



Education session with the CFO Forum and new completion timeline

Further discussions on contracts
with participating features

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Agenda

- Highlights of the latest IASB discussions
- Detailed analysis of the IASB discussion on the CFO Forum's Alternative Proposal for the accounting for insurance contracts with participating features
- Next steps and update on timetable

Highlights

Matters discussed at IASB meeting on 19 November 2014

- The IASB is still considering the appropriate accounting for contracts with participating features. The critical issues are:
 - How to account for the insurer's share of underlying items, including the effect of options and guarantees
 - Allocation of the CSM in profit or loss
 - Determining 'locked-in' interest expense for profit or loss
- Representatives of the European Insurance CFO Forum ("CFO Forum") presented their alternative proposal for the accounting for insurance contracts with participating features ("Alternative Proposal")
- The IASB did not intend to take tentative decisions on the Alternative Proposal at this meeting
- IASB Staff paper released after the meeting suggests new completion timeline that accommodates extra time on participating contracts
- The effective date is likely to be 1 January 2019

The CFO Forum's Alternative Proposal

The six principles of the Alternative Proposal

1. Scope is broad with no requirement to hold underlying items
2. No bifurcation of cash flows with a single discount rate and no different treatment for options and guarantees
3. Full unlocking of the CSM for all assumption changes that impact future profits, including the change in value of underlying
4. CSM is released to profit or loss in a way that best reflects the transfer of services under the contract
5. The book yield of the current portfolio is used to determine the interest expense in profit or loss
6. The use of OCI is an accounting policy choice

Discussions about the Alternative Proposal

CFO Forum's views

- Participating contracts represent the bulk of many life insurers businesses
- There needs to be a genuine step forward
- Wide concern that the IASB needs to develop further its current draft proposal
- Alternative Proposal provides a more meaningful and transparent way forwards
- The Alternative Proposal has the following key attributes:
 - It reports performance in a meaningful and useful way
 - It reflects the hybrid nature of the interconnection between the value to the customer and the reward to the insurer
 - It should provide a level playing field, providing consistent accounting treatment for economically similar products, and avoid creating artificial distinctions between products.

Discussions about the Alternative Proposal

CFO Forum's views (continued)

- There is common ground with the use of current values and the use of the BBA
- Concerns about artificial volatility in earnings can be addressed with the Alternative Proposal
- The IASB must avoid an accounting model that is not consistent with the economics of participating contracts and that may be difficult to understand
- The CFO Forum is concerned that investors would not be willing to invest in insurers without a higher cost of capital than other industries
- The most important element of the Alternative Proposal is for the CSM to be fully unlocked so that it represents the full amount of unearned profits at each reporting date
- Alternative Proposal received support from EFRAG, standard-setters and other participants in the insurance industry.

Discussions about the Alternative Proposal

Scope of the Alternative Proposal

- Applicable to all participating contracts which provide policyholders with a right to a variable return either contractually or at the discretion of the insurer, as the CFO Forum considers these to be economically similar
- IASB re-deliberations are likely to result in a narrower scope than the above as only contracts with an implicit management fee may end up in scope
- The variable return could be based on the performance of specific contracts, realised and/or unrealised investment returns on a specified pool of assets, or the profit/ loss of the insurer or the fund that contains the assets backing these contracts
- CFO Forum consider that the scope should not require the insurer to hold the underlying items.

Discussions about the Alternative Proposal

Scope – IASB comments and CFO Forum responses

- CFO Forum is not aware of any contracts where the shareholders share is 30% or 40% - the typical participation is 10%. This is completely different to a performance fee charged by a hedge fund
- Where the economics of a contract change over time, e.g. a minimum interest guarantee is in-the-money and this is expected to continue for the remaining life of the contract, the CFO Forum considers that the initial designation as a participating contract should remain unaltered.

Discussions about the Alternative Proposal

Discounting

- One yield curve used for discounting. Cash flows are not bifurcated and where a single yield curve is used the discount rate would need to change over time
- The actual mix of underlying items should be reflected in the book yield

IASB comments and CFO Forum responses

- Concern that the book yield approach would create accounting mismatches where underlying items are accounted for at FVOCI
- The determination of the book yield when a participating contract is not wholly dependent on the return from underlying items
- Whether interest expense should mirror investment returns in income statement
- Possible need for guidance about transferring assets between portfolios and how this would impact the book yield
- The CFO Forum noted that such asset transfers do not occur often

Discussions about the Alternative Proposal

Unlocking the CSM

- Full unlocking of the CSM results in the re-measurement of the unearned profit at each reporting date
- This is consistent with how the CSM is measured at inception and it reflects the long-term performance of the insurer
- CSM is also unlocked for the assumptions associated with investment returns
- Alternative Proposal addresses how future profits will be allocated to each reporting period.

Discussions about the Alternative Proposal

Unlocking the CSM – IASB comments and CFO Forum responses

- In some countries unrealised profits cannot be distributed to policyholders. CFO Forum confirmed that both realised and unrealised profit would impact the CSM measurement
- The CSM is unlocked for items that would otherwise be presented in profit or loss. However items presented in OCI unwind to zero over time
- The IASB noted that an investor would have to look at profit or loss, OCI and movements on the CSM to understand the performance of an insurer, which would be complex
- CFO Forum stated that re-measuring the CSM for non-participating contracts using the Alternative Proposal could be an option

Discussions about the Alternative Proposal

Release of the CSM

- Drivers for the release of the CSM depend on the nature of the services provided under a participating contract, such as the provision of insurance coverage, the administration of the contract and the provision of asset management services

IASB comments and CFO Forum responses

- The IASB raised concern that there may be a lack of consistency regarding the pattern of release of the CSM over the life of the contract
- CFO Forum noted that the mix of services would be different across existing participating contracts, therefore the best accounting principle is to assess and disclose this at the inception of the contract without having the new IFRS imposing a uniform basis
- CFO Forum stated that it would be complex to update the release pattern of the CSM, and they would expect insurers to come to similar release patterns for the same contract.

Discussions about the Alternative Proposal

Unit of account

- Insurers manage participating contracts and the investment portfolios that back these contracts over current and future generations of policyholders
- CFO Forum considers that the CSM should be determined at a level consistent with this business model, which is likely to be a higher level of aggregation than that reflected in the IASB's tentative decisions about non-participating contracts

IASB comments and CFO Forum responses

- The Alternative Proposal would use an open-ended portfolio whereby new contracts would be continuously added. The IASB noted that this would create cross-subsidies between old and new contracts, therefore it would be unlikely that the CSM would ever become negative
- CFO Forum considers that if the contractual arrangements allow for the offsetting of gains and losses over different generations of policyholders, such contracts should be included within the same portfolio.

Discussions about the Alternative Proposal

Presentation and disclosure – IASB comments and CFO Forum responses

- The IASB observed that there may be a need for disclosures concerning the different components and aggregation of insurance contracts in order to provide better insights for estimating future profitability and the contribution of different sources of profit
- The IASB noted that disclosing the expected release of the CSM in future years and the effect of changes in options and guarantees would be useful
- The CFO Forum noted that some insurers currently disclose the expected run-off of profits under embedded value reporting

The next steps and update on the timetable

Remaining issues, publication of the Standard and interaction with IFRS 9

- The IASB Staff has published a project update document that indicates the IASB will continue into 2015
- The Staff will brief the IASB on whether non-participating contracts will need to be revisited in the light of tentative decisions the IASB will eventually reach on participating contracts
- The IASB expects to publish the final Standard in 2015 and they will consider the need for testing and how to support implementation
- The IASB Staff project update suggest the effective date may be 1/1/2019
- Interaction with IFRS 9 Financial Instruments
 - Concern that IFRS 9 will be applied before the insurance standard
 - IASB will consider ways to ensure insurers applying the insurance standard one year later than IFRS 9 are not disadvantaged

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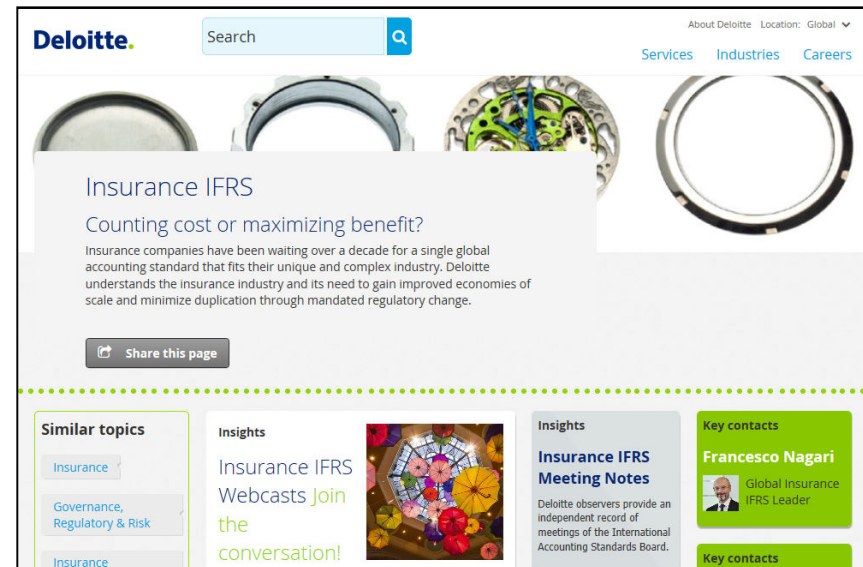
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