3Blocks®

Contractual Service Margin

“The number of coverage units in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration (IFRS 17, Art B119a).”

This is interpreted in the IASB and the TRG analysis as quantity of the relevant services

$$\frac{[\text{CU delivered}]}{[\text{CU delivered}] + [\text{CU projected}]} \times \text{CSM}$$

Coverage units should reflect a quantity of services provided to a policyholder, so understanding what type of services are provided should be a starting point for the coverage units definition.

Insurance service	Coverage for an insured event	Term insurance Protection insurance
Investment-return service	Generation of an investment return for the policyholder (for insurance contracts without direct participation features)	Deferred annuity with account balance accumulating before annuity payments start
Investment-related service	Management of underlying items on behalf of the policyholder (for insurance contracts with direct participation features)	Unit linked With profit

- Should not represent the pattern of expected cash flows or the changes in the risk adjustment (IFRS 17 art. BC279a; Feb 2018 TRG P5 art. 11)
- Should reflect the likelihood of an insured event occurring to the extent they affect the expected duration of contracts in the group (IFRS 17 B119a, Feb 2018 TRG P5 art 17a)
- Should not reflect the likelihood of an insured event occurring to the extent they affect the amount expected to be claimed in a period (Feb 2018 TRG P5 art 11, 17c)
- Should reflect different levels of cover across periods (Feb 2018 TRG P5 art 13, 17b, 19)
- Can be calculated on both a discounted and undiscounted basis (IFRS 17 BC282)
- Coverage units of the group are calculated as a sum of the coverage units of each contract in the group (IFRS 17 B119a)

Introduction to IFRS 17

CU examples - no investment component

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	Product Description	Coverage Units
Credit life loan insurance	Death benefit equal to principal and interest	Loan balance
Credit life - variable amount	Benefit equal to the outstanding credit balance	Expected credit balance
Mortgage loss cover	Default losses on mortgage after recovering the value of the property on which the mortage is secured	Mortgage balance or mortgage balance, less property value
Product warranty	Replacement of a purchased item if it fails to work properly	Product price
Extended product warranty	Replacement of a purchased item if it fails to work properly, after original warranty has expired	Product price, no CU in original warranty period
Live contingent annuity	Pays a fixed monthly amount until the annuitant dies	Monthly benefit
Deferred annuity	Annuity in future at a fixed rate	Monthly benefit, no CU in pre-annuity period

Introduction to IFRS 17

CU examples - with investment component

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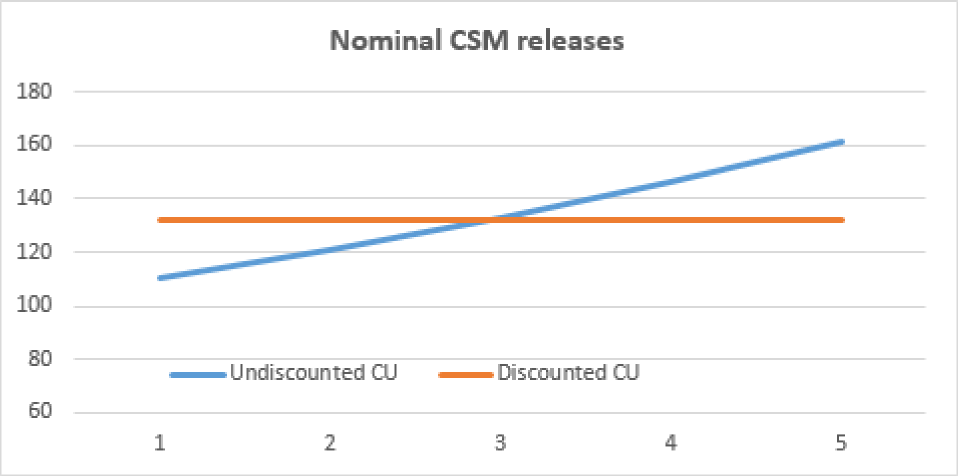
	Product Description	Coverage Units
Insurance and investment component with different durations	• Death Benefit in the first 5 years equal to the higher of 110% of the premium paid or the accumulated account value • An investment contract matures in year 10 and pays the customer the account value at maturity • Death Benefit has been assessed to represent a significant insurance risk	Coverage period 10 years, CU should reflect both insurance and investment component (e.g. max of Death Benefit and account value)
Endowment Policy (WP)	• Regular level premiums • Sum insured payable upon death or reaching the policy maturity of the life insurance • Policyholder is entitled to share of the investment returns from an underlying pool of assets • Possibility to allocate revisionary or terminal bonuses • The investment returns are allocated to the policyholder though bonuses that are added to the policy sum insured • Defined surrender value payable when the policy lapses before the maturity date	Amount payable on death (sum insured including allocated investment returns and bonuses)

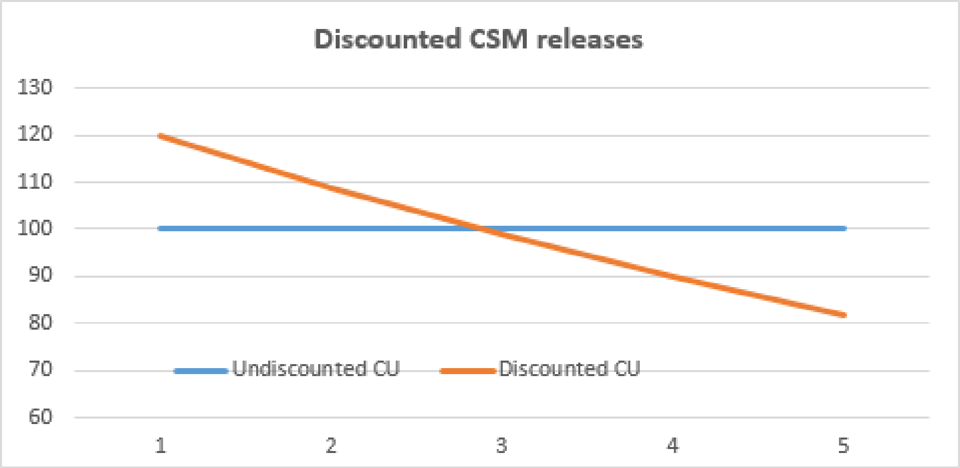
Introduction to IFRS 17
CU discounting [1]

Discounted coverage units result in a quicker release of the CSM



Discounted CUs result in a more even recognition of profits when analysed on a nominal basis i.e. without taking into account the time value of money.

Undiscounted coverage units give more even recognition of profits if we take into account the time value of money.



CU discounting [2]

Undiscounted coverage units

	1	2	3	4	5	
CSM opening balance	500	440	363	266	146	
Interest accretion	50	44	36	27	15	
Nominal CSM releases	110	121	133	146	161	
CSM closing balance	440	363	266	146	0	
PV of CSM releases	100	100	100	100	100	**500**
Coverage units	1	1	1	1	1	
Coverage units - cumulative	5	4	3	2	1	

Discounted coverage units

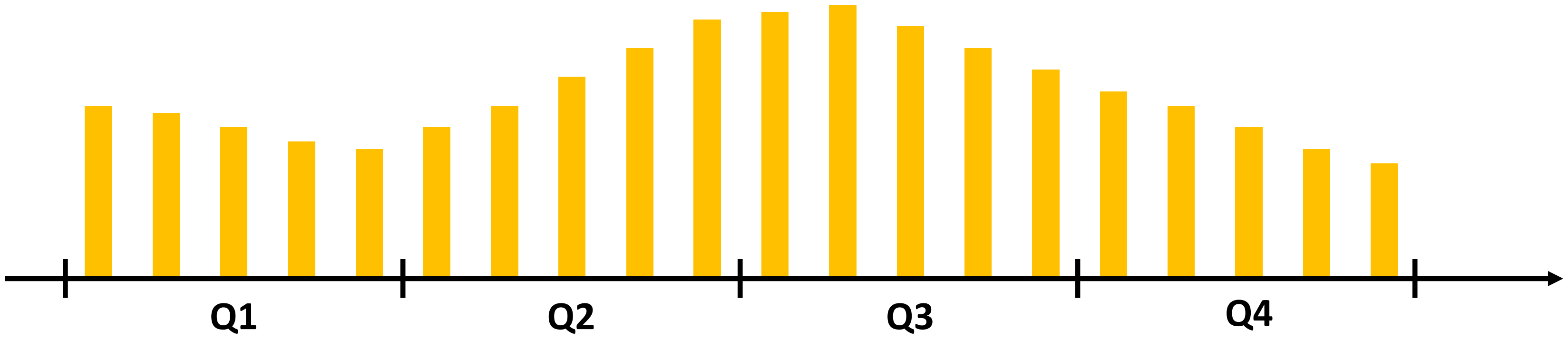
	1	2	3	4	5	
CSM opening balance	500	418	328	229	120	
Interest accretion	50	42	33	23	12	
Nominal CSM releases	132	132	132	132	132	
CSM closing balance	418	328	229	120	0	
PV of CSM releases	120	109	99	90	82	**500**
Coverage units	1	1	1	1	1	
Coverage units - discounted	0.91	0.83	0.75	0.68	0.62	
Coverage units - cumulative	3.79	2.88	2.06	1.30	0.62	

Discounted releases of the CSM are the same, regardless of whether discounted or undiscounted coverage units are used.

Coverage units approach (discounted or not) impacts how profits are recognized in future years (pattern)however, the present value of profits is the same.

Introduction to IFRS 17

Initial measurement and locked-in discount rates



Possible approach to the initial measurement discount rates

Avr Q1	Avr Q2	Avr Q3	Avr Q4

Possible approach to the locked-in discount rates

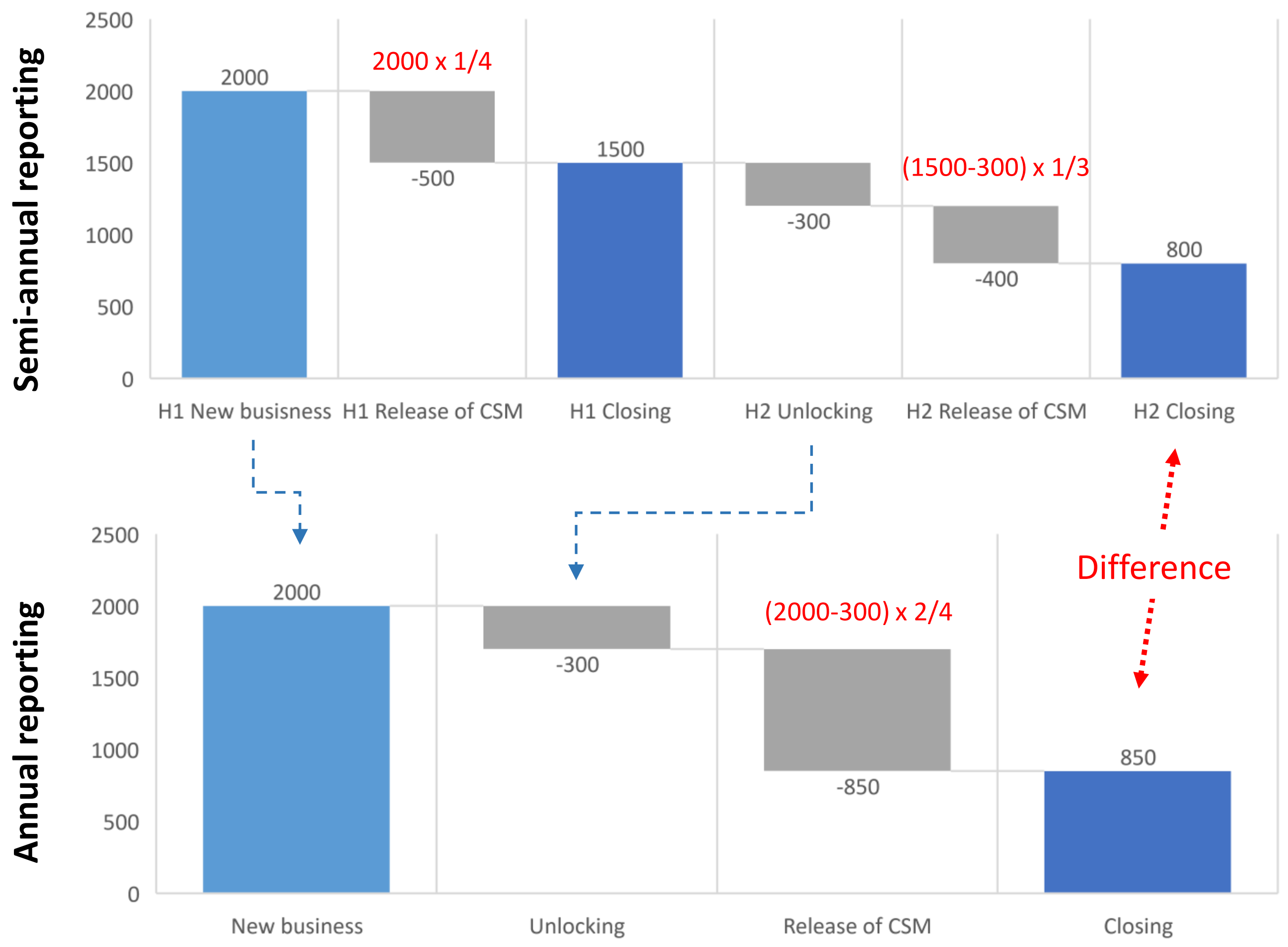
Avr Q1

Avr Q1-Q2

Avr Q1-Q3

Avr Q1-Q4

One of the possible approaches



IFRS 17.B137:

Notwithstanding the requirement in IAS 34 Interim Financial Reporting that the frequency of an entity's reporting shall not affect the measurement of its annual results, an entity shall not change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period.

Main consequence

- IFRS 17 calculations will not be on a 'year-to-date' basis.
- Annual financial result for IFRS 17 will be the sum of the four individual quarters or two semi-annual periods.