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DEUTSCHE
AKTUARVEREINIGUNG e.V.

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

IFRS 17: Übergangsbilanzierung (Transition)

Köln, 14. Juni 2022

Präambel

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

Zusammenfassung

Der Ergebnisbericht behandelt Fragestellungen zur Übergangsbilanzierung 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.

Im Rahmen der Übergangsbilanzierung erlaubt IFRS 17 drei Methoden, die an bestimmte Voraussetzungen und technische Details geknüpft sind. Diese Methoden – Vollständig Retrospektive Methode, Modifizierte Retrospektive Methode und Fair Value Methode – stehen im Fokus dieses Ergebnisberichts und werden aus aktuarieller Sicht beleuchtet.

Der Anwendungsbereich umfasst die Verträge, die unter den internationalen Rechnungslegungsstandard IFRS 17 *Insurance Contracts*[2] 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.[3]

Verabschiedung

Der Ergebnisbericht ist durch den Ausschuss Rechnungslegung und Regulierung am 14. Juni 2022 verabschiedet worden.

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[1] Der Ausschuss dankt der Unterarbeitsgruppe *Transition* der Arbeitsgruppe *IFRS* sowie den zentralen Reviewern ausdrücklich für die geleistete Arbeit, namentlich Vjaceslavs Geveilers und Carsten Horst (gemeinsame Leitung), Thorsten Ante, Dr. Christine Barop, Anja Eickhoff, Dr. Mark Hahmeier, Reinhard Lenz, Marcel Meier, Petra Rickers, Sabine Schadschneider, Dominik Schwab, Dr. Thorsten Wagner, Dr. Andreas Weng.

[2] Der Ergebnisbericht berücksichtigt hierbei die seit Erstveröffentlichung am 18. Mai 2017 erfolgten Änderungen vom 25. Juni 2020 und das „narrow scope amendment in Bezug auf Transitionanforderungen vom 9. Dezember 2021 sowie die in der Europäischen Union geltende Ausnahmeregelung in Bezug auf die Anwendung von Jahreskohorten („Annual cohort exemption") vom 23. November 2021.

[3] 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 Transition.[4]

Issue

This report deals with the interpretation and application of contracts that are subject to the international reporting Standard IFRS 17 on insurance contracts with respect to transition requirements and its practical application.

The application of IFRS 17 is compulsory for group reporting under IFRS and is written in English because it particularly addresses international and capital market oriented companies.

In particular the report intends to provide assistance to actuaries on how the new standard might be applied in practice.

As IFRS 17 foresees for transition three methods. The main focus of this report is on these methods – Full retrospective approach, Modified retrospective approach and Fair Value approach – from the actuarial perspective.

As the implementation work is ongoing and due to the amendments to IFRS 17 issued by the IASB on 25 June 2020 and 9 December 2021 as well as due to the European Union "Annual cohort exemption" on 23 November 2021, this report extends and adjusts the original report, adopted by the DAV's Accounting and Regulation Committee on 14 June 2019.

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 14 June 2022.

[4] The Committee would like to explicitly thank the sub-working group *Transition* of the working group *IFRS* and the key reviewing colleagues for their work, by name Vjaceslavs Geveilers and Carsten Horst (Leaders), Thorsten Ante, Dr. Christine Barop, Anja Eickhoff, Dr. Mark Hahmeier, Reinhard Lenz, Marcel Meier, Petra Rickers, Sabine Schadschneider, Dominik Schwab, Dr. Thorsten Wagner, Dr. Andreas Weng.

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1.1. General issues

At the transition date the applying insurance companies:

- have to identify, recognise and measure each group of insurance contracts as if IFRS 17 had always applied (-> see the specific requirements and simplifications under the admissible IFRS 17 transition approaches in this document: full retrospective approach in Chapter 2, modified retrospective approach in Chapter 3, fair value approach in Chapter 4);
- have to identify, recognise and measure any assets for insurance acquisition cash flows as if IFRS 17 had always applied (except that an entity is not required to apply the recoverability assessment in paragraph 28E before the transition date);
- derecognize previously reported balances that would not have existed if IFRS 17 had always been applied. These include deferred acquisition costs for insurance contracts, intangible assets related to insurance contracts (-> "value of business acquired"), insurance receivables and payables. Under IFRS 17 all these are included in the measurement of the insurance contracts;
- recognise any resulting net difference in equity.

The transition requirements for IFRS 17 are outlined in Appendix C of IFRS 17.

C2 defines the transition date as "*the beginning of the annual reporting period immediately preceding the date of initial application*". According to the amended IFRS 17 requirements in 2020 an entity shall apply IFRS 17 for annual reporting periods beginning on or after 1 January 2023[5] (C1).

At initial application, IFRS 17 must be applied retrospectively unless impracticable or paragraph C5A applies (C3).

Paragraph C5A has been incorporated in the june 2020 amendments and permits an exemption (applying fair value approach) for a group of insurance contracts with direct participation features if and only if the risk mitigation option (B115) is applied prospectively from the transition date and the entity has used derivatives, non-derivative financial instruments measured at fair value through profit or loss, or reinsurance contracts held to mitigate financial risk arising before the transition date.

With respect to the term "impracticable" in Paragraph C3, this means according to IAS 8 that the entity cannot apply this requirement after making every reasonable effort to do so.

[5] Transition date before amendment had been 1 January 2021.

According to IAS 8.5 applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

a) *the effects of the retrospective application or retrospective restatement are not determinable;*

b) *the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or*

c) *the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:*

   i. provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and

   ii. would have been available when the financial statements for that prior period were authorised for issue from other information.

Further guidance on how impracticability should be applied in practice can be found in IAS 8.50 to 8.53 and the explanations as provided in IAS 8 Basis for Conclusions in BC 23 to BC28. Based on this guidance in particular the usage of hindsight appears to be an important factor when assessing whether a (full) retrospective application of IFRS 17 is feasible.

Hindsight in the meaning of IAS 8 is considered the issue of potentially applying a non-objective accounting of financial information, as management would have been required to accounting for transactions or amounts using information that would have been unavailable when the financial statements for the prior period(s) were authorised for issue. Anyway as IAS 8.53 lay's out, that this does not mean that there can't be significant estimates also be made for an amended comparative information presented for prior periods and provides an example on how IAS 8 should be interpreted.

It should also be noted that "making every reasonable effort" should not be interpreted to be the same as "undue cost or effort". In fact IAS 8 BC24 outlines that the IASB decided that an exemption based on management's assessment of undue cost or effort is considered to be too subjective to be applied consistently by different entities and therefore rejected such proposals when IAS 8 in its current version has been established.

Coming back to the impacts at the transition date, and according to IFRS 17.BC374, *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.*

The measurement model in IFRS 17 comprises two components as stated in IFRS 17.BC375:

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.*

Corresponding to IFRS 17.BC376 there are *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.*

C3 to C5B describe the procedure how to select the appropriate approach for transition for (sets of) contracts; this may mean that within an entity, the transition approach can vary by different (sets of) of contracts.

According to paragraphs 114 and 115 of the standard, an entity needs to disclose which approach has been applied to which group of contracts and needs to explain the measurement methods used at the transition date, together with a reconciliation of the CSM (contractual service margin) and the insurance revenue.

If and only if, a full retrospective application (C3) is not practicable for a set of contracts, two alternative methods (C5) can be applied:

- C5(a): the modified retrospective approach (C6-C19A), subject to paragraph C6(a)
- C5(b): the fair value approach (C20-C24B)

This means that the entity first needs to analyse which approach is practicable for which contracts or set of contracts.

The june 2020 amendments of IFRS 17 incorporated additional transition reliefs

- for insurance contracts with direct participation features, to allow to apply the fair value approach instead of the full retrospective approach under certain circumstances in connection the risk mitigation option (C5A) and
- with respect to the handling an asset for insurance acquisition cash flows, in case for the entity it is impracticable to apply the full retrospective approach (C5B).

The objective of the modified retrospective approach acc. to C5 (a) is to produce a result that is as close as possible to the full retrospective approach using reasonable and adequate information (C6). Therefore

- modifications are only allowed to the extent that there is no reasonable and supportable information available to apply a retrospective approach (C8) and
- the entity has to apply the fair value approach if it is not possible to obtain the reasonable and supportable information necessary for applying the modified retrospective approach (C6(a))

On the other hand, information that could not be obtained without excessive costs or effort need not be used (C6(b)).

According to C3(a), the presentation of the quantitative information required by paragraph 28(f) of IAS 8 is not required; C3(b) prohibits the application of B115 for periods before the transition date, i.e. "hedged" changes in the CSM as described in B115 have to be recognized in the periods where IFRS 17 is applied retrospectively. An entity may apply the option in B115 prospectively on or after the transition date if, and only if, the entity designates risk mitigation relationships at or before the date it applies the option.C4(b) requires to "*derecognise any existing balances that would not exist had IFRS 17 always applied*". Hence, as an example, DAC existing in US-GAAP reporting have to be derecognized.

Any net difference resulting from initial application of IFRS 17 and derecognition of existing balances according to C4(b) is recognized in equity (C4(c)).

1.2. Segmentation

The segmentation of business in-force for transition depends on the approach applied. This in turn depends on whether a full retrospective application of the standard is practicable or not for the contracts in force at the transition date, which has to be analysed for single (sets of) contracts. Therefore, different approaches could apply to different (sets of) contracts.

In the full retrospective approach, each group of insurance contracts needs to be identified, recognized and measured as if IFRS 17 had always applied (C4(a)).

I.e. all (sets of) contracts where a full retrospective application is practicable have to be divided into portfolios and groups of contracts according to paragraphs 14-24 and 61. For all such (sets of) insurance contracts therefore the same granularity is applied as if IFRS 17 would have always been applied[6]. For segmentation compare the results document of the UAG Portfolio.

If a full retrospective application is not practicable for a set of contracts, either one of the alternative methods (C5) can be applied, provided reasonable and supportable information for applying the modified retrospective approach is available for those contracts (see "General issues").

At transition, the modified retrospective approach shall use up-to-date information regarding grouping, classification and discretionary cash flows as far as permitted

[6] In this regard, for an entity subject to reporting under the EU financial reporting framework, the impact of the EU "Annual cohort exemption" can be considered as well.

under C8 (C9). I.e. if there is reasonable and supportable information for forming the groups retrospectively available without undue cost and effort, then the groups have to be formed using this information[7]. Otherwise, current information can be used. For further details see Chapter 3.2.Additionally, when applying the modified retrospective approach, a segmentation into at most annual cohorts is not required if there is no reasonable and fitting information to do so (C10 and C8).

If the fair value approach is applied, groups of contracts can be built on current or retrospective basis (C21, C22). Annual cohorts are not required under this approach (C23). In contrast to the full or modified retrospective approach dividing insurance contracts issued within a year (or less) into groups in this approach is only allowed if the entity has reasonable and supportable information to make the division..

I.e. if there is no reasonable and supportable information available in which way contracts would have been assigned to portfolios (or groups) at their initial recognition or date of inception, the modified retrospective approach or the fair value approach applies and the entity may use the information at the date of transition in order to identify portfolios (and groups) of insurance contracts. This might lead to grouping the in force business in the same way as new business, e.g. if an entity separates new business in certain types of contracts into different portfolios, then this might lead to separating the in force contracts in the same way. Example: the entity's considerations for new business after the transition date lead to separating annuities and term life contracts into different portfolios. Then applying these considerations for the in force business at transition date might result in separate portfolios for in force annuities and term life contracts.

Applying the modified retrospective approach or the fair value approach might result in different levels of granularity depending on various factors like the availability of information without undue costs or effort.

For example, the result in an entity might be

- only one group of contracts containing the whole in force business or
- separate groups for (regulated) old and (deregulated) new business in Life insurance or
- separate groups for different interest rate generations in Life insurance.

Note that neither a complete list of possible outcomes nor a judgement on what would be the "right" outcome can be given here since this strongly depends on various individual factors like the individual structure of the in force business and the entity's individual circumstances and considerations.

[7] In this regard, for an entity subject to reporting under the EU financial reporting framework, the impact of the EU "Annual cohort exemption" can be considered as well.

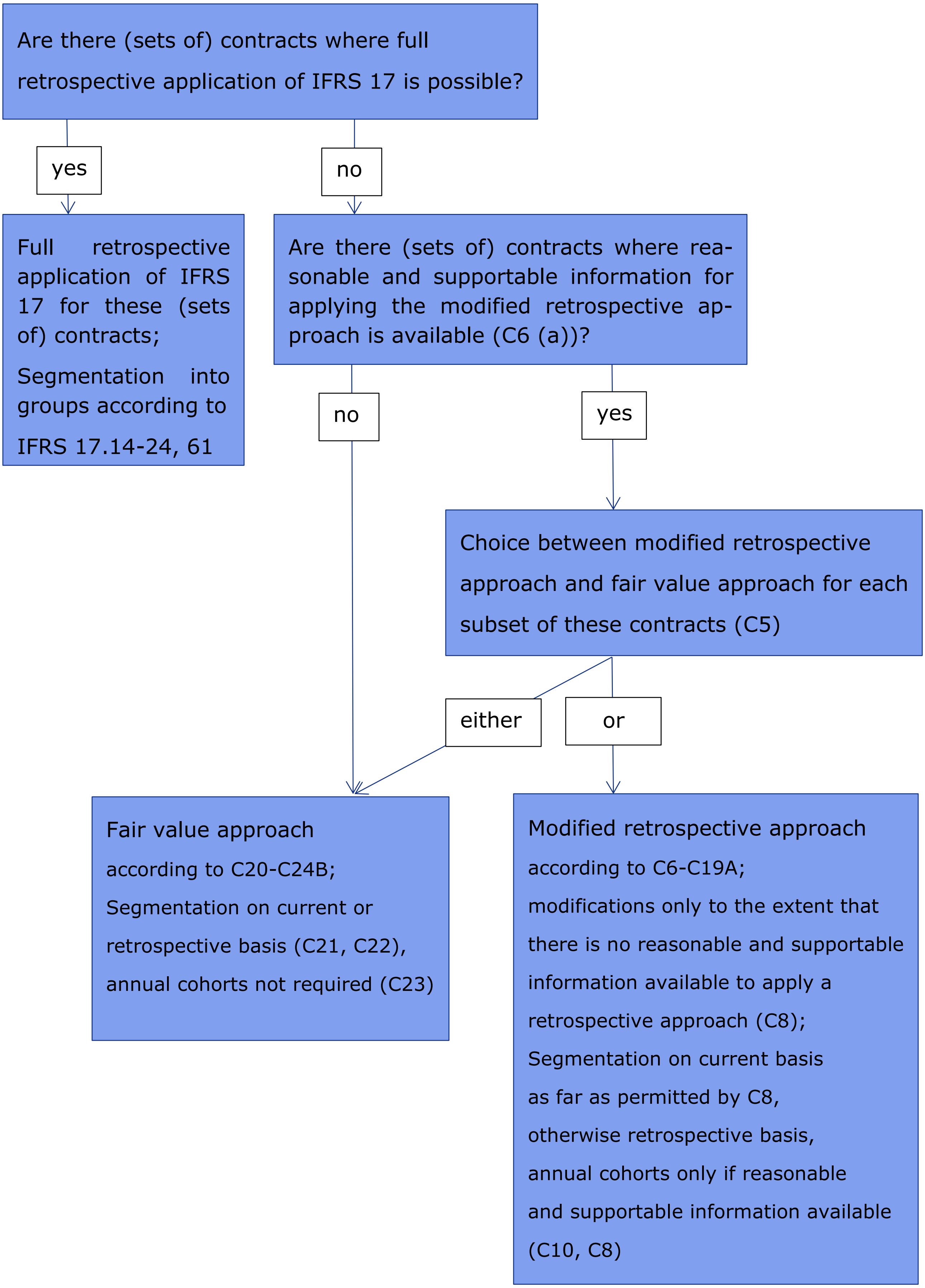


Figure 1 Segmentation for transition

1.3. Business Combinations prior to transition date

After the first issuance of IFRS 17 in May 2017 some stakeholders raised concerns and challenges with respect to insurance contracts acquired in their settlement period, when applying IFRS 17.

They were concerned about the impact on the interpretation of IFRS 17.B5 on initial recognition of such contracts acquired by an entity after the occurrence of an insured event that triggered a claim by the policyholder which ultimate costs are not yet known. For such contracts, the insured event for the acquiring entity is the determination of the ultimate cost of the claim acc. to IFRS 17.B5 interpretation, because the uncertainty about whether the insured event occurred is then known and therefore the acquirer provides a different service as insuring the event as in the original (acquired) contract.

Whilst the IASB decided to keep the requirements acc. to IFRS 17 unchanged the IASB granted related transition reliefs in the modified retrospective approach and the fair value approach.

These reliefs permit an entity not to reclassify the liability for incurred claims of an insurance contracts acquired in the settlement period prior to the transition date to a liability for remaining coverage, if the entity does not have reasonable and supportable information to apply a retrospective approach and the transfer of insurance contracts do not form a business or in a business combination within the scope of IFRS 3 (C9A respectively C22A).

1.4. Disclosures on transition amounts

As there might be sets of insurance contracts, which an entity can't account for fully retrospectively (see chapter 1.2), the standard contains several disclosures that are intended to enable users of the financial statements to sufficiently understand the impact of the transition impacts to IFRS 17.

According to 114 and 115 of the standard, an entity needs to provide disclosures that enable users of financial statements to identify the effect of group of contracts measured at the transition date applying the modified retrospective approach or the fair value approach on the CSM (contractual service margin) and the insurance revenue in subsequent periods.

As long as there exist insurance contracts, that existed at the transition date and to which the entity has applied the modified retrospective or the fair value approach for which a CSM or insurance revenue needs to be considered, the standard requires the entity to disclose information on that insurance contracts that enable the users of financial statements to understand the nature and significance of the methods used and the judgements applied in determining the transition amounts. In particular the entity has to explain how it determined the measurement of insurance contracts at the transition date.

In particular the entity shall disclose the reconciliation of the CSM applying 101(c) and the amount of insurance revenue applying 103 (a) separately for

a) insurance contracts that existed at the transition date to which the entity has applied the modified retrospective approach
b) insurance contracts that existed at the transition date to which the entity has applied the fair value approach
c) all other insurance contracts.

In addition to the CSM and insurance revenue and with respect to the insurance finance income or expense, for entities that choose to apply the OCI-Option paragraph 116 requires further disclosures for the groups of insurance contracts to which the disaggregation applies, if paragraphs C18(b), C19(b), C24(b) and C24(c) are applied to determine the cumulative difference between the insurance finance income or expenses that would have been recognised in profit or loss and the total insurance finance income or expenses at the transition date.

For all periods in which amounts determined applying these paragraphs exist, the entity is required to disclose a reconciliation from the opening to the closing balance of the cumulative amounts included in other comprehensive income for financial assets measured at fair value through other comprehensive income related to the groups of insurance contracts.

The reconciliation shall include, for example, gains or losses recognised in other comprehensive income in the period and gains or losses previously recognised in other comprehensive income in previous periods reclassified in the period to profit or loss.

2. Full retrospective approach

In line with IFRS 17.C3 *an entity shall **apply IFRS 17 retrospectively unless it is impracticable to do so, or paragraph C5A applies**, except that:*

- *a) an entity is not required to present the quantitative information required by paragraph 28(f) of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; and*
- *b) an entity shall not apply the option in paragraph B115 for periods before the transition. An entity may apply the option in paragraph B115 prospectively on or after the transition date if, and only if, the entity designates risk mitigation relationships at or before the date it applies the option*

*To apply IFRS 17 **retrospectively**, an entity shall at the transition date*, as stated in IFRS 17.C4:

- *a) identify, recognise and measure each group of insurance contracts as if IFRS 17 had always applied;*
- *aa) identify, recognise and measure any assets for insurance acquisition cash flows as if IFRS 17 had always applied (except that an entity is not required to apply the recoverability assessment in paragraph 28E before the transition date);*
- *b) derecognise any existing balances that would not exist had IFRS 17 always applied; and*
- *c) recognise any resulting net difference in equity.*

If, and only if, it is impracticable for an entity to apply the full retrospective approach for a group of insurance contracts, an entity is allowed to apply one of the following two approaches instead of applying IFRS 17.C4(a):

- a) the **modified retrospective approach** (see Chapter 3); or
- b) the **fair value approach** (see Chapter 4).

To apply IFRS 17 full retrospectively in particular *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*, can be challenging according to IFRS 17.BC377. *These amounts reflect a revision of estimates for all periods after the initial recognition of the group of insurance contracts.*

As stated in IFRS 17.BC378, *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.*

As already mentioned in chapter 1.1 it might therefore often be impracticable to measure a group of insurance contracts at the transition date fully retrospectively (because the measurement can only be achieved by using hindsight).

In addition to above also many accounting estimates needed to be determined retrospectively can’t be made without the usage of hindsight in making assumptions about what management’s intentions would have been in a prior period or in estimating amounts to be recognised, measured or disclosed in a prior period. But hindsight should not be used when applying a new accounting policy to a prior period, either in making assumptions about what management’s intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period (IAS 8.53).

Besides the above, also other areas for accounting insurance contracts according to IFRS 17 might lead to impracticability issues, when an entity intends to apply the standard fully retrospectively. For example BC381 and BC382 of the Basis for Conclusions on IFRS 17 indicate that, for contracts in force on transition, performing the following assessments at the initial recognition of the contracts would often be impracticable, as not possible without the use of hindsight:

a) *VFA eligiblity acc. to B101*

b) *grouping of insurance contracts and*

c) *determination of the effect of discretions on estimated cash flows for insurance contracts subject to the general model.*

Therefore it is reasonable to assume, that the applicability of the full retrospective approach will be impracticable for some groups of contracts, particularly for long-duration contracts that were written many years ago.

The applicability of the full retrospective approach for many sets of insurance contracts is also unlikely to be expected in the German insurance industry due to the following reasons:

a) as a result of the durations of the German life and health insurance contracts, partially there are very long durations of insurance contracts in the portfolio; therefore many older data are needed which were not available in the historical/older systems;

b) as a result of quite a few mergers & acquisitions in Germany many insurance companies own historical portfolios purchased and for which the contractual inception data are possibly limited;

c) in Germany, many portfolio migrations has been observed (e.g. due to reason b)); therefore the contractual inception data are also possibly limited.

As there is a variety of different reasons that can trigger impracticability, from which many are specific to an entity or a specific set of insurance contract, a specific historical point in time for which it is impracticable to apply the standard fully retrospectively for all kind of insurance contracts at the same date in the german insurance industry appears also unlikely.

3. Modified retrospective approach

3.1. Background

According to appendix C of the standard ("Effective date and transition"), an entity shall apply IFRS 17 retrospectively unless impracticable, i.e., in particular, shall identify, recognise and measure each group of insurance contracts as if IFRS 17 had always applied. If this retrospective approach is impracticable for a group of insurance contracts – which means according to IAS 8 that the entity cannot apply this requirement after making every reasonable effort to do so – an entity can choose between two options: applying either the modified retrospective approach or the fair value approach. This chapter focuses on the modified retrospective approach (cf. C6-C19A of the standard). The objective of the modified retrospective approach is to achieve the closest outcome to the full retrospective approach possible "using reasonable and supportable information available without undue cost or effort". In particular, an entity shall maximise the use of information that would have been used under the full retrospective approach.

Since entities shall use reasonable and supportable information without excessive cost or effort in order to reach a result which is as close as possible to the (full) retrospective approach, each entity has to decide what "reasonable and supportable information" means and to what extent it will undertake effort to make such information available. If the necessary information (to apply the modified approach as described in C6 to C19A) cannot be obtained, then the fair value approach has to be applied for a respective group of insurance contracts.

As stated in the previous chapter, due to the new data requirements, the long duration of life and health insurance contracts and making many assessments for prior periods to determine the amounts at transition without the usage of hindsight will make it very difficult to apply the full retrospective approach for many insurance contracts issued before the transition date.

With respect to the application of the full retrospective approach to new business in the years after 2017, it has to be recognized that many IFRS 17 projects are (yet still) ongoing and some final methods will often not be completely defined and in place before 2022. Accordingly, data requirements might often not be completely transparent before 2022. Thus, even for new business in these years after 2017 it might be difficult to apply the full retrospective approach since not all necessary information from the relevant years might be available in 2022 or it might not have been possible to sufficiently avout the risk of using hindsight.

C3 to C5B describe the procedure how to select the appropriate approach for transition for a group of contracts; this may mean that within an entity, the transition approach can vary by different groups of contracts.

The standard defines the following four areas where simplifications (of the full retrospective approach) are permitted (cf. C7), however only due to the lack of reasonable and supportable information to apply the (full) retrospective approach:

(1) Assessments of insurance contracts or groups of insurance contracts that would have been made at the date of inception or initial recognition;

(2) Amounts related to the CSM or loss component for insurance contracts without direct participation features;

(3) Amounts related to the CSM or loss component for insurance contracts with direct participation features;

(4) Insurance finance income or expenses.

In particular in the german life and health industry, where many insurance contracts have a long coverage period, the effort to gain sufficient reasonable and supportable historical financial information to determine the CSM at transition using any retrospective approach is challenging. In particular the strongly mutualizing business model add an additional layer of complexity, making it challenging to apply the standard retrospectively. The complexity can e.g. be reduced by considering the realized local regulatory results of historical periods based on the available "internal supervisory reporting" (interne Nachweisungen) by sources of income (i.e. post-mutualization). If a retrospective application is intened it is then necessary to come up with reasonable and supportable procedures that cope this complexities. In this regard it might be helpful, that additional disaggregated financial information on a finer level of granularity of sets of insurance contracts is usually available for supervisory reporting over a long period of time.

Also depending on the specific data availability of the respective IFRS adopter's acturial model (e.g. if an appropriate model is available earlier), a pragmatic / approximate approach may be one where the „technical transition date" is moved back in time. In this approach, the CSM at the "technical transition date" is calculated using the approximations as outlined above and then rolled forward appropriately to the "actual transition date" using the available data in full application of the IFRS 17 methodology and rolled forward to the transition date.

Such a technique then needs of course be aligned with the allowed modifications of the modified retrospective approach – i.e. inter alia by using the maximum available date in line with the intention of the standard and the specific modifications granted by the modified retrospective approach.

In the following sections, we present explanations, interpretations and examples to each of these topics. For the remaining, unless otherwise stated, it is assumed that an entity does not have reasonable and supportable information to apply a (full) retrospective approach.

3.2. Assessment of insurance contracts

An entity shall identify groups of contracts for transition in the same way as groups of contracts which are issued after the transition date, i.e. applying paragraphs 14-24 and 61 of the standard (c.f. "Assessment of unit of account on German Insurance" of the DAV AG IFRS). However, an entity may use information available at the transition date, if it does not have reasonable and supportable information which has been available at initial recognition or the date of inception of the contracts (to identify the groups of contracts).

According to paragraph 14, contracts can be grouped to portfolios of insurance contracts with similar risks and being managed together. If there is no information available in which way contracts have been managed at their initial recognition or date of inception, the entity may use the information of how the contracts are managed at the date of transition in order to identify portfolios of insurance contracts.

The standard requires, in particular, to separate

- contracts that are onerous at initial recognition,
- contracts that at initial recognition have no significant possibility of becoming onerous, and
- remaining contracts.

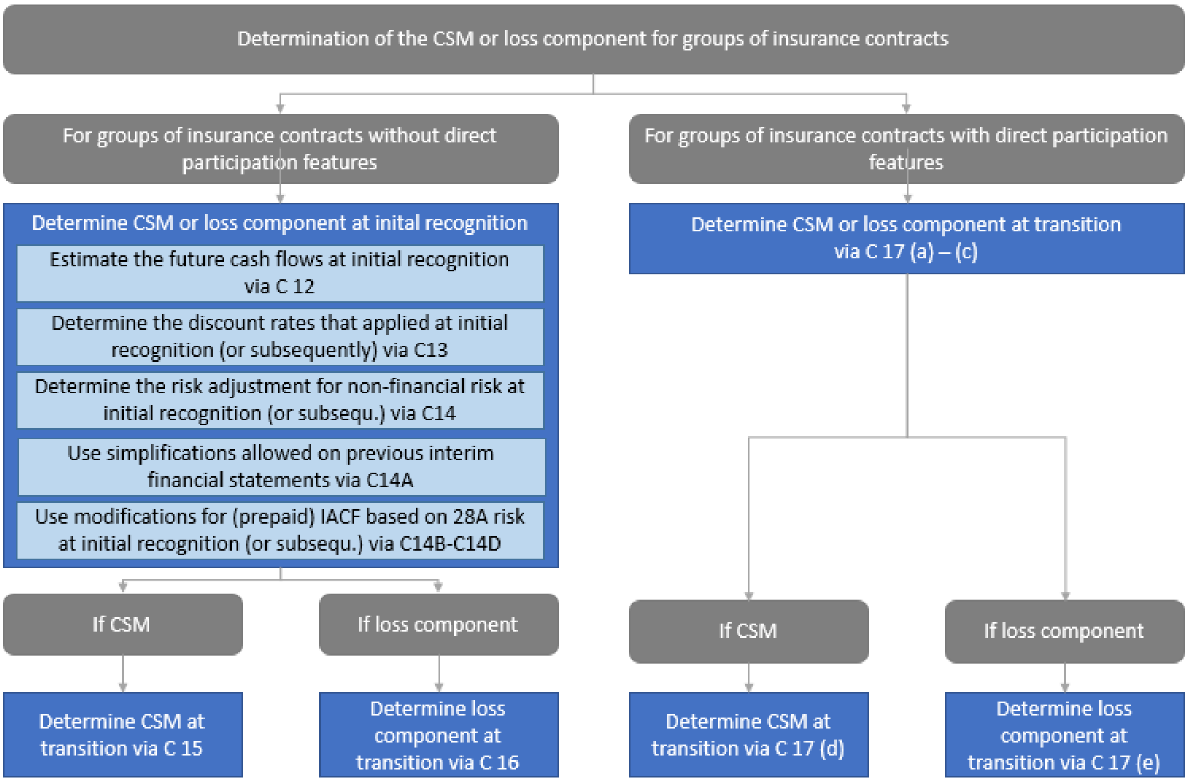
At transition, according to the full retrospective approach, an entity shall use the information which has been available at initial recognition to decide how to classify a contract in one of the three categories. If such information is not available at transition, the modified retrospective approach allows using the information available at the transition date for this decision. In other words, if the necessary information is not available on which a decision at initial recognition would have been based upon, information available at the transition date (e.g. whether a contract is onerous or not) could be used to separate contracts accordingly.

Example: Consider an annuity issued in 1995 with 4% guaranteed interest rate, which would be classified as not onerous considering the favourable market interest rates at that time if the required information at initial recognition were used. However, if the required information is not available at transition, the contract might be onerous according to today’s available information. Following the modified approach, the annuity might be classified as onerous.

The standard also requires to separate insurance contracts with from those without direct participation features (B101-B109). At transition, according to the full retrospective approach, an entity shall use the information which has been available at initial recognition to decide whether a contract would have been categorised as with or without direct participation features. If such information is not available at transition, the modified retrospective approach allows using the information available at the transition date to distinguish whether a contract fulfils the conditions for direct participation features or not.

Furthermore, for the modified retrospective approach, an entity may include contracts which are issued more than one year apart in the same group (C10, revoking paragraph 22) (as long as the other separation criteria are met).

The next two chapters explain the derivation of the CSM or loss component at the date of transition. The following chart therefore illustrates the procedure and the paragraphs to be applied for the CSM determination.



Due to the concerns raised on the handling of par. B137 on interim reporting and potential implications on reporting also for historical periods, within the june 2020 amendments an additional transition relief was granted by the IASB via C14A.

If the entity has chosen as its accounting policy not to change the treatment of accounting estimates made in previous interim financial statements, retrospective application requires the entity generally to 'roll forward' the CSM from inception, considering each interim reporting period. If then the entity is only able to use the modified retrospective approach instead of the fully retrospective approach (considering also paragraph C8), the relief on interim reporting permits the entity to determine the CSM at the transition date as if the entity had not prepared interim financial statements before the transition date.

Another important transition relief introduced in the june 2020 amendments relates to the allocation of any insurance acquisition cash flows paid (or for which a liability has been recognised applying another IFRS Standard) before the transition date (excluding any amount relating to insurance contracts that ceased to exist before the transition date) and based on the discussion held around par. 28A to 28F for "prepaid" insurance acquisition cash flows on "renewing" insurance contracts, where part of the insurance acquistions paid are paid in advance to consider reasonable future renewals of existing insurance contracts.

If these circumstance existed before the transition date paragraphs C14B to C14D allow to consider relief of the impacts on the CSM stemming from this as follows

(1) Use the same systematic and rational method as the entity expects to use after the transition date when applying par. 28A to allocate IACF to groups that are recognised at the transition date and groups that are

expected to be recognzised after transition date (to the extent permitted by C8)

(2) IACF paid before the transition date are allocated to groups recognized at the transation date to adjust the CSM of that group, to the extent insurance contracts expected to be in the group haave been recognised at that date (see par. 28C and B35C).

(3) Other IACF paid before the transition date, including those allocated to groups expected to be recognised after the transition date, are recognizd as an asset, applying par. 28B

(4) In case the entity does not have reasonable and supportable information to apply point (1) above, the following amounts shall be nil at transition date

   a. Adjustments to the CSM of a group recognized at the transition date and any asset for (prepaid) IACF relating to that group, and

   b. the asset for (prepaid) IACF for groups expected to be recognised after the transition date.

3.3. Determination of the CSM or loss component at the date of transition for groups of contracts without direct participation features

Determination of the discount rates at initial recognition

For the determination of the locked-in discount rates, an entity shall use an observable yield curve that approximates the "current" yield curve derived by applying paragraphs 36 and B72-B85 for at least three years immediately before the transition date, i.e. since 01.01.2019 if the transition date is the 1st of January 2022.

If such an observable yield curve as described above does not exist, an entity shall determine an average spread between an observable yield curve and the "current" yield curve derived by applying paragraphs 36 and B72-B85, and apply this spread to the observable yield curve to receive the locked-in discount rate. The average spread shall be calculated as the average over at least three years immediately before the transition date, e.g. as the average of the spreads in the years 2019 to 2021.

If both alternatives for the determination of the locked-in discount rates cannot be applied, the modified retrospective approach cannot be used; hence an entity has to apply the fair value approach.

In case that a group of contracts comprises contracts issued more than one year apart, the discount rates at initial inception can be determined at the date of transition according to C18 (a). The interpretations of the underlying guidance (B72(b) – B72(e)) are discussed in the UAG paper on Discount Rates.

Determination of the future cash flows at initial recognition

For a group of contracts with an initial recognition before the transition date, the future cash flows at initial recognition shall be estimated as the future cash flows at the transition date (or earlier date, if the future cash flows at that earlier date can be determined retrospectively), adjusted by the cash flows that have occurred before and for which information is available.

The necessary adjustments to the cash flows shall consider cash flows resulting from policies that have left the group since initial recognition, e.g. due to death, surrender or maturity. A backcasting approach might be reasonable to fulfil this requirement; however, there are some points to consider:

- Missing data on policies that are no longer in force should not materially skew the results.
- Assuming that sub-portfolios that are no longer in force are shorter term products and have a CSM of approximately zero, such contracts might be justified to be ignored or it's impacts may be estimated simplified.

Risk Adjustment at initial recognition

Whereas the financial risk is either already included in the estimates of the future cash flows or in the discount rate, the risk arising from insurance contracts other than financial risk (e.g. expense risk or lapse risk, but no general operational risk) shall be reflected in the risk adjustment for non-financial risk.

At the date of initial recognition, the risk adjustment of a group of contracts shall be calculated as the risk adjustment at transition, adjusted by the expected release of risk before the transition date. To determine the expected release of risk, an entity shall use the expected release of risk of similar insurance contracts which are issued at the transition date (cf. C14). In order to achieve this, two topics need to be clarified:

- The choice of similar contracts: in order to identify similar insurance contracts, we refer to the definition of a portfolio, in particular to the risk aspect, and to the results document of the UAG Portfolio.
- The transfer of the expected risk release pattern of similar contracts to the contracts in force at transition: the risk release of the former group shall be applied to the latter group based on the the same risk drivers; a stretching or compressing of the release pattern could be used to compensate different durations of the groups.

Example for the determination of the risk adjustment at initial recognition:

An entity issued a group A of insurance contracts 10 years before the transition date. The group has a duration of 20 years and a risk adjustment of 50 CU at the transition date. In order to determine the risk adjustment of the group at initial recognition and its release of risk, the entity identifies a group B of contracts with similar risks that is issued at the transition date and has a duration of 20 years.

The risk adjustment of group B amounts to 20 CU at inception (which is the transition date at the same time), decreases by 20% every year and equals zero in the last year. After 10 years, by calculation 2.15 CU (10.74%) of the initial 20 CU are left.

Applying this release pattern to group A results in an initial risk adjustment of 50 CU / 10.74% = 466 CU, and the annual risk adjustment for the subsequent years is obtained by multiplying the remaining proportion of the risk adjustment of group B with the initial risk adjustment of group A. This means for the second contract year for group A: 80% * 466 CU = 373 CU.

By this procedure, the risk adjustment pattern for both group A and B correspond to each other. The complete time line with the results is shown in the following figure.

Group of contracts issued at transition date, RA = 20 at inception

Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Volume	20,00	16,00	12,80	10,24	8,19	6,55	5,24	4,19	3,36	2,68	2,15	1,72	1,37	1,10	0,88	0,70	0,56	0,45	0,36	0,29	0,00
Release		4,00	3,20	2,56	2,05	1,64	1,31	1,05	0,84	0,67	0,54	0,43	0,34	0,27	0,22	0,18	0,14	0,11	0,09	0,07	0,29
Volume %	100%	80%	64%	51%	41%	33%	26%	21%	17%	13%	11%	9%	7%	5%	4%	4%	3%	2%	2%	1%	0%
Release %		20%	16%	13%	10%	8%	7%	5%	4%	3%	3%	2%	2%	1%	1%	1%	1%	1%	0%	0%	1%

Group of contracts issued 10 years before transition, RA = 50 at transition

Year	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Volume	465,66	372,53	298,02	238,42	190,73	152,59	122,07	97,66	78,13	62,50	50,00	40,00	32,00	25,60	20,48	16,38	13,11	10,49	8,39	6,71	0,00
Release		93,13	74,51	59,60	47,68	38,15	30,52	24,41	19,53	15,63	12,50	10,00	8,00	6,40	5,12	4,10	3,28	2,62	2,10	1,68	6,71
Volume %	100%	80%	64%	51%	41%	33%	26%	21%	17%	13%	11%	9%	7%	5%	4%	4%	3%	2%	2%	1%	0%
Release %		20%	16%	13%	10%	8%	7%	5%	4%	3%	3%	2%	2%	1%	1%	1%	1%	1%	0%	0%	1%

CSM or loss component at transition

Having determined, for the date of initial recognition, the future cash flows, the discount rates and the risk adjustment as described in the preceding sections, the result is a) either a (positive) CSM at the date of initial recognition, or b) a loss component of the liability for remaining coverage at the date of initial recognition. Depending on the CSM at initial recognition, i.e. case a) or b), the CSM or loss component at transition is determined as follows:

Case a)

According to B119, the insurance contract service provided under a group of insurance contracts in each period is reflected by an amount of the CSM recognised in profit or loss in that period. To determine this amount, the standard introduces the metric 'coverage unit' (compare with the results document of the UAG Leben on CSM release and coverage units discussion). The amount of the CSM recognised in profit or loss in each period is determined by the relation of coverage units that are provided in that period as compared to coverage units expected to be provided in the future.

In order to determine the CSM at transition from the CSM at initial recognition, the entity has to consider two factors: the interest accretion and the amount of the CSM recognised in profit or loss due to the services provided in the period from initial recognition and the transition date.

If the entity uses the simplification of the determination of the discount rates at initial recognition as stated above, these rates shall be applied for the interest accretion of the CSM.

For the determination of the amount of the CSM recognised in profit and loss due to the service provided before the transition date, the entity

- needs to identify the coverage units for the corresponding group of contracts,
- quantify the units for the service before and after the transition date, and
- allocate the CSM proportionally to the service provided before the transition date.

As a simple example, consider a group of contracts, duration 10 years, issued 5 years before transition, CSM at initial recognition 80, coverage unit is 1 in the first year, increasing by 2 in every future year (before and after transition). The CSM at transition is now determined by

$$(1-(1+3+5+7+9)/(1+3+5+7+9+11+13+15+17+19))*80=60$$

Case b)

An entity needs to determine all amounts that have been allocated to the loss component before the date of transition with the simplifications for the future cash flows, the discount rates and the risk adjustment. Following paragraph 50 of the standard, subsequent changes in fulfilment cash flows of the liability for remaining coverage (LRC) (before transition) shall be allocated between the loss component of the LRC and the LRC excluding the loss component (since changes in the fulfilment cash flows before transition could not be caused by non-financial assumption changes).

According to BC287, no specific methods to track the loss component are required. However, a systematic allocation is required, which should reflect the changes in the fulfilment cash flows of the LRC. Thus, the approach that an entity uses for the allocation of a group of contracts being already in force at the transition date should be the same as for a group of contracts issued in the year of initial application of IFRS 17.

A possible systematic allocation of the changes in the fulfilment cash flows to the CSM before transition could be represented by the ratio of the CSM and the sum of the present value of cash outflows and the risk adjustment. This may mean that, for the first year after initial recognition, the proportion of the CSM at initial recognition and the present value of fulfilment cash flows excluding premiums at initial recognition could be applied to the cash outflows, the release of the risk adjustment and the interest accretion of both (in case that the OCI solution is not used). Subsequent changes in fulfilment cash flows in the following years (before transition) could use the proportion of the respective previous year derived in an analogous manner. The effect of the application of the ratio to the cash flows and the release of risk adjustment could be represented in the P&L, both in 'Insurance Revenue' and to the same amount in 'Insurance Service Expenses', to make sure that there is no impact on the Insurance service result.

The tracking ends when the loss component becomes positive due to favourable changes in the fulfilment cash flows relating to future service; in such a case, a (positive) CSM is rebuilt and the loss component is set to zero.

Reinsurance Contracts held and loss-recovery components at transition

The explained modifications in this section have been primarily focused on insurance contracts issued and not specifically addressed reinsurance contracts held. These products are in scope of IFRS 17 as well and only few aspects needs specifically to be altered in the standard to handle the fact that in a reinsurance contract held, the entity is transferring substantial insurance risk to another party.

To avoid an accounting mismatch at initial recognition between sets of insurance contracts that are expected to be onerous but are covered to some extent by reinsurance contracts held the standard has been amended in june 2020 to cope with that mismatch. As a result an entity holding a group of reinsurance contracts held can recognise income when the entity recognises a loss on initial recognition of the underlying covered group of underlying insurance contracts and consider a corresponding loss-recovery component, which is recognized as the coverage is provided.

Accordingly to these adjustments also transition reliefs with respect on the determination of the loss-recovery component has been granted by the IASB in par. C16A to C16C.

As transition relief (see C16A) to the extent permitted by paragraph C8 an entity is permitted to determine the loss-recovery component by multiplying:

a) *the loss component of the LRC for the underlying insurnce contracts at the transition date (see par. C16 and C20); and*
b) *the percentage of claims for the underlying insurance contracts the entity expects to recover from the group of reinsurance contracts held.*

In this regard the relevant requirements of paragraphs 66A-66B needs to be considered.

When appliying the level of aggregation requirements (see par. 14-22) at the transition date an entity might include in an onerous group of insurance contracts both

- onerous insurance contracts covered by a group of insurance contracts held and
- onerous insurance contracts not covered by the group of reinsurance contracts held.

To apply in such cases the transition relief as prescribed before (see C16A), the entity is required to use a systematic and rational basis of allocation to determine the portion of the loss component of the group of insurnace contract that relates to insurance contracts covered by the group of reinsurance contracts held (C16B).

If an entity does not have reasonable and supportable information to apply the relief in C16A, the entity is not allowed to identify a loss-recovery component for the group of reinsurance contracts held (C16C).

3.4. Determination of the CSM or loss component at the date of transition for groups of contracts with direct participation features

For contracts with direct participation features, the CSM or loss component of the liability for remaining coverage at the transition date shall be calculated in the following simplified way:

i. the total fair value of the underlying items at the transition date,
ii. minus the fulfilment cash flows at the transition date,
iii. plus or minus amounts charged to the policyholders before the transition date,
iv. plus or minus amounts paid before the transition date that do not vary with the underlying item,

v. plus or minus the change in the risk adjustment due to the release from risk before the transition date,

vi. plus or minus insurance acquisition cash flows paid (or an adjustment for which a liability has been recognised applying another IFRS Standard) before the transition date that are allocated to the group (C17A).

The sum of these six components represents an approximation for the total CSM of the considered group of contracts, before any amounts that would have been recognised in profit or loss for services provided.

vii. If the sum of these components is greater than zero, corresponding to a (positive) CSM at recognition, then the amount representing the services provided before the transition date needs to be deducted in order to obtain the CSM at transition. This deduction can be estimated by a comparison of the remaining coverage units at the transition date with the coverage units provided before the transition date.

Otherwise, if the sum of the six components results in a loss component at recognition, an entity shall set the loss component at transition to zero and shall increase the liability for remaining coverage by the same amount (eliminating the loss component) as stated in C17(e).

The following interpretation of the six components shall give guidance for their determination.

Ad i: The definition of the underlying items is complex and may vary for different products, please see the papers "IFRS 17 for German Life Insurance" and "IFRS 17 for German Health Insurance" of the DAV AG IFRS Sub-Working Groups Life and Health. In any case, this value should be available at the transition date.

Ad ii: The generation of fulfilment cash flows at the transition date does not require any special simplifications for the modified retrospective approach.

Ad iii: Entities shall take into account amounts that are deducted from the underlying item before the transition date, i.e. the shareholder transfers.

Ad iv: When an entity applies the variable fee approach, it has to be examined whether all kinds of benefits have an impact on the underlying item, which might result in zero for this component. Please see the paper "IFRS 17 for German Life Insurance" as stated in (i) above.

Ad v: The standard requires to determine the release of risk of the risk adjustment by comparing similar contracts at the transition date. This procedure has already been discussed above.

Ad vi: This has been added in the june 2020 amendments and deals with the handling of insurance acquisition cash flows (pre)paid and the corresponding assets (28B) that are expected to arise from renewals of existing insurance contracts with direct participation features (C17A in connection with C14B-D). As the Variable Fee Approach in germany is predominatly relevant for the long term life and health insurance business and due to the (minimum) guarantees provided also for all kinds of additional options to increase coverage usually the contract boundaries of the insurance contracts are very broad, so that the june 2020 adjustments in this regard should only have a limited impact on the practical application.

To consider the challenges for the strongly mutualizing german VFA-business, which is (often nearly) at whole entity level, a practical technical approach to apply the fully retrospective standards requirements in combination with C17 in connection with C8 may be one, where a so called „technical transition date T*“ is moved back in time. Under this approach, the CSM is calculated at this "technical transition date T*" using the approximation method described above (C17 taking into account C8) and then appropriately rolled forward to the "actual transition date T" using available data in full application of the IFRS 17 methodology.

New business issued after the "technical transition date T*" can be measured in full retrospectively and rolled forward to the transition date T.

For a practical application this means, that the amounts as mentioned in C17 are technically determined at the point in time T* (which is prior to the transition date T for accounting purposes). The resulting CSM at date T* is then developed in line with the full retrospective accounting requirements and principles, in particular applying par. 17.45 in connection with B112-B114 and B119 of the standard, to derive the CSM as at transition date T. Of course such a technical point in time T* and the groups of insurance contracts that can be handled with that approach needs to be identified and justified based on the entity specific facts and circumstances on the insurance products such a practical approach is applied on. Also such a technique needs of course be aligned and justified within the allowed set of transition reliefs for the modified retrospective approach – i.e. inter alia by using the maximum available date in line with the intention of the standard and the specific modifications granted by the modified retrospective approach.

A	Date of the initial application (IFRS 17.C2) (01.01.2023)
T	Transition Date (IFRS 17.C2) (01.01.2022)
T*	Time from which fully retrospective application is possible
U	Origin/Initial recognition of the group of insurance contracts

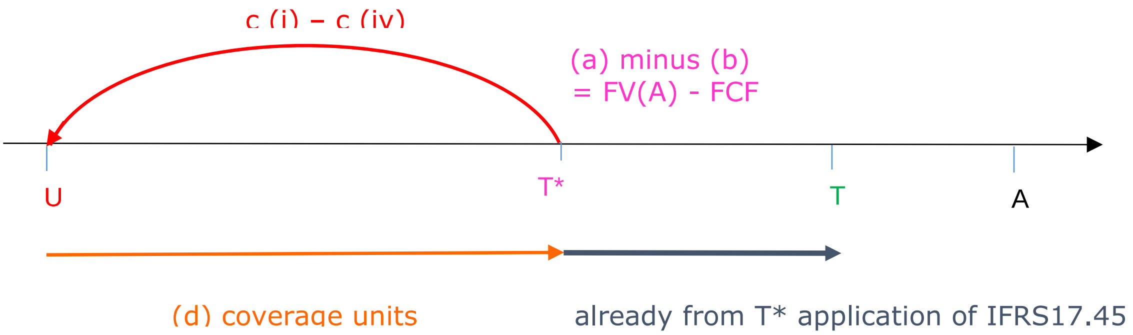


Figure 2: IFRS 17.C17 – full and modified retrospective approach for with direct participation features

3.5. *Presentation in P&L: Insurance finance income or expense*

Entities have the choice to disaggregate insurance finance income or expenses between amounts recognised in P&L and amounts recognised in other comprehensive income (OCI).

For groups which comprise only contracts that are issued within one year, the OCI at the transition date - for contracts for which changes in assumptions that relate to financial risk do not have a substantial effect on the amounts paid to the policyholder – shall be calculated as the difference between

- the sum of the fulfilment cash flows measured with the discount rates at initial recognition with the corresponding simplifications (see C13);
- and the sum of the fulfilment cash flows measured with the discount rate at the transition date.

In case changes in assumptions that relate to financial risk have a substantial effect on policyholders' benefits, the OCI is set to zero at the transition date (C19 (b)(ii)).

For groups that comprise contracts which are issued more than one year apart, an entity can apply the method for groups which comprise contracts issued within one year as described above, determining the discount rates at the transition date.

However, independently whether the group contains contracts which are issued less or more than one year part, if the group consists of contracts with direct participation features and the entity holds the underlying items, the OCI at the transition date equals the cumulative amount recognised in OCI on the underlying items; otherwise the OCI is set to zero at the transition date.

Due to the amendments made in june 2020 the standard now also transition reliefs regarding the application of par. B137 and interim financial reportings. Now an entity may choose not to change the treatment of accounting estimates made in previous interim financial statements. To the extent permitted by paragraph C8, an entity shall then determine amounts related to insurance finance income or expenses at the transition date as if it had not prepared interim financial statements before the transition date.

3.6. Applicability of the Mod Retrospective Approach in the Practice of German Life Insurance

The following recommendations might be helpful for the assessment of the business-in-force in sense of the Modified Retrospective vs Full Retrospective Approach applicability.

Generally, for companies which apply Solvency II, there will be usable information which might justify the full retrospective application from 2016 on. Even for contracts with a long historical duration this information could be used from 2016 on, whereas prior to 2016 it is assumed that one of the other two approaches is applied. For figuring out whether a full retrospective application is practicable or not the requirements of IAS 8 need to be fulfilled.

The full retrospective application requires a high amount of data and would be highly time-consuming. This is because for the whole in-force business at transition every component, i.e. expected discounted cash flows, risk adjustment and the CSM, has to be available for every group back to inception of the first insurance contract in a group. Additionally all influencing factors like actual experience or relevant estimates have to be considered. Furthermore the CSM would have to be adjusted for changes in estimates at each measurement point. These changes in estimates shall also include those relating to already expired contracts. All in all this means that the entire contract data as well as all assumptions and cash flows have to be stored and available. And in the end one has to repeat the adjustment of the CSM at every reporting date from inception until transition.

Also IFRS 17.BC378 points out some amounts that are needed for a retrospective application, but are often impracticable to determine. Paragraphs IFRS 17.BC381 and IFRS 17.BC382 suggest that product classification (for VFA), unit of account and the determination of effects of discretion on estimated cash flows for contracts subject to the general model are often impracticable to determine because those need assumptions at the date of inception or initial recognition. Such assessments might be impossible without making assumptions about expectations in the past. In IFRS 17.BC390 it is clarified that for a retrospective application one also needs effects from contracts which have already expired in order to calculate the CSM.

All in all one could therefore conclude for contracts with a long historical duration it is rather likely that a full retrospective application is impracticable due to a variety of reasons triggering hindsight und therefore trigger impracticability as well. Besides hindsight, this could be as well because of the possible lack of availability of all changes in estimates which would have affected the CSM and/or because the risk adjustment could not be reconstructed in a supportable manner.

4. Fair value approach

If, and only if, it is impracticable for a reporting entity to apply IFRS 17 retrospectively for a group of insurance contracts, the reporting entity can apply the modified retrospective approach (please refer to section 3 above) or the fair value approach described below.

Under the fair value approach, the contractual service margin or loss component of the liability for remaining coverage at the transition date is determined as the difference between the fair value of a group of insurance contracts at that date and the fulfilment cash flows measured at that date.

Definition of fair value

IFRS 13 "Fair value measurement" applies when another IFRS requires or permits fair value measurements. IFRS 13 defines fair value as "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", i.e. an exit price.

Unit of account for determining the fair value

The unit of account for measuring the fair value is determined in accordance with IFRS 17. Consequently, the unit of account is the "group of insurance contracts" as defined in IFRS 17. Please refer to section 1 above for the unit of account.

When applying the fair value approach, it is not prohibited to include contracts issued more than one year apart in the same group. For determining the groups of insurance contracts, there is a choice between using:

(i) reasonable and supportable information for what the reporting entity would have determined given the terms of the contract and the market conditions at the date of inception or initial recognition, as appropriate; or

(ii) reasonable and supportable information available at the transition date.

The same choice is applicable when determining

(i) whether an insurance contract meets the definition of an insurance contract with direct participation features; and

(ii) how to identify discretionary cash flows for insurance contracts without direct participation features.

Measurement of the fair value

The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. When a price for an identical asset or liability is not observable, a reporting entity measures fair value using another valuation technique that maximises the use of relevant observable inputs and minimises the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

Fair value measurement assumes an orderly transaction between market participants at the measurement date under current market conditions. Even when there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement shall assume that a transaction takes place at that date, considered from the perspective of a market participant that holds the asset or owes the liability. That assumed transaction establishes a basis for estimating the price to sell the asset or to transfer the liability.

When a quoted price for the transfer of an identical or a similar liability is not available and the identical item is not held by another party as an asset, a reporting entity shall measure the fair value of the liability or equity instrument using a valuation technique from the perspective of a market participant that owes the liability or has issued the claim on equity. For example, when applying a present value technique a reporting entity might take into account either of the following:

(i) the future cash outflows that a market participant would expect to incur in fulfilling the obligation, including the compensation that a market participant would require for taking on the obligation

(ii) the amount that a market participant would receive to enter into or issue an identical liability, using the assumptions that market participants would use when pricing the identical item (e.g. having the same credit characteristics) in the principal (or most advantageous) market for issuing a liability with the same contractual terms.

A reporting entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

The fair value of a liability reflects the effect of non-performance risk. Non-performance risk includes, but may not be limited to, the reporting entity's own credit risk. While this is explicitly mentioned in IFRS 13, the reporting entity's own credit risk may be the predominant non-performance risk in practice. Non-performance risk is assumed to be the same before and after the transfer of the liability. The fair value of a liability reflects the effect of non-performance risk on the basis of its unit of account.

Assumptions used for fair value measurement

Valuation techniques used to measure fair value shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date.

However, the fair value measurement objective remains the same, i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique.

A reporting entity shall develop unobservable inputs using the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, a reporting entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the reporting entity that is not available to other market participants (e.g. an entity-specific synergy). A reporting entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, a reporting entity shall take into account all information about market participant assumptions that is reasonably available.

It is permitted to determine the discount rates at the date of initial recognition of a group of insurance contracts and the discount rates at the date of the incurred claim at the transition date instead of at the date of initial recognition or incurred claim.

If the reporting entity applies the simplifications for determining the discount rates in line with the modified retrospective approach described in section 3 above [= paragraph C13] to groups of insurance contracts that do not include contracts issued more than one year apart to estimate the discount rates that applied at initial recognition (or subsequently), it shall also determine the locked-in discount rates applying these simplifications.

Comparison of fulfilment cash flows and fair value – also for further discussion

	Fair value	**Fulfilment cash flows**	**Potential differences**
Measurement notion	Exit price	Fulfilment value	
Applicable Standard	IFRS 13	IFRS 17	
Perspective	Market participant	Reporting entity	
Unit of account	Group of insurance contracts	Group of insurance contracts	none
Cash flows	Probability-weighted average (i.e. mean of the distribution) of possible future cash flows	Future cash flows within contract boundary as defined by IFRS 17	Certain overhead expenses; contract boundary; non-performance risk
Discounting	Rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (i.e. a risk-free interest rate)	Reflects time value of money and financial risks; determined using bottom-up or top-down approach with potential simplifications described above	Illiquidity premium
Risk adjustment	Compensation sought by risk-averse market participants for bearing the uncertainty inherent in the cash flows	Risk adjustment for non-financial risk reflects compensation for bearing uncertainty about amount and timing of cash flows	Risks taken into account; method; parameters; diversification

Remarks on potential differences

- Cash flows: Different amounts of fixed and variable overheads, e. g. differences in costs of accounting or building depreciation, may be applied for calculating the fair value and the fulfilment cash flows. While IFRS 17 defines the contract boundary, no explicit definition can be found in IFRS 13. Consequently, a different contract boundary may be argued when measuring the fair value. Non-performance risk has to be taken into account for calculation of the fair value, while it cannot be taken into account under IFRS 17.

- Risk adjustment: Under IFRS 17, the risk adjustment reflects the compensation for bearing the uncertainty about amount and timing of the cash flows that arises from non-financial risk. At the same time, no explicit principle for the risk adjustment is established in line with IFRS 13. Thus, different composition and consideration of risks may be applied when measuring the fair value (e.g. consideration of financial risk within the compensation sought by market participants for bearing the uncertainty inherent in the cash flows in the risk adjustment, which is not allowed under IFRS 17). As neither IFRS 17 nor IFRS 13 prescribe a specific methodology (e.g. cost of capital, conditional tail expectation) that has to be applied for calculation of the risk adjustment, also methodologies may differ. The same holds true for parameters (e.g. the cost of capital rate applied in a cost of capital approach). The diversification depends on the reporting entity or the market participant the insurance liabilities are transferred to. As a consequence, different diversification may be applied when measuring the fair value and the fulfilment cash flows.

OCI at transition

If the OCI option is exercised (i.e. a reporting entity chooses to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income), it is permitted to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date:

(i) retrospectively—but only if it has reasonable and supportable information to do so; or

(ii) as nil—unless (iii) applies; and

(iii) for insurance contracts with direct participation features where the reporting entity holds the underlying items as equal to the cumulative amount recognized in other comprehensive income from the underlying items.

Reinsurance Contracts Held

As mentioned in chapter 3.3 the standard has been amended in june 2020 to cope with the accounting mismatch between group of insurance contracts which are expected to be onerous at initial recognition and which are covered by a group of reinsurance contracts held. This ultimately lead to the introduction of a so called "loss-recovery component" to adequately reflect the income stemming from the cover of the relevant reinsurance contracts held.

Accordingly to these adjustments also transition reliefs with respect to the determination of the loss-recovery component using the fair value approach has been granted by the IASB in par. C20A and C20B.

The transition reliefs granted are similar to the ones as prescribed in chapter 3.3 regarding C16A and C16B. Anyway the focus is at transition date as generally true for the fair value approach and therefore without the need to meet the condition set out in paragraph B119C.

Assets for Insurance Acquisition Cashflows

The other new transition relief introduced for the fair value approach relates to the allocation of any insurance acquisition cash flows paid (or for which a liability has been recognised applying another IFRS Standard) relating to par. 28A to 28F for "prepaid" insurance acquisition cash flows on "renewing" insurance contracts.

Please see also chapter 3.1 in this regard.

In applying the fair value approach to an asset for IACF (see par. C5B(b)), at the transition date, acc. to paragraph C24A the entity is required to determine this assets at an amount equal to the IACF the entity would incur at the transition date for the rights to obtain

a) *recoveries of IACF from premiums of insurance contracts issued before the transition date but not recognised at the transition date;*
b) *future insurance contracts that are renewals of insurance contracts recognized at the date of the transaction and insurance contracts as described in point a) above; and*
c) *future insurance contracts, other than those in point (b) above, after the date of the transaction without paying again IACF the acquiree has already paid that are directly attributable to the related portfolio of insurance contracts.*

The entity shall hereby exclude from the measurement or any group of insurance contracts the amount of any asset for IACF at the transition date /see C24B).

5. Overarching practical implementation issues

This section contains specific practical application issues in the ongoing implementation projects and seeks to help actuarial practitioners with these implementation issues. It intends to provide stakeholders with an overview of the current state of discussions and the insights gained in the sub-working group. It is not a professionaly position of the DAV. It is meant to support actuaries in actuarial teams dealing with these implementation issues.

5.1. Historical not yet recognized amounts relating to Insurance Acquisition Cashflows

The working group would like to note first, that the first question in this section is not a specific transition related question, but has been incorporated here, as the answer on the first question is considered relevant for the transition relevant second question.

Question 1: Can insurance acquisition cash flows under both, the general model and the variable fee approach, be amortized in each reporting period in a systematic way on the basis of the passage of time based on coverage units and using discounting?

View of the working group:

According the understanding of the working group the answer is yes.

The working group understands that paragraph B125 applies to all types of contracts, unless the entity has elected to use the premium allocation approach, in which case paragraph B126 applies.

Acc. to B125 Insurance acquisition cash flows can be amortized in a systematic way on the basis of the passage of time under both the general model and the variable fee approach.

As the standard is silent on the specific systematic way on how the outcome above is achieved, an entity is not precluded from using coverage units to amortize insurance acquisition cash flows as well as to consider interest rates.

The working group wants to point out, that the way on how insurance acquisition cash flows can be recognized in each reporting period also has been subject to several international discussions during the last years, leading into a similar direction as the view of the working group expressed above.

For example, the way on how the IACF can be released and whether interest can be accreted on these amounts has been discussed by the Transition Resource Group for IFRS 17 in 2019 as well.

An answer specifically for the question on "interest accretion on insurance acquisition cash flows" can be found in the IFRS Staff Agenda Paper 2 from April 2019 of the Transition Resource Group regarding "Reporting on other questions submitted" in Log #121. In this response it is mentioned that "a systematic way to recognise insurance service expenses and insurance revenue related to insurance acquisition cash flows does not preclude a way that considers an interest accretion".

The working group considers it therefore reasonable to conclude on the application of coverage units similarly.

Question 2: The german life and health insurance business has predominantly a very long coverage period, which can be many decades. In this regard the question arises on how to practically deal with the corresponding insurance acquisition cash flows from a practical perspective, assuming that a retrospective approach is applied?

View of the working group:

The working group understands that this practical question should mainly relate to old underwriting years, e.g. insurance contracts issued long before 2017. The issue should in particular be an issue for retrospective application for business written many decades prior to the transition date. As discussed in chapter 2, it is therefore reasonable to assume that accordingly, for the concerned life and health insurance business, the full retrospective approach is not applicable.

Taking this into consideration and assuming the modified retrospective approach can be applied, it can be noted that the modified retrospective approach specifies modifications intended to approximate retrospective application by addressing some of the challenges that prevent entities applying IFRS 17 retrospectively.

These modifications include modifications for determining the CSM or the loss component on transition for the general model or the variable fee approach. In particular some modifications specify inter alia on how to determine the allocation of any insurance acquisition cash flows that occurred between the date of initial recognition and the transition date to groups of insurance contracts that are recognised at the transition date, and those that are expected to be recognised after the transition date (please refer to paragraphs C12 for the general model and C17 (c) for the variable fee approach).

To the extent permitted by paragraph C8, paragraph C12 specifies for the general model that an entity estimates the future cash flows at initial recognition as:

- the amount of the future cash flows at the transition date or earlier date, if the future cash flows at that earlier date can be determined retrospectively; adjusted by
- the cash flows that are known to have occurred between the date of initial recognition of a group of insurance contracts and the transition date or earlier date

and C17 requires to adjust the CSM for

- amounts charged by the entity to the policyholders (including amounts deducted from the underlying items) before that date and
- amounts paid before that date that would not have varied based on the underlying items.

Paragraph C8 of IFRS 17 requires then for each of the modifications above, that these are used only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach.

Thus, historical estimates must be used as far back as possible - essentially, following a full retrospective approach wherever possible.

Coming specifically back to the (actual historical) insurance acquisition cash flows paid for old groups of insurance contracts of life and health insurance business at transition, the transition requirements are silent on how to tackle the requirements of par. B125 to determine insurance revenue related to insurance acquisition cash flows by allocating the portion of the premiums that relate to recovering those cash flows to each reporting period in a systematic way on the basis of the passage of time.

To determine the remaining amounts of insurance acquisition cash flows not yet recognized into revenue (and correspondingly in insurance service expense to avoid a P&L impact from insurance acquisition cash flows in the overall IFRS results) in a systematic way on the basis of the passage of time a practical approach may be to use the financial information provided to the Federal Financial Supervisory Authority ("Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin) in the past.

These information contain reasonable and supportable information on the insurance acquisition expenses incurred of historical financial periods (acc. to german GAAP) on a more granular level as usually published within the external financial statements. Also these information are not only more granular, they can also be considered an objective basis to reasonably and supportably determine the basis for the corresponding insurance acquisition cash flows relevant for the IFRS 17 reporting. It is also noted, that with regard to deriving the actual amounts of insurance acquisition cash flows paid, the challenge of an objective determination of the relevant insurance acquisition cashflows according to IFRS 17, is then not different to the necessary splits as needed for the other directly attributable cash flows.

Once the relevant historical insurance acquisition cash flow amounts paid at initial recognition are derived from the information above for the relevant groups of insurance contracts at transition date, it appears reasonable for the working group, that the approach used to determine the remaining insurance acquisition cash flows paid as at transition date can be determined using the same method as used for groups of insurance contracts issued post-transition.

As discussed in question 1 above, this approach used to determine the remaining amount of insurance acquisition cash flows as per transition date could consider a way that considers interest accretion and the same Coverage Units as used for the CSM release pattern. We note that this is not a standard requirement.

5.2. *Practical implementation issues on insurance contracts without direct participation features measured under the GMM or the PAA*

The following questions are in particular relevant when entities intend to apply the simplifications for sets of insurance contracts without direct participation features measured under the GMM or the PAA and transition reliefs are granted by the Modified Retrospective Approach or the Fair Value Approach.

Question 1: What practical consequences or options does the application of the OCI-Option for Non-Life business with respect to transition have (whereas it is implicitly assumed that the financial risk has no a substantial effect on the amounts paid to the policyholder, so par. B131 of the standard applies)? Can the value of OCI at transition depend on the choice of the transition approach in case that the Full Retrospective Approach is impracticable?

View of the working group:

The discussions within the working group lead to the following results:

Consider a portfolio of insurance contracts without direct participation features and assume an entity applies the OCI option to that portfolio. Then, the entity needs to determine the cumulative amount of insurance finance income or expenses recognised in OCI at the transition date.

In the Full Retrospective Approach (FRA), the entity would have to do so, assuming IFRS 17 had always applied. If, for a group of insurance contracts, it is impracticable for an entity to apply the FRA, C5 allows to either choose the Modified Retrospective Approach (MRA) or the Fair Value Approach (FVA) (please refer also to figure 1 in chapter 1.2 in this report).

In the following, both cases are considered

- In case the entity applies the MRA:

  As it is assumed that the entity applies B131 (should be standard case with respect to financial risk for most german Non-Life products). Then, for groups of insurance contracts <u>that, applying paragraph C10, include contracts issued more than one year apart</u>, the entity is permitted to determine that cumulative amount either by applying paragraph C19(b) or as nil, provided that an entity doesn't have reasonable and supportable information to apply the necessary information retrospectively (C8). In contrast, for groups of insurance contracts <u>that do not include contracts issued more than one year apart</u>, the entity is not permitted to determine that cumulative amount as nil.[8]
- In case the entity applies the FVA:
  Then, according to C24, the entity is permitted to determine the cumulative amount of insurance finance income or expenses retrospectively (but only if it has reasonable and supportable information to do so) or as nil.

[8] If the entity applies paragraph C13 to estimate the discount rates at initial recognition, then – according to paragraph C19(b) – the entity shall determine that cumulative amount using the discount rates that applied at the date of initial recognition also applying paragraph C13.

In summary, if the FRA is impracticable, the entity has the free choice between the MRA and the FVA. However, whereas the FVA more freely allows to set the cumulative amount of insurance finance income or expenses as nil, the MRA allows to do so only if paragraph C10 is applied, and application of C10 is allowed (cf. C8) only to the extent that an entity does not have reasonable and supportable information (without undue cost or effort) to apply a retrospective approach.

So all in all the working group concludes that there could be a difference in the OCI depending on the choice of the transition approach, in case that the Full Retrospective Approach is impracticable.

Question 2: The following practical questions relates to the determination of the insurance finance income or expense for the liabilities for incurred claims. In determining insurance finance income or expenses at transition, it is necessary to differentiate between non-financial assumptions, which changes are recognized in the insurance service expense (e.g. changes in expectations of the risk adjustment) and financial assumptions, which changes are recognized in the insurance finance income or expense (or are impacting the OCI, if the OCI option is applied). For this, it is necessary, in particular, to determine the respective "locked in" discount rates, i.e. the discount rates at the date of initial recognition of a group specified in paragraphs B72(b)–B72(e)(ii) (i.e. in case of the general model) and the discount rates at the date of the incurred claim specified in paragraph B72(e)(iii) (i.e. in case of the PAA).

The question than arises, if it is possible – in determining insurance finance income or expenses from liabilities for incurred claims – to apply the Modified Retrospective Approach (MRA) and C10 (relief for transition not to use the annual cohorting requirements for transition purposes) <u>for all years before a specific calendar year</u> (e.g. before 2010) and to use a simplified approach in determining the respective curve of discount rates for a group of insurance contracts.

View of the working group:

Within the MRA, C10 and C18, in particular would allow for a simplified measurement of insurance finance income or expenses.

For groups of insurance contracts that, applying paragraph C10, include contracts issued more than one year apart, paragraph C18 allows to determine the discount rates at the date of initial recognition of a group specified in paragraphs B72(b)–B72(e)(ii) and the discount rates at the date of the incurred claim specified in paragraph B72(e)(iii) at the transition date instead of at the date of initial recognition or incurred claim.

The application of C10 or C18, however, is allowed only to the extent that an entity does not have reasonable and supportable information without undue cost or effort to apply the retrospective approach, respectively (cf. paragraph C8). In other words, the effort to obtain the necessary data must be disproportionate compared to the benefit of applying a retrospective approach in contrast to the simplified approach.

If the reliefs acc. to paragraphs C10 and C18 can be applied sets of insurance contracts issued and group together accordingly the discount rates at the transition date instead of at the date of initial recognition or incurred claim can be used.

5.3. Practical implementation issues for historical business combinations

Question 1: What are the practical impacts on the assessments on the VFA Eligibility for insurance contracts transferred in historical business combinations?

View of the working group:

As in germany insurance products which might qualify for the VFA are mainly issued by german life and health insurers, the working group expects relevant practical implications mainly for such entities.

In case of past business combinations the working group also notes, that as german life and health insurance related products usually contain strongly mutualizing features, the usual pecularitites of the german life and health insurance products hold for the business combinations as well (we would like to refer to the results document of the UAG Leben on these aspects).

The most substantial practicabel impact will then relate to the eligibility assessment acc. to paragraph B101 (c), i.e. that entities are able to justify that as per date of the historical business transaction, the entity could have reasonably expected that a substantial proportion of any change in the amounts to be paid to the policyholder varied with the change in fair value of the underlying items.

The practical implementation impact on insurance contracts that are acquired in a business combination will then substantially depend on the point in time the relevant business combination took place and how the mutualization is considered within the VFA eligiblity assessment by the entity.

Question 2: How to deal with practical challenges of historical business combinations under the VFA?

View of the working group:

Similarly to Question 1 above and provided that an entity is able to justify the VFA eligibitliy for the acquired insurance contracts within the business combination, the challenges for the measurement of these insurance contracts will be similar to other german insurance contracts subject to the variable fee approach with strongly mutualizing features (we would like to refer to the results documents of the DAV AG IFRS Sub-Working Groups Life and Health on these aspects).

Question 3: How to deal with practical challenges of historical business combinations under the GMM resp. PAA?

View of the working group:

As most of such historical business combinations in the german market took place at least a few years ago, the working group does not expect major practical challenges for such historical business combinations.

Based on the considerations in section 2, it appears reasonable for the working group to assume, that an entity will be able to justify, that the full retrospective application of IFRS 17 is impracticable based on the risk of using hindsight in such cases (please refer to chapter 2).

As for such cases the IASB permitted additional transition reliefs to cope with the main difficulties on business combinations for the GMM resp. PAA in connection with the understanding of paragraph B5 of the standard (please refer to section 1.3). An entity will then able to cope with that issue by being able to apply paragraphs C9A (for the modified retrospective approach) or C22A (for the fair value approach) which permits to classify, as a liability for incurred claims, a liability for settlement of claims incurred before an insurance contract was acquired in a transfer of insurance contracts that do not form a business, or in a business combination within the scope of IFRS 3, 'Business combinations'.