change in an entity's business model in accordance with IFRS 9. However, the Board acknowledged that there is a relationship between how entities manage their financial assets and their insurance contract liabilities. Therefore, to reduce the risk of accounting mismatches arising, the Board decided to allow an entity to reassess its business models on the initial application of IFRS 17 if they have previously applied IFRS 9.

Transition disclosures (paragraphs 114–116 of IFRS 17)

- BC399 The Board expects that there will be some differences in the measurement of insurance contracts when applying the different transition approaches permitted in IFRS 17. Accordingly, the Board decided to require that an entity provides disclosures that enable users of financial statements to identify the effect of groups of insurance contracts measured at the transition date applying the modified retrospective approach or the fair value approach on the contractual service margin and revenue in subsequent periods. Furthermore, the Board decided that entities should explain how they determined the measurement of insurance contracts that existed at the transition date for all periods in which these disclosures are required, for users of financial statements to understand the nature and significance of the methods used and judgements applied.

Disclosure of the amount of adjustment for each financial statement line item affected (paragraph 28(f) of IAS 8)

- BC400 An entity is required to apply the disclosure requirements of IAS 8 unless another Standard specifies otherwise. The Board decided that entities should not be required to disclose, for the current period and for each prior period presented, the amount of the adjustment for each financial statement line item affected, as required by paragraph 28(f) of IAS 8. In the Board's view, the cost of providing this disclosure, which would include the running of parallel systems, would exceed the benefits, particularly because IFRS 4 permitted an entity to use a wide range of practices.

Disclosure of claims development (paragraph 130 of IFRS 17)

- BC401 Paragraph 44 of IFRS 4 exempted an entity from disclosing some information about claims development in prior periods on first application of that Standard. The Board decided to carry forward in IFRS 17 a similar exemption for cost-benefit reasons.

Effective date (paragraphs C1 and C2 of IFRS 17)

- BC402 The Board generally allows at least 12 to 18 months between the publication of a new Standard and its mandatory effective date. However, in the case of major Standards, such as IFRS 17, that have a pervasive effect on entities, the Board has allowed longer implementation periods to allow entities time to resolve the operational challenges in implementing those Standards. At the same time, the Board needs to balance the advantage of a longer implementation period for preparers against the disadvantages of allowing inferior accounting practices, arising from IFRS 4, to continue.
- BC403 The Board noted that IFRS 17 will be complex for entities to apply. Accordingly, the Board decided that IFRS 17 should be applied by all entities for annual periods beginning on or after 1 January 2021, a period of approximately three and a half years from publication of the Standard. This allows entities a period of two and a half years to prepare, taking into account the need to restate comparative information.
- BC404 While the Board noted that this long implementation period may assist entities in meeting any increased regulatory capital requirements that follow the reporting of the higher liabilities that are expected in some jurisdictions, regulatory capital requirements and IFRS Standards have different objectives. The Board decided that the possible effects of regulatory capital requirements should not delay the implementation of a Standard intended to provide transparency about an entity's financial position.

Early application (paragraphs C1 and C2 of IFRS 17)

- BC405 IFRS 4 permitted an entity to change its accounting policies for insurance contracts if it showed that the change resulted in more relevant or reliable information. As a result, IFRS 4 would have permitted an entity to apply the requirements in IFRS 17, except for the requirements relating to other comprehensive income and transition relief. Accordingly, the Board concluded that it would be inappropriate to prohibit early application of IFRS 17.
- BC406 However, because IFRS 17 was developed in the context of IFRS 15 and IFRS 9, and given the extent of changes the Board expects will be needed to apply IFRS 17, the Board concluded that an entity should be permitted to apply IFRS 17 only when it also applies IFRS 15 and IFRS 9.

First-time adopters of IFRS Standards (Appendix D of IFRS 17)

- BC407 The Board sees no reason to give different transition approaches to first-time adopters of IFRS Standards from other entities. Consequently, the Board has amended IFRS 1 *First-time Adoption of International Financial Reporting Standards* to require the modified retrospective approach or the fair value approach in IFRS 17 when retrospective application of IFRS 17 is impracticable, as defined by IAS 8. The Board decided not to give any additional relief on the restatement of comparative amounts from that already in IFRS 1.

Appendix A

Summary of changes since the 2013 Exposure Draft

The following table summarises the main differences between the 2013 Exposure Draft and IFRS 17 *Insurance Contracts*.

Area of change	Description of change
Scope	
Fixed-fee service contracts	<ul style="list-style-type: none"> Removed the requirement that an entity must apply IFRS 15 <i>Revenue from Contracts with Customers</i> to fixed-fee service contracts that meet the definition of an insurance contract. An entity is permitted, but not required, to apply IFRS 15 to those contracts.
Combination of contracts	<ul style="list-style-type: none"> Revised the requirements on combining contracts so that insurance contracts should be combined only when a set of insurance contracts with the same or a related counterparty may achieve, or is designed to achieve, an overall commercial effect and combining those contracts is necessary to report the substance of those contracts.
Measurement	
Level of aggregation	<ul style="list-style-type: none"> Revised the requirements to require disaggregation of a portfolio of insurance contracts at initial recognition into groups of insurance contracts that are onerous, profitable with no significant possibility of becoming onerous and other profitable contracts, with a narrow exemption for the effects of law or regulatory constraints on pricing. Groups cannot contain contracts that are written more than one year apart. A portfolio of insurance contracts is defined as insurance contracts subject to similar risks and managed together.
Discount rate	<ul style="list-style-type: none"> Clarified the guidance when there is no, or little, observable market data.
Contractual service margin	<ul style="list-style-type: none"> Clarified the principle for the recognition pattern of the contractual service margin by providing guidance that, for contracts other than investment contracts with discretionary participation features, an entity should recognise the contractual service margin in profit or loss on the basis of coverage units. Revised the requirements so that an entity adjusts the contractual service margin for the changes in risk relating to future service, consistent with the changes in estimates of cash flows. Revised the requirements so that favourable changes in estimates that arise after losses were previously recognised in profit or loss are recognised in profit or loss, to the extent that they reverse previously recognised losses. Clarified what adjusts the contractual service margin. For example, changes in discretionary cash flows, as specified by the entity, are regarded as relating to future service.

BASIS FOR CONCLUSIONS ON IFRS 17 INSURANCE CONTRACTS

Area of change	Description of change
Insurance contracts with participation features	<ul style="list-style-type: none"> • Eliminated the mirroring approach proposed in the 2013 Exposure Draft for insurance contracts that require an entity to hold underlying items and specify a link to returns on those underlying items. • Introduced a definition of an insurance contract with direct participation features—ie a contract for which: (a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items; (b) the entity expects to pay the policyholder an amount equal to a substantial share of the returns from the underlying items; and (c) the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items. • Introduced a requirement that, for insurance contracts with direct participation features, changes in the estimate of the fee (equal to the entity’s expected share of the returns on underlying items minus any expected cash flows that do not vary directly with the underlying items) that the entity expects to earn from a group of insurance contracts adjust the contractual service margin. • Introduced an option for an entity not to adjust the contractual service margin for changes in fulfilment cash flows or the entity’s share of underlying items for which an entity uses derivatives to mitigate their financial risk in specified circumstances.
Premium allocation approach	
Measurement	<ul style="list-style-type: none"> • Revised the recognition of revenue over the coverage period to be according to the passage of time or, when the expected pattern of release of risk differs significantly from the passage of time, the expected timing of incurred insurance service expenses. • Revised to require an entity to determine the insurance finance income or expenses in profit or loss for the liability for incurred claims using the discount rates determined at the date the liability for incurred claims is recognised. This occurs when the entity applies the premium allocation approach to contracts for which the entity discounts the liability for incurred claims and chooses to present the effect of changes in discount rates in other comprehensive income.
Reinsurance contracts held	
Measurement	<ul style="list-style-type: none"> • Revised to require an entity that holds a group of reinsurance contracts to recognise immediately in profit or loss any changes in estimates of fulfilment cash flows that arise from changes in estimates of fulfilment cash flows for a group of underlying insurance contracts that are recognised immediately in profit or loss.
Presentation and disclosure	
Presentation of insurance revenue	<ul style="list-style-type: none"> • Amended to prohibit an entity from presenting premium information in profit or loss if that information is not consistent with insurance revenue determined by applying IFRS 17.

BASIS FOR CONCLUSIONS ON IFRS 17 INSURANCE CONTRACTS

Area of change	Description of change
Presentation of insurance finance income or expenses	<ul style="list-style-type: none"> • Introduced an accounting policy choice for an entity to: (a) include insurance finance income or expenses for the period in profit or loss; or (b) disaggregate insurance finance income or expenses for the period into an amount recognised in profit or loss and an amount recognised in other comprehensive income. • Specified that if the entity disaggregates insurance finance income or expenses into an amount recognised in profit or loss and an amount recognised in other comprehensive income: <ul style="list-style-type: none"> • in most circumstances, the amount included in profit or loss is determined by a systematic allocation of the total expected insurance finance income or expenses over the duration of the group of insurance contracts. • when the contracts are insurance contracts with direct participation features and the entity holds the underlying items (ie there is no economic mismatch between the group of insurance contracts and the related underlying items), the amount included in profit or loss is determined to eliminate accounting mismatches with the finance income or expenses arising on the underlying items held.
Transition	
When retrospective application is impracticable	<ul style="list-style-type: none"> • Revised to provide further simplifications for groups of insurance contracts for which retrospective application is impracticable, including allowing entities to choose between a modified retrospective approach and a fair value approach. The modified retrospective approach allows an entity to use specified simplifications to retrospective application, to the extent necessary because the entity lacks reasonable and supportable information to apply IFRS 17 retrospectively. The fair value approach requires an entity to determine the contractual service margin by reference to the fair value of the group of insurance contracts at the transition date.
Designation of financial instruments using IFRS 9 <i>Financial Instruments</i>	<ul style="list-style-type: none"> • Revised to permit an entity, when first applying IFRS 17 after having applied IFRS 9, to newly assess the business model for eligible financial assets based on facts and circumstances applicable at the date of initial application. • Revised to require an entity to provide additional disclosures to assist users of financial statements in understanding those changes when the classification and measurement of financial assets change as a result of applying any of the transition reliefs in IFRS 17.
Comparative information	<ul style="list-style-type: none"> • Revised to require only one comparative period to be restated, applying IFRS 17 on transition.

Appendix B Amendments to the Basis for Conclusions on other IFRS Standards

This appendix sets out the amendments to the Basis for Conclusions on other IFRS Standards that are a consequence of the International Accounting Standards Board issuing IFRS 17 Insurance Contracts.

IFRS 3 *Business Combinations*

A footnote is added to 'paragraph 17' in the first sentence of paragraph BC188.

IFRS 17 *Insurance Contracts*, issued in May 2017, replaced IFRS 4 and amended paragraph 17 of IFRS 3 for consistency with the requirements in IFRS 17.

A footnote is added to the heading '*Recognition, classification and measurement guidance for insurance and reinsurance contracts*' before paragraph BC189.

IFRS 17, issued in 2017, replaced IFRS 4. The requirements for insurance contracts acquired in a business combination are provided in IFRS 17 and are discussed in paragraphs BC323–BC327 of the Basis for Conclusions of IFRS 17.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

A footnote is added to 'insurance contracts' in paragraph BC13.

IFRS 17 *Insurance Contracts*, issued in May 2017, replaced IFRS 4. In developing IFRS 17, the Board concluded that fair value could be determined for insurance contracts. Nonetheless, groups of insurance contracts within the scope of IFRS 17 that are assets are excluded from the measurement requirements of IFRS 5.

IFRS 7 *Financial Instruments: Disclosures*

A footnote is added to 'IFRS 4 *Insurance Contracts*' in paragraph BC9.

IFRS 17 *Insurance Contracts*, issued in May 2017, replaced IFRS 4.

A footnote is added to 'IFRS 4' in paragraph BC37.

In developing IFRS 17, the Board concluded that fair value could be determined for such financial instruments. The disclosure requirements for contracts within the scope of IFRS 17 are provided in IFRS 17.

IFRS 9 *Financial Instruments*

A footnote is added to 'IFRS 4 *Insurance Contracts*' in paragraph BC22.9 and to 'insurance project' in paragraph BC5.43.

The Board completed its insurance project with the issuance of IFRS 17. IFRS 17, issued in May 2017, replaced IFRS 4. IFRS 17 did not change the scope requirements relating to financial guarantee contracts.

After paragraph BC3.31, a heading and paragraph BC3.32 are added.

Exemption for repurchased financial liabilities

BC3.32 IFRS 9 sets out the requirements for the derecognition of financial liabilities. IFRS 17 *Insurance Contracts* amended those derecognition requirements in IFRS 9 by permitting an exemption when an entity repurchases its financial liability in specific circumstances. The Board's considerations in providing that exemption are set out in paragraph BC65(c) of the Basis for Conclusions on IFRS 17.

A footnote is added to the first reference to 'Insurance Contracts project' in paragraph BC4.159 and to the heading 'Transitional insurance issues' before paragraph BC7.30.

IFRS 17 *Insurance Contracts*, issued in May 2017, replaced IFRS 4 *Insurance Contracts*.

IFRS 14 *Regulatory Deferral Accounts*

A footnote is added to 'IFRS 4 *Insurance Contracts*' in paragraph BC31.

IFRS 17 *Insurance Contracts*, issued in May 2017, replaced IFRS 4.

IFRS 15 *Revenue from Contracts with Customers*

A footnote is added to 'insurance contracts' in paragraph BC60.

IFRS 17 *Insurance Contracts*, issued in May 2017, permits an entity to choose whether to apply IFRS 17 or IFRS 15 to fixed-fee service contracts that meet the definition of an insurance contract. The Board's considerations for permitting this choice are set out in paragraphs BC95–BC97 of the Basis for Conclusions on IFRS 17.

A footnote is added to 'IFRS 4 *Insurance Contracts*' in paragraph BC65.

IFRS 17 *Insurance Contracts*, issued in May 2017, replaced IFRS 4.

A footnote is added to 'insurance contracts' in paragraph BC373.

The Board completed its insurance project with the issuance of IFRS 17 *Insurance Contracts*. IFRS 17, issued in May 2017, replaced IFRS 4.

IAS 16 *Property, Plant and Equipment*

After paragraph BC33G, a heading and paragraph BC33H are added.

Exemption for owner-occupied property

BC33H IFRS 17 *Insurance Contracts* amended the subsequent measurement requirements in IAS 16 by permitting entities to elect to measure owner-occupied properties in specified circumstances as if they were investment properties measured at fair value through profit or loss in accordance with IAS 40 *Investment Property*. The Board's considerations in providing that exemption are set out in paragraph BC65(c) of the Basis for Conclusions on IFRS 17.

IAS 19 *Employee Benefits*

Footnotes are added to 'IFRS 4 *Insurance Contracts*' in paragraphs BC190 and BC212.

IFRS 17 *Insurance Contracts*, issued in May 2017, replaced IFRS 4.

IAS 32 *Financial Instruments: Presentation*

The heading after paragraph BC31 is amended. New text is underlined and deleted text is struck through. After paragraph BC32, paragraph BC32A is added.

Treasury shares (paragraphs 33, ~~34~~ and AG36)

...

BC32A IFRS 17 *Insurance Contracts* amended IAS 32 by permitting an exemption to the requirements for treasury shares in paragraph 33 of IAS 32 in specified circumstances. The Board's considerations in providing that exemption are set out in paragraph BC65(c) of the Basis for Conclusions on IFRS 17.

IAS 40 *Investment Property*

A footnote is added to the last sentence in paragraph B34.

IFRS 17 *Insurance Contracts* amended the subsequent measurement requirements in IAS 16 by permitting entities to elect to measure owner-occupied properties in specified circumstances as if they were investment properties measured at fair value through profit or loss in accordance with IAS 40. The Board's considerations in providing that exemption are set out in paragraph BC65(c) of the Basis for Conclusions on IFRS 17.

IFRIC 22 *Foreign Currency Transactions and Advance Consideration*

A footnote is added to the last sentence of paragraph BC8.

The Board completed its insurance project with the issuance of IFRS 17 *Insurance Contracts* in May 2017. When applying IAS 21, a group of insurance contracts is treated as a monetary item.

SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*

A footnote is added to the end of the first sentence in paragraph 15.

IFRS 17 *Insurance Contracts*, issued in May 2017, replaced IFRS 4.