

PUBLIC BENEFIT ENTITY INTERNATIONAL FINANCIAL REPORTING STANDARD 4 INSURANCE CONTRACTS (PBE IFRS 4)

This Standard was issued on 11 September 2014 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 9 October 2014.

Reporting entities that are subject to this Standard are required to apply it in accordance with the effective date, which is set out in paragraph 45.1.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Tier 1 and Tier 2 PBE Standard has been issued as part of a revised full set of PBE Standards that incorporate enhancements for not-for-profit public benefit entities.

This Standard, when applied, supersedes PBE IFRS 4 *Insurance Contracts* issued in May 2013.

PBE IFRS 4 INSURANCE CONTRACTS

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PBE IFRS 4 INSURANCE CONTRACTS

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Public Benefit Entity International Financial Reporting Standard 4 *Insurance Contracts* (PBE IFRS 4) is set out in paragraphs 1–46 and Appendices A–D. All the paragraphs have equal authority. PBE IFRS 4 should be read in the context of its objective, the Basis for Conclusions and XRB A1 *Accounting Standards Framework*. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to specify the financial reporting for insurance contracts by any entity that issues such contracts (described in this Standard as an insurer). In particular, this Standard requires:
 - (a) Limited improvements to accounting by insurers for insurance contracts.
 - (b) Disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

Scope

2. An entity shall apply this Standard to:
 - (a) Insurance contracts (including reinsurance contracts) that it issues and reinsurance contracts that it holds.
 - (b) Financial instruments that it issues with a discretionary participation feature (see paragraph 35). PBE IPSAS 30 *Financial Instruments: Disclosures* requires disclosure about financial instruments, including financial instruments that contain such features.
- 2.1 **This Standard applies to Tier 1 and Tier 2 public benefit entities.**
3. This Standard does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see PBE IPSAS 28 *Financial Instruments: Presentation*, PBE IPSAS 29 *Financial Instruments: Recognition and Measurement*, and PBE IPSAS 30).
4. An entity shall not apply this Standard to:
 - (a) Product warranties issued directly by a manufacturer, dealer or retailer (see PBE IPSAS 9 *Revenue from Exchange Transactions* and PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*).
 - (b) Employers' assets and liabilities under employee benefit plans (see PBE IPSAS 25 *Employee Benefits* and the relevant international or national accounting standard dealing with share-based transactions) and retirement benefit obligations reported by defined benefit retirement plans (see the relevant international or national accounting standard dealing with employee retirement benefit plans).
 - (c) Contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see PBE IPSAS 13 *Leases*, PBE IPSAS 9 and PBE IPSAS 31 *Intangible Assets*).
 - (d) Financial guarantee contracts unless the issuer has previously applied accounting applicable to insurance contracts and adopted an accounting policy that treated financial guarantee contracts as insurance contracts, or the entity previously did not apply accounting applicable to insurance contracts but elects to treat financial guarantee contracts as insurance contracts on adoption of PBE IPSAS 28. In such cases the issuer may elect to apply either PBE IPSAS 29 and PBE IPSAS 28 or this Standard to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.
 - (e) Contingent consideration payable or receivable in a business combination (see PBE IFRS 3 *Business Combinations*).
 - (f) Direct insurance contracts that the entity holds (i.e., direct insurance contracts in which the entity is the policyholder). However, a cedant shall apply this Standard to reinsurance contracts that it holds.
- 4.1 **An entity which is a life insurer shall comply with the requirements of Appendix C.**
- 4.2 **An entity which issues insurance contracts, other than life insurers, shall comply with the requirements of Appendix D.**
5. For ease of reference, this Standard describes any entity that issues an insurance contract as an insurer, whether or not the issuer is regarded as an insurer for legal or supervisory purposes.

6. A reinsurance contract is a type of insurance contract. Accordingly, all references in this Standard to insurance contracts also apply to reinsurance contracts.

Embedded Derivatives

7. PBE IPSAS 29 requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in surplus or deficit. PBE IPSAS 29 applies to derivatives embedded in an insurance contract unless the embedded derivative is itself an insurance contract.
8. As an exception to the requirement in PBE IPSAS 29, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if the exercise price differs from the carrying amount of the host insurance liability. However, the requirement in PBE IPSAS 29 does apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).
9. Paragraph 8 applies equally to options to surrender a financial instrument containing a discretionary participation feature.

Unbundling of Deposit Components

10. Some insurance contracts contain both an insurance component and a deposit component. In some cases, an insurer is required or permitted to unbundle those components:
- (a) Unbundling is required if both the following conditions are met:
 - (i) The insurer can measure the deposit component (including any embedded surrender options) separately (i.e., without considering the insurance component).
 - (ii) The insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.
 - (b) Unbundling is permitted, but not required, if the insurer can measure the deposit component separately as in (a)(i) but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.
 - (c) Unbundling is prohibited if an insurer cannot measure the deposit component separately as in subparagraph (a)(i) above.
11. The following is an example of a case when an insurer's accounting policies do not require it to recognise all obligations arising from a deposit component. A cedant receives compensation for losses from a reinsurer, but the contract obliges the cedant to repay the compensation in future years. That obligation arises from a deposit component. If the cedant's accounting policies would otherwise permit it to recognise the compensation as revenue without recognising the resulting obligation, unbundling is required.
12. To unbundle a contract, an insurer shall:
- (a) Apply this Standard to the insurance component.
 - (b) Apply PBE IPSAS 29 to the deposit component.

Definitions

- 12.1 **The following terms are used in this Standard with the meanings specified:**

Acquisition costs are the fixed and variable costs of acquiring new business, including commissions and similar distribution costs, and costs of accepting, issuing and initially recording policies. (Acquisition costs relate to the costs incurred in acquiring specific life insurance contracts during the reporting period. They do not include the general growth and development costs incurred by a life insurer.)

The **attachment date** is, for a direct insurer, the date as from which the insurer accepts risk from the insured under an insurance contract or endorsement or, for a reinsurer, the date from which the reinsurer accepts risk from the direct insurer or another reinsurer under a reinsurance arrangement.

A **cedant** is the policyholder under a reinsurance contract.

A **claim** is a demand by any party external to the entity for payment by the insurer on account of an alleged loss resulting from an insured event or events, that have occurred, alleged to be covered by insurance.

A **claims expense** is the charge to surplus or deficit for the reporting period and represents the sum of claims settled and claims management expenses relating to claims incurred in the period and the movement in the gross outstanding claims liability in the period.

Claims incurred are claims that have occurred prior to the end of the reporting period; the claims could be reported or unreported at the end of the reporting period.

A **deposit component** is a contractual component that is not accounted for as a derivative under PBE IPSAS 29 and would be within the scope of PBE IPSAS 29 if it were a separate instrument.

A **deposit premium** is the premium charged by the insurer at the inception of a contract under which the final premium depends on conditions prevailing over the contract period and so is not determined until the expiry of that period. Direct insurance contract means an insurance contract that is not a reinsurance contract.

A **direct insurance contract** is an insurance contract that is not a reinsurance contract.

A **discretionary participation feature** is a contractual right to receive, as a supplement to guaranteed benefits, additional benefits:

- (a) That are likely to be a significant portion of the total contractual benefits;
- (b) Whose amount or timing is contractually at the discretion of the issuer; and
- (c) That are contractually based on:
 - (i) The performance of a specified pool of contracts or a specified type of contract;
 - (ii) Realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or
 - (iii) The surplus or deficit of the company, fund or other entity that issues the contract.

Financial risk is the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Future claims are claims in respect of insured events that are expected to occur in future reporting periods under policies where the attachment date is prior to the end of the reporting period.

A **general insurance contract** is an insurance contract that is not a life insurance contract.

A **general insurer** is an insurer that writes general insurance contracts.

A **general reinsurance contract** is a reinsurance contract that is not a life reinsurance contract.

Guaranteed benefits are payments or other benefits to which a particular policyholder or investor has an unconditional right that is not subject to the contractual discretion of the issuer.

A **guaranteed element** is an obligation to pay guaranteed benefits, included in a contract that contains a discretionary participation feature.

An **insurance asset** is an insurer's net contractual rights under an insurance contract.

An **insurance contract** is a contract under which one party (the insurer) 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. (See Appendix B for guidance on this definition.)

An **insurance liability** is an insurer's net contractual obligations under an insurance contract.

Insurance risk is risk, other than financial risk, transferred from the holder of a contract to the issuer.

An **insured event** is an uncertain future event that is covered by an insurance contract and creates insurance risk.

An **insurer** is the party that has an obligation under an insurance contract to compensate a policyholder if an insured event occurs.

Investment-linked is where the benefit amount under a life insurance contract or life investment contract is directly linked to the market value of the investments held in the particular investment-linked fund.

Inwards reinsurance are reinsurance contracts written by reinsurers.

Liability adequacy test is an assessment of whether the carrying amount of an insurance liability needs to be increased (or the carrying amount of related deferred acquisition costs or related intangible assets decreased), based on a review of future cash flows.

Life insurance business is all life insurance contract and life investment contract business conducted by a life insurer.

A **life insurance contract** is an insurance contract, or a financial instrument with a discretionary participation feature, issued by a life insurer.

A **life insurance liability** is a life insurer's net contractual obligations under a life insurance contract.

A **life insurer** is an entity operating under the Insurance (Prudential Supervision) Act 2010 and similar entities operating outside New Zealand.

A **life investment contract** is a contract which is not an insurance contract but is issued by life insurers, and gives rise to a financial asset and financial liability (as defined by PBE IPSAS 29). An investment contract cannot be a contract exempted from the definition of an insurance contract as found in paragraph 4 of this Standard.

A **life investment contract liability** is a life insurer's net contractual obligations under a life investment contract which arise under the financial instrument component of a life investment contract.

A **life reinsurance contract** is a life insurance contract issued by one insurer (the reinsurer) to compensate another insurer (the cedant) for losses on one or more contracts issued by the cedant.

Net claims incurred are direct claims costs net of reinsurance and other recoveries, and indirect claims handling costs, determined on a discounted basis.

Non-investment-linked business is life insurance business other than investment-linked business.

Outstanding claims liability is all unpaid claims and related claims handling expenses relating to claims incurred prior to the end of the reporting period.

A **policyholder** is a party that has a right to compensation under an insurance contract if an insured event occurs.

A **policy liability** is a liability that arises under a life insurance contract or a life investment contract including any asset or liability arising in respect of the management services element of a life investment contract.

A **premium** is the amount charged in relation to accepting risk from the insured, but does not include amounts collected on behalf of third parties.

Reinsurance assets are a cedant's net contractual rights under a reinsurance contract.

A **reinsurance contract** is an insurance contract issued by one insurer (the reinsurer) to compensate another insurer (the cedant) for losses on one or more contracts issued by the cedant.

A **reinsurer** is the party that has an obligation under a reinsurance contract to compensate a cedant if an insured event occurs.

To **unbundle** is to account for the components of a contract as if they were separate contracts.

A **weather derivative** is a contract that requires payment based on climatic, geological or other physical variables.

Terms defined in other PBE Standards are used in this Standard with the same meaning as in those Standards and are reproduced in the *Glossary of Defined Terms* published separately.

Recognition and Measurement

Temporary Exemption from some other PBE Standards

13. Paragraphs 12–15 of PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy if no PBE Standard applies specifically to an item. However, this Standard exempts an insurer from applying those criteria to its accounting policies for:
 - (a) Insurance contracts that it issues (including related acquisition costs and related intangible assets, such as those described in paragraphs 31 and 32); and
 - (b) Reinsurance contracts that it holds.
14. Nevertheless, this Standard does not exempt an insurer from some implications of the criteria in paragraphs 12–15 of PBE IPSAS 3. Specifically, an insurer:
 - (a) Shall not recognise as a liability any provisions for possible future claims, if those claims arise under insurance contracts that are not in existence at the end of the reporting period (such as catastrophe provisions and equalisation provisions).
 - (b) Shall carry out the liability adequacy test described in paragraphs 15–19.
 - (c) Shall remove an insurance liability (or a part of an insurance liability) from its statement of financial position when, and only when, it is extinguished—i.e., when the obligation specified in the contract is discharged or cancelled or expires.
 - (d) Shall not offset:
 - (i) Reinsurance assets against the related insurance liabilities; or
 - (ii) Revenue or expense from reinsurance contracts against the expense or revenue from the related insurance contracts.
 - (e) Shall consider whether its reinsurance assets are impaired (see paragraph 20).

Liability Adequacy Test

15. **An insurer shall assess at the end of each reporting period whether its recognised insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities (less related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32) is inadequate in the light of the estimated future cash flows, the entire deficiency shall be recognised in surplus or deficit.**
16. If an insurer applies a liability adequacy test that meets specified minimum requirements, this Standard imposes no further requirements. The minimum requirements are the following:
 - (a) The test considers current estimates of all contractual cash flows, and of related cash flows such as claims handling costs, as well as cash flows resulting from embedded options and guarantees.
 - (b) If the test shows that the liability is inadequate, the entire deficiency is recognised in surplus or deficit.

17. If an insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16, the insurer shall:
- (a) Determine the carrying amount of the relevant insurance liabilities¹ less the carrying amount of:
 - (i) Any related deferred acquisition costs; and
 - (ii) Any related intangible assets, such as those acquired in a business combination or portfolio transfer (see paragraphs 31 and 32). However, related reinsurance assets are not considered because an insurer accounts for them separately (see paragraph 20).
 - (b) Determine whether the amount described in (a) is less than the carrying amount that would be required if the relevant insurance liabilities were within the scope of PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. If it is less, the insurer shall recognise the entire difference in surplus or deficit and decrease the carrying amount of the related deferred acquisition costs or related intangible assets or increase the carrying amount of the relevant insurance liabilities.
18. If an insurer's liability adequacy test meets the minimum requirements of paragraph 16, the test is applied at the level of aggregation specified in that test. If its liability adequacy test does not meet those minimum requirements, the comparison described in paragraph 17 shall be made at the level of a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio.
19. The amount described in paragraph 17(b) (i.e., the result of applying PBE IPSAS 19) shall reflect future investment margins (see paragraphs 27–29) if, and only if, the amount described in paragraph 17(a) also reflects those margins.

Impairment of Reinsurance Assets

20. If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment loss in surplus or deficit. A reinsurance asset is impaired if, and only if:
- (a) There is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive all amounts due to it under the terms of the contract; and
 - (b) That event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.

Changes in Accounting Policies

21. [Not used.]
22. **An insurer may change its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs.**
- An insurer shall judge relevance and reliability by the criteria in PBE IPSAS 3.**
23. To justify changing its accounting policies for insurance contracts, an insurer shall show that the change brings its financial statements closer to meeting the criteria in PBE IPSAS 3, but the change need not achieve full compliance with those criteria. The following specific issues are discussed below:
- (a) Current interest rates (paragraph 24);
 - (b) Continuation of existing practices (paragraph 25);
 - (c) Prudence (paragraph 26);
 - (d) Future investment margins (paragraphs 27–29); and
 - (e) Shadow accounting (paragraph 30).

¹ The relevant insurance liabilities are those insurance liabilities (and related deferred acquisition costs and related intangible assets) for which the insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16.

Current Market Interest Rates

24. An insurer is permitted, but not required, to change its accounting policies so that it re-measures designated insurance liabilities² to reflect current market interest rates and recognises changes in those liabilities in surplus or deficit. At that time, it may also introduce accounting policies that require other current estimates and assumptions for the designated liabilities. The election in this paragraph permits an insurer to change its accounting policies for designated liabilities, without applying those policies consistently to all similar liabilities as PBE IPSAS 3 would otherwise require. If an insurer designates liabilities for this election, it shall continue to apply current market interest rates (and, if applicable, the other current estimates and assumptions) consistently in all periods to all these liabilities until they are extinguished.

Continuation of Existing Practices

25. An insurer may continue the following practices, but the introduction of any of them does not satisfy paragraph 22:
- (a) Measuring insurance liabilities on an undiscounted basis.
 - (b) Measuring contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services. It is likely that the fair value at inception of those contractual rights equals the origination costs paid, unless future investment management fees and related costs are out of line with market comparables.
 - (c) Using non-uniform accounting policies for the insurance contracts (and related deferred acquisition costs and related intangible assets, if any) of controlled entities, except as permitted by paragraph 24. If those accounting policies are not uniform, an insurer may change them if the change does not make the accounting policies more diverse and also satisfies the other requirements in this Standard.

Prudence

26. An insurer need not change its accounting policies for insurance contracts to eliminate excessive prudence. However, if an insurer already measures its insurance contracts with sufficient prudence, it shall not introduce additional prudence.

Future Investment Margins

27. An insurer need not change its accounting policies for insurance contracts to eliminate future investment margins. However, there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if it introduces an accounting policy that reflects future investment margins in the measurement of insurance contracts, unless those margins affect the contractual payments. Two examples of accounting policies that reflect those margins are:
- (a) Using a discount rate that reflects the estimated return on the insurer's assets; or
 - (b) Projecting the returns on those assets at an estimated rate of return, discounting those projected returns at a different rate and including the result in the measurement of the liability.
28. An insurer may overcome the rebuttable presumption described in paragraph 27 if, and only if, the other components of a change in accounting policies increase the relevance and reliability of its financial statements sufficiently to outweigh the decrease in relevance and reliability caused by the inclusion of future investment margins. For example, suppose that an insurer's existing accounting policies for insurance contracts involve excessively prudent assumptions set at inception and a discount rate prescribed by a regulator without direct reference to market conditions, and ignore some embedded options and guarantees. The insurer might make its financial statements more relevant and no less reliable by switching to a comprehensive investor-oriented basis of accounting that is widely used and involves:
- (a) Current estimates and assumptions;
 - (b) A reasonable (but not excessively prudent) adjustment to reflect risk and uncertainty;

² In this paragraph, insurance liabilities include related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32.

- (c) Measurements that reflect both the intrinsic value and time value of embedded options and guarantees; and
 - (d) A current market discount rate, even if that discount rate reflects the estimated return on the insurer's assets.
29. In some measurement approaches, the discount rate is used to determine the present value of a future profit margin. That profit margin is then attributed to different periods using a formula. In those approaches, the discount rate affects the measurement of the liability only indirectly. In particular, the use of a less appropriate discount rate has a limited or no effect on the measurement of the liability at inception. However, in other approaches, the discount rate determines the measurement of the liability directly. In the latter case, because the introduction of an asset-based discount rate has a more significant effect, it is highly unlikely that an insurer could overcome the rebuttable presumption described in paragraph 27.

Shadow Accounting

30. In some accounting models, realised gains or losses on an insurer's assets have a direct effect on the measurement of some or all of (a) its insurance liabilities, (b) related deferred acquisition costs and (c) related intangible assets, such as those described in paragraphs 31 and 32. An insurer is permitted, but not required, to change its accounting policies so that a recognised but unrealised gain or loss on an asset affects those measurements in the same way that a realised gain or loss does. The related adjustment to the insurance liability (or deferred acquisition costs or intangible assets) shall be recognised in other comprehensive revenue and expense if, and only if, the unrealised gains or losses are recognised in other comprehensive revenue and expense. This practice is sometimes described as 'shadow accounting'.

Insurance Contracts Acquired in a Business Combination or Portfolio Transfer

31. To comply with PBE IFRS 3, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and insurance assets acquired in a business combination. However, an insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:
- (a) A liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and
 - (b) An intangible asset, representing the difference between (i) the fair value of the contractual insurance rights acquired and insurance obligations assumed and (ii) the amount described in (a). The subsequent measurement of this asset shall be consistent with the measurement of the related insurance liability.
32. An insurer acquiring a portfolio of insurance contracts may use the expanded presentation described in paragraph 31.
33. The intangible assets described in paragraphs 31 and 32 are excluded from the scope of PBE IAS 26 *Impairment of Cash-Generating Assets* and PBE IPSAS 31. However, PBE IAS 26 and PBE IPSAS 31 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a business combination or portfolio transfer.

Discretionary Participation Features

Discretionary Participation Features in Insurance Contracts

34. Some insurance contracts contain a discretionary participation feature as well as a guaranteed element. The issuer of such a contract:
- (a) May, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it shall classify the whole contract as a liability. If the issuer classifies them separately, it shall classify the guaranteed element as a liability.
 - (b) Shall, if it recognises the discretionary participation feature separately from the guaranteed element, classify that feature as either a liability or a separate component of net assets/equity. This Standard does not specify how the issuer determines whether that feature is a liability or a component of net assets/equity. The issuer may split that feature into liability and net assets/equity components and

shall use a consistent accounting policy for that split. The issuer shall not classify that feature as an intermediate category that is neither liability nor net assets/equity.

- (c) May recognise all premiums received as revenue without separating any portion that relates to the net assets/equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in surplus or deficit. If part or all of the discretionary participation feature is classified in net assets/equity, a portion of surplus or deficit may be attributable to that feature (in the same way that a portion may be attributable to minority interests). The issuer shall recognise the portion of surplus or deficit attributable to any net assets/equity component of a discretionary participation feature as an allocation of surplus or deficit, not as expense or revenue (see PBE IPSAS 1 *Presentation of Financial Statements*).
- (d) Shall, if the contract contains an embedded derivative within the scope of PBE IPSAS 29, apply PBE IPSAS 29 to that embedded derivative.
- (e) Shall, in all respects not described in paragraphs 14–20 and 34(a)–(d), continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21–30.

Discretionary Participation Features in Financial Instruments

35. The requirements in paragraph 34 also apply to a financial instrument that contains a discretionary participation feature. In addition:
- (a) If the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraphs 15–19 to the whole contract (i.e., both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying PBE IPSAS 29 to the guaranteed element.
 - (b) If the issuer classifies part or all of that feature as a separate component of net assets/equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying PBE IPSAS 29 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph 9 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying PBE IPSAS 29 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher.
 - (c) Although these contracts are financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability.
 - (d) Although these contracts are financial instruments, an issuer applying paragraph 24(b) of PBE IPSAS 30 to contracts with a discretionary participation feature shall disclose the total interest expense recognised in surplus or deficit, but need not calculate such interest expense using the effective interest method.

Disclosure

Explanation of Recognised Amounts

36. **An insurer shall disclose information that identifies and explains the amounts in its financial statements arising from insurance contracts.**
37. To comply with paragraph 36, an insurer shall disclose:
- (a) Its accounting policies for insurance contracts and related assets, liabilities, revenue and expense.
 - (b) The recognised assets, liabilities, revenue and expense (and, if it presents its statement of cash flows using the direct method, cash flows) arising from insurance contracts. Furthermore, if the insurer is a cedant, it shall disclose:
 - (i) Gains and losses recognised in surplus or deficit on buying reinsurance; and

- (ii) If the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period.
- (c) The process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, an insurer shall also give quantified disclosure of those assumptions.
- (d) The effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial statements.
- (e) Reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.

Nature and Extent of Risks Arising from Insurance Contracts

38. **An insurer shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from insurance contracts.**

39. To comply with paragraph 38, an insurer shall disclose:

- (a) Its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks.
- (b) [Not used.]
- (c) Information about insurance risk (both before and after risk mitigation by reinsurance), including information about:
 - (i) Sensitivity to insurance risk (see paragraph 39A).
 - (ii) Concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (e.g., type of insured event, geographical area, or currency).
 - (iii) Actual claims compared with previous estimates (i.e., claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year.
- (d) Information about credit risk, liquidity risk and market risk that paragraphs 38–49 of PBE IPSAS 30 would require if the insurance contracts were within the scope of PBE IPSAS 30³. However:
 - (i) An insurer need not provide the maturity analyses required by paragraph 46(a) and (b) of PBE IPSAS 30 if it discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. This may take the form of an analysis, by estimated timing, of the amounts recognised in the statement of financial position.
 - (ii) If an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirement in paragraph 47(a) of PBE IPSAS 30. Such an insurer shall also provide the disclosures required by paragraph 48 of PBE IPSAS 30.
- (e) Information about exposures to market risk arising from embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.

39A. To comply with paragraph 39(c)(i), an insurer shall disclose either (a) or (b) as follows:

- (a) A sensitivity analysis that shows how surplus or deficit and net assts/equity would have been affected if changes in the relevant risk variable that were reasonably possible at the end of the reporting period had occurred; the methods and assumptions used in preparing the sensitivity

³ A Tier 2 entity shall comply in full with any requirements of PBE IPSAS 30 which are referred to in PBE IFRS 4.

analysis; and any changes from the previous period in the methods and assumptions used. However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 48 of PBE IPSAS 30.

- (b) Qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.

Effective Date and Transition

40–45. [Not used.]

- 45.1 **A public benefit entity shall apply this Standard for annual financial statements covering periods beginning on or after 1 April 2015. Earlier application is permitted for not-for-profit public benefit entities as long as the full suite of PBE Standards is applied at the same time.**

Withdrawal and Replacement of PBE IFRS 4 (May 2013)

- 46. This Standard, when applied, supersedes PBE IFRS 4 *Insurance Contracts* issued in May 2013.

Appendix A

Defined terms

[Not used.]

Appendix B**Definition of an Insurance Contract**

This Appendix is an integral part of the Standard.

- B1. This Appendix gives guidance on the definition of an insurance contract. It addresses the following issues:
- (a) The term ‘uncertain future event’ (paragraphs B2–B4);
 - (b) Payments in kind (paragraphs B5–B7);
 - (c) Insurance risk and other risks (paragraphs B8–B17);
 - (d) Examples of insurance contracts (paragraphs B18–B21);
 - (e) Significant insurance risk (paragraphs B22–B28); and
 - (f) Changes in the level of insurance risk (paragraphs B29 and B30).

Uncertain Future Event

- B2. Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:
- (a) Whether an insured event will occur;
 - (b) When it will occur; or
 - (c) How much the insurer will need to pay if it occurs.
- B3. In some insurance contracts, the insured event is the discovery of a loss during the term of the contract, even if the loss arises from an event that occurred before the inception of the contract. In other insurance contracts, the insured event is an event that occurs during the term of the contract, even if the resulting loss is discovered after the end of the contract term.
- B4. Some insurance contracts cover events that have already occurred, but whose financial effect is still uncertain. An example is a reinsurance contract that covers the direct insurer against adverse development of claims already reported by policyholders. In such contracts, the insured event is the discovery of the ultimate cost of those claims.

Payments in Kind

- B5. Some insurance contracts require or permit payments to be made in kind. An example is when the insurer replaces a stolen article directly, instead of reimbursing the policyholder. Another example is when an insurer uses its own hospitals and medical staff to provide medical services covered by the contracts.
- B6. Some fixed-fee service contracts in which the level of service depends on an uncertain event meet the definition of an insurance contract in this Standard but are not regulated as insurance contracts in some countries. One example is a maintenance contract in which the service provider agrees to repair specified equipment after a malfunction. The fixed service fee is based on the expected number of malfunctions, but it is uncertain whether a particular machine will break down. The malfunction of the equipment adversely affects its owner and the contract compensates the owner (in kind, rather than cash). Another example is a contract for car breakdown services in which the provider agrees, for a fixed annual fee, to provide roadside assistance or tow the car to a nearby garage. The latter contract could meet the definition of an insurance contract even if the provider does not agree to carry out repairs or replace parts.
- B7. Applying the Standard to the contracts described in paragraph B6 is likely to be no more burdensome than applying the PBE Standards that would be applicable if such contracts were outside the scope of this Standard:
- (a) There are unlikely to be material liabilities for malfunctions and breakdowns that have already occurred.
 - (b) If PBE IPSAS 9 *Revenue from Exchange Transactions* applied, the service provider would recognise revenue by reference to the stage of completion (and subject to other specified criteria). That approach is also acceptable under this Standard, which permits the service provider (i) to

continue its existing accounting policies for these contracts unless they involve practices prohibited by paragraph 14 and (ii) to improve its accounting policies if so permitted by paragraphs 22–30.

- (c) The service provider considers whether the cost of meeting its contractual obligation to provide services exceeds the revenue received in advance. To do this, it applies the liability adequacy test described in paragraphs 15–19 of this Standard. If this Standard did not apply to these contracts, the service provider would apply PBE IPSAS 19 to determine whether the contracts are onerous.
- (d) For these contracts, the disclosure requirements in this Standard are unlikely to add significantly to disclosures required by other PBE Standards.

Distinction Between Insurance Risk and Other Risks

- B8. The definition of an insurance contract refers to insurance risk, which this Standard defines as risk, other than financial risk, transferred from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract.
- B9. The definition of financial risk in paragraph 12.1 includes a list of financial and non-financial variables. That list includes non-financial variables that are not specific to a party to the contract, such as an index of earthquake losses in a particular region or an index of temperatures in a particular city. It excludes non-financial variables that are specific to a party to the contract, such as the occurrence or non-occurrence of a fire that damages or destroys an asset of that party. Furthermore, the risk of changes in the fair value of a non-financial asset is not a financial risk if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of a specific non-financial asset held by a party to a contract (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car’s physical condition, that risk is insurance risk, not financial risk.
- B10. Some contracts expose the issuer to financial risk, in addition to significant insurance risk. For example, many life insurance contracts both guarantee a minimum rate of return to policyholders (creating financial risk) and promise death benefits that at some times significantly exceed the policyholder’s account balance (creating insurance risk in the form of mortality risk). Such contracts are insurance contracts.
- B11. Under some contracts, an insured event triggers the payment of an amount linked to a price index. Such contracts are insurance contracts, provided the payment that is contingent on the insured event can be significant. For example, a life-contingent annuity linked to a cost-of-living index transfers insurance risk because payment is triggered by an uncertain event—the survival of the annuitant. The link to the price index is an embedded derivative, but it also transfers insurance risk. If the resulting transfer of insurance risk is significant, the embedded derivative meets the definition of an insurance contract, in which case it need not be separated and measured at fair value (see paragraph 7 of this Standard).
- B12. The definition of insurance risk refers to risk that the insurer accepts from the policyholder. In other words, insurance risk is a pre-existing risk transferred from the policyholder to the insurer. Thus, a new risk created by the contract is not insurance risk.
- B13. The definition of an insurance contract refers to an adverse effect on the policyholder. The definition does not limit the payment by the insurer to an amount equal to the financial impact of the adverse event. For example, the definition does not exclude ‘new-for-old’ coverage that pays the policyholder sufficient to permit replacement of a damaged old asset by a new asset. Similarly, the definition does not limit payment under a term life insurance contract to the financial loss suffered by the deceased’s dependants, nor does it preclude the payment of predetermined amounts to quantify the loss caused by death or an accident.
- B14. Some contracts require a payment if a specified uncertain event occurs, but do not require an adverse effect on the policyholder as a precondition for payment. Such a contract is not an insurance contract even if the holder uses the contract to mitigate an underlying risk exposure. For example, if the holder uses a derivative to hedge an underlying non-financial variable that is correlated with cash flows from an asset of the entity, the derivative is not an insurance contract because payment is not conditional on whether the holder is adversely affected by a reduction in the cash flows from the asset. Conversely, the definition of an insurance contract refers to an uncertain event for which an adverse effect on the policyholder is a contractual precondition for payment. This contractual precondition does not require the insurer to investigate whether the event actually caused an adverse effect, but permits the insurer to deny payment if it is not satisfied that the event caused an adverse effect.

- B15. Lapse or persistency risk (i.e., the risk that the counterparty will cancel the contract earlier or later than the issuer had expected in pricing the contract) is not insurance risk because the payment to the counterparty is not contingent on an uncertain future event that adversely affects the counterparty. Similarly, expense risk (i.e., the risk of unexpected increases in the administrative costs associated with the servicing of a contract, rather than in costs associated with insured events) is not insurance risk because an unexpected increase in expenses does not adversely affect the counterparty.
- B16. Therefore, a contract that exposes the issuer to lapse risk, persistency risk or expense risk is not an insurance contract unless it also exposes the issuer to insurance risk. However, if the issuer of that contract mitigates that risk by using a second contract to transfer part of that risk to another party, the second contract exposes that other party to insurance risk.
- B17. An insurer can accept significant insurance risk from the policyholder only if the insurer is an entity separate from the policyholder. In the case of a mutual insurer, the mutual accepts risk from each policyholder and pools that risk. Although policyholders bear that pooled risk collectively in their capacity as owners, the mutual has still accepted the risk that is the essence of an insurance contract.

Examples of Insurance Contracts

- B18. The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:
- (a) Insurance against theft or damage to property.
 - (b) Insurance against product liability, professional liability, civil liability or legal expenses.
 - (c) Life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance).
 - (d) Life-contingent annuities and pensions (i.e., contracts that provide compensation for the uncertain future event—the survival of the annuitant or pensioner—to assist the annuitant or pensioner in maintaining a given standard of living, which would otherwise be adversely affected by his or her survival).
 - (e) Disability and medical cover.
 - (f) Surety bonds, fidelity bonds, performance bonds and bid bonds (i.e., contracts that provide compensation if another party fails to perform a contractual obligation, for example an obligation to construct a building).
 - (g) Credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a guarantee, some types of letter of credit, a credit derivative default contract or an insurance contract. However, although these contracts meet the definition of an insurance contract, they also meet the definition of a financial guarantee contract in PBE IPSAS 29 and are within the scope of PBE IPSAS 28 and PBE IPSAS 29, not this Standard (see paragraph 4(d)). Nevertheless, an issuer of financial guarantee contracts may have elected, in accordance with PBE IPSAS 28, to use accounting applicable to insurance contracts for such financial guarantee contracts.
 - (h) Product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are within the scope of this Standard. However, product warranties issued directly by a manufacturer, dealer or retailer are outside its scope, because they are within the scope of PBE IPSAS 9 and PBE IPSAS 19.
 - (i) Title insurance (i.e., insurance against the discovery of defects in title to land that were not apparent when the insurance contract was written). In this case, the insured event is the discovery of a defect in the title, not the defect itself.
 - (j) Travel assistance (i.e., compensation in cash or in kind to policyholders for losses suffered while they are travelling). Paragraphs B6 and B7 discuss some contracts of this kind.

- (k) Catastrophe bonds that provide for reduced payments of principal, interest or both if a specified event adversely affects the issuer of the bond (unless the specified event does not create significant insurance risk, for example if the event is a change in an interest rate or foreign exchange rate).
- (l) Insurance swaps and other contracts that require a payment based on changes in climatic, geological or other physical variables that are specific to a party to the contract.
- (m) Reinsurance contracts.

B19. The following are examples of items that are not insurance contracts:

- (a) Investment contracts that have the legal form of an insurance contract but do not expose the insurer to significant insurance risk, for example life insurance contracts in which the insurer bears no significant mortality risk (such contracts are non-insurance financial instruments or service contracts, see paragraphs B20 and B21).
- (b) Contracts that have the legal form of insurance, but pass all significant insurance risk back to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder as a direct result of insured losses, for example some financial reinsurance contracts or some group contracts (such contracts are normally non-insurance financial instruments or service contracts, see paragraphs B20 and B21).
- (c) Self-insurance, in other words retaining a risk that could have been covered by insurance (there is no insurance contract because there is no agreement with another party).
- (d) Contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but do not require, as a contractual precondition for payment, that the event adversely affects the policyholder. However, this does not preclude the specification of a predetermined payout to quantify the loss caused by a specified event such as death or an accident (see also paragraph B13).
- (e) Derivatives that expose one party to financial risk but not insurance risk, because they require that party to make payment based solely on changes in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (see PBE IPSAS 29).
- (f) A credit-related guarantee (or letter of credit, credit derivative default contract or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see PBE IPSAS 29).
- (g) Contracts that require a payment based on a climatic, geological or other physical variable that is not specific to a party to the contract (commonly described as weather derivatives).
- (h) Catastrophe bonds that provide for reduced payments of principal, interest or both, based on a climatic, geological or other physical variable that is not specific to a party to the contract.

B20. If the contracts described in paragraph B19 create financial assets or financial liabilities, they are within the scope of PBE IPSAS 29. Among other things, this means that the parties to the contract use what is sometimes called deposit accounting, which involves the following:

- (a) One party recognises the consideration received as a financial liability, rather than as revenue.
- (b) The other party recognises the consideration paid as a financial asset, rather than as an expense.

B21. If the contracts described in paragraph B19 do not create financial assets or financial liabilities, PBE IPSAS 9 applies. Under PBE IPSAS 9, revenue associated with a transaction involving the rendering of services is recognised by reference to the stage of completion of the transaction if the outcome of the transaction can be estimated reliably.

Significant Insurance Risk

B22. A contract is an insurance contract only if it transfers significant insurance risk. Paragraphs B8–B21 discuss insurance risk. The following paragraphs discuss the assessment of whether insurance risk is significant.

- B23. Insurance risk is significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e., have no discernible effect on the economics of the transaction). If significant additional benefits would be payable in scenarios that have commercial substance, the condition in the previous sentence may be met even if the insured event is extremely unlikely or even if the expected (i.e., probability-weighted) present value of contingent cash flows is a small proportion of the expected present value of all the remaining contractual cash flows.
- B24. The additional benefits described in paragraph B23 refer to amounts that exceed those that would be payable if no insured event occurred (excluding scenarios that lack commercial substance). Those additional amounts include claims handling and claims assessment costs, but exclude:
- (a) The loss of the ability to charge the policyholder for future services. For example, in an investment-linked life insurance contract, the death of the policyholder means that the insurer can no longer perform investment management services and collect a fee for doing so. However, this economic loss for the insurer does not reflect insurance risk, just as a mutual fund manager does not take on insurance risk in relation to the possible death of the client. Therefore, the potential loss of future investment management fees is not relevant in assessing how much insurance risk is transferred by a contract.
 - (b) Waiver on death of charges that would be made on cancellation or surrender. Because the contract brought those charges into existence, the waiver of these charges does not compensate the policyholder for a pre-existing risk. Hence, they are not relevant in assessing how much insurance risk is transferred by a contract.
 - (c) A payment conditional on an event that does not cause a significant loss to the holder of the contract. For example, consider a contract that requires the issuer to pay one million currency units if an asset suffers physical damage causing an insignificant economic loss of one currency unit to the holder. In this contract, the holder transfers to the insurer the insignificant risk of losing one currency unit. At the same time, the contract creates non-insurance risk that the issuer will need to pay 999,999 currency units if the specified event occurs. Because the issuer does not accept significant insurance risk from the holder, this contract is not an insurance contract.
 - (d) Possible reinsurance recoveries. The insurer accounts for these separately.
- B25. An insurer shall assess the significance of insurance risk contract by contract, rather than by reference to materiality to the financial statements.⁴ Thus, insurance risk may be significant even if there is a minimal probability of material losses for a whole book of contracts. This contract-by-contract assessment makes it easier to classify a contract as an insurance contract. However, if a relatively homogeneous book of small contracts is known to consist of contracts that all transfer insurance risk, an insurer need not examine each contract within that book to identify a few non-derivative contracts that transfer insignificant insurance risk.
- B26. It follows from paragraphs B23–B25 that if a contract pays a death benefit exceeding the amount payable on survival, the contract is an insurance contract unless the additional death benefit is insignificant (judged by reference to the contract rather than to an entire book of contracts). As noted in paragraph B24(b), the waiver on death of cancellation or surrender charges is not included in this assessment if this waiver does not compensate the policyholder for a pre-existing risk. Similarly, an annuity contract that pays out regular sums for the rest of a policyholder’s life is an insurance contract, unless the aggregate life-contingent payments are insignificant.
- B27. Paragraph B23 refers to additional benefits. These additional benefits could include a requirement to pay benefits earlier if the insured event occurs earlier and the payment is not adjusted for the time value of money. An example is whole life insurance for a fixed amount (in other words, insurance that provides a fixed death benefit whenever the policyholder dies, with no expiry date for the cover). It is certain that the policyholder will die, but the date of death is uncertain. The insurer will suffer a loss on those individual contracts for which policyholders die early, even if there is no overall loss on the whole book of contracts.

⁴ For this purpose, contracts entered into simultaneously with a single counterparty (or contracts that are otherwise interdependent) form a single contract.

- B28. If an insurance contract is unbundled into a deposit component and an insurance component, the significance of insurance risk transfer is assessed by reference to the insurance component. The significance of insurance risk transferred by an embedded derivative is assessed by reference to the embedded derivative.

Changes in the Level of Insurance Risk

- B29. Some contracts do not transfer any insurance risk to the issuer at inception, although they do transfer insurance risk at a later time. For example, consider a contract that provides a specified investment return and includes an option for the policyholder to use the proceeds of the investment on maturity to buy a life-contingent annuity at the current annuity rates charged by the insurer to other new annuitants when the policyholder exercises the option. The contract transfers no insurance risk to the issuer until the option is exercised, because the insurer remains free to price the annuity on a basis that reflects the insurance risk transferred to the insurer at that time. However, if the contract specifies the annuity rates (or a basis for setting the annuity rates), the contract transfers insurance risk to the issuer at inception.
- B30. A contract that qualifies as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire.

Appendix C**Life Insurance Entities**

This Appendix is an integral part of the Standard.

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Application

C1.1 **This Appendix applies to the general purpose financial statements of:**

- (a) **Each life insurer that issues insurance contracts, or financial instruments with a discretionary participation feature; and**
- (b) **Each economic entity which includes a life insurer that issues insurance contracts or financial instruments with a discretionary participation feature.**

C1.1.1 This Appendix applies to the consolidated financial statements of an economic entity in relation to a life insurer controlled entity. Paragraph C4.2 is of particular relevance in these cases. This Appendix does not apply to reporting by an economic entity for its activities other than its life insurance business. In measuring and reporting business other than life insurance business as well as aspects of life insurance business where this Appendix contains no requirements, an economic entity that includes a life insurer should follow appropriate financial reporting standards.

C1.2–C1.4.1 [Not used.]

C1.4.2 For the purposes of PBE IAS 34 *Interim Financial Reporting* the determination of policy liabilities does not necessarily require a full actuarial valuation. In accordance with PBE IAS 34, policy liabilities would need to be determined on a reliable basis, would be based on reasonable estimates, would include a full review of assumptions, and would not be materially different from policy liabilities determined by a full actuarial valuation.

C1.5–C1.7 [Not used.]

Scope

Life Insurance Contracts

C2.1 **This Appendix applies to the general purpose financial statements of:**

- (a) **Each life insurer; and**
- (b) **Each economic entity which includes a life insurer.**

C2.1.1 An insurance contract is:

- (a) An insurance contract as defined by this Appendix, issued by a life insurer; or
- (b) A financial instrument with a discretionary participation feature, which is issued by a life insurer.

C2.1.2 All other insurance contracts are general insurance contracts and are accounted for under PBE IFRS 4 Appendix D *Financial Reporting of Insurance Activities* or PBE IFRS 4 *Insurance Contracts*.

C2.1.3 A life insurer is defined as an entity operating under the Insurance (Prudential Supervision) Act 2010 and similar entities operating outside New Zealand.

C2.1.4 [Not used.]

C2.1.5 Life insurers often sell contracts that do not meet the definition of an insurance contract in this Appendix. These contracts are referred to as investment contracts for the purposes of this Appendix. Section 12 addresses the requirements in relation to investment contracts.

C2.1.6 A financial instrument with a discretionary participation feature, issued by a life insurer, is defined as a life insurance contract for the purposes of this Appendix and, in measuring the insurance liability, issuers of such instruments would apply paragraph C8.9. PBE IPSAS 30 *Financial Instruments: Disclosures* addresses additional disclosure in relation to these financial instruments.

Embedded Derivatives

C2.2.1 PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in surplus or deficit. PBE IPSAS 29 applies to derivatives embedded in a life insurance contract unless the embedded derivative is itself a life insurance contract.

C2.2.2 As an exception to the requirement in PBE IPSAS 29, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount

based on a fixed amount and an interest rate) even if the exercise price differs from the carrying amount of the host insurance liability. However, the requirement in PBE IPSAS 29 applies to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).

C2.2.3 Paragraph 2.2.2 applies equally to options to surrender a financial instrument containing a discretionary participation feature.

Deposit Components

C2.3.1 Some life insurance contracts contain both an insurance component and a deposit component. In some cases, an insurer is permitted to unbundle those components.

C2.3.2 Unbundling is permitted if the insurer can measure the deposit component separately.

C2.3.3 If a life insurer cannot measure the deposit component separately, an insurer shall not unbundle the deposit component.

C2.3.4 To unbundle a life insurance contract, a life insurer:

- (a) Treats the insurance component as an insurance contract in accordance with this Appendix;
- (b) Subject to (c), treats the deposit component as an investment contract in accordance with this Appendix; and
- (c) Where the deposit component includes a discretionary participation feature, treats this component as a separate insurance contract in accordance with this Appendix.

Purpose of Appendix

C3.1 **The purpose of this Appendix is to:**

- (a) **Prescribe the methods to be used for reporting by life insurers; and**
- (b) **Require disclosures by life insurers in the financial statements.**

Entity and Consolidation Issues

The Life Insurer Entity

C4.1 **A life insurer shall recognise in its financial statement the assets, liabilities, revenue, expenses and net assets/equity of the entity, whether they are designated as relating to policyholders or to shareholders.**

C4.1.1 Life insurers may have both policyholders and shareholders with a financial interest in the entity. It is sometimes argued that the interests of policyholders and the interests of shareholders form the bases of separate entities that should prepare separate primary financial statements. However, the view adopted in this Appendix is that the interests of policyholders and shareholders are intertwined and form the basis of a single entity. The boundaries of this entity are defined by control. The directors of the life insurer, in pursuing its objectives, govern the decision-making in relation to the financial and operating policies of the life insurer, which includes the assets of the entity, whether they are designated as relating to policyholders or to shareholders.

C4.1.2 Equity in a shareholder-owned life insurer will generally comprise only shareholder equity. Although participants in the industry commonly refer to "policyholder retained profits", such amounts are unvested policyholder benefits liabilities. A life insurer will only have policyholder equity if that life insurer has foreign life insurance operations in a jurisdiction that permits accumulated comprehensive revenue and expense to remain unallocated between policyholders and shareholders, and the policyholders' component has yet to be determined.

Financial Statements of Economic Entities that Include a Life Insurer Controlled Entity

C4.2 **The consolidated financial statement of an economic entity that includes a life insurer controlled entity shall recognise all of the assets, liabilities, revenue and expenses of that controlled entity,**

whether they are designated as relating to the policyholders or to the shareholders of that life insurer. The insurance contracts, investment contracts, assets and other financial liabilities of a life insurer controlled entity and its economic entity recognised in the consolidated financial statement of an economic entity shall be measured in accordance with this Appendix.

- C4.2.1 For the same reasons that a life insurer entity is considered to comprise both policyholder and shareholder interests, the view adopted in this Appendix is that the controlling entity controls the interests of both policyholders and shareholders and, accordingly, the consolidated financial statements of the economic entity include all of those interests. The controlling entity of a life insurer effectively uses all of the resources of shareholders and policyholders in achieving its objectives and effectively controls policyholder interests for the benefit of both policyholders and shareholders.
- C4.2.2 Some life insurers are controlled by entities other than life insurers, such as banks, and some are controlled by other life insurers. The character of the controlling entity of a life insurer has no bearing on whether consolidated financial statements, prepared in accordance with paragraph C4.2, are required.

Premiums and Claims

- C5.1 **Subject to paragraph C5.2, insurance components of insurance contract premiums are revenue and insurance components of insurance contract claims are expenses and shall be recognised separately in surplus or deficit. Deposit components of insurance contract premiums are not revenue and deposit components of insurance contract claims are not expenses and shall be recognised as changes in insurance liabilities.**
- C5.2 **For insurance contracts where unbundling of the deposit component is prohibited under paragraph C2.3.3, premiums shall be recognised as revenue and claims shall be recognised as expenses.**
- C5.2.1 A wide variety of products are offered by life insurers – risk or insurance products, investment products and numerous hybrids of these two products. There will be hybrid products that fall within the scope of this Appendix that have both deposit and insurance components.
- C5.2.2 Premiums may comprise amounts that:
- (a) Give rise to revenue that is earned by providing services, including the bearing of risks; and
 - (b) Are akin to deposits and which qualify for recognition as liabilities.
- C5.2.3 Similarly, claims may comprise amounts that:
- (a) Give rise to expenses that are incurred in providing services, including the bearing of risks; and
 - (b) Are akin to withdrawals from deposits and which qualify for recognition as reductions in liabilities.
- C5.2.4 The performance of a life insurer is best reflected when only revenue and expenses are recognised in surplus or deficit. The inclusion of other types of cash flows limits the ability of users to assess the performance of a life insurer's operations relative to other entities or investments.

Reinsurance

Reporting by Cedants

- C6.1 **A cedant shall recognise:**
- (a) **Premiums ceded to reinsurers as reinsurance expenses;**
 - (b) **Claim recoveries and commissions from reinsurers as revenue; and**
 - (c) **Claim recoveries and other inflows not yet received from a reinsurer as an asset.**
- C6.1.1 Life insurers may reinsure some of their business. The cedant remains responsible for the total amount of successful claims of policyholders and, through reinsurance arrangements, may be entitled to recover amounts relating to some of those claims.
- C6.1.2 Reinsurance contracts are considered to be separate transactions from the original life insurance contracts and therefore give rise to separately recognisable amounts. The cedant recognises the gross amount of premiums received in accordance with paragraphs C5.1 and C5.2 and, where portions of the policies are

reinsured, the ceded premiums are recognised as expenses (except where they would otherwise be recognised as deposits, if not reinsured). Any recoveries from reinsurers are recognised as revenue by the cedant (except for any amounts representing the return of deposits). Consistent with this approach, the gross amount of life insurance liabilities is recognised as a liability and claim recoveries not yet received from a reinsurer are recognised as a receivable by the cedant.

Reporting by Reinsurers

C6.2 Inwards reinsurance premiums and outwards reinsurance claims shall be recognised by the accepting reinsurer as for premiums and claims in accordance with paragraphs C5.1 and C5.2. Life insurance liabilities assumed shall be recognised as a liability by the accepting reinsurer in accordance with section 8.

C6.2.1 From the perspective of the reinsurer, reinsurance premiums accepted are recognised in the same way as the cedant treats the acceptance of premiums under a direct insurance contract. Correspondingly, claims paid and payable to direct insurers are recognised as expenses by the reinsurer. Consistent with these treatments, life insurance liabilities assumed are recognised as a liability by the accepting reinsurer.

Impairment of Reinsurance Assets

C7.1.1 If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment in surplus or deficit. A reinsurance asset is impaired if, and only if:

- (a) There is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive amounts due to it under the terms of the contract; and
- (b) That event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.

Life Insurance Liabilities

Present Value and Best Estimates

C8.1 Obligations arising from life insurance contracts (life insurance liabilities) shall be recognised as liabilities and shall be measured at the end of each reporting period as:

- (a) **The net present value of future receipts from and payments to policyholders, including participating benefits, allowing for the possibility of discontinuance before the end of insurance contract periods, plus planned margins of revenues over expenses relating to services yet to be provided to policyholders, on the basis of assumptions that are best estimates and using a discount rate determined in accordance with paragraphs C8.7 or C8.8; or**
- (b) **The accumulated benefits to policyholders after allowing for the portion of acquisition costs expected to be recouped where the result would not be materially different from the application of paragraph C8.1(a).**

C8.1.1 The participating benefits component of life insurance liabilities includes previously vested benefits and future supportable bonuses. In addition to life insurance liabilities, there may be other liabilities that relate to participating policyholders. Insurance contract benefits attributable to participating policyholders that are not yet vested with specific policyholders are recognised as liabilities. These are further discussed in section 9.

C8.1.2 Premiums are generally received in advance of the provision of services to policyholders, including the payment of claims. In return for premiums, life insurers provide services sometimes over long periods. Entering into a life insurance contract is considered to be the event that gives rise to future benefits and present obligations under a policy.

C8.1.3 Where there are a number of variables relating to future uncertainties, a net present value approach to measuring life insurance liabilities is likely to provide the most appropriate measurement basis. The obligations under these more complex contracts are generally measured as the present value of the expected inflows, such as premiums and fees, and outflows, such as claims and other expenses, based on assumptions relating to whole populations of policyholders, and taking into account applicable taxation.

- C8.1.4 An accumulation approach involves accruing the entitlements in policyholders' records at the end of the reporting period. If the fees expected to be charged by the life insurer to the policyholder in each future reporting period are expected to equal or exceed any expenses incurred by the life insurer, the life insurance liability calculated under the accumulation approach would not be materially different from that obtained using the approach in paragraph C8.1(a).
- C8.1.5 The ultimate cost of meeting claims under many life insurance contracts depends on the frequency of occurrence of particular future events such as death and surrender, and in some cases may depend upon other factors such as the future levels of investment returns. Assumptions need to be made about these future events. In order to ensure that life insurance liabilities are measured reliably, such assumptions need to be "best estimates".
- C8.1.6 Best estimate assumptions used in determining the present value of life insurance liabilities, such as the best estimate of the bonus rate, are made on the basis of the assets available to the life insurer at the end of the reporting period and do not include any allowance for future contributions by owners and other funds which may be provided in the future to support the business.

Acquisition Costs

- C8.1.7 Life insurance contracts written in one reporting period often give rise to benefits to the life insurer in subsequent reporting periods, such as future management fees and surrender penalties. Therefore, there are future benefits associated with the costs of acquiring life insurance contracts, and such costs are often substantial.
- C8.1.8 In the life insurance industry, acquisition costs are usually recognised as expenses in the reporting period in which they are incurred. This is generally offset by identifying a portion of the planned margins included in life insurance liabilities as relating to the recovery of acquisition costs. The most useful and reliable information available about the acquisition costs that will give rise to future economic benefits is the amount of future charges for acquisition costs identified as part of the process of determining life insurance liabilities.

Recognition of Planned Margins as Revenues

- C8.2 **Planned margins of revenues over expenses for life insurance contracts shall be recognised in surplus or deficit over the reporting periods during which the services to which those margins relate are provided to policyholders, and the revenues relating to those services are received.**
- C8.2.1 In setting premium rates, life insurers will include planned margins of revenues over expenses. As noted in paragraph C8.1.2, premiums are generally received in advance of the provision of services to policyholders.
- C8.2.2 In this Appendix, planned margins are recognised in surplus or deficit when, and only when, the life insurer has performed the services necessary to establish a valid claim to those margins and has received the revenues relating to those services. To ensure that planned margins are recognised during the reporting period in which the relevant services are provided, life insurance liabilities include a component relating to those margins. These margins are then "released" based on one or more factors or "profit carriers" which correspond to the performance of services and the earning of the margins. In relation to many products, the profit carrier might be premiums or claims.

Differences Between Actual and Assumed Experience

- C8.3 **Except in relation to investment earnings rate assumptions for participating business, the effect of changes in life insurance liabilities resulting from a difference between actual and assumed experience determined during the reporting period shall be recognised in surplus or deficit as revenue or expenses in the reporting period in which the changes occur.**
- C8.3.1 The assumed patterns and frequencies of events used in determining life insurance liabilities are compared with actual events in each reporting period to assess their accuracy. The effects of differences between actual and assumed experience represent decreases or increases in the expected payments to policyholders and are revenue or expenses of the reporting period in which the differences occur. For example, where the assumed costs of death claims under a renewable term life product line are greater than the actual costs for a reporting period, revenue equal to the difference is recognised in surplus or deficit for the current reporting period.

- C8.3.2 The recognition of the net amount of changes in life insurance liabilities resulting from a difference between actual and assumed experience identified during the reporting period as revenue or an expense is consistent with the use of assumptions that are best estimates as at the end of each reporting period.

Changes to Underlying Assumptions

- C8.4 Assumptions used for measuring life insurance liabilities shall be reviewed for each reporting period. Where the review leads to changes in assumptions, with the exception of new business, the changes shall be deemed to occur at the end of the reporting period.**

C8.4.1 Assumptions used for measuring new business may be deemed to have occurred at the beginning of the reporting period, or at the date of commencement of the new business or at the end of the reporting period.

C8.4.2 In preparing interim financial statements, the end of the reporting period is the interim reporting period. Accordingly, changes in assumptions are deemed to occur at the end of the interim reporting period.

- C8.5 The financial effects of changes to the assumptions underlying the measurement of life insurance liabilities made during the reporting period shall be recognised in surplus or deficit over the future reporting periods during which services are provided to policyholders, except that:**

- (a) **Any estimated excess of the present value of future expenses over the present value of future revenues for a group of related products arising during the reporting period shall be recognised as an expense of the reporting period;**
- (b) **The reversal of an expense previously recognised in accordance with paragraph C8.5(a) shall be recognised as revenue of the reporting period in which the reversal of the loss is recognised;**
- (c) **The effects of a change to adopted discount rates and related economic assumptions caused by changes in investment market and general economic conditions shall be recognised as revenue or expense of the reporting period in which the change occurs; and**
- (d) **Material calculation errors and similar errors shall be treated under PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.**

C8.5.1 The assumptions underlying the measurement of life insurance liabilities are reviewed at the end of each reporting period. Based on past experience and revised expectations about the future, it may become apparent that particular assumptions are not consistent with likely future experience and need to be changed. Such changes are effectively a reassessment of the likely patterns and frequencies of future events. The normal revision of assumptions is not considered to be an error.

C8.5.2 Apart from the circumstances identified in paragraph C8.5, changes to underlying assumptions are effectively recognised over future reporting periods by adjusting the planned margins included in life insurance liabilities. If the effect of a changed assumption is a decrease in the present value of present obligations to policyholders, the planned margin is increased. If the effect is an increase in the present value of obligations to policyholders, the planned margin is reduced. The overall amount of life insurance liabilities is not affected by these changes to underlying assumptions, as long as the planned margin of revenues over expenses is not eliminated.

C8.5.3 Material calculation errors and similar errors are treated in accordance with PBE IPSAS 3. Under PBE IPSAS 3, except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error, an entity corrects material prior period errors retrospectively in the first financial statement authorised for issue after their discovery by:

- (a) Restating the comparative amounts for the prior period(s) presented in which the error occurred; or
- (b) If the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and net assets/equity for the earliest prior period presented.

Changes to Discount Rates and Related Economic Assumptions

C8.5.4 As with other assumptions, the discount rates and related economic assumptions used in determining life insurance liabilities are reviewed at the end of each reporting period. The effects of a change to adopted

discount rates and related economic assumptions caused by changes in investment market and economic conditions are recognised in the reporting period in which the change is made. For a life insurer with a typical spread of investments, if market yields fall, investment values generally rise and the resulting increases in investment values are recognised as revenue in the reporting period in which they occur. Where the discount rates are adjusted in line with such falls in market rates, life insurance liabilities for such contracts will increase and an expense will be recognised, having an offsetting (but not usually matching) effect on the increased investment values.

- C8.5.5 In relation to participating business (which is discussed in section 9), the effect of a change to the assumptions about discount rates, explained in paragraph C8.5.4, is a result of adjusting the best estimate of life insurance liabilities, including future participating benefits. For example, if market rates of return rise, investment values generally fall and the resulting decreases in investment values are recognised as an expense in the reporting period in which they occur. The fall in investment values will clearly impact on the ability of the life insurer to support future participating benefits. These are likely to be reduced, with an offsetting effect on the reduced investment values.

Liability Adequacy Test

C8.6 Life insurers shall perform a liability adequacy test.

- C8.6.1 Situations may arise where the present value of the planned margin of revenues over expenses for a group of related products will be adjusted as a result of changing underlying assumptions to the extent that the planned margin is eliminated and becomes a planned loss. That is, a review of expected future cash flows indicates that the present value of estimated future expenses for a group of related products exceeds the present value of estimated future revenues. In such circumstances, the excess of the present value of expenses over revenues arising during the reporting period is recognised in surplus or deficit in the reporting period in which the assessment is made. The loss reflects a higher present obligation due to adverse future experience, which is now expected in future years. While the future cash flows giving rise to the loss are yet to occur, this treatment is justified on the basis that entering into life insurance contracts is an event that gives rise to a present obligation to meet the expected future claims.
- C8.6.2 A group of related products, for the purpose of calculating the planned margin, performing the liability adequacy test and for disclosure, would be products that have substantially the same contractual terms and are priced on the basis of substantially the same assumptions.
- C8.6.3 In reviewing expected future cash flows, the insurer takes into account both future cash flows under insurance contracts it has issued and the related reinsurance contracts.
- C8.6.4 Where an intangible asset has arisen under paragraph C13.1.1(b), a loss arises when the present value of planned margins of revenues over expenses is less than the related intangible asset. This test is to be performed for groups of related products and the intangible asset is allocated, on a reasonable basis, across these groups. Any loss is recognised as an expense in surplus or deficit. In recognising the loss in surplus or deficit, the life insurer first writes down the related intangible asset and then reflects any additional liability in the life insurance liabilities.

Discount Rates

- C8.7 **To the extent that the benefits under life insurance contracts are not contractually linked to the performance of the assets held, the life insurance liabilities shall be discounted for the time value of money using risk-free discount rates based on current observable, objective rates that relate to the nature, structure and term of the future obligations.**
- C8.8 **To the extent that the benefits under a life insurance contract are contractually linked to the performance of the assets held, the life insurance liabilities shall be discounted using discount rates based on the market returns on assets backing life insurance liabilities.**
- C8.8.1 In applying paragraph C8.7, the discount rates adopted are not intended to reflect risks inherent in the liability cash flows, which might be allowed for by a reduction in the discount rate in a fair value measurement, nor are they intended to reflect the insurance and other non-financial risks and uncertainties reflected in the life insurance liabilities. The discount rates are not intended to include allowance for the cost of any options or guarantees that are separately measured as part of the life insurance liabilities.

- C8.8.2 In applying paragraph C8.7, typically, government bond rates may be appropriate discount rates for the purposes of this Appendix, or they may be an appropriate starting point in determining such discount rates.

Financial Instruments with Discretionary Participation Features

- C8.9 **Financial instruments with discretionary participation features are life insurance contracts for the purposes of this Appendix and shall be treated in accordance with paragraphs C8.1 to C8.8 and section 9.**

Participating Benefits

- C9.1 **Except for transfers from unvested policyholder benefits liabilities, participating benefits vested in policyholders in relation to the reporting period shall be recognised in surplus or deficit as expenses for the reporting period. Such benefits which remain payable as at the end of the reporting period shall be recognised as a component of life insurance liabilities.**
- C9.2 **Participating benefits that have been allocated in relation to the reporting period to participating policyholders generally, but that have not yet vested in specific policyholders, shall be recognised as expenses for the reporting period. Amounts that have been allocated to participating policyholders generally, but that have not vested in specific policyholders as at the end of the reporting period, shall be recognised as unvested policyholder benefits liabilities.**
- C9.2.1 Some life insurers sell participating business. Participating policyholders are generally eligible to receive the same types of benefits as other policyholders and, in addition, are entitled to participate in the surpluses relating to participating business. For example, a participating policyholder may receive a low contractually determined rate of return on savings together with term life cover and, in addition, receive benefits that depend on the investment performance of the pool of assets associated with participating policies and on the risk experience of participating policyholders. These additional benefits are often called bonuses and are at the discretion of the life insurer. In some reporting periods the life insurer may withhold a portion of the “profits” from the pool of participating business and recognise these “profits” as unvested policyholder benefits liabilities. In other reporting periods the life insurer may “top up” the vested benefits to participating policyholders. Such vesting of benefits is often done to provide a reasonably level vesting of benefits over time, despite volatility in periodic surpluses from participating business.
- C9.2.2 It is sometimes argued that the discretionary nature of participating benefits means that they should be treated as appropriations of surpluses in the same way as dividends to shareholders. Because life insurance liabilities relating to all types of policyholders are recognised as liabilities, it is appropriate for the participating benefits vested in relation to the reporting period, other than transfers from unvested policyholder benefits liabilities, to be recognised as expenses of the reporting period.
- C9.2.3 Mutual life insurers are effectively owned by their policyholder members. Nevertheless, the mutual life insurer also has obligations to its policyholders. These obligations are classified as policy liabilities. Benefits vested in a mutual life insurer’s policyholders, other than transfers from unvested policyholder benefits liabilities, are also to be recognised as expenses in the reporting period in which they are vested.
- C9.2.4 For financial reporting purposes, participating benefits vested in policyholders in a reporting period but not yet paid are included in life insurance liabilities and are measured at net present values. In the case of investment account participating business this may be approximately the same as the amount actually allocated to policyholder accounts. In the case of traditional participating business, there may be a significant difference between the net present value and the face value of the amount vested in policyholders. The net present value is relevant for financial reporting purposes because it is the best estimate of the net present value of the amount that the life insurer expects to pay out in the future using information based on experience up to the end of the reporting period.
- C9.2.5 Where a life insurer “tops up” the vested benefits from previously recognised unvested policyholder benefits liabilities, a transfer between liabilities is recognised. If a life insurer tops up the vested benefits for participating policyholders other than from unvested policyholder benefits liabilities, the amount of the “top up” is recognised as an expense of the reporting period in which the additional benefits are vested.

Assets Backing Life Insurance Liabilities or Life Investment Contract Liabilities

Fair Value Approach

C10.1.1 Paragraphs C10.2 to C10.7.3 address the measurement of certain assets backing life insurance liabilities or life investment contract liabilities. The fair value approach to the measurement of assets backing life insurance liabilities or life investment contract liabilities is consistent with the present value measurement approach for life insurance liabilities required by this Appendix and the fair value measurement approach for life investment contract liabilities required by this Appendix. Where assets are not backing life insurance liabilities or life investment contract liabilities, life insurers apply the applicable PBE Standards, making use of any measurement choices available.

Measurement

C10.2 Financial assets that:

- (a) **Are within the scope of PBE IPSAS 29;**
- (b) **Back life insurance liabilities or life investment contract liabilities; and**
- (c) **Are permitted to be designated as “at fair value through surplus or deficit” under PBE IPSAS 29;**

shall be designated as “at fair value through surplus or deficit” under PBE IPSAS 29 on initial recognition.

C10.2.1 An insurer applies PBE IPSAS 29 to its financial assets. Under PBE IPSAS 29 a financial asset at fair value through surplus or deficit is a financial asset that meets either of the following conditions:

- (a) It is classified as held for trading, or
- (b) It is designated as “at fair value through surplus or deficit” upon initial recognition. An entity may use this designation when the financial asset is a contract with an embedded derivative and paragraph 13 of PBE IPSAS 29 allows the entity to measure the contract as “at fair value through surplus or deficit”; or when doing so results in more relevant information, because either:
 - (i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an “accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
 - (ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity’s key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example, the entity’s governing board and chief executive officer.

C10.2.2 The view adopted in this Appendix is that, in all but rare cases, financial assets within the scope of PBE IPSAS 29 that back life insurance liabilities or life investment contract liabilities are permitted to be measured at fair value through surplus or deficit under PBE IPSAS 29. This is because the measurement of life insurance liabilities under this Appendix incorporates current information and measuring the financial assets backing these life insurance liabilities at fair value eliminates or significantly reduces a potential measurement inconsistency which would arise if the assets were classified as available for sale or measured at amortised cost. In addition, under PBE IPSAS 29, a group of financial assets may be designated as at fair value through surplus or deficit where it is both managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy. In the vast majority of cases, financial assets backing life investment contract liabilities and financial assets backing life insurance liabilities would be managed and their performance would be evaluated on a fair value basis, in accordance with a documented risk management or investment strategy.

C10.3 Investment property that is within the scope of PBE IPSAS 16 *Investment Property* and that backs life insurance liabilities or life investment contract liabilities, shall be measured at fair value under PBE IPSAS 16.

C10.4 Property, plant and equipment that is within the scope of PBE IPSAS 17 *Property, Plant and Equipment* and that backs life insurance liabilities or life investment contract liabilities shall be measured using the revaluation model under PBE IPSAS 17.

C10.4.1–C10.4.2 [Not used.]

C10.5 Investments in associates that:

- (a) **Are defined by PBE IPSAS 7 *Investments in Associates*;**
- (b) **Back either life insurance liabilities or life investment contract liabilities;**
- (c) **Are held by mutual funds, unit trusts and similar entities including investment-linked insurance funds; and**
- (d) **Are permitted to be designated as at “fair value through surplus or deficit” under PBE IPSAS 29;**

shall be designated as “at fair value through surplus or deficit” under PBE IPSAS 29 on initial recognition.

C10.5.1 An insurer applies PBE IPSAS 7 to its investments in associates. PBE IPSAS 7 requires investments in associates to be accounted for using the equity method but it does not apply to investments in associates held by mutual funds, unit trusts and similar entities including investment-linked insurance funds that are treated under PBE IPSAS 29 and designated as “at fair value through surplus or deficit”.

C10.5.1A Where an associate is not accounted for using the equity method under the conditions identified in PBE IPSAS 7, paragraph 19, that associate is classified as held for trading and accounted for in accordance with PBE IPSAS 29.

C10.6 Venturers’ interests in jointly controlled entities that:

- (a) **Are defined by PBE IPSAS 8 *Interests in Joint Ventures*;**
- (b) **Back either life insurance liabilities or life investment contract liabilities;**
- (c) **Are held by mutual funds, unit trusts and similar entities including investment-linked insurance funds; and**
- (d) **Are permitted to be designated as at “fair value through surplus or deficit” under PBE IPSAS 29;**

shall be designated as “at fair value through surplus or deficit” under PBE IPSAS 29 on initial recognition.

C10.6.1 Entities apply PBE IPSAS 8 to interests in joint ventures. PBE IPSAS 8 requires investments in joint ventures to be proportionately consolidated or to be accounted for using the equity method. However, PBE IPSAS 8 does not apply to venturers’ interests in jointly controlled entities held by mutual funds, unit trusts and similar entities including investment-linked insurance funds that are treated under PBE IPSAS 29 and designated as “at fair value through surplus or deficit”.

Separate Financial Statements

C10.7 When preparing separate financial statements, those investments in controlled entities, jointly controlled entities and associates that:

- (a) [Not used.]
- (b) **Back life insurance liabilities or life investment contract liabilities; and**
- (c) **Are permitted to be designated as at “fair value through surplus or deficit” under PBE IPSAS 29;**

shall be designated as “at fair value through surplus or deficit” under PBE IPSAS 29 on initial recognition.

C10.7.1 An insurer applies PBE IPSAS 6 to its investments in controlled entities, jointly controlled entities and associates when preparing separate financial statements. Under PBE IPSAS 6, in the controlling entity’s separate financial statements, the investments in controlled entities, jointly controlled entities and

associates can either be accounted for using the equity method, at cost or as a financial instrument in accordance with PBE IPSAS 29.

C10.7.2 In the controlling entity's separate financial statements, investments in controlled entities, jointly controlled entities and associates that are within the scope of PBE IPSAS 6 that the insurer considers back life insurance liabilities or life investment contract liabilities, and that are permitted to be designated "at fair value through surplus or deficit" under PBE IPSAS 29, are designated as "at fair value through surplus or deficit" under PBE IPSAS 29 on initial recognition.

C10.7.3 [Not used.]

Imputed Inflows and Outflows

C11.1 Subject to paragraph C18.3, a life insurer shall recognise imputed inflows and outflows as revenue and expenses when, and only when, such imputed flows relate to transactions with external entities.

C11.1.1 Life insurers often impute inflows and outflows to different classes of policyholders in order to help ensure that they are treated equitably. For example, a life insurer may own the buildings that it occupies. The funds of a particular group of policyholders are used to acquire and operate such buildings while a wider group of policyholders and shareholders may benefit from the use of the buildings. In the owner-occupied building example, the life insurer imputes an inflow of rent revenue to the policyholders whose funds are used to acquire and operate the buildings and imputes an outflow of rent cost to the other policyholders and to shareholders.

C11.1.2 In cases where there are no transactions with external entities, such as with owner-occupied buildings, the life insurer is dealing with itself. There is no transaction or other past event that gives rise to revenue or an expense. Any inflows and outflows imputed for internal management purposes would be eliminated in preparing external financial statements except in relation to the disaggregated disclosures required by paragraphs C18.1 and C18.2.

C11.1.3 In some cases, life insurers impute inflows and outflows where external entities are involved. For example, life insurers often lend funds to their employees at concessional rates of interest with the funds being provided by a particular group of policyholders, while other policyholders and any shareholders benefit from the services provided by those employees. Because external parties are involved, such imputed inflows and outflows are recognised as revenue and expenses when they can be reliably measured.

Life Investment Contracts

C12.1 Life investment contract liabilities that are permitted to be designated as "fair value through surplus or deficit" shall be designated as "at fair value through surplus or deficit" under PBE IPSAS 29.

C12.1.1 The view adopted in this Appendix is that, in all but rare cases, life investment contract liabilities within the scope of PBE IPSAS 29 are permitted to be measured at fair value through surplus or deficit under PBE IPSAS 29. This is because, when a life investment contract liability is backed by a financial asset measured at fair value through surplus or deficit, designating the life investment contract liability at fair value through surplus or deficit eliminates or significantly reduces a potential measurement inconsistency which would arise if the life investment contract liability were measured at amortised cost. In addition, in the vast majority of cases, life investment contract liabilities would be managed and their performance would be evaluated on a fair value basis, in accordance with a documented risk management or investment strategy.

C12.1.2 Some life investment contracts involve both the origination of one or more financial instruments and the provision of management services. Life investment contract liabilities arise under the financial instrument element and are treated under PBE IPSAS 29. The management services element, including associated acquisition costs, is treated under PBE IPSAS 9 *Revenue from Exchange Transactions*; this element may also give rise to assets and liabilities.

Life Insurance Contracts Acquired in a Business Combination or Portfolio Transfer

C13.1.1 To comply with PBE IFRS 3 *Business Combinations*, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and insurance assets acquired in a business combination.

However, an insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

- (a) A liability measured in accordance with the insurer's accounting policies for life insurance contracts that it issues; and
- (b) An intangible asset, representing the difference between
 - (i) The fair value of the contractual insurance rights acquired and insurance obligations assumed; and
 - (ii) The amount described in paragraph C13.1.1(a).

The subsequent measurement of this asset shall be consistent with the measurement of the related life insurance liability.

C13.1.2 An insurer acquiring a portfolio of life insurance contracts may use an expanded presentation described in paragraph C13.1.1.

13.1.3 The intangible assets described in paragraphs C13.1.1 and C13.1.2 are excluded from the scope of PBE IPSAS 26 *Impairment of Cash-Generating Assets* and from the scope of PBE IPSAS 31 *Intangible Assets* in respect of recognition and measurement. PBE IPSAS 26 and PBE IPSAS 31 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a business combination or portfolio transfer.

C13.1.4 PBE IPSAS 31 includes disclosure requirements in relation to this intangible asset.

C13.1.5 Where a life insurer recognises an intangible asset under paragraph C13.1.1(b), this intangible asset is considered when performing the liability adequacy test referred to in paragraph C8.6.

Life Insurance Contracts Disclosure – Explanation of Recognised Amounts

C14.1 A life insurer shall disclose information that identifies and explains the amounts in its financial statements arising from life insurance contracts.

C14.1.1 To comply with paragraph C14.1, a life insurer shall disclose:

- (a) Its accounting policies for life insurance contracts and related assets, liabilities, revenue and expense;
- (b) The recognised assets, liabilities, revenue, expense and cash flows arising from life insurance contracts. Furthermore, if the life insurer is a cedant, it shall disclose:
 - (i) Gains and losses recognised in surplus or deficit at the time of buying reinsurance; and
 - (ii) If the cedant defers and amortises gains and losses arising at the time of buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period;
- (c) The process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, a life insurer shall also give quantified disclosure of those assumptions;
- (d) The effect of changes in assumptions used to measure life insurance assets and life insurance liabilities, showing separately the effect of each change that has a material effect on the financial statements; and
- (e) Reconciliations of changes in life insurance liabilities and reinsurance assets.

C14.1.2 When applying paragraph C14.1.1(b) and disclosing recognised revenue arising from life insurance contracts, life insurers would normally disclose revenue from direct and reinsurance business. In accordance with the principles embodied in this Appendix, with the exception of premium revenue recognised in accordance with paragraph C5.1, all revenues are recognised and disclosed before the effects of any transfers to or from life insurance liabilities. Disclosure of the effects of transfers to and from life insurance liabilities is required by paragraph C14.1.1(e).

C14.1.3 In accordance with the principles embodied in this Appendix, with the exception of claims expense recognised in accordance with paragraph C5.1, all expenses are recognised and disclosed before the effects of any transfers to or from life insurance liabilities. Disclosure of the effects of transfers to and from life insurance liabilities is required by paragraph C14.1.1(e).

C14.1.4 To disclose and explain the expenses arising from life insurance contracts, life insurers would normally disclose:

- (a) Outwards reinsurance expense;
- (b) Operating expenses:
 - (i) Claims expense;
 - (ii) Policy acquisition expenses, separated into material components including commission;
 - (iii) Policy maintenance expenses;
 - (iv) Investment management expenses; and
 - (v) Other; and
- (c) The basis for the apportionment of operating expenses between:
 - (i) Life insurance contract acquisition;
 - (ii) Life insurance contract maintenance;
 - (iii) Investment management expenses;
 - (iv) Life investment contract acquisition;
 - (v) Life investment contract maintenance; and
 - (vi) Other expenses.

C14.1.5 When applying paragraph C14.1.1(c) and C14.1.1(d) and disclosing the process used to determine assumptions, quantified disclosure of assumptions and the effect of changes in assumptions, the life insurer would normally show the impact of changes in assumptions on future profit margins and life insurance liabilities. The assumptions that would normally have the greatest effect on the measurement of recognised amounts described in paragraph C14.1.1(b) are:

- (a) Discount rates and inflation rates;
- (b) Profit carriers used for each major product group;
- (c) Future maintenance and investment management expenses, the rate of inflation applicable to them and any automatic indexation of benefits and premiums;
- (d) Rates of taxation;
- (e) Mortality and morbidity, by reference to the identity of the tables;
- (f) Rates of discontinuance;
- (g) Surrender values;
- (h) Rates of growth of unit prices in respect of unit-linked benefits;
- (i) Rates of future supportable participating benefits; and
- (j) The crediting policy adopted in determining future supportable participating benefits.

C14.1.6 When applying paragraph C14.1.1(b) and disclosing the recognised liabilities arising from life insurance contracts, life insurers would normally disclose the following components of life insurance liabilities:

- (a) Future policy benefits, including participating benefits;
- (b) Balance of future expenses;
- (c) Planned margins of revenues over expenses;
- (d) Future charges for acquisition costs;

- (e) Balance of future revenues; and
- (f) Other items, separated into material components.

C14.1.7 When a life insurer is presenting the disclosures required by paragraphs C14.1.1(c) and C14.1.1(d) the insurer determines the level and extent of disclosure that is appropriate having regard to its circumstances and the qualitative characteristics of financial statements under the PBE *Framework* of understandability, relevance, reliability and comparability.

C14.1.8 The following revenues and related explanations shall be disclosed:

- (a) Premium revenue;
- (b) Inwards reinsurance revenues;
- (c) Investment revenue, showing separately revenue from:
 - (i) Equity securities;
 - (ii) Debt securities;
 - (iii) Properties; and
 - (iv) Other; and
- (d) Other revenue.

C14.1.9 Investment revenues are shown in four categories, and the amount in each category would potentially include amounts received, amounts receivable, and realised and unrealised gains and losses relating to the reporting period. So, for example, the category “investment revenues from equity securities” would include dividends received and receivable relating to the reporting period, realised gains and losses from trading during the reporting period and unrealised gains and losses from holding equity securities during the reporting period.

C14.1.10 The following assets shall be disclosed in the broad order of their liquidity:

- (a) Investments, showing separately:
 - (i) Equity securities;
 - (ii) Debt securities;
 - (iii) Properties; and
 - (iv) Other, by major class where applicable;
- (b) Operating assets; and
- (c) Reinsurance recoveries receivable.

C14.1.11 The presentation of assets and liabilities in the broad order of their liquidity is considered to be relevant to emphasise the importance of liquidity and solvency for life insurers. The current/non-current presentation of assets and liabilities is not considered to give rise to sufficiently useful information for users.

C14.1.12 Disclosure about the different types of investments and investment revenues provides users with information that assists them in understanding the nature and extent of the risks and returns associated with the investments held by a life insurer. Accordingly, investments are shown in classes that reflect their underlying nature. For example, units held in a property trust are classified as a property investment.

C14.1.13 In the life insurance industry, unlike other industries, acquisition costs are not recognised as an asset because there is no reliable measure of the probable future economic benefits that will arise from actual acquisition costs. In practice, acquisition costs are usually recognised as expenses in the reporting period in which they are incurred. This is generally offset by identifying a portion of the planned margins included in policyholder liabilities as relating to the recovery of acquisition costs. The most useful and reliable information available about the acquisition costs that will give rise to future economic benefits is the amount of future charges for acquisition costs identified as part of the process of determining policyholder liabilities. Disclosure of this amount is required under paragraph C14.1.6(d).

Life Insurance Contracts Disclosure – Nature and Extent of Risks Arising from Life Insurance Contracts

C15.1 A life insurer shall disclose information that enables users of its financial report to evaluate the nature and extent of risks arising from life insurance contracts.

C15.1.1 To comply with paragraph C15.1, a life insurer shall disclose:

- (a) Its objectives, policies and processes for managing risks arising from life insurance contracts and the methods used to manage those risks;
- (b) Information about insurance risk (both before and after risk mitigation by reinsurance), including information about:
 - (i) Sensitivity to insurance risk (see paragraph C15.1.3);
 - (ii) Concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (e.g., type of insured event, geographical area, or currency); and
 - (iii) Actual claims compared with previous estimates (i.e. claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. A life insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year;
- (c) Information about credit risk, liquidity risk and market risk that paragraphs 38–49 of PBE PSAS 30 would require if the life insurance contracts were within the scope of PBE IPSAS 30. However:
 - (i) A life insurer need not provide the maturity analysis required by paragraph 46(a) of PBE IPSAS 30 if it discloses information about the estimated timing of the net cash outflows resulting from recognised life insurance liabilities instead. This may take the form of an analysis, by estimated timing, of the amounts recognised in the statement of financial position; and
 - (ii) If a life insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirement in paragraph 47(a) of PBE IPSAS 30. Such an insurer shall also provide the disclosures required by paragraph 48 of PBE IPSAS 30⁵; and
- (d) Information about exposures to market risk arising from embedded derivatives contained in a host life insurance contract if the life insurer is not required to, and does not, measure the embedded derivatives at fair value.

C15.1.2 The claims development disclosure required by paragraph C15.1.1(b)(iii) only applies to classes of business where claims are not typically resolved within one year. For many life insurance products this disclosure would not normally be required. Furthermore, claims development disclosure would not normally be needed for annuity contracts, for example, because each periodic payment arises, in effect, from a separate claim about which there is no uncertainty.

C15.1.3 To comply with paragraph C15.1.1(b)(i), a life insurer shall disclose either (a) or (b) as follows:

- (a) A sensitivity analysis that shows how comprehensive revenue and expense and net assets/equity would have been affected had changes in the relevant risk variable that were reasonably possible at the end of the reporting period occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used. However, if a life insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 48 of PBE IPSAS 30; and

⁵ A Tier 2 entity shall comply in full with any requirements of PBE IPSAS 30 which are referred to in PBE IFRS 4.

- (b) Qualitative information about sensitivity, and information about those terms and conditions of life insurance contracts that have a material effect on the amount, timing and uncertainty of the life insurer's future cash flows.

Other Disclosures Relating to Life Insurance Contracts

C16.1 Where any premiums and any claims are separated into their revenue, expense and change in liability components in accordance with paragraph C5.1, total premiums and total claims shall be disclosed.

C16.1.1 The mix of products written by a life insurer will vary between life insurers. Comparability between life insurers is enhanced by the disclosure of total premiums and total claims.

C16.2 Where a surplus is recognised at the inception of a group of policies, the revenues and expenses associated with that group of related products shall be disclosed in the reporting period in which those policies were written.

C16.2.1 It is expected that surplus will be recognised at the inception of a policy only on rare occasions. It is considered that this surplus would be so infrequent that it should be disclosed.

Disclosures Relating to Life Insurance Contracts and Life Investment Contracts

Financial Performance

C17.1 The following components of surplus or deficit shall be shown, separated between policyholder and shareholder interests:

- (a) **Surplus related to movement in life insurance liabilities;**
- (b) **Surplus related to movement in life investment contract liabilities and movement in assets or liabilities arising in respect of the management services element of life investment contracts;**
- (c) **Investment earnings on assets in excess of policy liabilities; and**
- (d) **Other items, separated into material components.**

C17.2 The following components of surplus or deficit related to movements in life insurance liabilities, life investment contract liabilities and assets or liabilities arising in respect of the management services element of life investment contracts shall be shown:

- (a) **Planned margins of revenues over expenses;**
- (b) **The difference between actual and assumed experience;**
- (c) **The effects of changes to underlying assumptions;**
- (d) **Loss recognition on groups of related products or reversal of previously recognised losses required by paragraph C8.6; and**
- (e) **Other movements, separated into material components.**

Restrictions on Assets

C17.3 Restrictions attaching to assets held for the benefit of policyholders shall be disclosed.

C17.3.1 There are a number of restrictions on the use of assets invested for policyholders in life funds. It is important that these restrictions be disclosed so that users of the financial report can assess their impact.

Guaranteed or Assured Returns of Funds Invested

C17.4 A life insurer shall separately disclose:

- (a) **In respect of contracts with discretionary participation features, the amount of policy liabilities that relates to the guaranteed element;**
- (b) **In respect of investment-linked contracts, the amount of policy liabilities subject to investment performance guarantees; and**

- (c) **In respect of any other contracts not addressed in (a) or (b) with a fixed or guaranteed termination value, the amount of the current termination values.**

C17.4.1 Many life insurers issue contracts that provide some form of guarantee or assurance about the return of funds invested. It is useful for users of life insurers' financial statements to have information about the extent of such guarantees or assurances, since they involve the life insurer bearing investment risks on behalf of policyholders.

Net Assets/Equity

C17.5 The following components of net assets/equity shall be disclosed:

- (a) **Accumulated comprehensive revenue and expense wholly attributable to shareholders; and**
 (b) **Accumulated comprehensive revenue and expense where the allocation between participating policyholders, or participating holders of investment contracts and shareholders cannot be determined.**

C17.5.1 Information about the different components of accumulated **comprehensive revenue and expense** is useful in meeting the accountability obligations of the life insurer for the whole business and in showing the relative positions of the major stakeholders.

C17.5.2 A life insurer that has issued participating life insurance business may have "retained profits" generated from that business. These "retained profits" are liabilities which are disclosed separately from policyholders' liabilities in accordance with paragraph C14.1.6. In foreign life insurance operations, "retained profits" may exist which have yet to be allocated between policyholders and shareholders. Such "retained profits" should be separately disclosed.

C17.5.3 Where, in foreign life operations, "retained profits" exist, which have yet to be allocated and which are treated as net assets/equity, the insurer applies paragraphs C17.5.4 and C17.5.5 to this participating business written by foreign life operations.

C17.5.4 Where a life insurance contract with a discretionary participation feature is issued by a foreign life operation, the issuer of such a contract:

- (a) May, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it classifies the whole contract as a liability. If the issuer classifies them separately, it classifies the guaranteed element as a liability;
- (b) Shall, if it recognises the discretionary participation feature separately from the guaranteed element, classify that feature as either a liability or a separate component of net assets/equity. This Appendix does not specify how the issuer determines whether that feature is a liability or a component of net assets/equity. The issuer may split that feature into liability and net assets/equity components and shall use a consistent accounting policy for that split. The issuer shall not classify that feature as an intermediate category that is neither liability nor net assets/equity;
- (c) May recognise all premiums received as revenue without separating any portion that relates to the net assets/equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in surplus or deficit. If part of the entire discretionary participation feature is classified directly in net assets/equity, a portion of surplus or deficit may be attributable to that feature (in the same way that a portion may be attributable to minority interests). The issuer shall recognise the portion of surplus or deficit attributable to any net assets/equity component of a discretionary participation feature as an allocation of surplus or deficit, not as expense or revenue (see PBE IPSAS 1 *Presentation of Financial Statements*);
- (d) Shall, if the contract contains an embedded derivative within the scope of PBE IPSAS 29, apply PBE IPSAS 29 to that embedded derivative; and
- (e) Shall, in all respects not described in paragraphs 14 to 20 and 34(a) to (d) of PBE IFRS 4, continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21 to 30 of PBE IFRS 4.

C17.5.5 The requirements in paragraph C17.5.4 also apply to a life investment contract issued by a foreign life insurer that contains a discretionary participation feature. In addition:

- (a) If the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraph C8.6 to the whole contract (i.e., both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying PBE IPSAS 29 to the guaranteed element;
- (b) If the issuer classifies part or that entire feature as a separate component of net assets/equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying PBE IPSAS 29 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph C2.2.2 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying PBE IPSAS 29 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher; and
- (c) Although these contracts contain financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability, subject to the requirements of paragraphs C5.1 and C5.2.

C17.6–C17.7 [Not used.]

Solvency Information

C17.8 A life insurer shall disclose the amount of net assets/equity retained as solvency reserves and the basis of establishing the amount. An economic entity shall disclose the solvency position of each life insurer in the economic entity.

Managed Funds and Other Fiduciary Activities

C17.9 The nature and amount of the life insurer's activities relating to managed funds and trust activities, and whether arrangements exist to ensure that such activities are managed independently from its other activities, shall be disclosed.

Actuarial Information

C17.10 The following shall be disclosed in notes:

- (a) **If other than the end of the reporting period, the effective date of the actuarial report on policyholder liabilities and solvency reserves;**
- (b) **The name and qualifications of the actuary;**
- (c) **Whether the amount of solvency reserves disclosed in accordance with paragraph C17.8 has been determined in accordance with the standards and guidelines of the New Zealand Society of Actuaries (Inc);**
- (d) **Whether the actuary is satisfied as to the accuracy of the data from which the amount of policy liabilities has been determined; and**
- (e) **Any qualifications contained in the actuarial report.**

Assets Backing Life Insurance Liabilities or Life Investment Contract Liabilities

C17.11 An insurer shall disclose the process used to determine which assets back life insurance liabilities and life investment contract liabilities.

Other Disclosures

C17.12.1 [Not used.]

C17.13.1 This Appendix addresses disclosure requirements in relation to life insurance contracts and certain disclosure requirements in relation to life investment contracts. Other PBE Standards may be relevant to a life insurer's financial report. In particular, the disclosure requirements in PBE IPSAS 30 would normally be relevant to life insurers.

C17.13.2 This Appendix requires minimum disclosures and it is likely that, in many cases, more extensive disclosures would be appropriate. For example, in relation to investment properties it may be useful to disclose separately the extent of holdings in the commercial/retail, industrial, rural and residential sectors.

C17.14 A summary of the key assumptions used in determining policyholder liabilities shall be disclosed for each group of related products in notes to the financial statements, including:

- (a) **Discount rates, asset mix and inflation rates;**
- (b) **Profit carriers used for each major product group;**
- (c) **Future maintenance and investment management expenses, the rate of inflation applicable to them and any automatic indexation of benefits and premiums;**
- (d) **Rates of taxation;**
- (e) **Mortality and morbidity, by reference to the identity of the tables;**
- (f) **Rates of discontinuance;**
- (g) **The basis of calculating surrender values;**
- (h) **Rates of growth of unit prices in respect of unit-linked benefits;**
- (i) **Rates of future supportable participating benefits; and**
- (j) **The crediting policy adopted in determining future supportable participating benefits and how it compares with the life insurer's actual practice.**

Disaggregated Information

Investment-linked and Non-investment-linked Business

C18.1 This Appendix requires disclosure of disaggregated information as between those amounts relating to investment-linked business and those relating to non-investment-linked business. The following must be disclosed:

- (a) **Investment assets;**
- (b) **Other assets;**
- (c) **Policy liabilities;**
- (d) **Liabilities other than policy liabilities;**
- (e) **Accumulated comprehensive revenue and expense, showing the amount directly attributable to shareholders and other accumulated surpluses or deficits;**
- (f) **Premium revenue;**
- (g) **Investment revenue;**
- (h) **Claims expense;**
- (i) **Other operating expenses;**
- (j) **Investment revenues paid or allocated to policyholders;**
- (k) **Surplus (deficit) before tax; and**
- (l) **Surplus (deficit) after tax.**

C18.2 A life insurer shall disclose the information required by paragraphs C18.1(a) to C18.1(l) disaggregated between those amounts relating to investment-linked business and those relating to non-investment-linked business.

C18.2.1 The risks and potential rewards for a life insurer differ substantially between investment-linked business and non-investment-linked business. Accordingly, disaggregated information about these is considered to be useful in assessing the performance and financial position of a life insurer. The information required by paragraph C18.2 is for the entity's life insurance business as a whole; it is not required for each life fund.

C18.2.2 [Not used.]

Imputed Inflows and Outflows

C18.3 Disclosures required by paragraphs C18.1 and C18.2 shall include all imputed inflows and outflows as revenue and expenses where they can be reliably measured.

C18.3.1 As discussed in paragraph C11.1.1, life insurers often impute inflows and outflows to different classes of policyholders and shareholders to help ensure that they are treated equitably. Whereas, in relation to the statement of comprehensive revenue and expense and the statement of financial position, paragraph C11.1 only permits the recognition of imputed inflows and outflows relating to transactions with external parties, paragraph C18.3 requires all imputed inflows and outflows to be included in the disaggregated information to reflect the performance of each segment of the life insurer.

Policyholder Credit Account

C18.4 The notes to the financial statements shall disclose the movements in, and balance of, the Policyholder Credit Account.

C19.1–C20.1 [Not used.]

Appendix D**Financial Reporting of Insurance Activities**

This Appendix is an integral part of the Standard.

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Application

D1.1 **This Appendix deals with financial reporting of insurance activities.**

D1.3–D1.4.1 [Not used.]

D1.4.2 For the purposes of PBE IAS 34 *Interim Financial Reporting* the determination of the outstanding claims liability does not necessarily require a full actuarial valuation. In accordance with PBE IAS 34, the outstanding claims liability would need to be determined on a reliable basis, would be based on reasonable estimates, would include a full review of all assumptions, and would not be materially different from outstanding claims liability determined by a full actuarial valuation.

D1.5–1.7 [Not used.]

Scope

General Insurance Contracts

D2.1 **This Appendix applies to the general purpose financial statements of entities that issue insurance contracts, other than life insurers as defined in paragraph 12.1 of PBE IFRS 4.**

D2.1.1 There are various types of insurance contract. This Appendix deals with general insurance contracts (including general reinsurance contracts). General insurance contracts are defined as insurance contracts that are not life insurance contracts.

D2.1.2 [Not used.]

D2.1.3 For ease of reference, this Appendix describes any entity that issues an insurance contract as an insurer, whether or not the issuer is regarded as an insurer for legal, regulatory or supervisory purposes.

D2.1.4 A reinsurance contract is a type of insurance contract. Accordingly, all references in this Appendix to insurance contracts also apply to reinsurance contracts.

D2.1.5 Weather derivatives that meet the definition of an insurance contract under this Appendix are treated under this Appendix. A contract that requires payment based on climatic, geological or other physical variables only where there is an adverse effect on the contract holder is a weather derivative that is an insurance contract. To meet the definition of a general insurance contract, the physical variable specified in the contract will be specific to a party to the contract.

Transactions Outside the Scope of this Appendix

D2.2 **This Appendix does not apply to:**

- (a) **Life insurance contracts (see Appendix C);**
- (b) **Product warranties issued directly by a manufacturer, dealer or retailer (see PBE IPSAS 9 *Revenue from Exchange Transactions* and PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*);**
- (c) **Employers' assets and liabilities under employee benefit plans (see PBE IPSAS 25 *Employee Benefits* and the relevant international or national accounting standard dealing with share-based transactions) and retirement benefit obligations reported by defined benefit retirement plans (see the relevant international or national accounting standard dealing with employee retirement benefit plans);**
- (d) **Contingent consideration payable or receivable in a business combination (see PBE IFRS 3 *Business Combinations*);**
- (e) **Contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see PBE IPSAS 13 *Leases*, PBE IPSAS 9 and PBE IPSAS 31 *Intangible Assets*);**
- (f) **Financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* and PBE IPSAS 30 *Financial***

***Instruments: Disclosures* or this Appendix to such financial guarantee contracts. The issuer may take that election by contract, but the election for each contract is irrevocable; and**

- (g) **Direct insurance contracts that the entity holds (that is direct insurance contracts in which the entity is a policyholder). However a cedant shall apply this Appendix to reinsurance contracts that it holds.**

Embedded derivatives

D2.3.1 PBE IPSAS 29 requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in surplus or deficit. PBE IPSAS 29 applies to derivatives embedded in a general insurance contract unless the embedded derivative is itself a general insurance contract.

D2.3.2 As an exception to the requirement in PBE IPSAS 29, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate) even if the exercise price differs from the carrying amount of the host insurance liability. However, the requirement in PBE IPSAS 29 applies to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).

Deposit components

D2.4.1 Some insurance contracts contain both an insurance component and a deposit component. In some cases, an insurer is required or permitted to unbundle those components:

- (a) Unbundling is required if both the following conditions are met:
- (i) The insurer can measure the deposit component (including any embedded surrender options) separately (that is, without considering the insurance component); and
 - (ii) The insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.
- (b) Unbundling is permitted, but not required, if the insurer can measure the deposit component separately as in paragraph D2.4.1(a)(i) but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.
- (c) Unbundling is prohibited if an insurer cannot measure the deposit component separately as in paragraph D2.4.1(a)(i).

D2.4.2 The following is an example of a case when an insurer's accounting policies do not require it to recognise all obligations arising from a deposit component. A cedant receives compensation for losses from a reinsurer, but the contract obliges the cedant to repay the compensation in future years. That obligation arises from a deposit component. If the cedant's accounting policies would otherwise permit it to recognise the compensation as revenue without recognising the resulting obligation, unbundling is required.

D2.4.3 A general insurer, in considering the need to unbundle the deposit component of the contract, would consider all expected cash flows over the period of the contract and would consider the substance of the contract. For example, while some financial reinsurance contracts may require annual renewal, in substance they may be expected to be renewed for a number of years.

D2.4.4 To unbundle a general insurance contract, an insurer shall:

- (a) Apply this Appendix to the insurance component; and
- (b) Apply PBE IPSAS 29 to the deposit component. When applying PBE IPSAS 29, an insurer shall designate the deposit component as "at fair value through surplus or deficit on initial recognition of the deposit component.

Purpose of Appendix

D3.1 **The purpose of this Appendix is to:**

- (a) **Specify the manner of accounting for the insurance activities of an entity and for the investment activities integral to those insurance activities;**
- (b) **Specify the manner of accounting for general insurance contracts consistent with PBE IFRS 4; and**
- (c) **Require disclosure of information relating to insurance activities.**

Premium Revenue

Classification

D4.1.1 Premium revenue comprises:

- (a) Premiums from direct business, that is, premiums paid by a policyholder (that is neither an insurer nor reinsurer) to a general insurer; and
- (b) Premiums from reinsurance business, that is, premiums received by a reinsurer from an insurer or from another reinsurer.

D4.1.2 Premiums from direct business arise from contracts where a policyholder transfers significant insurance risk to an insurer.

D4.1.3 Premiums from reinsurance business arise from contracts where an insurer or reinsurer transfers significant insurance risk to another reinsurer.

Recognition

D4.2 **Premium revenue shall be recognised from the attachment date as soon as there is a basis on which it can be reliably estimated.**

D4.2.1 The amount of premium is determined by a general insurer or reinsurer so as to cover anticipated claims, reinsurance premiums, administrative, acquisition and other costs, and a surplus component (having regard to expected revenues from the investment of premiums). The amounts collected in respect of these components are revenue of an insurer on the basis that they are collected in consideration for the insurer rendering services by indemnifying those insured against specified losses.

D4.2.2 For certain classes of insurance business, government authorities may require the payment of levies and charges. Examples include levies imposed under the Accident Compensation Act 2001 to reimburse the non-compliers and insolvent insurers funds (accident insurance levies), earthquake commission premiums and fire service levies. Some such levies and charges, for example, accident insurance levies, are expenses of the insurer, rather than government charges directly upon those insured. The insurer is not acting simply as a collector of these levies and charges. Although not compelled to collect these amounts from those insured, the insurer may include in premiums an amount to cover the estimated amount of the levies and charges. The insurer is usually responsible for paying the levies and charges at a later date. The amount paid by the insurer does not depend on the amounts collected from those insured in relation to the levies and charges. Therefore, the amounts collected to meet these levies and charges are revenue of the insurer. Other levies and charges, such as earthquake commission premiums and fire service levies, are not included in the definition of premium as the insurer is acting simply as a collector.

D4.2.3 [Not used.]

D4.2.4 Premium revenue needs to be recognised from the date of the attachment of risk in relation to each contract of general insurance because insurers earn premium revenue by assuming risks from that date on behalf of those insured. However, for reasons of practicality, many general insurers use bases of recognition that attempt to approximate this date. Such bases are acceptable provided that they do not result in the recognition of a materially different amount of premium revenue in a particular reporting period than would be the case if recognition occurred from the date of attachment of risk for each general insurance contract.

D4.2.5 In recognising premiums from the attachment date, an insurer may recognise premiums relating to general insurance contracts where the contract period commences after the end of the reporting period,

commonly referred to as premiums in advance. The attachment date is the date from which an insurer accepts risk. An insurer may accept risk prior to the date a contract commences; for example, it is not unusual for insurers to issue renewals, and for renewals to be paid for by policyholders, prior to the commencement date of an insurance contract. For commercial lines insurance, where the policyholder may be using the services of an insurance broker, the renewal terms could be agreed by both the insurer and policyholder prior to the commencement date and before the policyholder has paid the premium. In this situation, there may also have been a transfer of risk. As premiums in advance relate entirely to insurance cover to be provided in a future period, premiums in advance will be recognised as part of the unearned premium liability. Premiums in advance are considered as part of the liability adequacy test required by section 9.

Reinsurance Premiums

- D4.2.6 From the perspective of the reinsurer, reinsurance premiums accepted are akin to premiums accepted by the direct insurer. The reinsurer recognises inwards reinsurance premiums ceded to it as revenue in the same way as a direct insurer treats the acceptance of direct premiums as revenue.
- D4.2.7 Premiums accepted by the reinsurer are recognised from the attachment date, that is, the date from which the reinsurer bears its proportion of the relevant risks underwritten by the cedant. Reinsurers usually use bases of recognition that approximate the dates of bearing the risks. For example, the reinsurer may assume that its acceptance of risks occurs from the middle of the period for which the aggregate ceded premiums are advised by the cedant. This approach is acceptable provided that the premiums received or receivable in respect of the reporting period are recognised in that period, whether or not the periodic advice from the cedant insurer has been received.

Measurement

- D4.3 **Premium revenue shall be recognised in surplus or deficit from the attachment date:**
- (a) **Over the period of the contract for direct business; or**
 - (b) **Over the period of indemnity for reinsurance business,**
in accordance with the pattern of the incidence of risk expected under the general insurance contract.
- D4.4 **In the case of business where the premium is subject to later adjustment, the adjusted premium shall be used, where possible, as the basis for recognising premium revenue. Where this is not possible, the deposit premium, adjusted for any other relevant information, shall be recognised as the premium revenue, provided that it is expected that this amount will not be materially different from the actual amount of premium.**
- D4.4.1 Premium revenue is recognised in surplus or deficit when it has been earned. An insurance contract involves the transfer of significant insurance risk. The insurer estimates the pattern of the incidence of risk over the period of the contract for direct business, or over the period of indemnity for reinsurance business, and the premium revenue is recognised in accordance with this pattern. This results in the allocation of the premium revenue and the claims incurred expense and hence the gross underwriting result over the period of the contract for direct business, or over the period of indemnity for reinsurance business, in accordance with the pattern of the incidence of risk.
- D4.4.2 Measuring premium revenue involves the following steps:
- (a) Estimating the total amount of premium revenue expected under the contract;
 - (b) Estimating the total amount of claims expenses expected under the contract and estimating when the claims are expected to arise;
 - (c) Estimating the pattern of the incidence of risk from the result of (b); and
 - (d) Recognising the premium revenue under the contract identified in (a) when it will be earned, that is, in accordance with the pattern of the incidence of risk determined in (c).
- D4.4.3 For some general insurance contracts, especially complex multi-year reinsurance contracts, these estimations will involve the use of significant judgement. The estimates are reassessed at the end of each

reporting period. This prospective estimate of all of the revenues and expenses expected under the contract is also necessary for the purposes of the liability adequacy test. Refer to section 9.

Direct Business

- D4.4.4 For most direct general insurance contracts the specified period of the contract is one year. For many direct insurance contracts the pattern of the incidence of risk will be linear, that is, the risk of events occurring that will give rise to claims is evenly spread throughout the contract period. For these contracts the premium revenue will be earned evenly over the period of the contract. However, for some direct insurance contracts the risk of events occurring that will give rise to claims is not evenly spread throughout the contract. For example, with motor insurance contracts, the risk of events occurring that will give rise to claims may be subject to seasonal factors.
- D4.4.5 Insurers estimate the pattern of the incidence of risk expected under the insurance contracts from the attachment date. An insurer may be able to reliably estimate the pattern for a particular type of insurance business based upon past experience. However, where there have been changes in the nature of the cover provided, or where there has been a change in loss experience, the insurer reflects this in the estimations.

Reinsurance Business

- D4.4.6 Reinsurers recognise reinsurance premiums over the period of indemnity provided by the reinsurance contract in accordance with the pattern of the incidence of risk. For a typical 12 month proportional treaty, such as a quota share treaty, written on a “risks attaching basis”, the period of indemnity will be 24 months, as the proportional treaty will indemnify the direct insurer (or, for retrocession, the reinsurer) for losses arising under direct policies written during the 12 month contract period. Hence, an underlying annual direct contract written on the last day of the reinsurance contract will have 12 months of insurance cover beyond the last day of the reinsurance contract. The reinsurer estimates the pattern of the incidence of risk over the 24 month indemnity period.
- D4.4.7 The reinsurer may be able to reliably estimate the pattern for a particular type of reinsurance business based upon past experience. The reinsurer is likely to seek information from the cedant to estimate the pattern of the incidence of loss expected. Where there have been changes in the nature of the cover provided or when there has been a change in loss experience the insurer will need to reflect this in the estimations.
- D4.4.8 To determine the pattern of the incidence of risk, reinsurers first determine the total premiums expected under the contract. The premiums receivable under reinsurance treaties often depend on the volume of business written by the direct insurer after the end of the reporting period but before the treaty expiry date. This is always true of proportional (quota share and surplus) treaties that span the end of the reporting period, and is often true of non-proportional treaties. For such treaties, to estimate the total premium revenue expected under the reinsurance contract, the reinsurer estimates the inwards reinsurance premium it will receive under the contract by estimating the gross premium revenue that the cedant is likely to receive. The reinsurer is likely to estimate this by communicating with the cedant, and by reviewing past experience.
- D4.4.9 For a typical non-proportional treaty, such as an excess of loss treaty, the period of indemnity is usually the same as the contract period. For example, an excess of loss treaty could indemnify an insurer for all claims incurred above the excess (either individual claims or in aggregate) during the contract period, or for all claims made during the contract period. For some of these contracts the pattern of the incidence of risk is likely to be linear and hence for these contracts the premium revenue expected under the contract is earned evenly over the contract period.
- D4.4.10 With a non-proportional treaty the reinsurer estimates the total liabilities that are likely to arise under the underlying insurance contracts to enable an estimation of the total inwards reinsurance premium revenue expected under the contract. Where relevant, the reinsurer estimates whether the cedant is likely to want to reinstate the contract, in which case the reinsurer considers the additional reinstatement premiums it is expected to receive and the extent that they may have been earned at the end of the reporting period. A reinsurer liaises closely with the cedant, reviews any market information on significant losses or events that may have arisen, for example a hailstorm or earthquake, and reviews past experience.
- D4.4.11 Some reinsurance contracts might involve an experience account. While such contracts may require annual renewal, in substance the contract period is likely to be greater than one year. In estimating the

total inwards reinsurance premium expected under the contract and in estimating the total reinsurance claims, to determine the pattern of the incidence of risk, the reinsurer considers the probability-weighted expected cash flows over the expected period of the contract, and discounts these cash flows to reflect the time value of money. Section 6 discusses the determination of discount rates. In considering the expected cash flows, the reinsurer considers any cash flows such as surplus commissions and commission rebates.

Adjusted Premiums

D4.4.12 For some classes of insurance it is usual for the premium to be adjusted as a result of events and information that only become known during or after the insurance contract period. For example, marine cargo insurance is a type of “adjustable” business for which a deposit premium is paid at the beginning of the contract period and subsequently adjusted on the basis of a cargo declaration.

Unclosed Business

D4.5 Premium revenue relating to unclosed business shall be recognised and measured in accordance with paragraphs D4.2, D4.3 and D4.4.

D4.5.1 Frequently, there is insufficient information available at the end of a reporting period to enable a general insurer to accurately identify the business written close to the end of the reporting period for which the date of attachment of risk is prior to the end of the reporting period. This is often referred to as unclosed business. Consistent with the principle stated in paragraph D4.2, that premium revenue is to be recognised from the attachment date, all unclosed business will need to be estimated and the premium relating to unclosed business included in premium revenue.

D4.5.2 Estimates of the amount of unclosed business can be made using information from prior periods adjusted for the impact of recent trends and events. In addition, information about unclosed business may become available after the end of the reporting period and before the financial statement is authorised for issue, which may enable more reliable estimates to be made.

Outstanding Claims Liabilities

Recognition and Measurement

D5.1 An outstanding claims liability shall be recognised in respect of direct business and reinsurance business and shall be measured as the central estimate of the present value of the expected future payments for claims incurred with an additional risk margin to allow for the inherent uncertainty in the central estimate.

D5.1.1 The recognition and measurement approach requires estimation of the probability-weighted expected cost (discounted to a present value) of settling claims incurred, and the addition of a risk margin to reflect inherent uncertainty in the central estimate.

D5.1.2 The longer the expected period from the end of the reporting period to settlement, the more likely it is that the ultimate cost of settlement will be affected by inflationary factors likely to occur during the period to settlement. These factors include changes in specific price levels, for example, trends in average periods of incapacity and in the amounts of court awards for successful claims. For claims expected to be settled within one year of the end of the reporting period, the impact of inflationary factors might not be material.

D5.1.3 For claims expected to be settled within one year of the end of the reporting period, where the amount of the expected future payments does not differ materially from the present value of those payments, insurers would not need to discount the expected future payments.

Central Estimate

D5.1.4 In estimating the outstanding claims liability, a central estimate is adopted. If all the possible values of the outstanding claims liabilities are expressed as a statistical distribution, the central estimate is the mean of that distribution.

D5.1.5 In estimating the outstanding claims liability, an insurer may make use of case estimates of individual reported claims that remain unsettled at the end of the reporting period. An insurer may base case estimates on the most likely claim costs. Where the range of potential outcomes is small, the likely cost

may be close to the mean cost. However, where the potential range of outcomes is large and where the probability distribution may be highly skewed, the most likely cost, or the mode, could be below the mean and hence below the central estimate. In this situation, the insurer would need to increase the case estimates accordingly to ensure that they represent the central estimate.

Risk Margin

- D5.1.6 The outstanding claims liability includes, in addition to the central estimate of the present value of the expected future payments, a risk margin that relates to the inherent uncertainty in the central estimate of the present value of the expected future payments.
- D5.1.7 Risk margins are determined on a basis that reflects the insurer's business. Regard is given to the robustness of the valuation models, the reliability and volume of available data, past experience of the insurer and the industry and the characteristics of the classes of business written.
- D5.1.8 The risk margin is applied to the net outstanding claims for the entity as a whole. The overall net uncertainty has regard to:
- (a) The uncertainty in the gross outstanding claims liability;
 - (b) The effect of reinsurance on (a); and
 - (c) The uncertainty in reinsurance and other recoveries due.
- D5.1.9 In practice, however, outstanding claims liabilities are often estimated on a class-by-class basis, including an assessment of the uncertainty in each class and the determination of a risk margin by class of business. When these estimates are combined for all classes, the central estimates are combined, however the risk margin for all classes when aggregated may be determined by some insurers to be less than the sum of the individual risk margins. The extent of the difference that some insurers may decide to recognise is likely to depend upon the degree of diversification between the different classes and the degree of correlation between the experiences of these classes.
- D5.1.10 For the purposes of the liability adequacy test, required by section 9, the risk margin for the entity as a whole is apportioned across portfolios of contracts that are subject to broadly similar risks and are managed together as a single portfolio.
- D5.1.11 Risk margins adopted for regulatory purposes may be appropriate risk margins for the purposes of this Appendix, or they may be an appropriate starting point in determining such risk margins.

Expected Future Payments

- D5.2 **The expected future payments shall include:**
- (a) **Amounts in relation to unpaid reported claims;**
 - (b) **Claims incurred but not reported (IBNR);**
 - (c) **Claims incurred but not enough reported (IBNER); and**
 - (d) **Costs, including claims handling costs, which the insurer expects to incur in settling these incurred claims.**
- D5.2.1 It is important to identify the components of the ultimate cost to an insurer of settling incurred claims, for the purposes of determining the claims expense for the reporting period and determining the outstanding claims liability as at the end of the reporting period. These components comprise the policy benefit amounts required to be paid to or on behalf of those insured, and claims handling costs, that is, costs associated with achieving settlements with those insured. Claims handling costs include costs that can be associated directly with individual claims, such as legal and other professional fees, and costs that can only be indirectly associated with individual claims, such as claims administration costs.
- D5.2.2 Policy benefit amounts and direct claims handling costs are expenses of an insurer, representing the consumption or loss of economic benefits. The outstanding claims liability includes unpaid policy benefits and direct claims handling costs relating to claims arising during current and prior reporting periods, as they are outgoings that an insurer is presently obliged to meet as a result of past events.
- D5.2.3 Indirect claims handling costs incurred during the reporting period are also expenses of an insurer, and include a portion of the indirect claims handling costs to be paid in the future, being that portion which

relates to handling claims arising during the reporting period. The outstanding claims liability includes these unpaid indirect claims handling costs.

- D5.2.4 It is important to ensure that claims are recognised as expenses and liabilities for the correct reporting period. For contracts written on a claims-incurred basis, claims arise from insured events that occur during the insurance contract period. Some events will occur and give rise to claims that are reported to the insurer and settled within the same reporting period. Other reported claims may be unsettled at the end of a particular reporting period. In addition, there may be events that give rise to claims that, at the end of a reporting period, have yet to be reported to the insurer (IBNR claims). The insurer also considers the need to recognise a liability for claims that may be re-opened after the end of the reporting period.
- D5.2.5 For contracts written on a claims-made basis, claims arise in respect of claims reported during the insurance contract period. The insured event that gave rise to the claim could have occurred in a previous period. While claims-made insurance contracts should theoretically only give rise to outstanding claims liabilities and IBNER claims (see paragraph D5.2.10), as claims cannot be incurred but not reported under such a contract, this may not be the case for reinsurers. A reinsurer may have reinsured a claims-made contract on a claims-incurred basis. In this case while a loss or other event would be reported to the direct insurer during the period of insurance to generate a valid claim, the reinsurer may not have received information about the claim but would have an IBNR liability. Similarly, a reinsurer may have issued a claims-made reinsurance contract but may need to consider that not all notices of claims may have been reported by the direct insurer. Insurers and reinsurers should also be aware of court rulings that may impact on the way claims made policies are interpreted.
- D5.2.6 Claims arising from events that occur during a reporting period and which are settled during that same period are expenses of that period. In addition, a liability and corresponding expense is recognised for reported claims arising from events of the reporting period that have yet to be settled. This involves a process of estimation that includes assessment of individual claims and past claims experience.
- D5.2.7 When, based on knowledge of the business, IBNR claims are expected to exist, an estimate is made of the amount of the claims that will arise therefrom. This involves recognition of a liability and corresponding expense for the reporting period. As in the case of reported but unsettled claims, an estimate of the amount of the current claims incurred but not reported is based on past experience and takes into account any changes in circumstances, such as recent catastrophic events that may have occurred during the reporting period and changes in the volume or mix of insurance contracts underwritten, that may affect the pattern of unreported claims.
- D5.2.8 Some insurers use estimations or formulae, related to the amount of outstanding claims and based on the past experience of the insurer and the industry, to arrive at an estimate of direct and indirect handling costs.
- D5.2.9 Claims expense and the outstanding claims liability are adjusted on the basis of information, including re-opened claims, that becomes available after the initial recognition of claims, to enable the insurer to make a more accurate estimate of the ultimate cost of settlement. This is often referred to as claims development. As is the case with other liabilities, the effect of the adjustments to the liability for outstanding claims and to claims expense is recognised in surplus or deficit when the information becomes available.
- D5.2.10 Where further information becomes available about reported claims and reveals that the ultimate cost of settling claims has been underestimated, the upwards adjustment to claims expense and to the liability for outstanding claims is often referred to as claims incurred but not enough reported (IBNER claims). Where further information reveals that the ultimate cost of settling claims has been overestimated, the adjustment is sometimes referred to as negative IBNER claims.
- D5.2.11 Appropriate allowance is made for future claim cost escalation when determining the central estimate of the present value of the expected future payments. Future claims payments may increase over current levels as a result of wage or price inflation, and as a result of superimposed inflation (cost increases) due to court awards, environmental factors or economic or other causes.
- D5.2.12 With inwards reinsurance claims the reinsurer will receive periodic advices from each cedant. These may include aggregate information relating to the claims liability. The reinsurer measures its outstanding claims liability on the basis of this information and its past experience of the claims payments made under

reinsurance arrangements. The reinsurer also considers market knowledge of losses and other events such as hailstorms or earthquakes.

Discount Rates

D6.1 The outstanding claims liability shall be discounted for the time value of money using risk-free discount rates that are based on current observable, objective rates that relate to the nature, structure and term of the future obligations.

D6.1.1 The discount rates adopted are not intended to reflect risks inherent in the liability cash flows, which might be allowed for by a reduction in the discount rate in a fair value measurement, nor are they intended to reflect the insurance and other non-financial risks and uncertainties reflected in the outstanding claims liability. The discount rates are not intended to include allowance for the cost of any options or guarantees that are separately measured within the outstanding claims liability.

D6.1.2 Typically, government bond rates may be appropriate discount rates for the purposes of this Appendix, or they may be an appropriate starting point in determining such discount rates.

D6.1.3 The portion of the increase in the liability for outstanding claims from the end of the previous reporting period to the end of the current reporting period that is due to discounted claims not yet settled being one period closer to settlement, ought, conceptually, to be recognised as interest expense of the current reporting period. However, it is considered that the costs of distinguishing this component of the increase in the outstanding claims liability exceed the benefits that may be gained from its disclosure. Thus, such increase is included in claims expense for the current reporting period.

Unearned Premium Liability

D7.1 Premium that has not been recognised in surplus or deficit is premium that is unearned and shall be recognised in the statement of financial position as an unearned premium liability.

D7.1.1 The unearned premium liability is to meet the costs, including the claims handling costs, of future claims that will arise under current general insurance contracts and the deferred acquisition costs that will be recognised as an expense in surplus or deficit in future reporting periods.

Acquisition Costs

D8.1 Acquisition costs incurred in obtaining and recording general insurance contracts shall be deferred and recognised as assets where they can be reliably measured and where it is probable that they will give rise to premium revenue that will be recognised in surplus or deficit in subsequent reporting periods. Deferred acquisition costs shall be amortised systematically in accordance with the expected pattern of the incidence of risk under the related general insurance contracts.

D8.1.1 Acquisition costs are incurred in obtaining and recording general insurance contracts. They include commission or brokerage paid to agents or brokers for obtaining business for the insurer, selling and underwriting costs such as advertising and risk assessment, the administrative costs of recording policy information and premium collection costs.

D8.1.2 Because such costs are usually incurred at acquisition while the pattern of earnings occurs throughout the contract periods, which may extend beyond the end of the reporting period, those acquisition costs which lead to obtaining future benefits for the insurer are recognised as assets.

D8.1.3 For an asset to be recognised, it will be probable that the future economic benefits will eventuate, and that it possesses a cost or other value that can be measured reliably. Direct acquisition costs such as commission or brokerage are readily measurable. However, it may be difficult to reliably measure indirect costs that give rise to premium revenue, such as administration costs, because it is difficult to associate them with particular insurance contracts.

Liability Adequacy Test

D9.1 The adequacy of the unearned premium liability shall be assessed by considering current estimates of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts. If the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts, plus an additional risk margin to reflect the inherent

uncertainty in the central estimate, exceed the unearned premium liability less related intangible assets and related deferred acquisition costs, then the unearned premium liability is deficient. The entire deficiency shall be recognised in surplus or deficit. In recognising the deficiency in surplus or deficit the insurer shall first write-down any related intangible assets and then the related deferred acquisition costs. If an additional liability is required this shall be recognised in the statement of financial position as an unexpired risk liability. The liability adequacy test for the unearned premium liability shall be performed at the level of a portfolio of contracts that are subject to broadly similar risks and are managed together as a single portfolio.

- D9.1.1 In determining the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts, the insurer applies sections 5 and 6 and includes an appropriate risk margin to reflect inherent uncertainty in the central estimate, as set out in paragraphs D5.1.6 to D5.1.11.
- D9.1.2 Whilst the probability of adequacy adopted in performing the liability adequacy test may be the same or similar to the probability of adequacy adopted in determining the outstanding claims liability, this Standard does not require the same or similar probabilities of adequacy. However, the users of financial statements need to be presented with information explaining any differences in probabilities of adequacy adopted, and insurers are required to disclose the reasons for any differences in accordance with paragraph D17.8(e).
- D9.1.3 The unearned premium liability may include premiums in advance as described in paragraph D4.2.5. Insurers also consider whether there are any additional general insurance contracts, where the premium revenue is not recognised in the unearned premium liability, under which the insurer has a constructive obligation to settle future claims that may arise. That is, there may be general insurance contracts where there has not been a transfer of risk, as described in paragraph D4.2.5, but where a constructive obligation has arisen. The cash flows expected under these contracts are considered as part of the liability adequacy test.
- D9.1.4 In reviewing expected future cash flows, the insurer takes into account both future cash flows under insurance contracts it has issued and the related reinsurance.
- D9.1.5 The related intangible assets referred to in paragraph D9.1 are those that arise under paragraph D13.3.1(b). As the liability adequacy test for the unearned premium liability is performed at the level of portfolios of contracts that are subject to broadly similar risks and are managed together as a single portfolio, the intangible asset is allocated on a reasonable basis across these portfolios.
- D9.1.6 As the liability adequacy test applies to deferred acquisition costs and to intangible assets, these assets are excluded from the scope of PBE IPSAS 26 *Impairment of Cash-Generating Assets*.

Outwards Reinsurance Expense

- D10.1 **Premiums ceded to reinsurers shall be recognised by the cedant as outwards reinsurance expense in surplus or deficit from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of the incidence of risk.**
- D10.1.1 It is common for general insurers or reinsurers to reinsure a portion of the risks that they accept. To secure reinsurance cover, the cedant passes on a portion of the premiums received to a reinsurer. This is known as outwards reinsurance expense.
- D10.1.2 The cedant accounts for direct insurance and reinsurance transactions on a gross basis, so that the extent and effectiveness of the reinsurance arrangements are apparent to the users of the financial statement, and an indication of the insurer's risk management performance is provided to users. The gross amount of premiums earned by the cedant during the reporting period is recognised as revenue because it undertakes to indemnify the full amount of the specified losses of those it has insured, regardless of the reinsurance arrangements. Correspondingly, the cedant recognises the gross amount of claims expense in the reporting period because it is obliged to meet the full cost of successful claims by those it has insured.
- D10.1.3 Accordingly, premium ceded to reinsurers is recognised in surplus or deficit as an expense of the cedant on the basis that it is an outgoing incurred in undertaking the business of direct insurance underwriting, and is not to be netted off against premium revenue.

- D10.1.4 Outwards reinsurance expense is recognised in surplus or deficit consistently with the recognition of reinsurance recoveries under the reinsurance contract. For proportional reinsurance the estimate of outwards reinsurance expense is based upon the gross premium of the underlying direct insurance contract. For non-proportional reinsurance the cedant estimates the total claims that are likely to be made under the contract and hence whether it needs to recognise additional outwards reinsurance expense under a minimum and deposit arrangement or whether it needs to recognise reinstatement premiums expense.
- D10.1.5 Some reinsurance contracts purchased by a cedant might involve an experience account. While these contracts may require annual renewal, in substance, the contract period is likely to be greater than one year. In estimating the outwards reinsurance expense and reinsurance recoveries to be recognised in the reporting period the cedant considers the probability-weighted expected cash flows over the expected period of indemnity and discounts the cash flows to reflect the time value of money. In determining the discount rates to be adopted, an insurer applies the same principles that are used to determine the discount rates for outstanding claims liabilities that are outlined in section 6. In considering all expected cash flows the reinsurer considers any commissions and commission rebates.

Reinsurance Recoveries and Non-reinsurance Recoveries

- D11.1 Reinsurance recoveries received or receivable in relation to the outstanding claims liability and non-reinsurance recoveries received or receivable shall be recognised as revenue of the cedant and shall not be netted off against the claims expense or outwards reinsurance expense in surplus or deficit, or the outstanding claims liability or unearned premium liability in the statement of financial position.**
- D11.1.1 The reinsurance recoveries receivable in the statement of financial position may not be received for some time. The reinsurance recoveries receivable are discounted on a basis consistent with the discounting of the outstanding claims liabilities outlined in section 6.
- D11.1.2 An insurer may also be entitled to non-reinsurance recoveries under the insurance contract such as salvage, subrogation and sharing arrangements with other insurers. Non-reinsurance recoveries are not offset against gross claims, but are recognised as revenue or assets, in the same way as, but separately from, reinsurance recoveries. The non-reinsurance recoveries receivable in the statement of financial position may not be received for some time. The non-reinsurance recoveries receivable are discounted on a basis consistent with the discounting of the outstanding claims liabilities outlined in section 6.
- D11.1.3 Amounts that reduce the liability to the policyholder, such as excesses or allowances for contributory negligence, are not non-reinsurance recoveries and are offset against the gross claims.

Impairment of Reinsurance Assets

- D12.1.1 If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment in surplus or deficit. A reinsurance asset is impaired if, and only if:
- (a) There is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive amounts due to it under the terms of the contract; and
 - (b) That event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.

Portfolio Transfers and Business Combinations

- D13.1 Where the responsibility in relation to claims on transferred insurance business remains with the transferring insurer, the transfer shall be treated by the transferring insurer and the accepting insurer as reinsurance business.**
- D13.1.1 Portfolio transfer is a term used to describe the process by which premiums and claims are transferred from one insurer to another. Transfers may be completed in a number of ways in relation to claims arising from events that occurred before the transfer. The receiving insurer may take responsibility in relation to all claims under the agreement or treaty that have not yet been paid, or it may take responsibility only in relation to those claims arising from events that occur after the date of transfer.

D13.1.2 In relation to the transfer of insurance business, while the acquiring insurer agrees to meet the claims of those insured from a particular time, the contractual responsibility of the original insurer to meet those claims normally remains.

D13.1.3 In relation to the withdrawal of a reinsurer from a reinsurance treaty arrangement, the contractual responsibility of the reinsurer to the direct insurer in relation to outstanding claims may be passed back to the direct insurer with a return of any premium relating to unexpired risk, or may be retained by the withdrawing reinsurer. In the former case, the direct insurer may choose to reinsure the outstanding claims with another reinsurer. This assuming reinsurer would be ceded premiums for bearing liability in relation to existing outstanding claims.

D13.1.4 Where the responsibility in relation to claims on transferred insurance business remains with the transferring insurer:

- (a) The transferring insurer recognises the transferred premium revenue and the relevant outstanding claims in the same way as other outwards reinsurance business; and
- (b) The accepting insurer recognises the premium revenue ceded to it and the relevant outstanding claims in the same way as other inwards reinsurance business.

D13.2 Where the responsibility in relation to claims on transferred insurance business passes from the transferring insurer to the accepting insurer, the transfer shall be accounted for as a portfolio withdrawal by the transferring insurer and as a portfolio assumption by the accepting insurer.

D13.3 A portfolio withdrawal shall be accounted for by the transferring insurer by eliminating the liabilities and assets connected with the risks transferred. A portfolio assumption shall be accounted for by the accepting insurer by recognising the relevant amount of unexpired premium revenue and the outstanding claims for which the transferring insurer is no longer responsible.

D13.3.1 To comply with PBE IFRS 3, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and insurance assets acquired in a business combination. However, an insurer is permitted, but not required, to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

- (a) A liability measured in accordance with the insurer's accounting policies for general insurance contracts that it issues; and
- (b) An intangible asset, representing the difference between
 - (i) The fair value of the contractual insurance rights acquired and insurance obligations assumed; and
 - (ii) The amount described in paragraph D13.3.1(a).

The subsequent measurement of this asset shall be consistent with the measurement of the related insurance liability.

D13.3.2 An insurer acquiring a portfolio of general insurance contracts may use an expanded presentation described in paragraph D13.3.1.

D13.3.3 The intangible assets described in paragraphs D13.3.1 and D13.3.2 are excluded from the scope of PBE IPSAS 26 and PBE IPSAS 31 in respect of recognition and measurement. PBE IPSAS 26 and PBE IPSAS 31 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a business combination or portfolio transfer.

D13.3.4 PBE IPSAS 31 includes specific disclosure requirements in relation to this intangible asset.

Underwriting Pools and Coinsurance

D14.1 Insurance business allocated through underwriting pools and coinsurance arrangements, by an entity acting as agent, shall be accounted for by the accepting insurer as direct insurance business.

D14.1.1 Direct insurers or reinsurers may form underwriting pools or enter coinsurance arrangements as vehicles for jointly insuring particular risks or types of risks. Premiums, claims and other expenses are usually shared in agreed ratios by insurers involved in these arrangements.

D14.1.2 Many underwriting pools and coinsurance arrangements involve the acceptance of risks by an entity acting as an agent for pool members or coinsurers. The entity receives premiums and pays claims and expenses, and allocates shares of the business to each pool member or coinsurer in agreed ratios. As the entity acting as agent is not an insurer, the business allocated to pool members and coinsurers is not reinsurance business. Pool members and coinsurers treat such business allocated to them as direct insurance business.

D14.2 Business directly underwritten by a member of an underwriting pool or coinsurance arrangement shall be treated as direct insurance business and the portion of the risk reinsured by other pool members or coinsurers, determined by reference to the extent of the shares in the pool or arrangement of other pool members or coinsurers, shall be treated as outwards reinsurance. The pool member's or coinsurer's share of insurance business that other insurers place in the pool or arrangement shall be treated as inwards reinsurance.

Assets Backing General Insurance Liabilities

Fair Value Approach

D15.1 Paragraphs D15.2 to D15.5 address the measurement of certain assets backing general insurance liabilities or financial liabilities that arise under non-insurance contracts. The fair value approach to the measurement of assets backing general insurance liabilities or financial liabilities that arise under non-insurance contracts is consistent with the present value measurement approach for general insurance liabilities, and the fair value measurement for financial liabilities that arise under non-insurance contracts, required by this Appendix. Where assets are not backing general insurance liabilities or financial liabilities that arise under non-insurance contracts, general insurers apply the applicable PBE Standards, making use of any measurement choices available.

Measurement

D15.2 **Financial assets that:**

- (a) **Are within the scope of PBE IPSAS 29;**
- (b) **Back general insurance liabilities; and**
- (c) **Are permitted to be designated as "at fair value through surplus or deficit" under PBE IPSAS 29;**

shall be designated as "at fair value through surplus or deficit" on initial recognition.

D15.2.1 An insurer applies PBE IPSAS 29 to its financial assets. Under PBE IPSAS 29 a financial asset "at fair value through surplus or deficit" is a financial asset that meets either of the following conditions:

- (a) It is classified as held for trading; or
- (b) It is designated as "at fair value through surplus or deficit" upon initial recognition. An entity may use this designation when the financial asset is a contract with an embedded derivative and paragraph 13 of PBE IPSAS 29 allows the entity to measure the contract as "at fair value through surplus or deficit"; or when doing so results in more relevant information, because either:
 - (i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an "accounting mismatch") that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
 - (ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example the entity's governing body and chief executive officer.

D15.2.2 The view adopted in this Appendix is that financial assets, within the scope of PBE IPSAS 29 that back general insurance liabilities, are permitted to be measured at fair value through surplus or deficit under PBE IPSAS 29. This is because the measurement of general insurance liabilities under this Appendix incorporates current information and measuring the financial assets backing these general

insurance liabilities at fair value, eliminates or significantly reduces a potential measurement inconsistency which would arise if the assets were classified as available for sale or measured at amortised cost.

D15.3 Investment property within the scope of PBE IPSAS 16 and that backs general insurance liabilities shall be measured using the fair value model under PBE IPSAS 16.

D15.4 Property, plant and equipment that is within the scope of PBE IPSAS 17 *Property, Plant and Equipment* and that backs general insurance liabilities, shall be measured using the revaluation model under PBE IPSAS 17.

D15.4.1–D15.4.2 [Not used.]

D15.5 When preparing separate financial statements, those investments in controlled entities, jointly controlled entities and associates that:

- (a) [Not used.]
- (b) **Back general insurance liabilities; and**
- (c) **Are permitted to be designated as “at fair value through surplus or deficit” under PBE IPSAS 29;**

shall be designated as “at fair value through surplus or deficit” under PBE IPSAS 29 on initial recognition.

D15.5.1 An insurer applies PBE IPSAS 6 to its investments in controlled entities, jointly controlled entities and associates when preparing separate financial statements. Under PBE IPSAS 6, in the controlling entity’s separate financial statements, the investments in controlled entities, jointly controlled entities and associates can either be accounted for using the equity method, at cost or as a financial instrument in accordance with PBE IPSAS 29.

D15.5.2 In the controlling entity’s separate financial statements, investments in controlled entities, jointly controlled entities and associates, that are within the scope of PBE IPSAS 6 that the insurer considers back general insurance liabilities, and that are permitted to be designated as “at fair value through surplus or deficit” under PBE IPSAS 29 are designated as “at fair value through surplus or deficit” under PBE IPSAS 29 on initial recognition.

D15.5.3 [Not used.]

Non-Insurance Contracts

D16.1 Non-insurance contracts shall be treated under PBE IPSAS 29 to the extent that they give rise to financial assets and financial liabilities. However, the financial assets and the financial liabilities that arise under these contracts shall be designated as “at fair value through surplus or deficit”, where permitted under PBE IPSAS 29.

D16.1.1 In relation to non-insurance contracts, an insurer applies PBE IPSAS 29 to its financial assets and financial liabilities. Under PBE IPSAS 29 a financial asset or financial liability at fair value through surplus or deficit is a financial asset or financial liability that meets either of the following conditions:

- (a) It is classified as held for trading; or
- (b) It is designated as “at fair value through surplus or deficit” upon initial recognition. An entity may use this designation when the financial asset is a contract with an embedded derivative and paragraph 13 of PBE IPSAS 29 allows the entity to measure the contract as “at fair value through surplus or deficit”; or when doing so results in more relevant information, because either:
 - (i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an “accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
 - (ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis

to the entity's key management personnel (as defined in PBE IPSAS 20 *Related Party Disclosures*), for example the entity's governing body and chief executive officer.

D16.2 Paragraphs D15.2, D15.3, D15.4 and D15.5 shall also be applied to the measurement of assets that back financial liabilities that arise under non-insurance contracts.

Disclosures

Statement of Comprehensive Revenue and Expense

D17.1 In relation to surplus or deficit, the financial statements shall disclose:

- (a) **The underwriting result for the reporting period, determined as the amount obtained by deducting the sum of claims expense, outwards reinsurance premium expense and underwriting expenses from the sum of direct and inwards reinsurance premium revenues and recoveries revenue;**
- (b) **Net claims incurred, showing separately:**
 - (i) **The amount relating to risks borne in the current reporting period; and**
 - (ii) **The amount relating to a reassessment of risks borne in all previous reporting periods.**

An explanation shall be provided where net claims incurred relating to a reassessment of risks borne in previous reporting periods are material; and

- (c) **In respect of D17.1(b)(i) and D17.1(b)(ii), the following components shall be separately disclosed:**
 - (i) **Gross claims incurred - undiscounted;**
 - (ii) **Reinsurance and other recoveries - undiscounted; and**
 - (iii) **Discount movements shown separately for (i) and (ii).**

D17.1.1 This Appendix requires the underwriting result for the reporting period to be disclosed. This disclosure gives an indication of an insurer's underwriting performance, including the extent to which underwriting activities rely on investment revenues for the payment of claims.

D17.1.1a The information provided by a direct insurer to a reinsurer may be insufficient to allow the reinsurer to make the claims development disclosures required by paragraph D17.1(b). On this basis, for inwards reinsurance business, the Appendix allows an exemption from the claims development disclosure requirements.

D17.1.2 Based on the total movement in net claims incurred, it may appear that there has not been a material reassessment of risks borne in previous periods, however, there may be material movements at a business segment level, that mitigate each other. For example, the insurer may have seen a material deterioration in its motor portfolio, which has been mitigated by material savings in the professional indemnity portfolio, such that when both portfolios are aggregated there appears to have been little change in the reporting period. In such circumstances, the insurer provides an explanation of the reassessments that took place in the net claims incurred for previous periods during the reporting period at the business segment level.

Statement of Financial Position

D17.2 The financial statements shall disclose in relation to the outstanding claims liability:

- (a) **The central estimate of the expected present value of future payments for claims incurred;**
- (b) **The component related to the risk margin;**
- (c) **The percentage risk margin adopted in determining the outstanding claims liability (determined from (a) and (b) above);**
- (d) **The probability of adequacy intended to be achieved through adoption of the risk margin; and**

- (e) **The process used to determine the risk margin, including the way in which diversification of risks has been allowed for.**

D17.3 An insurer shall disclose the process used to determine which assets back general insurance liabilities and which assets back financial liabilities arising under non-insurance contracts.

Non-Insurance Contracts

D17.4 Where a general insurer has issued a non-insurance contract or holds a non-insurance contract as a cedant, and that non-insurance contract has a material financial impact on the statement of comprehensive revenue and expense, statement of financial position or cash flow statement, the general insurer shall disclose:

- (a) **The nature of the non-insurance contract;**
- (b) **The recognised assets, liabilities, revenue, expense and cash flows arising from the non-insurance contract; and**
- (c) **Information that helps users to understand the amount, timing and uncertainty of future cash flows from the non-insurance contract.**

D17.4.1 In applying paragraph D17.4 a non-insurance contract must be considered together with any related contracts or side letters, when determining the need for disclosure, and in making the disclosures required.

D17.5–D17.5a [Not used.]

Insurance Contracts – Explanation of Recognised Amounts

D17.6 An insurer shall disclose information that identifies and explains the amounts in its financial statements arising from insurance contracts.

D17.6.1 To comply with paragraph D17.6, an insurer shall disclose:

- (a) Its accounting policies for insurance contracts and related assets, liabilities, revenue and expense;
- (b) The recognised assets, liabilities, revenue, expense and cash flows arising from insurance contracts. Furthermore, if the insurer is a cedant, it shall disclose:
 - (i) Gains and losses recognised in surplus or deficit on buying reinsurance; and
 - (ii) If the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period;
- (c) The process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, an insurer shall also give quantified disclosure of those assumptions;
- (d) The effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial statement; and
- (e) Reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.

D17.6.2 In applying paragraph D17.6.1(b), the recognised assets and liabilities arising from insurance contracts would normally include:

- (a) Gross outstanding claims liability;
- (b) Reinsurance recoveries receivable arising from the outstanding claims liability;
- (c) Gross unearned premium liability;
- (d) Reinsurance recoveries receivable arising from the unearned premium liability;
- (e) Unexpired risk liability;
- (f) Other reinsurance recoveries receivable;

- (g) Other recoveries receivable;
- (h) Outwards reinsurance expense asset or liability;
- (i) Direct premium revenue receivable;
- (j) Inwards reinsurance premium revenue receivable;
- (k) Deferred acquisition cost asset;
- (l) Intangible assets relating to acquired insurance contracts; and
- (m) Provisions for premium deficiency.

D17.6.3 In applying paragraph D17.6.1(b), the recognised revenue and expenses arising from insurance contracts would normally include:

- (a) Direct premium revenue;
- (b) Inwards reinsurance premium revenue (including retrocessions);
- (c) Reinsurance and other recoveries revenue;
- (d) Direct claims expense;
- (e) Reinsurance claims expense;
- (f) Outwards reinsurance premium expense (including retrocessions);
- (g) Acquisition costs expense; and
- (h) Other underwriting expenses, including claims handling expenses.

D17.6.4 When an insurer is presenting the disclosures required by paragraphs D17.6.1(c) and D17.6.1(d) the insurer determines the level and extent of disclosure that is appropriate having regard to its circumstances and the qualitative characteristics of financial statements under the PBE *Framework*, of understandability, relevance, reliability and comparability.

D17.6.5 For an insurer that is involved in a large number of insurance classes, across different jurisdictions, disclosure by class of business is likely to be voluminous and may not be understandable to the user of the financial statement. Furthermore, for such an insurer, disclosure for the entity as a whole is also likely to be at too high a level of aggregation to be relevant or comparable. It is expected that for most insurers disclosure at the major business segment level would normally be most appropriate. The insurer may believe that disclosure of a range of values would be relevant to the users of the financial statements.

D17.6.6 Some of the assumptions that would normally have the greatest effect on the measurement of the recognised amounts described in D17.6.1(b), are discount rates, inflation rates, average weighted term to settlement from the claims reporting date, average claim frequency, average claim size and expense rates. The insurer determines whether these assumptions shall be disclosed given the requirements of paragraph D17.6 and D17.6.1.

D17.6.7 The statement of financial position should disclose the following items, classified into current and non-current categories, or in the broad order of their liquidity:

- (a) Investments integral to the entity's insurance activities, by class of investment; and
- (b) Operating assets by class of asset.

Nature and Extent of Risks Arising from Insurance Contracts

D17.7 An insurer shall disclose information that enables users of its financial report to evaluate the nature and extent of risks arising from insurance contracts.

D17.7.1 To comply with paragraph D17.7, an insurer shall disclose:

- (a) Its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks;
- (b) Information about insurance risk (both before and after risk mitigation by reinsurance), including information about:
 - (i) Sensitivity to insurance risk (see paragraph D17.7.5);

- (ii) Concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (e.g., type of insured event, geographical area, or currency); and
 - (iii) Actual claims compared with previous estimates (i.e. claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year;
- (c) Information about credit risk, liquidity risk and market risk that paragraphs 38–49 of PBE IPSAS 30 *Financial Instruments: Disclosures* would require if the insurance contracts were within the scope of PBE IPSAS 30. However:
- (i) An issuer need not provide the maturity analysis required by paragraph 46(a) of PBE IPSAS 30 if it discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. This may take the form of an analysis, by estimated timing, of the amounts recognised in the statement of financial position; and
 - (ii) If an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirement in paragraph 47(a) of PBE IPSAS 30. Such an insurer shall also provide the disclosures required by paragraph 48 of PBE IPSAS 30⁶; and
- (d) Information about exposures to market risk arising from embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.

D17.7.2 For an insurer that is involved in a large number of insurance classes, across different jurisdictions, disclosure by class of business is likely to be voluminous and may not be understandable to the user of the financial report. Furthermore, for such an insurer disclosure for the entity as a whole would normally be at too high a level of aggregation to be relevant or comparable. It is expected that for most insurers disclosure at the major business segment level would normally be most appropriate.

D17.7.3 The claims development disclosure required by paragraph D17.7.1(b)(iii) only applies to classes of business where claims are not typically resolved within one year. The insurer, in disclosing claims development, ensures it is clear to the reader of the financial report, which classes of business, or which segments of the business, are covered by the disclosures and which classes of business, or which segments of the business, are not covered by the disclosures.

D17.7.4 [Not used.]

D17.7.5 To comply with paragraph D17.7.1(b)(i), an insurer shall disclose either (a) or (b) as follows:

- (a) A sensitivity analysis that shows how comprehensive revenue and expense and net assets/equity would have been affected had changes in the relevant risk variable that were reasonably possible at the end of the reporting period occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used. However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 48 of PBE IPSAS 30; and
- (b) Qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows.

⁶ A Tier 2 entity shall comply in full with any requirements of PBE IPSAS 30 which are referred to in PBE IFRS 4.

Liability Adequacy Test

D17.8 In relation to the liability adequacy test in section 9, the financial statements shall disclose:

- (a) **Where a deficiency has been identified, the amounts underlying the calculation performed, that is:**
 - (i) **Unearned premium liability;**
 - (ii) **Related reinsurance asset;**
 - (iii) **Deferred acquisition costs;**
 - (iv) **Intangible assets;**
 - (v) **Present value of expected future cash flows for future claims, showing expected reinsurance recoveries separately;**
 - (vi) **Deficiency;**
- (b) **Any write-down of deferred acquisition costs under the liability adequacy test;**
- (c) **Any write-down of intangible assets under the liability adequacy test;**
- (d) **In relation to the present value of expected future cash flows for future claims:**
 - (i) **The central estimate of the present value of expected future cash flows;**
 - (ii) **The component of present value of expected future cash flows related to the risk margin;**
 - (iii) **The percentage risk margin adopted in determining the present value of expected future cash flows (determined from (i) and (ii) above);**
 - (iv) **The probability of adequacy intended to be achieved through adoption of the risk margin;**
 - (v) **The process used to determine the risk margin, including the way in which diversification of risks has been allowed for;**
- (e) **Where the probability of adequacy disclosed in paragraph D17.2(d) is not the same or similar to the probability of adequacy disclosed in paragraph D17.8(d)(iv), the reasons for the difference; and**
- (f) **Where a surplus has been identified, the fact that the liability adequacy test identified a surplus.**

Actuarial Information

D17.8A Where an actuarial report has been obtained, the following must be disclosed in the notes:

- (a) **If other than the end of the reporting period, the effective date of the calculation or assessment in the actuarial report;**
- (b) **The name and qualifications of the actuary;**
- (c) **Where the actuary is satisfied as to the nature, sufficiency and accuracy of the data used to determine the outstanding claims liability;**
- (d) **The key assumptions used by the actuary in determining the outstanding claims liability; and**
- (e) **Any qualifications contained in the actuarial report.**

Disclosure of Assumptions

D17.8B A summary of the key assumptions used in determining the outstanding claims liability shall be disclosed for each portfolio and for financial liabilities, if applicable, in the notes including:

- (a) **The methodology used in determining the liability;**
- (b) **Discount rates;**

- (c) **Inflation rates applicable to claim payments;**
- (d) **Future claims expenses (allocated and unallocated);**
- (e) **The pattern of claims run-off; and**
- (f) **Any other significant assumptions for the methodology used.**

Other Disclosures

D17.8C The credit rating of the insurer must be disclosed. If the insurer is not required to have a credit rating this must be disclosed.

D17.8D The insurer must disclose by way of descriptive note the principles on which the insurer's reinsurance programme is structured.

D17.8E The amount of net assets/equity retained for the purpose of financial soundness and the basis of establishing that amount must be disclosed. An economic entity must make this disclosure for each insurer in the economic entity.

D17.8F.1 The disclosures on reinsurance and the amount of net assets/equity retained by an insurer should describe how the insurer manages its unexpected risks – those risks arising from claims volatility or catastrophe. The disclosure should include the insurer's assessment of the likelihood of claims volatility or catastrophe for particular classes of business and the geographical distribution of its risks, as it is these assessments that determine the total level of unexpected risk and therefore the best way of managing that risk.

D17.8F.2 Disclosures on reinsurance and the amount of net assets/equity retained by an insurer to maintain its continuing financial soundness should describe the types of risk that are covered by these measures and the level of coverage compared to the insurer's total exposure to that type of risk. If the insurer uses other methods to manage its unexpected risks this additional information should also form part of these disclosures. These other methods could include self-reinsurance through a controlling entity, reinsurance through its own asset base, or credit lines that the insurer can draw upon if required. These disclosures in total (reinsurance, net assets/equity retention and additional information) should give the user of the financial statements a general understanding of the insurer's principles and methods for managing unexpected risks rather than a detailed explanation.

D17.9.1 This Appendix addresses disclosure requirements in relation to general insurance contracts. Other PBE Standards may be relevant to a general insurer's financial statement. In particular, the disclosure requirements in PBE IPSAS 30 would normally be relevant to general insurers.

D18.1–D19.1 [Not used.]

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, PBE IFRS 4.

BC1. The New Zealand Accounting Standards Board (NZASB) has not modified the recognition and measurement requirements in NZ IFRS 4 *Insurance Contracts* for application by Tier 1 and Tier 2 public benefit entities. Where applicable, disclosure concessions have been identified for Tier 2 entities and the language generalised for use by public benefit entities. The NZASB considered that the requirements of NZ IFRS 4 are appropriate for application by public benefit entities.

History of Amendments

PBE IFRS 4 *Insurance Contracts* was issued in September 2014.

This table lists the pronouncements establishing and substantially amending PBE IFRS 4.

Pronouncements	Date issued	Early operative date	Effective date (annual financial statements ... on or after ...)
PBE IFRS 4 <i>Insurance Contracts</i>	Sept 2014	Early application is permitted for not-for-profit public benefit entities	1 April 2015