

# Appendix II

## Alternative approach proposed for participating contracts by the insurance industry

### Executive Summary

The approach proposed in the ED for participating contracts (bifurcation of cash flows and limited unlocking of contractual service margin (“CSM”)) is seen by constituents as a key concern. The insurance industry has developed an alternative approach using the existing framework in the ED to create an approach for participating insurance contracts that is more consistent with the general building blocks approach as defined in the ED. Its principles can be summarised as follows:

- The measurement of insurance liabilities for participating insurance contracts should follow the general principles and measurement model of the revised ED.
- All insurance liabilities would be measured at current fulfilment value on the face of the balance sheet without bifurcation of cash flows.
- The CSM should always reflect the unearned profit arising from the insurance contracts and be determined on a fully unlocked basis. For participating contracts an intrinsic element of the unearned profit are the investment returns arising from the contract.
- Profit for all contracts would be recognised in accordance with the fulfilment of the contract as services are provided, in accordance with general revenue recognition principles.

These principles will apply uniformly. However, consistent with the differing types of products and the business model for asset and liability management, the practical application of the principles will vary and can therefore be conducted under both a ‘Current Value through OCI’ and a ‘Current Value through P&L’ applications with the fulfilment cash flows, risk adjustment, CSM, and shareholders’ equity reflecting the attributes of the contracts.

#### Key advantages:

- Builds on existing principles of the ED instead of defining an exception for contracts with a link to underlying items.
- Current fulfilment value measurement for all insurance contracts and all components of the liability in the balance sheet.
- Full transparency of potential impact of changes in reinvestment assumptions.
- P&L reflects long-term nature of business: distinguish between earned returns for services provided (P&L) and changes in the expected future profits (CSM).
- Asset dependent P&L discount rate for insurance liability avoids accounting mismatches in P&L.
- Reflects the asset / liability linkage for participating contracts.
- Fully unlocked measurement of the CSM simplifies retrospective application at transition and also modifications made to insurance contracts.
- No bifurcation of cash flows and use of a single yield curve for measurement of the whole contract, which removes undue complexity and is in line with the integrated nature of the products.

→ *Faithful presentation of performance, better comparability & reduced complexity*

### A. Background and purpose of paper

- (1) The IASB’s June 2013 exposure draft (the “ED”) includes requirements attached to its “mirroring” principles that have the effects of:
  - (a) Requiring overly complex bifurcation of cash flows into different elements for measurement and presentation purposes.

The requirement to bifurcate is arbitrary and complex. The costs of the IASB’s requirements very significantly outweigh any benefits. Through the order in which companies undergo the separate

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calculations there is a high likelihood that the measurement will be subjective and inconsistent even if the same base assumptions are applied.

(b) Inappropriate and inconsistent measurement of the CSM.

The ED defines the CSM as representing the unearned profit that the entity recognises as it provides services under the insurance contract. The CSM principle has not been fully developed for participating contracts as the ED imposes artificial constraints to exclude asset returns that are earned over the contract in line with the provision of services. This creates inconsistent measurement of the CSM for participating contracts with this feature compared to unit linked contracts where the CSM is recalibrated for the impact of changes in projected future fees due to volatility in market values of assets held to back the contracts.

For unit linked business, the services are asset management, protection and administration and these are provided over the coverage period. Changes in the value of underlying items and changes in reinvestment assumptions result in changes in estimates of future cash flows. In accordance with the ED, the CSM is unlocked for these changes and is recognised over the coverage period in line with the provision of services.

For other participating business, services also include asset management, protection and administration and these services are similarly provided over the coverage period. For these contracts, under the ED changes in estimates of future cash flows resulting from changes in the value of underlying items and changes in reinvestment assumptions are taken to the P&L. This is not consistent with unit linked business and is not consistent with the broader principles of the ED as these changes in estimates are not recognised in line with the provision of services.

This results in an inconsistency in the financial statements for contracts that have substantially similar contractual features.

- (2) This paper explains the principles of the proposed alternative approach. The proposal develops the existing IASB building blocks approach in order to apply a consistent basis for all insurance business and takes account of the particular features of participating contracts.

### **B. Underlying principle**

- (3) We believe that accounting should reflect the long-term nature of insurance business and address the linkage between assets and liabilities in reporting performance. Insurers apply asset liability management strategies in which insurance liabilities and guarantees and their related assets (including derivatives) are managed together according to the insurance contract liability profile to meet obligations to policyholders.
- (4) The IASB proposal for participating contracts in the ED does not meet these objectives. Therefore the insurance industry has developed an alternative approach which is described in this document.

### **C. Scope**

- (5) The ED includes a measurement and presentation exemption for a narrowly defined group of participating contracts. The alternative approach proposes a current fulfilment value in accordance with the general building blocks approach as defined in the ED. We suggest that all cash flows of a contract are valued in a single calculation (or a single calculation per scenario where a stochastic model is used), consistent with the building block approach, with the investment return and discount rate assumptions reflecting the returns on underlying assets.
- (6) It aims to measure economically similar contracts in a consistent way, including those where all or a significant part of the cash flows are dependent on returns from underlying items. This is in contrast to the IASB's proposed 'mirroring approach', which applies only to contracts that require the entity to hold the underlying items and specify a link to returns on those underlying items.

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- (7) Our principles based approach provides a solution for a wide range of contracts from different jurisdictions, which have different participating mechanisms and are subject to different legal and regulatory frameworks.
- (8) The proposal works equally for contracts which are reported under a 'current value through P&L' or a 'current value through OCI' application. While presenting the same current value on face of the balance sheet, both a P&L and an OCI treatment needs to be available for performance reporting to best reflect the different asset liability management approaches which exist as a result of different product characteristics.

### D. Key measurement principles

- (9) Under the alternative approach, all insurance liabilities are measured at current fulfilment value on the face of the balance sheet to ensure a consistent measurement basis.
- (10) The insurance liabilities and the related assets are measured and presented in a consistent way, reflecting their interaction. The insurance liability is calculated under the general building blocks approach and includes all contractual and discretionary expected future cash flows. When the policyholder participates in the investment returns of underlying items, entities consider both (i) expected cash flows from existing assets, which are reflected in the expected cash flows of the insurance liability, and (ii) expected cash flows from future reinvestments, which are considered in the measurement of the liability using current reinvestment assumptions.
- (11) The starting point for the valuation of insurance liabilities is the current fulfilment cash flows. All cash flows under a contract are treated consistently without bifurcation as proposed by the ED.
- (12) Options and guarantees embedded in the insurance contracts which are not separated are reflected at current value determined under a set of stochastic scenarios, in order to reflect the potential effects on the liability. This is in line with the IASB's general measurement requirements, which apply to all cash flows arising from insurance contracts without distinguishing the cash flows that specifically arise from options and guarantees.
- (13) The CSM always reflects the unearned profit of shareholders arising from the insurance contracts and is determined on a fully unlocked basis without the artificial restrictions for unlocking imposed by the ED. Changes in future gross profit expectations are deferred through the CSM.
- (14) In contrast to the ED, the CSM is also adjusted for changes in financial assumption for participating contracts whose cash flows significantly depend on the asset returns, including changes in the value of underlying items and changes in reinvestment assumptions.
- (15) The release of the CSM considers the provision of services as satisfied over the life of the contract, and is based on the insurer's expectations of total unearned profit and allocates that unearned profit in a reasonable, systematic way. As a result, profit is recognised in accordance with general revenue principles. The profit drivers will reflect the services provided which, as for non-participating business, will vary depending upon the nature of the contract.
- (16) In summary, the measurement of the expected present value of future cash flows in the balance sheet under the alternative approach does not differ from the general building blocks model proposed in the ED. However, the ED proposes to not apply this model but requires to bifurcate the cash flows for certain types of participating insurance contracts according to paragraphs 33 and 34, and a measurement in accordance with the asset measurement. This would lead to a different measurement basis compared to the alternative model. In addition, compared to the ED proposals, under the alternative model the CSM will be recalibrated to incorporate unearned profit so that the substance of the contractual arrangements is properly reflected for all types of participating business.

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### E. Adjusting the contractual service margin

- (17) The ED defines the CSM as unearned profit that the entity recognises as it provides services under the insurance contract. For the subsequent measurement, paragraph 30 of the ED requires an adjustment to the remaining amount of the CSM for a difference between the current and previous estimates of the present value of future cash flows that relate to future coverage and other future services. The alternative approach builds on the definition of the CSM as unearned profit and the unlocking principles of paragraph 30 of the ED.
- (18) Under the alternative approach, the CSM is adjusted each reporting period to represent the whole of the remaining unearned profit arising from the insurance contract. This requires that all assumptions underlying the calculation of the CSM as the present value of future profits are updated. As a result, the CSM under the alternative approach is defined consistently at initial recognition and for subsequent measurement, as it is calculated on a fully unlocked basis, consistent with the other building blocks.
- (19) The alternative approach takes the view that asset management activities, i.e. crediting asset returns to the policyholder, are explicit services under the insurance contracts. The level of these services changes over time because expectations of future asset returns which impact the liability cash flows are changing with the change of the investment portfolio and with the changes in reinvestment assumptions in case of an asset-liability mismatch. Therefore, the CSM is adjusted for such changes in the profitability of the contract as required by paragraph 30 of the ED.
- (20) However, the ED contains guidance, which could lead to an interpretation that unlocking the CSM is not allowed for changes in the estimates relating to the returns of assets backing insurance contracts (BC41). This is only appropriate for contracts where cash flows do not vary with the changes in the underlying items.
- (21) Under the view that the CSM represents the remaining unearned profit at each reporting date, entities release this margin and recognise profits as services are provided. The services provided to the policyholder throughout the contract period include insurance cover, investment management services and provision of an increasing level of guaranteed bonuses as the period the contract is in force increases. The amount of asset returns credited to the policyholders could serve as a proxy for the services provided in that period, because asset management services are often the main service provided under a participating contract.
- (22) Regarding this pattern of release, it should be noted that the IASB's ED provides principles based guidance only, as it requires entities to release the CSM in the systematic way that best reflects the remaining transfer of services that are provided under the contract, and does not prescribe a specific pattern of release.
- (23) Under the alternative approach, entities indirectly accrete interest on the CSM consistently with how interest expense is recognised in profit or loss for the other components of the insurance liability.
- (24) As the CSM presents the value of future profits it includes the projected future allocations of asset returns to shareholders based on the underlying contractual or regulatory participating mechanism (i.e. fair value through OCI, fair value through P&L, amortised cost or a mixture of those). The asset base used consists of all assets backing the liability currently allocated to policyholders.
- (25) In contrast, the IASB's proposals would accrete interest on the CSM based on the locked-in discount rate determined at inception which is in contrast to the fully unlocked nature of the CSM. This results in a different profit recognition pattern compared with the alternative approach.
- (26) To be able to present the CSM on an unlocked basis with the same definition at initial recognition and at every subsequent reporting date, under the alternative approach the CSM is also adjusted for changes in the risk adjustment related to future coverage as well. The ED does not allow this.
- (27) In summary, the CSM under the alternative approach reflects the remaining unearned profit of the insurance contract, and this profit would be earned as it emerges over time, consistently at inception of the contract and for subsequent measurement. In contrast, the CSM under the IASB's approach represents the unearned profit arising from the insurance contract as estimated at the inception of the

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contract, subsequently only partially updated and reflecting locked in assumptions. Thus, at subsequent measurement dates it does not represent unearned profit anymore.

### F. Presenting changes of insurance liabilities

- (28) For the purposes of unwinding the current insurance liabilities to recognise interest expense in profit or loss, entities would use a discount rate. That includes the reflection of the dependence of the liability cash flows on the returns of assets, which the ED has defined in paragraph 26(a). A single yield curve is used for discounting all fulfilment cash flows under the contract and measuring the unearned profit in CSM.
- (29) The discount rate would “mirror” the presentation of the assets in the statement of profit or loss:
- i. Where the insurer applies FVOCI the discount rate would reflect the measurement of the underlying assets (e.g. for FVOCI assets the discount rate would be an amortised cost based rate which is unlocked when changes in the underlying items change the expected future cash flows under the contract, including a change in reinvestment assumptions).
  - ii. Where the insurer applies FVPL the discount rate would be a current period rate.
- (30) As a result, the discount rate used for the alternative approach is in line with the requirements of the ED.
- (31) Changes in the value of options and guarantees are treated consistently with all other elements of the insurance liability. This means that changes in the value of options and guarantees are recognised based on the nature of the change and the measurement application followed (including the application of OCI and/or FVPL and the CSM) for other elements of the insurance liability and backing assets.

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## Illustrations of the alternative approach under FVOCI

- (32) In this illustration, assets purchased at inception are measured at fair value through OCI. Consistently, entities would use OCI to report changes in the insurance liability arising from changes in the current discount rate from these assets. Accordingly, the amounts reported in OCI would reflect short-term movements in the discount rates that reverse automatically over time and that do not affect the performance of the period.
- (33) However, interest rate movements will impact the performance of future periods if the entity is exposed to reinvestment risk. In that case, the present value of the future profits will change and entities would adjust the CSM to reflect a higher or lower expected reinvestment yield in the gross profits arising from the portfolio. The reinvestment yield would be measured based on market assumptions.
- (34) For the purposes of unwinding the current insurance liabilities to recognise interest expense in profit or loss:
- For the existing assets, the yield of the assets, adjusted for expected defaults that back the insurance contract should be used; where fair value through OCI is used for assets, such yield reflects an amortised cost based yield.
  - For reinvestments the expected reinvestment yield based on current market rates and the existing asset allocation should be used.
- (35) Illustrating example European 90/10 participating life contract:
- 20 year liability duration
  - Single premium of CU 1,000
  - Premiums are invested in FVOCI bonds with a 15 year duration at a 5% coupon
  - Market interest rates at inception  $t=0$ : 5%
  - Market interest rates at  $t=1-20$ : 4%
  - Guaranteed return of 3%, annual crediting of asset returns
  - Value of options and guarantees: put on 90% assets
  - For simplicity it has been assumed: no death benefit, no acquisition cost, no risk adjustments, no surrenders

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- A duration mismatch exists, the insurer bears the reinvestment risk and in year 1 the current interest rate drops from 5% to 4%. -> Lower profit expectation from year 15 onwards.
- The difference in expected profit due to the drop in interest rates goes to the fully unlocked CSM.
- The main profit driver of the CSM is the book return from the asset side.
- The change in reinvestment rates after year 15 goes to the CSM, all other changes in interest rates go to OCI.
- The CSM takes reinvestment assumptions into account, it shows ALM and an economic result, without the need for cash flow bifurcation.
- The fully unlocked CSM would also provide users with a meaningful figure as it reflects the estimated unearned profit of the contract.
- In this particular example any change in the value of options and guarantees are unlocked in the CSM as it should be treated consistently with all other elements of the insurance liability for measurement and presentation. Reporting the change in the time value of options and guarantees in OCI and P&L would also be an appropriate application under the alternative approach.

	Year				
	0	1	2	3	20
Current interest rate	5,0%	4,0%	4,0%	4,0%	4,0%
Book yield		5,0%	5,0%	5,0%	4,0%
Investment amortized cost	1.000,0	1.050,0	1.102,5	1.157,6	2.529,3
Investment fair value	1.000,0	1.200,5	1.248,6	1.298,5	2.529,3
Best Estimate Liability amort. cost	940,1	991,4	1.040,4	1.091,7	2.376,4

<b>Balance Sheet</b>					
<b>ASSETS</b>	<b>1.000,0</b>	<b>1.200,5</b>	<b>1.248,6</b>	<b>1.298,5</b>	<b>2.529,3</b>
BEL current	940,1	1.132,9	1.177,6	1.224,1	2.376,4
Contractual Service Margin	59,9	53,6	51,9	50,1	0,0
<b>INSURANCE LIABILITIES</b>	<b>1.000,0</b>	<b>1.186,4</b>	<b>1.229,5</b>	<b>1.274,2</b>	<b>2.376,4</b>
Retained Earnings	0,0	5,0	10,3	15,8	152,9
OCI from Assets	0,0	150,5	146,1	140,9	0,0
OCI from Liabilities	0,0	141,4	137,2	132,4	0,0
OCI	0,0	9,1	8,8	8,5	0,0
<b>EQUITY</b>	<b>0,0</b>	<b>14,1</b>	<b>19,1</b>	<b>24,3</b>	<b>152,9</b>

<b>Income Statement</b>					
Investment Income		50,0	52,5	55,1	97,3
CSM amortization		6,3	1,7	1,8	3,8
BEL unwinding		-51,3	-48,9	-51,4	-91,4
<b>NET INCOME</b>		<b>5,0</b>	<b>5,3</b>	<b>5,5</b>	<b>9,7</b>
Assets		150,5	-4,5	-5,2	0,0
Liabilities		-141,4	4,2	4,9	0,0
<b>OCI</b>		<b>9,1</b>	<b>-0,3</b>	<b>-0,3</b>	<b>0,0</b>
<b>TCI</b>		<b>14,1</b>	<b>5,0</b>	<b>5,2</b>	<b>9,7</b>

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### Illustrations of the alternative approach under FVPL

- (36) For the types of business for which this approach is applicable the shareholder profit represents fees earned over the duration of the contract for the provision of services for investment management and policyholder benefits. However, unlike the products for which FVOCI application may be appropriate, the distinction between realised and unrealised gains and losses on the assets backing the contract is not relevant and to do so for accounting purposes would be inappropriate. Instead the policyholder receives, over the duration of the contract, the surplus earned by the fund from investment return (including realised and unrealised gains and losses) and other surpluses through, for example, sharing of the surpluses from providing insurance coverage, net of the fee earned by the shareholder. This type of business may be attractive to policyholders as they are sold as long duration (e.g. 20-25 years) with the backing assets deliberately spread across a wide range of asset categories such as equities, investment properties, debt securities. By deliberately investing in a wide range the aim is to provide the policyholder benefits that are attractive partly by reference to the total return on the assets, including unrealised gains and losses. To reflect the underlying commercial substance therefore the value movements on the investment assets and policyholder liabilities are recorded solely in profit or loss.
- (37) Under the FVPL basis the effect of the change in the discount rate will be booked in profit or loss together with the effect of changes to fulfilment cash flows (incl. risk adjustment) arising from changes to expected future cash flows. In addition the unwind of discount booked in the income statement is at the current rate. The treatment reflects:
- i. the broad based nature of the investments backing the contracts (equities, investment properties, bonds, and other investments);
  - ii. the fact that the assets and policyholder liabilities are managed on a fair value basis; and
  - iii. pay-outs to policyholders reflect returns on a fair value basis
- (38) Similarly to unit linked business, the release from the CSM reflects the fees earned in the period for provision of investment management and policyholder benefits. In the balance sheet the CSM alters for the release to profit or loss for the fees earned and also as the fair values on the investments arising from the contractual cash flows fluctuate for market movements to the extent that they are not reflected in changes to projected policyholder benefits. These amounts represent changes to projected future fees. This is no different in substance from the fluctuating value of future fees on unit linked contracts which are unlocked in the CSM under the ED. Accordingly, and as for the OCI approach, the CSM is recalibrated for changes in future cash flows.
- (39) For these contracts profit or loss will incorporate the asset returns (including realised and unrealised gains and losses (distinction between these components is not relevant) for the fund as a whole, of which the majority will be allocated to policyholder liabilities. Mechanically the allocation can be represented as an unwind of insurance liability discount at current period rates (rather than historic book yields which are not relevant to this type of contract) and the excess or deficit of the additional investment return.
- (40) Setting aside changes to the risk adjustment and other incidental changes of operating assumptions and experience variances, the main movement in profit or loss is that the returns arising in the year which have yet to be earned (because the services have not been provided to policyholders) are allocated as a charge for an increase in the CSM. As services are provided to the policyholder amounts are released to profit or loss.
- (41) A simple illustration of these features is shown below.

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- This illustration shows how investment variances would be accounted for using a fully unlocked CSM for entities using FVPL.
- For illustration purposes, it is assumed that the excess investment return is allocated 90:10 between policyholders and shareholders.
- For simplicity, the cost of guarantees is not considered, it is assumed that there is no change to the discount rate and the risk adjustment is assumed not to depend on investment return.
- The fulfillment cash flows (including risk adjustment) are increased by the policyholders' share of the excess investment return.
- The CSM is increased by the shareholders' share of the excess investment return.
- The net profit or loss reflects the release from the CSM in line with the pattern of transfer of services (such as asset management, protection and administration).

	<i>Year 1</i>
<b><i>Investment return</i></b>	
- Expected return	200
- Excess (unexpected return)	1,000
<b><i>Total investment return</i></b>	<b>1,200</b>
<b><i>Change in fulfilment cash flows</i></b>	
- Unwind of discount rate	(200)
- Change in cash flow estimates	(900)
<b><i>Total change in fulfilment cash flows</i></b>	<b>(1,100)</b>
<b><i>Change in risk adjustment</i></b>	-
<b><i>Change in CSM</i></b>	
- Accretion of interest	(10)
- Amortisation	50
- Change in cash flow estimates	(100)
<b><i>Total change in CSM</i></b>	<b>(60)</b>
<b><i>Total profit or loss</i></b>	<b>40</b>
<b><i>Other comprehensive income</i></b>	-
<b><i>Total comprehensive income</i></b>	<b>40</b>

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### Comparison with the IASB's proposals

(42) The tables below compare the alternative approach proposed by the industry with the IASB's general requirements and the measurement and presentation exception proposed in the ED for contracts that require the entity to hold the underlying items and specify a link to the returns on those underlying items (the 'mirroring approach').

(43) Scope & Initial measurement

Initial measurement	IASB's mirroring approach	IASB's general requirements	Alternative approach with FVOCI	Alternative approach with FVPL
Scope	<ul style="list-style-type: none"> <li>Contracts which require an entity to hold underlying items and specify a link between the payments to the policyholder and the returns on those underlying items.</li> </ul>	<ul style="list-style-type: none"> <li>All insurance contracts.</li> </ul>	<ul style="list-style-type: none"> <li>No specific scope definition needed, as general building blocks model applied with reflection of asset dependency in determination of fulfilment cash flows and discount rate.</li> </ul>	<ul style="list-style-type: none"> <li>Same as FVOCI.</li> </ul>
Insurance liability (excluding contractual service margin)	<ul style="list-style-type: none"> <li>Bifurcation of cash flows.</li> <li>Cash flows that vary directly with returns on underlying items are measured by reference to the carrying amount of the underlying items.</li> <li>Other cash flows are measured at current fulfilment value.</li> <li>Options and guarantees are bifurcated.</li> </ul>	<ul style="list-style-type: none"> <li>Measured at current fulfilment value.</li> <li>Treatment of options and guarantees unclear.</li> </ul>	<ul style="list-style-type: none"> <li>Same as IASB's general requirements.</li> <li>The cash flows arising from options and guarantees are treated in the same way as any other expected cash flows.</li> </ul>	<ul style="list-style-type: none"> <li>Same as FVOCI.</li> </ul>
Contractual service margin (CSM)	<ul style="list-style-type: none"> <li>No differences for determination of the CSM. Represents expected unearned future profit.</li> </ul>			

(44) Subsequent measurement

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Subsequent measurement	IASB's mirroring approach	IASB's general requirements	Alternative approach FVOCI	Alternative approach FVPL
Interest expense presented in profit or loss / OCI	<ul style="list-style-type: none"> <li>• Changes in cash flows that vary directly with returns on underlying items are presented on the same basis as the recognition of changes in the value of the underlying items.</li> <li>• For fixed cash flows, determined using locked-in discount rate, with difference reported in OCI.</li> <li>• Option components that are not separately accounted for as derivatives are measured at current value through P&amp;L.</li> </ul>	<ul style="list-style-type: none"> <li>• Unwinding of the insurance liability based on locked-in discount rate at inception and updated discount rate for cash flows that are expected to vary directly with returns on underlying items.</li> <li>• Amount stored in OCI equals the difference between the carrying amount of the insurance contract measured using the current rate and the carrying amount of the insurance contract measured using the discount rate for determination of interest expense in profit or loss. All other changes in insurance liabilities presented in P&amp;L</li> </ul>	<ul style="list-style-type: none"> <li>• Unwinding of the insurance liability for P&amp;L purposes based on the P&amp;L return of the existing assets backing the contract and the expected yield for reinvested assets. When assets reported under FVOCI, this represents an amortised cost based rate.</li> <li>• See IASB's general requirements for basic mechanics.</li> </ul>	<ul style="list-style-type: none"> <li>• Unwinding of the insurance liability for P&amp;L purposes based on a current market based rate.</li> <li>• Effectively, all changes of insurance liability presented in P&amp;L and no amounts reported in OCI.</li> </ul>

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Subsequent measurement	IASB's mirroring approach	IASB's general requirements	Alternative approach FVOCI	Alternative approach FVPL
Contractual service margin (CSM)	<ul style="list-style-type: none"> <li>• Adjust CSM for changes in estimates of the present value of future cash flows that relate to future coverage and other future services:               <ul style="list-style-type: none"> <li>○ Gains and losses on underlying items do not relate to unearned profit from future services from the insurance contract.</li> <li>○ No unlocking for changes in the value of options and guarantees.</li> <li>○ No unlocking for changes in risk adjustment.</li> </ul> </li> <li>• Accretion of interest using locked-in discount rate.</li> <li>• Release CSM as service is provided.</li> </ul>	<ul style="list-style-type: none"> <li>• See IASB's mirroring approach.</li> </ul>	<ul style="list-style-type: none"> <li>• The CSM is measured on a fully unlocked basis and represents the unearned profit of the contract at each reporting date consistent with initial measurement at day one, based on updated financial and non-financial assumptions which impact performance.</li> <li>• This is in line with adjusting of the CSM for all changes in estimates of future cash flows that relate to future coverage and other future services.</li> <li>• This results in adjusting the CSM for changes               <ul style="list-style-type: none"> <li>○ in reinvestment assumptions and changes in underlying items related to future coverage and services;</li> <li>○ in risk adjustment related to future coverage and services;</li> <li>○ Implicit accretion of interest with the interest rate applied to determine interest expense in P&amp;L.</li> </ul> </li> <li>• Release of CSM based on changes of the present value of expected future profits.</li> </ul>	<ul style="list-style-type: none"> <li>• Same as FVOCI.</li> </ul>

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- (45) The alternative approach would require a disclosure of the changes in the CSM in the reporting period. This would show a reconciliation of the unearned profit of the insurer due to changes in financial assumptions (reinvestment assumptions) and changes in non-financial assumptions. In this way, all changes are clearly and transparently disclosed to the users of financial statements.
- (46) Comparison of alternative approach with ED principles:
- a) **“Introduce a comprehensive, coherent framework for all insurance contracts** that provides information that reflects the many different ways in which entities make money from insurance contracts, whether through fees from asset management services, investment income from a spread business or underwriting profit from a protection business” (Basis for Conclusions, EA12).  
*-> One consistent measurement model for all insurance contracts.*
  - b) Measure an insurance contract an entity issues **“using a current value approach”** (ED.2). “Including all the cash flows that arise from insurance contracts is consistent with the IASB’s principle that the measurement of an insurance contract should treat all cash flows that arise from the contract in the same way” (Basis for Conclusions, BCA59).  
*-> No exception for participating contracts – apply building blocks model.*
  - c) Adjust “the estimates of future cash flows for the time value of money, using discount rates that reflect the characteristics of those cash flows” (ED.25).  
*-> Asset dependency is reflected consistently in cash flow projection and discount rate.*
  - d) Contractual Service Margin: “Representing the unearned profit that the entity recognises as it provides services under the insurance contract” (Appendix A).  
*-> Fully unlocked measurement of CSM based on updated assumptions. Apply the same rationale at inception and for subsequent measurement (i.e., deferral of future gains).*
  - e) Adjust the remaining amount of the CSM for a difference between the current and previous estimates of the cash flows that relate to future coverage and other future services (ED.30).  
*-> Changes in financial assumptions change level of future service and thus should unlock the CSM.*