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Potential implementation question

IFRS 17 allows the OCI option to be taken and specifies how it shall be applied to different types of insurance contracts through paragraph 88 and 89. The application of OCI option requires a systematic allocation to calculate the amount going into P&L. B132 further provides more guidance to paragraph 88 and states the two options on how a rate / rates shall be determined for groups of insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to polidyholders.

B132(a)(i) and (ii) stipuates that either a constant rate or a pattern following crediting rate shall be used to determine the systematic allocation. It is understood that these two approaches are largely making reference to the OCI approach applied to bond investment. However, an insurance contract normally has both positive and negative cash flow arising at different future time points, there may be situations that a constant rate (or a fixed margin above or below crediting rate) is mathematically insolvable which deems the OCI approach impracticable for some contracts. The question is whether alternative ways to apply systematic allocation, which are proposed in detail in the section of "Analysis of the Question", still fulfill the requirement of IFRS 17?

Paragraph of HKFRS/IFRS 17 *Insurance Contracts*

88 Unless paragraph 89 applies, an entity shall make an accounting policy choice between:
(a) including insurance finance income or expenses for the period in profit or loss; or
(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount determined by a systematic allocation of the expected total insurance finance income or expenses over the duration of the group of contracts, applying paragraphs B130–B133.

89 For insurance contracts with direct participation features, for which the entity holds the underlying items, an entity shall make an accounting policy choice between:
(a) including insurance finance income or expenses for the period in profit or loss; or
(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount that eliminates accounting mismatches with income or expenses included in profit or loss on the underlying items held, applying paragraphs B134–B136.

B130 If paragraph 88(b) applies, an entity shall include in profit or loss an amount determined by a systematic allocation of the expected total finance income or expenses over the duration of the group of insurance contracts. In this context, a systematic allocation is an allocation of the total expected finance income or expenses of a group of insurance contracts over the duration of the group that:
(a) is based on characteristics of the contracts, without reference to factors that do not affect the cash flows expected to arise under the contracts. For example, the allocation of the finance income or

expenses shall not be based on expected recognised returns on assets if those expected recognised returns do not affect the cash flows of the contracts in the group.
(b) results in the amounts recognised in other comprehensive income over the duration of the group of contracts totalling zero. The cumulative amount recognised in other comprehensive income at any date is the difference between the carrying amount of the group of contracts and the amount that the group would be measured at when applying the systematic allocation.

B131 For groups of insurance contracts for which changes in assumptions that relate to financial risk do not have a substantial effect on the amounts paid to the policyholder, the systematic allocation is determined using the discount rates specified in paragraph B72(e)(i).

B132 For groups of insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders:
(a) a systematic allocation for the finance income or expenses arising from the estimates of future cash flows can be determined in one of the following ways:
(i) using a rate that allocates the remaining revised expected finance income or expenses over the remaining duration of the group of contracts at a constant rate; or
(ii) for contracts that use a crediting rate to determine amounts due to the policyholders—using an allocation that is based on the amounts credited in the period and expected to be credited in future periods.
(b) a systematic allocation for the finance income or expenses arising from the risk adjustment for non-financial risk, if separately disaggregated from other changes in the risk adjustment for non-financial risk applying paragraph 81, is determined using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.
(c) a systematic allocation for the finance income or expenses arising from the contractual service margin is determined:
(i) for insurance contracts that do not have direct participation features, using the discount rates specified in paragraph B72(b); and
(ii) for insurance contracts with direct participation features, using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.

Analysis of the question

When a constant rate / margin cannot be found for an insurance contract (or a group of contracts), the following solutions could be applied, which are alterations from literal interpretation of B132:
1) The OCI option shall be abandoned because strict compliance is not possible. We are in the view that this is not the intention of IASB when the requirement of B132(a) is introduced; or
2) The problem of insolvable formula arises from a mixture of positive and negative cash flow. Instead, a constant rate / margin could be solved for all positive cash flow and another rate for all negative cash flow. The P&L amount will then be equal to the sum of the two rates multiplied by the corresponding asset / liability amount; or
3) Making reference to B131 for insurance contracts for which changes in assumptions that relate to

financial risk do not have a substantial effect on the amounts paid to the policyholder through the application of discount rate specified in paragraph B72(e)(i) instead, which is the discount rate determined at the date of initial recognition. This will be used until a solution occurs.

In case that the problem of insolvable rate only arises after initial adoption of OCI option, there is also another possible practice:
4) To follow the rate determined last period until a solution to the constant rate / margin arises again. In case no solution arises until the end of contract, the full amount of outstanding OCI will be recognized in P&L.