The Alternative Proposal for Participating Contracts

CFO Forum

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Introduction

1. This paper for the November IASB Board meeting has been prepared by the European Insurance CFO Forum ("CFO Forum"), a body representing the views of 21 of Europe's largest insurance companies. The objective of this paper is to describe the CFO Forum's alternative proposals for participating contracts (the "Alternative Proposal") for the consideration of the IASB. The paper provides a detailed explanation of the Alternative Proposal with reasoning of why the proposal is needed in order to contribute to the IASB Board's re-deliberations on the 2013 Insurance Contracts Revised Exposure Draft (the "2013 ED"). It aims to address potential questions that the IASB may have and to assist the IASB in understanding why an alternative to the IASB's current proposals for participating contracts is needed.

2. The Alternative Proposal was developed by insurers who operate worldwide. The Alternative Proposal's key principles have gained support from the global industry including those represented by Insurance Europe, the Hub Global Insurance Group, the American Council of Life Insurers (ACLI) and a growing number of national accounting standard setters. Furthermore, the European Financial Reporting Advisory Group ("EFRAG") provided favourable feedback on the key principles of the Alternative Proposal in its response to the 2013 ED and continues to be supportive.

3. We also note that the CFO Forum presented the large global audit firms with the Alternative Proposal who agreed with the high level objectives of the Alternative Proposal.

4. This paper includes an **Executive Summary**, detailed **sections 1 and 2** and an **appendix**.

5. **Section 1** provides background to the industry concerns, the development of the Industry Proposal and describes the nature of participating contracts:

Part 1A	Paragraphs 20 to 29	Describes the CFO Forum's key concerns in relation to the IASB's proposals for participating contracts
Part 1B	Paragraphs 30 to 36	Describes the nature of participating contracts
Part 1C	Paragraphs 37 to 41	Explains the development of the Alternative Proposal

6. **Section 2** describes the key principles of the Alternative Proposal and the application of those principles. It particularly focuses on the key principles relating to unlocking of the CSM, the use of the current portfolio book yield, the release of the CSM to profit or loss as well as scope noting that these are areas where IASB Board members have expressed most interest in developing further understanding:

Part 2A	Paragraphs 42 to 53	Provides an overview on the Alternative Proposal and its key principles
Part 2B	Describes each key principle in detail, explains its rationale and provides a conclusion	
	Paragraphs 54 to 72	Full unlocking of the CSM

	Paragraphs 73 to 89	Profit recognition pattern
	Paragraphs 90 to 103	Presentation of interest expense in profit or loss
	Paragraphs 104 to 113	Scope
	Paragraphs 114 to 122	Single measurement basis
	Paragraphs 123 to 128	Non-mandatory use of OCI

7. **Appendix 1** compares the components of the Alternative Proposal to the proposals in the 2013 ED and current IASB re-deliberations.

8. Although the focus for this paper is on certain elements of accounting for participating contracts, there are other non-participating contract areas of concern with the IASB's Insurance Contracts Project that are of significant importance to the insurance industry.

9. We have not included simplified examples in this paper. The industry prepared illustrative examples in the past which have been presented to the IASB staff and selected IASB board members earlier. The CFO Forum is happy to present such examples to all board members, but due to their nature these cannot be simply included in this paper.

10. Whilst we have included the key elements of the Alternative Proposal in this paper, together with the background and rationale, we realise that this is a complex topic and that it is useful to present and discuss the topics included in more detail. The CFO Forum will be pleased to do so and continues to be available for working together with the IASB to successfully develop a new insurance contracts standard.

Executive summary

11. The CFO Forum supports the need for a comprehensive and high quality insurance contracts accounting standard. The CFO Forum has closely followed the Insurance Contracts Project and contributed throughout the consultation processes. The CFO Forum has supported key elements of the IASB proposals such as the building block model and the ability to present the impact of changes in interest rates in OCI.

12. The CFO Forum's primary objective for the final standard is to ensure that for all insurance contracts, including participating contracts, it provides an accounting basis that reflects the long-term nature and other features of insurance contracts, addresses the inherent link between underlying assets and insurance liabilities and provides an appropriate basis for the reporting of performance.

13. The CFO Forum is concerned that the 2013 exposure draft and current re-deliberations do not provide an appropriate basis to explain the performance of insurance business to investors and do not adequately reflect the nature of long-term insurance contracts, particularly participating contracts. Participating contracts represent a significant portion of the products written by the global insurance industry and are a core part of long term insurance business. It is critical that the final accounting model reflects the substance of the contracts in the liability measurement and reporting of performance, including when considering the application of IFRS 9. Without this, the standard will not provide an appropriate basis for reporting the performance of insurers.

14. The key concerns with the 2013 ED and current re-deliberations cover a number of areas. Firstly, the limited scope of potential approaches would exclude many types of participating contracts written by insurers. The exclusion of unlocking of the CSM for financial assumptions which is one of the key profit drivers of participating contracts is a key concern. Additionally, we believe the 2013 ED did not adequately address the fact that the inherent link between assets and liabilities requires a presentation of interest expense in profit or loss which is consistent with the measurement basis of the underlying assets and avoids accounting mismatches. Furthermore the requirement to measure an insurance contract in its component pieces (bifurcation of cash flows) including the separate treatment of changes in options and guarantees through profit or loss results in undue complexity and inconsistency. The combined effect of these aspects is that the IASB proposals will give rise to a lack of transparency and meaningful results.

15. In response to these concerns the industry developed the Alternative Proposal. It uses the IASB's framework for insurance liabilities (current fulfilment value) to create an approach for participating contracts that is more consistent with the IASB's building block principles. The Alternative Proposal was developed as the best solution available within the constraints of the IASB's current fulfilment value and mixed measurement for financial instruments in IFRS 9.

16. The Alternative Proposal represents a set of key principles which have global support:

- Applicable to all participating contracts ensuring consistent treatment of economically similar contracts.
- In our opinion provides for a single measurement basis for all types of contracts, with a single discount rate applied for liability measurement and consistency in the treatment of options and guarantees with all other cash flows.
- Full unlocking of the CSM for all assumption changes that impact expected future profits, including financial assumptions which are impacted by the change in value of underlying assets and reinvestment assumptions. The CSM represents all expected future profits from the provision of services in the contract.
- CSM is released to profit or loss in a way that best reflects the transfer of services under the contract.
- Current portfolio book yield used to determine interest expense in profit or loss to provide consistency in the reporting of interest expense and interest income.

- The insurer elects to present the effect of changes in the discount rate in OCI or profit or loss as an accounting policy choice which is needed to reflect the insurer's asset liability management strategies and as a result of the accounting policy for the assets.

17. The key principles of the Alternative Proposal interconnect and taken together as an integrated package provides an accounting basis which reflects the economic substance of participating contracts. The proposal addresses industry concerns whilst retaining the IASB building block principles and providing transparent reporting and disclosure of the financial position and performance of the insurer. The Alternative Proposal ties back to the IASB's existing framework and provides transparency through the current fulfilment value balance sheet, the measurement of all the options and guarantees and transparent presentation of (changes in) estimated future profits in the CSM.

18. Under the Alternative Proposal the insurer's financial position and performance would be very transparent to users of financial statements. The current fulfilment value balance sheet reveals the insurer's financial position under current conditions and the CSM shows the future profitability of in-force business on a consistent basis for all contracts; this is more transparent that any other industry. This is highly relevant information for long-term contracts but only where the CSM is fully unlocked.

19. It is critical that the final standard provide an appropriate basis for reporting the performance of participating contracts. The CFO Forum wishes to work with the IASB to achieve this.

Section 1 - Background

1A Key concerns with the IASB proposals

20. The CFO Forum supports the need for a high quality insurance contracts accounting standard and believes that the development of a comprehensive global accounting standard for insurance contracts is important. Pressure on the current re-deliberation timeline should not be to the detriment of developing a high quality standard.

21. The CFO Forum has in previous communications with the IASB supported a number of the key elements of the IASB's proposals and supported the progress made by the Board in the developments in the project. A key concern of the CFO Forum is that the proposed IASB requirement for a current balance sheet measure of insurance liabilities gives rise to relevant performance reporting in the income statement, in particular for participating contracts.

22. The CFO Forum is concerned that the proposals in the 2013 ED and the current re-deliberations do not provide an appropriate basis to measure and report the performance of insurance business to investors. For participating insurance contracts in particular the IASB proposals would not provide a consistent or transparent accounting basis in a number of respects as explained in the following paragraphs.

23. The scope proposal for participating contracts in the 2013 ED under the "mirroring approach" was limited to contracts where the insurer has to contractually hold the underlying assets, which is not a requirement in many jurisdictions for many participating contracts, even though in practice the insurer would hold the underlying assets in many cases. The current IASB re-deliberations to limit the application of any extension to unlocking of the CSM, that the IASB might be prepared to consider, to where there is an "implicit and minimum asset management fee" in the contract will result in fundamentally different accounting frameworks for contracts with similar economic features and bases of reporting profits that are very different to that of the asset management industry. To provide an appropriate basis for reporting the performance of insurance business it is essential that consistent accounting principles are applied to all types of participating contracts.

24. The CFO Forum supported the IASB's decision to unlock the CSM for changes in estimates relating to future coverage and future services as set out in the 2013 ED. However, the 2013 ED did not permit the unlocking for changes in financial assumptions arising from, for example, interest rates, reinvestment, and for the effect of asset returns where applicable. The limited unlocking of the CSM means that the principle of the CSM representing the future unearned profits has not been fully developed for participating contracts. A fully unlocked contractual service margin is needed for participating contracts. This would ensure consistency in the measurement of the CSM at contract inception and at subsequent measurement.

25. The interaction between assets and liabilities is the core of an insurer's approach to managing its business and reporting its performance. As different measurement bases apply through the application of IFRS 9, the reporting of interest expense on insurance liabilities in profit or loss on a consistent basis with the backing assets is needed to eliminate accounting mismatches in reported profits. This principle is relevant for any type of insurance contract.

26. A single measurement model should be applied to all types of insurance contracts. Whilst the nature of the cash flows within a contract may differ, all cash flows should be considered jointly for measurement purposes, reflecting the way the contract is managed by the insurer. Consequently, the CFO Forum did not support the requirement to bifurcate cash flows proposed in the 2013 ED for either measurement or presentation purposes because an insurance contract should be recognised as a whole, rather than as separate components.

27. The 2013 ED proposed that for contracts to which the “mirroring approach” is applied changes in the value of options and guarantees embedded in the insurance contract are reported in profit or loss. We believe this is inconsistent with the treatment of other cash flows in the liability. Options and guarantees should be treated consistently with all other elements of the insurance liability for measurement and presentation.

28. To provide an appropriate accounting basis that reflects the nature of participating contracts and services provided, a fully integrated approach is needed where the IASB’s current value of fulfilling obligations to policyholders in the balance sheet is combined with the reporting of earnings in a manner which reflects the long-term operating performance of the insurer. The income statement should reflect a measure of earnings that is relevant to the long-term performance of the insurer, recognising profits as services are provided, taking account of all service drivers that underlie the contracts. The future unearned profits should be reported in the balance sheet with appropriate disclosure.

29. The Insurance Contracts Project will bring about a fundamental change in the accounting and reporting of results by insurance companies. The cost of implementing IFRS 4 and IFRS 9 for insurers will be extensive in terms of expenses, resources and management commitment and is expected to substantially exceed the cost of adopting IFRS in 2005. To justify the implementation costs it is critical that the final standard provides an appropriate basis for the reporting of performance by the industry. If the standard does not achieve this, then not only will the costs of implementing the new requirements outweigh the benefits to users, but non-GAAP measures will be needed to appropriately explain the performance results. Such non-GAAP measures would undermine the objective of the insurance contracts standard.

1B Nature of participating insurance business

30. Participating insurance contracts allow policyholders to enter into a long-term contract and, in addition to life insurance protection/coverage, the policyholder shares in the benefits/risks of investment returns, mortality, expenses and other sources of earnings arising from the contract. Typically these benefits, in addition to the guaranteed amount, include a return on the pooled underlying fund of assets managed over the long-term, paid annually and on claim (death, survival or surrender) or maturity of the contract. Participating contracts typically also provide options and guarantees to policyholders. The insurer manages the insurance exposure and investment portfolios over a large number of policyholders, and potentially generations of policyholders, over a long period of time.

31. The insurer is compensated for the provision of insurance and investment management services. The investment management services element of the compensation received by the insurer over the contract term (which may be 25 years or more) takes various forms. For example, for unit-linked contracts, the policyholder agrees to pay explicit fees for services provided. For other types of participating contracts, whilst they are very similar in economic substance and the services provided, the policyholder instead agrees that the insurer’s compensation for services is in the form of a portion of returns (investment returns on underlying assets, mortality results and results from expense- or other items). The nature of such investment returns may be based on fair value returns or book yields and realised profits.

32. The performance of participating contracts is driven by compensation received by the insurer for provision of both insurance and investment management components. These components are comingled. Often insurers are able to offset lower profits from one component with higher profits from another component. Also, many participation mechanisms to some extent allow for an offsetting of policyholder participation from different profit sources, which emphasises the interdependency of profit sources. For participating contracts, different accounting treatment for separate components of compensation would artificially split the profit sources of the contract, be

inconsistent with the integrated nature of the fulfilment cash flows arising from contract, and would not represent the economics of the contract.

33. Whilst the underlying assets to the participating contract represent in substance investments of the policyholder, these assets are reported on the balance sheet of the insurer. The insurer holds and manages all of these assets in its capacity of providing a long-term managed investment return to the policyholder rather than holding separate pools of assets for the policyholder and insurer respectively. These asset portfolios are managed under the governance arrangement agreed with the policyholder to provide a long-term managed investment return which the insurer may also directly share depending on the compensation arrangement for services. This governance framework and the often regulated nature of participating contracts impact the level of influence that the insurer has over the underlying assets held for policyholders.

34. Participating insurance contracts cover many different types of insurance products written throughout Europe, North America and Asia. Participating insurance contracts represent a large portion of the insurance products written by the insurance industry and for some major groups may be the majority of their business. Examples of broad categories of participating contracts include European style participating contracts, with-profits style contracts written in the UK, Ireland and Asia, unit-linked contracts and universal life contracts (which are prevalent globally). The features within these broad categories can vary significantly, which contributes to the complexity of reflecting the nature of these products in the accounting requirements.

35. Depending on the nature of the contract and local regulations or market practice, a wide variety of asset classes are used to back the contracts. For some types of contracts this may be a combination of assets including equity securities, fixed income securities, and investment properties. For others, there may be predominantly fixed income securities. The use of derivative instruments and hedging strategies also differs between types of contracts.

36. The objective of providing transparent and meaningful information to users of financial statements requires that the final standard adequately reflects the nature and substance of participating contracts as discussed above, in particular:
    - Dependency of insurer's profits on returns on underlying assets, which vary over time;
    - The high interdependency of investment and non-investment related profit sources;
    - Management of contracts over a large number of policyholders (and potentially generations of policyholders);
    - The long-term nature of contracts, frequently resulting in the requirement to re-invest existing assets.

1C Industry developments in relation to participating contracts

37. It was in response to the industry's concerns and to adequately reflect the nature of participating contracts that the Alternative Proposal for participating contracts was developed. The Alternative Proposal seeks to apply a fully integrated approach. It combines the current fulfilment value in the balance sheet with performance reporting on the basis of services rendered in the income statement. It has a CSM that has a meaning to users of financial statements as it represents the unearned profit from in-force business at all times.

38. The Alternative Proposal was developed with the aim to maintain the building block approach and the current fulfilment value in the balance sheet framework of the 2013 ED, as well as the IASB's approach to measurement of financial instruments in IFRS 9. Therefore the Alternative Proposal has been developed as the best solution available for participating contracts within the constraints of the IASB's framework for insurance liabilities and financial instruments.

39. The CFO Forum has consistently highlighted the interaction between assets and liabilities is the core part of the insurer's approach to managing its business and reporting its performance. An area of

concern previously expressed is in respect of the different measurement bases of assets in IFRS 9 versus the measurement basis for insurance liabilities under the 2013 ED. The Alternative Proposal works within the existing framework of IFRS 9 and hence does not require changes to IFRS 9 that would otherwise have been needed when IFRS 9 is applied with the IASB proposals for insurance contracts.

40. The Alternative Proposal results in a current fulfilment value measurement of the insurance liability in the balance sheet, including the value of options and guarantees. As such, all options and guarantees are reported in the balance sheet at current fulfilment value. The current fulfilment value balance sheet is combined with a deferral of profits at inception so that profits are recognised over the life of the contracts. The estimate of future profits is updated each period combined with disclosure of the developments in the estimated future profits. This provides full transparency to users of the financial statements.

41. The following section of the paper describes the Alternative Proposal in further detail covering the key principles of the approach and the application of those principles.

Section 2 - The Alternative Proposal for participating contracts

2A Overview of the Alternative Proposal and its Key Principles

42. The Alternative Proposal is built from a set of key principles which are explained in detail in the following sections of this paper. The CFO Forum believes that these key principles interconnect and together represent an alternative accounting model for participating contracts. This means that it is important that the key principles are taken together as a whole and not considered in isolation.

43. The Alternative Proposal applies the IASB building block principles to all types of insurance contracts. Its objective is to ensure that each of the building blocks captures throughout the life of the contract the same economically relevant components as they do on day one. The Best Estimate Liability always captures the current fulfilment cash flows, the Risk Adjustment always captures the current estimate of the compensation for bearing risk and the CSM always captures the current estimate of future profits that are ultimately for the shareholder.

44. Instead of introducing exceptions to the 2013 ED building block model for certain contracts, the Alternative Proposal would result in applying the IASB building block principles in a suitable manner to all contracts. As it is applicable to all types of participating contracts it will enable economically similar contracts to be measured consistently. As such, the Alternative Proposal would contribute to increased comparability across insurers by ensuring the many different types of participating policies sold globally but which have similar economics are consistently measured.

45. The service-driven release of the CSM over the remaining contract period to the P&L provides an appropriate measurement of long-term performance over the life of the contract. An analysis of movements in the CSM during the reporting period in the disclosures provides additional insight in the developments that have impacted expected future profits to the shareholder.

46. The key principles of the Alternative Model are summarised as follows:

Applicable to all types of participating contracts.
One measurement basis for all insurance contracts. Options and guarantees that are embedded in the insurance contract are treated consistently with other elements of the insurance liability.
Fully unlocked CSM which represents unearned profit at initial recognition and throughout life of contract.
Profit recognition in accordance with fulfilment of the contract as services are provided.
The discount rate used to present interest expense in the P&L is determined consistently with the investment return recorded in the P&L for the assets which back the insurance contract liabilities.
Both the FVOCI and FVPL applications are available as an accounting policy choice.

47. The Alternative Proposal would apply to all types of participating insurance contracts which means that it provides a broader scope than the "mirroring approach" in the 2013 ED and the scope envisaged by the IASB staff's May 2014 proposal for an "implicit asset management fee".

48. The measurement of the insurance contract liabilities in the balance sheet for participating contracts under the Alternative Proposal follows the general IASB building block principles for non-participating contracts reflecting the current fulfilment value of the contract. In the Alternative Proposal a single discount rate curve is applied to the measurement of all of the contractual cash flows in the insurance contract liability. There is no need to bifurcate cash flows and options and guarantees would be treated similar to other elements of the contract.

49. Under the Alternative Proposal the CSM reflects the future unearned profits arising from provision of services for the participating insurance contract. This is considered to be consistent with the CSM definition set out in the 2013 ED that the CSM is *"a component of the measurement of the insurance contract representing the unearned profit that the entity recognises as it provides services under the insurance contract"*. This means that the CSM is unlocked for all factors that affect future unearned profits arising from the provision of services, including both financial and non-financial assumptions. This ensures consistency in the measurement of the CSM at contract inception and at subsequent measurement.

50. Profit is recognised in the income statement from the amortisation of the CSM on the basis of the drivers of service in the contract. Interest expense reported in the income statement is determined consistently with the underlying assets backing the insurance contracts liability. Where an insurer applies amortised cost and/or FVOCI measurement to all or part of the underlying assets, the interest expense is determined under the current portfolio book yield. The book yield is determined consistently with the investment return reported in the income statement for the underlying assets. This allows the reported performance of the insurer to reflect the inherent linkage between assets and liabilities.

51. The Alternative Proposal would not alter the measurement or presentation of the related assets. The assets would continue to be measured and presented in accordance with their respective IFRS standards.

52. The financial statement disclosures presented by the insurer under the Alternative Proposal will provide disclosure of the components of CSM and how it developed over the reporting period, providing transparency about future profitability of in-force business. The disclosures will provide transparency over the movement in the fulfilment cash flows, risk adjustment and the CSM and the drivers of reported performance in the period.

53. The following sections describe each of the key principles and the rationale for their application. We understand that IASB Board members are most interested in the principles relating to the full unlocking of CSM and the book yield approach. As such, this paper addresses these two principles first.

2B Explanation of the key principles of the Alternative Proposal

2B.1 Fully unlocked CSM

Description of the principle

54. In the Alternative Proposal the CSM represents all of the profits to be earned in the future from the provision of services under the participating contract. For participating contracts, the services provided include administering the contract and the provision of insurance coverage but also include the provision of asset management services. The CSM is unlocked for non-financial assumptions and financial assumptions, including those which are impacted by the change in value of the underlying assets and reinvestment assumptions. Changes in financial and non-financial assumptions are treated consistently for subsequent measurement of the CSM.

55. The Alternative Proposal is consistent with the principle in the 2013 ED that the CSM reflects the future unearned profit arising from the provision of services. The Alternative Proposal includes the projected future allocation of asset returns based on the underlying participation mechanism. Following the recognition of this in the determination of the CSM at inception of the contract, the unlocking of the CSM continues to incorporate the current estimate of the projected future allocation of asset returns at each subsequent reporting date.

56. We believe that the determination of the CSM on day one under the Alternative Proposal is consistent with the general approach under the 2013 ED. On subsequent measurement, in the Alternative Proposal the CSM is unlocked in a manner that ensures it is measured consistently with the day one calculation. As such, we believe that the Alternative Approach's subsequent measurement is consistent with the 2013 ED's day one calculation instead of the 2013 ED's subsequent measurement basis.

57. The full unlocking of the CSM encompasses all components contributing to future profits, both financial and non-financial assumptions and including financial assumptions linked to returns on assets. The return on assets is based on the underlying portfolio of assets, which may include various types of investments and derivative instruments, which are included in the projection of the cash flows attaching to the contracts.

58. The insurer manages the insurance exposure and investment portfolios for participating contracts over a large number of policyholders, and potentially generations of policyholders, over a long period of time. In order to reflect the business model, it is essential that the CSM is determined on a level consistent with how the insurer manages the contracts.

59. The CSM for a portfolio cannot become negative; therefore, if the CSM for a portfolio is exhausted then all changes are directly reported in profit or loss so that expected future losses are presented in profit or loss immediately.

Basis for the application of the principle and rationale

60. The following paragraphs discuss the key arguments supporting the full unlocking of the CSM. In summary, the full unlocking of the CSM results in a:
- consistent CSM measurement at day 1 and throughout the life of the contract,
- meaningful updated CSM which can be a key source of information on expected future profits (instead of a "plug" based on outdated assumptions),
- consistent reflection of financial and non-financial profit sources,
- adequate reflection of the asset dependent nature of participating contracts and
- deferral of changes which impact future services resulting in a meaningful performance reporting.

61. We believe that the determination of the CSM on day one under the Alternative Proposal is consistent with the approach under the 2013 ED. It is important to note that as a result of the prospective measurement model of the 2013 ED, in the case of participating contracts, our view is that the initial measurement of the insurance contract liability, including the CSM, requires projections of future asset returns in determining the fulfilment cash flows. These projections reflect returns from existing assets and current reinvestment assumptions in case the duration of the assets is shorter than the duration of the insurance contracts (duration mismatch).

62. On subsequent measurement, in the Alternative Proposal the CSM is not a "plug" based on outdated assumptions for allocation to future periods. Instead, it is unlocked in a manner that ensures it is measured consistently with the day one calculation. It thus has a meaning to users of financial statements. The CSM is fully unlocked to encompass all components contributing to future profits. Financial assumptions linked to asset returns impact unearned profits from the participating contract as the insurer provides both insurance coverage services and investment management services. Those assumptions should not be accounted for as a separate transaction from the other cash flows between the policyholder and insurer. The accounting should reflect the economic substance of the contracts and the way compensation is earned from the provision of investment management services as well as insurance coverage. As such, we believe that the Alternative Approach's subsequent measurement is consistent with the 2013 ED's day one calculation instead of the 2013 ED's subsequent measurement basis.

63. The performance of participating contracts is driven by different profit and expense sources (mainly expenses, risk and investments). For these contracts, consistent with the integrated nature of the pricing, governance, and determination of policyholder benefits and insurer compensation, both underwriting and investment results reflect profits under the contract and should be presented together through the fully unlocked CSM. For these contracts a strict separation and different treatment of underwriting and investment result would artificially split up profit sources. Unlocking the CSM for non-investment profit sharing (expenses, risk) but not for asset returns ("partially unlocked") would not provide a meaningful CSM or shareholders' equity as it would contain updated profit assumptions for risk and expenses, but locked-in assumptions at contract inception for investment returns. Such distinction would also be inconsistent with the requirements for unbundling. Components that are not unbundled should also not be artificially split for unlocking the CSM.

64. Under the Alternative Proposal, the CSM responds in line with the change in future unearned profits from the contract. For example, if there are changes in financial assumptions as a result of negative investment returns and this reduces the expected future unearned profit from in-force business then this is reflected through a reduction of the CSM in the balance sheet. If instead for example, as proposed by the 2013 ED, the changes were recognised in profit or loss or OCI without subsequently unlocking the CSM, a contract issued in a high yield environment would have a high CSM reflecting the expectation of the share of investment returns at initial recognition, even if the expected future profits from the contract had significantly decreased due to a decrease in interest rates. This would misstate the expected future earnings from this contract and thus, the CSM would become meaningless.

65. Under the Alternative Proposal, the income statement reflects a result that is relevant to the long-term performance of the insurer, with profits earned over time as services are provided to the policyholder. The change in financial assumptions linked to reinvestment assumptions and changes in asset valuation are not reported as performance in the period in which the change in value occurs, as this actually represents a change in future unearned profits in relation to the insurance contract. As the objective in the 2013 ED is to recognise profit over the life of the contract, recognising the change in asset valuation in this way is consistent with the overall principles in the 2013 ED.

66. Expected returns on underlying items are included in determining contractual cash flows when projecting expected outflows to policyholders. Similarly, the fully unlocked CSM in the Alternative Proposal captures the change in future unearned profits from the change in expected future returns. These returns result from the rights and obligations with the policyholder arising from the contract and can be seen to form part of the fulfilment cash flows in the boundary of the contract.

67. For participating contracts asset returns are not standalone as they also impact the policyholder liability. For participating contracts the portion of asset returns that is not distributed to policyholders is part of the long-term performance of the contracts as an inherent portion of the profitability sources of the contract consistently with other fees paid by the policyholder.

68. The full CSM unlocking does not change the accounting for the underlying items. The items would be transparently recognised in the balance sheet and income statement in accordance with their respective IFRS. This would not be different from how the underlying items would be accounted for if they did not back insurance contracts with participating features. However, the CSM would then be adjusted in a second step (if applicable), in accordance with the requirements of the Insurance Contracts Standard. The Alternative Proposal does not impact the way an entity applies IFRS 9, but the reported earnings are impacted by the interaction between IFRS 9 and IFRS 4.

69. For participating contracts there is a pool of underlying assets which are used to determine the fulfilment cash flows on day one. These assets are also used for determination of the day one CSM and the subsequent unlocking of the CSM. Adjusting the CSM will refer to this existing information about which underlying items relate to the contract. When benefits to policyholders are asset

dependent, (expected) returns on these assets have to be used for a traceable cash flow projection. Typically, insurers hold these assets on their books (often they are required by regulation). The assets used to determine the unlocking of the CSM are the same as those that are used for the projection of the fulfilment cash flows. For some types of participating contracts the underlying assets may be mixed with assets from other insurance contracts (for example in general account portfolios). It is not necessary for assets to be legally ring-fenced for the insurer to identify the relevant underlying assets. Insurers usually separately track returns attributable to policyholders and such information will already be required for determination of the fulfilment cash flows.

70. The Alternative Proposal for the treatment of the CSM reflects the nature of participating contracts and not the underlying investments. Estimates of future compensation for investment and fund management services change with the movements in returns from underlying assets and expected reinvestments. The CSM should reflect the updated estimate of future profits including those returns. Unlike trading portfolios or minority interest holdings, the investment portfolios are required to be held throughout the contract term and are managed on a combined basis for the benefit of the policyholders and shareholders. As such, the insurer is being compensated for its services based on these investment returns.

71. A fully unlocked measurement of the CSM reduces issues around determination of the CSM at the earliest period presented on transition to the new standard, as it would eliminate the need to recalculate prior period building block values. It thus significantly simplifies retrospective application of the insurance contracts standard for participating contracts.

Conclusion

72. To ensure that the income statement reflects the long-term performance of the insurer the CSM should be fully unlocked so that it represents all of the future unearned profits from the contract consistent with the measurement of the CSM at inception.

2B.2 Profit recognition in accordance with fulfilment of the contract as services are provided

Description of the principle

73. The principle for the release of the CSM is that the CSM is recognised in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of services that are provided under the contract. Therefore, the driver for the release of the CSM in the income statement in the Alternative Proposal is the nature of the services provided under the participating contract. This principle is consistent with the 2013 ED.

74. For non-participating contracts the main services include insurance coverage and administering the contract. For participating contracts, the additional service provided is asset management services because the policyholder benefits from investment returns realised by the insurer based on their premiums. Participating contracts therefore oblige the entity to provide asset management services in addition to insurance coverage and administering the contract.

75. The weighting of services provided will depend on the underlying nature of the participating insurance contract, including the participating features. Services for participating contracts may include administering the policy, providing insurance coverage and asset management services. Hence different drivers may be used for different types of contracts. The types of service drivers that may be appropriate for participating contracts include for example assets under management, the passage of time or providing insurance coverage. The insurer therefore needs to determine the drivers which best reflects the pattern of the combined coverage and asset management services and then recognise the margin in profit or loss over the coverage period.

76. The basis for the pattern of services should be determined at contract inception and will be disclosed in the financial statements. At the end of the life of the contracts the CSM will be fully released to profit or loss.

Basis for the application of the principle and rationale

77. Reflecting the nature of the services in the release pattern means profits are earned consistently with the timing of the services provided by the insurer and hence reflecting long-term performance. A principles based approach to the determination of the pattern of service is important because if the pattern of service was mandated for specific product types it could lead to unintended consequences if the driver does not reflect the nature of the services provided under the contract. As explained in Section 1 D participating contracts exist in various forms globally and differ substantially. This underpins the need for a principle based approach to enable an adequate reflection of the different nature of these contracts in performance reporting.

78. Releasing the fully unlocked CSM to profit or loss in line with the transfer of services provides for a similar profit profile that would be recognised by an asset manager who recognises its performance fees as they are earned. For participating contracts, the building blocks approach reflects the net present value of all future asset management fees for all future periods. Without unlocking of the CSM, the full impact on all future asset management fees would also be recognised immediately; thus, the CSM helps to ensure a closer level of consistency with the profit recognition of asset managers. For comparison, the contractual measurement period for performance fees for hedge fund managers may exceed a year in duration and their fees may be based on a share of gains earned. In this situation, it is unlikely that under the applicable IFRS all expected performance fees could be recognised until the ultimate fee is certain.

Conclusion

79. The CSM should be recognised in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of services that are provided under the contract. A principle based approach should be maintained for the release of the CSM so that the recognition of profits over the life of the portfolio of contracts reflects the nature and timing of services provided by the insurer.

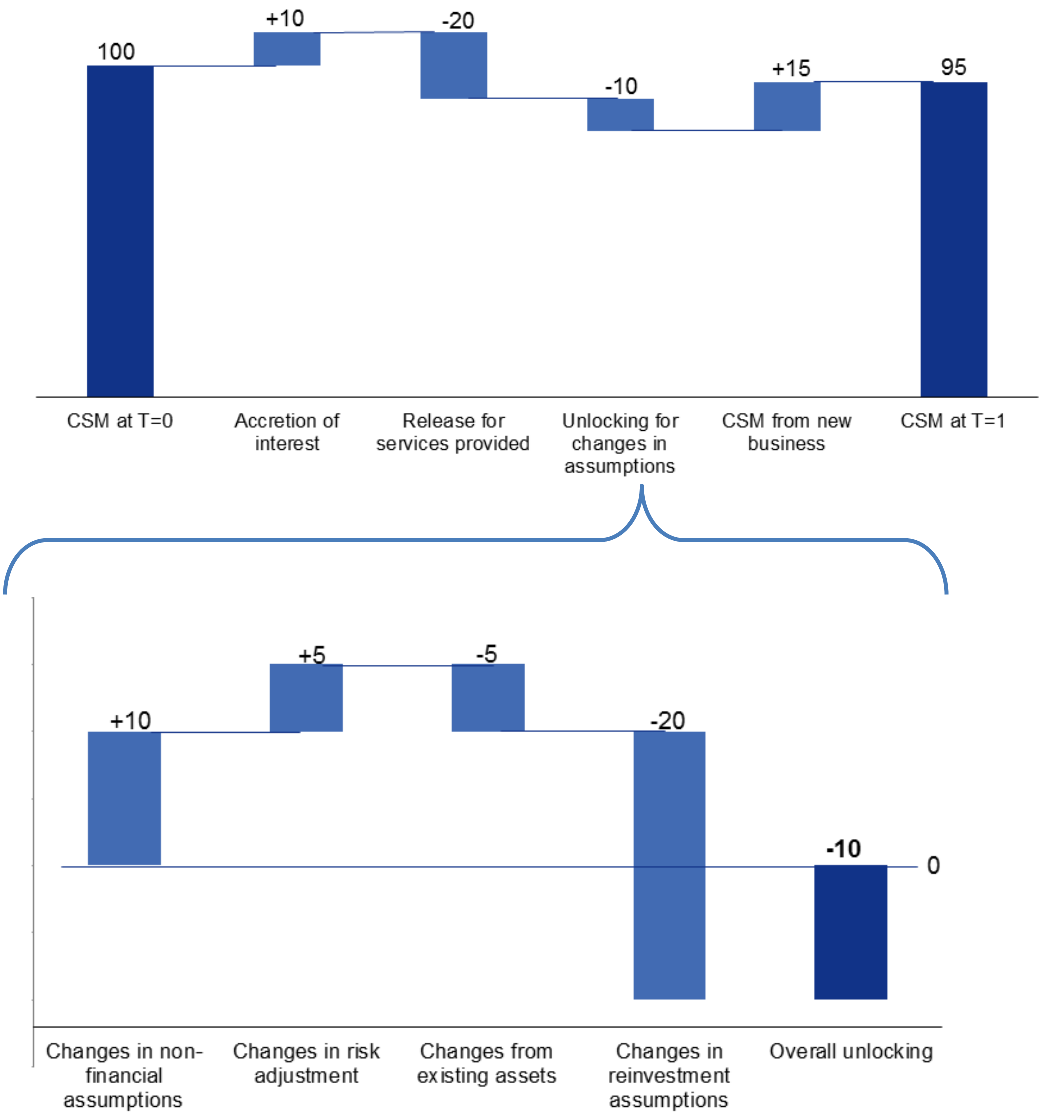
The two principles for the CSM in combination result in meaningful information for users

80. The CSM should not merely be a balancing item at day one that is allocated to reporting periods, but it should provide useful information about the financial position and performance. This is why under the Alternative Proposal the CSM represents the unearned profit for the entity arising from in-force insurance contracts at all reporting dates.

81. The performance of the underlying items is integral to the overall performance of the participating contract. Therefore, unlocking the CSM for non-investment profit sharing (expenses, risk) but not for investment profit sharing ("partially unlocked") does not present the overall unearned profit from the in-force business. A fully unlocked CSM provides a better information basis to estimate future shareholder cash flows and thus dividend capacities for users of financial statements.

82. Compared to the 2013 ED, detailed analyses of the CSM together with showing sensitivity to certain parameters or assumptions would make the profitability of participating contracts very transparent and provide meaningful information.

83. As an example, a CSM roll-forward disclosure that could be presented in an insurer's published consolidated IFRS financial statements could contain the following:



84. Whereas ‘accretion of interest’ and ‘release for services provided’ noted in the above diagram illustrate what happened in the reporting period, ‘unlocking for changes in assumptions’ and ‘CSM from new business’ are forward looking:

- ‘Unlocking for changes in assumptions’ illustrates changes in estimated future profits on the in-force business due to events and assumption changes in the reporting period.
- ‘CSM from new business’ shows the estimated future profitability of contracts sold in the period.

85. It is recognised that short-term fluctuations in the value of the underlying items will be reflected in the unlocked CSM where that fluctuation impacts the future unearned profits from the contract. This is appropriate in the context of participating contracts where those fluctuations impact the value of the compensation to be earned in the future by the insurer.

86. We would expect the CSM to be presented as a separate line item in the balance sheet (being part of the overall insurance liability). Users of financial statements could thus transparently read the current value of fulfilment cash flows and the CSM based on current assumptions from the balance sheet.

87. Further disclosures of the different components, as illustrated for ‘unlocking for changes in assumptions’, or different aggregation levels, could provide more detailed and granular insights into development of estimated future profitability. Similarly, further analyses could also be done e.g. for

'release for services provided', which would illustrate the contribution of different profit sources to the overall profitability of the contracts.

88. Such disclosures would be similar to certain existing disclosures in current Embedded Value reporting and could avoid the need for such non-GAAP reporting. However, such analyses only provide meaningful information if these are conducted on a consistent basis from day one to subsequent measurement. This is the case with the Alternative Proposal's fully unlocked CSM, which is consistently determined for existing and new contracts. Comparing profitability of new business with in-force business in changing (economic) scenarios is particularly important for assessing performance. Under the Alternative Proposal, the CSM will be a key performance metric to users. This will only be possible if the CSM is fully unlocked because otherwise inconsistent numbers based on different assumptions will be added together.

89. As a result, the insurer's financial position and performance would be very transparent to users of financial statements:

- The current fulfilment value balance sheet reveals the insurer's financial position under current conditions;
- The performance of the period reflecting the long-term nature of the business is presented in profit or loss;
- The CSM shows the future profitability of in-force business on a consistent basis for all contracts, which is highly relevant information for long-term contracts; and
-
- Further disclosures illustrate the contribution of different profit sources to the overall profitability of the contracts.

2B.3 Interest expense in the P&L is determined consistently with the investment return

Description of the principle

90. For participating contracts presenting interest expense in profit or loss using the historical locked-in discount rate is not appropriate. Instead the interest expense should be determined on the basis of an updated rate consistent with the investment returns recognised in profit or loss on the underlying assets.

91. The Alternative Proposal uses the current portfolio book yield so that the interest expense is determined consistently with the investment return recognised in the P&L on underlying assets. The objective of the book yield approach for reporting the interest expense in the income statement is to provide a consistent basis of presenting interest income and interest expense in the income statement for participating contracts and to mitigate accounting mismatches.

92. Insurers will apply IFRS 9 to the underlying assets. As different IFRS 9 measurement bases will apply to underlying assets, the reporting of interest expense in profit or loss under IFRS 4 Phase II on a consistent basis with the backing asset is needed to eliminate accounting mismatches in reported profits. The application of the book yield meets this objective by providing a consistent determination of the yield on the liability with the asset yield.

93. The difference between the interest expense reported in the income statement under the current portfolio book yield and the interest expense under the discount rate used to measure the insurance contract liability in the balance sheet is reported in OCI. Where FVPL is applied, the discount rate for profit or loss would equal the discount rate used to measure the insurance contract liability in the balance sheet,which utilises either the 'top-down' or 'bottom-up'approach.

94. The current portfolio book yield reflects the investment return reported in the income statement for the underlying assets backing the insurance liabilities under the accounting model that applies to those assets. Therefore, the determination of the book yield depends on the nature of the underlying

items and the accounting measurement basis applied to those assets as the Alternative Proposal would not alter the accounting for the related assets. The Alternative Proposal is built on the IASB's building block principles and is therefore a portfolio based model. This means in practice there should be one book yield curve that adequately reflects the investment return reported in the income statement for the portfolio of underlying assets including where there are assets with mixed measurement.

95. For a debt instrument the book yield represents the effective interest rate on the debt instrument adjusted for the assumed reinvestment when the bonds mature and are reinvested in new assets. This adjustment for reinvestment occurs when the asset duration is not available for the entire expected duration of the liability. This occurs frequently in practice due to the long term nature of participating contracts which can have a longer duration than available suitable debt instruments. For all reinvestments, the expected reinvestment rate would be based on current market rates reflecting the characteristics of the liability. This long-end of the book yield curve based on current reinvestment assumptions would be the same current rate as used for the balance sheet. Therefore no OCI results from this part of the book yield curve. Changes in reinvestment assumptions do impact the CSM as they usually change the profitability expectations for the insurer.

96. Any realised gains/losses on the sale of debt instruments measured at amortised cost or FVOCI will impact the current portfolio book yield for the remaining portfolio. Realising a gain means that there will be a lower yield on the new, remaining or reinvested assets, meaning a lower discount rate to report interest expense in the income statement. This will result in a higher charge for accreting interest on the insurance contract liability and offsetting (part of) the capital gain.

97. If the underlying assets are all measured at FVPL the discount rate used to present interest expense in the income statement will be the same current discount rate that is used to measure the insurance contract liability in the balance sheet.

98. Other types of assets may also form part of the underlying assets of the participating contract, for example investment property, owner-occupied property, equities, or a share in the underlying results of a subsidiary or associate. Where relevant a current portfolio book yield for such assets could be determined through reflecting the return reported in the income statement for the assets or, in the absence thereof, the discount rate applied in the measurement of the insurance contract liability in the balance sheet (current rate).

99. To calculate the current portfolio book yield the insurer would complete the following steps:
- Identify the underlying assets which back the portfolio
- Determine the basis of the accounting return or book yield for those underlying items.
- Construct a yield curve based on the book yield at each reporting date to cover the duration of the projected cash flows of the participating contracts.
- This yield curve will incorporate an assumption for expected future reinvestments for the unmatched period beyond the term of the debt instruments held by the insurer.

100. When the current portfolio book yield is applied at inception of a contract there might be an initial difference between the liability discount rate applied in the balance sheet and the current portfolio book yield. In theory, such difference would be separately identifiable for a single contract with assets specifically acquired and allocated to the individual contract. In practice, the premiums received from new policyholders could be used to settle claims on contracts with existing policyholders. New contracts could be backed with assets the insurer already holds (i.e., there is some 'heritage' between policyholders). The book yield of 'inherited' assets will reflect market interest rates from the date the assets were purchased. It will thus typically not be possible to determine an OCI effect per contract. However, this reflects the nature of participating contracts, which are managed over different generations of policyholders. Where new assets are purchased with new premiums, investment returns would reflect current rates and thus gradually adjust the book yield, so that no or only a very limited additional OCI effect would occur. This "day one OCI" will be

an inherent component of the overall (change in) OCI for the period. Conceptually, it would be desirable to avoid such "day one OCI". However, in practice we do not believe this is a significant disadvantage. It should also be noted that there are other comparable accounting treatments in IFRS which result in an initial amount being reported in OCI on day one, such as the recently finalised requirements on expected credit losses in IFRS 9.

Basis for the application of the principle

101. In the Alternative Proposal, the discount rate applied for the presentation of changes in the discount rate in the income statement is determined using a basis consistent with investment return reported in the income statement for the assets backing the insurance liabilities. Therefore, the Alternative Proposal allows consistency between the presentation in the income statement of the insurance liabilities and the underlying assets. This reflects the inherent linkage between assets and liabilities in the reporting of the insurer's performance and allows the reflection of the insurer's asset and liability management strategies through the use of OCI.

102. As underlying assets are required to be measured under different bases through application of IFRS 9, the book yield provides consistent reporting of performance where an insurer has a business model for its assets which results in amortised cost or FVOCI measurement for those assets, reflecting the long-term nature of the underlying insurance contracts. The application of the book yield and the OCI presentation means that current interest rate movements that are not relevant to the business model in this scenario are reported in OCI and reversed over the life of the contract.

Conclusion

103. The current portfolio book yield combined with the use of OCI for presenting changes in insurance liabilities is a critical component of the Alternative Proposal to allow an insurer to report the long term nature of its business in the reporting of income and expense in the income statement.

2B.4 Applicable to all types of participating contracts

Description of the principle

104. The Alternative Proposal is applicable to all types of participating contracts. This ensures that there is consistent treatment of all contracts with similar economic characteristics. This is intended to ensure a single measurement model for economically similar contracts to reduce complexity and increase consistency and comparability.

105. Participating contracts include all contracts which provide policyholders with a right to receive, as a supplement to the guaranteed benefits, a variable return, either contractually or at the discretion of the issuer. The variable return could be based upon one or more of the following:

(a) the performance of a specified pool of contracts or a specified type of contract;
(b) realised and/or unrealised investment returns on a specified pool of assets; or
(c) the profit or loss of the company, fund or other entity that issues the contract.

106. This definition is largely consistent with the existing definition in current IFRS 4 which has been effective in practice. If there are concerns that contracts with only insubstantial asset dependency would be captured within the scope, there is the potential that this definition could also incorporate a concept of "substantial share of the total return on underlying items".

107. It is important that the scope is consistent for the two key features of the Alternative Proposal for the full unlocking of the CSM and the use of a current portfolio book yield. As the book yield and the fully unlocked CSM interact with each other, the same scope is required.

Basis for the application of the principle

108. The scope of the Alternative Proposal is intended to capture all types of participating contracts irrespective of whether or not the specified pool of assets is required to be held by the insurer. Participating insurance contracts cover many different types of insurance products written by insurers. Examples of such contracts would include (but would not be limited to) European style participating contracts (e.g. 90/10), UK style with-profits contracts, unit-linked contracts and universal life contracts.

109. The scope of the Alternative Proposal reflects the nature of the contracts where in many cases insurers use discretion to provide policyholders with a more stable long term rate of return over the life of the contract, for example by allocating a higher return in poor years which will be offset in future years when returns are higher. The scope of participating contracts is a key principle in the Alternative Proposal as the use of discretion in the level of returns allocated to policyholders is present in many types of participating contracts.

110. The scope of the Alternative Proposal is not restricted to contracts under which the insurer is required to hold the underlying assets as such strict requirement does not exist in many participating contracts. In reality insurers do usually hold the assets, on which the actual results are based, due to solvency, ALM or other requirements. As described in paragraph 69, there is a pool of underlying assets which are used to determine the fulfilment cash flows on day one. Under the Alternative Proposal these assets are used for the determination of the day one CSM and the subsequent unlocking of the CSM.

111. The recent IASB tentative proposals in respect of an "implicit asset management fee" and the minimum amount which must be retained considerations would result in too narrow a scope and such criteria would not provide meaningful information to users. There is a wide variety of participating contracts in which companies earn compensation for the provision of investment management as well as insurance coverage and for which the fully unlocked CSM is needed. Artificial constraints based on a notion of an implicit asset management fee are not appropriate.

112. The application of the principles based Alternative Proposal is appropriate for all types of participating contracts. The application of the Alternative Proposal key principles has been examined for a variety of participating contracts written globally. If there are additional types of participating contracts that should also be examined, the CFO Forum is willing to investigate the application to such products.

Conclusion

113. Application of the Alternative Proposal to all types of participating contracts is needed to provide for consistency of the treatment of similar contracts.

2B.5 One measurement basis for all insurance contracts. Options and guarantees that are embedded in the insurance contract are treated consistently with other elements of the insurance liability

Description of the principle

114. In our opinion the Alternative Proposal provides for a single measurement basis for all insurance contracts. It ensures that the building block measurement basis is applied to all insurance contracts, both participating and non-participating. The projection of fulfilment cash flows reflects the asset dependency where relevant. A single discount rate yield curve is applied to the measurement of all contractual cash flows.

115. The discount rate applied for the measurement of the insurance contract liability in the balance sheet is a current yield curve that reflects the characteristics of the liability cash flows, such as the timing,

currency and liquidity of the cash flows. It is determined using either a 'top-down' or a 'bottom-up' methodology. This methodology is consistent with the principles set out in paragraph 25 and the associated application guidance in the 2013 ED. For the avoidance of doubt, this means that the discount rate may be determined by adding adjustments to a risk free yield curve in a 'bottom-up' methodology or by making deductions from an asset based yield curve in a 'top-down' methodology. In a 'top-down' methodology an insurer may start with the yield on its actual asset portfolio held or a reference portfolio. The discount rate, as determined using either the 'top-down' or 'bottom-up approach' will reflect the characteristics of the liability.

116. The measurement of the insurance contract liability under the Alternative Proposal includes all options and guarantees, except for those which are required to be unbundled as an embedded derivative that is not closely related to the host insurance contract. Options and guarantees represent features embedded in the insurance contract which provides policyholders with additional benefits or returns, for example, a contract feature that provides a guaranteed minimum return to policyholders.

117. The Alternative Proposal requires that options and guarantees embedded in the contract are treated consistently with all other elements of the insurance liability for measurement and presentation purposes.

118. In their asset liability management, insurers commonly utilise derivatives to manage or hedge several risks such as interest rate or equity risk. The Alternative Proposal would ensure that these derivatives, which reduce the risk exposures for the insurer and/or the policyholder, will not result in artificial volatility caused by accounting mismatches. It is important that the accounting for hedging strategies properly interacts with the model for participating insurance contracts in order to align the economic effectiveness of the hedging relationship with its reflection in the financial statements.

Basis for the application of the principle

119. An insurance contract should be measured and recognised as a whole, rather than as component pieces, reflecting the basis on which the insurer manages the contract. An insurance contract may contain different types of cash flows depending on the contractual terms, such as death benefits, guarantees or options and asset management services. Whilst the nature of the underlying cash flows may differ, all cash flows should be considered jointly for measurement purposes, reflecting the way the contract is managed by the insurer.

120. The application of a single yield curve for the measurement of the liability is less operationally complex than applying multiple discount rates to different cash flow types. It will also lead to a more consistent and comparable measurement of cash flows across economically similar contracts.

Conclusion

121. A single approach to measurement should be applied to all types of insurance contracts.

122. A single discount rate curve should be applied in the measurement of the insurance contract. This will require an amendment to the existing discount rate principles in the 2013 ED to remove the requirement for application of different discount rates depending on the cash flow component characteristics.

2B.6 Both the FVOCI and FVPL applications available to avoid accounting mismatches.

Description of the principle

123. The Alternative Proposal provides that an insurer should elect to present the effect of changes in the discount rate in OCI or in profit or loss as an accounting policy choice.

Basis for the application of the principle

124. The ability to present the effect of changes in the discount rate in OCI or profit or loss is also needed for participating contracts in order to provide consistent presentation with the treatment of the underlying participating assets.

125. The current portfolio book yield approach described in this paper is linked with the use of OCI to present the difference between the discount rate used to measure the insurance liability and the book yield. For participating contracts it is necessary for the existing OCI principle for non-participating contracts to be amended as the book yield used for presentation in the income statement is updated each period to reflect variations in the payments to policyholders.

126. The ability to present changes in the discount rate in OCI is needed in combination with the fully unlocked CSM to reflect the inherent link between assets and liability and the insurer's asset liability management strategies. The nature of the participating contracts may mean that insurers hold debt instruments for the long-term on behalf of the policyholder and the policyholder shares in the interest income on the debt instrument and any realised gains. If such assets will be measured at FVOCI the ability to present interest expense in the income statement on a consistent basis is needed to reduce accounting mismatches and reflect the nature of the insurance contract.

127. Extending the ability to present changes in the discount rate in OCI to participating contracts ensures consistency in the accounting principles applied to all types of insurance contracts.

Conclusion

128. The principle of electing to present the effect of changes in the discount rate in OCI or profit or loss as an accounting policy choice should be equally available for participating and non-participating contracts.

Appendix 1 - Comparison of the Alternative Proposal and the 2013 ED and IASB current re-deliberations

The table below compares the Alternative Proposal to the 2013 ED / current IASB re-deliberation status and explains the Industry's concerns with the IASB's proposals compared with the Alternative Proposal.

Topic	Alternative Proposal	2013 ED / current IASB re-deliberations	Comparison of the Alternative Proposal and 2013 ED / current re-deliberations
Scope	Applicable to all participating contracts. Participating contracts include all contracts which provide policyholders with a right to receive, as a supplement to the guaranteed benefits, a variable return either contractually or at the discretion of the issuer. The variable return could be based upon one or more of the following: (a) the performance of a specified pool of contracts or a specified type of contract; (b) realised and/or unrealised investment returns on a specified pool of assets; or (c) the profit or loss of the company, fund or other entity that issues the contract.	**Current IASB re-deliberations** The Board decided that if adopted, the scope of the unlocking of the CSM for changes in the insurer's share of asset returns will be limited to contracts when those changes can be viewed as an "implicit asset management fee". This is defined as only when: • the returns to be passed to the policyholder arise from the underlying items the entity holds (regardless of whether the entity is required to hold those items or whether the entity has discretion over the payments to policyholders); • there is a minimum amount (either fixed or determinable) that the entity must retain; and • the policyholder will receive a substantial share of the total return on underlying items. **2013 ED "Mirroring Approach"** The "mirroring approach" proposed to limit the application to those contracts which "requires the entity to hold underlying items" and "specifies a link between the payments to the	The scope proposed for the "mirroring approach" in the 2013 ED and in current IASB re-deliberations relating to an "implicit management fee" is too narrow in scope and would exclude a significant amount of participating contracts written by insurers from the proposals. This will result in inconsistent accounting treatment of contracts which are economically similar in nature. The Alternative Proposal is intended to be applicable to all types of participating contracts to ensure consistency in application of the accounting principles. This would allow for consistent treatment of economically similar contracts and improve comparability. The Alternative Proposal reflects the nature of the contracts where insurers use discretion to provide policyholders with a more stable long term rate of return over the life of the contract. The use of discretion in the level of returns allocated to policyholders is present in many types of participating contracts.

Topic	Alternative Proposal	2013 ED / current IASB re-deliberations	Comparison of the Alternative Proposal and 2013 ED / current re-deliberations
		policyholder and the returns on those underlying items".	
Discount rate used to present interest expense in profit or loss	Interest expense reported in the income statement is determined using the current portfolio book yield where an insurer applies amortised cost, FVOCI or mixed measurement to the underlying assets. The current portfolio book yield is determined consistently with the investment return reported in the income statement for the assets which back the insurance contract liabilities. The book yield approach would be applied to all participating contracts to which the Alternative Proposal is applied.	**Current IASB re-deliberations** The IASB is exploring two approaches for determining the discount rate used for the presentation of interest expense in profit or loss, the "Effective yield" and a "Book yield". **Book yield** The book yield approach proposed by the IASB staff is applicable only in the circumstances when it minimises accounting mismatches with underlying items. The book yield would have limited application. It is not permitted when equity instruments are measured at FVOCI or when investment properties are measured at cost and the policyholder receives a share of capital gains. At inception of the contract, the yield curve for the presentation of the unwind of the discount that would be recognised in profit or loss is the same as the yield curve used for the measurement of the liability on the balance sheet. The effect of the difference in those yield curves immediately after inception would be recognised as a gain or loss in profit or loss in subsequent periods	The book yield approach described by the IASB staff would only apply to a narrow subset of participating contracts. This will not eliminate accounting mismatches in the same manner as the book yield in the Alternative Proposal and will also not achieve consistency in reporting between assets and liabilities. As the book yield in the Alternative Proposal applies to all types of participating contracts it ensures economically similar contracts are treated consistently. The book yield described by the IASB staff differs to the book yield in the Alternative Proposal, as the IASB staff proposes prohibiting its application where equity instruments are measured at FVOCI and investment properties are valued at cost but the policyholder shares in the capital gains. The CFO Forum's view is that a limitation is not required as such assets can be accommodated by the computation of the book yield. The effective yield proposed by the staff would not eliminate accounting mismatches as successfully as the book yield proposed under the Alternative Proposal as its application will be limited to portfolios containing only debt instruments when in many instances insurers will have a mixed portfolio of assets underlying the participating contract.

Topic	Alternative Proposal	2013 ED / current IASB re-deliberations	Comparison of the Alternative Proposal and 2013 ED / current re-deliberations
		Effective yield The effective yield approach proposed by the staff is a form of the effective interest method used to allocate the interest income or interest expense in profit or loss. The staff has recommended that approaches would be applied to contracts for which the cash flows that vary with underlying items are a substantial proportion of the total benefits to the policyholder over the life of the contract.	
Initial measurement of CSM	The day one liability calculation includes the insurer's compensation (i.e. the potential profit on the contract). The day one calculation includes the expected future returns on the underlying investments which impact the best estimate liability for the policyholder. Hence the CSM calculation includes the relevant portion of these future returns on underlying assets that relate to compensation to the insurer for future services. The CSM is the difference between the present value of premium inflows and the present value of expected benefits and expenses plus the risk adjustment. It contains	We believe the day one liability calculation is the same as for the Alternative Proposal.	We believe that on day one the general approach under the 2013 ED and the Alternative Approach have the same outcome.

Topic	Alternative Proposal	2013 ED / current IASB re-deliberations	Comparison of the Alternative Proposal and 2013 ED / current re-deliberations
	expected compensation to the insurer for services from all profit sources, including expected investment returns.		
Subsequent measurement of CSM - unlocking	The CSM reflects the future unearned profits arising from provision of services for the participating insurance contract. The CSM is unlocked for all assumption changes that impact expected future profits and that relate to future services, including financial assumptions which are impacted by the change in value of the underlying assets and changes in reinvestment assumptions. Changes in financial and non-financial assumptions are treated consistently for subsequent measurement. As financial assumptions, including investment returns, impact the day one CSM calculation it is consistently reflected in the subsequent measurement.	**2013 ED** The 2013 ED proposed to treat the changes in assumptions on subsequent measurement inconsistently to the day one initial measurement treatment for participating contracts: It proposes that the financial assumptions, including the future investment returns for the insurer are not included in the unlocking of the CSM, despite in our interpretation it being so on day one. Paragraph B68d stated that the contractual service margin is not adjusted for changes in estimates of cash flows that depend on investment returns if those changes arise as a result of changes in the value of the underlying items. The ED proposed that such changes do not relate to services provided under the contract. **Current re-deliberations** The IASB staff have described an approach where if the CSM was to be adjusted for changes in the insurer's share of asset returns this would only be in the circumstances when those changes can be viewed as an implicit management fee. For any other type of participating contracts the CSM is not adjusted for changes in estimates of cash flows that depend on investment returns if those changes arise as a	**Reflecting future unearned profits** The approach described by the staff in the current re-deliberations would be very limited in scope of its application. This would mean that the CSM would not represent the total future unearned profits for a significant portion of participating contracts despite them being economically similar to those contracts included within the IASB's scope. The CSM is defined in the ED as unearned profit that the entity recognises as it provides services under the contract. For many participating contracts, the share in the underlying asset returns not attributed to policyholders form part of the insurer's profits for services provided. These profits are earned over the life of the contract in line with the provision of services. The service margin earned by insurers incorporates amounts that the entity will participate in over time from the underlying assets recognising that services are provided over the life of the contract. It is therefore wider than an implicit management fee. Asset management activities, i.e. crediting asset returns to the policyholder, are explicit services under the insurance contracts. The level of future compensation for these services changes with asset returns, which impacts the future cash flows to policyholders in the liability and the unearned profit in the CSM. The benefit of the Alternative Approach is that CSM 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. The 2010 ED introduced the concept of nil gain at inception of the contract

Topic	Alternative Proposal	2013 ED / current IASB re-deliberations	Comparison of the Alternative Proposal and 2013 ED / current re-deliberations
		result of changes in the value of the underlying items. In effect the CSM represents a residual.	and subsequent IASB decisions to unlock the CSM for changes in cash flows results in the CSM being an updated measurement each period representing future unearned profit. It is relevant therefore that the CSM is also unlocked for all elements of the compensation the insurer receives from the contract.
Release of the CSM	The release of the CSM is in accordance with the fulfilment of the contract as services are provided. The appropriate service driver(s) for the release of the CSM to the income statement will depend on the nature of the services provided by the relevant participating insurance contract.	**2013 ED** The 2013 ED provided principles based guidance requiring the CSM to be released in a systematic way best reflecting the remaining transfer of services being provided under the contract. The 2013 ED acknowledged that the services in a participating contract include insurance coverage and asset management. **Current re-deliberations** For non-participating contracts the Board has decided to specify that the appropriate pattern for the transfer of services is according to the passage of time. The IASB has not yet decided on the appropriate recognition pattern for the contractual service margin for contracts with participating features. The IASB staff paper for the May 2014 Board meeting noted that because the CSM is a blend of insurance coverage and asset management services that are not separately identifiable, any recognition pattern for the CSM is inevitably arbitrary, at least to some extent.	The CFO Forum supported the principle in the 2013 ED for the release of the CSM. The Alternative Proposal provides the same principle based approach for the release of the CSM. If the pattern of service to be used is mandated for specific product types it could lead to inappropriate performance reporting if the driver does not reflect the nature of the services provided under the contract.

Topic	Alternative Proposal	2013 ED / current IASB re-deliberations	Comparison of the Alternative Proposal and 2013 ED / current re-deliberations
Presentation of changes in insurance liabilities due to changes in the discount rate in OCI or profit or loss	An insurer should elect to present the effect of changes in the discount rate in OCI or in profit or loss as an accounting policy choice.	**2013 ED** The OCI approach for the presentation of discount rate change is applied to non-participating contracts. In subsequent re-deliberations the option to present changes in OCI or P&L is an accounting policy choice for non-participating contracts. **Current re-deliberations** The IASB has identified that it is yet to decide on whether the OCI approach provides useful information for participating contracts.	The principle in the Alternative Proposal for the presentation of changes in the discount rate is consistent with the IASB's tentative decision from the March 2014 Board meeting for non-participating contracts. In the Alternative Proposal this principle is extended to participating insurance contracts.
Options and Guarantees	Cash flows arising from options and guarantees that are embedded in the insurance contract are treated consistently with all other elements of the insurance contract liability.	**2013 ED** The 2013 ED proposed that changes in the value of options and guarantees embedded in the insurance contract are reported in the P&L for contracts in the scope of the "mirroring approach". **Current re-deliberations** The IASB has identified that it is yet to decide on how an entity should account for changes in the value of options and guarantees.	We believe the treatment of the cash flows associated with options and guarantees proposed in the 2013 ED for contracts in the scope of the "mirroring approach" is inconsistent with the remainder of the cash flows in the insurance contract. Options and guarantees embedded in the insurance contract represent an element of the fulfilment cash flows consistent with all other components of the liability. To be consistent with IASB building block principles, options and guarantees embedded within the insurance contract should be treated in the same way as all other components of the insurance contract.
Bifurcation of cash flows	There is no requirement to bifurcate cash flows. A single yield curve is applied to the measurement of the whole insurance contract liability, including options and guarantees.	**2013 ED** The 2013 ED proposed that for contracts in the scope of the "mirroring approach" to determine interest expense in the income statement, different discount rates should be applied to the different types of cash flows contained in the contract: • The discount rate applied to cash flows that vary with returns on underlying	The application of the discount rate to measure the insurance contract liability in the Alternative Proposal is consistent in concept with the requirements in the 2013 ED for non-participating contracts. The difference in application with the 2013 ED for participating contracts is the removal of the requirement to bifurcate cash flows and the application of a single yield to all contractual cash flows. The 2013 ED requirement to bifurcate cash flows was overly complex and does not correspond to the way the contracts are

Topic	Alternative Proposal	2013 ED / current IASB re-deliberations	Comparison of the Alternative Proposal and 2013 ED / current re-deliberations
		items would be reset each time there is a change in estimate of investment returns that results in changes to the amounts paid to policyholders. • The discount rate applied to cash flows that do not vary with underlying items would be locked in at inception. **Current re-deliberations** In the discussion of the potential direction on participating contracts, the IASB Board has suggested that the measurement model should not result in the requirement to bifurcate cash flows. The IASB intends to consider how to avoid the bifurcation of cash flows for presentation purposes.	managed. The operational challenge and cost of implementing the requirement would outweigh the benefits.
Disclosure	Disclosure of the components of the CSM and how the CSM develops over the reporting period. Including the movement in the fulfilment cash flows, risk adjustment and the CSM and the drivers of reported performance in the period.	**2013 ED** The disclosure objective in the 2013 ED was that an entity shall provide sufficient information to permit reconciliation of the amounts disclosed to the line items that are presented in the statements of profit or loss and other comprehensive income and of financial position. Similar disclosures to that described for the Alternative Proposal would be required to meet this disclosure objective for CSM.	The CFO Forum recognises that an essential component of the reporting proposition is transparent disclosure. We envisage that the final standard should include requirements that enable the reader to understand the key aspects such as assumptions, features of options and guarantees, and sensitivities. As under the Alternative Proposal the CSM is intended to represent future unearned profit, it has significant similarities with the value of in force business recognised in Embedded Value reporting. The life insurance industry has extensive experience in developing disclosures that demonstrate period on period movements, expected run-off, and other aspects of interest to users of such supplementary information.