DAV

DEUTSCHE AKTUARVEREINIGUNG e.V.

Ergebnisbericht des Ausschusses Rechnungslegung und Regulierung
(Report on findings of the Accounting and Regulation Committee)

Portfoliobildung unter IFRS 17

Köln, 31. Dezember 2019

Präambel

Der Ausschuss Rechnungslegung und Regulierung der Deutschen Aktuarvereinigung e. V. hat den vorliegenden Ergebnisbericht erstellt.[1]

Zusammenfassung

Der Ergebnisbericht behandelt Fragestellungen zur Segmentierung der Bestände an Versicherungsverträgen in Bezug auf den IFRS 17 und betrifft Aktuare, die in aktuariellen Abteilungen, im Rechnungswesen, bei Wirtschaftsprüfungsgesellschaften oder als Berater für IFRS 17 Implementierungen tätig sind und aktuarielle Aufgaben im Rahmen von Quartals- und Jahresabschlüssen bei Erst- oder Rückversicherungsunternehmen wahrnehmen.

Der Anwendungsbereich umfasst die Verträge, die unter den internationalen Rechnungslegungsstandard IFRS 17 *Insurance Contracts* vom 18. Mai 2017 fallen. Die Anwendung von IFRS 17 ist für nach IFRS berichtende Konzerne verpflichtend. Da hiervon vor allem internationale kapitalmarktorientierte Unternehmen betroffen sind, wurde der vorliegende Ergebnisbericht in englischer Sprache verfasst.

Der Ergebnisbericht ist an die Mitglieder und Gremien der DAV zur Information über den Stand der Diskussion und die erzielten Erkenntnisse gerichtet und stellt keine berufsständisch legitimierte Position der DAV dar.[2]

Verabschiedung

Der Ergebnisbericht ist durch den Ausschuss Rechnungslegung und Regulierung am 31. Dezember 2019 verabschiedet worden.

---

[1] Der Ausschuss dankt der Unterarbeitsgruppe *Portfolio* der Arbeitsgruppe *IFRS* ausdrücklich für die geleistete Arbeit, namentlich Dr. Maximilian Happacher und Vjaceslavs Geveilers (Leitung), Dr. Christine Barop, Friedrich Bolz, Anja Eickhoff, Dr. Volker Goersmeyer, Volker Hannemann, Dr. Christian Knoller, Reinhard Lenz, Dr. Andreas Weng.

[2] Die sachgemäße Anwendung des Ergebnisberichts erfordert aktuarielle Fachkenntnisse. Dieser Ergebnisbericht stellt deshalb keinen Ersatz für entsprechende professionelle aktuarielle Dienstleistungen dar. Aktuarielle Entscheidungen mit Auswirkungen auf persönliche Vorsorge und Absicherung, Kapitalanlage oder geschäftliche Aktivitäten sollten ausschließlich auf Basis der Beurteilung durch eine(n) qualifizierte(n) Aktuar DAV/Aktuarin DAV getroffen werden.

Preamble

The Accounting and Regulation Committee of the German Association of Actuaries (Deutsche Aktuarvereinigung (DAV) e. V.) has issued the following report on findings to the topic IFRS 17 Portfolio.[3]

Issue

The report is intended to provide assistance to actuaries in the preparation for IFRS 17 and to provide guidance how to apply the new standard in practice. This report deals with the questions of IFRS 17 segmentation / Unit of Account determination and concerns actuaries, working on the IFRS 17 implementation in Actuarial Departments, in Accounting, for Audit Companies or as Consultants, taking over actuarial tasks in context of the Annual and Interim Reporting of Primary Insurance or Reinsurance companies.

This report addresses the contract definition under IFRS 17, combination of contracts and separation of components and the requirements for building the Units of Account, as well as contract boundary and contract modifications.

The report is addressed to actuaries and is focused on providing an overview of the current state of discussions and the insights gained in the sub-working group. It is not a professionally position of the DAV and is meant to support actuaries in actuarial teams.

Adoption

The report on findings was adopted by the DAV's Accounting and Regulation Committee on 31 December 2019.

[3] The Committee would like to explicitly thank the sub-working group *Portfolio* of the working group *IFRS* for their work, by name Dr. Maximilian Happacher and Vjaceslavs Geveilers (Leader), Dr. Christine Barop, Friedrich Bolz, Anja Eickhoff, Dr. Volker Goersmeyer, Volker Hannemann, Dr. Christian Knoller, Reinhard Lenz, Dr. Andreas Weng.

Inhaltsverzeichnis

1. Introduction

This paper addresses the contract definition under IFRS 17, combination of contracts and separation of components and the requirements for building the units of account, as well as contract boundary and contract modifications. The unit of account for the initial and subsequent measurement of the CSM is formed by so-called groups of insurance contracts (GICs), see IFRS 17.14-24.

The definition for insurance contracts remains largely unchanged compared to IFRS 4. Special issues arising for certain product are discussed in the separate papers on Property & Casualty, Life and Health business.

2. Contracts and Contract boundary

2.1. Contracts

The term "contract" is defined in IFRS 17.2 as an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be based on oral or written agreements or can even be generated by the entity's business practice.

Contractual terms include not only the terms agreed in the contract, but also terms imposed by law or regulation.

Enforceability of the rights and obligations is a legal matter.

According to IFRS 17 Appendix A, an insurance contract is "a contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder."

2.2. Separation of Non-Insurance Components

According to IFRS 17.11-12, the following components shall be separated from an insurance contract and measured according to the applicable IFRSs:

- derivatives embedded in the contract if not closely related (IFRS 9)
- investment components if distinct (IFRS 9)
- promises to transfer goods or non-insurance services if distinct (IFRS 15)

"Distinct" is defined in IFRS 17.B31-32 as not highly interrelated (i.e. the components can be measured separately or the policyholder can benefit from one component even if the other is not present) and the component could theoretically be sold as a separate product in the same market or jurisdiction.

The remaining paragraphs of IFRS 17 apply to the host contract after separation of these components (IFRS 17.13).

2.2.1 Embedded Derivatives

Embedded derivatives that are themselves contracts within the scope of IFRS 17 are excluded from the scope of IFRS 9 (IFRS 9.2.1(c)); hence such embedded derivatives should not be separated.

In general, it should be analysed if

- the criteria for an embedded derivative are fulfilled (see IFRS 9) and
- the embedded derivative is not closely related to the host contract and
- the embedded derivative is not in the scope of IFRS 17

If all three criteria are fulfilled then the embedded derivative has to be separated. In typical German insurance products, there are no embedded derivatives to be separated.

2.2.2 Investment Components

Investment components are defined as the amounts that an insurance contract requires the entity to repay a policyholder even if an insured event does not occur (IFRS 17, Appendix A).

The contract does not contain investment components if there is one scenario where the policyholder does not receive any payment out of the contract (see also BC34).

Non-distinct investment components are not separated, but excluded from profit or loss (see IFRS 17.85).

IFRS 9 is applied on separated investment components (see IFRS 17.11(b)).

2.2.3 Service Components

Non-insurance components that do not fulfil the criteria for separation have to be measured together with the host contract (IFRS 17.BC114).

According to IFRS 17.B35 a good or non-insurance service that is promised to the policyholder is not distinct if:

a) the cash flows and risks associated with the good or service are highly interrelated with the cash flows and risks associated with the insurance components in the contract; and

b) the entity provides a significant service in integrating the good or non-insurance service with the insurance components.

Promises to transfer goods or non-insurance services in insurance contracts have to be checked on individual contract clause basis.

2.3. Combination of Contracts and Separation of Insurance Components

IFRS 17.9 allows treating different insurance contracts with the same or a related counterparty as one contract if this is necessary in order to report the substance of those contracts.

Although not required or stated in the standard, companies might on the other hand consider to disaggregate certain insurance contracts into several insurance components, provided these components are separable (e.g. in analogy to the criteria given in B31–B32 and BC100 for investment components), if this leads to more useful information about the economic substance of the contract.

Note that this is only permissible for insurance components; separation of other components is prohibited if not required. IFRS 17.13 (compare BC 114) requires applying IFRS 17 to all components after obligatory separation – but if the contract is separated in two insurance components, both would be subject to IFRS 17[4].

---

[4] According to the TRG (February 2018), there is a presumption that a single legal contract is the lowest unit of account, but it may be appropriate to override this

2.4. Contract boundary

The contract boundary marks the point where substantial rights and obligations resulting from the contract (i.e. the binding elements between the parties) cease to exist. This boundary is reassessed at each reporting date (B64).

Only cash flows within the contract boundary are included in the measurement of the contract (IFRS 17.33).

According to IFRS 17.34, binding elements between the parties are rights and obligations, e.g.

- The entity's obligation to provide services or
- The policyholder's obligation to pay premiums (IFRS 17.34).

A substantive obligation to provide services (and hence the boundary of a contract) ends when the entity can set a price or level of benefits that fully reflects the risks of

- the particular policyholder

or

- of a set of insurance contracts that contains the contract and the pricing of the premiums for coverage up to the date when the risks[5] are reassessed does not take into account the risks that relate to future periods.

General rules and requirements for the existence of rights and obligations (e.g. enforceability of rights and obligations, legal forms of contracts, definition of contractual terms, law and regulation being part of the contract) are outlined in IFRS

---

presumption in order to reflect the substance of the contractual rights and obligations. An example given by the TRG is "when more than one type of insurance cover is included in one legal contract solely for the administrative convenience of the policyholder and the price is simply the aggregate of the standalone prices for the different insurance covers provided."

[5] A TRG Agenda Paper 03 (May 2018) clarifies that "risks" in this context means "risks transferred from the policyholder to the entity". It also states that the entity has to be able to set a price that fully reflects the risks for the entire contract, not only for certain components. If this is not the case, the criteria of IFRS 17.34 are not fulfilled and the reassessment does not mark a contract boundary. Further, the TRG views constraints in pricing that equally affect new and existing contracts as no restriction of the entity's practical ability to reprice existing contracts. On the other hand, according to the TRG, a practical ability to reassess the risks does not mark a contract boundary if the entity lacks a right for adequate repricing. The TRG also points out that pricing constraints are not limited to legal or regulatory constraints.

17.2. These rules have to be applied when deciding whether rights and obligations are still present, i.e. when determining the contract boundary (B61).

Following BC160-BC163, the core of the contract boundary is the existence of binding elements between the parties; if both parties are equally bound or if neither party is bound, the boundary of the contract is rather clear.

Hence, the point where the entity is no longer required to provide coverage and the policyholder has no right of renewal marks the outer limit of the contract (BC160(a)).

If the policyholder has the right to stop premium payment, but the entity has to continue to accept premiums paid and has to continue to provide coverage, then those premiums and this coverage are within the contract boundary (BC162(b)).

There are cases where the entity's rights to reassess the risks within a contract have the effect that the entity is no longer bound by the existing contract (BC160(b)-BC163).

3. Unit of account

3.1. Overview

After the assessment of relevant requirements on separation and combination, insurance contracts have to be aggregated into units of accounts (GICs) for initial (and subsequent) measurement, see IFRS 17.14-24.

According to BC 126, the board's objective behind the criteria for building the GIC is to achieve a balance between loss of information and useful information rather than ending up with a very large number of GICs and thus in an operational burden, which would contradict the objective (see also BC 123-127).

According to IFRS 17.1, the objective of the standard is "to ensure that entities provide relevant information in a way that faithfully represents those contracts."

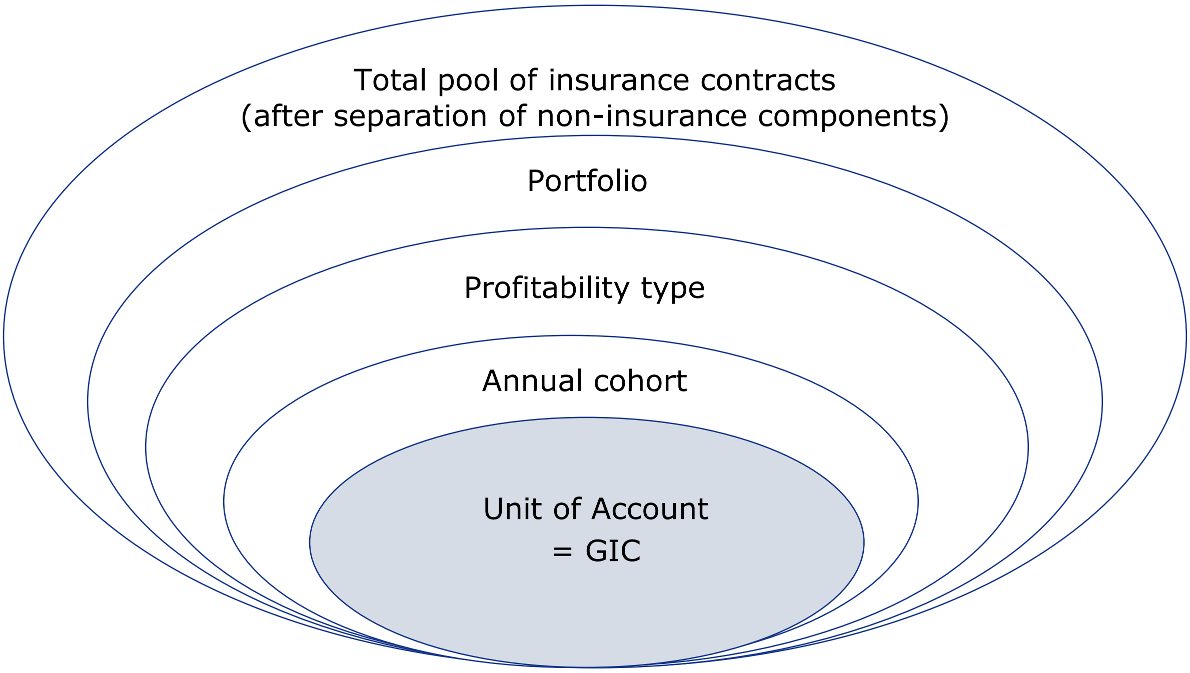
Given the standard aims for relevant and faithful information about the entity's insurance business, this overall purpose is a guideline for forming groups of insurance contracts.

Further background information on the IASB's considerations concerning grouping of insurance contracts for measurement purposes can be found in IFRS 17.BC115-139.

To build Groups of Insurance Contracts, the total pool of the entity's insurance contracts should be subdivided as follows:

- portfolios of contracts, i.e. contracts that have similar risks and are managed together
- within the same portfolio: different profitability types, i.e. contracts that are onerous at inception, contracts that have no significant probability to become onerous and all other contracts
- within different profitability types: cohorts of contracts issued within one year

Moreover, although not explicitly addressed in IFRS 17.14-24, it may be assumed that contracts subject to different measurement models (BBA, VFA or PAA) cannot be in the same GIC.



Further distinctions within the subsets, e.g. separate profitability buckets for finer profitability-levels based on information from the entity's internal reporting are permitted but not required (see IFRS 17.21).

When allocating contracts to portfolios and GICs, contractual rights and options have to be taken into account. For more details please refer to chapter 4 (contract modifications).

The following chapter covers the questions on segmentation assessment that arise at initial measurement of insurance contracts.

The requirements for forming the unit of account at transition are addressed in the paper on transition.

3.2. Unit of account at initial measurement

3.2.1 Portfolio of insurance contracts

According to IFRS 17.14 an entity shall identify portfolios of insurance contracts. A portfolio comprises contracts which are subject to similar risks and which are managed together. Contracts within a product line would be expected by the IASB to have similar risks and hence would be expected to be in the same portfolio if they are managed together. Contracts in different product lines would not be expected to have similar risks and hence would be expected to be in different portfolios. The notion of product lines is not further defined in the standard.

3.2.1.1 Similar Risks

The definition of "similar risks" is rather wide (product lines, see IFRS 17.14) and the notion is not defined in the standard.

Any definition for "similar risk" must start with a definition of risk (in terms of risk for what?). In order to identify contracts subject to similar risks, several criteria can be applied. Potential definitions could cover

- insurance risk (uncertainty with regard to insured events)
- financial risk

and broader aspects like the risk of the company's default, risk for capital injections, risk for the company's dividend payment capability, risk for the expected profit stream etc.

With regard to a consistent and meaningful reporting the term "risk" could be seen as risk for the profitability of the new business when initially measured.

Obviously, some risks may be existent at the same time within a legal insurance contract. E.g. one legal insurance contract could include several insurance risks (like modular coverages in P&C or main contract plus rider like disability in life). As a general guidance, if these insurance risks are independent from each other and not similar and the corresponding components can be measured separately, a split of one legal insurance contract into separate insurance contracts allocated to separate portfolios could be performed. In contrast, if the different components of a legal insurance contract, be it insurance risk or financial risk, are not independent from each other and cannot be measured separately, the different components belong to the same insurance contract allocated to one portfolio.

If multiple risks belong to one insurance contract, it requires judgement considering the hierarchy of the relevance of these risks. Usually an entity should be able to determine the contract's predominant risk structure which then determines the portfolio the contract belongs to.

3.2.1.2 Managed together

The term "managed together" is also not explicitly defined in the standard. Assessment for "managed together" requires the internal view of the applying entity and would thus be based on the internal lines of business reporting, internal profit responsibility etc. Therefore, only some hints and indications how to identify contracts considered as managed together can be given here.

For example, an analysis might be based on

- the entity's internal management practice and
- the board's objective to obtain useful information without creating too large numbers of GICs

and might e.g. take some of the following considerations into account (note that this is not intended as a directive, let alone a complete list):

The level of…

- …(new business) reporting
- …pricing
- …(local GAAP) policyholder profit participation schemes
- …reinsurance
- …asset management
- …underwriting rules
- …different treatment of inforce business

Typically the management of insurance contracts follows the insurance principle, i.e. achieving predictable cash flows for all stakeholders by pooling homogenous risks in one set of contracts. We assume that dividing the contracts into "similar risks" (see criterion above) should usually fulfil the requirement "managed together". However, if there are strict separated responsibilities (e.g. derivation of assumptions, separate models, etc.), further segmentations of the portfolio might be required.

The price of the protection provided for the risks within the pool typically results from a mathematical model. The pricing model typically is the basis for initial pricing of contracts as well as for actions during the lifetime of a policy such as premium increases or portfolio cleaning. For this reason the contracts covered by one pricing model could be one criterion for the consideration "managed together".

3.2.1.3 Examples

A starting point for defining portfolios for IFRS 17 purposes could be the Lines of Businesses as defined in Solvency II.

For Life insurance, a first step is usually to differentiate between traditional vs. unit-linked business. Furthermore, term life, endowments or annuities could form different portfolios as they have different inherent risks. Depending on how the contracts are managed, a further separation could be reasonable. On the other side, the German life business is mutualized in the sense of IFRS 17.B67-B71, meaning that the management of the business is usually performed at a high level.

For P&C primary business additional aspects in comparison to the Solvency II Lines of Businesses – such as customer segments or distribution channels – could be included, but might already be too granular for the definition of portfolios and more suited to be considered for assessing profitability types (see next chapter).

For more details please refer to the publications of the DAV-working groups for Health/Life/Non-Life, respectively.

3.2.2 Profitability types

Portfolios of insurance contracts issued should be further divided according to IFRS 17.16 into a minimum of:

a) a group of contracts that are onerous at initial recognition, if any;

b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and

c) a group of contracts of the remaining contracts in the portfolio, if any.

According to IFRS 17.47 and 17, the assessment whether contracts are onerous or have no significant possibility of becoming onerous can be carried out for a set of contracts if there is "reasonable and supportable information" that the contracts are in the same group. On the contrary, if there is a lack of reasonable and supportable information, individual contracts have to be considered.

IFRS 17.20 provides an exception if the only reason for contracts within the same portfolio to fall into different profitability types are constraints imposed by law or regulation on taking certain characteristics of different policyholders into account when setting the price or benefit levels. In this case, these contracts may be included in the same group.

If the respective portfolio would not be separated without those constraints imposed by law or regulation, then the portfolio need not be separated on these grounds.

As the cash flow calculations are used for determining the profitability types, cross-effects (e. g. "mutualisation") between different types of products are taken into account when determining the probability of becoming onerous (IFRS 17.B67-B69).

The standard setter allows in IFRS 17.21 to further subdivide the groups described in IFRS 17.16. E.g. an entity may choose to divide the portfolios into:

(a) more groups that are not onerous at initial recognition—if the entity's internal reporting provides information that distinguishes:

(i) different levels of profitability; or

(ii) different possibilities of contracts becoming onerous after initial recognition; and

(b) more than one group that are onerous at initial recognition—if the entity's internal reporting provides information at a more detailed level about the extent to which the contracts are onerous.

Special case: PAA

According to IFRS 17.18, contracts that are accounted for under the Premium Allocation Approach (PAA) are assumed to be not onerous at initial recognition, "unless facts and circumstances indicate otherwise". An onerous contract test should be conducted any time during the coverage period, if "facts and circumstances" indicate that a group of contracts is onerous. There is no further specification in IFRS 17 regarding facts and circumstances which means that entities shall perform their own qualitative assessment. A differentiation between profitability types b) and c) could be based on an analysis taking into account "the likelihood of changes in applicable facts and circumstances".

If a (set of) contract(s), at any time during the coverage period has been assessed as being onerous, a loss component shall be established. For further details see "DAV-Report on findings of the Accounting and Regulation Committee: IFRS 17 for non-life insurers", chapter "Identification of onerous contracts (OCT)".

All other measurement models

For contracts not subject to the PAA, the profitability types have to be analysed according to IFRS 17.19: the analysis whether a contract that is not onerous at inception has a significant possibility of becoming onerous (i.e. whether the contract is of type b) or c) following IFRS 17.16), should be based on the assumptions which impact the profitability of the contract, taking the likelihood of changes in those assumptions into account (see IFRS 17.19 (a)). Moreover, the analysis should be based on "information about estimates provided by the entity's internal reporting" i.e. relevant data readily available in internal reporting should be regarded, but there is no need to gather additional information (see IFRS 17.19 (b)).

Hence the question is how to discern between the different subcategories listed in IFRS 17.16. Generally this has to be answered by each single company based on its own expectations and analysis. Of course this analysis has to be in line with the IASB's general objective to provide useful and timely information about onerous contract groups and, in particular, to avoid inappropriate offsetting of onerous groups with profitable groups. Note that taking certain interactions between contracts (e. g. risk sharing among sets of contracts or mutualisation) into account is required by the Standard and hence not inappropriate offsetting (see IFRS 17.B68 and BC 171). The entity might consider to include suitable rules in its accounting policy, which describes the methods used for identifying onerous contracts, and sets definite criteria for the identification of insurance contracts that have no significant risk of becoming onerous.

The principle of "using reasonable and supportable information" is not defined unambiguously with respect to the words "reasonable" and "supportable". On the other hand a more detailed definition would lead to inappropriate limitations as the interpretation heavily depends on the specifics of the insurance business written and how it is managed. For this reason any further clarification does not appear to be necessary for meeting the IASB's objective to clearly present under-priced new business.

If exogenous profitability measures are available, the aggregation of insurance contracts to the groups of contracts can potentially also be based on these measures. One example could be a legal or regulatory requirement that prohibits an entity to write loss-making business. In such a circumstance, there would be strong evidence that there are no onerous contracts at inception within the portfolio.

More detailed considerations w.r.t. the profitability assessment

Typically the price for insurance protection and the profitability of a contract as well as the risk of insurance contract becoming onerous is linked to the sensitivity and volatility of the key drivers of the risk insured. Consequently, considering relevant information on the risk drivers in pricing has a major influence on the profitability of a contract. This leads to the question to what extent pricing information relates to the differentiation for accounting purposes: Does any information considered in pricing trigger a differentiation in accounting? Or changing necessity and sufficiency: Is it necessary to differentiate in accounting in case of availability of additional information not included in pricing?

Starting point of the assessment of needed level of differentiation is any information available regarding the individual characteristics of each contract affecting the cash flows and consequently the expected individual profitability. However, according to IFRS 17.17, individual assessment is not necessary if "an entity has reasonable and supportable information to conclude that a set of contracts will all be in the same group applying paragraph 16".

The following list discusses some aspects which might be taken into account in the assessment. These are only examples and not intended as a directive, let alone a complete list of possible criteria and interpretations.

Positively,

- The entity might adopt a rather detailed pricing and/or underwriting strategy for certain products which might e.g. involve premium surcharges for impaired risks (which are considered in premium cash flows) or differentiation in acquiring contracts, including pricing, product styling and underwriting process, or different practice regarding contract administration and claims settlement. These aspects might be considered in the assessment as far as they might lead to different profitability types in the sense of IFRS 17.16.
- On the other hand, the entity might adopt a less detailed pricing and/or underwriting strategy for certain products which might cause certain effects like e.g. anti-selection. If these effects are observable or expected on a reasonable and supportable basis, they might be taken into account in case they might lead to different profitability types in the sense of IFRS 17.16.

Negatively,

- Individual characteristics would not be considered if they are not readily available for the actuarial valuation process because of the application of a cost over benefit analysis.

- Knowledge would be ignored which is not systematically assessed but incidentally obtained that does not provide representational or unbiased information. E.g., if the insurer incidentally knows that 2 out of 100 insured people are smokers while the insurer had expected in its mortality assumptions that 40 insured persons smoke, the insurer would not consider that knowledge about the actual mix, since it is already included in the average, if there is no indication that this information would affect the acquisition process or result in antiselection. The fact that the insurer incidentally knows a characteristics which is not or would not be relevant for managing the contracts would not change the measurement, since the incidental fact of availability of the knowledge does not change the economics of the contracts and the business activity.
- If there are objectively determinable differences in expected profitability between contracts, but the insurer could not achieve the profits of the more profitable contracts without accepting the less profitable contracts, the differentiation is not economically relevant since the contracts are interrelated. Consequently differentiation would not provide decision-useful information. E.g., if the insurer has to accept contracts without the ability to respond appropriately to a relevant differentiating characteristic, the acceptance of less profitable contracts is the unavoidable consequence of accepting the more profitable contracts. As long as those contracts are together profitable, the insurer made an economically reasonable decision in writing them.
- Information can be ignored, if differences in pricing reflect the different levels of a risk driver leading to homogenous profit levels (e.g. pricing for professional groups etc.).
- Constraints on pricing imposed by law or regulation need not be considered if the criteria of IFRS 17.20 are fulfilled.

3.2.3 Annual Cohorts

IFRS 17.22 requires that entities should not include contracts issued more than one year apart in the same GIC. To achieve this, the entity shall, if necessary, further divide the subsets described in IFRS 17.16–21.

Please note the related comments of the DAV on the Exposure Draft Amendments to IFRS 17 of the International Accounting Standards Board. Especially, the DAV strongly disagrees with the clarification in BC150, which states that "the intention of paragraph 22 of IFRS 17 is to refer to the time at which insurance contracts are issued, rather than recognized. Therefore, the Board is not proposing to amend paragraph 22 of IFRS 17".

In our view, the objectives of the annual cohorts requirements, i.e. to appropriately depict trends in an entity's profit over time; to recognize profits of contracts over the duration of those contracts, and timely recognition of losses from onerous contracts, are met for both concepts (i.e. issue date or recognition date). However, to build up a group of contracts and therefore track them based on the issue date would require a data base which is not available in systems so far. An implementation of the "issued" approach would require significant change to the current systems.

The DAV interpreted the corresponding tentative decision made by the IASB during the development of the Insurance Contracts standard differently and still strongly believe, that the requirements of the proposed standard need to be consistent between Recognition and Level of aggregation of insurance contracts.

We believe that conceptually it is more appropriate to align the date for the grouping with the recognition date than with the issue date. Grouping a contract that is not yet recognized into an established annual cohort would rather be confusing. To keep the date for the grouping consistent with the recognition date fits better to the way of how the entity manage its business.

Overall, the DAV believes that the requirement to use the issue date for the annual cohorts requirements would require substantial additional implementation costs which out-weigh significantly the additional benefits it might have.BC 138 indicates that annual cohorts might not be necessary if the same accounting outcome is achieved without annual cohorts. Especially in Life and Health insurance, cash flow cross-influences between contracts (in particular mutualisation) give rise to certain questions when forming the GIC and annual cohorts. These questions are addressed in the respective papers on Life and Health business.

3.3. Assigning cash flows to the unit of account

According to IFRS 17.24, the level of aggregation used for determining the cash flows can differ from the level of aggregation used for the GIC as long as the cash flows can be allocated to the GIC in an appropriate way. The allocation to each GIC must happen in a systematic and rational way.

Certain cash flows resulting from cross-effects between GICs have to be considered (see BC 171-174), IFRS 17.B67-B71 provide guidance for the case that policyholders of different GIC share in the same return on a specified pool of underlying items and the return for a GICs is influenced by the other GICs. According to IFRS 17.B70, the resulting cross-effects might only be determinable on a higher level of aggregation, in which case they also have to be allocated to the GICs in a systematic and rational way.

There is no further specification on how an allocation in a systematic and rational way should be done.

Note that cash flows of a single legal insurance contract may belong to different GICs, e.g. variable single premium payments into one contract where the insurance company has the right to fully reprice with every new single premium. On the other hand, such contract features might in certain cases also be seen as cash flows crossing the contract boundary (IFRS 17.B61, B63 and B64 last sentence) or as non-specified contract modifications (see below).

The special issues arising for Life, Health and P&C business are addressed in the respective separate papers.

3.4 Unit of Account at Subsequent measurement

According to IFRS 17.24, the GIC is established at initial recognition and not reassessed afterwards. This means that each contract is ear-marked at inception to which GIC it belongs, as long as the contract is not modified.

For contracts measured under models other than the PAA, entities are required to allocate the contractual service margin for a GIC over the current period and expected remaining coverage period; that allocation should be performed on the basis of coverage units, reflecting the expected duration and size of the contracts in the GIC (IFRS 17.38-39, 43-46 and B119).

3.5 Presentation

In the balance sheet, the LRC is shown as one amount which means that GICs, and in particular onerous groups having loss components, are not shown separately. However, in the disclosures, reconciliations from the opening to the closing balances have to be shown for the LRC excluding any loss component and the loss component separately (IFRS 17.100).

Under all measurement models, the establishment of and changes in a loss component have to be recognized immediately in P/L (IFRS 17.47).

After initial measurement, GICs usually appear in a liability position. Under some circumstances, however, a GIC may be an asset (e.g. contracts with payment in arrears). Initially, the Standard required entities to present GICs which are assets and GICs which are liabilities separately in the balance sheet (IFRS 17.78). Under the Exposure Draft ED/2019/4 this has been changed to a separation on portfolio level only.

4. Contract modifications and contractual options

4.1 Contract modifications

IFRS 17.72 defines contract modifications and the conditions under which a contract modification is specified, i.e. when such a modification triggers derecognition of the original contract and recognition of the modified contract as a new contract:

- A contract modification is a change in the terms of the contract, induced e.g. by mutual agreement or changes in regulations.
- Exercising contractual options is not a contract modification.
- A contract modification is specified if the modified terms would have caused differences in the applicability of IFRS 17, the separation of components, the contract boundary (only if substantially different) or the GIC at initial measurement. Modifications that affect the applicability of the measurement model of the original contract are also specified modifications (see IFRS 17.72 (a)-(c)).

If the contract modification is specified, the original contract is derecognized as described in IFRS 17.76 (a), (c) and 77(a), and the modified contract is recognized according to IFRS 17.77(b) as a new contract:

- The fulfilment cash flows of the original contract are derecognized from the GIC, the CSM is adjusted by the difference between the change in the carrying amount resulting from derecognition and the modified new premium (i.e. premium that would have been charged for a new contract with the same terms at the modification date) and the coverage units are adjusted according to the derecognition yielding a respective recognition in profit or loss.
- The new contract is measured assuming that the modified new premium was received at the date of modification.

If the contract modification is not specified, the changes are treated as changes in the fulfilment cash flows and reflected according to IFRS 17.40-52 (see IFRS 17.73), as long as they are still within the contract boundary.

4.2 Exercising contractual options

Exercising a contractual option is not a contract modification (IFRS 17.72[6]) and hence, the regulations in IFRS 17 concerning contract modifications do not apply. Contractual options can also arise from law or regulation (IFRS 17.2). Contractual options are considered when determining the units of account as long as these options are within the contract boundary.

According to IFRS 17.B62, the exercise of contractual options within the contract boundary has to be considered in an appropriate way when determining the future cash flows.

[6]See also TRG Agenda Paper 03 (May 2018) paragraph 43.

Estimating this impact is subject to the general principles outlined in IFRS 17.B37-B39, especially that it should be "based on reasonable and supportable information available at the reporting date without undue cost or effort". For example, depending on the entity's judgement, estimations considering future conversion options within the contract boundary might as well be based on reasonable and supportable assumptions about e.g. the expected future margins, outcome or characteristic features of the future products instead of actually modelling future products.

4.3 Considerations concerning non-specified modifications and contractual options outside the contract boundary

In general, IFRS 17.B61, B63 and B64 last sentence provide guidance for cash flows that cross the contract boundary. Crossing the contract boundary is treated as a change in estimates.

Contractual options might be outside the contract boundary. For example, a contractual right to add a new feature to the original contract might be outside the contract boundary if for the new feature a risk assessment based on current information is carried out and reflected in the pricing of the new feature.

If the new feature cannot be viewed as distinct (i.e. the cash flows of the new feature and the original contract are highly interrelated), adding the new feature might nevertheless be treated as a contract modification since it requires mutual consent and/or risk adjustment, underwriting etc. If this modification is not specified in the sense of IFRS 17.72, then IFRS 17.73 applies, i.e. the contract is not de- and re-recognized and the changes in cash flows caused by the modification are treated as changes in the fulfilment cash flows.

The same reasoning can be applied when such features already exist and can (due to a contractual right or a modification) be cancelled before the original contract terminates.

On the other hand, new features outside the contract boundary that are clearly distinct and separable from the original contract might be treated as new contracts.

Contractual options are also discussed in TRG Agenda Paper 03 (May 2018) and TRG Agenda Paper 05 (September 2018). The TRG points out that an option for adding insurance coverage is a feature of the contract which is not measured separately from the host contract unless it is a separate contract. Non-separate options with guaranteed terms are considered to be within the contract boundary.

If

a) the additional coverage is not a separate contract,

b) the terms of the additional coverage are not guaranteed and

c) the entity cannot reprice the whole contract when the option is exercised,

then the exercise date of the option does not mark a contract boundary.

The changes in cash flows after exercising the option are treated as changes in estimates.

4.4 Overview