

EPISODE 3 CSM SUBSEQUENT MEASUREMENT

# IFRS 17 Explained — Episode 3

**What Hits the CSM vs P&L?** — The FCF Routing Rules  
Decoded

# Recap: Where We Left Off

## ● EPISODE 1

### LRC at Inception

IFRS 17 Para 32–38 · GMM/BBA

|       |   |           |
|-------|---|-----------|
| PVFCF | – | \$150,000 |
| RA    | + | \$30,000  |
| CSM   | + | \$120,000 |

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LRC Net = \$0

Product: **20-yr Whole Life**

Policyholders: **1,000**

Death Benefit: **\$200,000**

Para 32–38 · Day-1 LRC = \$0 (no gain at inception)

## ● EPISODE 2

### CSM Roll-Forward Mechanics

IFRS 17 Para 44–45, B119

Locked-in rate: **5% p.a.**

Total CUs ( $\Sigma$ CU): **17,150**

Exits/year: **15 (10 deaths + 5 lapses)**

#### Year 1 Roll-Forward

Opening CSM: **\$120,000**

+ Accretion: **\$6,000**

– Release: **\$7,347**

Closing CSM: **\$118,653**

Amortisation ratio Yr 1: 5.831% → Yr 20: 100%

## ● EPISODE 3

## 📍 YOU ARE HERE

### FCF Routing Rules — Decoded

IFRS 17 Para 44(c), B96–B100

THE CORE QUESTION:

**FCF change -> CSM?**

**or -> P&L directly?**

- Future service FCF changes **adjust the CSM**
- Past/current service variances go **straight to P&L**

⚡ Experience Variances

⚙️ Assumption Changes

P&L volatility routing rules · IFRS 17

# The Full CSM Roll-Forward: All 5 Steps

IFRS 17 · PARA 44(A)–(E)

Episode 2 introduced the 5-step roll-forward formula, simplifying by assuming **no FCF changes**. Episode 3 now fully decodes **Step 4 — FCF Changes**, revealing the routing rules that govern P&L volatility.

## STEP (A) · OPENING BALANCE

### Opening CSM

Starting balance carried forward from prior period. **Year 1: \$120,000** at inception; **Year 2+: prior closing CSM**.

## STEP (B) · NEW BUSINESS

### (+) New Contracts

CSM from newly issued contracts added in the period. **Episode example: \$0** (single cohort; no new contracts assumed).

## STEP (C) · TIME VALUE

### (+) Interest Accretion (Locked-In Rate)

CSM grows at the **locked-in 5%** discount rate. **Year 1: +\$6,000** ( $5\% \times \$120,000$ ). Rate never unlocked for non-financial risk.

## STEP (D) · FCF CHANGES · NOW DECODED — EPISODE 3

### (±) FCF Changes **NOW DECODED**

Changes in **future service FCFs** adjust the CSM. Changes for **past or current service** bypass CSM entirely and flow to **P&L directly**.

## STEP (E) · ALWAYS LAST · PARA 44(E)

### (–) CSM Release (Amortization)

Released to P&L based on coverage units. **Year 1: \$7,347** ( $5.831\% \times$  closing pre-release CSM). **Release is always the final step** — mandated by Para 44(e).

## CRITICAL ROUTING RULE · EPISODE 2 FOUNDATION

### Past / Current Service → P&L Directly

Experience variances on **current or past service** (e.g., actual vs. expected claims, premiums, expenses) **never touch the CSM**. They hit P&L immediately as insurance service result.

## POLICY CHOICE · IFOA CSM WORKING PARTY (2019)

### Order of Steps (a)–(d) is Entity's Choice

IFRS 17 does not prescribe the sequence of steps (a)–(d). Entities choose a **consistent accounting policy**. Only step (e) — CSM release — is mandated as the final adjustment.

## PSAK 117 · OJK MANDATE · EFFECTIVE 1 JAN 2025

### PSAK 117 Adopts Identical Mechanics

Indonesian insurers follow the same 5-step roll-forward under **PSAK 117**. All FCF routing rules, locked-in rates, and Para 44(e) sequencing apply equally.

**Episode 3 Focus:** Decoding exactly which FCF changes adjust the CSM vs. flow directly to P&L — the routing rules that determine insurance service result volatility.

# What Adjusts the CSM? The Routing Decision Tree

IFRS 17 PARA 44(C)

B96–B100

⚠️ PARA 87

Every FCF change must be classified: Future Service → CSM | Past/Current Service → P&L



## FUTURE SERVICE

→ Adjusts CSM · Para 44(c)

● **Non-financial assumption changes** for future periods **B96**

Revised mortality, lapse rates, expense assumptions (Years 2–20)

● **Premium experience variances** relating to future service **B96(a)**

Only the future-service portion adjusts CSM; current-period portion → P&L

● **Acquisition cost variances** tied to future service **B96**

Costs for past/current service go directly to P&L

● **Knock-on effects** of current-period experience on future FCF **IFoA 2020**

e.g. higher mortality in Year 1 reduces future in-force count → changes future FCF



## PAST / CURRENT SERVICE

→ Direct to P&L · Para 44(c)

● **Actual vs. expected claims** for the current period **Current**

Experience variance on death benefits paid in the reporting period

● **Actual vs. expected premiums** for the current period **Current**

Premium shortfall or surplus attributable to the current coverage period

● **Actual vs. expected expenses** for the current period **Current**

Maintenance cost variances incurred in the current reporting period

⚠️ **Financial assumption changes** (discount rate) **Para 87**

Financing impacts → P&L or OCI only. **NOT the CSM**. PSAK 117 adopts identical rule.



### KEY ASYMMETRY RULE

↑ **Favourable** future-service FCF change → **increases CSM** (deferred profit) | ↓ **Adverse** future-service FCF change → **decreases CSM**, floored at zero

⚠️ Excess adverse change → **Loss Component** recognised in P&L immediately

# Four Types of FCF Changes That Adjust the CSM

## TYPE A Non-Economic Assumption Changes

Revised **mortality, lapse, or expense assumptions** for future periods trigger a CSM adjustment. These are non-financial changes — discount rate changes are excluded (Para 87 → P&L/OCI).

 Actuary revises Year 5–20 mortality improvement → projected future claims fall by \$10,000 PV → CSM increases by \$10,000.

## TYPE B Premium Experience Variances (Future Service)

Per **Para B96(a)**, only the portion of premium variances attributable to **future coverage periods** adjusts the CSM. The current-period premium variance goes directly to P&L.

 Policy: 1,000 policyholders, 20-yr whole life. Premium shortfall for Years 2–20 → CSM reduced; Year 1 shortfall → P&L.

## TYPE C Acquisition Cost Variances (Future Service)

Differences between **actual and expected acquisition costs** tied to future service adjust the CSM. Costs relating to past or current service are expensed to P&L immediately.

 \$200k death benefit policy: excess agent commission for future renewals → CSM down; commission for Year 1 → P&L.

## TYPE D Knock-On Effects of Current Experience

Current-period variances alter the **in-force count**, changing projected future FCF for all remaining years. Per **IFoA Working Party (Jan 2020)**, this knock-on impact on future service adjusts the CSM.

 Year 1: 12 deaths vs. expected 10 → in-force 988 vs. expected 990 → future FCF for Yrs 2–20 revised → CSM adjusted.



**Key Asymmetry Rule:** All four types adjust the CSM **only if relating to FUTURE service** — favourable changes increase CSM (deferred profit); adverse changes decrease CSM. **CSM is floored at zero** — excess adverse change creates a **Loss Component** → **P&L immediately**. Policy basis: 1,000 policyholders · 20-yr whole life · \$200k benefit · 15 exits/yr · locked-in rate 5% · ΣCU = 17,150.

# Numerical Example: FCF Change Adjusting the CSM

EPISODE 3 · IFRS 17 PARA 44(C) · MORTALITY IMPROVEMENT SCENARIO · 1,000 POLICYHOLDERS · 20-YR WHOLE LIFE · \$200K DEATH BENEFIT

| EPISODE 2 — BASE CASE                   |           | No FCF Change |
|-----------------------------------------|-----------|---------------|
| Opening CSM (Year 1)                    | \$120,000 |               |
| (+) Accretion of interest @ 5%          | +\$6,000  |               |
| (+) FCF change — no assumption revision | —         |               |
| (-) CSM release (5.831% × \$126,000)    | -\$7,347  |               |
| Closing CSM — Year 1                    | \$118,653 |               |

| EPISODE 3 — WITH FCF CHANGE                             |           | Mortality Improvement + \$10,000 |
|---------------------------------------------------------|-----------|----------------------------------|
| Opening CSM (Year 1)                                    | \$120,000 |                                  |
| (+) Accretion of interest @ 5%                          | +\$6,000  |                                  |
| (+) FCF change — mortality improvement (future service) | +\$10,000 |                                  |
| (-) CSM release (5.831% × \$136,000)                    | -\$7,927  |                                  |
| Closing CSM — Year 1                                    | \$128,073 |                                  |



KEY INSIGHT — P&L SMOOTHING FUNCTION OF THE CSM

**+\$9,420**  
Higher Closing CSM vs. Base Case

The **favourable FCF change (+\$10,000)** from the mortality improvement assumption is absorbed into the CSM — it is **not recognised immediately in P&L**. The CSM defers this additional profit, releasing it over future service periods as policyholders receive coverage. This is the core **P&L smoothing mechanism** of IFRS 17: the CSM acts as a buffer, preventing volatile assumption changes from flowing directly to the income statement.

*IFRS 17 Para 44(c) · Non-economic assumption change relating to future service → adjusts CSM upward*

# Adverse FCF Changes: When the CSM Absorbs Losses

IFRS 17 Para 44(c) & 47–52 · Episode 2 Policy · 1,000 policyholders · 20-yr whole life · \$200k death benefit · 5% locked-in rate

## Scenario A — Adverse Within CSM

Para 44(c)

LAPSE ASSUMPTION REVISED UPWARD · FCF INCREASE \$15,000 PV

### YEAR 1 CSM ROLL-FORWARD

|                                                                                  |           |
|----------------------------------------------------------------------------------|-----------|
| Opening CSM                                                                      | \$120,000 |
| + Accretion (5% × \$120,000)                                                     | +\$6,000  |
| – FCF Change (adverse lapse revision)<br>Higher lapses → fewer premiums received | –\$15,000 |
| – Release (5.831% × \$111,000)                                                   | –\$6,472  |

Closing CSM (Year 1) \$104,528

✓ CSM absorbs adverse change — No P&L impact from assumption change itself.

P&L protected · CSM reduced but remains positive

CSM Floor = 0

## Scenario B — Adverse Exceeds CSM

Para 47–52

CATASTROPHIC CLAIMS REVISION · ADVERSE FCF INCREASE \$130,000 PV

### YEAR 1 CSM ROLL-FORWARD — LOSS COMPONENT TRIGGERED

|                                                                                  |            |
|----------------------------------------------------------------------------------|------------|
| Opening CSM                                                                      | \$120,000  |
| + Accretion (5% × \$120,000)                                                     | +\$6,000   |
| CSM pre-change (after accretion)                                                 | \$126,000  |
| – Adverse FCF Change (catastrophic revision)<br>Exceeds CSM balance of \$126,000 | –\$130,000 |

CSM floored at zero  Floor \$0

→ Loss Component (excess to P&L) \$4,000  
Recognised immediately as insurance service expense

! Loss Component: \$4,000 → P&L immediately · CSM exhausted.  
LC tracked separately within LRC · Reversed before CSM re-established

# The **Loss Component**: Tracking & Reversal

IFRS 17 Para 47–52

## RULE 1



### Trigger — Loss Component Created

When an adverse FCF change exceeds the remaining CSM balance, the CSM is reduced to zero and the excess is recognised **immediately in P&L** as insurance service expense. No deferral is permitted under Para 47.

**i** PSAK 117: LC balance must be disclosed separately in LRC roll-forward

## RULE 2



### Tracking — LC Within the LRC

The Loss Component is tracked **separately within the LRC** and systematically released to P&L as the onerous coverage period unwinds — allocated proportional to remaining coverage units (Para 50(b)).

**i** OJK reporting: LC movements disclosed in LRC note each period

## RULE 3



### Reversal — LC Reduced First

If subsequent FCF changes are **favourable** (e.g., mortality improves in Year 3), the LC must be reduced to zero *before* any CSM is re-established. Favourable changes cannot bypass the LC to create a new CSM (IFoA, 2020).

**i** Sequence: Reduce LC → then rebuild CSM if LC reaches zero

## RULE 4



### Onerousness Testing — Every Period

Onerousness must be tested at **every reporting date**. A profitable group can become onerous; an onerous group can recover. Groups are locked — *no offsetting* across cohorts or annual groups is permitted.

**i** PSAK 117: Annual cohort lock — no cross-group netting allowed



#### SEA INSURER RISK — KPMG INDONESIA (SEPT 2024)

**Long-duration guaranteed life products** in Indonesia, Thailand & Philippines are most exposed to LC risk when interest rates fall sharply or claims experience deteriorates. PSAK 117 requires explicit disclosure of LC balance and movements in financial statements.

# Key Takeaways & What's Next



## THE ROUTING RULE

Every FCF change is classified: **future service** → **adjusts CSM**; past/current service → **P&L directly**. Financial assumption changes (discount rate) route to P&L or OCI via **Para 87** — never through the CSM. The classification decision drives all subsequent accounting.



## FOUR FCF CHANGE TYPES → CSM

Non-economic assumption changes, premium experience variances, acquisition cost variances, and knock-on effects of current experience on future FCF — all **adjust the CSM** when relating to future service **Para 44(c), B96–B100**. Financial (economic) changes are excluded from this route.



## CSM AS P&L SMOOTHER

Base closing CSM Year 1: **\$118,653**. Favourable FCF change **+\$10,000** → closing **\$128,073**. Adverse FCF change **–\$15,000** → closing **\$104,528**. The CSM absorbs both swings, preventing volatile P&L impacts from assumption revisions.



## LOSS COMPONENT FLOOR

CSM is floored at **zero** **Para 47**. Adverse FCF changes exceeding the CSM balance create a **Loss Component** recognised immediately in P&L as insurance service expense. Onerousness tested every reporting date. LC is reversed before any CSM is re-established **Para 47–52**.

## COMING NEXT — EPISODE 4



**Liability for Incurred Claims (LIC)** — IBNR estimation, claims development triangles, and the LIC roll-forward under IFRS 17 / PSAK 117.

1,000 policyholders · 20-yr whole life

\$200k benefit · 5% rate ·  $\Sigma CU=17,150$

# References & Sources

IFRS 17 EXPLAINED

*Sources underpinning Episode 3: CSM Mechanics — Unwinding, Adjustments & Release. For educational purposes only. Indonesian context: PSAK 117 (IAI) effective 1 Jan 2025, mandated by OJK for all insurers.*

## OFFICIAL STANDARDS & REGULATORY

IASB · MAY 2017 / AMENDED JUN 2020 / EFF. 1 JAN 2023

### IFRS 17 Insurance Contracts

Para 44(c), B96–B100 (coverage units); Para 47–52 (CSM adjustments); Para 87 (P&L release); Para B119 (risk adjustment).

IAI · EFF. 1 JAN 2025 · OJK MANDATED

### PSAK 117 Kontrak Asuransi

Indonesian adoption of IFRS 17. Replaces PSAK 62. Mandated by OJK for all Indonesian insurers. Mirrors IASB paragraphs with local regulatory guidance.

IASB TRG · FEB 2018

### AP5: Determining Quantity of Benefits for Coverage Units

Transition Resource Group paper on coverage unit identification methodology under IFRS 17.

## INDUSTRY RESEARCH & PRACTITIONER GUIDES

IFOA CSM WORKING PARTY · 2019–2020

### CSM Working Papers (3 papers)

'CSM: Order of Adjustments' (Jul 2019) · 'Identification of Coverage Units' (May 2019) · 'CSM Adjustment for Experience Variances' (Jan 2020).

PRACTITIONER ARTICLES

### Acturtle · IFRS Buddy

Acturtle — 'Measuring CSM IFRS 17' (Feb 2025). IFRS Buddy — 'IFRS 17 CSM' (2025).

INDONESIA-SPECIFIC · 2024–2026

### KPMG Indonesia · Actua.dev

KPMG — 'PSAK 117 Implementation' (May 2024) & Post-Implementation Series (Oct–Nov 2024). Actua.dev — IFRS 17 Calculator (2024).

**Policy Basis (Episodes 1–3): 1,000 policyholders · 20-yr whole life · \$200k death benefit · 5% locked-in discount rate ·  $\Sigma$ CU = 17,150 · 15 exits/year** — consistent assumptions used throughout all three episodes for comparability.