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Moving ahead

The IASB discusses contracts with participating features and takes decisions on four non-targeted issues

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Agenda

- Highlights of decisions from IASB meeting this month
- IASB staff recommendations and Board discussions
- Next steps and update on timetable

Highlights

IASB Insurance Contracts Educational Session 20th May 2014

- Educational non-decision making session on possible adaptations for contracts with participating features
- Discussed whether adaptations for contracts with participating features are needed to the IASB's previous decisions, and if so, what those adaptations are
- The "alternative approach" proposed by the European CFO Forum and similar to the Deloitte proposal was considered in describing the various adaptations
- There were no staff recommendations or Board decisions

Highlights (contd.)

IASB Meeting 21st May 2014

- Discussed 4 of the 7 non-targeted issues that the IASB agreed to consider
- The Board tentatively agreed the following:
  1. An entity should recognise the remaining CSM in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of the services that are provided under an insurance contract.
  2. An entity should be permitted (but not required) to apply the revenue recognition standard to fixed-fee service contracts that meet the definition of insurance contracts.
  3. To retain the additional guidance in the revised ED that significant insurance risk occurs only when there is a possibility that an insurer incurs a loss on a present value basis.
  4. To clarify that contracts acquired through a portfolio transfer or business combination should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or business combination

Education Session

Measuring the fulfilment cash flows

- The main issue appears to be whether different discount rates need to be applied to cash flows that vary, and those that do not vary, with underlying items.

Staff comments and Board discussion

- The Staff noted that techniques are available that only require the use of one yield curve, but dividing cash flows and applying appropriate discount rates to each may still be needed in order to provide consistency in the measurement of the CSM and the presentation of interest expense.
- The Board commented that:
  - the use of the book yield approach was only relevant to determining what components are reported in profit or loss, or in other comprehensive income.
  - the main focus should be on the objectives rather than on prescribing particular techniques.
  - many respondents did not like the mirroring exception because it presented material operational issues.

Education Session

Measuring the CSM

- The main issues on measuring the CSM are the recognition pattern for the CSM and the treatment of changes in estimates of investment returns that affect the amount paid to policyholders.

Staff comments and Board discussion

- The Board commented that:
  - some participating contracts provide the insurer with significant discretion whereas others are subject to more restrictive regulations. This diversity appears to make it difficult to prescribe one model for all forms of participation.
  - bespoke solutions to accommodate this diversity will likely result in more difficulty and complexity which may make it more difficult that such more complex guidance delivers benefits that outweigh its costs.
- There was discussion about whether it would be appropriate to unlock the CSM for explicit and/or implicit investment management fees which produced mixed opinions.

Education Session

Changes in the value of options and guarantees

- The main issue is the accounting for changes in the insurance liability from embedded options and guarantees that are not unbundled. The options considered were to recognise those changes in profit or loss, other comprehensive income or the CSM.

Staff comments and Board discussion

- The Staff noted that if changes in options and guarantees were accounted for in the CSM this could cause an accounting mismatch if the insurer was economically hedged with free standing derivatives because changes in the measurement of derivatives would be accounted for in profit or loss.
- One Board member stated that if the Board does not like the use of the CSM it must require changes in estimates to be accounted for in the P&L. Problems would be compounded if these were accounted for through OCI.
- The Staff confirmed that surrender options were not regarded as options or guarantees for the purposes of the current discussions, that the consequential effect of any decisions taken on measurement/presentation, including the use of OCI for par contracts would be explored later, and that locked-in discount rates did not work for par contracts.

Education Session

Presentation of interest expense

- The main issue related to the presentation of interest expense for contracts with participating features when the OCI solution is adopted.

Staff comments and Board discussion

- The Staff noted that the book yield approach would not provide a complete match with assets because of asymmetries such as the accounting treatment of impairment losses.
- The Staff confirmed that an insurer would only use the book yield to measure the unwinding of the discount rate, and that this would not be used for the measurement of the liability.
- One Board member stated that he would prefer all changes to be accounted for in the P&L, with an explanation of the movements provided in the notes, but noted the problem of identifying the underlying assets and their durations would add complexity.

IASB Meeting May 2014 – CSM earning pattern guidance

Should the remaining CSM be recognised in profit or loss in a systematic way that reflects the provision of the service of insurance?

Staff Recommendation

- The Staff recommended that the Board:
  1. Confirms the principle that an entity should recognise the remaining CSM in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of the services that are provided under an insurance contract; and
  2. Clarifies that, for non-participating contracts, the service represented by the CSM is insurance coverage which:
     i. is provided on the basis of the passage of time; and
     ii. reflects the expected number of contracts in force.

IASB Meeting May 2014 – CSM earning pattern guidance (cont.)

Staff comments and Board discussion

- The Board discussed whether the incidence of claims should also be a consideration when claims were expected to be spread unevenly over the duration of the contracts.
- The Staff commented that using claims pay-outs would be counter-intuitive and it would usually back end load the recognition of a life contract profit.
- The Staff clarified that the value as well as the number of contracts in force should be taken into account.

Vote

➢ 13 Board members agreed with the Staff's recommendations, while 3 disagreed.

IASB Meeting May 2014 – Fixed fee service contracts

Should entities be permitted, but not required, to apply the revenue recognition Standard to the fixed fee service contracts that meet the criteria stated in paragraph 7(e) of the 2013 ED?

Staff Recommendation

The Staff recommended that the Board permits, but does not require, entities to apply IFRS 15 to the fixed-fee service contracts that meet the criteria to be accounted for as insurance contracts

Staff comments and Board discussion

- The Board discussed whether an option was desirable, as some Board members felt that options do not improve IFRSs in general.
- The Staff expressed the view that there would not be much difference in practice between applying either the IFRS on Insurance Contracts or IFRS 15 to fixed-fee service contracts, therefore comparability would not be impaired.

IASB vote

- 15 Board members agreed with the Staff's recommendations, while 1 disagreed

IASB Meeting May 2014 – Significant insurance risk

Does the IASB agree to clarify the guidance in paragraph B19 of the 2013 ED that significant insurance risk occurs only when there is a possibility that an issuer incurs a loss on a present value basis?

Staff Recommendation

The Staff recommended that the Board clarifies the guidance that significant insurance risk only occurs where there is a possibility that an issuer incurs a loss on a present value basis

Staff comments and Board discussion

- The Staff asked the Board to agree to clarify the guidance in the 2013 ED.
- There were very few comments made by the Board members.

Vote

- The Board members agreed unanimously with the Staff's recommendation.

IASB Meeting May 2014 – Portfolio transfers & business combinations

Does the IASB agree to amend the requirements for the contracts acquired through a portfolio transfer or a business combination?

Staff Recommendation

The Staff recommended that the Board amends the requirements for the contracts acquired through a portfolio transfer or a business combination to clarify that such contracts should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or the business combination.

Staff comments and Board discussion

- The Staff asked the Board to agree to amend the requirements for the contracts acquired through a portfolio transfer or a business combination, to clarify that such contracts should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or the business combination.
- The Staff indicated that in situations where the fair value was less than the insurance liability measured in accordance with the insurance standard, the IFRS 3 fair value requirement would be overridden. The excess would be recorded as an additional amount of goodwill.

IASB Meeting May 2014 – Portfolio transfers & business combinations (cont.)

Does the IASB agree to amend the requirements for the contracts acquired through a portfolio transfer or a business combination?

Staff comments and Board discussion (cont.)

- The issue arises when an insurer acquires a portfolio of contracts where the coverage is fully expired (e.g. a portfolio of unpaid claims)
- The current profit recognition principle for the CSM is that it must be fully earned when coverage expires. This opens the question of whether a gain on initial recognition is permitted from this business combinations or portfolio transfers
- The 2013 ED had already introduced a rule for retrospective insurance that creates a reinsurance CSM liability earned over the claims handling period.
- The Staff confirmed that also in the event of a business combination and/or portfolio transfer the CSM would be recognised in profit or loss over the claims handling period where the period of cover had expired.
- Deloitte had previously observed that the arbitrary nature of the earning over coverage period would have triggered a rule-based approach in other situations.

IASB vote

- 15 Board members agreed with the Staff's recommendation, while 1 disagreed.

The next steps and update on timetable

Future meetings

In future meetings the Board will:

- Consider the 3 remaining non-targeted issues in the ED that the IASB tentatively decided to address, which are:
  - References to ‘unit of account’ and ‘portfolio’ in the 2013 ED and whether it will be possible to clarify the IASB’s intentions and provide more consistent guidance;
  - Whether to provide further guidance regarding discount rates for long-term contracts when there is little or no observable market data; and
  - Whether there is an accounting mismatch between insurance contracts and reinsurance contracts because of the asymmetrical treatment of their contractual service margins.
- Consider the application of the model for non-participating contracts to contracts with participating features, including assessing any modifications that may be needed to reflect these features.
- Consider the transition requirements in the context of a near final model.

The next steps and update on timetable

Finalisation of the new standard

- The IASB expects that redeliberations of its proposals for the accounting for insurance contracts will be completed in 2014.

- The publication of a final Standard is expected in the first half of 2015.

- A more exact timetable will depend on the time that will be spent to conclude upon the decisions the IASB will take in the next few months.

- Decisions of the IASB become final only after completion of a formal ballot to issue a final standard.

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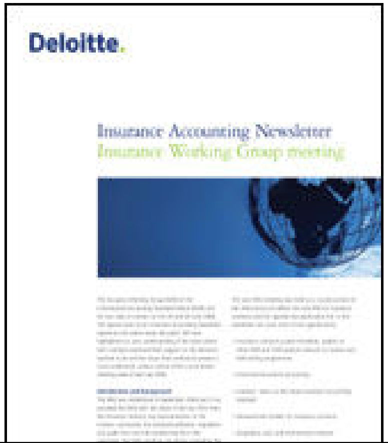

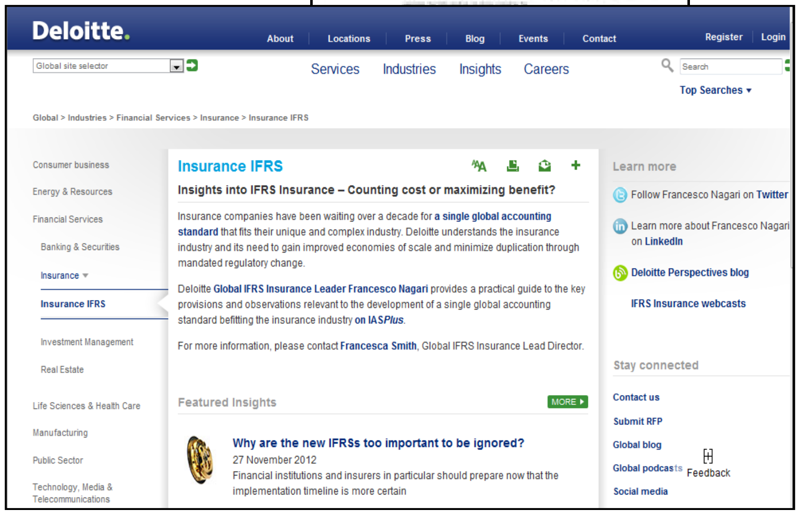

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