IFRS 17 *Insurance Contracts* – Endorsement

Grouping insurance contracts: profitability buckets and annual cohorts

Executive Summary

Project Type	Endorsement
Project Scope	Significant
Purpose of the paper	
At its 9 July 2021 meeting the Board agreed to consider a separate paper on issues arising in respect of IFRS 17's level of aggregation requirements, including those relating to annual cohorts. This paper provides background to the issues, the Secretariat's assessment work to date and an overview of the EU's expected carve out. It also includes an indication of UK stakeholder views on the matter. Appendix 1 sets out a draft assessment against the technical accounting endorsement criteria.	
Summary of the issues	
A group of contracts is the basic measurement unit (unit of account) in IFRS 17. Portfolios must be divided into 'profitability buckets' and contracts issued more than one year apart cannot be included in the same group. Some stakeholders, especially in the EU, have expressed concerns that the annual cohort requirement will not result in useful financial information for all contracts, and that the burden of collecting and managing data at this level will not meet the cost/benefit test. The EU is expected to introduce a carve out from the annual cohort requirements of IFRS 17 for certain types of contract.	
Decisions for the Board	
No decisions are required at this stage. Board members are asked for comments on: • The technical content of, and approach to reporting, the preliminary assessment; and • Any further analysis required to enable the assessment to be finalised for inclusion in the DECA. Comments on the implications for UK entities of an EU carve out are also welcome and will be incorporated in the long term public good assessment to be addressed in more detail in October.	
Recommendations	
The paper recommends including the assessment set out in Appendix 1 in the DECA, subject to any amendments required by the Board and any drafting refinements.	
Appendices	
Appendix 1	Assessment of IFRS 17's requirements in respect of annual cohorts

Background and IFRS 17's requirements

1. Risk-pooling is central to the insurance business model.[1] Measuring profitability on an individual contract level may not reflect this so some level of aggregation in the accounting for insurance contracts is generally considered appropriate. IFRS 17's requirements aim to balance the loss of information caused by aggregating contracts with the operational burden of collecting information, and to ensure that useful information about profitability is not lost.

2. IFRS 17 requires groups of contracts to be determined in the following manner:

    - Identify portfolios of contracts. A portfolio comprises contracts subject to similar risks and managed together.

    - Divide portfolios into a minimum of three groups[2]:

        - A group of contracts that are onerous at initial recognition;

        - A group of contracts that have no significant possibility of becoming onerous; and

        - A group of the remaining contracts.

    - Further divide groups to ensure a group does not include contracts issued more than one year apart (the 'annual cohort requirement').

3. The IASB's core objectives in requiring annual cohorts[3] include ensuring that:

    - changes in profitability are captured;

    - losses from onerous contracts are identified and recognised promptly; and

    - profits are recognised over the contracts' coverage period and not longer.

4. Some stakeholders have expressed concerns that the annual cohort requirement will not result in useful information for contracts that share risks across policyholder cohorts. When the IASB considered proposing amendments to the standard, it considered such concerns and challenges but decided to retain the annual cohort requirement. It therefore did not ask a question on annual cohorts when it issued the ED for the 2020 Amendments. Nevertheless, some stakeholders (mostly from the EU) continued to request changes and exemptions from the annual cohort requirement.

5. EFRAG's Final Endorsement Advice addressed the issue in detail but did not reach a consensus. Subsequently, the EC's Accounting Regulatory Committee proposed an

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[1] "By pooling the risks arising from a large number of similar contracts, an insurer acquires a reasonable statistical basis for making a credible estimate of the amount, timing and uncertainty of the cash flows arising from the contracts. If the outcome of one contract is independent of the outcome on other contracts, pooling of risks also reduces the risk of random statistical fluctuations." Source: IASB 2007 Discussion Paper *Preliminary Views on Insurance Contracts,* para. 18(b)

[2] These are sometimes referred to as 'profitability buckets'

[3] Cohorts can be for periods less than one year, e.g. quarterly cohorts

optional exemption from the annual cohort requirement – this is now subject to scrutiny by the European Parliament and the Council of the EU.

6. Although stakeholder feedback indicates that annual cohorts are not considered as significant an issue by UK stakeholders (see paragraph 17 below), implications for UK entities could emerge in respect of competitiveness and comparability with EU insurers that apply the exemption.

7. Further background and explanatory information on the annual cohort requirement has been provided to the Board as part of educational and supplementary material.

8. The remainder of this paper is structured as follows:

- Overview of assessment work carried out by the Secretariat to date;
- Summary of views expressed by UK stakeholders;
- Overview of proposed EU carve out and implications for UK entities; and
- Questions for the Board and proposed next steps.

Assessment work carried out to date

9. The key elements of the Secretariat's assessment work on this issue to date include the following:

   a) Desk-top analysis, including reviews of comment letters and other feedback to the IASB during the development and finalisation of the standard;

   b) Review of results from our preparer outreach, including our preparer survey;

   c) Discussions with the IASB, including at a meeting of the Insurance Technical Advisory Group (TAG);

   d) Review of feedback received during our outreach to users of accounts; and

   e) Discussions with EFRAG and European regulators regarding the EU carve out.

10. The March 2021 meeting of the Insurance TAG included a presentation on annual cohorts from the IASB staff. A summary of the Insurance TAG's discussions relating to this topic is available in the meeting summary on the UKEB website.[4]

Views expressed by UK stakeholders

Results from our preparer outreach

11. Our preparer survey was carried out in September and October of 2020 and included specific questions on IFRS 17's level of aggregation and annual cohorts in particular.

[4] https://www.endorsement-board.uk/endorsement-projects/ifrs-17/technical-advisory-group

12. 13 out of the 16 respondents expected to recognise significantly more groups of contracts than they do currently. 6 respondents (all except one of which were life insurers) opposed the requirement to divide portfolios into profitability buckets. While there was support for the objective of avoiding the offset of profitable contracts against onerous ones, insurers expressed concerns around cost and complexity and stated that the requirement did not reflect the way they managed the business. There were specific comments that the split between 'contracts that have no significant possibility of becoming onerous' and 'other' was highly judgemental and of little benefit to users.

13. The majority (66%) of respondents neither supported nor opposed the annual cohort requirement. While one general insurer supported the requirement, three life insurers opposed it. Comments from those opposed included:

- "*Insurance contracts are fundamentally managed together as a portfolio, as are the assets backing those liabilities. The annual cohort requirement undermines the fundamental business model of insurance.*"
- *"We understand the rationale behind annual cohorts, however the approach proposed is not representative of how certain products are designed to operate."*

14. More supportive comments included:

- *"The requirement aligns with the underwriting year view of planning and is consistent with the insurance cycle. Enhancing disclosure around profitability of each underwriting cohort enhances transparency."*
- *"The need for annual cohorts is understood, but at the same time results in additional calculation complexity."*

15. Other insurers noted the challenge of ongoing cost and complexity and one considered that the IASB's objectives could be achieved without the need for annual cohorts. This insurer noted that:

- "… *sharing of risks can be between generations of policyholder, i.e. across annual cohorts. Consequently, separate consideration of the profitability of individual cohorts is not meaningful. We have, however, developed systems to accommodate the annual cohort requirement and, therefore, any changes to the requirement would be of little operational benefit and potentially disruptive to our implementation of IFRS 17.*"

16. In spite of the concerns expressed in our preparer survey, our outreach has consistently indicated that the annual cohorts requirement is not a priority concern for UK insurers. For example, we understand that the topic has not been debated at the ICAEW Insurance Committee. Recent feedback from the ABI confirmed that the annual cohorts requirement is not a significant active issue for its members and that there is no significant desire for a carve out similar to that proposed by the EU.

17. The reasons why annual cohorts requirements are less of a concern for UK insurers include the following:

- In the UK assets are generally measured at fair value and returns shared with policyholders are generally determined on a fair value basis. Additional issues in the EU caused by discretionary participation benefits being generally based on realised gains do not arise in the UK. In particular, EU funds do not typically have the concept of asset share determined on a fair value basis.

- The operational impact is not as great in the UK because funds are managed at a granular level already. For example, asset share calculations are typically performed at the level of actuarial 'model points' (perhaps 100 contracts or even on an individual contract basis).

- The terminal bonus scale for UK with-profits contracts is generally set at a cohort level (which might be annual cohorts or a more granular level).

- By design, guarantees in the UK are low, providing more flexibility for entities to invest in assets with a potential for higher returns (e.g. there are high levels of equity investment). In the EU the trend in profitability may be causing concern especially in the continuing low interest rate environment. While in the UK there can be cross-subsidies between cohorts, the greater headroom UK funds typically have limits such inter-generational mutualisation so that annual cohorts are more consistent with how the business is managed.

- Due to the mutualisation that exists in typical UK with-profit funds, in the UK IFRS 17's annual cohorts requirement is generally most challenging to apply for with-profits business. However, most UK insurers stopped writing significant volumes of with-profits business a number of years ago, so in general the business is declining in significance for the UK.

- Given the date most UK with-profits business incepted, fully retrospective transition is unlikely to be practicable so UK insurers are expected to apply the fair value transition approach to much of this business. The fair value approach permits an election to treat pre-transition business as one cohort.

- In the case of UK with-profits funds, there is typically little or no discretion over the entity's share of returns on underlying items (being fixed at 10%); this reduces the amount of subjectivity required in the determination of CSM, which was one of the concerns raised by some EU stakeholders.

Feedback from Insurance TAG

18. The IFRS 17 annual cohort requirement was discussed by the Insurance TAG following the presentation on the topic by the IASB staff in March 2021. TAG members were generally supportive of the requirement, based on the expected benefits of enhanced information on profitability trends and loss-making contracts. Although the one year limit may be arbitrary, it aligned with the annual financial reporting cycle and it would be difficult to define a more appropriate period while maintaining useful information about performance.

19. One TAG member noted that separate measurement of the CSM by annual cohort was highly complex to maintain after initial recognition and that the requirement did not work well for European participating funds. However, it was acknowledged that UK with-

profits products had different characteristics and did not present the same level of operational challenges.

20. TAG members noted that it would be difficult to define the scope of any exemption but commented that the scope of the proposed EU exemption seemed wide.

Feedback from users of accounts

21. Specific comment on IFRS 17's level of aggregation requirements, including the annual cohorts requirement, from users of accounts during our outreach has been limited. This may be because at this stage it is difficult for users to assess the impact except at a theoretical level.

22. Overall, however, users appear to be supportive of the requirement, considering it will provide useful information. The IASB's summary of its own outreach to users of accounts noted that many investors and analysts welcomed the fact that IFRS 17 will require entities to identify onerous contracts at initial recognition and subsequently.[5] Recent public statements from ratings agencies in particular have been supportive of the annual cohort requirement. For example,

- a UK representative of AM Best stated that it would be "very disappointing" for users should the annual cohort requirement be subject to a carve out;[6]

- on 27 July 2021 Fitch Ratings reported that "*reporting by annual cohorts gives insightful information on historical pricing and subsequent profit emergence, helping users of financial statements to analyse and project profitability*."[7]

Draft assessment against the technical accounting criteria

23. Appendix 1 to this paper presents a draft assessment of IFRS 17's principal requirements in respect of annual cohorts against the technical endorsement criteria of understandability, relevance, reliability and comparability.

Questions for the Board
24. Does the Board have any comments on the draft assessment? 25. Are there any further important considerations that ought to be included in the assessment? 26. Has the Board identified any further analysis work required to enable the assessment to be finalised for inclusion in the DECA?

5 IASB Board paper 2A, July 2017

6 AM Best TV interview: http://www.ambest.com/v.asp?v=ifrs17421

7 See article here

EU carve out

27. Assessment of the implications for UK entities of an EU carve out in respect of the annual cohort requirement will form part of the long term public good assessment included in the IFRS 17 DECA.

28. As noted above, EFRAG was unable to reach a consensus regarding whether the annual cohorts requirement met its endorsement criteria, both in terms of the technical accounting criteria and the European public good.[8] Seven board members concluded that the endorsement criteria were met and seven concluded that they were not met. In addition, two board members abstained from expressing a view on whether or not the annual cohorts requirement on its own met the endorsement criteria: they considered that the requirement should not be assessed in isolation and that, on balance, the annual cohorts requirement should not in isolation prevent the endorsement of IFRS 17 as a whole.

29. The lack of consensus relates to the application of the requirement to two particular types of contracts, termed by EFRAG 'intergenerationally-mutualised' and 'cash flow matched' contracts. Such contracts comprise a majority of the life insurance markets in several EU jurisdictions.[9] Non-life business is not affected.

30. In July the EC's Accounting Regulatory Committee proposed an optional exemption from the annual cohorts requirement for intergenerationally-mutualised and cash flow matched contracts. The carve out would work by permitting companies not to apply paragraph 22 of IFRS 17[10] to these contracts, described in the draft Regulation as:

    f) "*groups of insurance contracts with direct participation features and groups of investment contracts with discretionary participation features as defined in Appendix A to the Annex*[11] *to this Regulation, and with cash flows that affect or are affected by cash flows to policyholders of other contracts as laid down in paragraphs B67 and B68 of Appendix B of that Annex*;

    g) *groups of insurance contracts that are managed across generations of contracts and that meet the conditions laid down in Article 77b of Directive 2009/138/EC and have been approved by supervisory authorities for the application of the matching adjustment*."

31. The proposal is that the Commission should review the exemption by 31 December 2027, taking into account the IASB's post-implementation review of IFRS 17. The proposal is now subject to scrutiny by the European Parliament and the Council of the EU.

32. The EU carve out is optional, so it will be possible for EU-listed entities to apply IFRS 17 as issued by the IASB. However, some listed entities from jurisdictions including

8 EFRAG's Final Endorsement Advice can be found here

9 No detailed analysis has been carried out of which UK products would fall within the definitions proposed by ARC (see paragraph 30). However, based on informal feedback from stakeholders we understand the definitions would probably capture most UK with-profits and annuity business.

10 IFRS 17 para. 22 contains the annual cohort requirement

11 The 'Annex' refers to IFRS 17, so Appendix A means IFRS 17's definitions and Appendix B means IFRS 17's Application Guidance.

France, Spain and Italy might make use of the carve out option. Since stakeholders have informed us that the annual cohorts requirement was not a priority issue for the UK, and given that details of the expected EU carve out have only recently become available, our work has been limited to potential implications for UK entities, should the UK adopt IFRS 17 as issued. We propose to consult specifically on this issue when issuing the DECA for public consultation. Considerations might include:

a) Operational factors (cost and complexity): these may affect groups operating across the EU and the UK differently:

- UK-based groups with operations in the EU: based on stakeholder feedback, UK life businesses have only limited operations in the EU. The accounting needs of any EU subsidiaries would depend on the financial reporting requirements in the relevant jurisdiction, but it is likely that such subsidiaries would need to prepare local GAAP accounts. They are therefore likely to be reporting under two accounting frameworks already so are unlikely to be affected by a difference between UK- and EU-adopted IFRS.

- EU-based groups with operations in the UK: UK subsidiaries[12] of EU listed entities will need to prepare UK entity accounts in accordance with UK law, i.e. applying either UK GAAP or UK-adopted IFRS. Should the subsidiary need to prepare accounts on a different basis for consolidation purposes, the subsidiary would incur additional implementation and ongoing costs. However, based on our analysis there are few UK subsidiaries of EU listed parents with significant life business.

b) Competition for capital: the EU carve out is expected to reduce the incidence of losses on onerous contracts being recognised, thereby potentially concealing economic losses and enhancing perceived performance. However, the potential for two different versions of IFRS 17 is viewed negatively by users of accounts. Although the greater flexibility in financial reporting afforded by a carve out might appear an advantage, if the accounts of groups adopting the carve out are perceived to be less transparent, that might be a disadvantage in the competition for capital. EU entities making use of the EU carve out would have to disclose that fact. No UK insurance entities have listings on an exchange in the EEA, and, with one exception,[13] we are not aware of any EU-listed insurance groups which also have a UK listing.

c) Competition for customers: our outreach and the economic study suggest that accounting differences such as a carve out for annual cohorts are unlikely to affect the competitiveness of insurers in the product market. Decisions regarding pricing and product offering are likely to be made at portfolio level and driven more by capital requirements and taxation. Although lower accounting costs might theoretically offer an advantage, in the context of the relevant insurers' total cost base this seems unlikely to have an impact.

12 Business conducted through UK branches of overseas companies is insignificant in the context of the market as a whole.

13 FBD Holdings, listed on Euronext Dublin, has a cross-listing on the LSEG.

Questions for the Board
33. Does the Board have any preliminary comments on the implications for the UK of an EU carve out in respect of annual cohorts? 34. Are there any further important considerations that will need to be addressed in the IFRS 17 long term public good assessment?

Proposed next steps

35. Subject to the Board's comments on the draft assessment set out in Appendix 1 and any further analysis work required, the Secretariat will incorporate the content of the Appendix in the [draft] Endorsement Criteria Assessment.

36. In addition, implications for UK entities of an EU carve out in respect of annual cohorts will be addressed in the long term public good part of the DECA (to be considered by the Board in October 2021).

IFRS 17 *Insurance Contracts* – Endorsement Grouping insurance contracts: profitability buckets and annual cohorts

Appendix 1: [draft] assessment against the technical accounting endorsement criteria

IFRS 17 requirements

Initial recognition

1. IFRS 17 requires an entity to recognise and measure groups of insurance contracts. Groups are determined by:

   a) Identifying portfolios of contracts – a portfolio comprises contracts subject to similar risks and managed together; [IFRS 17: 14]

   b) Dividing portfolios into a minimum of three groups, sometime referred to as 'profitability buckets':

      i. A group of contracts that are onerous at initial recognition, if any;

      ii. A group of contracts that at initial recognition have no significant possibility of becoming onerous, if any; and

      iii. A group of the remaining contracts, if any; [IFRS 17: 16]

   c) Dividing the profitability buckets into groups of contracts issued not more than one year apart (annual cohorts). [IFRS 17: 22]

   d) For contracts to which the entity applies the premium allocation approach, an entity assumes that no contracts are onerous at initial recognition, unless facts and circumstances indicate otherwise. [IFRS 17: 18]

Subsequent measurement

2. Entities must apply IFRS 17's recognition and measurement requirements to the groups of contracts determined as set out in paragraph 1 above. Entities must not reassess the composition of groups subsequently. [IFRS 17: 24]

Disclosures

3. IFRS 17 does not contain specific disclosure requirements relating to the determination of portfolios, profitability buckets or groups of contracts. However, the standard requires the disclosure of qualitative and quantitative information about the amounts recognised in the accounts and the significant judgements made to enable the effect

of insurance contracts on the entity's financial position and performance to be assessed. [IFRS 17:93] The significant judgements made include the methods used to measure insurance contracts and the processes for estimating the inputs to those methods. It is expected that these disclosures would include the basis for determining portfolios and groups of contracts. [IFRS 17:117]

Annual cohorts – accounting impact

4. IFRS 17's level of aggregation requirements are likely to mean an increase in the number of units of account for insurers compared with current practice. Fulfilment cash flows are permitted to be estimated at a higher level of aggregation than the group as long as they can then be allocated appropriately to groups of contracts to meet the standard's measurement requirements for groups. [IFRS 17: 24]

5. The annual cohorts requirement is expected to lead to the earlier recognition of losses from onerous contracts when contracts become onerous subsequent to initial measurement, compared to the outcome if there was no annual cohort requirement.

6. IFRS 17's objective is to identify contracts that are onerous as individual contracts. However, if an entity can determine that a set of contracts will all be in the same group, then it can measure that set to determine whether the contracts are onerous or not. The same principle applies to the identification of contracts that have no significant possibility of becoming onerous subsequently. [IFRS 17: BC129]

Assessment against the endorsement criteria

7. The insurance business is one of risk pooling and risk sharing so some level of aggregation is appropriate. For example, when an entity issues a number of identical insurance contracts it has an expectation of a particular level of aggregate claims. The probability of claims might change for some contracts within the group with the result that they would be onerous if accounted for on an individual contract basis, even though the aggregate result of the group of contracts remains as expected. Defining IFRS 17's unit of account as a group of contracts therefore provides **relevant** information.

8. The requirement to divide portfolios of insurance contracts into 'profitability buckets' provides useful information about loss-making groups of contracts, and hence an entity's pricing decisions, thereby **enhancing the relevance** of the financial statements. This requirement also means that groups of loss-making contracts are not offset against groups of profitable contracts.

9. For groups of contracts that are not onerous, dividing contracts between groups of contracts that have no significant possibility of becoming onerous and other groups reduces the risk of losses not being recognised on a timely basis, should future changes in conditions make previously profitable contracts loss-making. Such losses might otherwise be offset against profits on other contracts. IFRS 17's requirement therefore **increases the relevance and reliability** of the financial information.

10. The prohibition on grouping contracts issued more than one year apart avoids the possibility of perpetually open portfolios and the associated loss of useful information, thereby **enhancing relevance, reliability and inter-period comparability**:

a) Annual cohorts provide information on the development of profitability over time. Without annual cohorts different levels of profitability in different periods would be intermingled and profits would not always be recognised in the period they were earned.

b) The requirement for annual cohorts also means that the CSM for a group of contracts cannot persist beyond the duration of contracts in the group: that is, it avoids the continued recognition of CSM for contracts that are no longer in force.

c) Annual cohorts mean that losses from onerous contracts are likely to be identified and recognised promptly, when facts and circumstances change.

11. IFRS 17's requirements ensure a degree of standardisation in the way entities aggregate insurance contracts, **increasing comparability** across entities, while permitting entities to identify portfolios in a way which reflects individual business models and circumstances, thereby enhancing **relevance**.

12. Disclosures of significant judgements are expected to address methods of determining groups of contracts, and any changes in such methods, **enhancing understandability and enabling comparability**.

13. The benefits of including a time-based cohort requirement are set out in the preceding paragraphs. Specifying ***annual*** cohorts as the unit of account, while strictly arbitrary, aligns with the traditional underwriting year view of planning and reporting performance and represents a practical convention that is **easily understandable**.

Potential challenges to the endorsement criteria and mitigations

'Profitability buckets'

14. Some stakeholders consider that IFRS 17's requirement to divide contracts between those that 'have no significant possibility of becoming onerous' and 'other' requires a significant degree of judgement and at the fringes might be arbitrary. Further, the requirement does not always reflect the way an insurer manages its business: some entities monitor profitability at the level of portfolios. While there is general support for the objective of avoiding the offset of profitable contracts against onerous ones, these stakeholders perceive a risk that the resulting financial information is **less relevant and reliable** and hence less useful to users of the accounts.

15. However, these risks need to be balanced against the benefits of profitability buckets as set out above. Absent IFRS 17's requirements, contracts could be grouped at a higher level of aggregation, for example at the level of the portfolio, with the risk that onerous contracts could be offset against profitable contracts and information about onerous contracts could be lost. Feedback from users indicates that they particularly welcome the fact that IFRS 17 will require the identification of onerous contracts at initial recognition and subsequently.

16. Less profitable groups of contracts have less resilience to adverse changes and hence carry a greater risk of becoming onerous. "*A difference in the likelihood of a contract being or becoming onerous is an important economic difference between groups of insurance contracts. Grouping contracts that have different likelihoods of becoming*

onerous reduces the information provided to users of financial statements." [IFRS 17: BC134] By prohibiting the grouping of insurance contracts that have substantially different likelihoods of becoming onerous, IFRS 17 enhances the **relevance** of information provided to users of financial statements. It is therefore appropriate to account for such groups separately.

Risk sharing across annual cohorts

17. Some stakeholders are concerned that annual cohorts do not provide useful information when insurance contracts share risks across generations of policyholders (i.e. across different annual cohorts). For example, benefits to certain policyholders may be reduced to meet claims of other policyholders, and profits on contracts incepted in one year may support returns to policyholders of contracts incepted in other years. These stakeholders consider that annual cohorts fail to reflect the sharing of risks across cohorts, **reducing the relevance** of the resulting information.

18. Risk sharing across different annual cohorts, in particular when management exercises discretion as to the timing and allocation of policyholder profit shares, imposes the need to allocate adjustments to fulfilment cash flows, and hence profits, between cohorts. Some stakeholders are concerned that such allocations will be arbitrary, because profits are not determinable on an annual cohort basis, and in their view will therefore **reduce relevance and impair reliability**.

19. However, the effect of profit-sharing between generations of policyholders is captured by the requirements of IFRS 17: B67 – B71: the measurement of the fulfilment cash flows takes into account the way that the cash flows of one group affect, or are affected by, cash flows of other groups. Profit-sharing ***between policyholder*** cohorts does not mean that the ***entity's*** share of profits (captured in the CSM) is not affected: this could change from one year to the next and should be accounted for accordingly. Scenarios in which the entity bears no share of risk at all are rare. The entity will therefore bear its share, and that share will be different from period to period depending on pricing decisions, how insurance risks and claim levels evolve, and market conditions.

20. The annual cohorts requirement should therefore provide **relevant** information about the entity's profitability, irrespective of profit-sharing between cohorts of policyholders. By contrast, removing the annual cohort requirement would result in variable levels of profitability being averaged across cohorts, and a loss of information about changes in profitability. This is particularly important when the effect of guarantees is partly borne by the entity and during periods of challenging market conditions. Profits reported might mask the fact that, for example, newer contracts were subsidising older contracts or, conversely, that aggressive pricing of new business was being subsidised by more profitable established business. Consequently, annual cohorts are likely to **enhance the relevance** of financial information, better enabling primary users of accounts to assess future prospects as well as the stewardship of management. In particular, annual cohorts "*ensure that trends in the profitability of a portfolio of contracts [are] reflected in the financial statements on a timely basis*". [IFRS 17: BC 136]

21. Further, even in cases where management has discretion over the allocation of policyholder profits, the overall split between the entity and the body of policyholders as a whole is generally specified (as, for example, in a typical UK with-profits fund). This means that the entity's share is not arbitrary but objectively identifiable, and hence

reliable. In any event, this judgement is required to determine the CSM of new business, irrespective of the annual cohort requirement.

22. The objective of IFRS 17 is to prescribe a level of aggregation that balances the risk of an excessive level of granularity and numbers of groups (disregarding the risk pooling inherent in insurance business), with the risk of the loss of information relating to profitability and the identification of onerous contracts. The annual cohorts requirement represents a practical approach based on a straightforward and understandable convention. Overall, the standard strikes a balance that is likely to provide useful information in the great majority of cases.