

IFRS 17: CSM – Order of adjustments

[This article is one in a series of articles (which can be found [here](#) and [here](#)) published on behalf of the [IFRS 17 CSM Working Party](#). Members are Antoon Pelsser, Asim Ghosh, Clarence Er, Huina Zhang, James Thorpe, Joanna Stansfield, Kruti Malde, Natalia Mirin (Deputy Chair), Richard Dyle, Rob Walton, Timothy Berry, Weihe Qin and Wijdan Yousuf (Chair).]

The IFRS 17 standard specifies how to calculate the contractual service margin (CSM) at initial recognition. Further, the standard sets out the various adjustments that need to be made to arrive at the CSM at subsequent measurement. However, the standard is silent on what order an entity should make these adjustments.

On subsequent measurement, CSM for insurance contracts without direct participating features will be calculated as follows (in no particular order):

CSM at start of reporting period

Add: New business

Add: Interest unwind (Locked-in rate)

Add/Less: Change in fulfilment cash flows (FCF) towards future service, e.g. due to:

- a. Modelling changes*
- b. Non-economic assumption change*
- c. Experience variance*

Add/Less: Other experience adjustments related to future services, e.g.:

- a. Premium variance*
- b. Premium related cash flow variance such as taxes, commissions, etc.*
- c. Acquisition expense variance*
- d. Non-distinct investment component variance*

Add/Less: Effect of any currency exchange differences

Less: Release of CSM (amortization)

Net: CSM at end of reporting period

The above changes are subject to CSM being positive post adjustments, and if the CSM turns negative then the excess portion will be recognized in the profit and loss account through the establishment of a loss component.

In case of insurance contracts with direct participating features and reinsurance contracts, adjustments made to CSM will differ from those mentioned above. However, the principles to be followed while deciding the order of the adjustments remains the same for all the types of contracts. More discussion on adjustments to be made to loss component and CSM for different types of contracts will be covered in more detail as part of sessional paper.

Paragraph 44 (e) of the standard states that the amount recognized as insurance revenue, i.e. release of CSM, will be determined at the end of the reporting period and hence shall be the last element in the order of adjustments. This leaves it open for an entity to decide the timing of rest of the items set out above.

The timing of these adjustments can give rise to different results when measured at start or end of the year. There is no right or wrong choice, however it is important to have consistency between various elements such as calculation of interest unwind or insurance revenue.

For instance, let's assume that the entity makes a choice to recognize a non-economic assumption change impact on FCF at the start of reporting period. This would result in the effect being captured in CSM at start of period too. Consequently, the interest unwind will be on CSM at start of period after

adjusting for the impact of change in FCF. Further, while calculating the release of CSM, the coverage units used shall also reflect revised coverage units for the current as well as subsequent period. Lastly, in the case of insurance revenue for the reporting period, it shall comprise expected cash outflows based on the revised assumptions too.

Conversely, let's assume the entity makes a choice to recognize assumption change impacts at the end of reporting period, resulting in adjustments to the CSM being captured at the end of period as well as before any release of CSM. The interest unwind will be now calculated on opening CSM before any adjustments. While the release of CSM will still be the last element, the coverage units will reflect opening assumptions for current period and revised assumptions for subsequent periods. The computation of insurance revenue should also reflect expected cash outflows at start of period to maintain consistency.

The financial implications of choosing either of the two approaches can differ in different scenarios depending on the magnitude and direction of the changes. The standard allows adjustments to CSM only for future service and hence the choice reflects how the company interprets future service. In first case where the impact is taken at start of period, the future service includes the current reporting period whereas in the second case, the future service comprises strictly the service provided after the end of reporting period.

The choice can also depend on the past practices, or on how easy or difficult either approach is from an operational point of view. The approach, once decided, should not vary year-on-year, to make reasonable comparison of results.

As mentioned earlier, there is no right or wrong way in timing or order of adjustments and the entity has to decide the approach that is more suitable to them. If you have any questions or suggestions, feel free to get in touch through the comments sections.

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