© DRSC e.V. ‖ Zimmerstr. 30 ‖ 10969 Berlin ‖ Tel.: (030) 20 64 12 - 0 ‖ Fax.: (030) 20 64 12 - 15
www.drsc.de - info@drsc.de

Diese Sitzungsunterlage wird der Öffentlichkeit für die FA-Sitzung zur Verfügung gestellt, so dass dem Verlauf der Sitzung gefolgt werden kann. Die Unterlage gibt keine offiziellen Standpunkte der FA wieder. Die Standpunkte der FA werden in den Deutschen Rechnungslegungs Standards sowie in seinen Stellungnahmen (Comment Letters) ausgeführt.
Diese Unterlage wurde von einem Mitarbeiter des DRSC für die FA-Sitzung erstellt.

# IFRS-FA – öffentliche SITZUNGSUNTERLAGE

| | |
|---|---|
| Sitzung: | 68. IFRS-FA / 23.07.2018 / 15:15 – 17:15 Uhr |
| TOP: | 04 – IFRS 17 Versicherungsverträge |
| Thema: | CSM-Auflösung bei Verträgen mit Investmentservices |
| Unterlage: | 68_04b_IFRS-FA_IFRS17_CSM |

# Standard requirements

**IFRS 17.B119:**

$$\textbf{CSM release} = CSM_{eop} \bullet \frac{CU_{current\ period}}{CU_{current\ period} + CU_{future\ periods}}$$

The number of **coverage units (CU)** in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract **the quantity of the benefits provided** under a contract and its **expected coverage duration**.

**Appendix A Coverage period:** The period during which the entity provides **coverage for insured events**. [...]

**IFRS 17.BC279**: **insurance coverage** is the **defining service** provided by insurance contracts.

**IFRS 17.BC280**: [..] the entity provides multiple services in return for an expected fee based on the expected duration of contracts, […] the entity should recognise that fee over the coverage period **as the insurance services are provided**, not when the returns on the underlying items occur.

- Objective of the CSM release:
  - To reflect the services provided under the group of insurance contracts in each period.
- Open question: how to interpret the coverage units and the "service provided"?
  - The definition of the coverage period and the explanation of the provision of services in the basis for conclusion indicate that only the insurance coverage would be reflected in the determination of the coverage units.
  - For insurance contract with investment component, the investment-related services will not be reflected in the CSM release.

- **Shall the quantity of benefits include investment-related services?**
- **Shall the coverage duration include periods in which there are no insurance but investment-related services?**

# Discussion around the CSM release for insurance contracts with investment components

## May 2018 TRG Agenda Paper 5

- The determination of coverage units is not an accounting policy choice but involves judgement and estimates to best achieve the principle of reflecting the services provided in each period.
- Quantity of benefits provided under a contract: The benefits expected to be received by the policyholder, not the costs of providing those benefits expected to be incurred by the entity.
- TRG members agreed that the coverage period and quantity of benefits for **variable fee approach contracts** should include investment-related services in addition to insurance coverage.
- Most TRG members argued that the accounting for **insurance contracts with investment components under the general model** should reflect the provision of investment-related services in addition to insurance coverage.

## June 2018 IASB Board meeting Agenda Paper 2B

- The staff recommend that the Board proposes an amendment to the definition of the coverage period for insurance contracts with direct participation features, i.e. contracts in the scope of the VFA, in the next *Annual Improvements to IFRS Standards Cycle*.
  - ➢ The Board agreed with the staff recommendation
- The staff recommend the Board not to consider any change to the definition of coverage period for contracts under the general measurement model; the staff expressed the view that
  - Any change to the definition of the coverage period or any extension of the period used to determine coverage units under the general model would fall outside the scope of the Annual Improvements Process.
  - This issue needed to be investigated more substantively.

**Focus on insurance coverage only not workable for insurance contracts with investment component**

# Description of the issue - Economic misrepresentation (1/2)

- **“Insurance coverage is the defining service”?**
  - There is a vast variety of insurance products which also provide investment-related services in addition to insurance coverage
  - For example, fixed index annuities (FIA) sold by Allianz Life Insurance Company of North America
    - FIA fall under the general measurement model as they do not fulfil the requirements set out in IFRS 17.B101(a)-(c)
    - However, FIA provide substantial investment related services (see product flyer to the right).
    - Likewise, the policyholder‘s perception is that the investment-related services are an important part of the benefits provided by the contract.

## Understanding the basics

A fixed index annuity is a contract between you and an insurance company that may help you reach your long-term financial goals. In exchange for your premium payment, the insurance company provides you income, either starting immediately or at some time in the future.

### How a fixed index annuity works

Annuities are designed to HELP **PROVIDE INCOME** IN RETIREMENT.

Most fixed index annuities have two phases. First, there's an accumulation phase, during which you let your money earn interest. This is followed by a distribution or payout phase, during which you receive money from your annuity.

A fixed index annuity also guarantees you will receive at least the minimum guaranteed interest credited to the contract. Remember that all of these guarantees are backed by the claims-paying ability of the issuing company.

With a fixed index annuity, you defer paying taxes on your contract's interest until you receive money from the contract. Tax-deferred interest means the money in your contract can grow faster.

Your principal and bonus are never subject to market index risk. A downturn in market index(es) cannot reduce your contract values.

**Phase one: Accumulation**
The accumulation phase begins as soon as you purchase your annuity. Your annuity can earn a fixed rate of interest that is guaranteed by the insurance company or an interest rate based on the growth of an external index.

**Phase two: Distribution**
The distribution phase of a fixed index annuity begins when you choose to receive income payments. You can always take income in the form of scheduled annuitization payments over a period of time, including your lifetime. And many fixed index annuities allow you to take income withdrawals as an alternative to annuitization payments. Either way, you can choose from several different payout options based on your personal needs, including options for guaranteed lifetime income.

Today's fixed index annuities **offer a range of features and benefits** that may help you accumulate assets for retirement, preserve what you've accumulated, turn those assets into a guaranteed stream of income, and help you pass on a financial legacy to your loved ones.

2

**Some non-VFA contracts are economically similar as the VFA contracts and provide substantial investment related services**

# Description of the issue - Economic misrepresentation (2/2)

- **In many cases the CSM release only over the insurance coverage period would lead to distorted profit recognition pattern**
  - Example of a deferred fixed annuity:
    - Accumulation period: 10 years; after 10 years: Option to choose a life contingent annuity (with guaranteed annuitization rate), alternative is a lump-sum payment.
    - No death benefit.
      - ➢ Deferred fixed annuity is an insurance contract due to the longevity risk of the life contingent annuity.
      - ➢ If it is treated as providing only insurance services, no CSM release during the first ten years of the deferred annuity.
      - ➢ CSM release only starts when the policyholder elects the annuity option. If the policyholder elects the lump sum, full profit recognition in the point in time in which the payment to the policyholder is performed.

    ⇨ **Limiting the CSM release to the period during which the insurance coverage is provided would result in back-loaded profit recognition.**

  - Example of life insurance contracts with death benefit in the first 5 years
    - The CSM includes also the expected fees for the investment service over the whole contract period (see also next slide)

    ⇨ **Limiting the CSM release to the period during which the insurance coverage is provided would result in premature profit recognition.**

    ⇨ **Not including investment-related services for the purpose of CSM release would allow steering profit patterns by intended product design**

**Focus on insurance coverage only does not reflect an appropriate profit pattern.**

# Description of the issue - Conceptual inconsistency (1/2)

- **Margins from investment management services are included in the initial CSM for the contracts under the general measurement model**
  - Example: Universal life type insurance contract

| | t=0 | t=1 | t=2 | t=3 | t=4 | t=5 |
|---|---|---|---|---|---|---|
| **Premium** | 1000 | | | | | |
| **Current market rate** | 5.0% | 5.0% | 5.0% | 5.0% | 5.0% | |
| **Spread** | 0.5% | 0.5% | 0.5% | 0.5% | 0.5% | |
| **Crediting Rate** | 4.5% | 4.5% | 4.5% | 4.5% | 4.5% | |
| **Account value** | 1000 | 1045.0 | 1092.0 | 1141.2 | 1192.5 | 1246.2 |
| | | | | | | |
| **PV Benefits** | 976.4 | | | | | |
| **CSM** | 23.6 | | | | | |

- Policyholder crediting = Earned rate – Spread
- Account value projected based on expected crediting rate
- Discounting based on current rate
- Difference between PV Benefits and Premium in CSM

⇨ CSM reflects the spread that the entity expects to earn over the full contract period (fee for the investment-related services).

⇨ Accordingly, the initially expected difference between the asset returns and the credited rate is recognized in the CSM and subsequently becomes part of the underwriting result.

⇨ If the spread were not reflected in the CSM there would be a day one gain!

**Expected fee for the investment management services are reflected in the initial CSM.**

# Description of the issue - Conceptual inconsistency (2/2)

- **How would adjustments to CSM be treated after there is no more CSM left?**
  - Some contracts provide insurance coverage that ends substantially before the end of investment-related services.
  - If investment services are not reflected in the determination of coverage units for the CSM release pattern, the CSM would be released to zero when the insurance coverage ends.

➢ The question is, how to deal with adjustments to the CSM in such cases? E.g.

- Because there are changes in non-financial assumptions (e.g., expenses, lapses)?
- Or, because there is a change in the discretionary cash flows (e.g. changes in the spread for investment-related services) in accordance with IFRS 17.B98?

⇨ How can the assumption changes adjust the CSM which will not be able to be released anymore?

⇨ Reflecting the changes in profit or loss seems to be inconsistent with the Standard's requirements for such cases.

**Limiting the CSM release over the insurance coverage period only could lead to inconsistent treatment of the CSM adjustment and makes the mechanics of measurement model questionable**