

Life Insurer Comments on Field Testing of IASB Insurance Contracts Proposal

17 June 2016

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17 June 2016

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board (“IASB” or the “Board”)
30 Cannon Street
London EC4M 6XH
United Kingdom

**Re: Field Testing of the updated tentative decisions by the IASB during
re-deliberations of the IASB Exposure Draft (ED) – *Insurance Contracts***

Dear Chairman Hoogervorst:

We continue to be fully committed to helping the Board achieve its goal of a high-quality global accounting standard on insurance contracts. As a result, we have again spent significant time and effort to complete Field Testing of the revised IASB proposal. Field Testing was performed to cover a wide range of products and several possible economic scenarios. The results of our testing, along with key findings and observations, are the subject of this document.

In this document, we do not provide comments on all aspects of the proposal; instead, we focus on areas where we encountered uncertainty interpreting the guidance, challenges applying it, or outcomes that were not reflective of our expectations or the underlying economics of the business. We are pleased that many of the tentative decisions made by the Board during its re-deliberations implement suggestions from our previously provided Comment Letter.

Our executive summary provides key findings and observations from our 2016 Field Testing and the recommendations or alternatives that the IASB should consider in drafting in response to certain of those key findings and observations. In certain areas, we have not reached a conclusion on a recommendation or alternative proposal, but we think that, with due consideration, alternatives could be devised.

We categorized our key findings and observations in our executive summary under three main headings:

- 1) Sections sufficiently addressed by the tentative decisions
- 2) Level of aggregation
- 3) Sections requiring additional focus during drafting

We once again thank the Board for its careful consideration of our previous comments and hope the key findings, observations and recommendations in this letter are similarly helpful in the drafting of the final standard. Should you have any questions or would like to meet with us regarding the contents of this letter, either separately or together, please do not hesitate to contact us.

Very truly yours,

A handwritten signature in blue ink that reads "Lynda Sullivan". The signature is fluid and cursive.

Lynda Sullivan
Executive Vice President and Chief Accounting Officer
Manulife

A handwritten signature in blue ink that reads "Peter M. Carlson". The signature is stylized and cursive.

Peter M. Carlson
Executive Vice President and Chief Accounting Officer
MetLife, Inc.

A handwritten signature in blue ink that reads "Robert M. Gardner". The signature is stylized and cursive.

Robert M. Gardner
Vice President and Controller
New York Life Insurance Company

A handwritten signature in blue ink that reads "Robert Axel". The signature is stylized and cursive.

Robert Axel
Senior Vice President and Controller
Prudential Financial, Inc.

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1. Executive Summary

In June 2013, the International Accounting Standards Board (“IASB” or the “Board”) released an Exposure Draft for the proposed insurance contracts standard (the “2013 ED”). Manulife; MetLife Inc.; New York Life; and Prudential Financial Inc. (collectively, the “Group,” “our” or “we”) performed extensive Field Testing (the “2013 Field Testing”) of the 2013 ED and submitted those results to the IASB in a comment letter dated 11 October 2013 (the “2013 Comment Letter”).

Subsequently, the Board began re-deliberating the proposed standard for the comments received from constituents during the exposure period. We observed the IASB’s re-deliberations with interest and remain committed to helping the Board achieve the goal of a high-quality global accounting standard for insurance. Accordingly, we refreshed our Field Testing (the “2016 Field Testing”) of the proposed insurance contracts standard to reflect the tentative decisions made by the IASB through February 2016.

We are pleased that many of the tentative decisions addressed comments that we highlighted or suggested in our 2013 Field Testing. Nevertheless, issues of clarity and operability remain that we urge the IASB to address either in the final draft of the standard or during the course of implementation. Due to time and resource constraints, we have not tested all aspects of the proposals. As we continue to analyze the proposals of the Board, we may have more recommendations to discuss.

Our observations are summarized into three main categories: (1) sections sufficiently addressed by the tentative decisions, (2) level of aggregation, and (3) sections requiring additional focus during drafting. Each is discussed in turn below:

1) Sections sufficiently addressed by the tentative decisions

We previously commented on the points below and believe that the Board has addressed our concerns. We request that the Board give the observations from our 2016 Field Testing the same due consideration. Within this section we identify areas of the proposed insurance contracts standard that, based on the 2016 Field Testing, are now sufficiently clear and do not need to be addressed further during drafting:

- a) Discount rates – We support the current principles-based approach to adjusting observable market rates to be consistent with the liabilities and for entities to be able to estimate unobservable inputs based on the best information available.
- b) Insurance interest expense – We support the tentative decision to allow entities an accounting policy election to disaggregate insurance interest expense between profit or loss and other comprehensive income (“OCI”). Further, when using OCI, the objective should be to present insurance investment expense based on a cost measure.
- c) Recognition of contractual service margin (“CSM”) into profit or loss – We support the tentative decision that the CSM should be recognized into profit or loss based on the passage of time.
- d) Reversal of negative CSM – We support the tentative decision that previous losses recorded in profit or loss should first be recovered through profit or loss before re-establishing the CSM.

2) Level of aggregation

The level of contract aggregation is a key component for the measurement of the CSM at initial recognition and subsequent measurement.

The wording of the required level of aggregation is too narrow. Specifically, the proposed wording requires a group of insurance contracts to be established based on measuring profitability at the individual contract level (e.g., CSM as a percentage of premiums) and only grouping insurance contracts with similar profitability. It is not meaningful to measure profitability at this level because the assumptions that serve as the inputs to the CSM are determined at a more aggregate level (e.g., the product level), and costs are not allocated to such a detailed level.

Additionally, the current requirements of level of aggregation would cause our companies to track and maintain thousands of groupings, which would be operationally costly and burdensome in relation to the benefit provided. Providing users of financial statements results based on thousands of disaggregated groups of insurance contracts would not provide the best information as it is inconsistent with how management considers and assesses performance of the business.

We suggest that the Board adopt the following language:

A loss for onerous contracts should be recognized only when the CSM is negative for a group of contracts, and that the group should:

- a) Comprise insurance contracts that at inception provide coverage for similar risks and that the entity expects will respond in similar ways to key drivers of those risks in terms of amount and timing; and
- b) Be consistent with the entity's manner of acquiring, servicing, and analyzing and measuring the profitability of its insurance contracts.

In the basis for conclusions, include paragraphs that state:

When assessing whether a group of contracts is consistent with how management acquires, services, and analyzes and measures the profitability of the business, the entity should consider principles similar to those for reporting revenue under IFRS¹ 15, *Revenue from Contracts with Customers*, and the sensitivity of the ultimate expected profitability to market conditions at the initial recognition of the contract.

For example, the ultimate expected profitability of a single premium life annuity is closely related to market conditions at the time of initial recognition of the contract. This is because the entity receives the entire premium for the contract at inception of the contract and must invest the premium at prevailing market rates shortly thereafter. Similarly, the ultimate expected profitability of a permanent whole life insurance contract is less sensitive to market conditions at the time of initial recognition. This is because the entity expects to receive premiums over a long period of time and will invest those premiums at the then prevailing market rates when they are received.

For the recognition of the CSM into profit or loss:

¹ International Financial Reporting Standards ("IFRS")

- a) The objective for the release of the CSM for a group of insurance contracts is to recognize the CSM in profit or loss in a way that best reflects the service to be provided by the contracts. Hence, if there is no more service to be provided under the insurance contracts after the end of the reporting period, the CSM would be fully recognized in profit or loss.
 - b) An entity can group contracts for releasing the CSM provided that the periodic release for the group meets the objective in a).
 - c) An entity that groups insurance contracts is deemed to meet the objective in a), provided that:
 - I. The insurance contracts in the group:
 - a. Provide coverage for similar risks and that the entity expects will respond in similar ways to key drivers of those risks in terms of amount and timing; and
 - b. Are consistent with the entity's manner of acquiring, servicing, and analyzing and measuring the profitability of its insurance contracts.
 - II. The entity adjusts the release of the CSM for the group in the period to reflect the following principles:
 - a. When a group contains contracts of different expected durations, the release of the CSM in the period should be relatively larger (smaller) if there are proportionally more longer (shorter) duration contracts that have been derecognized during the period than expected (i.e., surrendered or claimed); and
 - b. When a group contains contracts of different sizes (e.g., a life insurance policy for CU1,000 vs a life insurance policy for CU10,000), the release of the CSM in the period should be relatively larger (smaller) if there are proportionally more large (small) contracts that have been derecognized during the period than expected (i.e., surrendered or claimed).
- 3) Sections requiring additional focus during drafting:

Within this section we identify areas that the IASB should focus on during the drafting of the final standard in order to provide additional clarity concerning the intent of the tentative decisions or to address operational issues:

- a) Scope of the Variable Fee Approach – The following are our concerns with the scope guidance as proposed:
 - I. Closed blocks of business resulting from corporate de-mutualizations should be re-assessed for qualification under the Variable Fee Approach. Such closed blocks of business are required by regulation to provide policyholders with a defined share (often 100%) of the designated assets backing the closed block. Even if the closed block contracts did not qualify for the Variable Fee Approach when they were issued, the creation of such a closed block should be deemed a significant enough change to their circumstances that they should qualify for reassessment for qualification for the Variable Fee Approach when the closed block is created.

For certain types of insurance contracts, the death benefits may constitute such a large percentage of cash flows that some may view it impossible for those policies to

qualify even though their features would make them prime examples for use of the Variable Fee Approach. A fixed death benefit on a 90/10 or variable life contract should not prevent the application of the Variable Fee Approach.

- b) CSM unlocking – We continue to have concerns with paragraph B68 of the 2013 ED, in particular with the “asymmetrical treatment of acceleration and deceleration of cash flows.” We agree with the subsequent tentative decisions to treat the net impact from the current period experience differences and the associated changes in projected future cash flows resulting from the experience differences consistently in either the CSM or in the statement of comprehensive income. We remain concerned, however, with the tentative decision to sometimes report the net effect on the statement of comprehensive income (i.e., accelerations) but at other times offset the net effect by unlocking the CSM (i.e., decelerations).

By treating accelerations and decelerations differently, the impact of expected and naturally occurring offsetting variances in actual experience will not produce offsetting variances in comprehensive income, even if experience over time exactly matches the assumption. There could be additional distortions in certain circumstances such as participating contracts and accelerations or decelerations that do not result in a termination.

We urge the Board to recognize these concerns while updating paragraph B68 to address tentative decisions made during the re-deliberations.

- c) Options and guarantees – In the 2013 Comment Letter, we discussed the complexity of separating cash flows related to options and guarantees from other cash flows when unlocking the CSM. The Variable Fee Approach addresses this issue for insurance contracts that meet the criteria; however, the issue was not explicitly addressed in re-deliberations for insurance contracts with indirect participation features.

We do not believe there is a strong conceptual basis for treating options and guarantees differently depending on whether there are direct participation features in the contract. Therefore, the current tentative decisions would reduce complexity, increase comparability and improve the conceptual coherence of the model to treat options and guarantees within contracts with indirect participation features consistently with options and guarantees within contracts that qualify for the Variable Fee Approach. In other words, changes in projected cash flows related to options and guarantees should be offset by unlocking the CSM, regardless of whether the insurance contract contains direct participation features. In addition, reporting entities should be permitted to elect to include the options and guarantees in profit or loss if they are hedged in accordance with the Board’s criteria such that the additional complexity of separating the cash flows would be worthwhile in faithfully representing the economics of the hedged risk.

- d) Disclosures – Two areas that we continue to be particularly concerned with are the requirement to produce an equivalent confidence level disclosure for the risk adjustment and insurance contract revenue. While we realize the Board has discussed them extensively, they present serious operational challenges and will not provide users of financial statements with significant benefits. We recommend the IASB modify these disclosures.

With respect to providing an equivalent confidence level for the risk adjustment when using a method other than the confidence level approach, we are not aware of a reliable or practical method for calculating the equivalence for products with multiple risks over a long duration. We recommend the adoption of a qualitative disclosure instead.

With respect to insurance contract revenue, the requirement to split the investment components from the expected claims and amortization of acquisition costs as well as adjustments to expected claims and fulfillment expenses for amounts that have already been recognized in profit or loss will be operationally challenging. This disclosure could be simplified by removing these requirements without a significant loss of information to the users of financial statements.

- e) Transition – We observe that the current gated approach, where each method must be shown to be impracticable under IAS 8² before proceeding to the next possible method, will result in companies spending significant time, resources and cost for little or no benefit.

We recommend the IASB permit an accounting policy election by portfolio for the transition method with the appropriate level of disclosure and provide a practical expedient for the use of portfolios under existing generally accepted accounting principles (“GAAP”) similar to the FASB³ tentative decision. If the accounting policy election is not provided, additional examples of impracticability would be helpful along with examples of reasonable judgment, such as the following:

- I. A portfolio of contracts that was issued beyond the entity’s internal document retention policy. That is, if a portfolio was issued 20 years ago and the entity has a 7-year document retention policy, there should be no further evidence required proving impracticability.
 - II. If, under the prior insurance contracts standard, an entity’s acquisition costs were \$100 and under the proposed insurance contracts standard the eligible acquisition costs were \$95, it would be considered reasonable to multiply historical acquisition costs by 95% under the simplified retrospective method.
- f) Transition timeline – The 2013 ED stated that the proposed insurance contracts standard would set the effective date approximately three years following the publication of the final standard. This timeline will likely not be achievable; a transition period of approximately five years will likely be needed to fully adopt the proposed standard.

Developing a consistent global interpretation of the proposed standard will take a significant amount of time given the variety of products in jurisdictions across the world. Together with the implementation of financial instruments,⁴ the proposed standards will result in changes to almost every aspect of insurance company financial statements, requiring changes to virtually all underlying financial reporting systems. It should also be considered that, in the year prior to the effective date, companies will need to perform a parallel year of reporting in order to be in a position to issue comparative financial

² International Financial Reporting Standard (IFRS) 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

³ Financial Accounting Standards Board

⁴ IFRS 9, *Financial Instruments*

statements in the year of adoption where required. A five-year implementation period will also allow the IASB to address any implementation issues that arise prior to the mandatory effective date.

2. Introduction

On 20 June 2013, the IASB released an exposure draft on the accounting for insurance contracts (the “2013 ED”) to replace IFRS 4.⁵ We performed our own Field Testing of the proposals in the 2013 ED and provided the results and observations submitted to the IASB on 11 October 2013 (the “2013 Comment Letter”).

The IASB re-deliberated certain aspects of the 2013 ED from January 2014 through February 2016 and has made tentative decisions that reject, replace, enhance or confirm the principles and guidance in the 2013 ED. Among other important tentative decisions (refer to section 3.2 for a high-level summary of the tentative decisions made by the IASB), the IASB introduced a modification for direct participating contracts referred to as the Variable Fee Approach, which is discussed further in this document.

From late 2015 to April 2016, we updated our 2013 Field Testing to reflect the impacts of the Board’s tentative decisions through February 2016 (the “2016 Field Testing”). The objectives of this comment letter (the “2016 Comment Letter” or “this Comment Letter”) are to (a) provide the IASB with an update on Field Testing results that reflect its most recent tentative decisions, (b) provide our observations on those tentative decisions and (c) provide updated comments to assist the IASB staff in drafting the final standard.

This document assumes a base understanding of the IASB’s proposals and should be read in conjunction with the 2013 ED and the IASB’s tentative decisions since the 2013 ED as summarized in the IASB’s *Effect of Re-deliberations* publication dated February 2016. This paper is also incremental to and should be read in conjunction with our 2013 Comment Letter, as the approach, results and observations for the 2013 Field Testing have not been replicated in this document, but can be found on the IASB’s website under comment letters related to the 2013 ED.

Our Field Testing project has remained a joint effort of the same four global financial services companies with leading life insurance operations in the United States, Canada, Asia, Europe and Latin America. Together, our product offerings include individual and group life and health insurance, property and casualty insurance, participating and non-participating contracts, and annuities. Our companies have experience preparing financial statements under both US GAAP and IFRS.

We remain fully committed to assisting the IASB to achieve its goal of developing a high-quality accounting standard. We spent significant time and effort updating our previous Field Testing, utilizing more than 20 accountants and actuaries over 6 months. The significant time and effort required to update our Field Testing alone should be considered when reading this paper. It is also indicative of the significant importance that the Group places on ensuring a high-quality final standard that achieves the desired objectives set by the Board, while remaining operational.

⁵ International Financial Reporting Standard (IFRS) 4, *Insurance Contracts*

Evaluating the effects of the IASB's standard on financial instruments⁶ and accounting for insurance contracts together is the only way to gain an in-depth understanding of the impacts of the accounting for insurance contracts on our business. However, as with the 2013 Field Testing, we have not simultaneously evaluated the impacts of the IASB's revised standard on financial instruments for the purposes of this Field Test, due to time and resource limitations.

The same nine products that are considered representative of typical products written by life insurance companies in North America that were included in the 2013 Field Testing are presented in this Comment Letter. All tested products used the General Model or the Variable Fee Approach, reflecting the long-term nature of most of our products. We also used the same December 2007 to December 2012 time frame (the "Study Period") as was used in the 2013 Field Testing, for comparative purposes.

We engaged a third-party consultant (the "consultant") to collect and review the data necessary to perform the Field Testing update and to do so in a manner that would preserve the confidentiality of each member company's competitive information. To replicate the level of aggregation expected for actual financial reporting and to preserve the confidentiality of each company's individual product data (both from each other and the public), the consultant scaled and combined the data received from the member companies, ultimately presenting it under four operating segments prior to releasing to the members.

We focused our efforts on assessing the key tentative decisions made by the IASB and have applied certain simplifying assumptions in order to provide the results of the Field Testing in a timely manner.

⁶ IFRS 9, *Financial Instruments*

3. Methodology and Approach

3.1 Scope

The main purpose of the 2016 Field Testing was to update our 2013 Field Testing to reflect the key tentative decisions made by the IASB through February 2016 while retaining the products tested, the data used and the outputs constant. The key tentative decisions affecting the 2016 Field Testing are summarized in section 3.2.

Our baseline testing was modeled using the General Model (formerly referred to as the Building Block Approach) for all segments, except for the Variable Annuity Segment, which was modeled under the Variable Fee Approach. Policies issued 2007 and prior were combined into a single transition portfolio. New business sold in 2008 through 2012 was added to results in accordance with our interpretation of IASB tentative decisions. Appendix A describes key modeling techniques and assumptions.

Certain other sensitivity analyses on the 2016 Field Testing model were also performed to evaluate the impact of alternative interpretations, judgments or assumptions on the financial information produced. Details of the sensitivities performed are provided within relevant sections of this document.

Due to time and system restrictions associated with the 2016 Field Testing, we were again unable to apply certain requirements or perform a comprehensive analysis of systems or data needs for applying the tentative standard's requirements. In cases where we used simplifying assumptions, they are noted in the "Approach" descriptions in sections 5–7.

3.2 Summary of Key IASB Draft Tentative Decisions Since the 2013 ED

This section summarizes the key tentative decisions made by the IASB during the re-deliberation period through February 2016, as compared to the 2013 ED, that we used to either update our 2016 Field Testing or provide our view in this Comment Letter.

	2013 ED	Tentative Decisions
Unit of account/level of aggregation ⁷	<p>A portfolio is defined as a group of insurance contracts that provide coverage for similar risks and that are priced similarly relative to the risk taken on, and are managed together as a single pool.</p> <p>In applying the definition, “An entity needs to assess whether a contract is onerous when facts and circumstances indicate that the portfolio of contracts that will contain the contract is onerous. A portfolio of insurance contracts is onerous if, after the entity is bound by the terms of the contract, the sum of the fulfillment cash flows and any pre-coverage cash flows is greater than zero. Any excess of this sum over zero shall be recognized in profit or loss as an expense.”</p>	<p>A portfolio is defined as “insurance contracts that provide coverage for similar risks and are managed together as a single pool.”</p> <p>In “determining the contractual service margin or loss at initial recognition, an entity should not aggregate onerous contracts with profit-making contracts.” The “objective of the proposed insurance contracts Standard is to provide principles for the measurement of an individual insurance contract, but that in applying the standard, an entity could aggregate insurance contracts provided that it meets the objective.”</p> <p>Insurance contracts that will respond in a similar way to key drivers of risk, and on inception have similar expected profitability, should be grouped.</p> <p>For the release of the CSM, the objective is to recognize the CSM for an individual contract or groups of homogenous contracts. An entity may group contracts for allocating the CSM provided that the grouping represents contracts that respond in a similar way to key drivers of risk, have similar expected profitability, and the entity adjusts for the remaining expected duration and size of contracts.</p>
Discount rates ⁸	<p>In determining the fulfillment cash flows, entities would “adjust the estimates of future cash flows for the time value of money, using discount rates that reflect the characteristics of those cash flows.” The rates should “(a) be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract, in terms of, for example, timing, currency and liquidity; and (b) exclude the effect of any factors that influence the observable market prices but that are not relevant to the cash flows of the insurance contract.”</p>	<p>Discount rates used to adjust the cash flows in an insurance contract for the time value of money should be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract. Appropriate adjustments may be made to observable inputs and that unobservable inputs should be developed using the best information available in the circumstances, while remaining consistent with the objective of reflecting how market participants assess those inputs (i.e., should not contradict any available and relevant market data).</p>

⁷ Proposals to the 2013 ED on unit of account/level of aggregation were discussed at the 17 June 2014 and 19/20 January 2016 IASB meetings.

⁸ Proposals to the 2013 ED on discount rate were discussed at the 17 June 2014 IASB meeting.

	2013 ED	Tentative Decisions
Interest accretion on fulfillment cash flows ⁹	<p>An entity should recognize and present in OCI the difference between (a) the carrying amount of the insurance contract measured using the discount rates that were used to determine that interest expense at the reporting date and (b) the carrying amount of the insurance contract that were measured using the current discount rates.</p>	<p>For all insurance contracts measured under the General Model, entities should choose to present the effect of changes in discount rates in profit or loss or in other comprehensive income as the entity's accounting policy and should apply that accounting policy to all contracts within a portfolio. Such election would be made at inception, on a portfolio-by-portfolio basis.</p> <p>An entity recognizes in OCI the difference between presenting insurance investment expense in profit or loss using a cost measurement basis, referred to as an effective yield approach, and a current measurement basis. The IASB would provide additional guidance that the mechanics should result in an allocation of the yield over the life of the contract on a systematic basis.</p> <p>For contracts in which there is no economic mismatch between the insurance contract and the related items held by the entity, the use of a current period book yield approach will be allowed.</p> <p>Economic mismatches do not exist "(a) when the contract is a direct participation contract (i.e., the entity has an obligation to pay the policyholders the fair value of the underlying items and, therefore, applies the Variable Fee Approach; and (b) the entity holds the underlying items, either by choice or because it is required to."</p>

⁹ Proposals to the 2013 ED on interest accretion on fulfillment cash flows were discussed at the 18 March 2014 and 23 September 2015 IASB meetings.

	2013 ED	Tentative Decisions
CSM – contracts without participation features ¹⁰	<p>The remaining CSM should be recognized to profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract.</p> <p>The CSM should not be negative. Unfavorable changes in the CSM should be absorbed to the extent that the contractual service margin is sufficient to absorb an unfavorable change. An entity shall recognize in profit or loss any changes in the future cash flows that do not adjust the contractual service margin.</p>	<p>The differences between current and previous estimates of the risk adjustment that relate to future coverage and other services should be added to, or deducted from, the CSM subject to the condition that the CSM should not be negative. Changes in the risk adjustment that relate to the coverage and other services provided in the current and past periods should be recognized immediately in profit or loss.</p> <p>It was confirmed that an entity should recognize the CSM in a systematic way that best reflects the remaining transfer of services that are provided under an insurance contract and that, for contracts with no participating features, the service represented by the CSM is insurance coverage that is provided on the basis of passage of time and reflects the expected number and size of contracts in-force.</p> <p>In the event that the CSM is reduced to zero and losses are recognized due to unfavorable changes in estimates of future cash flows, subsequent favorable changes in estimates of future cash flows should be reversed through profit or loss before re-establishing the CSM.</p>
CSM – Variable Fee Approach ¹¹	<p>The 2013 ED did not specifically address contracts with direct participating features and related modifications on the general measurement model.</p> <p>Instead, a measurement exception from the Building Block Approach was provided to the entities that have contracts that required holding specified assets and liabilities, an underlying pool of insurance contracts or if the underlying item specified in the contract is the assets and liabilities of the entity as a whole and there was a link between the returns on the underlying items and the payment to the policyholder. Such entities were able to measure fulfillment cash flows by reference to the carrying amount of the underlying items.</p>	<p>The Variable Fee Approach is introduced that would apply to participating contracts when the following criteria is met:</p> <p>The entity's obligation to the policyholder is considered to be the net of (a) the obligation to pay the policyholder an amount equal to the fair value of the investment portfolio (and any other underlying item) and (b) a variable fee that the entity deducts in exchange for the services provided by the insurance contract;</p> <p>Changes in the estimate of the obligation to pay the policyholder are either recognized in profit or loss or OCI; and</p> <p>Changes in the estimate of the variable fee that an entity expects to earn are adjusted in the CSM.</p> <p>The IASB tentatively decided that the CSM associated with insurance contracts accounted for under the Variable Fee Approach is to be recognized in profit or loss on the basis of the passage of time, which is consistent with the General Model.</p>

¹⁰ Proposals to the 2013 ED on the CSM general model were discussed at the 18 March 2014 and 21 May 2014 IASB meetings.

¹¹ Proposals to the 2013 ED on the Variable Fee Approach were discussed at the 22–25 June 2015 and 19/20 January 2016 IASB meetings.

	2013 ED	Tentative Decisions
CSM – General Model for contracts with participating features ¹²		The Board tentatively decided that there are two viable alternatives to consider discretion for contracts with participation features accounted for under the General Model: (1) an entity can specify how it determines the effect of discretion or (2) an entity can specify further guidance by stating that it must determine the effect of discretion by reference to the market. The Board tentatively believes that it is viable to only view the expected return based on current market conditions less a spread or, if higher, the guaranteed return, as not discretionary.
Options and guarantees ¹³ – Variable Fee Approach ¹⁴	For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when it expects any changes in those returns to affect the amount of those cash flows.	<p>The IASB notes that some believe the policyholder receives all of the variable returns from the underlying items and that the policyholder pays the entity a variable fee out of the proceeds of its investment; thus the effect of changes in market variables on the entity's share of returns from underlying items less the costs of providing the contracts (such as the costs of providing guarantees) may be regarded as part of the variability of fees for future service (Paragraph 23 and 25 of Agenda Paper 2A).</p> <p>Changes in the value of any options or guarantees in the contract would be adjusted against the CSM.</p> <p>The IASB also tentatively decided that, subject to specified restrictions, when an entity uses the Variable Fee Approach to measure insurance contracts and uses a derivative measured at fair value through profit or loss ("FVTPL") to mitigate the financial market risk from the guarantee embedded in the insurance contract, the entity would be permitted to recognize, in profit or loss, the changes in the value of the guarantee embedded in an insurance contract determined using fulfillment cash flows.</p>

¹² Proposals to the 2013 ED on the Variable Fee Approach were discussed at the 19/20 January 2016 IASB meetings.

¹³ We refer to "options and guarantees" throughout this document because the term "financial guarantee" used by the IASB in its tentative decisions already has a definition in IFRS that is inconsistent with our understanding of the IASB's usage in this context.

¹⁴ Proposals to the 2013 ED on the options and guarantees were discussed at 23 September 2015 IASB meeting.

4. Segment-Level Results

For each segment, we present the financial information prepared using the 2016 IASB tentative decisions, compared to current US GAAP and the 2013 Comment Letter financial information. Depending on the significance of the impact that the IASB's tentative decisions had on the financial information we previously presented, we include all or some of the below analysis in our segment discussions for each of the four segments, as presented in the 2013 Comment Letter:

- 1) Pretax profit or loss;¹⁵
- 2) Pretax OCI;
- 3) Pretax comprehensive income (loss);
- 4) Change in insurance liability; and
- 5) Components of insurance liability.¹⁶

Segment results were driven by specific characteristics and features of the tested products, as well as the impact of product aggregation into the segment results. Similar tests on different products could lead to different results. Key observations are discussed for each segment grouping. Our observations focus on the difference in financial results generated by tentative decisions made by the IASB in re-deliberating the 2013 ED and isolate issues that have not been resolved in subsequent deliberations.

4.1 Traditional Life Segment

4.1.1 Key Observations

We applied the 2016 Field Testing approach to the valuation of the Traditional Life Segment reserves. The revised approach resulted in the pretax comprehensive income for the segment becoming less volatile and more aligned with the comprehensive income under current US GAAP. The slight decrease in pretax profit or loss (Exhibit 4.1.1A) and the reduction in volatility of the comprehensive income (Exhibit 4.1.1C) compared to 2013 Field Testing was driven by the following changes in Field Testing assumptions and methodologies:

- 1) As shown in Exhibit 4.1.1A, the 2016 Field Testing produced lower pretax income between years 2008 and 2011 when compared to 2013 Field Testing, due to a slower pattern of CSM release into revenue. This was an indirect impact of the change in methodology for discount rates after the observable period. For most valuation dates, the ultimate discount rate was higher in 2016 Field Testing than 2013 Field Testing. Although this resulted in a higher initial CSM, there was less release during the 2008-2012 period. Overall, the change in amortization basis produced a negligible impact on profit or loss.

¹⁵ Including net realized capital gains and losses on investments and derivatives

¹⁶ All financial information is presented in currency units (CUs).

- 2) The change in methodology for discount rates beyond the observable period contributed to:
- a) Reduction of interest accretion expense, resulting from increased interest accretion income on insurance liabilities in a net asset position, as a result of updated discount rates used for the 2016 Field Testing. The change had a positive impact on the pretax profit or loss relative to 2013 Field Testing.
 - b) Reduction in the volatility reflected in OCI as compared to 2013 Field Testing. As shown in Exhibit 4.1.1B, the grading to long-term average discount rates significantly reduced the volatility in OCI, particularly in years 2008 and 2009, when compared to 2013 Field Testing.

As shown in Exhibit 4.1.1E, the present value of fulfillment cash flows for this segment was in an asset position during the Study Period, which led to the segment being in a net insurance asset position in 2010, 2011 and 2012. This resulted in a mismatch in movement of OCI, as the changes in the insurance contract assets from current discount rate changes and the unrealized gains and losses on invested assets moved in tandem rather than in opposite directions (see Exhibit 4.1.1B).

The following graphs support our analysis:

Exhibit 4.1.1A

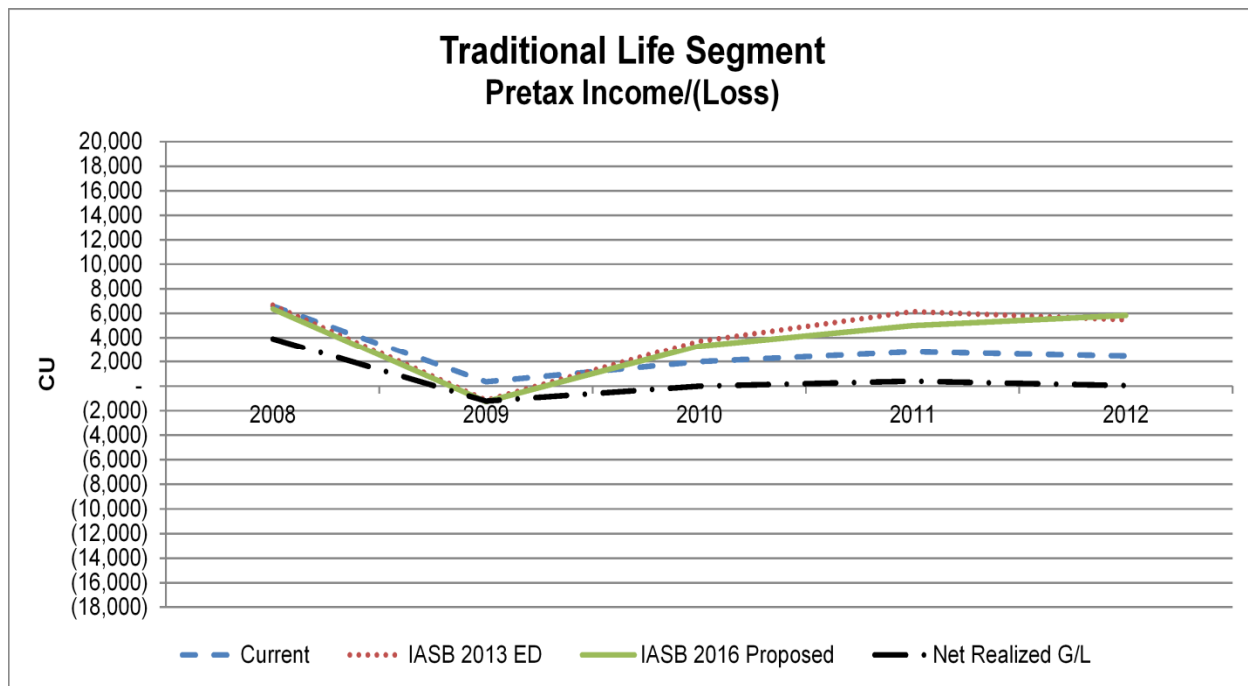


Exhibit 4.1.1B

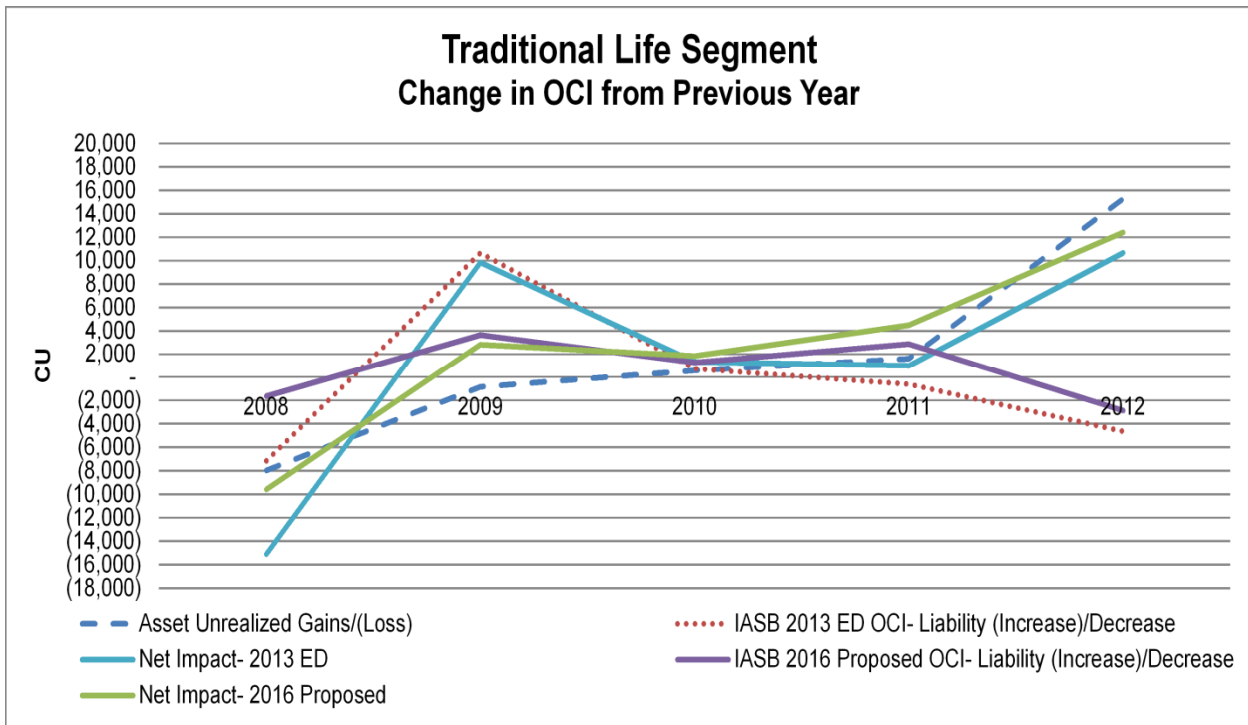


Exhibit 4.1.1C

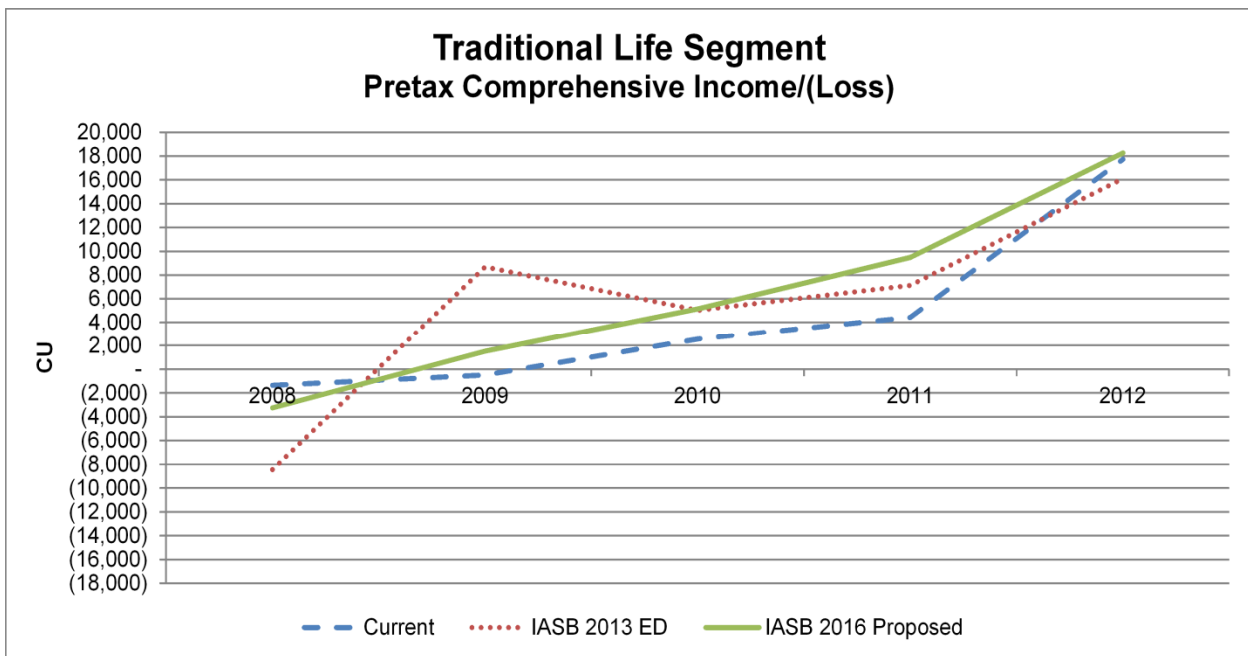


Exhibit 4.1.1D

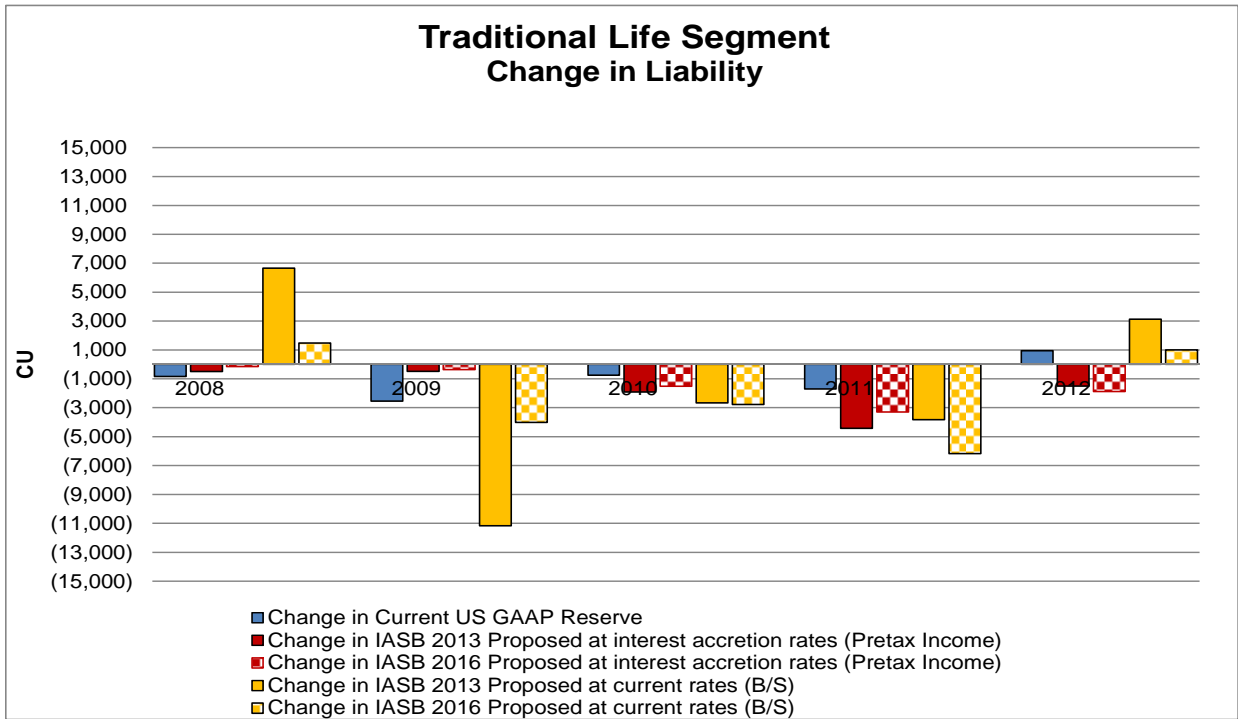
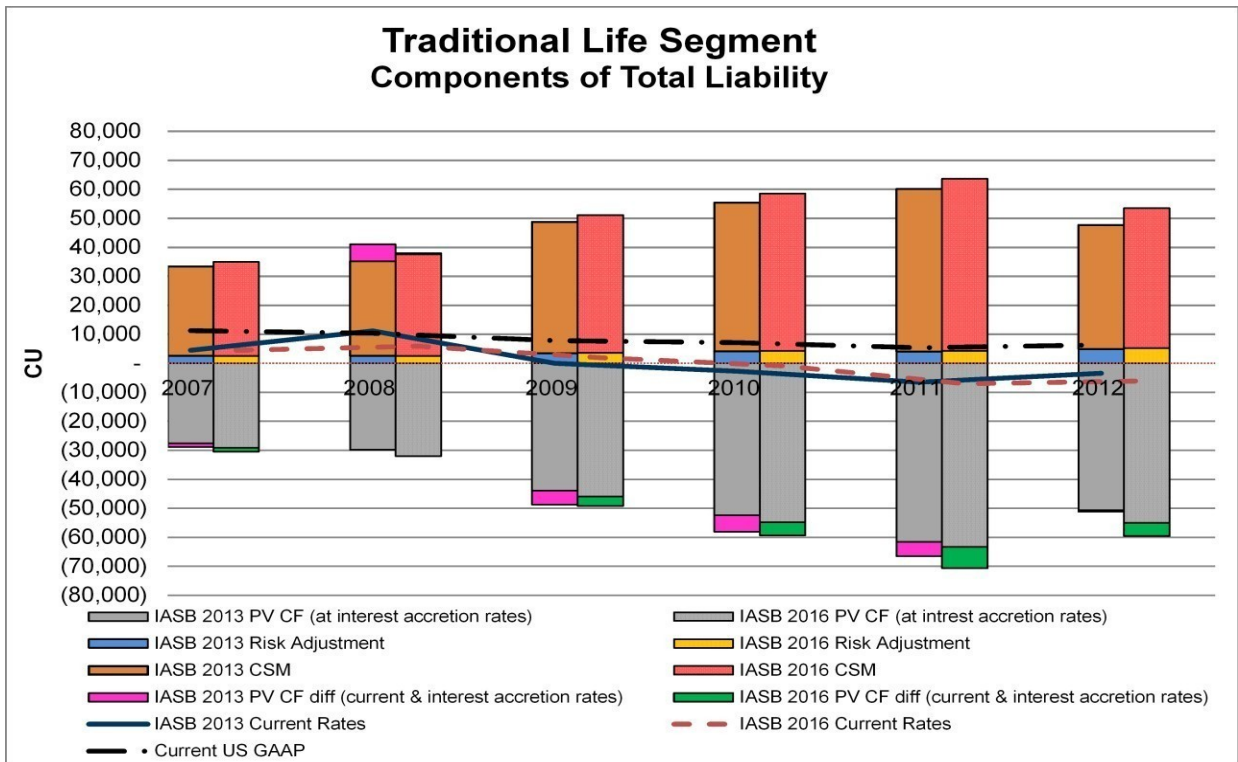


Exhibit 4.1.1E



4.2 Retirement Segment

4.2.1 Key Observations

We applied the 2016 Field Testing to the valuation of the Retirement Segment reserves. This resulted in the Retirement Segment pretax comprehensive income becoming less volatile, while the pretax profit or loss pattern remained similar to 2013 Field Testing. As shown in Exhibit 4.2.1A, 2016 Field Testing showed a higher profit or loss pattern for all years when compared to 2013 Field Testing, and were driven by the following changes in Field Testing assumptions and methodologies:

- 1) Retirement Segment income was higher than the 2013 Field Testing for all years because of the acceleration of income due to the change in the CSM basis for release (passage of time is faster than release from risk).
- 2) Additionally, we revised the discount rates beyond the observable period based on our interpretation of updated guidance. The change in methodology for the discount rate contributed to:
 - a) Reduction of interest accretion expense, which further increased the pretax income under 2016 Field Testing relative to the 2013 Field Testing; and
 - b) Reduction in the volatility in OCI under the 2016 Field Testing.

Further expanding on 2) above, liability cash flows on products in the Retirement Segment extend longer than the available assets. Therefore, the liabilities were more sensitive to changes in discount rates than the assets backing the reserves. The discount rate approach used in the 2013 Field Testing led to a more volatile pattern of changes reflected in OCI than 2016 Field Testing, as shown in Exhibit 4.2.1B. Changes applied to the 2016 Field Testing resulted in a closer alignment between recognition of OCI for invested assets and the insurance liability. As shown in Exhibit 4.2.1E, the change in discount rate approach for 2016 Field Testing was more pronounced in years 2011 and 2012, resulting in reduction of reserves.

Overall, the proposed changes resulted in less volatility in comprehensive income due to changes in interest rates, which better reflects the long-term nature of these insurance obligations.

The following graphs support our analysis:

Exhibit 4.2.1A

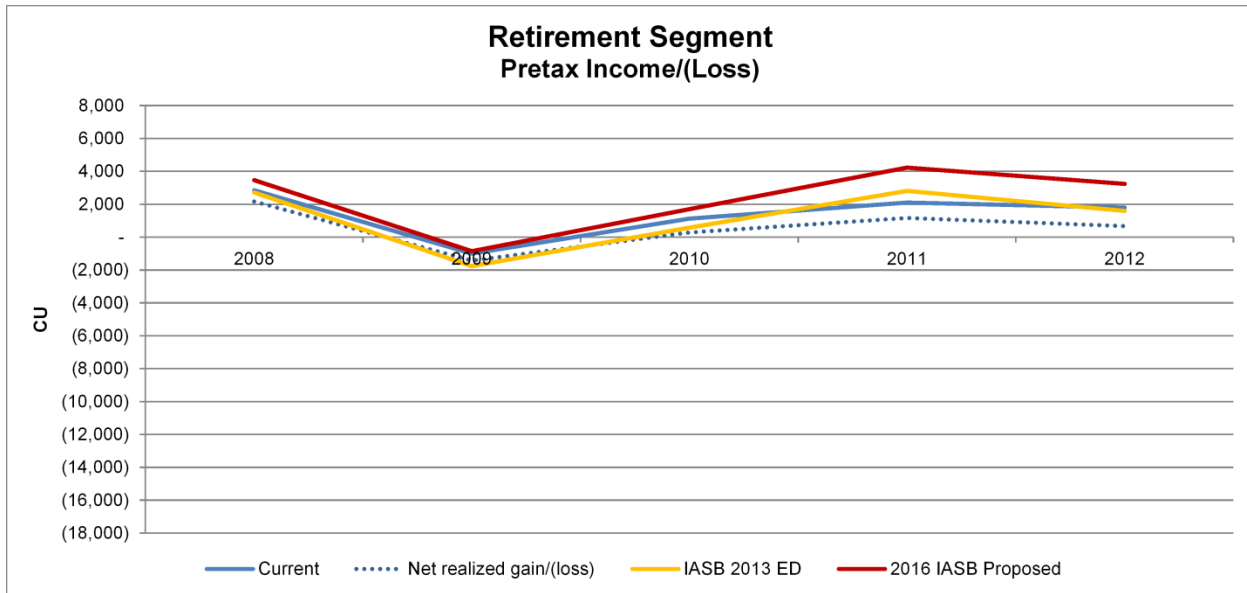


Exhibit 4.2.1B

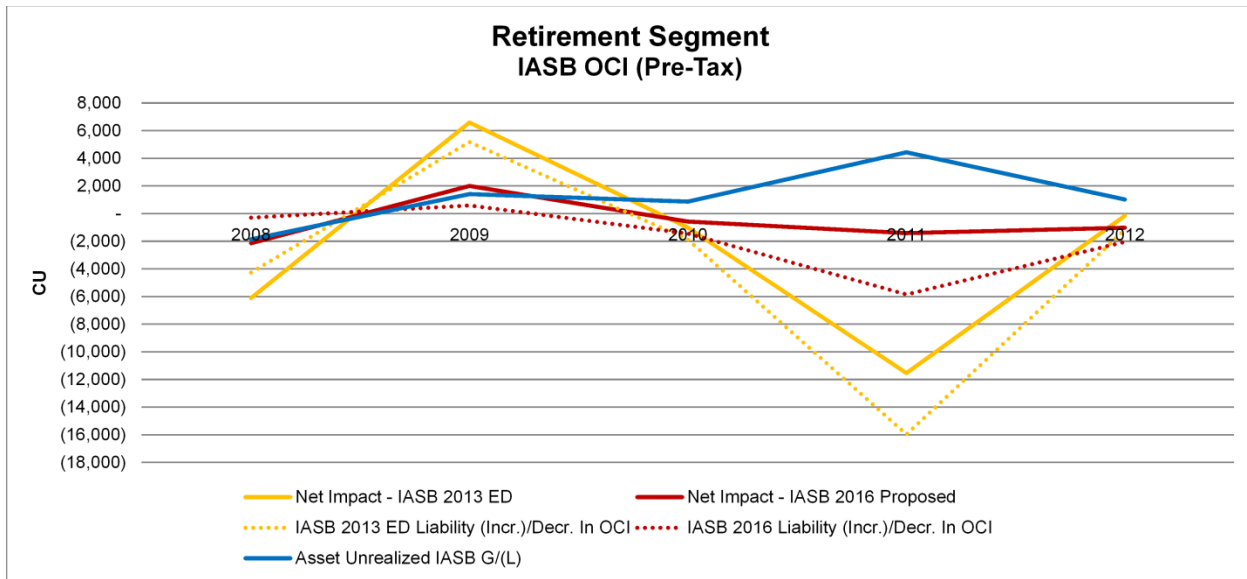


Exhibit 4.2.1C

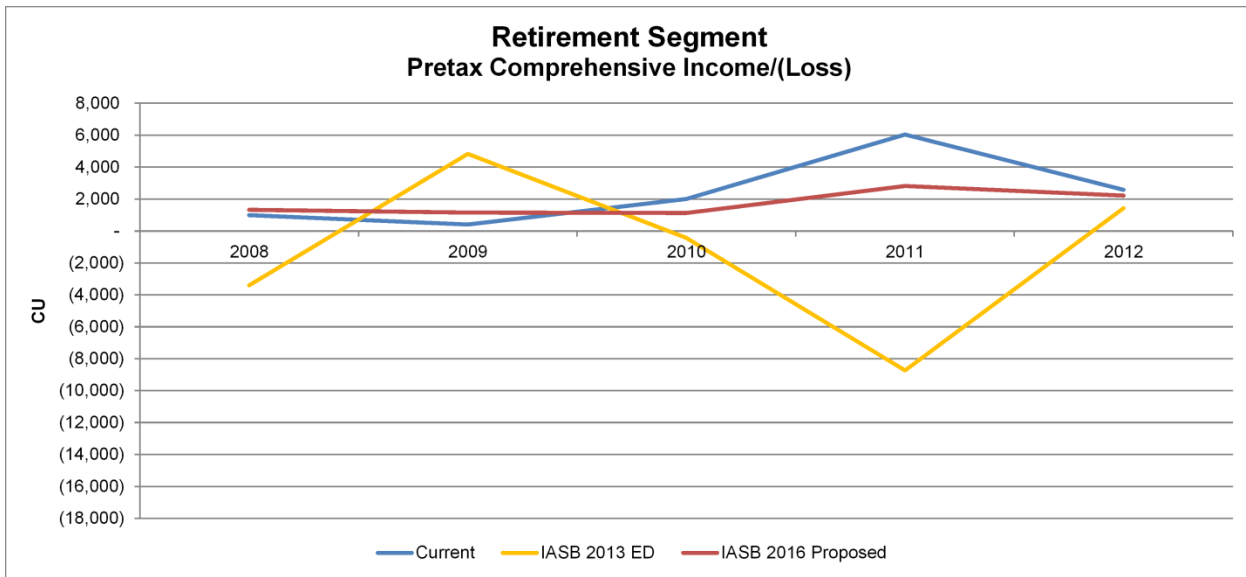


Exhibit 4.2.1D

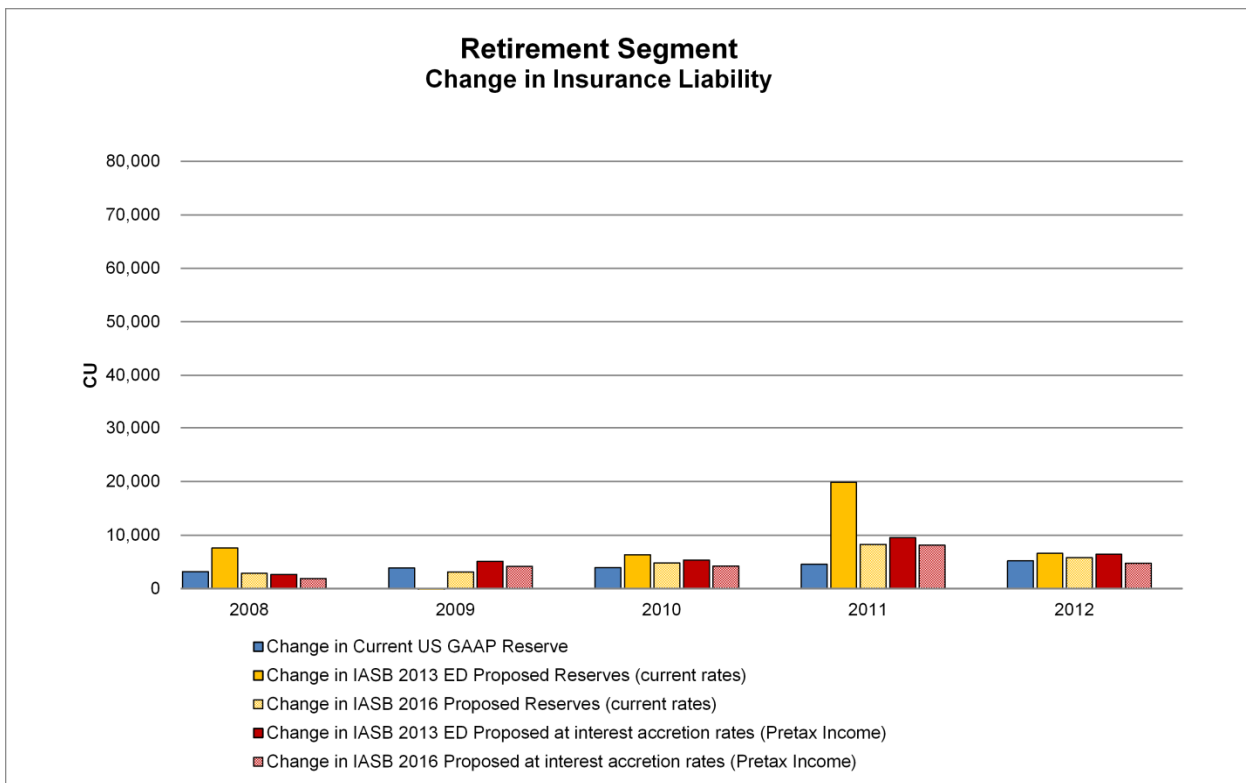
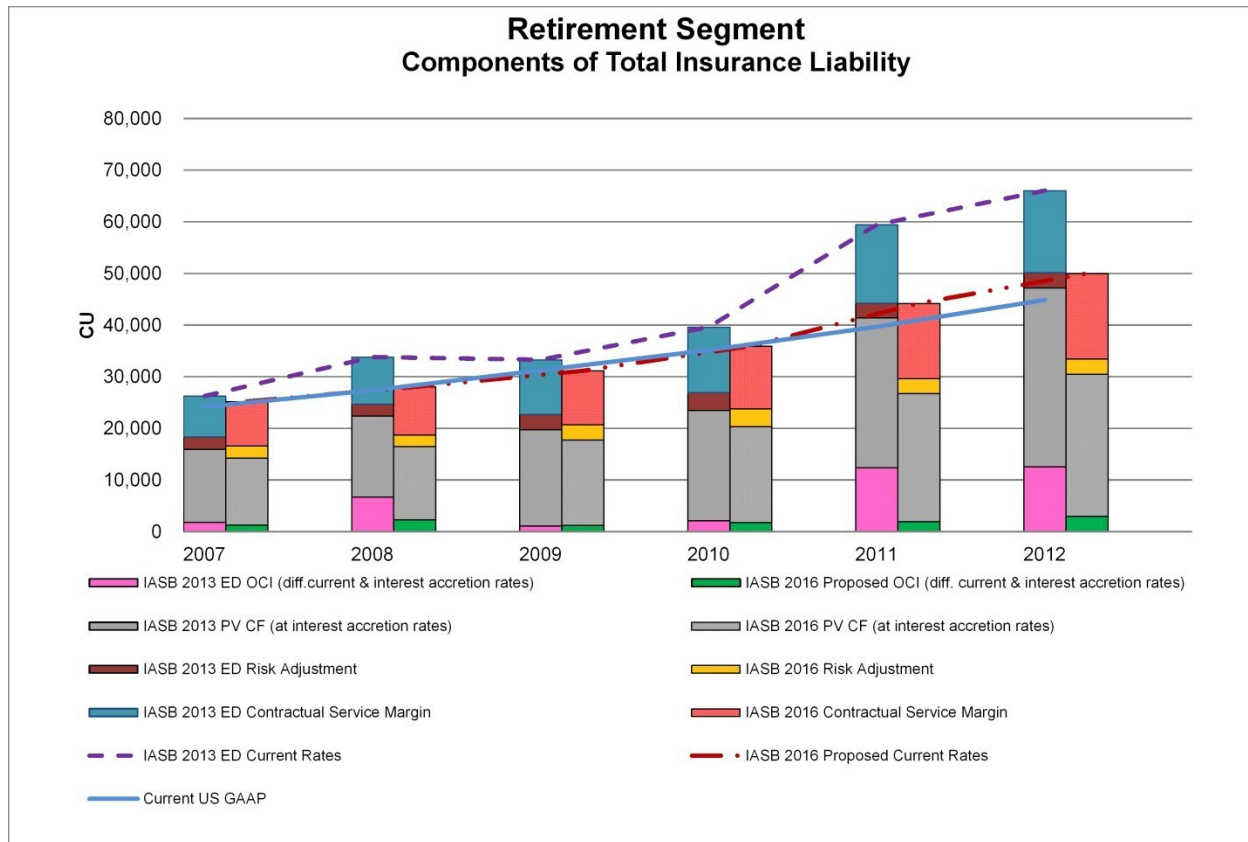


Exhibit 4.2.1E



4.3 [Indirect] Participating Segment¹⁷

4.3.1 Key Observations

Our application of the 2016 Field Testing approach and its interpretations to the valuation of the participating segment reserves resulted in less volatility in the segment pretax comprehensive income and reserves (Exhibits 4.3.1C and 4.3.1D), when compared to the 2013 Field Testing. The reduction in volatility of the comprehensive income compared to 2013 Field Testing was driven by the following changes in Field Testing assumptions and methodologies:

- 1) The use of the effective yield approach for determining interest accretion on the liability in 2016 Field Testing reduced the level of mismatch in asset and liability movements recognized through pretax income. The changes in the insurance liability due to changes in current discount rates not covered by the effective yield were reflected in OCI. This differed from the 2013 Field Testing, where all changes due to current discount rates were reflected in pretax income. The use of the effective yield approach decreased the noneconomic volatility recognized through pretax income (Exhibit 4.3.1A).

¹⁷ In order to be consistent with the 2013 Field Testing, the name "Participating Segments" will be retained for use within this Comment letter

- 2) The reversal of previously recognized losses prior to re-establishing the CSM had a positive impact on the pretax income profit or loss relative to 2013 Field Testing. As shown in Exhibit 4.3.1E, the CSM decreased under the 2016 Field Testing for all years, which, in turn, contributed to the decrease of the total insurance liability for years 2007, 2008, 2011 and 2012.
- 3) The change in methodology for discount rates beyond the observable period contributed to:
 - a) Reduction in the present value of fulfillment cash flows, most notably in years 2008, 2011 and 2012 (Exhibit 4.3.1E); and
 - b) Reduction in the volatility of the insurance liability driven by grading of the discount rate to the ultimate rate (Exhibit 4.3.1E). This reduction was evident in the present values of fulfillment cash flows for years 2010, 2011 and 2012 when compared to corresponding balances under the 2013 Field Testing. The remaining volatility in the segment was due to actual economic events.

The following graphs support our analysis:

Exhibit 4.3.1A

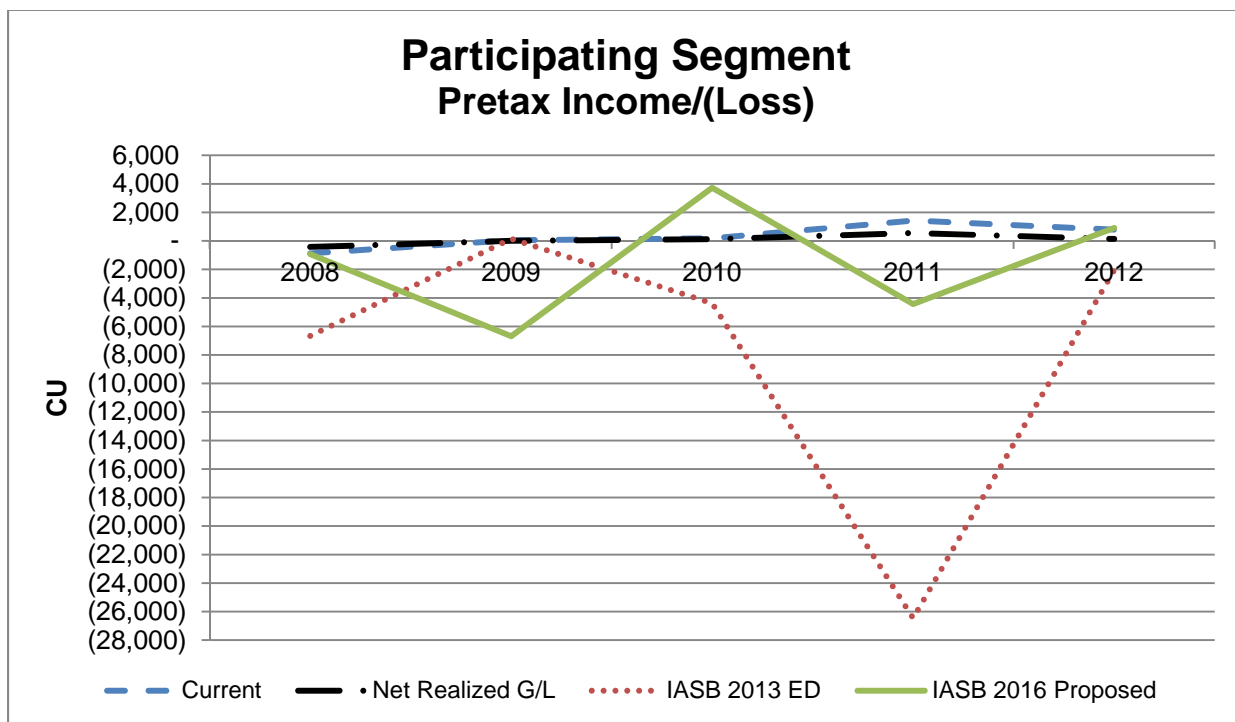


Exhibit 4.3.1B

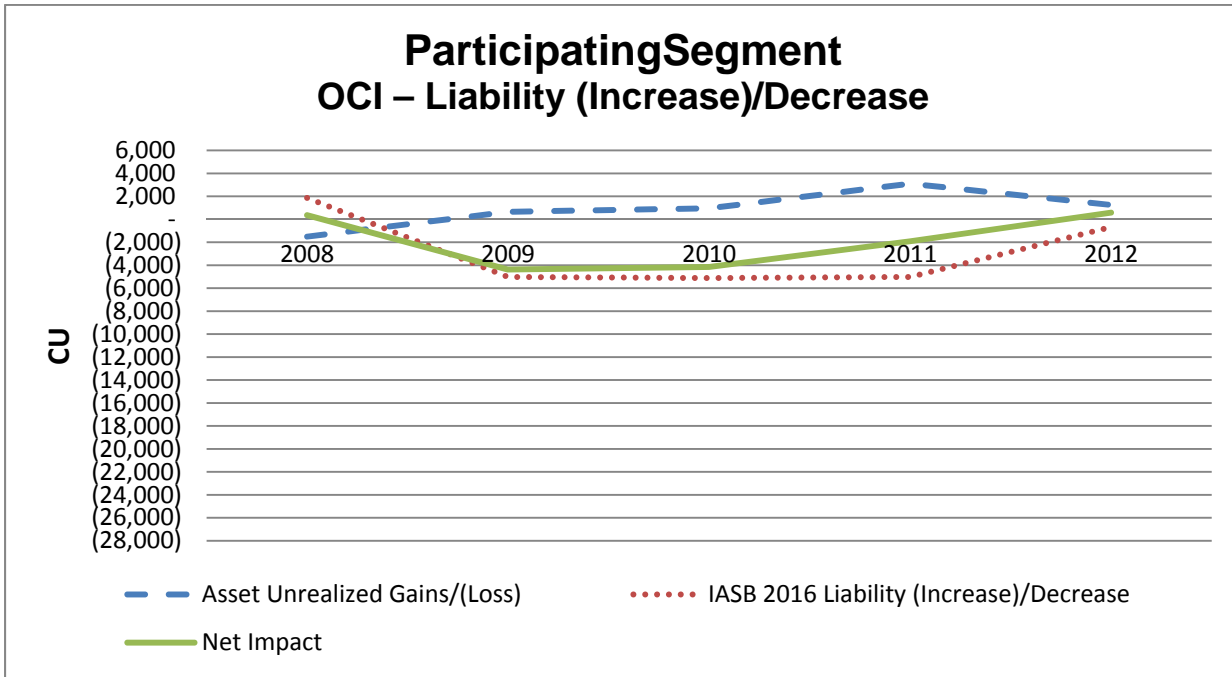


Exhibit 4.3.1C

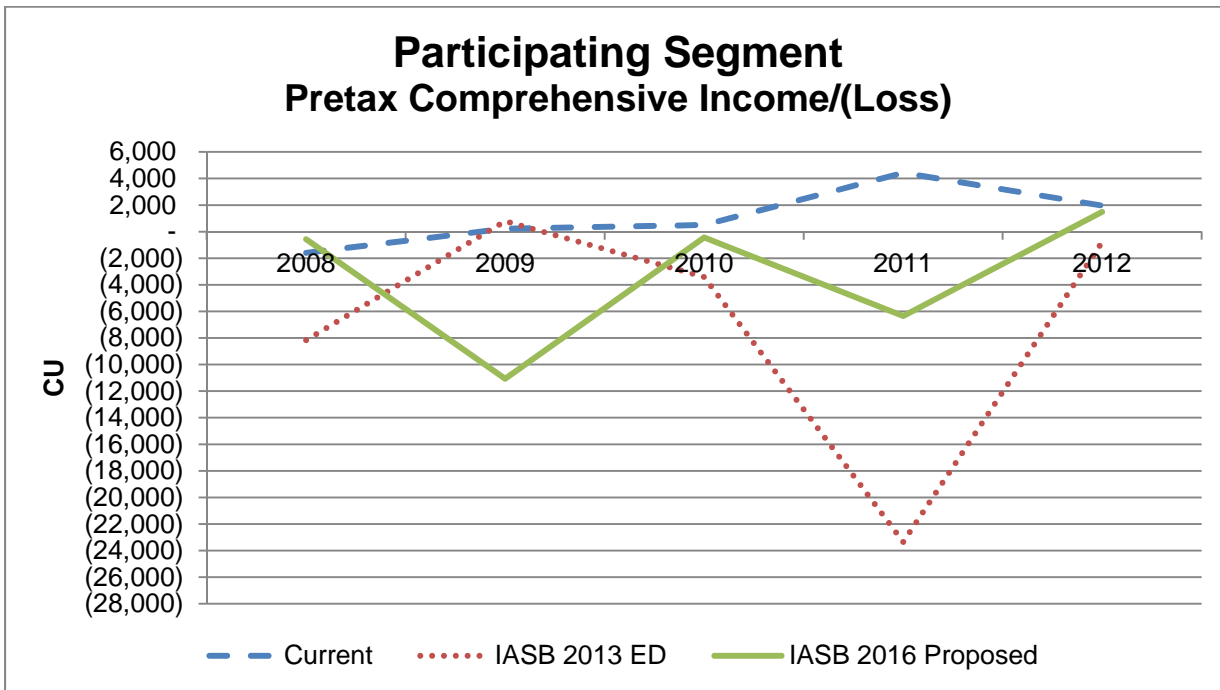


Exhibit 4.3.1D

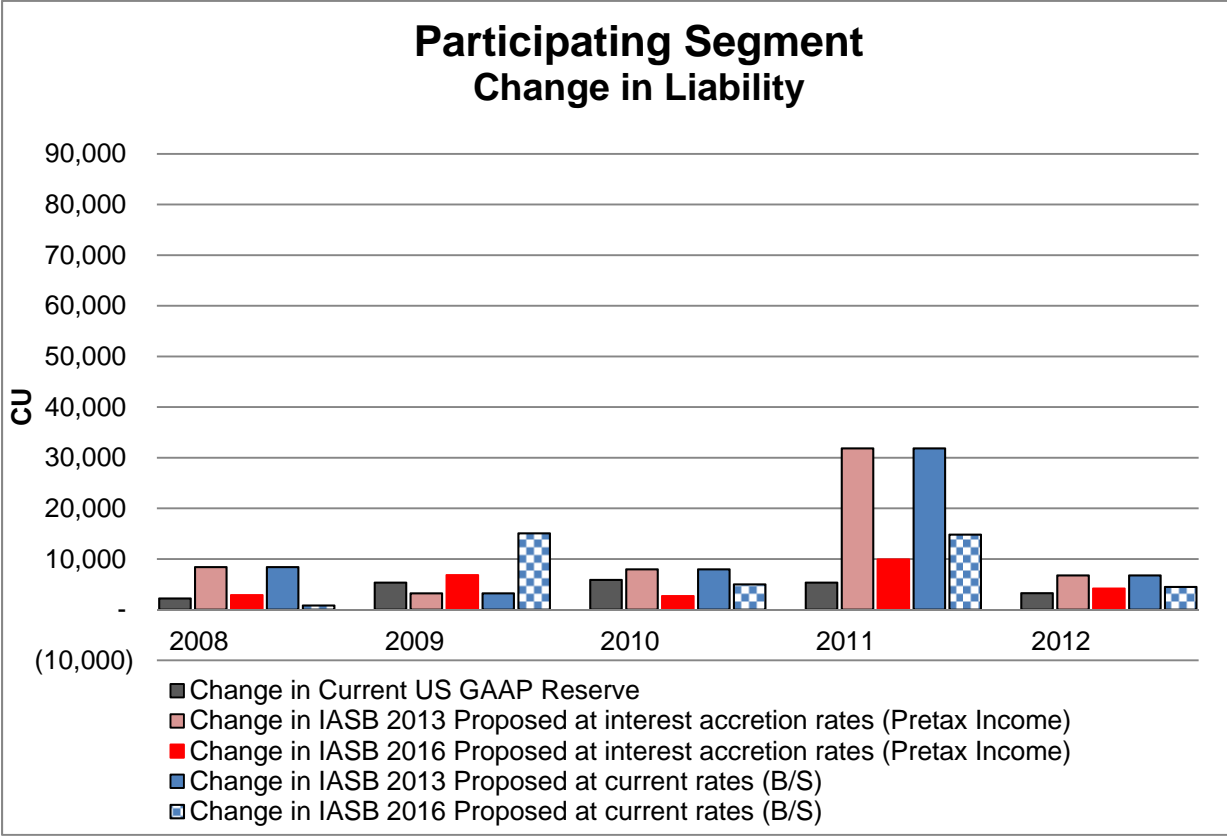
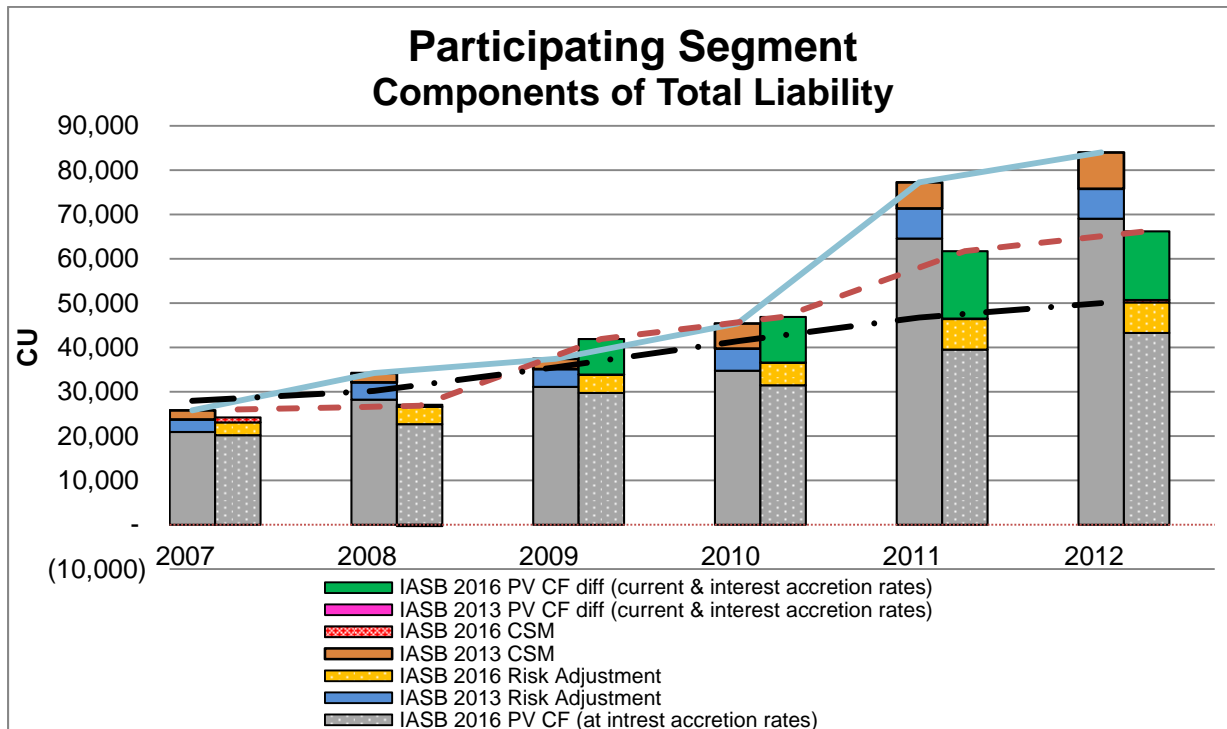


Exhibit 4.3.1E



4.4 Variable Annuity Segment

4.4.1 Key Observations

For purposes of the 2016 Field Testing, the Variable Fee Approach was used to measure the Variable Annuity Segment. Despite this change, the 2016 Field Testing pretax profit or loss did not differ dramatically from the 2013 Field Testing. The impacts of the change from the General Model to the Variable Fee Approach on pretax profit or loss did not appear to be significant for the Variable Annuity Segment, as they were overshadowed by recovery through pretax profit or loss of previously recognized losses (reversal of prior period negative CSM). Below, we discuss the changes to the 2013 Field Testing assumptions and methodologies that impacted the Variable Annuity Segment:

- 1) Inclusion of non-life contingent riders in the fulfillment cash flows in the 2016 Field Testing created variability in the changes in the present value of future cash flows as shown in years 2008 and 2011 of Exhibit 4.4.1C. In contrast to the 2013 Field Testing, the riders that were accounted as embedded derivatives at fair value under current GAAP were included as part of fulfillment cash flows. Additionally, this change decreased the CSM in 2011 and 2012 to zero, as shown in Exhibit 4.4.1C. This was a result of low discount rates increasing the value of the riders that was offset against the CSM before impacting profit or loss.
- 2) As compared to the 2013 Field Testing, pretax profit or loss increased in 2009 and 2012 mainly due to reversal of previously recognized losses through income prior to re-establishing the CSM, as per the tentative decisions.

Similar earning patterns emerged under the 2016 Field Testing (Variable Fee Approach) and 2013 Field Testing (General Model) due to the negative or low CSM on transition

portfolios, as well as emergence of additional onerous losses throughout the period tested. Because the CSM was not sufficient to absorb variability in fulfillment cash flows, the following changes impacted profit or loss, instead of the CSM:

- a) Changes to the present value of future fees due to changes in current discount rates (i.e., changes in discount rates that would have been offset against the CSM were recorded in pretax income); and
- b) Changes in cash flows related to the riders in 2011 and 2012.

Volatility remained in the segment, which reflected unhedged benefits. Additionally, the lower CSM levels under the 2016 Field Testing (due to the reversal of prior losses) resulted in less CSM being released into pretax profit or loss in subsequent years.

The following graphs support our analysis:

Exhibit 4.4.1A

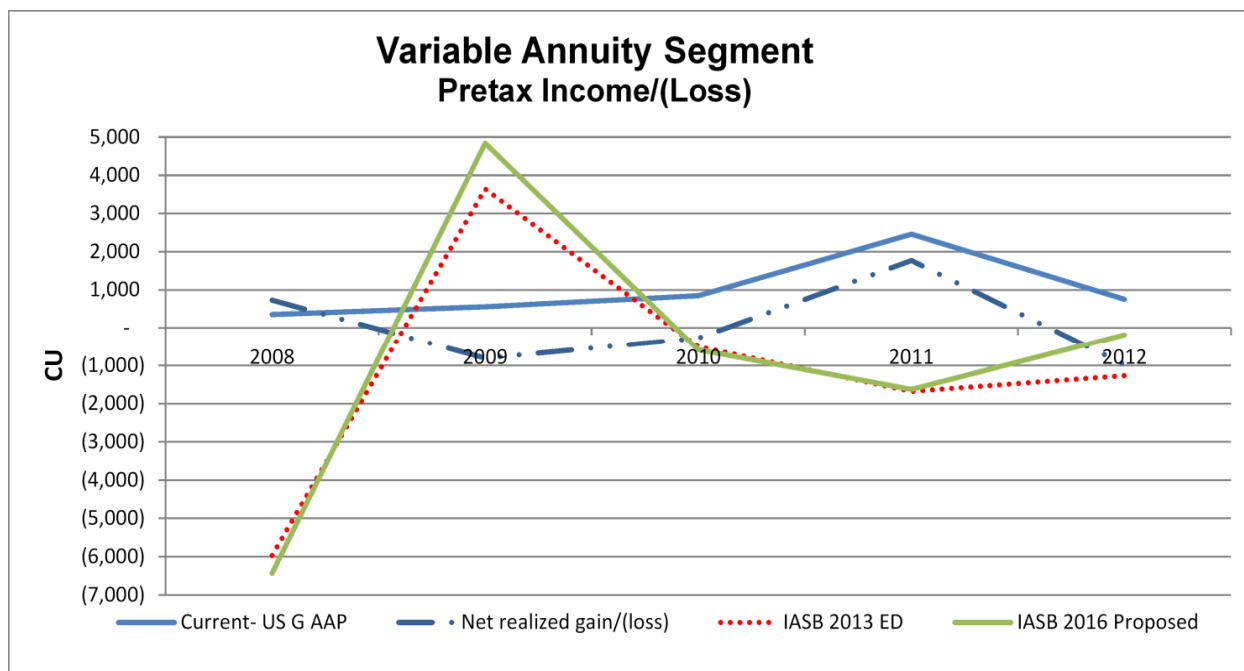


Exhibit 4.4.1B

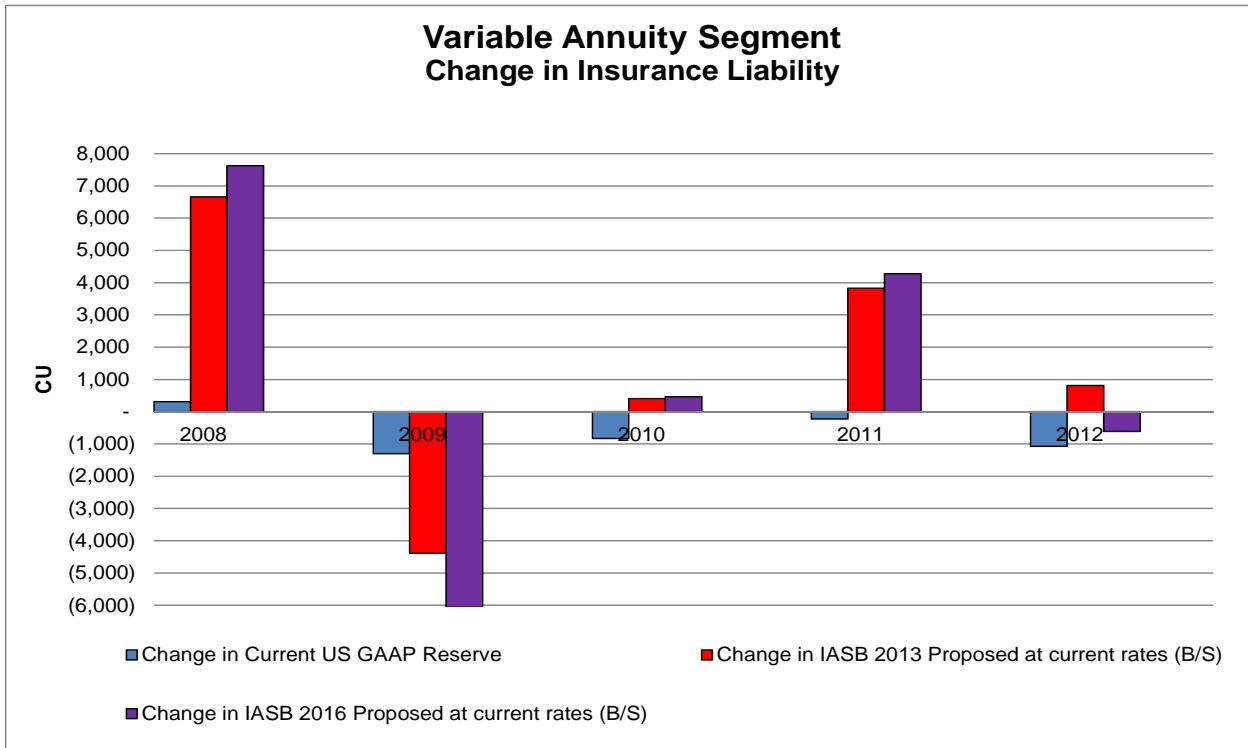
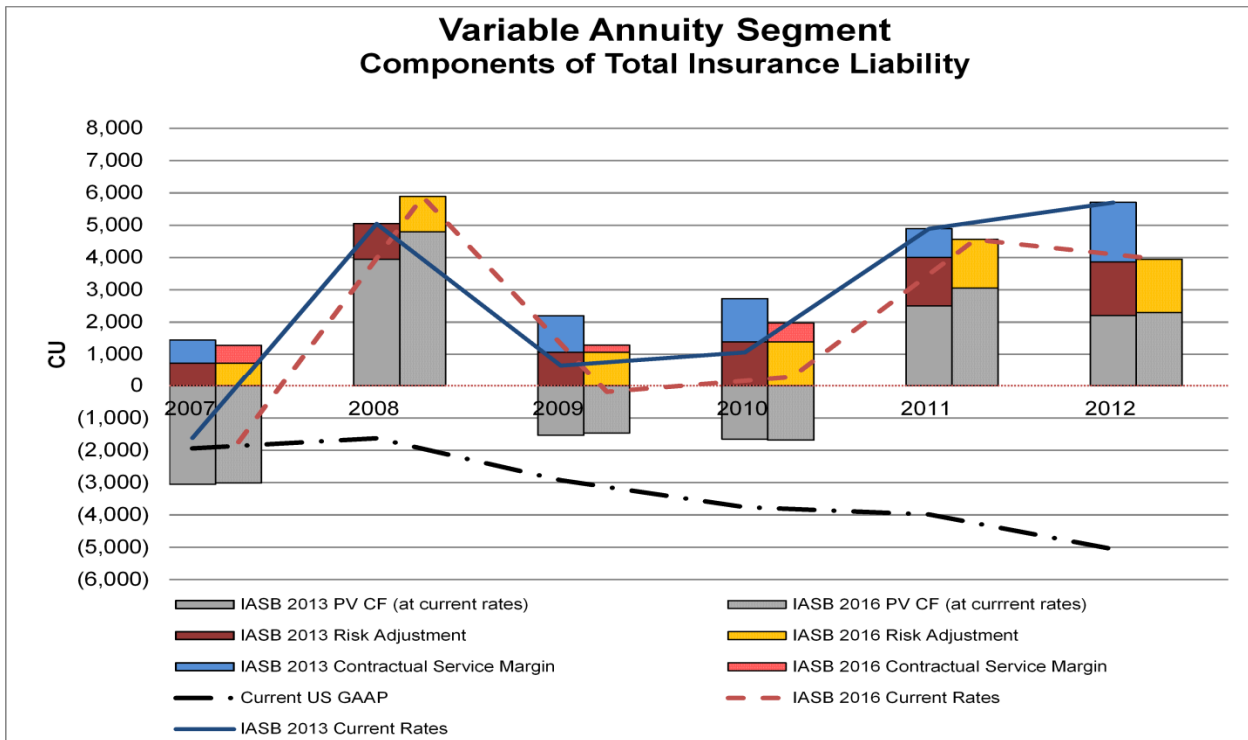


Exhibit 4.4.1C



5. Unit of Account/Level of Aggregation

The level of aggregation is a key component for the measurement of the CSM and is discussed here as it is a fundamental concept independent of the General Model and the Variable Fee Approach.

The disclosures related to the CSM have the potential to provide valuable insights to users of our financial statements on the value of new business written, the value of in-force contracts and the impact of noneconomic risks on our future profitability. The usefulness of the CSM disclosures will only be realized, however, when the level of aggregation strikes the right balance between being too narrow and too broad. Our objective in commenting on the level of aggregation is to help the IASB find this balance.

2013 ED and Subsequent Tentative Decisions

The 2013 ED defined the unit of account for a portfolio of insurance contracts as “a group of insurance contracts that (a) provide coverage for similar risks and that are priced similarly relative to the risk taken on and (b) are managed together as a single pool.”¹⁸

During re-deliberations, the IASB tentatively decided to remove the explicit requirement of pricing as part of the unit of account definition and to make other changes to the definition. Specifically, the IASB tentatively decided to:

- 1) Clarify that the objective is to provide principles for the measurement of an individual insurance contract, but that in applying the standard, an entity could aggregate insurance contracts provided that it meets that objective;
- 2) Amend the definition of a portfolio of insurance contracts to be “insurance contracts that provide coverage for similar risks and are managed together as a single pool”; and
- 3) Add guidance to explain that in determining the CSM or loss at initial recognition, an entity should not combine onerous contracts with profit-making contracts. An entity should consider the facts and circumstances to determine whether a contract is onerous at initial recognition.¹⁹

The IASB tentatively decided to require a loss for onerous contracts to be recognized at inception:

“Only when the CSM is negative for a group of contracts, and that the group should comprise contracts that at inception:

- 1) Have cash flows that the entity expects will respond in similar ways to key drivers of risk in terms of amount and timing; and
- 2) Had similar expected profitability (e.g., similar CSM as a percentage of premiums).²⁰

¹⁸ 2013 ED, Appendix A Defined Terms

¹⁹ IASB meeting, 17 June 2014

²⁰ IASB meeting, 19 January 2016, Agenda Paper 2A

Subsequently, for the release of the CSM, the IASB tentatively decided that:

- 1) “The objective for the allocation of the contractual service margin is to recognize the contractual service margin for an individual contract or groups of homogenous contracts in profit or loss over the coverage period of the contract in a way that best reflects the service to be provided by the contract. Hence, if there is no more service to be provided by a contract after the end of the reporting period, the contractual service margin for that contract should have been fully recognized in profit or loss.
- 2) An entity can group contracts for allocating the CSM, provided that the allocation of the CSM for the group meets the objective in (a).
- 3) An entity that groups contracts is deemed to meet the objective in (a) provided that:
 - a) The contracts in the group:
 - I. Have cash flows that the entity expects will respond in similar ways to key drivers of risk in terms of amount and timing; and
 - II. On inception had similar expected profitability (i.e., similar CSM as a percentage of the premium); and
 - b) The entity adjusts the allocation of the CSM for the group in the period to reflect the expected duration and size of the contracts remaining after the end of the period.”²¹

The IASB tentatively decided that there should be no exceptions to the level of aggregation for determining onerous contracts or the release of the CSM when regulation affects the pricing of contracts. Accordingly, two contracts that otherwise have similar, or even identical, insurance benefits and conditions, but have dissimilar profitability as a consequence of regulation with respect to pricing, may not be grouped for determining onerous contracts and for the release of the CSM.

Approach and Simplifying Assumptions

For operational reasons and in consideration of limitations on time and resources, we did not apply the IASB tentative decisions for developing a unit of account for the 2016 Field Testing. Depending on how the updated principles on unit of account were intended to be interpreted in practice, applying such guidance would have required significant data changes and re-projections of future cash flows at a level of granularity that exceeds the current level of detail used by management in pricing and evaluating the ongoing profitability of such products. This potential effort would have required substantially more time and resources than were available. Therefore, the policyholder data and models that were used to project the future cash flows that measure the initial CSM and that were used to adjust the subsequent CSM for grouped contracts used existing definitions of portfolios and segregated them further into annual cohorts by issue year.

²¹ IASB meeting, 19 January 2016, Agenda Paper 2A addendum

Observations

As noted in the June 2014 IASB meeting, many constituents have expressed a concern that the wording in the 2013 ED was not clear and could result in a level of aggregation that was “excessively narrow and burdensome.” Following the tentative decisions made by the IASB between 2014 and January 2016, we continue to have those concerns.

The CSM and its related disclosures have the potential to provide valuable information to users of our financial statements; however, our interpretation of the current proposed wording would result in too narrow a level of aggregation to achieve this value. In addition, the system and control requirements for this information would be more expensive to implement than is justified by the benefits.

Conceptual Concerns

For long-duration insurance contracts, the CSM approximately represents the excess underwriting margin that an entity is able to charge its policyholders. Users will have an interest in both the CSM created on newly issued insurance contracts as well as the amount of CSM remaining on in-force blocks of contracts. For this information to be useful to users, however, the CSM must be calculated in line with the underlying business model in order to properly assess management’s stewardship of the business.

To expand on this, it is useful to remember how each component of the CSM is developed.

- 1) At initial recognition, the CSM is equal to:
 - a) The present value of insurance cash flows; less
 - b) The risk adjustment; less
 - c) Any acquisition costs.
- 2) The lowest common denominator among the inputs to the calculation of the CSM is generally at the product level. Ascribing meaning to calculations (e.g., CSM on an individual contract²²) performed at a level below the lowest common denominator at which the inputs are determined requires additional allocations that unnecessarily introduce a layer of subjectivity to the measurement.
 - a) In order to measure the present value of insurance cash flows, an entity must estimate the probabilities associated with insured events based on the experience of a large number of contracts. Typically insurers will achieve this by combining the experience of contracts on similar types of insurance contracts offered. For example:
 - I. Mortality tables are usually developed by combining the experience on multiple types of insurance contracts with similar demographics but different product features, distribution methods and initial underwriting valuations.
 - II. Statistical graduation methods are then used to develop the final tables. Those graduation methods produce tables that will vary from the original data for certain

²² For this purpose, discussion of a single contract is equally applicable to a grouping of homogeneous contracts. We recognize that such groupings are clearly allowed, but the arguments outlined are not affected by that grouping.

data points. The tables will also incorporate assumptions about improvements in future mortality that are generally quite broad and determined only at an overall or limited number of levels.

III. The final mortality assumption will therefore not be applicable to any particular contract but only to the broad base of contracts.

- b) Many deferrable overhead expenses are also determinable only at an overall level, and their allocation to individual products can be subjective. A contract that shows a loss using one basis of expense allocation might well show a profit using another.
 - c) In order to measure the risk adjustment, an entity may consider the diversification benefits it expects through offering multiple types of insurance contracts and how much of this diversification the entity will reflect in what it charges policyholders. A single contract, of course, will not, by itself, be able to realize this diversification benefit. Therefore, the risk adjustment is only appropriate at the higher product level and certainly not at the individual insurance contract level.
 - d) While certain acquisition costs may be directly related to an individual contract (e.g., commissions paid), others are only relevant to portfolios of contracts (e.g., commission bonuses based on achieving certain sales objectives, allocations at a portfolio level of deferrable overhead amounts that are directly related to issuing new business). Again, different bases of allocations of those expenses could change a loss for a policy into a gain.
- 3) The final inputs to the calculation of the CSM at initial recognition are the interest rates in effect. The IASB has taken care in the statement of comprehensive income to separate the presentation of underwriting results from investment results; however, to calculate the CSM on long-duration insurance products, the effects of expected underwriting and investment results are blended together.

The ultimate profitability of a portfolio of insurance contracts depends on the investment results. Many long-duration insurance contracts have premium-paying periods that extend beyond the investable horizon, and an investment return may not be locked in at issue. It is obviously impossible to directly attribute any investment return to a particular policy. Furthermore, any investment assumption will only be accurate over a period of time. Even if the assumption is altered every calendar quarter, the actual investments made during that quarter as well as the yield curve in effect can be expected to vary during that period. Investment assumptions can best be evaluated over a period of time; trying to apply it to a single policy will produce results that are not meaningful. We would hope, therefore, to be able to group policies at least by issue year if they meet other requirements under the guidance.

- 4) In order for the CSM and related disclosures to provide valuable information to users of financial statements, the unit of account needs to reflect the level at which the inputs are developed and provide information about the performance of the grouped contracts relative to management's expectations at the time of pricing. If these principles are not reflected, the disclosures related to the CSM will require technical explanations of the accounting as opposed to explanations reflecting underlying business drivers.

Practical Concerns

We are also concerned that complying with the tentative decisions will put a severe burden on companies. For instance, it is not uncommon for a single product to show different profit levels for particular pricing points. A range of the present value of profits at issue divided by present value of premiums for a single year of issues might range from -5% to as high as 20% or more. These differences reflect market tightness and price sensitivity as well as the company's ability to market to certain populations. Normally, of course, the extremes will apply to smaller populations of sales, and overall profits will tend to be in the middle of the range.

Such a range could, under some interpretations, require at least three and possibly as many as ten different groupings. Extending this interpretation over the entire portfolio of a large company, with many issue years and products in-force, there could be many hundreds²³ of new groupings that the company will be required to keep track of and measure annually. Furthermore, implementation will be quite difficult since we will not be able to leverage information from our existing GAAP reporting due to the changes that would be required to the overall structure for how the data is organized and structured.

It is important to emphasize that having this fine a breakdown will not be useful to users of financial statements. This level of aggregation is not how management governs the company and will potentially allow important information to be lost in the significant amount of detail that would be presented.

Recommendation

We recommend that the IASB modify the language of the tentative decisions regarding the level of aggregation for determining if a group of contracts is onerous at initial recognition and for recognizing the CSM in profit or loss to reflect the principles discussed above.

This could be achieved by modifying the wording as follows:

A loss for onerous contracts should be recognized only when the CSM is negative for a group of contracts, and that the group should:

- 1) Comprise insurance contracts that at inception provide coverage for similar risks and that the entity expects will respond in similar ways to key drivers of those risks in terms of amount and timing; and
- 2) Be consistent with the entity's manner of acquiring, servicing, and analyzing and measuring the profitability of its insurance contracts.

For the tentative decision regarding the recognition of the CSM into profit or loss:

- 1) The objective for the allocation of the CSM for a group of insurance contracts is to recognize the CSM in profit or loss in a way that best reflects the service to be provided by the contracts. Hence, if there is no more service to be provided by under the contracts after the end of the reporting period, the CSM should have been fully recognized in profit or loss.

²³ For example, each of the Group has over 60 issue years of individual life products in-force as well as many as 20 different products. Assuming only 5 different products a year and at least 3 groupings per product, this requires 900 groupings, and this is certainly an understatement. Including annuities, health insurance and various group products only exacerbates the practical issue.

- 2) An entity can group contracts for allocating the CSM provided that the allocation for the group meets the objective.
- 3) An entity that groups contracts is deemed to meet the objective provided that:
 - a) The contracts in the group:
 - I. Provide coverage for similar risks and that the entity expects will respond in similar ways to key drivers of those risks in terms of amount and timing; and
 - II. Are consistent with the entity's manner of acquiring, servicing, and analyzing and measuring the profitability of its insurance contracts.
 - b) The entity adjusts the release of the CSM for the group in the period to reflect the following principles:
 - I. When a group contains contracts of different expected durations, the release of the CSM in the period should be relatively larger (smaller) if there are proportionally more longer (shorter) duration contracts that have been derecognized during the period than expected (i.e., surrendered or claimed); and
 - II. When a group contains contracts of different sizes (e.g., a life insurance policy for CU1,000 vs a life insurance policy for CU10,000), the release of the CSM in the period should be relatively larger (smaller) if there are proportionally more large (small) contracts that have been derecognized during the period than expected (i.e., surrendered or claimed).

6. Observations on the General Model

Through tentative decisions made during re-deliberations, the IASB has refined, clarified and reinforced certain aspects of the General Model for contracts that do not have participating features. For our 2016 Field Testing, we have reflected the impacts of these changes in the results for all segments to the extent that they apply. For the Traditional Life and Retirement Segments, all aspects of the changes discussed in this section apply. For those contracts that have participating features, certain aspects of the General Model apply unless specifically discussed in section 7.

Focusing on critical areas of the General Model, we discuss the implications of tentative decisions subsequent to the 2013 ED on our 2016 Field Testing in this section. We identify those areas where there may remain uncertainties in interpreting guidance, challenges applying it, or outcomes that are not reflective of expectations or underlying economics.

6.1 Discount Rates

As a reflection of the tentative decisions since the 2013 ED, the discussion in this section focuses on clarifications related to discount rates in the General Model, specifically observable and unobservable inputs, use of OCI and interest accretion. We note that certain interpretations we made within the 2013 Comment Letter (including market risk premium) have not been included in this Comment Letter, because there have been no changes since the 2013 ED and the approach in the 2013 Field Testing remain consistent with the principles and guidance provided.

6.1.1 Current Discount Rates

2013 ED and Subsequent Tentative Decisions

The 2013 ED did not prescribe the method to make adjustments for discount rates, but instead outlined two methods for consideration, including a top-down approach to determine the yield curve for the insurance contract based on a yield curve that reflects the current market rates of the returns either for the actual portfolio of assets that the entity holds or for a reference portfolio of assets as a starting point.

The IASB tentatively decided:

- 1) To confirm the principle that the discount rates “should be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract;”²⁴
- 2) To “provide additional application guidance that, in determining those discount rates, an entity should use judgment to:
 - a) Ensure that appropriate adjustments are made to observable inputs to accommodate any differences between observed transactions and the insurance contracts being measured; and

²⁴ IASB meeting, 17 June 2014, Paper 2A

- b) Develop any unobservable inputs using the best information available in the circumstances. Accordingly, any unobservable inputs should not contradict any available and relevant market data.”²⁵

Approach and Simplifying Assumptions

For the 2013 Field Testing, we held the last point on the observable market yield curve level for periods beyond the last observable point. As the last observable rate was updated each period, the rate used on all cash flows in the unobservable periods was updated by the same amount. We also tested the sensitivity of both the liability and total comprehensive income of a change in the discount rate assumption used to discount cash flows beyond the point where there is reliable and observable information.

The baseline calculations were updated for the 2016 Field Testing to reflect discount rates linearly graded from the 20-year point on the curve to a best estimate ultimate spot rate (6%) at year 30.²⁶

Observations

The IASB’s clarification that “appropriate adjustments may be made to observable inputs” and that “unobservable inputs be developed using the best information available in the circumstances” is appropriate. The adjustments to points on the yield curve for the 2016 Field Testing are consistent with this guidance based on the period of Field Testing. Specifically, when there are few or no observable inputs, the Group either adjusted observable inputs or used best information to develop inputs to the yield curves used in discounting future cash flows.

We are satisfied with the Board’s changes with respect to this issue. Our 2016 Field Testing supports the benefit of the IASB’s clarification in that it produces more reasonable results.

6.1.2 Other Comprehensive Income

2013 ED and Subsequent Tentative Decisions

In the 2013 ED, the IASB proposed the mandatory use of OCI to present the effect of changes in discount rates on the measurement of insurance contracts²⁷.

The IASB tentatively decided²⁸ that an entity should choose to present the effect of changes in discount rates in profit or loss or in OCI as its accounting policy and should apply that accounting policy to all insurance contracts within a portfolio.

Approach and Simplifying Assumptions

Consistent with the 2013 Field Testing, we reflected changes in the discount rate within OCI for Traditional and Retirement Segments.

²⁵ IASB meeting, 17 June 2014, Paper 2A

²⁶ See Appendix A for details.

²⁷ 2013 ED, Paragraph 64

²⁸ IASB meeting, 18 March 2014

Observations

We support the IASB's tentative decision to allow for the use of OCI to be optional based on a company's accounting policy and for that election to be made on a portfolio-by-portfolio basis.

6.1.3 Interest Accretion for Contracts Without Participating Features

2013 ED and Subsequent Tentative Decisions

The IASB tentatively decided²⁹ that:

“For all insurance contracts, the forthcoming Standard should present an insurance investment expense in profit or loss using a cost measurement basis and not specify detailed mechanics for the determination of the insurance investment expense using a cost measurement basis.”

The IASB will provide additional guidance that the mechanics should result in an allocation of the yield over the life of the contract on a systematic basis.

Approach and Simplifying Assumptions

Consistent with the 2013 Field Testing, we accreted interest using the locked-in forward spot rates implied by the discount yield curve at inception, except for certain products for which, due to data limitations, we used a single rate rather than a yield curve.

Observations

We support the IASB's decision to establish a principle for a cost measurement basis without specifying detailed mechanics.

6.2 Risk Adjustment

2013 ED and Subsequent Tentative Decisions

The IASB tentatively decided that differences between current and previous estimates of the risk adjustment that relate to future coverage and other services should be added to, or deducted from, the CSM, subject to the CSM remaining positive. Changes in risk adjustment that relate to the coverage and other services provided in the current and past periods would be recognized immediately in profit or loss.

Approach and Simplifying Assumptions

Consistent with 2013, we used the cost of capital (“CoC”) method to calculate the risk adjustment for all products, which determined the level of capital an entity would need to hold in order to fulfill its obligations. In our calculations, we applied a CoC rate of 6% on estimated required capital, across all products for all time periods. We did not translate the results of the risk adjustment calculations into a confidence level as required by the IASB, because doing so would be costly and impracticable.

In order to separate impacts of the release from risk and the changes in future services, the testing would require additional model runs. Due to limitations on time and available resources,

²⁹ IASB meeting, 23 September 2015

we did not perform these additional runs and instead recorded the total change in risk adjustment on the statement of comprehensive income. As a result of the current unavailability of data and limited time for Field Testing, we did not have the ability to separately measure the change in the risk adjustment that is related to future coverage and services and that would be offset in the CSM.

Observations

As in the 2013 Comment Letter, we note that any risk adjustment calculation approach that incorporates the discount rate would drive impacts to the risk adjustment and that such effects of discounting should be accounted for through OCI. Indeed, a large component of the change from period to period in our Field Testing is due to the change in discount rates.

We were unable to calculate an equivalent confidence level for the cost of capital method. The required disclosure comparison to a confidence level would be operationally challenging due to the amount of required stochastic runs. We suggest that the IASB consider this when drafting the disclosures and change the disclosure requirement to be a qualitative description of the method and assumptions used in the calculation of the risk adjustment, instead of requiring the comparison to the confidence-level approach. The qualitative descriptions would provide users better insight into how the risk adjustment was calculated and enable users to compare how different companies perform the calculation.

6.3 Contractual Service Margin

The tentative decisions made by the IASB during re-deliberations related to the General Model for contracts without participating features will likely have the most impact on the CSM at transition and for subsequent measurement. In particular, the tentative decisions have refined the approach to unlock the CSM and release it to revenue.

6.3.1 CSM at Inception/Transition

2013 ED and Subsequent Tentative Decisions

In applying the 2013 ED proposals for calculating the initial CSM, we determined the CSM as the excess of the present value of cash inflows over the present value of cash outflows, less the risk adjustment. The 2013 ED required that the tentative guidance be applied by full retrospective application upon transition; however, practical expedients were provided for establishing the interest accretion rates and the risk adjustment.

The IASB tentatively decided³⁰ that at the beginning of the earliest period presented, if the simplified approach³¹ is impractical, an entity should apply a “fair value approach.” Under this approach, the entity should determine the transition CSM to be the difference between the fair value of the insurance contract at that date and the fulfillment cash flows measured at that date.

³⁰ IASB meeting, 23 October 2014

³¹ As described in paragraphs C5 and C6 of the 2013 ED and adjusted by tentative decisions, 23 October 2014

Approach and Simplifying Assumptions

Due to practical limitations, the Group made no changes to the 2013 approach, and as such, transition was performed based on substantial simplifications made in the 2013 Field Testing and carried forward to the 2016 Field Testing.

Observations

Either the simplified retrospective method or the fair value method will be used for the majority of insurance portfolios for transition based on the available data. In order to apply the simplified retrospective method, additional simplifying assumptions may be necessary (e.g., to estimate the amount of direct acquisition expenses historically).

We are concerned with the amount of time, cost and effort that will be required to demonstrate the impracticability of the full retrospective and simplified retrospective methods under IAS 8. Further, the amount of judgment that may be used in applying the simplified retrospective method is unclear. We recommend that the IASB provide examples to clarify the term “impractical” and demonstrate examples of reasonable estimates that may be made, such as the following:

- 1) A portfolio of contracts that was issued beyond the entity’s internal document retention policy. That is, if a portfolio was issued 20 years ago and the entity has a 7-year document retention policy, there should be no further evidence required proving impracticability.
- 2) If under prior insurance contracts accounting, an entity’s acquisition costs were \$100 and under the proposed insurance contracts standard the eligible acquisition costs were \$95, it would be considered reasonable to multiply historical acquisition costs by 95% under the simplified retrospective method.

6.3.2 Releasing the CSM

2013 ED and Subsequent Tentative Decisions

The 2013 ED stated that, “an entity shall recognize the remaining CSM in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract.”³² The IASB formally acknowledged that the services provided would mainly be insurance coverage, but can also include asset management and other services.

The IASB tentatively decided³³ to confirm the 2013 ED proposal that an entity should recognize the remaining CSM in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of the services that are provided under an insurance contract. The IASB also clarified that for contracts with no participating features, the service represented by the CSM is insurance coverage that is (a) provided on the basis of the passage of time and (b) reflects the expected number of contracts in-force for nonparticipating contracts.

³² 2013 ED, paragraph 32

³³ IASB meeting, 21 May 2014

This tentative decision³⁴ reflects observations from respondents that the release pattern for the CSM would have a material impact on the profit reported by entities, and without guidance from the IASB, there may be subjectivity in determining the pattern of underlying services, which may create diversity in the pattern of recognizing the CSM in profit or loss.

Approach and Simplifying Assumptions

For the 2016 Field Testing, policy count was used as the driver of release for CSM, except for the Retirement Segment and one variable annuity product. Specifically within the Retirement Segment, premium was used as the driver of release for the long-term care product, and monthly benefit was used as a proxy of actual policy in-force for single premium immediate annuity contracts (“SPIA”). For one variable annuity product, maintenance expense was used as a proxy for policy count, assuming that all active policies receive one consistent expense charge.

Observations

In applying the principle for releasing the CSM over the coverage period, the insurer has to determine the period over which insurance risk is covered. As a specific example identified in our Field Testing, long-term care products have variable coverage periods due to claimants’ ability to recover and receive life contingent benefits following a claim. In consideration of this, we used the present value of all future premiums as a proxy for the long-term care product in force.

6.3.3 Unlocking the CSM

2013 ED and Subsequent Tentative Decisions

Within the 2013 ED, the IASB provided clarification for the subsequent measurement of the CSM, specifically, that an adjustment was required “to the remaining amount of the contractual service margin for a difference between the current and previous estimates of the cash flows that relate to future coverage and other future services.”

Accordingly, per paragraph B68 of the 2013 ED:

- 1) “The contractual service margin is not adjusted for changes in estimates of incurred claims, because these claims relate to past coverage. Such changes are recognized immediately in profit or loss.
- 2) The contractual service margin is adjusted for experience differences that relate to future coverage, for example, if they relate to premiums for future coverage. The entity adjusts the margin for both the change in premiums and any resulting changes in future outflows.
- 3) The contractual service margin is not adjusted for a delay or acceleration of repayments of investment components if the change in timing did not affect the cash flows relating to future services. The contractual service margin is adjusted only for any net effect on the contractual service margin of the delay or acceleration.

³⁴ IASB meeting, 21 May 2014, Agenda Paper 2C

- 4) 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. Such changes do not relate to services provided under the contract.
- 5) The contractual service margin is adjusted for changes in estimates of cash flows that are expected to vary directly with returns on underlying items only if those cash flows relate to future services under the insurance contract. Gains or losses on the underlying items do not relate to unearned profit from future services from the insurance contract and are recognized in accordance with the Standards relevant to the underlying items.”³⁵

The IASB tentatively decided to confirm the proposal in the 2013 ED that:

“After contract inception, differences between the current and previous estimates of the present value of cash flows related to future coverage and other future services should be added to, or deducted from, the CSM subject to the CSM not being negative. Differences between the current and previous estimates of the present value of cash flows that do not relate to future coverage and other future services should be recognized immediately in profit or loss.”³⁶

The IASB also tentatively decided to require favorable changes in estimates to reverse previously recognized losses relating to coverage and services in the future.

Approach and Simplifying Assumptions

In the 2013 Comment Letter, we observed that the available models were unable to consistently and reliably split the impacts of changes in estimates of future cash flows as conceived by the IASB. As such, we were unable to apply the guidance exactly as it was written. We attempted to apply the guidance in the 2013 ED paragraphs B68d³⁷ and B68e as we interpreted it, but we were unable to make any adjustments for paragraphs B68a, B68b or B68c. Ultimately, the only adjustment made to the CSM related to specifics identified in paragraph B68 was for changes in the base variable annuity contracts in accordance with paragraph B68e.

During the 2016 Field Testing, only certain products had the available data from the Study Period in order to split the changes in cash flows related to changes in in-force from those related to changes in assumptions. Impacts of both in-force and assumption changes were adjusted within the CSM when the split was not attainable based on data availability. Consistent with the IASB’s tentative decisions, for the Traditional Life Segment, where there was no data limitation, the changes in cash flows due to higher actual in-force than expected resulted in the CSM being unlocked while the changes due to lower actual in-force than expected resulted in the immediate recognition of a loss in profit or loss.

Observations

In the 2013 Comment Letter, we observed a number of challenges encountered in both interpreting and applying paragraph B68 of the 2013 ED. We noted that a number of tentative decisions have been made during re-deliberations by the IASB that may impact this section of

³⁵ Paragraph B68(a)–(e) of the 2013 ED

³⁶ IASB tentative decisions, 18 March 2014

³⁷ Paragraph B68(a)–(e) of the 2013 ED discusses “Changes in current estimates of cash flows”

the 2013 ED, but the paragraph itself has not been substantially updated or rescinded. As currently written, paragraph B68 will be subject to differing interpretations, could produce unintuitive results and will be extremely challenging to implement due to the requirement to split cash flows in ways not currently modeled or captured.

Specifically, we wish to reiterate a point made in the 2013 Comment Letter related to what we refer to as the “asymmetrical treatment of acceleration and deceleration of cash flows.” In the 2013 Comment Letter, we interpreted and applied paragraph B68b to mean that if more term life policyholders are in-force at the end of a particular reporting period than expected due to lower-than-expected mortality or lapses, it was considered an assumption change and impacted the CSM. The 2013 ED was unclear as to how this type of change in expectations should be treated, but was clear that experience differences (e.g., benefits paid in the current period that were expected in a future period) should not impact the CSM. We were also concerned that the concept would be operationally difficult to implement.

We agree with the subsequent tentative decisions to treat the net impact from the current period experience differences and the associated changes in projected future cash flows resulting from the experience differences consistently in either the CSM or on the statement of comprehensive income. It would be inconsistent with the economics of the contract, for example, to recognize a surrender charge from an unexpected lapse in current period income while offsetting the lost future profits from that lapse in the CSM. Both the current period surrender charge and the reduction in future profits are the result of a single event and should be accounted for consistently. We do not agree, however, with the tentative decision to sometimes report the net effect on the statement of comprehensive income but other times offset the net effect by unlocking the CSM.

Conceptually, the net effect of experience differences and projected cash flow updates for in-force should offset consistently either on the statement of comprehensive income or the CSM, regardless of whether the actual experience difference represents an acceleration or deceleration of cash flows. In the case of termination experience, with an individual contract unit of account it may appear appropriate for to reflect the effect of accelerations in comprehensive income, while reflecting decelerations in CSM as accelerated terminations mean that fewer contracts are in-force and thus have no more CSM in those particular contracts that terminated.

The conceptual discussion above ignores, however, that insurance assumptions are naturally subject to variability, and even if the assumption is “correct,” we would naturally expect there would be periods when actual experience exceeds the assumption and offsetting periods when actual experience is less than assumed. By treating accelerations and decelerations differently, the impact of expected and naturally occurring offsetting variances in actual experience will not produce offsetting variances in comprehensive income, even if experience over time exactly matches the assumption.

Further, there are situations where accelerations and decelerations of cash flows could occur due to effects other than terminations. For example, there could be partial surrenders, an ancillary benefit paid or flexible premiums. In these cases, accelerations and decelerations would not be associated with any write-off of the CSM due to contract termination. In the special case of participating contracts, there may be further distortions if variances in

termination experience cause changes in dividends projected to contracts that remain in-force and if offsetting variances in termination experience are not treated equivalently.

6.3.4 “Negative” CSM

2013 ED and Subsequent Tentative Decisions

The IASB tentatively decided that “favorable changes in estimates that arise after losses were previously recognized in profit or loss should be recognized in profit or loss to the extent that they reverse losses that relate to coverage and other services in the future.”³⁸

Approach and Simplifying Assumptions

For segments where a change in future cash flows related to future coverage and other services resulted in a loss in profit or loss, we tracked the losses for the potential for future recoveries at the portfolio level. We tracked the losses for future recovery and accreted interest in that future recovery amount.

Observations

We support the IASB’s tentative decision that previous losses recorded in profit or loss should first be recovered in profit or loss before re-establishing the CSM, in the cases where the CSM has been reduced below zero as evidenced from our 2016 Field Testing of the Variable Annuity Segment, as documented in section 4 of this document.

6.3.5 Accretion of Interest on the CSM

2013 ED and Subsequent Tentative Decisions

The IASB tentatively decided that, for contracts without participating features, an entity should use the locked-in rate at the inception of the contract for accreting interest on the CSM and for calculating the change in present value of expected cash flows that offsets that margin.

The IASB tentatively decided not to require or permit in the General Model the re-measurement of the CSM using current discount rates, which creates significant noneconomic income volatility in comprehensive income.

Approach and Simplifying Assumptions

Interest was accreted using locked-in forward spot rates implied by the discount yield curve at inception, except for certain products for which, due to data limitations, we used a single rate.

Observations

The observations from the 2013 Field Testing are consistent with principles provided by the IASB. The only changes in the CSM in the 2016 Field Testing are a result of the change in the discount rate methodology as described elsewhere in this Comment Letter, which impacts the initial CSM and the interest accretion rate.

³⁸ IASB tentative decisions, 18 March 2014

7. Observations on the Approaches for Participating Contracts

7.1 Contracts with Participating Features

2013 ED and Subsequent Tentative Decisions

Since the 2013 ED, the IASB has tentatively decided to specifically define accounting for “insurance contracts with direct participation features” and to modify the General Model for such contracts using the Variable Fee Approach. The IASB tentatively decided that the mirroring approach proposed in the 2013 ED should not be permitted or required.

The IASB also discussed modifications to the General Model for contracts with participating features that do not qualify for the Variable Fee Approach and made tentative decisions about those modifications, particularly as they relate to the treatment of the impacts of discretion. Hereinafter, these two modification approaches are referred to as the Variable Fee Approach and the General Model for contracts with indirect participating features.

7.2 Variable Fee Approach

7.2.1 Scope

The IASB has defined contracts with direct participation features as:

“Contracts for which:

- 1) The contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items;
- 2) The entity expects to pay to the policyholder a substantial share of the returns from the underlying items; and
- 3) A substantial proportion of the cash flows that the entity expects to pay to the policyholder are expected to vary with the cash flows from the underlying items.”³⁹

Approach and Simplifying Assumptions

The Group used the Variable Fee Approach for the base case testing of the Variable Annuity Segment. The General Model was modified for indirect participation features for the Participating Segment.

The Traditional and Retirement Segments were considered to have no (or minimal) cash flows that are impacted either directly or indirectly by the returns on underlying items.

As a simplifying assumption, we expected that policyholders would choose to invest the majority of their funds into the separate account options as opposed to the general account.⁴⁰

³⁹ IASB tentative decisions, 25 June 2015

⁴⁰ In most variable annuity and variable universal life insurance contracts in the US, the policyholder has the option to invest some of the individual’s account in a fixed fund that is invested in the general account of the company. The fixed fund generally credits a rate set by the company each quarter at its discretion, subject to any minimum guarantee.

Observations

We understand that the Board intends to clarify the guidance for direct participation features. We ask the Board to clarify specifically:

- 1) Contracts in a closed block created by a demutualization can be accounted for under the Variable Fee Approach

Our understanding is that the Variable Fee Approach is assessed at issue and not reassessed. There are certain events, however, such as demutualization, that should allow reassessment of the Variable Fee Approach at that time. Closed blocks of business upon demutualization are required by regulation to provide policyholders with a defined share (often 100%) of specified assets backing the closed block. Even if the closed-block contracts did not qualify for the Variable Fee Approach when they were issued, the creation of such a closed block should be deemed a significant enough change to their circumstances that they should qualify for reassessment of the Variable Fee Approach at that time. In most cases, the Variable Fee Approach is the appropriate accounting for contracts in such closed blocks.

- 2) How to determine whether a contract meets criterion c. in 7.2.1

In order to use the Variable Fee Approach, the value of the insurance contract liabilities should be highly correlated with the change in the underlying items. For several types of contracts, however, fixed death benefits and other fixed benefits form a substantial portion of the cash flows. A fixed death benefit on a 90/10 or variable life contract should not prevent the application of the Variable Fee Approach to those contracts.

7.2.2 CSM at Inception/Transition

Tentative Decisions Since the 2013 ED

The IASB tentatively decided that for the simplified retrospective transition approach for a contract with direct participating features:

- 1) An entity should estimate the CSM at inception of the contract as the total fair value of the underlying items, less the fulfillment cash flows adjusted to reflect relevant cash flows that already occurred between the inception of the contract and date of initial application of the standard.
- 2) An entity should estimate the amount of CSM that relates to service provided before the date of initial application of the proposed standard by comparing the remaining coverage with the total coverage period of the contract⁴¹.

Approach and Simplifying Assumptions

Due to the limited availability of data and the time and resources that would be required to identify and track cash flows that occurred before initial application of the proposed standard, we used the same approach to determining the transition CSM for the 2016 Field Testing as the 2013 Field Testing, which was based on averaging results for the five years of new business issued 2008–2012.

⁴¹ IASB tentative decisions, November 2015

Observations

As noted above, we performed a simplified approach for the CSM at transition for the 2016 Field Testing. Our comments, therefore, are the same as under the General Model.

7.2.3 Releasing the CSM

Tentative Decisions Since the 2013 ED

The IASB tentatively decided that for all insurance contracts with participation features, an entity should release the CSM in profit or loss on the basis of the passage of time.⁴²

The Staff noted that:

“An entity would need to ensure that the allocation pattern of the CSM reflects the expected number of contracts that would be in-force. Therefore, it would not be necessary to state that the CSM should be recognized in profit or loss in a way that reflects the expected number of contracts in-force.”⁴³

Approach and Simplifying Assumptions

In accordance with our interpretation of the tentative decisions by the IASB, we released the CSM based on the passage of time adjusted for the expected number of contracts in-force.

Observations

The example shown in Staff Paper 2B of the March 2015 IASB meeting showed the CSM adjusted by the full value of the change in the present value of the variable fee and did not show an amount to be recognized for the period. The result was that the CSM was equal to the present value of the future variable fees. This was inconsistent with recognizing the CSM based on the passage of time. In contrast to the IASB’s examples, the CSM may not always equal the present value of expected fees in the fulfillment cash flows using a current discount rate when using the passage of time as the release basis for the CSM.

The Group also noted that this approach to releasing the CSM was consistent with the approach under the General Model, but the requirement did not explicitly (but did implicitly) require adjustment based on the number of contracts in-force.

7.2.4 Unlocking the CSM

Tentative Decisions Since the 2013 ED

The IASB tentatively decided⁴⁴ that for contracts with direct participation features:

“Changes in the estimate of the fee that the entity expects to earn (entity’s expected share of returns on underlying items less cash flows which do not vary directly with the underlying items) from the contract are adjusted in the CSM.”⁴⁵

⁴² IASB tentative decisions, 25 June 2015

⁴³ IASB meeting, 25 June 2015, Agenda Paper 2C

⁴⁴ IASB tentative decisions, 25 June 2015

⁴⁵ IASB tentative decisions, 25 June 2015

Approach and Simplifying Assumptions

In order to apply the guidance provided, the CSM was unlocked for changes in the variable fee, effectively offsetting all changes in estimates of future cash flows.

Since the CSM is updated and recalculated based on the present value of future fees using current discount rates, the Group implicitly accreted interest on the CSM using current rates by adjusting the variable fee (as discussed in IASB Agenda Papers). While not specifically stated within tentative decisions to date, this approach reflected the provided principles.

For variable annuities, this equated to the CSM under the General Model, with the addition that the CSM was also unlocked for changes in present value cash flows, which resulted from changes in interest rates.

Observations

We agree with the IASB's tentative decisions, as they are consistent with our expectations for CSM under the Variable Fee Approach.

7.2.5 Options and Guarantees

Since insurers may mitigate the risk of certain embedded derivatives within the insurance contract through hedging strategies, the IASB provided specific considerations in order to avoid the potential accounting mismatch between the changes in the value of the guarantee embedded in an insurance contract adjusted in the CSM and the changes in the value of the derivative recognized through profit or loss.

Tentative Decisions Since the 2013 ED

The IASB tentatively decided that “the Variable Fee Approach should not be amended so that a financial guarantee embedded in an insurance contract would be treated as if it were part of the underlying assets.”⁴⁶

Instead, the IASB tentatively decided that, subject to specific criteria:

“If an entity uses the Variable Fee Approach to measure insurance contracts and uses a derivative measured at FVTPL to mitigate the financial market risk from the guarantee embedded in the insurance contract, the entity would be permitted to recognize in profit or loss the changes in the value of the guarantee embedded in an insurance contract, determined using fulfillment cash flows.”⁴⁷

The IASB tentatively decided that the guidance above should be used for the following situations:

- 1) An entity that mitigates the financial market risk from the guarantee using a derivative should be permitted to recognize in profit or loss the changes in the value of the guarantee embedded in an insurance contract, determined using fulfillment cash flows only if:
 - a) That risk mitigation is consistent with the entity's risk management strategy;
 - b) An economic offset exists between the guarantee and the derivative; and

⁴⁶ IASB tentative decisions, 18 November 2015

⁴⁷ IASB tentative decisions, 23 September 2015

c) Credit risk does not dominate the economic offset.⁴⁸

Additionally, an entity should be required to document, before it starts recognizing changes in the value of the guarantee in profit or loss, the entity's risk management objective and the strategy for using the derivative to mitigate the financial market risk embedded in the insurance contract. An entity should discontinue recognizing in profit or loss changes in the value of the guarantee prospectively from the date on which the economic offset does not exist anymore.⁴⁹

At transition, the option discussed above to recognize changes in the value of the guarantee embedded derivative in the insurance contract with direct participation features in profit or loss should be applied prospectively from the date of initial application of the standard.⁵⁰ The IASB has noted that an entity would be able to document its risk mitigation strategy only at the effective date of the Standard, and as such, the option could not be performed retrospectively.

Approach and Simplifying Assumptions

The Group interpreted this guidance to mean that the changes in fair value of embedded options and guarantees that are not separated from the host insurance contract are adjusted against the CSM.

Reflecting the IASB's tentative decision to allow an entity to recognize in profit or loss the changes in the measurement of the guarantee embedded in an insurance contract, when the guarantee is mitigated by a derivative measured at FVTPL, the Group quantified the impact of hedged options and guarantees and, as a sensitivity, removed that impact from the change in the CSM and included it on the income statement.

Observations

We agree with the IASB's tentative decision related to the potential accounting mismatch for financial guarantees. As part of the sensitivity test performed in our Field Testing, we noted that when the value of the guarantee was moved into profit or loss, the remaining profit or loss reflected the hedge inefficiency.

We are concerned that the IASB's decisions treat options and guarantees differently depending on whether the contract qualifies for the Variable Fee Approach. Whether the contract meets the criteria for the Variable Fee Approach, there is no meaningful difference in the nature of the options and guarantees. Therefore, it would provide more comparability and consistency to extend the accounting for options and guarantees for contracts that qualify for the Variable Fee Approach to all contracts with participating features. Also, as discussed in our 2013 Comment Letter, splitting the cash flows related to options and guarantees from other cash flows when measuring contracts with indirect participation features can be unduly complex.

We therefore recommend that changes in projected cash flows related to options and guarantees should be offset by unlocking the CSM, regardless of whether the contract contains direct participation features. In addition, the option currently provided for contracts that qualify for the Variable Fee Approach to include changes in hedged options and

⁴⁸ IASB tentative decisions, 23 September 2015

⁴⁹ IASB tentative decisions, 23 September 2015

⁵⁰ IASB tentative decisions, 18 November 2015

guarantees in profit or loss should be extended to all contracts with participation features. If the company elects to include such hedged options and guarantees in profit or loss, that would indicate that the benefit to representational faithfulness from matching the accounting of the options and guarantees with the fair value accounting of the hedging instruments more than offsets the cost of additional complexity. The improvement to representational faithfulness from applying this approach does not depend on whether the participation features in the contract are direct or indirect or if the contract contains a combination of both direct and indirect participation features. As an example, a fully hedged minimum interest guarantee on a general account fund in a deferred annuity would be represented most faithfully regardless of whether the fund was within a variable annuity that qualified for the Variable Fee Approach or a fixed annuity that did not. Similarly, it would not be representationally faithful to treat an unhedged minimum interest guarantee on a general account fund differently depending on whether the fund was within a variable or fixed annuity.

7.2.6 Interest Accretion – Book Yield

Tentative Decisions Since the 2013 ED

For the modification of disaggregating changes in market variables between profit or loss and OCI, the IASB tentatively decided that:

“To present the insurance investment expense that eliminates accounting mismatches in profit or loss between the insurance investment expense and the items held that are measured using a cost measurement basis in profit or loss. The approach that meets the modified objective is referred to as the current period book yield approach. Accordingly, in the current period book yield approach, the difference between the changes in the contract arising from changes in market variables and the insurance investment expense is recognized in OCI.”⁵¹

The IASB further clarified that:

“Economic mismatches do not exist when:

- 1) The contract is a direct participation contract; and
- 2) The entity holds the underlying items, either by choice or because it is required to.”⁵²

The IASB tentatively decided that for simplifying the initial application of the standard:

“When an entity applies the current period book yield approach, the entity should assume that the insurance investment expenses (or income) is equal and opposite in amount to the gain (or loss) presented in profit or loss of the items held by the entity. Accordingly, an entity should assume that the accumulated balance of OCI is determined as follows:

- 1) When the items held are measured at fair value through profit or loss, there would be no amounts accumulated in OCI; and

⁵¹ IASB tentative decisions, 23 September 2015

⁵² IASB tentative decisions, 23 September 2015

- 2) When the items held are measured at cost in profit or loss, the accumulated balance of OCI for the insurance contracts would be the difference between the items held measured at cost and their fair value.”⁵³

Approach and Simplifying Assumptions

The Group interpreted this requirement to apply to a subset of products that apply the Variable Fee Approach for which there was no potential for economic mismatches because the insurance entity held the underlying items and passed on 100% of the returns on the underlying items to the policyholder. We interpreted that the Variable Annuity Segment would meet this requirement.

The Participating Segment was deemed by the Group to not meet this requirement because there was a possibility of economic mismatch.

Observations

We have no observations as we did not apply the book yield approach during the 2016 Field Testing.

7.3 Modifications to the General Model for Contracts with Participating Features

The Group applied the General Model with modifications for contracts with participating features as the baseline for the Participating Segment. This section discusses the guidance, approach taken and observations with respect to that baseline.

7.3.1 Effects of Discretion

Tentative Decisions Since the 2013 ED

The IASB tentatively decided “to require an entity to specify at the inception of the contract how it viewed its discretion under the contract, and to use that specification to distinguish between the effect of changes in market variables and changes in discretion.”⁵⁴ The default benchmark is a current market return.

Approach and Simplifying Assumptions

In the 2013 Comment Letter, the Group encountered difficulty categorizing cash flows as those directly impacted, indirectly impacted or not impacted by underlying items and separately modeling them for Field Testing purposes. Ultimately, the Group did not model cash flows separately and concluded that the illustration provided in the 2013 ED⁵⁵ could not be applied in practice to products typical in North America. We provided explanations of the challenges encountered within the 2013 Comment Letter.

In 2016, we did not assume any deviations from the prescribed methodology, and therefore, we did not apply discretion.

⁵³ IASB tentative decisions, 23 September 2015

⁵⁴ IASB tentative decisions, 19 and 20 January 2016

⁵⁵ 2013 ED, illustrative example 11

Observations

We did not gather any observations as we did not assume any deviations from the prescribed methodology, and therefore, none of the changes were deemed to be the result of changes in discretion.

7.3.2 Interest Accretion – Effective Yield

Tentative Decisions Since the 2013 ED

The IASB tentatively decided that, for contracts with participation features:

“An entity could choose, as an accounting policy, either:

- 1) To disaggregate changes in market variables between profit or loss and OCI; or
- 2) To present the insurance investment expense in profit or loss using a cost measurement basis (i.e., effective yield).⁵⁶

The IASB also tentatively decided that “an entity should present changes in estimates of the amount of cash flows that result from changes in market variables in the same location in the statement of comprehensive income consistently with the changes in discount rates.”⁵⁷

Approach and Simplifying Assumptions

The Group’s interpretation of this guidance is that the effective yield should be updated when the contract cash flows are predominantly impacted by changes in market factors. This means that changes in cash flows resulting from changes in interest rates that do not relate to discretion (i.e., market variables) are presented in profit or loss consistently with the impact of changes in discount rates.

Under the Group’s approach, the change in estimates of cash flows that resulted from changes in future dividends or crediting rates was presented in the profit or loss and the impact of changes in the effective yields was similarly presented in the profit or loss. The difference between the change in market rates and the change in effective yields was presented in OCI.

Observations

We agree that the effective yield should be updated along with fulfillment cash flows. This reflects the impact of the underlying items, which is representative of the economics of the insurance or reinsurance contracts. The IASB has acknowledged that the effective yield should be updated as a result of changes to the fulfillment cash flows to reflect the impact of underlying items, but not to a current rate as was originally included in the 2013 ED.

The effective yield approach produces more stable present value cash flows than using unadjusted locked-in rates when there are changes in future projected cash flows consistent with changes in interest rates. This is consistent with the nature of these contracts having a floating interest rate. Combined with assets that are held at book value, the effective yield

⁵⁶ IASB tentative decisions, 23 September 2015

⁵⁷ IASB tentative decisions, 23 September 2015

approach produces a more stable income pattern when the product is generating a stable interest spread, and is consistent with the economics of the contract.

There are a number of appropriate approaches that could be used to determine the effective yield approach. For certain contracts, other shapes (e.g., level) may create a distortion to projected income, unless an effective yield adjustment is made every year. The IASB's tentative decision appropriately provides flexibility to use an effective yield approach that balances precision in determining the yield curve shape against the cost of producing the necessary calculation.

7.3.3 Interest Accretion on the CSM

Tentative Decisions Since the 2013 ED

The IASB tentatively decided “not to require or permit in the General Model the re-measurement of the CSM using current discount rates.”⁵⁸

Approach and Simplifying Assumptions

The Group interpreted the tentative decision to mean that accretion of interest on the CSM for the Participating Segment would be based on locked-in discount rates. This approach was consistent with the profit or loss for contracts for which we elected to report OCI.

Observations

Our Field Testing confirmed⁵⁹ that using a locked-in discount rate to accrete interest on the CSM resulted in an accounting mismatch that impacted comprehensive income if there were any changes in asset values due to market variables.

7.3.4 Consistencies with the General Model

For completeness, we noted that contracts with participating features that did not apply the Variable Fee Approach applied the same guidance as for the un-modified General Model for the following aspects of that model:

- 1) Best estimate cash flow projections;
- 2) Current discount rates;
- 3) Releasing the CSM;
- 4) Unlocking the CSM; and
- 5) Risk adjustment.

⁵⁸ IASB tentative decisions, 18 November 2015

⁵⁹ IASB illustrative examples of the Variable Fee Approach, March 2015

8. Remaining Operational Challenges

This section provides comments concerning the challenges that preparers will face implementing the proposed standard in addition to those identified in the sections above

8.1 Transition Timeline

We continue to be concerned that the Board will set the effective date approximately three years following publication of the final standard. This timeline will likely not be achievable; a transition period of approximately five years will be preferable to fully adopt the proposed standard.

This proposed standard, together with the adoption of IFRS 9, *Financial Instruments*, will present the largest accounting changes in the history of insurance companies whereby all aspects of an insurer's financial statements will be changed. All areas of the organization's operating model will be significantly impacted, including, but not limited to, its systems architecture, data management and financial statement processes. While some insurance companies can leverage investments made to comply with Solvency II, there will be a large number of additional differences, such as the CSM, which will require important time and resources. These changes will have a significant cost impact with respect to collecting and analyzing data and disclosing and reporting information to the users of their financial statements.

Additionally, insurers will likely need a lengthy period to interpret the standard and develop global resolutions of interpretation issues. Also, companies in some jurisdictions are required to have management certify the controls and the auditors provide an opinion on two years of past results. As a result, there will be a need to run the impact of the proposed standard in parallel with current reporting for several years.

In addition, system upgrades would need to take into account the implications of any changes in definitions of portfolios, contract boundaries or non-distinct investment components. Such system upgrades are possible if the time and resources are available to implement them, but the extent of resources and time required to do so should not be underestimated. Extensive process and system changes will be necessary to meet the requirements of the proposed standard. These changes include, but are not limited to, updating general and sub-ledger structures, implementing/enhancing stochastic modeling capability, re-calibrating cash flows models, and in particular, introducing/enhancing new rollforwards and attribution analyses of insurance liabilities. These new changes need to operate in a well-controlled environment to comply with internal control (e.g., SOX) requirements. While, in isolation, each of these projects may be a two- to three-year undertaking, when combined into one project and incorporating dependencies between them, the scale and duration could reach up to five years.

8.2 Expected Future Cash Flows

As noted in the 2013 Comment Letter, our experience indicated that, upon actual application of the proposed guidance, most, if not all, of the actuarial models that are currently available

would require fundamental changes. The fundamental changes include the following as examples:

- 1) Modify the models to meet the measurement requirements of the proposed standard, including the objective of a probability-weighted mean, to amortize and unlock the CSM and to calculate the risk adjustment;
- 2) Allow for anticipated expansion of inputs, whether for additional policyholder data and attributes or for economic or noneconomic assumptions;
- 3) Incorporate the processing power and data-storage capacity required to perform multiple runs for every portfolio to produce financial results and profit or loss attributions at each reporting date; and
- 4) Incorporate the required level of processes, procedures, analytics and controls to produce financial statement and related disclosure amounts that are certifiable and explainable by management and auditable within reasonable time frames for timely and accurate internal and external financial reporting.

8.3 Practical Expedients at Transition

We continue to be concerned that it may not be possible to apply the requirements of the simplified retrospective approach, and therefore, we recommend the IASB consider additional practical expedients such as the IASB's introduction of the fair value approach at transition.

In cases where both the full retrospective and the simplified retrospective approach are impracticable, substantial time, cost and effort would be required simply to establish impracticability under IAS 8. We recommend the IASB instead offer an option for entities to elect a transition approach for each portfolio and then disclose the reasons for the method selected.

We also suggest introducing a practical expedient similar to the one proposed by the FASB in its 2013 exposure draft, that is, an expedient that would allow an entity to determine portfolios based on its accounting policy in effect immediately before the beginning of the earliest period presented. This expedient would greatly simplify the transition cost without materially altering the results.

8.4 Insurance Contract Revenue Presentation

Neither our 2013 nor 2016 Field Testing included the preparation of all proposed requirements. However, we observed that we could not have calculated the proposed insurance contract revenue metric without major cost and time delays. In particular, three aspects of the proposed insurance contract revenue metric were overly complex without providing significant benefits to users. These aspects were the requirement to separate investment components from expected insurance benefits, the amortization of acquisition costs from prior periods, and adjustments to expected claims and expenses for amounts previously recognized in profit or loss. We suggest the IASB simplify the insurance contract revenue metric by removing these requirements.

Tracking acquisition costs over the lifetime of an insurance contract will require storing additional data and putting control processes in place to report the correct amounts. For some long-duration insurance contracts, this may be required for a period of 100 years or more,

leading to substantial costs. While spreading the acquisition costs over the lifetime of a contract may lead to a more theoretically correct definition of revenue, the costs do not outweigh the benefits. There are sufficient disclosures with respect to acquisition costs incurred during the period that removing this component of insurance contract revenue will not result in the loss of information to users.

With respect to the requirement to separate investment components from expected death benefits and the adjustments to expected claims and expenses for amounts previously recognized in profit or loss, our concerns relate to users' potential interpretation of the underwriting margin in the statement of comprehensive income.

Under existing IFRS 4, users apply significant scrutiny to experience gains/loss with respect to mortality, morbidity and policyholder behavior (including lapse/surrender). As currently constructed, the statement of comprehensive income will require a separate line to show the gain/loss on the return of investment components to policyholders for contracts if they are not separated under paragraph 10.

This additional line would include gains/losses on the return of investment components resulting from both insured events (death, sickness, etc.) and policyholder-driven events (e.g., surrender). This line would also not give users information on expected cash flows for these events, limiting the ability of the users to assess an entity's assumptions.

We recommend the IASB modify the requirement to separate investment components resulting from insured events and instead include these amounts in the expected cash flows. This will allow users to better assess the quality of an entity's assumptions.

Similarly, the requirement to adjust expected cash flows for amounts that have already been recorded in profit or loss adds complexity for the user. We anticipate that users will have difficulty in assessing the amount of the underwriting gain or loss relative to the expected cash flows (or components of expected cash flows) as these amounts will be shown across multiple lines. As a result, we recommend removing this requirement from insurance contract revenue.

8.5 Disclosures

Our Field Testing focused on the recognition, measurement and presentation of insurance contracts as described throughout this Comment Letter. Owing to time and availability of resources during the Field Testing, we were limited to a review and interpretation without the ability to model the required disclosures proposed. Our careful interpretation of the requirements left us with a concern that producing and reconciling items at the level of granularity described in the proposed disclosures will require substantial effort as part of the ongoing production of the full IFRS financial statements. This level of effort should not be underestimated.

We also strongly repeat our objection to the requirement to disclose the confidence interval for the risk adjustment since, if the risk adjustment is calculated by the cost of capital method, a meaningfully equivalent confidence interval cannot be calculated objectively in a practical or reliable way.

Appendix A – Key Baseline Modeling Techniques and Assumptions

In the 2013 Comment Letter, the Group used certain assumptions and key operational techniques to reflect simplifications of the 2013 ED requirements in order to complete testing with limited time and data availability.

While certain tentative decisions were reflected through updates to the testing approach, the overall testing models themselves were not holistically changed as part of the 2016 Field Testing.

The key baseline techniques and assumptions used for the 2016 Field Testing remain consistent with the 2013 Field Testing except for the items documented in the table below:

Topic	Key Techniques and Assumptions (2013)	Key Techniques and Assumptions (2016)
Separation of components	<ol style="list-style-type: none"> 1) We did not separate any investment components. 2) For variable annuities, we bifurcated certain options and guarantees as embedded derivatives and valued them under IFRS 9.⁶⁰ 	<ol style="list-style-type: none"> 1) The embedded derivatives were calculated as part of the Variable Fee Approach and were not separately bifurcated.
Unit of account/level of aggregation	<ol style="list-style-type: none"> 1) For transition, we combined business issued in 2007 and prior into a single portfolio. 2) We assumed that contracts issued in 2008 and subsequent years contained similar risks and were thus grouped into portfolios by issue year for each product. 	<ol style="list-style-type: none"> 1) Notwithstanding the IASB's tentative decision that the principle is the individual contract, to apply this principle would have required policyholder data to be grouped in ways not precisely done for recognizing and allocating the CSM, which was not practical due to limited time and resource constraints. 2) Refer to section 5 for detailed discussion on unit of account/level of aggregation.

⁶⁰ Existing US GAAP and IFRS requirements for unbundling embedded derivatives may currently result in different treatment under each framework. For the purposes of field testing, we did not re-evaluate or change current accounting treatment for unbundling embedded derivatives when presenting our results under the proposals in the 2013 ED.

Topic	Key Techniques and Assumptions (2013)	Key Techniques and Assumptions (2016)
Cash flows	<p>For unbiased probability-weighted estimate of future cash flows:</p> <ol style="list-style-type: none"> 1) We calculated fulfillment cash flows based on current in-force files, current models and assumptions that reflected each company's best estimates at the time of valuation. Each valuation reflected information known to each company at the valuation date, and actual experience that emerged over the Study Period was reflected in the 2013 Field Testing. 2) We calculated fulfillment cash flows based on a single best estimate for demographic assumptions (e.g., mortality or morbidity). 3) We used single best estimate assumptions for expenses. 4) We used stochastic interest and equity scenarios where indicated for some products. 	<ol style="list-style-type: none"> 1) We made no changes to the 2013 Field Testing approach.
Discount rates used to measure the insurance contract liability (or asset)	<p>We used a top-down approach for discount rate determination. For a majority of the products, the discount rate was based on the returns of the asset portfolio (or reference asset portfolio) and defined as:</p> <ol style="list-style-type: none"> 1) Future gross investment market yield 2) Less expected defaults (based on historical averages for the purposes of Field Testing) 3) Less an assumed spread for the risk surrounding expected default losses (except for products where the risk is shared with the policyholders and therefore attributed some of the risk to the policyholders) <p>For subsequent measurements, we updated the discount rate to reflect the economic environment and asset assumptions as of the valuation date. Given the use of the top-down approach, we based the discount rate on the returns of the asset portfolio (or reference asset portfolio) as defined above. Additionally, we made a baseline assumption that the discount rate tail was set equal to the 30-year rate for all tenors after year 30 (i.e., the end of the observable period).</p>	<ol style="list-style-type: none"> 1) We updated our approach to adjust observable and unobservable inputs as estimated and as necessary. Discount yield curves were linearly graded to an ultimate long-term average rate of 6%, from the 20-year point of the yield curve over a period of 10 years. 2) The Variable Annuity Segment continued to use risk-free rates (swaps or treasuries) with the 30-year rate held level for subsequent points on the yield curve, consistent with scenarios used to develop the cash flows.

Topic	Key Techniques and Assumptions (2013)	Key Techniques and Assumptions (2016)
CSM – initial measurement	<ol style="list-style-type: none"> 1) If there was a gain at issue, we determined the CSM as the excess of the present value (“PV”) of cash inflows over the PV of cash outflows, less the risk adjustment for the CSM. 2) For simplicity, we developed the margin at transition based on an average ratio of margin on new business from the subsequent years covered by the Study Period. <ol style="list-style-type: none"> a) We determined an average ratio of margin to a product-specific driver (e.g., the face amount or PV of benefits (depending on the product)) of new business cohorts in subsequent years for each product. b) We adjusted this ratio, where necessary, to reflect the fact that the transition cohort was no longer in its first year. <p>We applied the average of the subsequent year factors to the transition cohort to determine the margin to be established at transition.</p> 	<ol style="list-style-type: none"> 1) The transition and annual cohort practical simplifications made in 2013 were repeated again in 2016.
CSM – release and interest accretion	<ol style="list-style-type: none"> 1) We released the CSM at the portfolio level, where possible. Where data limitations existed, portfolios were grouped and the margin was released at the product level. 2) At the end of each period, we prospectively revised the CSM release pattern for changes in estimates of future cash flows. 3) We accreted interest on the margin based on the same yield curve that was used to discount the cash flows that was locked-in at issue. 	<ol style="list-style-type: none"> 1) For the General Model, we accreted interest on the CSM using discount rates applied at inception. 2) For the Variable Fee approach, we accreted interest using current discount rates.
CSM – unlocking	<ol style="list-style-type: none"> 1) We adjusted the CSM to reflect the impact of changes in fulfillment cash flows (prospective unlocking). 	<ol style="list-style-type: none"> 1) For practical reasons, the CSM was not adjusted for the impact of changes in the risk adjustment related to future coverage and other services. 2) Changes in the fulfillment cash flows were split between in-force and unlocking for assumption updates for products with available data during the Study Period. 3) Using the Variable Fee Approach, the CSM was adjusted for the entity's share of the variable fee.

Topic	Key Techniques and Assumptions (2013)	Key Techniques and Assumptions (2016)
Onerous contracts	<ol style="list-style-type: none"> 1) We re-established the CSM immediately upon any positive changes in future cash flows related to future coverage and other services immediately. 	<ol style="list-style-type: none"> 1) For groupings of contracts that recorded an onerous loss and subsequent recovery of the CSM, we tracked negative CSM balances, with reversals recognized prior to the CSM balance becoming positive. 2) Interest was accrued on negative CSM balances that we tracked.
Discount rates used to accrete interest – contracts with no discretionary participation features	<ol style="list-style-type: none"> 1) We accreted interest on fulfillment cash flows using interest accretion rates locked in at issue for each portfolio. 2) At transition, we estimated a locked-in interest accretion curve intended to represent a blend of historical rates that would have been locked in over time. 	<ol style="list-style-type: none"> 1) We made no changes to the 2013 Field Testing approach. 2) We acknowledge that this is now optional. As most assets are available for sale/fair value through OCI, this approach is preferred for the Traditional and Retirement Segments.
Discount rates – Variable Fee Approach	<ol style="list-style-type: none"> 1) No prior guidance. 2) We used current rates to accrete interest on fulfillment cash flows. 	<ol style="list-style-type: none"> 1) As our approach in 2013 was consistent with tentative decisions, no changes were made for 2016 Field Testing for the Variable Annuity Segment.
Discount rates used to accrete interest – contracts with discretionary participation features	<ol style="list-style-type: none"> 1) For discretionary participating products (i.e., participating whole life contract (“WL”) and universal life contract with secondary guarantees (“ULSG”)), due to practical limitations, we were unable to split cash flows between those that are fixed and those that vary directly or indirectly with returns on underlying assets, so we treated all cash flows as varying directly with underlying assets. 2) We used current rates to accrete interest on fulfillment cash flows. 	<ol style="list-style-type: none"> 1) We applied the IASB’s tentative decisions regarding a change in expectations of future credited rates. The effective yield used to discount the fulfillment cash flows was updated to reflect the change in future participation in underlying items.
Acquisition costs	<ol style="list-style-type: none"> 1) We made a simplified assumption that acquisition costs were consistent with those determined under current US GAAP for all, except two products. 2) For the products where we presented insurance contract revenue, we used FASB acquisition cost amortization expense as a simplifying assumption. 	<ol style="list-style-type: none"> 1) We made no changes to the 2013 Field Testing approach. 2) We are not showing a revenue presentation, due to practical challenges and time limitations.
Risk adjustment	<ol style="list-style-type: none"> 1) We established and re-measured at a product level. The product-level risk adjustment was then allocated to portfolios as necessary based on a driver relevant to that product. 2) We used a cost-of-capital approach to estimate the risk adjustment using each company’s internal capital models. 3) We re-measured the risk adjustment each period based on updated assumptions at the time of valuation. 	<ol style="list-style-type: none"> 1) No changes were made to our approach in measuring the risk adjustment in 2016.

Appendix B – Rollforward of Insurance Liability, Assets and Margins by Product Segment

Each member of the Group has independently provided data to a third-party consultant under strict confidentiality protocols for the purpose of aggregation and simulation to provide Field Testing of the 2013 ED and subsequent tentative decisions and underlying Agenda Papers provided during re-deliberations on the *Accounting for Insurance Contracts* published by the IASB. The Field Testing results are not financial information relating to any individual company or the companies in aggregate and should not be relied upon separately or in conjunction with information filed by the companies in any jurisdiction under securities regulation or for any other purpose.

IASB rollforwards of the insurance liability (asset) and rollforwards of the margin presented in this appendix for each segment relate to balances produced using 2013 ED and subsequent tentative decisions. These exhibits are presented on a stand-alone basis and are not intended to be reconciled to pretax profit or loss or pretax comprehensive income (loss) graphs presented within the body of this paper.

Totals may not foot or cross-foot due to rounding.

Traditional Life Segment

IASB Rollforward of Insurance Contracts Liability (Asset)

Traditional Life Segment Rollforward of Insurance Contracts Liability - IASB Basis (CU)	12/31/2008				12/31/2009			
	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability
Carrying amount beginning of period	(30,433)	2,584	32,309	4,459	(31,665)	2,510	35,082	5,927
Changes recognized in profit or loss								
Release (including inforce update)	-	(56)	(5,498)	(5,554)	-	195	(5,799)	(5,604)
Experience adjustment	525	-	-	525	1,551	-	-	1,551
Changes in assumptions (including inforce update)	(1,494)	(231)	1,494	(231)	(9,594)	577	9,594	577
Accretion of interest	(1,427)	-	1,588	161	(2,012)	-	1,628	(384)
Total changes recognized in profit or loss	(2,396)	(288)	(2,415)	(5,099)	(10,054)	772	5,422	(3,860)
Changes recognized in OCI								
Changes in discount rate	1,627	-	-	1,627	(3,629)	-	-	(3,629)
New contracts								
Expected premiums	(17,734)	-	-	(17,734)	(23,721)	-	-	(23,721)
Expected acquisition costs	3,916	-	-	3,916	4,590	-	-	4,590
Expected claims and margins	8,417	214	5,188	13,818	11,792	270	7,069	19,132
Total new contracts	(5,401)	214	5,188	-	(7,339)	270	7,069	-
Cash flows								
Premiums received/paid	12,241	-	-	12,241	13,351	-	-	13,351
Claims paid/reimbursed	(3,253)	-	-	(3,253)	(5,076)	-	-	(5,076)
Actual surrenders	(143)	-	-	(143)	(387)	-	-	(387)
Acquisition costs paid	(3,905)	-	-	(3,905)	(4,410)	-	-	(4,410)
Total cash flows	4,940	-	-	4,940	3,478	-	-	3,478
Carrying amount end of period	(31,665)	2,510	35,082	5,927	(49,209)	3,552	47,573	1,916

Traditional Life Segment

IASB Rollforward of Insurance Contracts Liability (Asset)

Traditional Life Segment Rollforward of Insurance Contracts Liability - IASB Basis (CU)	12/31/2010				12/31/2011				12/31/2012			
	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability
Carrying amount beginning of period	(49,209)	3,552	47,573	1,916	(59,378)	4,267	54,241	(870)	(70,677)	4,291	59,334	(7,052)
Changes recognized in profit or loss												
Release (including inforce update)	-	(25)	(7,170)	(7,196)	-	(172)	(8,062)	(8,234)	-	(31)	(8,907)	(8,938)
Experience adjustment	(93)	-	-	(93)	745	-	-	745	(503)	-	-	(503)
Changes in assumptions (including inforce update)	(2,231)	409	2,231	409	595	(161)	(595)	(161)	14,613	494	(14,613)	494
Accretion of interest	(2,528)	-	2,359	(169)	(4,281)	-	2,861	(1,420)	(4,061)	-	2,987	(1,074)
Total changes recognized in profit or loss	(4,852)	384	(2,580)	(7,048)	(2,942)	(333)	(5,795)	(9,070)	10,049	463	(20,533)	(10,021)
Changes recognized in OCI												
Changes in discount rate	(1,271)	-	-	(1,271)	(2,866)	-	-	(2,866)	2,873	-	-	2,873
New contracts												
Expected premiums	(29,269)	-	-	(29,269)	(33,144)	-	-	(33,144)	(32,632)	-	-	(32,632)
Expected acquisition costs	4,717	-	-	4,717	4,937	-	-	4,937	5,056	-	-	5,056
Expected claims and margins	14,974	331	9,248	24,552	16,961	357	10,888	28,206	17,625	464	9,487	27,576
Total new contracts	(9,579)	331	9,248	-	(11,245)	357	10,888	-	(9,951)	464	9,487	-
Cash flows												
Premiums received/paid	14,605	-	-	14,605	16,406	-	-	16,406	18,162	-	-	18,162
Claims paid/reimbursed	(3,999)	-	-	(3,999)	(5,187)	-	-	(5,187)	(5,645)	-	-	(5,645)
Actual surrenders	(529)	-	-	(529)	(397)	-	-	(397)	(381)	-	-	(381)
Acquisition costs paid	(4,543)	-	-	(4,543)	(5,068)	-	-	(5,068)	(4,003)	-	-	(4,003)
Total cash flows	5,533	-	-	5,533	5,754	-	-	5,754	8,133	-	-	8,133
Carrying amount end of period	(59,378)	4,267	54,241	(870)	(70,677)	4,291	59,334	(7,052)	(59,573)	5,217	48,288	(6,067)

Retirement Segment

IASB Rollforward of Insurance Contracts Liability (Asset)

Retirement Segment Rollforward of Insurance Contracts Liability (CU)	12/31/2008				12/31/2009			
	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability
Carrying amount beginning of period	14,293	2,337	8,568	25,198	16,523	2,246	9,280	28,049
Changes recognized in profit or loss								
Release	-	(343)	(847)	(1,190)	-	323	(981)	(658)
Experience adjustment	(270)	-	-	(270)	(263)	-	-	(263)
* Changes in estimates	717	-	(717)	-	327	-	(312)	15
Accretion of interest	849	-	536	1,385	973	-	503	1,476
Total changes recognized in profit or loss	1,296	(343)	(1,028)	(75)	1,037	323	(789)	570
Changes recognized in OCI								
Changes in discount rate	293	-	-	293	(587)	-	-	(587)
New contracts								
Expected premiums	(8,261)	-	-	(8,261)	(9,845)	-	-	(9,845)
Expected acquisition costs	822	-	-	822	974	-	-	974
Expected claims and margins	5,504	251	1,741	7,496	6,528	393	1,950	8,871
A Total new contracts	(1,934)	251	1,741	57	(2,343)	393	1,950	-
Cash flows								
Premiums received/paid	6,510	-	-	6,510	7,392	-	-	7,392
Claims paid/reimbursed	(2,892)	-	-	(2,892)	(3,165)	-	-	(3,165)
Actual surrenders	(32)	-	-	(32)	(43)	-	-	(43)
Acquisition costs paid	(1,012)	-	-	(1,012)	(1,029)	-	-	(1,029)
Total cash flows	2,575	-	-	2,575	3,155	-	-	3,155
Carrying amount end of period	16,523	2,246	9,280	28,049	17,783	2,962	10,441	31,186

Retirement Segment

IASB Rollforward of Insurance Contracts Liability (Asset)

Retirement Segment Rollforward of Insurance Contracts Liability (CU)	12/31/2010				12/31/2011				12/31/2012			
	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability
Carrying amount beginning of period	17,783	2,962	10,441	31,186	20,364	3,468	12,141	35,973	26,810	2,843	14,613	44,266
Changes recognized in profit or loss												
Release	-	89	(1,128)	(1,039)	-	(863)	(1,341)	(2,205)	-	(161)	(1,587)	(1,747)
Experience adjustment	(314)	-	-	(314)	(617)	-	-	(617)	(835)	-	-	(835)
* Changes in estimates	236	-	(231)	5	134	-	(143)	(9)	1,389	-	(1,372)	17
Accretion of interest	1,078	-	560	1,638	1,174	-	661	1,835	1,285	-	773	2,057
Total changes recognized in profit or loss	1,001	89	(798)	291	691	(863)	(823)	(995)	1,838	(161)	(2,185)	(508)
Changes recognized in OCI												
Changes in discount rate	1,448	-	-	1,448	5,847	-	-	5,847	2,049	-	-	2,049
New contracts												
Expected premiums	(11,341)	-	-	(11,341)	(12,950)	-	-	(12,950)	(16,327)	-	-	(16,327)
Expected acquisition costs	1,126	-	-	1,126	1,267	-	-	1,267	1,506	-	-	1,506
Expected claims and margins	7,300	417	2,498	10,215	8,175	238	3,295	11,707	10,371	275	4,194	14,840
A Total new contracts	(2,916)	417	2,498	-	(3,508)	238	3,295	24	(4,450)	275	4,194	18
Cash flows												
Premiums received/paid	7,598	-	-	7,598	8,297	-	-	8,297	9,759	-	-	9,759
Claims paid/reimbursed	(3,389)	-	-	(3,389)	(3,602)	-	-	(3,602)	(3,944)	-	-	(3,944)
Actual surrenders	(45)	-	-	(45)	(40)	-	-	(40)	(53)	-	-	(53)
Acquisition costs paid	(1,116)	-	-	(1,116)	(1,240)	-	-	(1,240)	(1,519)	-	-	(1,519)
Total cash flows	3,048	-	-	3,048	3,416	-	-	3,416	4,244	-	-	4,244
Carrying amount end of period	20,364	3,468	12,141	35,973	26,810	2,843	14,613	44,266	30,491	2,957	16,621	50,069

Participating Segment

IASB Rollforward of Insurance Contracts Liability (Asset)

Participating Segment Rollforward of Insurance Contracts Liability - IASB Basis (CU)	12/31/2008				12/31/2009			
	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability
Carrying amount beginning of period	21,999	2,907	1,101	26,007	22,436	3,889	495	26,819
Changes recognized in profit or loss								
Release (including inforce update)	-	305	(120)	186	-	(489)	(49)	(539)
Experience adjustment	(728)	-	-	(728)	265	-	-	265
Changes in assumptions (including inforce update)	54	-	(848)	(794)	3,780	-	(437)	3,343
Accretion of interest	1,094	-	53	1,146	883	-	21	904
Total changes recognized in profit or loss	419	305	(916)	(191)	4,928	(489)	(465)	3,973
Changes due to crediting rate/dividend scale updates								
Changes in discount rate	(1,859)	-	-	(1,859)	5,027	-	-	5,027
New contracts								
Expected premiums	(10,493)	-	-	(10,493)	(9,742)	-	-	(9,742)
Expected acquisition costs	580	-	-	580	437	-	-	437
Expected claims and margins	9,095	677	309	10,081	11,487	722	-	12,209
Total new contracts	(817)	677	309	169	2,182	722	-	2,903
Cash flows								
Premiums received/paid	6,467	-	-	6,467	7,193	-	-	7,193
Claims paid/reimbursed	(1,713)	-	-	(1,713)	(1,792)	-	-	(1,792)
Actual surrenders	(926)	-	-	(926)	(1,078)	-	-	(1,078)
Acquisition costs paid	(1,135)	-	-	(1,135)	(1,139)	-	-	(1,139)
Total cash flows	2,693	-	-	2,693	3,185	-	-	3,185
Carrying amount end of period	22,436	3,889	495	26,819	# 37,757	4,121	29	41,908

Participating Segment

IASB Rollforward of Insurance Contracts Liability (Asset)

Participating Segment Rollforward of Insurance Contracts Liability - IASB Basis (CU)	12/31/2010				12/31/2011				12/31/2012			
	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfillment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability
Carrying amount beginning of period	37,757	4,121	29	41,908	41,742	5,062	91	46,895	54,738	6,894	99	61,730
Changes recognized in profit or loss												
Release (including inforce update)	-	227	(3)	224	-	921	(11)	910	-	(513)	(11)	(523)
Experience adjustment	(1,498)	-	-	(1,498)	(1,927)	-	-	(1,927)	(2,815)	-	-	(2,815)
Changes in assumptions (including inforce update)	(5,935)	-	26	(5,909)	3,101	-	13	3,114	435	-	301	736
Accretion of interest	1,767	-	2	1,769	2,065	-	6	2,070	2,539	-	5	2,544
Total changes recognized in profit or loss	(5,666)	227	25	(5,414)	3,239	921	8	4,168	159	(513)	295	(59)
Changes due to crediting rate/dividend scale updates												
Changes in discount rate	5,118	-	-	5,118	5,016	-	-	5,016	672	-	-	672
New contracts												
Expected premiums	(10,409)	-	-	(10,409)	(12,574)	-	-	(12,574)	(8,931)	-	-	(8,931)
Expected acquisition costs	1,494	-	-	1,494	1,068	-	-	1,068	827	-	-	827
Expected claims and margins	10,417	714	37	11,167	11,845	910	-	12,755	7,910	518	123	8,552
Total new contracts	1,502	714	37	2,253	338	910	-	1,249	(194)	518	123	447
Cash flows												
Premiums received/paid	7,625	-	-	7,625	9,088	-	-	9,088	8,175	-	-	8,175
Claims paid/reimbursed	(2,217)	-	-	(2,217)	(2,154)	-	-	(2,154)	(2,534)	-	-	(2,534)
Actual surrenders	(1,087)	-	-	(1,087)	(1,107)	-	-	(1,107)	(1,139)	-	-	(1,139)
Acquisition costs paid	(1,290)	-	-	(1,290)	(1,424)	-	-	(1,424)	(1,084)	-	-	(1,084)
Total cash flows	3,031	-	-	3,031	4,403	-	-	4,403	3,418	-	-	3,418
Carrying amount end of period	41,742	5,062	91	46,895	54,738	6,894	99	61,730	58,793	6,899	517	66,209

Variable Annuity Segment

IASB Rollforward of Insurance Contracts Liability (Asset)

Variable Annuity Segment Rollforward of Insurance Contracts Liability - IASB Basis (CU)	12/31/2008				12/31/2009			
	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability
Carrying amount beginning of period	(3,015)	719	555	(1,742)	4,784	1,098	-	5,882
Changes recognized in profit or loss								
Release	-	116	(81)	35	-	(196)	-	(196)
Experience adjustment	13	-	-	13	(209)	-	-	(209)
Changes in assumptions (including inforce update)	5,092	-	(497)	4,594	(5,421)	-	2,606	(2,815)
Reversal of negative CSM	-	-	-	-	-	-	(2,969)	(2,969)
Accretion of interest	(94)	-	24	(70)	65	-	-	65
Changes in discount rate	1,078	-	-	1,078	(801)	-	561	(239)
Total changes recognized in profit or loss	6,088	116	(555)	5,650	(6,366)	(196)	199	(6,364)
New contracts								
Expected premiums	(1,226)	-	-	(1,226)	(1,462)	-	-	(1,462)
Expected acquisition costs	665	-	-	665	532	-	-	532
Expected claims and margins	2,074	263	-	2,336	784	161	24	969
Total new contracts	1,512	263	-	1,775	(147)	161	24	38
Cash flows								
Premiums received/paid	1,076	-	-	1,076	1,046	-	-	1,046
Claims paid/reimbursed	(303)	-	-	(303)	(283)	-	-	(283)
Actual surrenders	-	-	-	-	-	-	-	-
Acquisition costs paid	(575)	-	-	(575)	(506)	-	-	(506)
Total cash flows	198	-	-	198	258	-	-	258
	-	-	-	-	-	-	-	-
Carrying amount end of period	4,784	1,098	0	5,882	(1,472)	1,063	222	(186)

Variable Annuity Segment

IASB Rollforward of Insurance Contracts Liability (Asset)

Variable Annuity Segment Rollforward of Insurance Contracts Liability - IASB Basis (CU)	12/31/2010				12/31/2011				12/31/2012			
	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability	Expected present value of fulfilment cash flows	Risk adjustment	Contractual Service Margin	Total insurance contract liability
Carrying amount beginning of period	(1,472)	1,063	222	(186)	(1,689)	1,373	592	277	3,048	1,501	-	4,550
Changes recognized in profit or loss												
Release	-	211	(30)	181	-	(59)	(77)	(136)	-	95	-	95
Experience adjustment	(130)	-	-	(130)	(78)	-	-	(78)	(117)	-	-	(117)
Changes in assumptions (including inforce update)	(474)	-	339	(136)	2,765	-	(518)	2,247	(1,426)	-	-	(1,426)
Reversal of negative CSM	-	-	-	-	-	-	-	-	-	-	-	-
Accretion of interest	(8)	-	2	(6)	(5)	-	3	(2)	23	-	-	23
Changes in discount rate	101	-	(79)	22	1,385	-	-	1,385	2	-	-	2
Total changes recognized in profit or loss	(511)	211	232	(68)	4,066	(59)	(592)	3,415	(1,517)	95	-	(1,422)
New contracts												
Expected premiums	(1,143)	-	-	(1,143)	(1,619)	-	-	(1,619)	(857)	-	-	(857)
Expected acquisition costs	432	-	-	432	561	-	-	561	325	-	-	325
Expected claims and margins	493	100	138	731	1,230	187	-	1,417	541	61	-	602
Total new contracts	(218)	100	138	20	173	187	-	360	8	61	-	69
Cash flows												
Premiums received/paid	1,312	-	-	1,312	1,476	-	-	1,476	1,584	-	-	1,584
Claims paid/reimbursed	(288)	-	-	(288)	(303)	-	-	(303)	(378)	-	-	(378)
Actual surrenders	-	-	-	-	-	-	-	-	-	-	-	-
Acquisition costs paid	(513)	-	-	(513)	(675)	-	-	(675)	(460)	-	-	(460)
Total cash flows	511	-	-	511	498	-	-	498	746	-	-	746
Carrying amount end of period	(1,689)	1,373	592	277	3,048	1,501	(0)	4,550	2,286	1,657	-	3,943

Appendix C – Glossary

Terms used in this Comment Letter

2013 ED – The Insurance Contracts Exposure Draft issued by the IASB in June 2013

2013 Comment Letter – The Comment Letter dated 11 October 2013 developed by the Group and communicated to the IASB and FASB

2016 Comment Letter (this Comment Letter) – Represents this document developed by the Group and communicated to the IASB

Agenda Papers – Documents provided by the IASB in advance of re-deliberation meetings, which include the Staff’s questions to the IASB and corresponding analysis

CoC – Cost of capital

CSM – Contractual service margin

CU – Currency unit

FASB – Financial Accounting Standards Board

FVTPL (“Fair Value Through Profit or Loss”) – Reported on the balance sheet at fair value, with changes in fair value reported in profit or loss on the statement of comprehensive income

The Group (or “our” or “we”) – Manulife; MetLife, Inc.; New York Life and Prudential Financial, Inc.

IASB – International Accounting Standards Board

IFRS – International Financial Reporting Standards

IFRS 4 – International Financial Reporting Standard 4, *Insurance Contracts*

IFRS 9 – International Financial Reporting Standard 9, *Financial Instruments*

OCI – Other comprehensive income

PV – Present value

Staff – Represents the staff of the International Accounting Standards Board

SPIA – Single premium immediate annuity contracts

Study Period – The period from 31 December 2007 through 31 December 2012 for which the Group performed this Field Testing

Tenor – The amount of time left for the repayment of a loan or fixed income security or the initial term length; can be expressed in years, months or days

US GAAP – US generally accepted accounting principles

ULSG – Universal life contracts with secondary guarantees

WL – Whole of life contract; can be participating (par) or nonparticipating (non-par)

IASB Defined Terms

Acquisition Costs – The costs of selling, underwriting and initiating an **insurance contract**

Contractual Service Margin – A component of the measurement of the **insurance contract**, representing the unearned profit that the entity recognizes as it provides services under the **insurance contract**

Coverage Period – The period during which the entity provides coverage for **insured events**. That period includes the coverage that relates to all premiums within the boundary of the insurance contract

Direct Participating Contracts – Contracts which (i) the contractual terms specify that the **policyholder** participates in a share of a clearly identified pool of underlying items; (ii) the entity expects to pay to the **policyholder** an amount equal to a substantial share of the returns from the underlying items; and (iii) a substantial proportion of the cash flows that the entity expects to pay to the **policyholder** – should be expected to vary with the cash flows from the underlying items.

Fulfillment Cash Flows – An explicit, unbiased, and probability-weighted estimate (i.e., expected value) of the present value of the future cash outflows, less the present value of the future cash inflows that will arise as the entity fulfills the **insurance contract**, including a **risk adjustment**

General Model – Formerly referred to as the Building Block Approach, the General Model is applied for contracts that do not have participating features

Insurance Contract – A contract under which one party (the issuer) accepts significant **insurance risk** from another party (the **policyholder**) by agreeing to compensate the policyholder if a specified uncertain future event (the **insured event**) adversely affects the **policyholder**

Insured Event – An uncertain future event that is covered by an **insurance contract** and that creates **insurance risk**

Investment Component – The amounts that an **insurance contract** requires the entity to repay to a **policyholder** even if an **insured event** does not occur

Policyholder – A party that has a right to compensation under an **insurance contract** if an **insured event** occurs

Portfolio of Insurance Contracts – A group of **insurance contracts** that provides coverage for similar risks and are managed together as a single pool

Pre-coverage Cash Flows – Cash flows paid or received before the **insurance contract** is recognized that relate directly to the acquisition or the fulfillment of the **portfolio of insurance contracts** that will contain the **insurance contract**

Risk Adjustment – The compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfills the **insurance contract**

Variable Fee Approach – The IASB's staff proposed measurement model for participating contracts where changes in the estimate of the future fees that an entity expects to earn from participating contract policyholders are adjusted against the CSM