IASB documents published to accompany

IFRS 4

Insurance Contracts

The text of the unaccompanied standard, IFRS 4, is contained in Part A of this edition. The text of the Basis for Conclusions on IFRS 4 is contained in Part C of this edition. Its effective date when issued was 1 January 2005. This part presents the following document:

IMPLEMENTATION GUIDANCE

CONTENTS

Guidance on implementing IFRS 4 *Insurance Contracts*

This guidance accompanies, but is not part of, IFRS 4.

Introduction

IG1 This implementation guidance:

(a) illustrates which contracts and embedded derivatives are within the scope of the IFRS (see paragraphs IG2–IG4).

(b) includes an example of an insurance contract containing a deposit component that needs to be unbundled (paragraph IG5).

(c) illustrates shadow accounting (paragraphs IG6–IG10).

(d) discusses how an insurer might satisfy the disclosure requirements in the IFRS (paragraphs IG11–IG71).

Definition of insurance contract

IG2 IG Example 1 illustrates the application of the definition of an insurance contract. The example does not illustrate all possible circumstances.

IG Example 1: Application of the definition of an insurance contract		
Contract type		***Treatment phase I***
1.1	Insurance contract (see definition in Appendix A of the IFRS and guidance in Appendix B).	Within the scope of the IFRS, unless covered by scope exclusions in paragraph 4 of the IFRS. Some embedded derivatives and deposit components must be separated (see IG Examples 2 and 3 and paragraphs 7–12 of the IFRS).
1.2	Death benefit that could exceed amounts payable on surrender or maturity.	Insurance contract (unless contingent amount is insignificant in all scenarios that have commercial substance). Insurer could suffer a significant loss on an individual contract if the policyholder dies early. See IG Examples 1.23–.27 for further discussion of surrender penalties.
1.3	A unit- linked contract that pays benefits linked to the fair value of a pool of assets. The benefit is 100 per cent of the unit value on surrender or maturity and 101 per cent of the unit value on death.	This contract contains a deposit component (100 per cent of unit value) and an insurance component (additional death benefit of 1 per cent). Paragraph 10 of the IFRS permits unbundling (but requires it only if the insurance component is material and the issuer would not otherwise recognise all obligations and rights arising under the deposit component). If the insurance component is not unbundled, the whole contract is an investment contract because the insurance component is insignificant in relation to the whole contract.
1.4	Life- contingent annuity.	Insurance contract (unless contingent amount is insignificant in all scenarios that have commercial substance). Insurer could suffer a significant loss on an individual contract if the annuitant survives longer than expected.

IG Example 1: Application of the definition of an insurance contract		
1.5	Pure endowment. The insured person receives a payment on survival to a specified date, but beneficiaries receive nothing if the insured person dies before then.	Insurance contract (unless the transfer of insurance risk is insignificant). If a relatively homogeneous book of pure endowments is known to consist of contracts that all transfer insurance risk, the insurer may classify the entire book as insurance contracts without examining each contract to identify a few non- derivative pure endowments that transfer insignificant insurance risk (see paragraph B25).
1.6	Deferred annuity: policyholder will receive, or can elect to receive, a life- contingent annuity at rates guaranteed at inception.	Insurance contract (unless the transfer of insurance risk is insignificant). The contract transfers mortality risk to the insurer at inception, because the insurer might have to pay significant additional benefits for an individual contract if the annuitant elects to take the life- contingent annuity and survives longer than expected (unless the contingent amount is insignificant in all scenarios that have commercial substance).
1.7	Deferred annuity: policyholder will receive, or can elect to receive, a life- contingent annuity at rates prevailing when the annuity begins.	Not an insurance contract at inception, if the insurer can reprice the mortality risk without constraints. Within the scope of IFRS 9 *Financial Instruments* unless the contract contains a discretionary participation feature. Will become an insurance contract when the annuity rate is fixed (unless the contingent amount is insignificant in all scenarios that have commercial substance).
1.8	Investment contract[(a)] that does not contain a discretionary participation feature.	Within the scope of IFRS 9.
1.9	Investment contract containing a discretionary participation feature.	Paragraph 35 of the IFRS sets out requirements for these contracts, which are excluded from the scope of IFRS 9.
1.10	Investment contract in which payments are contractually linked (with no discretion) to returns on a specified pool of assets held by the issuer.	Within the scope of IFRS 9. Payments denominated in unit values representing the fair value of the specified assets are measured at current unit value (see paragraph B4.3.8(g) of IFRS 9).
1.11	Contract that requires the issuer to make specified payments 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. The contract may have various legal forms (eg insurance contract, guarantee or letter of credit).	Insurance contract, but within the scope of IFRS 9, not IFRS 4. However, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IFRS 9 and IAS 32[(b)] or IFRS 4 to such financial guarantee contracts. The legal form of the contract does not affect its recognition and measurement. Accounting by the holder of such a contract is excluded from the scope of IFRS 9 and IFRS 4 (unless the contract is a reinsurance contract). Therefore, paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* apply. Those paragraphs specify criteria to use in developing an accounting policy if no IFRS applies specifically to an item.

IG Example 1: Application of the definition of an insurance contract		
1.12	A credit‑ related guarantee that does not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index.	Not an insurance contract. A derivative within the scope of IFRS 9.
1.13	Guarantee fund established by contract. The contract requires all participants to pay contributions to the fund so that it can meet obligations incurred by participants (and, perhaps, others). Participants would typically be from a single industry, eg insurance, banking or travel.	The contract that establishes the guarantee fund is an insurance contract (see IG Example 1.11).
1.14	Guarantee fund established by law.	The commitment of participants to contribute to the fund is not established by a contract, so there is no insurance contract. Within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
1.15	Residual value insurance or residual value guarantee. Guarantee by one party of the fair value at a future date of a non‑ financial asset held by a beneficiary of the insurance or guarantee.	Insurance contract within the scope of the IFRS (unless changes in the condition of the asset have an insignificant effect). The risk of changes in the fair value of the non‑ financial asset is not a financial risk because the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific asset held (a non‑ financial variable). However, if the contract compensates the beneficiary only for changes in market prices and not for changes in the condition of the beneficiary's asset, the contract is a derivative and within the scope of IFRS 9. Residual value guarantees given by a lessee under a lease are within the scope of IFRS 16 *Leases*.
1.16	Product warranties issued directly by a manufacturer, dealer or retailer.	Insurance contracts, but excluded from the scope of the IFRS (see IFRS 15 *Revenue from Contracts with Customers* and IAS 37).
1.17	Product warranties issued by a third party.	Insurance contracts, no scope exclusion. Same treatment as other insurance contracts.
1.18	Group insurance contract that gives the insurer an enforceable and non‑ cancellable contractual right to recover all claims paid out of future premiums, with appropriate compensation for the time value of money.	Insurance risk is insignificant. Therefore, the contract is a financial asset within the scope of IFRS 9. Servicing fees are within the scope of IFRS 15 (recognise when (or as) services are provided, subject to various conditions).
1.19	Catastrophe bond: bond in which principal, interest payments or both are reduced if a specified triggering event occurs and the triggering event does not include a condition that the issuer of the bond suffered a loss.	Financial instrument with embedded derivative within the scope of IFRS 9.
1.20	Catastrophe bond: bond in which principal, interest payments or both are reduced significantly if a specified triggering event occurs and the triggering event includes a	The contract is an insurance contract, and contains an insurance component (with the issuer as policyholder and the holder as the insurer) and a deposit component.

IG Example 1: Application of the definition of an insurance contract		
	condition that the issuer of the bond suffered a loss.	(a) If specified conditions are met, paragraph 10 of the IFRS requires the holder to unbundle the deposit component and apply IFRS 9 to it. (b) The issuer accounts for the insurance component as reinsurance if it uses the bond for that purpose. If the issuer does not use the insurance component as reinsurance, it is not within the scope of the IFRS, which does not address accounting by policyholders for direct insurance contracts. (c) Under paragraph 13 of the IFRS, the holder could continue its existing accounting for the insurance component, unless that involves the practices prohibited by paragraph 14.
1.21	An insurance contract issued by an insurer to a defined benefit pension plan covering the employees of the insurer, or of another entity consolidated within the same financial statements as the insurer.	The contract will generally be eliminated from the financial statements, which will include: (a) the full amount of the pension obligation under IAS 19 *Employee Benefits*, with no deduction for the plan's rights under the contract. (b) no liability to policyholders under the contract. (c) the assets backing the contract.
1.22	An insurance contract issued to employees as a result of a defined contribution pension plan. The contractual benefits for employee service in the current and prior periods are not contingent on future service. The insurer also issues similar contracts on the same terms to third parties.	Insurance contract within the scope of the IFRS. If the employer pays part or all of the employee's premiums, the payment by the employer is an employee benefit within the scope of IAS 19. See also IAS 19, paragraphs 39–42 and 104–104D. Furthermore, a 'qualifying insurance policy' as defined in IAS 19 need not meet the definition of an insurance contract in this IFRS.
1.23	Loan contract containing a prepayment fee that is waived if prepayment results from the borrower's death.	Not an insurance contract. Before entering into the contract, the borrower faced no risk corresponding to the prepayment fee. Hence, although the loan contract exposes the lender to mortality risk, it does not transfer a pre- existing risk from the borrower. Thus, the risk associated with the possible waiver on death of the prepayment fee is not insurance risk (paragraphs B12 and B24(b) of Appendix B of the IFRS).
1.24	Loan contract that waives repayment of the entire loan balance if the borrower dies.	This contract contains a deposit component (the loan) and an insurance component (waiver of the loan balance on death, equivalent to a cash death benefit). If specified conditions are met, paragraph 10

IG Example 1: Application of the definition of an insurance contract		
		of the IFRS requires or permits unbundling. If the insurance component is not unbundled, the contract is an insurance contract if the insurance component is significant in relation to the whole contract.
1.25	A contract permits the issuer to deduct a market value adjustment (MVA) from surrender values or death benefits to reflect current market prices for the underlying assets. The contract does not permit an MVA for maturity benefits.	The policyholder obtains an additional survival benefit because no MVA is applied at maturity. That benefit is a pure endowment (see IG Example 1.5). If the risk transferred by that benefit is significant, the contract is an insurance contract.
1.26	A contract permits the issuer to deduct an MVA from surrender values or maturity payments to reflect current market prices for the underlying assets. The contract does not permit an MVA for death benefits.	The policyholder obtains an additional death benefit because no MVA is applied on death. If the risk transferred by that benefit is significant, the contract is an insurance contract.
1.27	A contract permits the issuer to deduct an MVA from surrender payments to reflect current market prices for the underlying assets. The contract does not permit an MVA for death and maturity benefits. The amount payable on death or maturity is the amount originally invested plus interest.	The policyholder obtains an additional benefit because no MVA is applied on death or maturity. However, that benefit does not transfer insurance risk from the policyholder because it is certain that the policyholder will live or die and the amount payable on death or maturity is adjusted for the time value of money (see paragraph B27 of the IFRS). The contract is an investment contract. This contract combines the two features discussed in IG Examples 1.25 and 1.26. When considered separately, those two features transfer insurance risk. However, when combined, they do not transfer insurance risk. Therefore, it is not appropriate to separate this contract into two ‘insurance’ components. If the amount payable on death were not adjusted in full for the time value of money, or were adjusted in some other way, the contract might transfer insurance risk. If that insurance risk is significant, the contract is an insurance contract.
1.28	A contract meets the definition of an insurance contract. It was issued by one entity in a group (for example a captive insurer) to another entity in the same group.	If the entities present individual or separate financial statements, they treat the contract as an insurance contract in those individual or separate financial statements (see IAS 27 *Separate Financial Statements*). The transaction is eliminated from the group’s consolidated financial statements. If the intragroup contract is reinsured with a third party that is not part of the group, the reinsurance contract is treated as a direct insurance contract in the consolidated financial statements because the intragroup contract is eliminated on consolidation.
1.29	An agreement that entity A will compensate entity B for losses on one or more contracts issued by entity B that do not transfer significant insurance risk.	The contract is an insurance contract if it transfers significant insurance risk from entity B to entity A, even if some or all of the individual contracts do not transfer significant insurance risk to entity B. The contract is a reinsurance contract if any of the contracts issued by entity B are insurance contracts. Otherwise, the contract is a direct insurance contract.

IG Example 1: Application of the definition of an insurance contract	
(a)	The term ‘investment contract’ is an informal term used for ease of discussion. It refers to a financial instrument that does not meet the definition of an insurance contract.
(b)	When an entity applies IFRS 7 *Financial Instruments: Disclosures*, the reference to IAS 32 is replaced by a reference to IFRS 7.

Embedded derivatives

IG3 IFRS 9 requires an entity to separate embedded derivatives that meet specified conditions from the host instrument that contains them, measure the embedded derivatives at fair value and recognise changes in their fair value in profit or loss. However, an insurer need not separate an embedded derivative that itself meets the definition of an insurance contract (paragraph 7 of the IFRS). Nevertheless, separation and fair value measurement of such an embedded derivative are not prohibited if the insurer’s existing accounting policies require such separation, or if an insurer changes its accounting policies and that change meets the criteria in paragraph 22 of the IFRS.

IG4 IG Example 2 illustrates the treatment of embedded derivatives contained in insurance contracts and investment contracts. The term ‘investment contract’ is an informal term used for ease of discussion. It refers to a financial instrument that does not meet the definition of an insurance contract. The example does not illustrate all possible circumstances. Throughout the example, the phrase ‘fair value measurement is required’ indicates that the issuer of the contract is required:

(a) to measure the embedded derivative at fair value and include changes in its fair value in profit or loss.

(b) to separate the embedded derivative from the host contract, unless it measures the entire contract at fair value and includes changes in that fair value in profit or loss.

IG Example 2: Embedded derivatives

	Type of embedded derivative	***Treatment if embedded in a host insurance contract***	***Treatment if embedded in a host investment contract***
2.1	Death benefit linked to equity prices or equity index, payable only on death or annuitisation and not on surrender or maturity.	The equity- index feature is an insurance contract (unless the life- contingent payments are insignificant), because the policyholder benefits from it only when the insured event occurs. Fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the life- contingent payments are insignificant).
2.2	Death benefit that is the greater of: (a) unit value of an investment fund (equal to the amount payable on surrender or maturity); and (b) guaranteed minimum.	Excess of guaranteed minimum over unit value is a death benefit (similar to the payout on a dual trigger contract, see IG Example 2.19). This meets the definition of an insurance contract (unless the life- contingent payments are insignificant) and fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the life- contingent payments are insignificant).
2.3	Option to take a life- contingent annuity at guaranteed rate (combined guarantee of interest rates and mortality charges).	The embedded option is an insurance contract (unless the life- contingent payments are insignificant). Fair value measurement is	Not applicable. The entire contract is an insurance contract (unless the life- contingent payments are insignificant).

IG Example 2: Embedded derivatives			
		not required (but not prohibited).	
2.4	Embedded guarantee of minimum interest rates in determining surrender or maturity values that is at or out of the money on issue, and not leveraged.	The embedded guarantee is not an insurance contract (unless significant payments are life- contingent[(a)]). However, it is closely related to the host contract (paragraph B4.3.8(b) of IFRS 9). Fair value measurement is not required (but not prohibited). If significant payments are life- contingent, the contract is an insurance contract and contains a deposit component (the guaranteed minimum). However, an insurer is not required to unbundle the contract if it recognises all obligations arising from the deposit component (paragraph 10 of the IFRS).	Fair value measurement is not permitted (paragraph B4.3.8(b) of IFRS 9).
		If cancelling the deposit component requires the policyholder to cancel the insurance component, the two cancellation options may be interdependent; if the option to cancel the deposit component cannot be measured separately (ie without considering the other option), both options are regarded as part of the insurance component (paragraph B4.3.8(h) of IFRS 9).	
2.5	Embedded guarantee of minimum interest rates in determining surrender or maturity values: in the money on issue, or leveraged.	The embedded guarantee is not an insurance contract (unless the embedded guarantee is life- contingent to a significant extent). Fair value measurement is required (paragraph B4.3.8(b) of IFRS 9).	Fair value measurement is required (paragraph B4.3.8(b) of IFRS 9).
2.6	Embedded guarantee of minimum annuity payments if the annuity payments are contractually linked to investment returns or asset prices:		
	(a) guarantee relates only to payments that are life- contingent.	The embedded guarantee is an insurance contract (unless the life- contingent payments are insignificant). Fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the life- contingent payments are insignificant).

IG Example 2: Embedded derivatives			
	(b) guarantee relates only to payments that are not life- contingent.	The embedded derivative is not an insurance contract. Fair value measurement is required (unless the guarantee is regarded as closely related to the host contract because the guarantee is an unleveraged interest floor that is at or out of the money at inception, see paragraph B4.3.8(b) of IFRS 9).	Fair value measurement is required (unless the guarantee is regarded as closely related to the host contract because the guarantee is an unleveraged interest floor that is at or out of the money at inception, see paragraph B4.3.8(b) of IFRS 9).
	(c) policyholder can elect to receive life- contingent payments or payments that are not life- contingent, and the guarantee relates to both. When the policyholder makes its election, the issuer cannot adjust the pricing of the life- contingent payments to reflect the risk that the insurer assumes at that time (see paragraph B29 of the IFRS for discussion of contracts with separate accumulation and payout phases).	The embedded option to benefit from a guarantee of life- contingent payments is an insurance contract (unless the life- contingent payments are insignificant). Fair value measurement is not required (but not prohibited). The embedded option to receive payments that are not life- contingent ('the second option') is not an insurance contract. However, because the second option and the life- contingent option are alternatives, their fair values are interdependent. If they are so interdependent that the issuer cannot measure the second option separately (ie without considering the life- contingent option), the second option is closely related to the insurance contract. In that case, fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the life- contingent payments are insignificant).
2.7	Embedded guarantee of minimum equity returns on surrender or maturity.	The embedded guarantee is not an insurance contract (unless the embedded guarantee is life- contingent to a significant extent) and is not closely related to the host insurance contract. Fair value measurement is required.	Fair value measurement is required.
2.8	Equity- linked return available on surrender or maturity.	The embedded derivative is not an insurance contract (unless the equity- linked return is life- contingent to a significant extent) and is not closely related to the host insurance contract. Fair value measurement is required.	Fair value measurement is required.
2.9	Embedded guarantee of minimum equity returns that	The embedded guarantee is an insurance contract	Not applicable. The entire contract is an insurance

IG Example 2: Embedded derivatives			
	is available only if the policyholder elects to take a life- contingent annuity.	(unless the life- contingent payments are insignificant), because the policyholder can benefit from the guarantee only by taking the annuity option (whether annuity rates are set at inception or at the date of annuitisation). Fair value measurement is not required (but not prohibited).	contract (unless the life- contingent payments are insignificant).
2.10	Embedded guarantee of minimum equity returns available to the policyholder as either (a) a cash payment, (b) a period- certain annuity or (c) a life- contingent annuity, at annuity rates prevailing at the **date of annuitisation**.	If the guaranteed payments are not contingent to a significant extent on survival, the option to take the life- contingent annuity does not transfer insurance risk until the policyholder opts to take the annuity. Therefore, the embedded guarantee is not an insurance contract and is not closely related to the host insurance contract. Fair value measurement is required. If the guaranteed payments are contingent to a significant extent on survival, the guarantee is an insurance contract (similar to a pure endowment). Fair value measurement is not required (but not prohibited).	Fair value measurement is required.
2.11	Embedded guarantee of minimum equity returns available to the policyholder as either (a) a cash payment (b) a period- certain annuity or (c) a life- contingent annuity, at annuity rates set at **inception**.	The whole contract is an insurance contract from inception (unless the life- contingent payments are insignificant). The option to take the life- contingent annuity is an embedded insurance contract, so fair value measurement is not required (but not prohibited). The option to take the cash payment or the period- certain annuity ('the second option') is not an insurance contract (unless the option is contingent to a significant extent on survival), so it must be separated. However, because the second option and the life- contingent option are alternatives, their fair values are interdependent. If they are so interdependent that the issuer cannot measure the second option separately (ie without considering the life- contingent option), the second option is closely	Not applicable.

IG Example 2: Embedded derivatives			
		related to the host insurance contract. In that case, fair value measurement is not required (but not prohibited).	
2.12	Policyholder option to surrender a contract for a cash surrender value specified in a schedule (ie not indexed and not accumulating interest).	Fair value measurement is not required (but not prohibited: paragraph 8 of the IFRS). The surrender value may be viewed as a deposit component, but the IFRS does not require an insurer to unbundle a contract if it recognises all its obligations arising under the deposit component (paragraph 10).	The surrender option is closely related to the host contract if the surrender value is approximately equal to the amortised cost at each exercise date (paragraph B4.3.5(e) of IFRS 9). Otherwise, the surrender option is measured at fair value.
2.13	Policyholder option to surrender a contract for account value based on a principal amount and a fixed or variable interest rate (or based on the fair value of a pool of interest- bearing securities), possibly after deducting a surrender charge.	Same as for a cash surrender value (IG Example 2.12).	Same as for a cash surrender value (IG Example 2.12).
2.14	Policyholder option to surrender a contract for a surrender value based on an equity or commodity price or index.	The option is not closely related to the host contract (unless the option is life- contingent to a significant extent). Fair value measurement is required (paragraphs 8 of the IFRS and B4.3.5(c) and (d) of IFRS 9).	Fair value measurement is required (paragraph B4.3.5(c) and (d) of IFRS 9).
2.15	Policyholder option to surrender a contract for account value equal to the fair value of a pool of equity investments, possibly after deducting a surrender charge.	If the insurer measures that portion of its obligation at account value, no further adjustment is needed for the option (unless the surrender value differs significantly from account value) (see paragraph B4.3.8(g) of IFRS 9). Otherwise, fair value measurement is required.	If the insurer regards the account value as the amortised cost or fair value of that portion of its obligation, no further adjustment is needed for the option (unless the surrender value differs significantly from account value). Otherwise, fair value measurement is required.
2.16	Contractual feature that provides a return contractually linked (with no discretion) to the return on specified assets.	The embedded derivative is not an insurance contract and is not closely related to the contract (paragraph B4.3.5(f) of IFRS 9). Fair value measurement is required.	Fair value measurement is required.
2.17	Persistency bonus paid at maturity in cash (or as a period- certain annuity).	The embedded derivative (option to receive the persistency bonus) is not an insurance contract (unless the persistency bonus is life- contingent to a significant extent).	An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent

IG Example 2: Embedded derivatives			
		Insurance risk does not include lapse or persistency risk (paragraph B15 of the IFRS). Fair value measurement is required.	adjustment to the approximate current market rate of interest at the time of the extension (paragraph B4.3.5(b) of IFRS 9). If the option or provision is not closely related to the host instrument, fair value measurement is required.
2.18	Persistency bonus paid at maturity as an enhanced life- contingent annuity.	The embedded derivative is an insurance contract (unless the life- contingent payments are insignificant). Fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the life- contingent payments are insignificant).
2.19	Dual trigger contract, eg contract requiring a payment that is contingent on a breakdown in power supply that adversely affects the holder (first trigger) and a specified level of electricity prices (second trigger). The contingent payment is made only if both triggering events occur.	The embedded derivative is an insurance contract (unless the first trigger lacks commercial substance). A contract that qualifies as an insurance contract, whether at inception or later, remains an insurance contract until all rights and obligations are extinguished or expire (paragraph B30 of the IFRS). Therefore, although the remaining exposure is similar to a financial derivative after the insured event has occurred, the embedded derivative is still an insurance contract and fair value measurement is not required (but not prohibited).	Not applicable. The entire contract is an insurance contract (unless the first trigger lacks commercial substance).
2.20	Non- guaranteed participating dividend contained in a life insurance contract. The amount is contractually at the discretion of the insurer but is contractually based on the insurer's actual experience on the related block of insurance contracts.	The contract contains a discretionary participation feature, rather than an embedded derivative (paragraph 34 of the IFRS).	Not applicable. The entire contract is an insurance contract (unless the life- contingent payments are insignificant).
(a)	Payments are life- contingent if they are contingent on death or contingent on survival.		

Unbundling a deposit component

IG5 Paragraph 10 of the IFRS requires an insurer to unbundle some insurance contracts that contain a deposit component. IG Example 3 illustrates this requirement. Although arrangements of this kind are more common in reinsurance, the same principle applies in direct insurance. However, unbundling is not required if the insurer recognises all obligations or rights arising from the deposit component.

IG Example 3: Unbundling a deposit component of a reinsurance contract

Background

A reinsurance contract has the following features:

(a) The cedant pays premiums of CU10[a] every year for five years.

(b) An experience account is established, equal to 90 per cent of cumulative premiums (including the additional premiums discussed in (c) below) less 90 per cent of cumulative claims.

(c) If the balance in the experience account is negative (ie cumulative claims exceed cumulative premiums), the cedant pays an additional premium equal to the experience account balance divided by the number of years left to run on the contract.

(d) At the end of the contract, if the experience account balance is positive (ie cumulative premiums exceed cumulative claims), it is refunded to the cedant; if the balance is negative, the cedant pays the balance to the reinsurer as an additional premium.

(e) Neither party can cancel the contract before maturity.

(f) The maximum loss that the reinsurer is required to pay in any period is CU200.

This contract is an insurance contract because it transfers significant insurance risk to the reinsurer. For example, in case 2 discussed below, the reinsurer is required to pay additional benefits with a present value, in year 1, of CU35, which is clearly significant in relation to the contract.

(a) In this Implementation Guidance monetary amounts are denominated in 'currency units (CU)'.

IG Example 3: Unbundling a deposit component of a reinsurance contract

The following discussion addresses the accounting by the reinsurer. Similar principles apply to the accounting by the cedant.

Application of requirements: case 1—no claims

If there are no claims, the cedant will receive CU45 in year 5 (90 per cent of the cumulative premiums of CU50). In substance, the cedant has made a loan, which the reinsurer will repay in one instalment of CU45 in year 5.

If the reinsurer's accounting policies require it to recognise its contractual liability to repay the loan to the cedant, unbundling is permitted but not required. However, if the reinsurer's accounting policies would not require it to recognise the liability to repay the loan, the reinsurer is required to unbundle the contract (paragraph 10 of the IFRS).

If the reinsurer is required, or elects, to unbundle the contract, it does so as follows. Each payment by the cedant has two components: a loan advance (deposit component) and a payment for insurance cover (insurance component). Applying IFRS 9 to the deposit component, the reinsurer is required to measure it initially at fair value. Fair value could be measured by discounting the future cash flows from the deposit component using a valuation technique. Assume that an appropriate discount rate is 10 per cent and that the insurance cover is equal in each year, so that the payment for insurance cover is the same in every year. Each payment of CU10 by the cedant is then made up of a loan advance of CU6.7 and an insurance premium of CU3.3.

The reinsurer accounts for the insurance component in the same way that it accounts for a separate insurance contract with an annual premium of CU3.3.

The movements in the loan are shown below.

Year	Opening balance	Interest at 10 per cent	Advance (repayment)	Closing balance
	CU	CU	CU	CU
0	0.00	0.00	6.70	6.70
1	6.70	0.67	6.70	14.07

IG Example 3: Unbundling a deposit component of a reinsurance contract

2	14.07	1.41	6.70	22.18
3	22.18	2.21	6.70	31.09
4	31.09	3.11	6.70	40.90
5	40.90	4.10	(45.00)	0.00
Total		11.50	(11.50)	

IG Example 3: Unbundling a deposit component of a reinsurance contract

Application of requirements: case 2—claim of CU150 in year 1

Consider now what happens if the reinsurer pays a claim of CU150 in year 1. The changes in the experience account, and resulting additional premiums, are as follows.

Year	Premium	Additional premium	Total premium	Cumulative premium	Claims	Cumulative claims	Cumulative premiums less claims	Experience account
	CU	CU	CU	CU	CU	CU	CU	CU
0	10	0	10	10	0	0	10	9
1	10	0	10	20	(150)	(150)	(130)	(117)
2	10	39	49	69	0	(150)	(81)	(73)
3	10	36	46	115	0	(150)	(35)	(31)
4	10	31	41	156	0	(150)	6	6
		106	156		(150)			

Incremental cash flows because of the claim in year 1

The claim in year 1 leads to the following incremental cash flows, compared with case 1:

Year	Additional premium	Claims	Refund in case 2	Refund in case 1	Net incremental cash flow	Present at value 10 per cent
	CU	CU	CU	CU	CU	CU
0	0	0			0	0
1	0	(150)			(150)	(150)
2	39	0			39	35
3	36	0			36	30
4	31	0			31	23
5	0	0	(6)	(45)	39	27
Total	106	(150)	(6)	(45)	(5)	(35)

IG Example 3: Unbundling a deposit component of a reinsurance contract

The incremental cash flows have a present value, in year 1, of CU35 (assuming a discount rate of 10 per cent is appropriate). Applying paragraphs 10–12 of the IFRS, the cedant unbundles the contract and applies IFRS 9 to this deposit component (unless the cedant already recognises its contractual obligation to

IG Example 3: Unbundling a deposit component of a reinsurance contract

repay the deposit component to the reinsurer). If this were not done, the cedant might recognise the CU150 received in year 1 as income, and the incremental payments in years 2–5 as expenses. However, in substance, the reinsurer has paid a claim of CU35 and made a loan of CU115 (CU150 less CU35) that will be repaid in instalments.

The following table shows the changes in the loan balance. The table assumes that the original loan shown in case 1 and the new loan in case 2 met the criteria for offsetting in IAS 32. Amounts shown in the table are rounded.

Loan to (from) the reinsurer

Year	Opening balance	Interest at 10 per cent	Payments per original schedule	Additional payments in case 2	Closing balance
	CU	CU	CU	CU	CU
0	–	–	6	–	6
1	6	1	7	(115)	(101)
2	(101)	(10)	7	39	(65)
3	(65)	(7)	7	36	(29)
4	(29)	(3)	6	31	5
5	5	1	(45)	39	0
Total		(18)	(12)	30	

Shadow accounting

IG6 Paragraph 30 of the IFRS permits, but does not require, a practice sometimes described as 'shadow accounting'. IG Example 4 illustrates shadow accounting.

IG7 Shadow accounting is not the same as fair value hedge accounting under IFRS 9 and will not usually have the same effect.

IG8 Shadow accounting is not applicable for liabilities arising from investment contracts (ie contracts within the scope of IAS 39) because the underlying measurement of those liabilities (including the treatment of related transaction costs) does not depend on asset values or asset returns. However, shadow accounting may be applicable for a discretionary participation feature within an investment contract if the measurement of that feature depends on asset values or asset returns.

IG9 Shadow accounting is not applicable if the measurement of an insurance liability is not driven directly by realised gains and losses on assets held. For example, assume that financial assets are measured at fair value and insurance liabilities are measured using a discount rate that reflects current market rates but does not depend directly on the actual assets held. The measurements of the assets and the liability both reflect changes in interest rates, but the measurement of the liability does not depend directly on the carrying amount of the assets held. Therefore, shadow accounting is not applicable and changes in the carrying amount of the liability are recognised in profit or loss because IAS 1 *Presentation of Financial Statements* requires all items of income or expense to be recognised in profit or loss unless an IFRS requires otherwise.

IG10 Shadow accounting may be relevant if there is a contractual link between payments to policyholders and the carrying amount of, or returns from, owner- occupied property. If an entity uses the revaluation model in IAS 16 *Property, Plant and Equipment*, it recognises changes in the carrying amount of the owner- occupied property in revaluation surplus. If it also elects to use shadow accounting, the changes in the measurement of the insurance liability resulting from revaluations of the property are also recognised in revaluation surplus.

IG Example 4: Shadow accounting

Background

IG Example 4: Shadow accounting

Under some national requirements for some insurance contracts, deferred acquisition costs (DAC) are amortised over the life of the contract as a constant proportion of estimated gross profits (EGP). EGP includes investment returns, including realised (but not unrealised) gains and losses. Interest is applied to both DAC and EGP, to preserve present value relationships. For simplicity, this example ignores interest and ignores re- estimation of EGP.

At the inception of a contract, insurer A has DAC of CU20 relating to that contract and the present value, at inception, of EGP is CU100. In other words, DAC is 20 per cent of EGP at inception. Thus, for each CU1 of realised gross profits, insurer A amortises DAC by CU0.20. For example, if insurer A sells assets and recognises a gain of CU10, insurer A amortises DAC by CU2 (20 per cent of CU10).

Before adopting IFRSs for the first time in 20X5, insurer A measured financial assets on a cost basis. (Therefore, EGP under those national requirements considers only realised gains and losses.) However, under IFRSs, it classifies its financial assets as measured at fair value through profit or loss.

In 20X5, insurer A recognises unrealised gains of CU10 on the assets backing the contract and in 20X6 it sells the assets for an amount equal to their fair value at the end of 20X5.

Application of paragraph 30 of the IFRS

Paragraph 30 of the IFRS permits, but does not require, insurer A to adopt shadow accounting. If insurer A adopts shadow accounting, it amortises DAC in 20X5 by an additional CU2 (20 per cent of CU10) as a result of the change in the fair value of the assets. Insurer A recognises the additional amortisation of CU2 in profit or loss.

When insurer A sells the assets in 20X6, it makes no further adjustment to DAC.

In summary, shadow accounting treats an unrealised gain in the same way as a realised gain. If insurer A does not adopt shadow accounting, unrealised gains on assets do not affect the amortisation of DAC.

Disclosure

Purpose of this guidance

IG11 The guidance in paragraphs IG12–IG71 suggests possible ways to apply the disclosure requirements in paragraphs 36–39A of the IFRS. As explained in paragraphs 36 and 38 of the IFRS, the objective of the disclosures is:

(a) to identify and explain the amounts in an insurer’s financial statements arising from insurance contracts; and

(b) to enable users of those financial statements to evaluate the nature and extent of risks arising from insurance contracts.

IG12 An insurer decides in the light of its circumstances how much detail it gives to satisfy those requirements, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information that has materially different characteristics. It is necessary to strike a balance so that important information is not obscured either by the inclusion of a large amount of insignificant detail or by the aggregation of items that have materially different characteristics. For example:

(a) a large international insurance group that operates in a wide range of regulatory jurisdictions typically provides disclosures that differ in format, content and detail from those provided by a specialised niche insurer operating in one jurisdiction.

(b) many insurance contracts have similar characteristics. When no single contract is individually material, a summary by classes of contracts is appropriate.

(c) information about an individual contract may be material when it is, for example, a significant contributor to an insurer’s risk profile.

To satisfy the requirements, an insurer would not typically need to disclose all the information suggested in the guidance. This guidance does not create additional requirements.

IG13 IAS 1 *Presentation of Financial Statements* requires an entity to 'provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.'

IG14 For convenience, this Implementation Guidance discusses each disclosure requirement in the IFRS separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures may satisfy more than one requirement. For example, information about the assumptions that have the greatest effect on the measurement of amounts arising from insurance contracts may help to convey information about insurance risk and market risk.

Materiality

IG15 IAS 1 defines materiality and notes that a specific disclosure requirement in an IFRS need not be satisfied if the information is not material.

IG16 Paragraph 7 of IAS 1 also explains the following:

> Assessing whether information could reasonably be expected to influence decisions made by the primary users of a specific reporting entity's general purpose financial statements requires an entity to consider the characteristics of those users while also considering the entity's own circumstances. Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial statements for much of the financial information they need. Consequently, they are the primary users at whom general purpose financial statements are directed. Financial statements are prepared for users who have a reasonable level of knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may seek the aid of an adviser to understand information about complex economic phenomena.

Explanation of recognised amounts (paragraphs 36 and 37 of the IFRS)

Accounting policies

IG17 IAS 1 requires disclosure of accounting policies and paragraph 37(a) of the IFRS highlights this requirement. In developing disclosures about accounting policies for insurance contracts, an insurer might conclude that it needs to address the treatment of, for example, some or all of the following, if applicable:

(a) premiums (including the treatment of unearned premiums, renewals and lapses, premiums collected by agents and brokers but not yet passed on and premium taxes or other levies on premiums).

(b) fees or other charges made to policyholders.

(c) acquisition costs (including a description of their nature).

(d) claims incurred (both reported and not reported), claims handling costs (including a description of their nature) and liability adequacy tests (including a description of the cash flows included in the test, whether and how the cash flows are discounted and the treatment of embedded options and guarantees in those tests, see paragraphs 15–19 of the IFRS). An insurer might disclose whether insurance liabilities are discounted and, if they are discounted, explain the methodology used.

(e) the objective of methods used to adjust insurance liabilities for risk and uncertainty (for example, in terms of a level of assurance or level of sufficiency), the nature of those models, and the source of information used in the models.

(f) embedded options and guarantees (including a description of whether (i) the measurement of insurance liabilities reflects the intrinsic value and time value of these items and (ii) their measurement is consistent with observed current market prices).

(g) discretionary participation features (including a clear statement of how the insurer applies paragraphs 34 and 35 of the IFRS in classifying that feature as a liability or as a component of equity) and other features that permit policyholders to share in investment performance.

(h) salvage, subrogation or other recoveries from third parties.

(i) reinsurance held.

(j) underwriting pools, coinsurance and guarantee fund arrangements.

(k) insurance contracts acquired in business combinations and portfolio transfers, and the treatment of related intangible assets.

(l) as required by IAS 1, the judgements, apart from those involving estimations, management has made in the process of applying the accounting policies that have the most significant effect on the amounts recognised in the financial statements. The classification of discretionary participation features is an example of an accounting policy that might have a significant effect.

IG18 If the financial statements disclose supplementary information, for example embedded value information, that is not prepared on the basis used for other measurements in the financial statements, it is appropriate to explain the basis. Disclosures about embedded value methodology might include information similar to that described in paragraph IG17, as well as disclosure of whether, and how, embedded values are affected by estimated returns from assets and by locked- in capital and how those effects are estimated.

Assets, liabilities, income and expense

IG19 Paragraph 37(b) of the IFRS requires an insurer to disclose the assets, liabilities, income and expenses that arise from insurance contracts. If an insurer presents its statement of cash flows using the direct method, paragraph 37(b) requires it also to disclose the cash flows that arise from insurance contracts. The IFRS does not require disclosure of specific cash flows. The following paragraphs discuss how an insurer might satisfy those general requirements.

IG20 IAS 1 requires disclosures in the statement of financial position. An insurer might conclude that, to satisfy those requirements, it needs to present separately in its statement of financial position the following amounts arising from insurance contracts:

(a) liabilities under insurance contracts and reinsurance contracts issued.

(b) assets under insurance contracts and reinsurance contracts issued.

(c) assets under reinsurance ceded. Under paragraph 14(d)(i) of the IFRS, these assets are not offset against the related insurance liabilities.

IG21 Neither IAS 1 nor the IFRS prescribes the descriptions and ordering of the line items presented in the statement of financial position. An insurer could amend the descriptions and ordering to suit the nature of its transactions.

IG22 IAS 1 requires disclosure, either in the statement of financial position or in the notes, of subclassifications of the line items presented, classified in a manner appropriate to the entity’s operations. Appropriate subclassifications of insurance liabilities will depend on the circumstances, but might include items such as:

(a) unearned premiums.

(b) claims reported by policyholders.

(c) claims incurred but not reported (IBNR).

(d) provisions arising from liability adequacy tests.

(e) provisions for future non- participating benefits.

(f) liabilities or components of equity relating to discretionary participation features (see paragraphs 34 and 35 of the IFRS). If an insurer classifies these features as a component of equity, disclosure is needed to comply with IAS 1, which requires an entity to disclose ‘a description of the nature and purpose of each reserve within equity.’

(g) receivables and payables related to insurance contracts (amounts currently due to and from agents, brokers and policyholders related to insurance contracts).

(h) non- insurance assets acquired by exercising rights to recoveries.

IG23 Similar subclassifications may also be appropriate for reinsurance assets, depending on their materiality and other relevant circumstances. For assets under insurance contracts and reinsurance contracts issued, an insurer might conclude that it needs to distinguish:

(a) deferred acquisition costs; and

(b) intangible assets relating to insurance contracts acquired in business combinations or portfolio transfers.

IG23A Paragraph 14 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose the carrying amount of financial assets pledged as collateral for liabilities, the carrying amount of financial assets pledged as collateral for contingent liabilities, and any terms and conditions relating to assets pledged as collateral. In complying with this requirement, an insurer might also conclude that it needs to disclose segregation requirements that are intended to protect policyholders by restricting the use of some of the insurer's assets.

IG24 IAS 1 lists line items that an entity should present in its statement of comprehensive income. It also requires the presentation of additional line items when this is necessary to present fairly the entity's financial performance. An insurer might conclude that, to satisfy these requirements, it needs to present the following amounts in its statement of comprehensive income:

(a) revenue from insurance contracts issued (without any reduction for reinsurance held).

(b) income from contracts with reinsurers.

(c) expense for policyholder claims and benefits (without any reduction for reinsurance held).

(d) expenses arising from reinsurance held.

IG25 IFRS 15 requires an entity to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Although revenue from insurance contracts is outside the scope of IFRS 15, similar disclosures may be appropriate for insurance contracts. The IFRS does not prescribe a particular method for recognising revenue and various models exist:

(a) Under some models, an insurer recognises premiums earned during the period as revenue and recognises claims arising during the period (including estimates of claims incurred but not reported) as an expense.

(b) Under some other models, an insurer recognises premiums received as revenue and at the same time recognises an expense representing the resulting increase in the insurance liability.

(c) Under yet other models, an insurer recognises premiums received as deposit receipts. Its revenue includes charges for items such as mortality, and its expenses include the policyholder claims and benefits related to those charges.

IG26 IAS 1 requires additional disclosure of various items of income and expense. An insurer might conclude that, to satisfy these requirements, it needs to disclose the following additional items, either in its statement of comprehensive income or in the notes:

(a) acquisition costs (distinguishing those recognised as an expense immediately from the amortisation of deferred acquisition costs).

(b) the effect of changes in estimates and assumptions.

(c) losses recognised as a result of applying liability adequacy tests.

(d) for insurance liabilities measured on a discounted basis:

(i) accretion of interest to reflect the passage of time; and

(ii) the effect of changes in discount rates.

(e) distributions or allocations to holders of contracts that contain discretionary participation features. The portion of profit or loss that relates to any equity component of those contracts is an allocation of profit or loss, not expense or income (paragraph 34(c) of the IFRS).

IG27 Some insurers present a detailed analysis of the sources of their earnings from insurance activities either in the statement of comprehensive income or in the notes. Such an analysis may provide useful information about both the income and expense of the current period and the risk exposures faced during the period.

IG28 The items described in paragraph IG26 are not offset against income or expense arising from reinsurance held (paragraph 14(d)(ii) of the IFRS).

IG29 Paragraph 37(b) also requires specific disclosure about gains or losses recognised on buying reinsurance. This disclosure informs users about gains or losses that may, using some measurement models, arise from imperfect measurements of the underlying direct insurance liability. Furthermore, some measurement models require a cedant to defer some of those gains and losses and amortise them over the period of the related risk exposures, or some other period. Paragraph 37(b) also requires a cedant to disclose information about such deferred gains and losses.

IG30 If an insurer does not adopt uniform accounting policies for the insurance liabilities of its subsidiaries, it might conclude that it needs to disaggregate the disclosures about amounts reported in its financial statements to give meaningful information about amounts determined using different accounting policies.

Significant assumptions and other sources of estimation uncertainty

IG31 Paragraph 37(c) of the IFRS requires an insurer to describe the process used to determine the assumptions that have the greatest effect on the measurement of assets, liabilities, income and expense arising from insurance contracts and, when practicable, give quantified disclosure of those assumptions. For some disclosures, such as discount rates or assumptions about future trends or general inflation, it may be relatively easy to disclose the assumptions used (aggregated at a reasonable but not excessive level, when necessary). For other assumptions, such as mortality tables, it may not be practicable to disclose quantified assumptions because there are too many, in which case it is more important to describe the process used to generate the assumptions.

IG32 The description of the process used to determine assumptions might include a summary of the most significant of the following:

(a) the objective of the assumptions. For example, an insurer might disclose whether the assumptions are intended to be neutral estimates of the most likely or expected outcome ('best estimates') or to provide a given level of assurance or level of sufficiency. If they are intended to provide a quantitative or qualitative level of assurance, an insurer might disclose that level.

(b) the source of data used as inputs for the assumptions that have the greatest effect. For example, an insurer might disclose whether the inputs are internal, external or a mixture of the two. For data derived from detailed studies that are not carried out annually, an insurer might disclose the criteria used to determine when the studies are updated and the date of the latest update.

(c) the extent to which the assumptions are consistent with observable market prices or other published information.

(d) a description of how past experience, current conditions and other relevant benchmarks are taken into account in developing estimates and assumptions. If a relationship would normally be expected between experience and future results, an insurer might explain the reasons for using assumptions that differ from past experience and indicate the extent of the difference.

(e) a description of how the insurer developed assumptions about future trends, such as changes in mortality, healthcare costs or litigation awards.

(f) an explanation of how the insurer identifies correlations between different assumptions.

(g) the insurer's policy in making allocations or distributions for contracts with discretionary participation features, the related assumptions that are reflected in the financial statements, the nature and extent of any significant uncertainty about the relative interests of policyholders and shareholders in the unallocated surplus associated with those contracts, and the effect on the financial statements of any changes during the period in that policy or those assumptions.

(h) the nature and extent of uncertainties affecting specific assumptions. In addition, to comply with paragraphs 125–131 of IAS 1, an insurer may need to disclose that it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of insurance liabilities and insurance assets. Paragraph 129 of IAS 1 gives further guidance on this disclosure.

IG33 The IFRS does not prescribe specific assumptions that would be disclosed, because different assumptions will be more significant for different types of contract.

Changes in assumptions

IG34 Paragraph 37(d) of the IFRS requires an insurer to disclose the effect of changes in assumptions used to measure insurance assets and insurance liabilities. This is consistent with IAS 8, which requires disclosure of the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods.

IG35 Assumptions are often interdependent. When this is the case, analysis of changes by assumption may depend on the order in which the analysis is performed and may be arbitrary to some extent. Therefore, the IFRS does not specify a rigid format or content for this analysis. This allows insurers to analyse the changes in a way that meets the objective of the disclosure and is appropriate for their particular circumstances. If practicable, an insurer might disclose separately the impact of changes in different assumptions, particularly if changes in some assumptions have an adverse effect and others have a beneficial effect. An insurer might also describe the impact of interdependencies between assumptions and the resulting limitations of any analysis of the effect of changes in assumption.

IG36 An insurer might disclose the effects of changes in assumptions both before and after reinsurance held, especially if the insurer expects a significant change in the nature or extent of its reinsurance programme or if an analysis before reinsurance is relevant for an analysis of the credit risk arising from reinsurance held.

Changes in insurance liabilities and related items

IG37 Paragraph 37(e) of the IFRS requires an insurer to disclose reconciliations of changes in insurance liabilities. It also requires disclosure of changes in reinsurance assets. An insurer need not disaggregate those changes into broad classes, but might do that if different forms of analysis are more relevant for different types of liability. The changes might include:

(a) the carrying amount at the beginning and end of the period.

(b) additional insurance liabilities arising during the period.

(c) cash paid.

(d) income and expense included in profit or loss.

(e) liabilities acquired from, or transferred to, other insurers.

(f) net exchange differences arising on the translation of the financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity.

IG38 An insurer discloses the changes in insurance liabilities and reinsurance assets in all prior periods for which it reports full comparative information.

IG39 Paragraph 37(e) of the IFRS also requires an insurer to disclose changes in deferred acquisition costs, if applicable. The reconciliation might disclose:

(a) the carrying amount at the beginning and end of the period.

(b) the amounts incurred during the period.

(c) the amortisation for the period.

(d) impairment losses recognised during the period.

(e) other changes categorised by cause and type.

IG40 An insurer may have recognised intangible assets related to insurance contracts acquired in a business combination or portfolio transfer. IAS 38 *Intangible Assets* contains disclosure requirements for intangible assets, including a requirement to give a reconciliation of changes in intangible assets. The IFRS does not require additional disclosures about these assets.

Nature and extent of risks arising from insurance contracts (paragraphs 38–39A of the IFRS)

IG41 The disclosures about the nature and extent of risks arising from insurance contracts are based on two foundations:

(a) There should be a balance between quantitative and qualitative disclosures, enabling users to understand the nature of risk exposures and their potential impact.

(b) Disclosures should be consistent with how management perceives its activities and risks, and the objectives, policies and processes that management uses to manage those risks. This approach is likely:

(i) to generate information that has more predictive value than information based on assumptions and methods that management does not use, for instance, in considering the insurer’s ability to react to adverse situations.

(ii) to be more effective in adapting to the continuing change in risk measurement and management techniques and developments in the external environment over time.

IG42 In developing disclosures to satisfy paragraphs 38–39A of the IFRS, an insurer decides in the light of its circumstances how it would aggregate information to display the overall picture without combining information that has materially different characteristics, so that the information is useful. An insurer might group insurance contracts into broad classes appropriate for the nature of the information to be disclosed, taking into account matters such as the risks covered, the characteristics of the contracts and the measurement basis applied. The broad classes may correspond to classes established for legal or regulatory purposes, but the IFRS does not require this.

IG43 Under IFRS 8 *Operating Segments*, the identification of reportable segments reflects the way in which management allocates resources and assesses performance. An insurer might adopt a similar approach to identify broad classes of insurance contracts for disclosure purposes, although it might be appropriate to disaggregate disclosures down to the next level. For example, if an insurer identifies life insurance as a reportable segment for IFRS 8, it might be appropriate to report separate information about, say, life insurance, annuities in the accumulation phase and annuities in the payout phase.

IG44 [Deleted]

IG45 In identifying broad classes for separate disclosure, an insurer might consider how best to indicate the level of uncertainty associated with the risks underwritten, to inform users whether outcomes are likely to be within a wider or a narrower range. For example, an insurer might disclose information about exposures where there are significant amounts of provisions for claims incurred but not reported (IBNR) or where outcomes and risks are unusually difficult to assess (eg asbestos).

IG46 It may be useful to disclose sufficient information about the broad classes identified to permit a reconciliation to relevant line items in the statement of financial position.

IG47 Information about the nature and extent of risks arising from insurance contracts is more useful if it highlights any relationship between classes of insurance contracts (and between insurance contracts and other items, such as financial instruments) that can affect those risks. If the effect of any relationship would not be apparent from disclosures required by the IFRS, further disclosure might be useful.

Risk management objectives and policies for mitigating risks arising from insurance contracts

IG48 Paragraph 39(a) of the IFRS requires an insurer to disclose its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks. Such discussion provides an additional perspective that complements information about contracts outstanding at a particular time. Such disclosure might include information about:

(a) the structure and organisation of the insurer's risk management function(s), including a discussion of independence and accountability.

(b) the scope and nature of the insurer's risk reporting or measurement systems, such as internal risk measurement models, sensitivity analyses, scenario analysis, and stress testing, and how the insurer integrates them into its operating activities. Useful disclosure might include a summary description of the approach used, associated assumptions and parameters (including confidence intervals, computation frequencies and historical observation periods) and strengths and limitations of the approach.

(c) the insurer's processes for accepting, measuring, monitoring and controlling insurance risks and the underwriting strategy to ensure that there are appropriate risk classification and premium levels.

(d) the extent to which insurance risks are assessed and managed on an entity- wide basis.

(e) the methods the insurer employs to limit or transfer insurance risk exposures and avoid undue concentrations of risk, such as retention limits, inclusion of options in contracts, and reinsurance.

(f) asset and liability management (ALM) techniques.

(g) the insurer's processes for managing, monitoring and controlling commitments received (or given) to accept (or contribute) additional debt or equity capital when specified events occur.

These disclosures might be provided both for individual types of risks insured and overall, and might include a combination of narrative descriptions and specific quantified data, as appropriate to the nature of the insurance contracts and their relative significance to the insurer.

IG49–IG50 [Deleted]

Insurance risk

IG51 Paragraph 39(c) of the IFRS requires disclosures about insurance risk. Disclosures to satisfy this requirement might build on the following foundations:

(a) Information about insurance risk might be consistent with (though less detailed than) the information provided internally to the entity's key management personnel (as defined in IAS 24 *Related Party Disclosures*), so that users can assess the insurer's financial position, performance and cash flows 'through the eyes of management'.

(b) Information about risk exposures might report exposures both gross and net of reinsurance (or other risk mitigating elements, such as catastrophe bonds issued or policyholder participation features), especially if the insurer expects a significant change in the nature or extent of its reinsurance programme or if an analysis before reinsurance is relevant for an analysis of the credit risk arising from reinsurance held.

(c) In reporting quantitative information about insurance risk, an insurer might disclose the methods used, the strengths and limitations of those methods, the assumptions made, and the effect of reinsurance, policyholder participation and other mitigating elements.

(d) Insurers might classify risk along more than one dimension. For example, life insurers might classify contracts by both the level of mortality risk and the level of investment risk. It may sometimes be convenient to display this information in a matrix format.

(e) If an insurer's risk exposures at the end of the reporting period are unrepresentative of its exposures during the period, it might be useful to disclose that fact.

(f) The following disclosures required by paragraph 39 of the IFRS might also be relevant:

  (i) the sensitivity of profit or loss and equity to changes in variables that have a material effect on them.

  (ii) concentrations of insurance risk.

  (iii) the development of prior year insurance liabilities.

IG51A Disclosures about insurance risk might include:

(a) information about the nature of the risk covered, with a brief summary description of the class (such as annuities, pensions, other life insurance, motor, property and liability).

(b) information about the general nature of participation features whereby policyholders share in the performance (and related risks) of individual contracts or pools of contracts or entities, including the general nature of any formula for the participation and the extent of any discretion held by the insurer.

(c) information about the terms of any obligation or contingent obligation for the insurer to contribute to government or other guarantee funds (see also IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

Sensitivity to insurance risk

IG52 Paragraph 39(c)(i) of the IFRS requires disclosure about sensitivity to insurance risk. To permit meaningful aggregation, the sensitivity disclosures focus on summary indicators, namely profit or loss and equity. Although sensitivity tests can provide useful information, such tests have limitations. An insurer might disclose the strengths and limitations of sensitivity analyses performed.

IG52A Paragraph 39A permits two alternative approaches for this disclosure: quantitative disclosure of effects on profit or loss and equity (paragraph 39A(a)) or qualitative disclosure and disclosure about terms and conditions (paragraph 39A(b)). An insurer may provide quantitative disclosures for some insurance risks (in accordance with paragraph 39A(a)), and provide qualitative information about sensitivity and information about terms and conditions (in accordance with paragraph 39A(b)) for other insurance risks.

IG53 Informative disclosure avoids giving a misleading sensitivity analysis if there are significant non- linearities in sensitivities to variables that have a material effect. For example, if a change of 1 per cent in a variable has a negligible effect, but a change of 1.1 per cent has a material effect, it might be misleading to disclose the effect of a 1 per cent change without further explanation.

IG53A If an insurer chooses to disclose a quantitative sensitivity analysis in accordance with paragraph 39A(a), and that sensitivity analysis does not reflect significant correlations between key variables, the insurer might explain the effect of those correlations.

IG54 [Deleted]

IG54A If an insurer chooses to disclose qualitative information about sensitivity in accordance with paragraph 39A(b), it is required to disclose information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of cash flows. To achieve this, an insurer might disclose the qualitative information suggested by paragraphs IG51–IG58 on insurance risk and paragraphs IG62–IG65G on credit risk, liquidity risk and market risk. As stated in paragraph IG12, an insurer decides in the light of its circumstances how it aggregates information to display the overall picture without combining information with different characteristics. An insurer might conclude that qualitative information needs to be more disaggregated if it is not supplemented with quantitative information.

Concentrations of insurance risk

IG55 Paragraph 39(c)(ii) of the IFRS refers to the need to disclose concentrations of insurance risk. Such concentration could arise from, for example:

(a) a single insurance contract, or a small number of related contracts, for instance, when an insurance contract covers low‑ frequency, high‑ severity risks such as earthquakes.

(b) single incidents that expose an insurer to risk under several different types of insurance contract. For example, a major terrorist incident could create exposure under life insurance contracts, property insurance contracts, business interruption and civil liability.

(c) exposure to unexpected changes in trends, for example, unexpected changes in human mortality or in policyholder behaviour.

(d) exposure to possible major changes in financial market conditions that could cause options held by policyholders to come into the money. For example, when interest rates decline significantly, interest rate and annuity guarantees may result in significant losses.

(e) significant litigation or legislative risks that could cause a large single loss, or have a pervasive effect on many contracts.

(f) correlations and interdependencies between different risks.

(g) significant non‑ linearities, such as stop‑ loss or excess of loss features, especially if a key variable is close to a level that triggers a material change in future cash flows.

(h) geographical and sectoral concentrations.

IG56 Disclosure of concentrations of insurance risk might include a description of the shared characteristic that identifies each concentration and an indication of the possible exposure, both before and after reinsurance held, associated with all insurance liabilities sharing that characteristic.

IG57 Disclosure about an insurer's historical performance on low‑ frequency, high‑ severity risks might be one way to help users to assess cash flow uncertainty associated with those risks. Consider an insurance contract that covers an earthquake that is expected to happen every 50 years, on average. If the insured event occurs during the current contract period, the insurer will report a large loss. If the insured event does not occur during the current period, the insurer will report a profit. Without adequate disclosure of the source of historical profits, it could be misleading for the insurer to report 49 years of reasonable profits, followed by one large loss; users may misinterpret the insurer's long‑ term ability to generate cash flows over the complete cycle of 50 years. Therefore, it might be useful to describe the extent of the exposure to risks of this kind and the estimated frequency of losses. If circumstances have not changed significantly, disclosure of the insurer's experience with this exposure may be one way to convey information about estimated frequencies.

IG58 For regulatory or other reasons, some entities produce special purpose financial reports that show catastrophe or equalisation reserves as liabilities. However, in financial statements prepared using IFRSs, those reserves are not liabilities but are a component of equity. Therefore they are subject to the disclosure requirements in IAS 1 for equity. IAS 1 requires an entity to disclose:

(a) a description of the nature and purpose of each reserve within equity;

(b) information that enables users to understand the entity's objectives, policies and processes for managing capital; and

(c) the nature of any externally imposed capital requirements, how those requirements are incorporated into the management of capital and whether during the period it complied with any externally imposed capital requirements to which it is subject.

Claims development

IG59 Paragraph 39(c)(iii) of the IFRS requires disclosure of claims development information (subject to transitional relief in paragraph 44). Informative disclosure might reconcile this information to amounts reported in the statement of financial position. An insurer might disclose unusual claims expenses or developments separately, allowing users to identify the underlying trends in performance.

IG60 As explained in paragraph 39(c)(iii) of the IFRS, disclosures about claims development are not required for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year. Therefore, these disclosures are not normally required for most life insurance contracts. Furthermore, claims development disclosure is not normally needed for annuity contracts because each periodic payment arises, in effect, from a separate claim about which there is no uncertainty.

IG61 IG Example 5 shows one possible format for presenting claims development information. Other possible formats might, for example, present information by accident year rather than underwriting year. Although the example illustrates a format that might be useful if insurance liabilities are discounted, the IFRS does not require discounting (paragraph 25(a) of the IFRS).

IG Example 5: Disclosure of claims development

This example illustrates a possible format for a claims development table for a general insurer. The top half of the table shows how the insurer's estimates of total claims for each underwriting year develop over time. For example, at the end of 20X1, the insurer estimated that it would pay claims of CU680 for insured events relating to insurance contracts underwritten in 20X1. By the end of 20X2, the insurer had revised the estimate of cumulative claims (both those paid and those still to be paid) to CU673.

The lower half of the table reconciles the cumulative claims to the amount appearing in the statement of financial position. First, the cumulative payments are deducted to give the cumulative unpaid claims for each year on an undiscounted basis. Second, if the claims liabilities are discounted, the effect of discounting is deducted to give the carrying amount in the statement of financial position.

Underwriting year	*20X1*	*20X2*	*20X3*	*20X4*	*20X5*	*Total*
	CU	CU	CU	CU	CU	CU
Estimate of cumulative claims:						
At end of underwriting year	680	790	823	920	968	
One year later	673	785	840	903		
Two years later	692	776	845			
Three years later	697	771				
Four years later	702					
Estimate of cumulative claims	702	771	845	903	968	
Cumulative payments	(702)	(689)	(570)	(350)	(217)	
	–	82	275	553	751	1,661
Effect of discounting	–	(14)	(68)	(175)	(285)	(542)
Present value recognised in the statement of financial position	–	68	207	378	466	1,119

Credit risk, liquidity risk and market risk

IG62 Paragraph 39(d) of the IFRS requires an insurer to disclose information about credit risk, liquidity risk and market risk that paragraphs 31–42 of IFRS 7 would require if insurance contracts were within its scope. Such disclosure includes:

(a) summary quantitative data about the insurer's exposure to those risks based on information provided internally to its key management personnel (as defined in IAS 24); and

(b) to the extent not already covered by the disclosures discussed above, the information described in paragraphs 36–42 of IFRS 7.

The disclosures about credit risk, liquidity risk and market risk may be either provided in the financial statements or incorporated by cross- reference to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time.

IG63 [Deleted]

IG64 Informative disclosure about credit risk, liquidity risk and market risk might include:

(a) information about the extent to which features such as policyholder participation features mitigate or compound those risks.

(b) a summary of significant guarantees, and of the levels at which guarantees of market prices or interest rates are likely to alter the insurer's cash flows.

(c) the basis for determining investment returns credited to policyholders, such as whether the returns are fixed, based contractually on the return of specified assets or partly or wholly subject to the insurer's discretion.

Credit risk

IG64A Paragraphs 36–38 of IFRS 7 require disclosure about credit risk. Credit risk is defined as 'the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss'. Thus, for an insurance contract, credit risk includes the risk that an insurer incurs a financial loss because a reinsurer defaults on its obligations under the reinsurance contract. Furthermore, disputes with the reinsurer could lead to an impairment of the cedant's reinsurance asset. The risk of such disputes may have an effect similar to credit risk. Thus, similar disclosure might be relevant. Balances due from agents or brokers may also be subject to credit risk.

IG64B A financial guarantee contract reimburses a loss incurred by the holder because a specified debtor fails to make payment when due. The holder is exposed to credit risk, and IFRS 7 requires the holder to provide disclosures about that credit risk. However, from the perspective of the issuer, the risk assumed by the issuer is insurance risk rather than credit risk.

IG65 [Deleted]

IG65A The issuer of a financial guarantee contract provides disclosures complying with IFRS 7 if it applies IFRS 9 in recognising and measuring the contract. If the issuer elects, when permitted by paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring the contract, it provides disclosures complying with IFRS 4. The main implications are as follows:

(a) IFRS 4 requires disclosure about actual claims compared with previous estimates (claims development), but does not require disclosure of the fair value of the contract.

(b) IFRS 7 requires disclosure of the fair value of the contract, but does not require disclosure of claims development.

Liquidity risk

IG65B Paragraph 39(a) and (b) of IFRS 7 requires disclosure of a maturity analysis for financial liabilities that shows the remaining contractual maturities. For insurance contracts, the contractual maturity refers to the estimated date when contractually required cash flows will occur. This depends on factors such as when the insured event occurs and the possibility of lapse. However, IFRS 4 permits various existing accounting practices for insurance contracts to continue. As a result, an insurer may not need to make detailed estimates of cash flows to determine the amounts it recognises in the statement of financial position. To avoid requiring detailed cash flow estimates that are not required for measurement purposes, paragraph 39(d)(i) of IFRS 4 states that an insurer need not provide the maturity analyses required by paragraph 39(a) and (b) of IFRS 7 (ie that show the remaining contractual maturities of insurance contracts) if it discloses an analysis, by estimated timing, of the amounts recognised in the statement of financial position.

IG65C An insurer might also disclose a summary narrative description of how the maturity analysis (or analysis by estimated timing) flows could change if policyholders exercised lapse or surrender options in different ways. If an insurer considers that lapse behaviour is likely to be sensitive to interest rates, the insurer might disclose that fact and state whether the disclosures about market risk reflect that interdependence.

Market risk

IG65D Paragraph 40(a) of IFRS 7 requires a sensitivity analysis for each type of market risk at the end of the reporting period, showing the effect of reasonably possible changes in the relevant risk variable on profit or loss or equity. If no reasonably possible change in the relevant risk variable would affect profit or loss or equity, an entity discloses that fact to comply with paragraph 40(a) of IFRS 7. A reasonably possible change in the relevant risk variable might not affect profit or loss in the following examples:

(a) if a non- life insurance liability is not discounted, changes in market interest rates would not affect profit or loss.

(b) some insurers may use valuation factors that blend together the effect of various market and non- market assumptions that do not change unless the insurer assesses that its recognised insurance liability is not adequate. In some cases a reasonably possible change in the relevant risk variable would not affect the adequacy of the recognised insurance liability.

IG65E In some accounting models, a regulator specifies discount rates or other assumptions about market risk variables that the insurer uses in measuring its insurance liabilities and the regulator does not amend those assumptions to reflect current market conditions at all times. In such cases, the insurer might comply with paragraph 40(a) of IFRS 7 by disclosing:

(a) the effect on profit or loss or equity of a reasonably possible change in the assumption set by the regulator.

(b) the fact that the assumption set by the regulator would not necessarily change at the same time, by the same amount, or in the same direction, as changes in market prices, or market rates, would imply.

IG65F An insurer might be able to take action to reduce the effect of changes in market conditions. For example, an insurer may have discretion to change surrender values or maturity benefits, or to vary the amount or timing of policyholder benefits arising from discretionary participation features. Paragraph 40(a) of IFRS 7 does not require entities to consider the potential effect of future management actions that may offset the effect of the disclosed changes in the relevant risk variable. However, paragraph 40(b) of IFRS 7 requires an entity to disclose the methods and assumptions used to prepare the sensitivity analysis. To comply with this requirement, an insurer might conclude that it needs to disclose the extent of available management actions and their effect on the sensitivity analysis.

IG65G Some insurers manage sensitivity to market conditions using a method that differs from the method described by paragraph 40(a) of IFRS 7. For example, some insurers use an analysis of the sensitivity of embedded value to changes in market risk. Paragraph 39(d)(ii) of IFRS 4 permits an insurer to use that sensitivity analysis to meet the requirement in paragraph 40(a) of IFRS 7. IFRS 4 and IFRS 7 require an insurer to provide sensitivity analyses for all classes of financial instruments and insurance contracts, but an insurer might use different approaches for different classes. IFRS 4 and IFRS 7 specify the following approaches:

(a) the sensitivity analysis described in paragraph 40(a) of IFRS 7 for financial instruments or insurance contracts;

(b) the method described in paragraph 41 of IFRS 7 for financial instruments or insurance contracts; or

(c) the method permitted by paragraph 39(d)(ii) of IFRS 4 for insurance contracts.

Exposures to market risk under embedded derivatives

IG66 Paragraph 39(e) of the IFRS requires an insurer to disclose information about exposures to market risk under embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivative at fair value (for example, guaranteed annuity options and guaranteed minimum death benefits).

IG67 An example of a contract containing a guaranteed annuity option is one in which the policyholder pays a fixed monthly premium for thirty years. At maturity, the policyholder can elect to take either (a) a lump sum equal to the accumulated investment value or (b) a lifetime annuity at a rate guaranteed at inception (ie when the contract started). For policyholders electing to receive the annuity, the insurer could suffer a significant loss if interest rates decline substantially or if the policyholder lives much longer than the average. The insurer is exposed to both market risk and significant insurance risk (mortality risk) and a transfer of insurance risk occurs at inception, because the insurer fixed the price for mortality risk at that date. Therefore, the contract is an insurance contract from inception. Moreover, the embedded guaranteed annuity option itself meets the definition of an insurance contract, and so separation is not required.

IG68 An example of a contract containing minimum guaranteed death benefits is one in which the policyholder pays a monthly premium for 30 years. Most of the premiums are invested in a mutual fund. The rest is used to buy life cover and to cover expenses. On maturity or surrender, the insurer pays the value of the mutual fund units at that date. On death before final maturity, the insurer pays the greater of (a) the current unit value and (b) a fixed amount. This contract could be viewed as a hybrid contract comprising (a) a mutual fund investment and (b) an embedded life insurance contract that pays a death benefit equal to the fixed amount less the current unit value (but zero if the current unit value is more than the fixed amount).

IG69 Both these embedded derivatives meet the definition of an insurance contract if the insurance risk is significant. However, in both cases market risk may be much more significant than the mortality risk. If interest rates or equity markets fall substantially, these guarantees would be well in the money. Given the long- term nature of the guarantees and the size of the exposures, an insurer might face extremely large losses. Therefore, an insurer might place particular emphasis on disclosures about such exposures.

IG70 Useful disclosures about such exposures might include:

(a) the sensitivity analysis discussed above.

(b) information about the levels where these exposures start to have a material effect on the insurer's cash flows (paragraph IG64(b)).

(c) the fair value of the embedded derivative, although neither the IFRS nor IFRS 7 requires disclosure of that fair value.

Key performance indicators

IG71 Some insurers present disclosures about what they regard as key performance indicators, such as lapse and renewal rates, total sum insured, average cost per claim, average number of claims per contract, new business volumes, claims ratio, expense ratio and combined ratio. The IFRS does not require such disclosures. However, such disclosures might be a useful way for an insurer to explain its financial performance during the period and to give an insight into the risks arising from insurance contracts.

