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GMM Approach Consideration for Assumption Change and Experience Variance - Understanding with examples

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Measurement models

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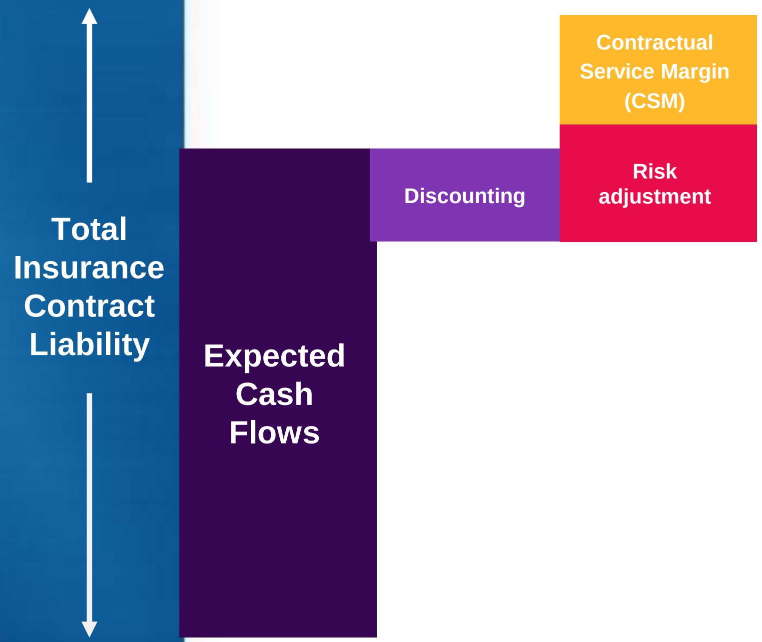
General measurement model	Variable fee approach	Premium allocation approach
All, except contracts with DPF	Direct Participating features	Less than one year or short-term contracts
Default	Mandatory	Optional

General Measurement models – the building blocks



Present value of future cash flows

- **Present value of future cash flows**: estimate the future cash flows of a contract within the **contract boundary**; and adjust for time value:

Present value of cash outgoes – Present value of cash income

- *Incorporate, in an **unbiased way**, all reasonable and supportable information available without undue cost or effort about **the amount, timing and uncertainty of those future cash flows**. To do this, an entity shall estimate the expected value (i.e., the **probability-weighted mean**) of the full range of possible outcomes*
- *Current estimates*
- *Adjust to reflect the **time value of money** and the financial risks related to the future cash flows, to the extent that the financial risks are not included in the estimates of the future cash flows*

Risk adjustment

- Reflects the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risks

Contractual Service Margin

- Quantifies the unearned profit the insurer expects to earn as it fulfils contract
- Ensures no gain at initial recognition
- Allocated over coverage period
- Cannot be negative

Present value of future cash flows: set out in B65 and B66

Inclusions:

Yes	**Premiums** (within boundary,including premium adjustments and instalment premiums)
Yes	**Payments** to (or on behalf of) a policyholder (including RBNS, IBNR and all other claims)
Yes	Payments to (or on behalf of) a policyholder that vary depending on returns on underlying items
Yes	Payments to (or on behalf of) a policyholder resulting from derivatives, for example, options and guarantees embedded in the contract (unless unbundled)
Yes	an allocation of **insurance acquisition cash flows attributable** to the portfolio to which the contract belongs.
Yes	**Claim handling costs**
Yes	**Policy administration and maintenance costs**, including renewal commission
Yes	**transaction-based taxes** (such as premium taxes, value added taxes and goods and services taxes) and levies (such as fire service levies and guarantee fund assessments) that arise directly from existing insurance; and payments by the insurer in **fiduciary capacity to meet tax obligations** incurred by the policyholder, and related receipts
Yes	potential cash inflows from recoveries
Yes	an **allocation of fixed and variable overheads** (such as the costs of accounting, human resources, information technology and support, building depreciation, rent, and maintenance and utilities) directly attributable to fulfilling insurance contracts. Such overheads are allocated to groups of contracts using methods that are systematic and rational, and are consistently applied to all costs that have similar characteristics.
Yes	any other **costs specifically chargeable to the policyholder** under the terms of the contract

Present value of future cash flows: set out in B65 and B66

Exclusions:

No	**Investment returns**; investments are recognised, measured and presented separately
No	Cash flows (payments or receipts) that arise under **reinsurance** contracts held. Reinsurance contracts held are recognised, measured and presented separately.
No	cash flows that may arise from **future insurance contracts**, ie cash flows outside the boundary of existing contracts
No	cash flows relating to **costs that cannot be directly attributed to the portfolio of insurance contracts** that contain the contract, such as some product development and training costs. Such costs are recognised in profit or loss when incurred.
No	cash flows that arise from **abnormal amounts of wasted labour** or other resources that are used to fulfil the contract. Such costs are recognized in profit or loss when incurred.
No	**income tax payments** and receipts the insurer does not pay or receive in a fiduciary capacity. Such payments and receipts are recognised, measured and presented separately applying IAS 12 Income Taxes.
No	cash flows between different components of the reporting entity, such as policyholder funds and shareholder funds, if those cash flows do not change the amount that will be paid to the policyholders.
No	Cash flows from unbundled components that are accounted for using other applicable Standards

Contractual Service Margin on subsequent measurement dates

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Contractual Service Margin under the GMM

CSM at start of period

\+ CSM for new contracts

\+ Interest at locked in rate

+/- Changes in cash flows

- Experience adjustment for premium received
- Changes in estimates of cash flows relating to future service
- Difference between expected and actual investment component paid in the period
- Change in risk adjustment for future service

+/- Currency exchange

\- CSM allocated to period

- Allocation based on coverage units

CSM at end of period

Other key terms:

fulfilment cash flows	An explicit, unbiased and **probability-weighted estimate** (ie expected value) of the **present value** of the future cash **outflows minus** the present value of the future cash **inflows** that will arise as the entity fulfils insurance contracts, including a **risk adjustment** for non-financial risk
contractual service margin	A component of the carrying amount of the asset or liability for a group of insurance contracts representing the **unearned profit** the entity will **recognise as it provides insurance contract services** under the insurance contracts in the group
investment component	The amounts that an insurance contract requires the entity to repay to a policyholder in all circumstances, regardless of whether an insured event occurs
coverage unit	The number of coverage units in a group is the **quantity of insurance contract services** 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 period**