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IFRS Project Insights
Insurance Contracts

The International Accounting Standards Board ("IASB"/"the Board") is undertaking a comprehensive project on the accounting for insurance contracts, with the objective of developing a comprehensive standard that will address recognition, measurement, presentation and disclosure requirements.

The Board issued a Discussion Paper ("DP") *Preliminary Views on Insurance Contracts* in May 2007. In August 2010, the Board issued Exposure Draft ED/2010/8 *Insurance Contracts* ('the 2010 ED').

On 20 June 2013, the Board issued revised Exposure Draft ED/2013/7 *Insurance Contracts* ("the 2013 ED") which included changes in the insurance accounting proposals in response to the concerns raised by the insurance industry and other stakeholders on the 2010 ED. The Board decided to seek comments only on the 5 targeted areas where significant changes have been made since the 2010 ED. These are:

i. unlocking the contractual service margin ("CSM") to reflect changes in cash flows for future coverage and/or services;

ii. splitting interest expense between profit or loss and other comprehensive income ("OCI solution");

iii. presenting insurance contract revenue and expenses;

iv. measuring and presenting cash flows from contracts with a contractual link to underlying items ("mirroring approach"); and

v. transition provisions for the first application of the standard with a modified retrospective application of all the new requirements.

The comment period for the 2013 ED closed on 25 October 2013.

The Board also conducted extensive international fieldwork, discussions and outreach activities between June and December 2013.

In February 2016 the Board has concluded that it has taken all the necessary due prbocess steps and has granted the Staff permission to begin the balloting process. Since then the Board has sent a field-testing questionnaire to a number of preparers to test the interpretation of the drafted words. Currently the Board has considered narrow scope issues arisen during the drafting process and is expecting to finish drafting and issue a standard in March 2017.

Convergence

On October 2008, the IASB and the Financial Accounting Standards Board ("FASB") agreed to undertake the project on insurance contracts jointly and have held several joint meetings from 2008 until the publication of the 2013 ED by the IASB and the Proposed Accounting Standards Update ("ASU") by the FASB on 20 June 2013.

A joint meeting by the IASB and the FASB was held in January 2014 to consider the respective Staff summaries of the feedback received from users of financial statements and outreach activities. The discussions highlighted the key areas of concerns from the respondents on the respective IASB and FASB proposals. No decisions were required during that meeting.

Following this joint meeting, the FASB had a separate redeliberation meeting on 19 February 2014 where it decided to take a new course for its insurance contracts project. The FASB's new direction is to substantially preserve the current U.S. pronouncements affecting insurance entities and to identify and release an ASU which will introduce only certain targeted amendments.

Tentative decisions during 16 November 2016 meeting

The Board met to discuss the results and feedback from external testing and issues that arose during drafting.

The Board tentatively revised its previous tentative decision on the level of aggregation, retaining the definition of portfolio but refining the definition of groups. Groups are now defined as part of a portfolio comprising up to twelve months' worth of contracts that, at initial recognition, are unlikely to become onerous or are profitable but may become onerous in the future or, if any, are onerous contracts at initial recognition.

The Board tentatively revised its earlier tentative decisions on the reporting of experience adjustments under both the general measurement and the variable fee approach.

Under the general measurement model when experience adjustments directly cause change in the estimated present value of future fulfilment cash flows, the combined effect of the experience adjustment and the resulting change in the estimate of future fulfilment cash flows should be recognised in profit or loss.

Under the variable fee approach experience adjustments resulting from non-financial risks not affecting the underlying items and the resulting change in estimate of future fulfilment cash flows should be recognised in profit or loss.

When full retrospective application is impracticable the Board tentatively revised its earlier decision and approved for an entity to have the choice of either modified retrospective or fair value approaches. Specific modifications are permitted for variable fee approach contracts.

The Board tentatively approved 21 sweep issues. Of particular note were issues 12-14 focussing on the scope of the VFA: meaning of contractual terms; meaning of 'substantial' variation in returns and whether it is assessed over the life of the contract or over the reporting period only; and whether the underlying items need to be measured at fair value to determine scope if they are not typically so measured.

The Board tentatively decided that if it is published during the first half of 2017, IFRS 17 will be mandatorily applicable for annual periods beginning on or after 1 January 2021. Early application will be permitted, provided entities apply IFRS 9 and IFRS 15 at the same time.

Methodology and results of external testing

Methodology of external testing

The Board were presented with the methodology used for external testing outlining the method of selecting participants, and the questions used in the questionnaire.

The questions related to:

- level of aggregation.
- scope of variable fee approach.
- derivatives used to mitigate financial market risk.
- determining the amount of insurance finance income or expenses in OCI.
- recognition of changes in estimates.
- transition.

The first pre-ballot draft of IFRS 17 was also sent to selected individuals, responding in their personal capacity.

Results of external testing

The Board reviewed the results of external testing which informed the papers. Mainly feedback was received on the granularity of the level of aggregation, the practicality of transition modifications and on other questions (sweep issues). These informed the papers presented for tentative decisions.

Level of aggregation

The Board tentatively revised its previous tentative decision on the level of aggregation. The Board tentatively decided to:

a. Retain its definition of a portfolio as a group of contracts managed together as a pool and subject to similar risks. On similarity of risk the Board plans to provide guidance that contracts within the same product line would be considered similar, whereas contracts from different product lines would not.

b. Require contracts onerous at inception to be identified and grouped separately from non-onerous contracts.

c. Require that at minimum non-onerous contracts should be grouped into those not likely to become onerous and other non-onerous contracts.

d. Prohibit entities to group contracts issued more than twelve months apart.

e. Require the allocation of CSM over the remaining coverage based on the passage of time and based on 'coverage units' reflecting the expected duration and size of the contracts in the group.

In deciding the likelihood at inception of non-onerous contracts becoming onerous later an entity would:

1. Assess the risk of contracts becoming onerous in a manner consistent with internally reported information on changes in estimates.

2. Assess the significant risk of contracts becoming onerous based on sensitivity analysis of changes in fulfilment cash flows to changes in relevant factor.

3. Be permitted to divide portfolios into greater number of groups if the entity monitors the risk of contracts becoming onerous at a more granular level.

One year cohorts and mutualisation
The Board did not modify its tentative decision to prohibit grouping contracts issued more than one year apart in respect of mutualised contracts. However, cash flows of mutualised contracts are required to reflect mutualisation and this produced the same outcome if it is done at portfolio or group level. Changes in the portfolio fulfilment cash flows, after adjusting for mutualisation, those changes are allocated to annual groups' CSM balances in a manner reflecting the impact of mutualisation on the CSM of those groups.

Experience adjustments

The Board tentatively revised its earlier tentative decisions on the reporting of experience adjustments.

General model contracts
When experience adjustments directly change the estimated present value of future fulfilment cash flows, the combined effect of the experience adjustment and the resulting change in the estimate of future fulfilment cash flows should be recognised in profit or loss. Additional guidance would clarify that experience adjustments *directly cause* a change in the present value of future fulfilment cash flows *only* when they change future rights and obligations for a group of contracts (i.e. the number of coverage units). A change in measurement only of existing rights and obligations is not directly caused by experience adjustment.

Entities may consider past experience to detect trends and may revise their underlying assumptions such as mortality, morbidity, longevity and persistence rates. Such changes in rate assumptions are not considered to be caused by experience adjustments.

Variable fee approach contracts
Experience adjustments arising from non-financial risks that do not affect the underlying items (i.e. they are no shared with policyholders) should be recognised in profit or loss, not the CSM. Further, any changes in the present value estimates of future cash flows directly caused by such experience adjustments should also be recognised in profit or loss.

Transition issues

The Board tentatively revised its earlier decision and decided to allow greater choice of modification alternatives when full retrospective application of the new IFRS is impracticable.

Choice of modifications to full retrospective application
The Board tentatively decided on transition to the new IFRS to:

1. Require full retrospective application of IFRS 17 to groups of insurance contracts unless this is impracticable.

2. Permit, for insurance contracts where groups cannot be identified and for those contracts where full retrospective application is impracticable, a *choice* between fair value and modified retrospective approach. If the modified retrospective approach is impracticable the entity must apply the fair value approach.

3. State that the objective of a modified retrospective approach is to approximate the full retrospective approach as closely as possible using reasonable and supportable information.

4. Permit the use of specified modifications but to state that the new IFRS would only permit the use of the minimum necessary. Appendix B to the paper provides a list of permitted modifications.

5. Require entities to maximise in the modified retrospective approach the use of that information available without undue cost and effort that would have been used under the full retrospective approach.

Modifications on transition for variable fee approach contracts
The Board tentatively decided that entities may use permitted modifications for the variable fee approach determined as at the beginning of the earliest period presented.

The permitted modification is that the CSM at the beginning of the earliest period presented (rather than on the date of initial application) equals to:

Total fair value of underlying items at that date

Less
Fulfilment cash flows at the beginning of earliest period presented adjusted for cash flows that already occurred between inception and that date

Less
The amount of CSM relating to service provided before the beginning of earliest period presented (comparing the remaining coverage units with the total coverage units)

Fair value approach at transition
In applying the fair value approach the entity would be permitted to assess either at inception of the contracts or at the beginning of the earliest period presented:

1. Whether contracts are eligible for the variable fee approach.

2. How to group contracts.

3. How to determine the effect of discretion on estimated cash flows for contracts subject to the general measurement model.

The assessments made as at inception of the contracts must be made based on reasonable and supportable evidence for what the entity would have determined given the contractual terms and market conditions at that time.

Modifications for grouping of contracts
The Board tentatively decided that under both the modified retrospective and the fair value approaches to transition:

1. Entities need not group contracts issued more than twelve months apart (i.e. groups at transition can capture more than one year's worth of insurance contracts initially recognised).

2. Entities are permitted for the general measurement model contracts to accrete interest on the restated CSM using the discount rate as at the beginning of the earliest period presented.

3. For non-participating contracts presenting part of changes in discount rates in OCI, entities are permitted to use for profit and loss presentation the discount rates determined as at the beginning of the earliest period presented. In this case additional disclosures for profit and loss are required for contracts issued before the earliest period presented and after that date. Further, period movement reconciliation is required for cumulative OCI amounts financial assets measured through FVOCI that are related to these contracts.

Disclosure
The Board tentatively decided to require disclosures relating to CSM, insurance revenue and finance income/expense separately for contracts existing at beginning of the earliest period and that are presented for each type of transition method: full retrospective, modified retrospective or fair value and separately for contracts issued subsequently. Entities are required to explain how they determined measurement at transition, methods used and judgements applied.

Mitigating financial risks reflected in insurance contracts

Variable fee approach
The Board tentatively decided to permit entities that use derivatives to mitigate financial risks arising from contracts accounted for under the variable fee approach to exclude the effect of changes in those financial risks from the CSM and present such effect in profit or loss when specified conditions are met. This broadens the scope of financial risks that can be considered for this accounting treatment because the IFRS would now include all financial risks relating to the entity's share in the underlying items. The tentative decision is restricted to the variable fee approach and relates only to financial risks.

Other sweep issues

The Board tentatively approved the decisions on the tabled twenty one sweep issues and did not raise any new sweep issues. Of particular note were issues 12-14 focussing on the scope of the VFA.

Issue 12 was about the meaning of contractual terms. The Board tentatively confirmed its intention that the link to the underlying items, though subject to discretion, should be enforceable. This would include the analysis of all substantive rights and obligations that are held by the entity, whether they arise from a contract, law or regulation. The Board tentatively decided to include additional guidance.

Issue 13 focussed on the meaning of 'substantial' in the second criterion:

"The entity expects to pay to the policyholder an amount equal to a **substantial** share of the returns from the underlying items". Further question was whether variation in returns is assessed over the life of the contract or over the reporting period only in applying the third criterion.

The Board tentatively confirmed that the meaning of 'substantial' will be an area of judgement, but the intention of the wording is to identify whether the entity's primary obligation is to pay to the policyholder an amount equal to the fair value of the underlying items, less the variable fee for service.

Issue 14 looked at the practicability of needing to measure the underlying items at fair value to determine scope, if these items are not typically so measured. The Board tentatively confirmed that the defining feature of the VFA is that the issuer has an obligation to pay the policyholders an amount substantially based on the fair value of the underlying items less fee for service. Accordingly, fair value would need to be measured based on the guidance in IFRS 13. No further action was proposed.

Mandatory effective date

The Board tentatively decided that assuming IFRS 17 is issued in the first half of 2017 the standard will be mandatorily applicable for annual periods beginning on or after 1 January 2021.
Early application will be permitted, provided entities apply IFRS 9 and IFRS 15 at the same time.

Tentative decisions during 22 June 2016 meeting

The Board met to discuss narrow scope issues arisen during the balloting process.

In order to determine the level of aggregation for the allocation of CSM the Board tentatively decided to:

- redefine the objective;
- specify the level of aggregation required to be the same as used to determine if the contract is onerous; and
- specify the manner of allocation of CSM to profit and loss to reflect the expected duration and size of the contracts remaining in the group.

Board's other tentative decisions:

To revise the guidance on when changes in fulfilment cash flows adjust the CSM for contracts without direct participating features.

To provide a choice as to whether to disaggregate or not the movements of the risk adjustment into financing and underwriting components, with relevant disclosures.

To revise previous tentative decision on the objective of disaggregating insurance finance income or expense between profit or loss and OCI.

The revised objective is to achieve a systematic allocation of the total expected finance income or expense in the profit or loss over the life of the contract, rather than to achieve a cost measurement basis presentation in profit or loss. For non-participating contracts the systematic allocation is based on the discount rate at the inception of the contract. For contracts where changes in financial assumptions impact amounts due to policyholder the systematic allocation could be one of two ways. One way would be the constant rate that allocates the remaining revised expected finance expense over the remaining life of the contract. Alternatively, if the contract uses crediting rates the allocation could be based on the amount credited in the period and amounts expected to be credited in future periods.

The Board tentatively decided to include a disclosure objective to explain the total amount of insurance finance income or expense in a reporting period, rather than asking for a detailed analysis. An entity would need to explain its calculation methods for amounts presented in profit or loss and the relationship between insurance finance income or expense and the return on the related assets.

The Board tentatively decided to amend the scope of the variable fee approach to exclude reinsurance contracts that a reinsurer issues or a cedant holds.

Narrow scope issues

Adjustment and allocation of CSM

The Board tentatively decided that the objective for the CSM is to represent the profit for the future services to be provided for a group of contracts. The group of contracts used for measuring the CSM should be the same as the group used for determining when contracts are onerous, and the allocation of the CSM of the group of contracts to profit or loss should reflect the expected coverage duration and size of the contracts remaining at the end of the reporting period. The Staff confirmed that the proposals would result in more granularity than preparers would like.

Changes in the carrying amount of the CSM for insurance contracts without direct participation features

The Board tentatively approved the guidance text on changes to the CSM for insurance contracts without direct participation features, i.e. under the general model. This guidance explains which experience variances would be reported in profit or loss and which one would instead be reported as an adjustment to the CSM because they are related to changes in assumptions underpinning cash flows for the remaining coverage. Effectively the treatment of experience variances arising while there is remaining coverage will have to be carefully investigated to establish their accounting treatment. Experience variances that relate to incurred claims will always be reported to profit or loss.

Presentation and disclosure of insurance finance income or expenses

The Board considered certain aspects of the presentation of insurance finance income or expenses: the risk adjustment and the changes in the present value of the future cash flows.

It is not feasible to require entities to identify the effect of a change in discount rate on the risk adjustment given the different techniques that are available for measuring the risk adjustment. Consequently, the Board tentatively decided not to require disaggregation of the movements in the risk adjustment into financing and underwriting components. If the entity does not make such a disaggregation, it should present the entire change in the risk adjustment as part of the underwriting result.

The Board tentatively decided to remove the reference to a cost measurement basis as the objective of presenting insurance finance income or expense in profit or loss, and instead to provide an alternative systematic allocation guidance. The systematic allocation would be based on the characteristics of the contract without reference to factors that do not affect its measurement, and results in the amounts recognised in OCI over the life of the contract amounting to zero.

Where changes in financial assumptions do not have a material effect on the amounts paid to the policyholder the systematic allocation would be determined using the discount rate(s) applicable at inception of the contract. For contracts where changes in financial assumptions impact the amounts due to policyholders the systematic allocation could be one of two ways. One way would be the constant rate that allocates the remaining revised expected finance expense over the remaining life of the contract. Alternatively, if the contract uses crediting rates the allocation could be based on the amount credited in the period and the amounts expected to be credited in future periods.

The Board tentatively decided to remove the requirement to disclose a specified breakdown of total insurance finance income or expense. This would be replaced by the inclusion of a requirement to explain the total amount of insurance finance income or expense in a reporting period, combined with requirements to highlight the relationship with the investment return on the related assets, and to explain the methods used to calculate the information presented in profit or loss.

Reinsurance contracts issued and held and the scope of the variable fee approach

The Board tentatively decided to amend the scope of the variable fee approach to exclude reinsurance contracts that a reinsurer issues or a cedant holds.

This is because the variable fee approach was developed to address situations in which the policyholder pays a premium and expects to receive both insurance coverage and investment returns in excess of the premiums paid. In contrast, in a reinsurance contract the cedant pays a premium but does not generally expect reimbursement greater than the premium paid, and the reinsurer does not provide a cedant with a return on underlying items and keeps a proportion for itself as a fee. The profit the reinsurer earns is not a fee for providing investment management services, but is earned from providing reinsurance coverage.

Tentative decisions during 16 February 2016 meeting

Topics discussed at the 16 February 2016 IASB meeting:

During this meeting, the IASB reviewed the mandatory and non-mandatory due process steps taken on the insurance project.

The Board tentatively decided that the necessary due process steps have been taken.

The Board granted permission to the Staff to begin the balloting process.

No members at this stage indicated their intention to dissent.

Due process and drafting process

The Board reviewed the mandatory and non-mandatory due process steps taken on the insurance contracts project and decided that all the necessary due process steps have been taken. The Board congratulated the Staff on their hard work on the project and granted permission to the Staff to begin the balloting process.

During the discussion, a possibility was raised of a need to conduct some further outreach activities to discuss constituent concerns, to enhance the understanding of application issues and to check how the words used in the drafting would be interpreted. It was clarified that any 'road-testing' would be not of the model itself instead it would be designed to operate as a quality control around the words used in drafting and how they may be interpreted. A suggestion was made to combine an outreach to a broader audience on a few selective issues and broader exposure to a small group of people. In particular, one of the new areas of the standard would be the variable fee approach that was not previously exposed.

In response to a request for more examples in order to reduce diversity in practice the Staff explained that the examples in the new IFRS will be designed to illustrate one point at a time. They are not comprehensive, and care needs to be taken not to extrapolate more meaning from them than intended. This may be leading to unintended consequences. There was also weariness of 'drawing unintentional bright lines' by using the examples in interpreting such concepts as 'similar contracts'.

The three areas in particular that, in some Board members' view, would benefit from more guidance were:

1. use of OCI for indirect participating contracts;
2. amortisation of the CSM over the contract life; and
3. allocation of CSM in the case of contract lapses.

Finally, a suggestion was made to remove the reference to the 'OCI solution' as the preferred approach, when compared to presenting all the changes in the discount rate in the profit or loss. This was also echoed by the Chairman of the IASB asking for a redrafting of this point. In his view, managing of the discount rate is an integral part of the insurer's business and while the Board allowed an OCI solution, he hoped that several insurance companies would show the discount rate's impact in the profit and loss.

The Staff assured the Board that they will work on the drafting of the final text of the new standard so that it can be completed within the targeted nine months period and that they will keep the constituents up to date on their process via summary papers and various proposed targeted consultation activities.

Tentative decisions during 19-20 January 2016 meeting

During this meeting, the IASB discussed the remainder of the planned technical decisions on accounting for insurance contracts.

The Board tentatively decided to require a recognition of a loss for onerous contracts only when the CSM is negative for a group of contracts. The group should contain contracts that at inception have cash flows that the entity expects will respond in similar ways to key drivers of risk in terms of amount and timing, and have similar expected profitability (expressed as CSM as a percentage of premium).

The Board tentatively agreed that the objective of the CSM allocation is to recognise the remaining CSM for an individual contract, or a group of homogenous contracts, in profit or loss over the remaining coverage period in the systematic way that best reflects the remaining services to be provided by the contract. Therefore, if there is no more service to be provided by a contract, the individual contract's CSM should be fully recognised in profit or loss.

The Board tentatively agreed that while the wording would need to be revised, the objective of the CSM allocation is to represent the profit an insurer makes in a period from fulfilling its obligations to cover the policyholder from the adverse effect of uncertain insured events. The Board tentatively agreed that the CSM only relates to contracts in force and that rigid criteria were not required to achieve that accounting objective. However there should be a 'safe harbour' example of a grouping that would definitely meet the objective.

The Board tentatively agreed there should be no exception to the level of aggregation for determining onerous contracts or determining the allocation of the CSM as a result of regulation on how an insurance contract is priced.

The Board tentatively decided to require an entity to specify at the inception of the contract how it viewed its discretion, and to use that specification to distinguish between the effect of changes in market variables and changes in discretion. If the entity is unable at inception to specify how it will determine amounts due to the policyholders, then the default benchmark is the current market return for the contract.

Level of aggregation

Level of aggregation for onerous contracts

The need to consider the level of aggregation arises because in some circumstances gains are treated differently from losses, therefore an accounting mismatch may be created if contracts were accounted for individually. For example, on initial recognition, and entity would recognise a positive CSM over the coverage period, but recognise a negative CSM immediately in profit or loss.

In order to avoid the recognition of inappropriate losses that arise on individual contracts just because expected events across a group affect individual contracts differently, the Board tentatively decided to specify a level of aggregation to be used in determining whether a group of contracts is onerous. The group should contain contracts that at inception have cash flows that the entity expects will respond in similar ways to key drivers of risk in terms of amount and timing, and have similar expected profitability (expressed as CSM as a percentage of premium).

Level of aggregation for the allocation of contractual service margin (CSM)

The other aspect for which the level of aggregation is relevant is the allocation of the CSM. For those contracts for which the coverage period ends earlier than the average coverage period of the group, measuring contracts on an individual basis would mean that the CSM associated with those contracts would be fully recognised in profit or loss over the shorter period up to the point when the coverage period ends. Whereas measuring the contracts on a group basis would not necessarily mean that the CSM associated with those contracts would be fully recognised in profit or loss when the coverage period ends. The Board agreed that the wording would need to be revised, but voted twelve against two to support the Staff recommendation that the objective of the CSM allocation is to achieve very homogenous groups, that grouping is allowed if the objective of representing individual contract accounting is met and there should be a 'safe harbour' example of a grouping that definitely meets the objective. The Board tentatively decided that CSM only relates to contracts in force and if there is no more service to be provided by the contract, the individual contract's CSM should be fully recognised in profit or loss.

No exception to the level of aggregation for the effect of regulation

The Board tentatively agreed there should be no exception to the level of aggregation for determining onerous contracts or determining the allocation of the CSM as a result of regulation. For example, gender equality regulations mean that insurers need to charge the same premium to male and female policyholders even if the risks are different, resulting in different levels of profitability.

Specifying the effect of discretion in the general model

Participating contracts that are not accounted for under the variable fee approach will often include cash flows that the entity expects to pay, but which it has discretion to change, which are included in the fulfilment cash flows. Changes in estimates of discretionary cash flows would adjust the CSM because they are regarded as relating to future service. The 2013 Exposure Draft simply stated that changes in future service adjust the CSM.

The Board tentatively decided to require an entity to specify at the inception of these contracts how it viewed its discretion, and to use that specification to distinguish between the effect of changes in market variables and changes in discretion. Entities that gave different specifications about discretion would get different results from similar contracts, but this could provide useful information to the users of financial statements because such information reflects the entity's perspective about its discretion and it is relevant to users. If the entity is unable at inception to specify how it will determine amounts due to the policyholders, then the default benchmark is the current market return for the contract.

Tentative decisions during 18 November 2015 meeting

During this meeting, the IASB discussed the differences in measurement under the variable fee approach and the general measurement model and whether these differences could be removed to result in one model.

The Board reconfirmed the key decision under the variable fee approach to adjust the CSM for changes in fulfilment cash flows caused by guarantees embedded in insurance contracts before recognising them in profit or loss.

The Board also tentatively decided not to allow in the general model the use of current discount rates to calculate the unlocking adjustments and the accretion of time value of money on the CSM balance

The Board was asked to consider explicitly the definition of the effects of discretion to be recognised in the CSM for participating contracts under the general model, but was not able to reach a conclusion and the issue is expected to be brought back at the next meeting.

The Board tentatively decided to extend the ability to fair value through profit or loss some assets/items that underlie the direct participating contracts, in the same way as that exception is already permitted for unit-linked contracts

In determining the CSM on transition under the variable fee approach the IASB tentatively decided that the entity would be required to restate the prior period CSM by taking the CSM determined at the date of initial application and by assuming that the total fee for the contract has not changed since the beginning of the earliest period presented other than for the passage of time.

In addition, the IASB tentatively decided to permit the option to recognise changes in the embedded guarantees in profit or loss under the variable fee approach to be applied only prospectively from the date of initial application of the standard in order to avoid the use of hindsight.

Tretment of embedded financial guarantees under the variable fee approach

Contracts need to meet a set of criteria in order to qualify for the measurement under the variable fee approach. The different measurement creates a potential 'two models' effect and at this meeting the Board discussed whether different types of contracts could be accommodated within one model. It was felt that given the stage of the project, the need for a practical solution for different types of contracts outweighed the possible 'cliff effects' from having effectively two models.

The IASB agreed with the Staff recommendation that the variable fee approach should not be amended to include financial guarantees embedded in the insurance contract in the underlying items. That is, the Board reconfirmed their previous tentative decision that under the variable fee approach, the changes in fulfilment cash flows caused by guarantees embedded in insurance contracts should adjust the CSM before being recognised in profit or loss. This would reflect the different nature of those direct participating contract that meet the three criteria to qualify for the variable fee approach.

Discount rate used for accretion and unlocking of CSM

In relation to the CSM the general model uses the locked in discount rates, whereas the variable fee approach uses current discount rates. The Board tentatively agreed with the Staff recommendation to not allow accretion or unlocking of the CSM at the current discount rates in the general measurement model. The main justifications for keeping two different accretion mechanisms were that the introduction of current rates for all contracts would be too complex; allowing an option under the general model would create too much diversity in measurement; and the CSM under the general model represents a residual, rather than a future cash flow, as the contract premium is not 'repriced' at each reporting date.

Definition of the effects of discretion to be recognised in the CSM for participating contracts under the general model

The Board members discussed four potential definitions of the effects of discretion in the participating contracts that did not meet the variable fee approach criteria and that would be measured under the general model. The Board also considered the different resulting impacts on the CSM. Given the variability of outcomes and the sensitivity of the CSM result to the assumptions used, the Board asked the Staff to bring the issue back at the next meeting.

Consequential issues arising from the variable fee approach

Extending the ability to fair value through profit or loss some assets underlying contracts with direct participation features
There was a unanimous Board agreement to extend the ability to fair value through profit or loss some assets/items that underlie the direct participating contracts, in the same way as that exception is already permitted for the unit-linked contracts. This would apply to investment properties, investments in associates, owner occupied properties, own debts and own shares if they are underlying items for contracts with direct participating features.

CSM on transition for contracts measured using the variable fee approach
Given the difficulty in determining CSM on transition under the variable fee approach without the use of hindsight the Board unanimously approved the simplification proposed by the Staff, subject to some clarification in the recommended wording.

Under this simplified approach, an entity would measure the CSM of direct participating contracts at the date of initial application as:

- The total fair value of the underlying items at that date.
- Less.
- The fulfilment cash flows adjusted to reflect relevant cash flows that have already occurred between the inception of the contract and the date of initial application of the Standard.

The CSM at the initial recognition of the contracts is assumed to be the "gross up" of the CSM determined at the date of initial application multiplied by the ratio between the total expected coverage for the contracts and the period of coverage already expired from the initial recognition to the initial application date.

The CSM would then be "rolled back" to calculate the amounts related to the comparative periods by assuming that only the allocation of CSM has taken place. The underlying items are assumed to be at the same values as at the initial application of the Standard. The allocation of the CSM would only be affected by the passage of time and derecognition of contracts.

Application of the option to recognise the changes in the value of embedded guarantees in profit or loss rather than the CSM
The changes in the guarantees embedded in the insurance contract under the variable fee approach are recognised in the CSM. However, these changes can be recognised in the profit or loss, if an entity uses a stand-alone derivative that mitigates, as part of its documented risk management strategy, the financial market risk created by the guarantee. This strategy must be documented without the use of hindsight.

To avoid the use of hindsight, the Board tentatively decided to permit the application of the option to recognise changes in the embedded guarantees in profit or loss under the variable fee approach only prospectively from the date of initial application of the Standard.

Tentative decisions during 21 October 2015 meeting

Deferral of IFRS 9

In September the IASB decided, after the Chairman had exercised his casting vote, to propose a package of temporary measures in relation to the application of the new financial instruments Standard, IFRS 9, before the new insurance contracts Standard comes into effect. At this meeting the IASB discussed how those measures would apply to first-time adopters and set the comment period for the exposure draft.

The IASB agreed with the Staff recommendation to prohibit deferral and overlay approaches to implementation of IFRS 9 for first time adopters (see paper 14B). This is on the grounds that both the deferral approach and the overlay approach require information resulting from applying IAS 39 in part or in full, which in itself would be a new requirement for first time adopters. Accordingly, both approaches are considered not to be relevant to first time adopters and prohibiting them is consistent with the principles of IFRS 1 of applying the current versions of IFRSs and enhancing comparability within entity over time.

Comment Period

In considering the comment letter period for the December 2015 exposure draft, the Board agreed that the matter is both narrow in scope and urgent and decided on a comment period of 60 days. This decision would now need to be approved by Due Process Oversight Committee.

Transition to the new insurance contracts Standard

For transition, the Board tentatively decided to permit entities to reassess the business model for financial assets designated as related to contracts within the scope of the new insurance contracts Standard. In addition, the reassessment would be based on facts and circumstances existing on initial application of the new insurance standard (that is the beginning of the latest period presented) with new classifications/designations applying retrospectively.

The Board members asked the Staff to clarify in the drafting that the re-assessment of the business model does not imply that the model itself has changed (with the meaning specified in IFRS 9), but rather in light of the new standard and new circumstances an entity would have arrived at different classifications/designations. It was also highlighted that the reassessment or re-designations are optional.

Restatement of comparative information on initial application of the new insurance contracts Standard

The Board members agreed to reconfirm once more the intention to require for all entities the restatement of comparative information about insurance contracts. However, the Board tentatively decided for entities already applying IFRS 9 on initial application of the new insurance contracts Standard to permit (but not require) the restatement of comparatives for financial assets only if it is possible to complete it without the use of hindsight and the entity has also decided to use the transitional reliefs:

a. to reassess its business model for managing financial assets

b. to financal assets under FVO or to elect the OCI presentation for equity investments

The "Mirroring" Approach

There was a unanimous agreement by the Board to abandon the mirroring approach as the proposal was viewed as being too complex and potentially inconsistent for some participating contracts.

Presentation

The Board agreed to confirm the 2013 ED proposals for presentation of insurance contract line items in the financial statements.

The Board members considered the need to present separately insurance contracts measured using different methods. Overall, the Board members felt that the reference to the IAS 1 requirement to present separately items of different nature or with different features should be emphasised more strongly.

Disclosure

The Board approved a fresh set of disclosure requirements that will be applied with regards to the revised transition provisions for financial assets when the entity first adopts the new insurance contracts Standard. These new or revised disclosures as noted in the IASB Update are:

a. "when an entity applies the transition relief for the assessment of the business model for managing financial assets, the entity should disclose its policy for designating financial assets to which that transition relief is applied;

b. when the classification and measurement of financial assets changes as a result of applying any of the transition reliefs in the new insurance contracts Standard, an entity should disclose for those financial assets by class:

   i. the measurement category and carrying amount immediately before the first application of the new insurance contracts Standard;

   ii. the new measurement category and carrying amount determined as a result of applying the transition provisions in the new insurance contracts Standard;

   iii. the amount of any financial assets in the statement of financial position that were previously designated under the FVO but are no longer so designated, distinguishing between those that an entity was required to de-designate and those that an entity elected to de-designate;

iv. qualitative information that would enable users of financial statements to understand how an entity applied the transition provisions in the new insurance contracts Standard to those financial assets whose classification has changed as a result of initially applying that Standard, including:

1. the reasons for any designation or de-designation of financial assets under the FVO; and

2. an explanation of why the entity came to a different conclusion in the new assessment of its business model."

In addition, the Board confirmed the disclosures proposed in paragraphs 69-95 of the 2013 ED, with the following changes:

a. to add a requirement that an entity that measures contracts using the variable fee approach, and chooses to recognise changes in the value of the guarantee embedded in the insurance contract in profit or loss, should disclose the value of the guarantee that has been recognised in profit or loss in the reporting period;

b. to add a requirement that an entity that chooses to disaggregate investment interest expense into an amount presented in profit or loss and an amount presented in OCI should disclose an explanation of the method that an entity uses to calculate the cost information presented in profit or loss;

c . to add a requirement that an entity that chooses to disaggregate investment interest expense into an amount presented in profit or loss and an amount presented in OCI, and uses the simplified approach at transition that results in the accumulated balance in OCI for the insurance contract being zero, should disclose a reconciliation from the opening to closing balance of the accumulated balance of OCI for financial assets relating to contracts within the scope of the new insurance contracts Standard that are measured at fair value through other comprehensive income (FVOCI) in accordance with paragraph 4.1.2A of IFRS 9. The reconciliation should be provided at the date of transition and in each subsequent reporting period. The entity would designate financial assets (that are classified in the FVOCI measurement category) as relating to contracts within the scope of the new insurance contracts Standard at the date of initial application;

d. to add a requirement that an entity should disclose:

i. changes in the fulfilment cash flows that adjust the contractual service margin;

ii. an explanation of when the entity expects to recognise the remaining contractual service margin in profit or loss either on a quantitative basis using the appropriate time bands or by using qualitative information;

iii. the amounts in the financial statements determined at transition using simplified approaches, both on transition and in subsequent periods; and

iv. any practical expedients that an entity used.

e. to delete the proposed requirements that an entity should disclose:

i. a reconciliation of revenue recognised in profit or loss in the period to premiums received in the period (paragraph 79 of the 2013 ED); and

ii. an analysis of total interest expense included in total comprehensive income disaggregated at a minimum into:

1. interest accretion at the discount rate that applied at initial recognition of insurance contracts reported in profit or loss for the period; and

2. the movement in other comprehensive income for the period (a tentative decision from March 2014 – see below in this document).

Tentative decisions during 21-23 September 2015 meeting

Deferral of IFRS 9

The Board tentatively decided to amend IFRS 4 to allow companies whose business model is to predominantly issue insurance contracts the option to defer the effective date of IFRS 9 until the earliest of the mandatory (or early adoption) effective date of the new insurance contracts Standard or 1 January 2021. The 2021 date operates a 'sunset clause' for the Deferral Approach. This amendment would also provide insurers who implement IFRS 9 the option to remove from profit or loss some of the accounting mismatches and temporary volatility that could occur before the new insurance contracts Standard is implemented. This option is called the Overlay Approach and it will be available only from 1 January 2021 in the event that the new insurance contracts Standard is not yet mandatorily effective.

The initial Board vote on this issue was tied, but the Chairman of the IASB used his casting vote to result in 8 votes in favour of these measures, with 7 votes against.

The reason for the 'sunset clause' which puts a time limit on how long insurers can defer implementing IFRS 9 is to address the concern that if there are unexpected delays in issuing the new insurance contracts Standard, the consequence would be that insurers would not be implementing IFRS 9 for many years after all other companies, which the IASB considered to be unacceptable.

The effective date of 2021 would limit this delay in implementing IFRS 9 by insurers to a maximum of three years. The Chairman of the IASB made it clear that he hoped that the IASB's deliberations on the new insurance contracts Standard would be completed by the end of this year or early next year, with the new Standard published in 2016. If this occurs, the likely effective date for the new insurance contracts Standard would be 1 January 2020, with implementation of IFRS 9 by insurance companies occurring at the same time.

The Board also voted in favour of an exposure draft stating these approaches to be published later this year for public consultation.

Disaggregating changes arising from changes in market variables in the statement of comprehensive income (SCI)

In March 2014, the IASB tentatively decided that for contracts without participation features the entity may choose as its accounting policy choice to disaggregate changes in discount rate between profit or loss and OCI. If so, the presentation of interest expense in the SCI should be determined using the discount rate locked in at inception for the profit or loss account and accordingly the difference between that insurance investment expense determined using a cost and the one determined using a current discount rate is presented in OCI.

The Board discussed this presentation approach when it applies to contracts with participation features including the practical mechanics, whether different requirements are needed for some specific participating contracts in which there are no economic mismatches between the contract and the items held, whether such disaggregation between profit or loss and OCI should be an accounting policy choice and finally, whether there should be simplified transitional arrangements for the determination of the accumulated balance of OCI when retrospective application is impracticable.

Changes in estimates of cash flows arising from changes in market variables

The Board tentatively decided that an entity shall present changes in estimates of the amount of cash flows that result from changes in market variables in the SCI consistently with the presentation of changes in discount rates. Effectively the cash flows would be split into those affected by market variables and those that are not. The presentation of the affected cash flows would then be forced down either OCI or profit or loss depending on the application of the OCI solution to discount rate changes.

Objective of disaggregating changes arising from changes in market variables

The objective of disaggregating changes in the insurance contract arising from changes in market variables between profit or loss and OCI is to present an insurance investment expense in profit or loss using a cost measurement basis.

Accordingly, the difference between presenting an insurance investment expense in profit or loss using a cost measurement basis and current measurement basis is recognised in OCI and these amounts reverse. The IASB tentatively decided that the Standard should not specify detailed mechanics for the determination of the insurance investment expense using a cost measurement basis. The Board considered instances of accounting mismatches arising from applying the cost measurement basis to insurance investment expense. To address these concerns the Board specifically looked at contracts with no economic mismatches. Additionally the IASB considered allowing an accounting policy choice to present insurance investment expense using either a cost or a current measurement basis.

Modification of the objective for contracts with no economic mismatches

When there are no economic mismatches between the cash flows from insurance contracts and the items held to fund those cash flows there is merit in considering whether the accounting mismatches in profit or loss could also be eliminated. To that effect the objective of disaggregating changes in market variables between profit or loss and OCI should be modified to present the insurance investment expense in profit or loss with reference to the accounting bases used for those items, irrespective of whether those items are measured using a cost measurement basis in profit or loss.

Accordingly the IASB tentatively decided to modify the objective and to present the difference between the changes in the contract arising from changes in market variables (e.g. changes in the fair value of the underlying items) and the insurance investment expense in OCI. The Standard will define this approach as the current period book yield approach.

Economic mismatches do not exist when the contract is a direct participation contract (i.e. the entity has an obligation to pay the policyholders the fair value of the underlying items and therefore applies the variable fee approach), and the entity holds the underlying items, either by choice or because it is required to.

Modification to the objective for disaggregating changes in market variables between profit or loss and OCI

As mentioned above, the IASB tentatively decided to modify the objective of disaggregating changes in market variables between profit or loss and OCI for contracts in which economic mismatches do not exist.

The Board decided that when an entity is required to change between the cost measurement approach (e.g. the effective yield approach) and the current period book yield approach (and vice versa) it shall not restate the opening accumulated balance of OCI for insurance liability. This would result in these amounts of gains and losses never being recycled to profit or loss. (i.e. accumulated OCI remains in equity).

An entity shall only disclose in the period in which the change of approach occurred what is the reason for the change, the effect of the change on each financial statement line item affected and the value of the contracts that no longer qualify for the current period book yield approach but previously qualified (and vice versa).

For a change between methods, the IASB tentatively decided that accumulated gains or losses would be recognised in profit or loss in the period of change and future periods using the same assumptions as applicable to the approach used prior to the change.

Accounting policy choice

The IASB also tentatively decided that it should extend to contracts with participating feature its previous decisions on the presentation of insurance investment expense for contracts without participation features. An entity shall choose as its accounting policy to present an insurance investment expense in profit or loss using either (a) a cost measurement basis, or (b) a current measurement basis. Presenting an insurance investment expense in profit or loss using a cost measurement basis would require disaggregating changes in market variables between profit or loss and OCI. Accordingly, the difference between presenting the insurance investment expense on a cost measurement basis or a current measurement basis would be reflected in OCI. The board tentatively decided that an entity would be required to apply that accounting policy to groups of similar contracts, taking into consideration the portfolio in which the contracts are included, the assets that the entity holds and how those assets are accounted for. Further, an entity would be required to apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to any changes in that accounting policy.

For contracts with no economic mismatches between the cash flows from insurance contracts and those from the items held, the IASB tentatively decided that an entity should choose as its accounting policy either to disaggregate changes in market variables between profit or loss and OCI by presenting (based on modified objective) an insurance investment expense in profit or loss using the current period book yield or by presenting an insurance investment expense in profit or loss using a current measurement basis (with no disaggregation). If the current period book yield is chosen, the difference in the insurance investment expense presented and that based on a current measurement basis would be reported in OCI.

Simplified transition requirements for the accumulated balance of OCI

When retrospective application is impracticable the approach for determining the accumulated balance of OCI created by the insurance investment expense prior to the transition date for contracts in which changes in market variables affect the amount of cash flows will be set as follows: for contracts for which the objective is to present an insurance investment expense using a cost measurement basis in profit or loss (i.e. those applying an effective yield approach) an entity should assume that the earliest market variable assumptions that should be considered are those that occur when the entity first applies the new Standard (the transition date).

Accordingly, at the date when the entity first applies the new Standard, the accumulated balance of OCI for the insurance contract is zero; following the modification in the objective of disaggregating changes arising from changes in market variables between profit or loss and OCI, an entity applying the current period book yield approach should assume that the insurance investment expense (or income) is equal and opposite in amount of the accumulated gain (loss) presented in equity for the relevant underlying items the entity holds. As such, an entity should assume that the accumulated balance of OCI is determined by reference to that associated with the underlying items that will be considered in the application of the current period book yield from transition date.

Accounting consequences of mitigating risks related to insurance contracts

An entity may have accounting mismatches between changes in the value of the guarantee embedded in a direct participating contract. Under the variable fee approach the changes in the expected cash flows from that embedded guarantee will adjust the CSM. However, the changes in fair value of a derivative that the entity holds to mitigate the risks arising from this guarantee would be recognised in profit or loss. These mismatches could not be eliminated using existing hedge accounting requirements in IFRS 9.

The IASB members tentatively decided in favour of an approach that would state that if an entity uses the variable fee approach to measure insurance contracts and uses a derivative measured at Fair Value through Profit or Loss to mitigate the financial market risk from the guarantee embedded in the insurance contracts, an entity should be permitted to recognise in profit or loss the changes in the value of the guarantee embedded in an insurance contract, determined using fulfilment cash flows.

Limiting criteria

The IASB tentatively decided that an entity that mitigates the financial market risk from the guarantee using a derivative should be permitted to recognise in profit or loss the changes in the value of the guarantee embedded in an insurance contract, determined using fulfilment cash flows only if that mitigation is consistent with the risk management strategy and an economic offset exists between the guarantee and the derivative. An entity should not consider accounting measurement differences in assessing the economic offset, and credit risk ought not to dominate the economic offset.

An entity should be required to document its risk management objective and its strategy for using the derivative to mitigate the financial market risk embedded in the insurance contract, and to discontinue recognising in profit or loss changes in the value of the guarantee prospectively from the date on which the economic offset does not exist anymore.

Cumulative effect of recognising changes in the value of the guarantee in profit or loss

Further, the Staff recommended that an entity should disclose as part of the reconciliation of the CSM the cumulative effect of recognising changes in fulfilment cash flows of the guarantee in profit or loss instead of an adjustment to the CSM. However, several Board members expressed concern with the Staff recommendation as this disclosure could be misleading as the changes do not adjust the CSM. The Staff intend to present an amended recommendation for discussion at a future meeting.

Tentative decisions during 20 July 2015 meeting

Accounting consequences of different effective dates for IFRS 9 and IFRS 4

Many constituents noted that applying IFRS 9 before the new insurance contracts Standard may lead to additional accounting mismatches and temporary volatility in profit or loss. As such, the topic was discussed again by the IASB at their July 2015 meeting.

The Staff paper considered the extent to which IFRS 4 already allows an entity to reduce any additional accounting mismatches and temporary volatility in profit or loss that could arise from the accounting of financial assets backing insurance liabilities, and whether the IASB should make amendments to I FRS 4 that would enable entities to reduce these effects further when IFRS 9 is effective on 1 January 2018. The IASB acknowledged that the effective date of the new IFRS on insurance contracts that will replace IFRS 4 is likely to be much later (Deloitte estimates that it may be effective on 1 January 2020). This different effective dates would create accounting mismatches that would only be addressed when IFRS 9 and the new IFRS on insurance contracts are both effective.

The methods that are already available in IFRS 4 for reducing accounting mismatches and temporary volatility in profit or loss that is not due to economic factors are:

1. shadow accounting, which is a way of adjusting insurance liabilities to reduce accounting mismatches that can arise when unrealised gains and losses on assets held by the entity are recognised in the financial statements but corresponding changes in the measurement of the insurance contract liabilities are not (IFRS 4 paragraph 30);

2. use of current market interest rates in the measurement of designated insurance liabilities (IFRS 4 paragraph 24); and

3. ability to change accounting policies for insurance contracts when financial statements are made more relevant and no less reliable or more reliable and no less relevant than before the change (IFRS 4 paragraph 22).

The Staff also presented three potential amendments to IFRS 4 to address new accounting mismatches arising from the date in which IFRS 9 is effective, which are:

1. shadow adjustments for shareholders' interests in underlying assets – the practice of accounting for financial assets backing participating contracts liabilities under the available-for-sale category results in the changes in these interests to be accounted for outside the profit or loss account. When these assets can no longer be accounted for in the same way under IFRS 9 (i.e. they will not meet the criteria for fair value through OCI accounting) there will be more gains and losses reported in profit or loss than under IAS 39. This reporting feature would disappear when the new IFRS on insurance contracts introduces the "variable fee approach" (see June 2015 IASB decision on this approach);

2. shadow accounting for assets backing nonparticipating insurance contracts – this would address the reclassification from available-for-sale to fair value through profit or loss under IFRS 9 of assets backing insurance liabilities for which the shadow accounting was not possible under the current text of IFRS 4; and

3. apply IFRS 9 with an adjustment to the insurance liabilities which reverses in OCI the effect of IFRS 9 on accounting more gains and losses in profit or loss than it was possible under IAS 39.

The Board unanimously voted to pass the tentative decision that would amend IFRS 4 to permit an entity to account for an adjustment to its insurance liabilities that would exclude from profit or loss and recognise in OCI the difference between the amounts that would have been recognised in profit or loss in accordance with IFRS 9 and the amounts previously recognised in profit or loss in accordance with IAS 39, subject to meeting certain criteria.

In applying this guidance, an entity would apply IFRS 9 in full but it would make adjustments to its insurance liabilities such that there is an entry in profit or loss and OCI 1) in relation to assets that were previously, or would have been, classified at amortised cost or available-for-sale in accordance with IAS 39 and are classified in accordance with IFRS 9 at fair value through profit or loss and relate to insurance activities, and 2) provide that the entity issues contracts accounted for under IFRS 4 and applies IFRS 9 in conjunction with IFRS 4.

In addition, the IASB decided that the net effect on profit or loss will reflect the IAS 39 accounting for those specified assets.

Tentative decisions during 25 June 2015 meeting

Please refer to "Education Session: accounting for participating contracts" section of this newsletter for further details of previous Board discussions on these topics.

Variable fee for service approach for direct participating contracts

The general measurement model for insurance contracts does not address the accounting for the insurer's share in the returns of the underlying items which is a feature existing in participating contracts. Accordingly, the Board tentatively decided to modify the general model as it applies to participating contracts so that changes in the estimate of the insurer's expected share in the returns on underlying items less any expected cash flows that do not vary directly with underlying items will be adjusted in the CSM.

The Board also tentatively decided to define participating contracts as contracts for which:

1. the contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items;

2. the insurer expects to pay to the policyholder an amount equal to a substantial share of the returns from the underlying items; and

3. a substantial proportion of the cash flows that the insurer expects to pay to the policyholder should be expected to vary with the cash flows of the underlying items.

The above criteria do not require that the underlying items should be assets that the insurer actually holds nor does it require that the returns should be from the assets that the insurer actually holds.

Recognition of contractual service margin in profit or loss for participating contracts

The general principle for recognising the CSM as applied to non-participating contracts is to recognise CSM in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of services that are provided under the insurance contract. This principle would allow insurers to recognise the CSM based on the pattern of delivery of the service considered as the primary service being provided in a participating contract, which may be insurance coverage or investment management service.

The Board agreed with the Staff proposal and has tentatively decided that, for participating contracts, the insurer should recognise CSM in profit or loss based on the passage of time only. This is considered as the least complex and the least subjective approach to achieve the principle of a systematic recognition of the expected profit from participating insurance contracts.

Education session (23 June 2015): Application of IFRS 9 *Financial Instruments* before the new insurance contracts Standard

The IASB discussed their views in an education session held on 23 June 2015 on the following topics:

- implications of applying the requirements of IFRS 9 *Financial Instruments* (effective date of 1 January 2018) prior to the effectivity of the new insurance contracts Standard (expected to be one or more years later);
- the implications if IFRS 9 is deferred for insurers and the scope of the deferral; and
- potential accounting mismatches that could occur if variable fee for service approach is applied to direct participating contracts where the insurer hedged financial market risks, e.g. duration mismatch, with a derivative and the approaches that could be explored to address these mismatches.

No decisions were required from the Board during this session.

Applying IFRS 9 prior to the new insurance contracts Standard

Common concerns raised by the constituents on the timing difference between the effective dates of IFRS 9 and the new insurance contracts Standard are as follows:

- temporary increased volatility in profit or loss due to increase in accounting mismatches between the insurance liabilities and the assets held to back those liabilities. This additional volatility will arise during the intervening period between the effective dates of IFRS 9 and the new insurance contracts Standard;
- additional costs for preparers in sequentially implementing two highly interconnected accounting standards within a short time interval; and
- added complexity for both preparers and users of financial statements.

The Staff analysed that the current asset-liability management activities of insurers already address existing accounting mismatches. If IFRS 9 is applied before the new insurance contracts standard, new accounting mismatches could arise, and existing Standards may not have sufficient guidance or requirements to allow insurers to eliminate, if not reduce, these new accounting mismatches.

The Staff analysed the following options that can be explored to address and reduce these mismatches:

1. on the perspective of accounting for insurance liabilities, the Board could consider the existing options provided in IFRS 4, *Insurance Contracts,* or consider providing additional options through amendments to IFRS 4; or
2. on the perspective of accounting for financial assets, the Board could consider deferring the effective date of IFRS 9 for insurers.

Available options in IFRS 4, Insurance Contracts

The Staff indicated that IFRS 4, the existing insurance contracts Standard, provides insurers with optional approaches that can be applied to reduce accounting mismatches. These approaches will remain available and relevant when IFRS 9 becomes effective. These approaches include the use of shadow accounting where there is a direct link between the realisation of the gains or losses on the assets and the measurement of the insurance liabilities. Such approach allows insurers to change its accounting policies so that the effect of a recognised but unrealised gain or loss on an asset will be the same as that of a realised gain or loss. The related adjustment to the insurance liability or deferred acquisition costs or intangible assets, is recognised in other comprehensive income, if and only if the unrealised gains or losses are recognised in other comprehensive income [IFRS 4, para. 30]. Another approach is the use of current market interest rates in measuring part or all of an insurer's insurance liabilities to address and reduce accounting mismatches.

Potential amendments to IFRS 4, *Insurance Contracts*

The Staff analysis discussed that the Board could consider providing amendments to IFRS 4, to be applied on an optional basis, in order to address potential accounting mismatches that could occur when IFRS 9 is applied. These are:

1. allow an adjustment similar to that of shadow accounting that would result in the recognition of gains and losses on insurance liabilities that would offset any unrealised gains and losses on the assets when:

   - there is no direct relationship between the assets and the insurance liabilities, as is the case for non-life insurance contracts; and

   - those gains and losses arising in contracts for which there is a direct link between the realisation of assets and measurement of insurance liabilities, but the gains and losses would be attributable to the insurer and not the policyholder.

2. allow insurers to recognise a liability adjustment to reflect the differences between the change in value of the assets under IAS 39 and change in their fair value under IFRS 9 to the extent that those changes are recognised in profit or loss. This approach defers the impact of applying IFRS 9 but not its actual application.

Under both approaches, there is a need for the Board to consider defining the assets that would result to these adjustments and to consider whether to allow insurers to designate the assets to which the adjustments would apply.

Deferral of IFRS 9, *Financial Instruments* for the insurance industry

The Staff analysis discussed that the Board could consider deferring the effective date of IFRS 9 for the insurance industry. This alternative approach to address the potential accounting mismatches that could occur if IFRS 9 is applied prior to the effective date of the new Insurance Contracts standard will require the Board to consider the following:

- determine the scope and setting the criteria to be met in order to be able to apply the deferral;

- assess the need for additional presentation and disclosure requirements;

- identify any accounting implications if deferral is permitted and whether there is a need for additional guidance to address these implications; and

- whether the deferral is optional or mandatory.

The Staff analysis discussed three approaches for the deferral of IFRS 9. Using the example scenario provided by the Staff in Agenda Paper 2G (June 2015 meeting), the deferral would be applied as follows:

HoldCo			
Sub A		Sub B	Sub C
Insurance activities	Banking activities	Insurance activities	Banking activities

Source: From IASB June 2015 Agenda paper 2G

Approach 1: Apply the deferral at the reporting entity level.

Each reporting entity that qualifies for the deferral would apply either IFRS 9 or IAS 39, *Financial Instruments: Recognition and Measurement* to **all** its financial instruments. In the example scenario illustrated above where Sub A conducts both insurance activities and banking activities, Sub A can apply either IFRS 9 or IAS 39, which needs to be consistently applied to all its financial instruments, not on a subset of it. At the Hold Co level, Hold Co will need to assess whether the group as a whole can qualify for the deferral. Hold Co's choice of either applying IAS 39 or IFRS 9 on its consolidated accounts will need to be applied consistently to all its financial instruments. In this scenario, only one financial instrument Standard is applied by the reporting entity.

The Staff analysed that the following criteria could be considered by the Board in setting the scope of which reporting entity is qualified to apply the deferral:

- the entity issues contracts that are in scope of IFRS 4;

- the insurance activities are considered a significant part of the entity's activities; and/or

- the entity is a regulated insurance entity.

Approach 2: Apply deferral at the legal entity level

Each legal entity that qualifies for the deferral would apply either IFRS 9 or IAS 39, *Financial Instruments: Recognition and Measurement* to **all** its financial instruments. The difference of this approach to that of Approach 1 is that for a reporting entity that is comprised of several legal entities such as Hold Co in the example scenario above, Hold Co could apply both IAS 39 and IFRS 9 in its consolidated accounts, because Sub B can choose to apply IAS 39, while Sub C will have to apply IFRS 9 which will be carried forward in Hold Co's consolidated accounts.

Approach 3: Apply deferral for insurance activities
In this approach, a legal entity which has an insurance activity that would qualify for deferral of IFRS 9 will be able to apply both IAS 39 and IFRS 9 in its accounts. In the example scenario, if the insurance activities of Sub A qualify for the deferral and choose to apply the deferral, then it can apply IAS 39 in accounting for its financial instruments related to insurance activities, and IFRS 9 for financial instruments related to banking activities.

The Staff analysed that using either Approach 2 or Approach 3 will require the Board to consider accounting and disclosure requirements for transfer of financial assets among legal entities within a single reporting entity in a scenario where both IAS 39 and IFRS 9 will be applied by the reporting entity in accounting for its financial instruments. The existing reclassification requirements of IAS 39, the transition requirements of IFRS 9 and the change in accounting policy under IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* do not envisage the accounting of financial instruments in the scenario described above.

Three alternatives for accounting of transfers of financial assets accounted for under the two different financial instruments standards, IAS 39 and IFRS 9 in the consolidated financial statements can be explored:

1. require a reassessment and if necessary a change in the classification upon a transfer;

2. prohibit a change in classification upon a transfer

3. require a reassessment and if necessary a change in classification in some, but not all, circumstances.

The Board also discussed their views on whether the deferral will be made optional or mandatory.

Hedging of risks related to insurance activities

The Board discussed their views on the potential accounting mismatches that could arise where the variable fee for service approach is applied in a scenario where the insurer hedges the financial market risks in an insurance contract with a derivative. The Staff analysed that an accounting mismatch will arise in such a scenario because the effect of changes in financial assumptions on the value of the derivative would be recognised immediately while the effect of the change of the financial assumptions will be adjusted against the CSM and it would impact profit or loss only as the CSM is recognised over the coverage period.

The Board explored three approaches for addressing accounting mismatches if the variable fee approach is applied:

- Approach 1: Limited application of the variable fee for service approach. In this approach, an insurer has an option to (a) use the variable fee for service approach where it hedges the risk related to insurance activity by entering into a derivative arrangement but will need to accept the accounting mismatch that will arise in cases where hedge accounting cannot be applied; or (b) use general measurement model to recognise changes related to the guarantees and the insurer's share in the underlying items.

- Approach 2: Recognise changes in the value of the guarantee and the insurer's share in the underlying items in profit or loss instead of the CSM;

- Approach 3: Designate the derivative as an underlying item. In this approach, the insurer will need to designate a notional derivative that exactly mitigates its exposure to the identified financial market risk as part of the underlying items.

The Board has to consider whether to allow insurers to apply any of the above approaches on an unconditional basis or conditional on specified criteria which would be similar to those set out in paragraph 6.4.1 of IFRS 9, but modified to reflect the complexities in applying hedge accounting for insurance contracts.

Education session: Proposed accounting model for participating contracts

This section of the newsletter only includes Staff analyses as presented during the education session. Where necessary, views of Board members were included in italics.

Alternative accounting model for participating contracts proposed by the European CFO Forum

During the 19 November 2014 meeting, representatives of the European CFO Forum presented in an educational session the alternative proposal to account for contracts with participating features ("participating contracts").

The alternative accounting model for participating contracts was developed by the European CFO Forum in response to the concerns insurers have on the 2013 ED proposals on the accounting for participating contracts. These proposals in the 2013 ED were known as the 'mirroring' approach. The proposed alternative accounting model builds on the IASB's framework of current fulfilment value measurement for insurance liabilities and it is intended to be in line with the general building block model as proposed by the IASB. Consequently, the European CFO Forum argues that there will be a single measurement basis for all insurance contracts. Refer to 'Proposed alternative model by European CFO Forum: accounting for participating contracts' section for details of the proposals.

Categories of participating contracts

Direct participating contracts

Direct participating contracts are those contracts that meet the criteria set out for eligibility to use variable fee approach (see '19 March 2015 Education Session' section of this newsletter).

Indirect participating contracts

Indirect participating contracts are those in which cash flows vary with the returns on the underlying items, but the contract does not create an obligation for the insurer to pay the policyholder an amount equal to the underlying items less a variable fee for service. These are contracts that are not eligible to be accounted for under the variable fee approach.

Proposed accounting for direct participating contracts

Variable fee approach where there is mutualisation

Mutualisation occurs where the policyholders share in the returns on the same pool of underlying items but where a group of policyholders have residual claims (subject to any minimum guarantees) on those returns to that of other group/s of policyholders, such that the returns they received may be reduced by any guarantees made to other policyholders.

In defining when a mutualisation occurs, there is a need to clarify and distinguish a scenario where an insurer varies the amount it earns from one group of policyholders in order to pay an amount to a group of policyholders suffering losses on its portfolio as against a scenario where a group of policyholders shares the positive returns on the underlying items from its portfolio to another group of policyholders that suffers loss on its portfolio.

In applying the variable fee approach, the level of aggregation for contractual service margin ("CSM") is determined taking into account the mutualisation arrangement and will result in:

- no losses being recognised in profit or loss when a group of policies become onerous, if another group of policyholders bears those losses; and
- losses are only recognised in profit or loss from onerous contracts when the underlying items in the fund as a whole are insufficient to bear those losses.

The Staff believed that introducing an exception such that losses will be recognised at inception for contracts with mutualisation arrangement will add further complexity. However, the Staff will consider whether additional disclosures will be required on the nature of guarantees issued to policyholders in order to increase transparency.

Application of revenue proposals to direct participating contracts under variable fee approach
The Staff presented three sample scenarios illustrating the application of the revenue proposals for non-participating contracts as these apply to direct participating contracts accounted for under variable fee approach. No adaptations were proposed.

Application of transition requirements to direct participating contracts under variable fee approach
The Staff presented two approaches to transition for direct participating contracts accounted for under variable fee approach when applying the simplified retrospective approach.

(1) No additional simplifications required. This would mean that in applying the variable fee approach, insurers will generally apply the fair value (FV) approach for determining the CSM at transition date when the full restatement is impracticable.

(2) ***Provide additional simplifications as follows:*** In determining the cumulative release of the CSM before the transition date, the insurer can assume that:

(a) the CSM at initial recognition is derived by adding the (i) the expected variable fee at transition date, adjusted by the time value of money between the date of initial recognition and the transition date; and (ii) the payments of cash flows related to the variable fee that occurred before the transition date.

(b) the amount of CSM released between the initial recognition and the transition date can be estimated by assuming that the CSM at initial recognition was released on a straight-line basis.

In determining the amount accumulated in other comprehensive income (OCI) when the current book yield approach is applied, the insurer can assume that:

- there are no differences in the accumulated balance of OCI for the insurance contracts and the underlying items because of the timing differences in the initial recognition of the insurance contract with that of the underlying items; and
- the accumulated balance of OCI for the insurance contract is determined as per below depending on how the underlying items are accounted for:

Basis of measurement of underlying items	Accumulated balance of OCI for the insurance contract will be:
FV through profit or loss	Nil
FV through OCI	Amount equal and opposite to the accumulated balance of OCI for the underlying items
Amortised cost	Amount equal to the difference between the amortised cost and FV of the underlying items

Proposed accounting for indirect participating contracts
The Staff presented its analysis on the application of previous IASB tentative decisions on non-participating contracts as they apply to indirect participating contracts.

Changes in cash flows where insurer has discretion over policyholder's share in returns on underlying items.

The table below shows how insurers will account for the change in the fulfilment cash flows ("FCFs") relating to future service resulting from a change in the financial assumptions or a change in the participation percentage.

Is there a change in financial assumptions (i.e. interest)	Is there a change in participation percentage?	Change in FCFs relating to future service will be recognised in:
Yes	No	Profit or loss
No	Yes	Adjustment to CSM

However, if there is a change in financial assumptions but there is no consequent change in the expected cash flows because the insurer exercise its discretion over the policyholder's share in the returns on underlying items such that in exercising this discretion, there is no change in the expected cash flows, the insurer shall account for the net change as follows:

1. recognise in profit or loss the amount of change resulting from the change in financial assumptions; and
2. recognise as an adjustment to CSM the offsetting change that arises because the insurer exercise its discretion over the participation percentage to ensure that the expected cash flows remains unchanged.

Discount rate used in determining the CSM at subsequent measurement

The Staff also presented their analysis on the Board's previous tentative decisions on the discount rate to use in determining the CSM at subsequent measurement as applied to indirect participating contracts. In particular, these are:

- the discount rate to use in determining the change in FCFs relating to future service should be the rates that reflect the characteristics of the cash flows of the insurance contract, determined at the date of initial recognition (tentatively decided during March 2014 meeting); and

- the discount rate to use in accreting interest on the CSM will be the rate determined at initial recognition of the insurance contract (tentatively decided during July 2014 meeting).

Implications of the variable fee approach for measuring indirect participating contracts

The Staff noted that at initial recognition, there is no difference between the general model and the variable fee approach when applied to indirect participating contracts. However, at subsequent measurement, the CSM measured under the two approaches will differ because under the variable fee approach, the CSM reflects the current period's estimate of asset returns, while the general model uses the locked-in rate to adjust the CSM and accrete interest on the CSM. Further, under the general model, the opening balance of the CSM will reflect locked-in discount rates.

Interest expense in the statement of comprehensive income

The Staff presented their analysis on the applicability of the effective yield approach to contracts in which the insurer expects that a substantial proportion of cash flows will vary with changes in the underlying items, with no modifications required, as any modifications will increase complexity in the determination of the effective yield.

Presentation of interest expense for contracts with participating features

Where the effective yield approach is used to determine the interest expense in profit or loss, an insurer can have an accounting policy choice to present interest expense either:

(a) all in profit or loss; or

(b) in profit or loss and OCI using the effective yield approach.

For contracts that would have qualified for current book yield approach to determine interest expense through profit or loss (see '19 March 2015 Education Session' section of this newsletter), the Staff proposed to provide instead an accounting policy choice on determining the interest expense in profit or loss among:

(a) the current period book yield approach;

(b) the effective yield approach; or

(c) current discount rates (i.e. all in profit or loss).

19 March 2015 Education Session

Two approaches were considered to apply where the insurance contracts provide the policyholder with payments that vary with returns of underlying items.

Approach 1: accounting for the insurer's interest in the underlying items as a share of the economic returns from the underlying items

Under this approach, the insurer's profit arises from the difference between the returns from the investments and the payments that the insurer promised to make to the policyholders under the insurance contract out of those returns. The policyholder is viewed as having entitlement only to a portion of the investment returns with the remaining portion of these investment returns being attributable to the insurer. Consequently, the change in the insurance contract liability will not necessarily be in the same quantum as the change in the value of the underlying items. This reflects the change in the economic interest of the insurer on the underlying items during that period. No adjustment is made to the contractual service margin (CSM).

Approach 2: accounting for the insurer's interest in the underlying items as a variable fee for service deducted from the benefits accrued to the policyholders

This approach views insurer as having an obligation to pay the policyholder an amount equal to the value of the underlying items less a variable fee for services. This approach, however, is applicable only when the following criteria are met:

- Where the contract specifies that the policyholder participates in a clearly identified pool of underlying items;

- Where the insurer expects that a substantial portion of cash flows from the contract will vary with changes in the underlying items; and

- Where the insurer expects the policyholder to receive an amount representing a substantial share of the returns from the underlying items.

The term 'substantial proportion' and 'substantial share' will be defined by the insurer based on its judgement.

Under this approach, it is viewed that the policyholder is entitled to all the variable returns from the underlying items, with a variable fee being paid to the insurer out of the proceeds of its investment. Consequently, the expectation is that this approach is only applicable when there is no possibility of an economic mismatch and the insurer holds the underlying items. Any change in the value of the underlying items will result in an equal and opposite change in the value of the insurance contract liability. A change in the components of insurance liability will be required resulting in the reallocation to the CSM of the portion of the fulfilment cash flows that represents the estimated additional service fee that the policyholder will pay for future service to be rendered in the contract.

Proposed accounting for Contractual service margin (CSM) and Other Comprehensive Income (OCI)

Contractual service margin (CSM)

Where it is viewed that the insurer's interest in the underlying items is a share of the economic returns from the underlying items, no major adaptations from the general accounting model for non-participating contracts are required.

On the other hand, where it is viewed that the insurer's interest in the underlying items is that of a variable fee for service, certain adaptations on the CSM at subsequent measurement are proposed. Changes in the estimates of the variable fee for future services will be accounted for in a way consistent with the changes in the estimate relating to future service. Accordingly, such changes in estimates would be adjusted in the CSM so that they would be recognised in future periods, rather than in the period in which they occur.

The rate to be used to accrete interest on the CSM and to calculate the adjustments to the CSM will be the current interest rates. This is different from the requirement for non-participating contracts were the locked-in interest rate is used.

Interest expense[1] in the statement of comprehensive income

Two approaches to presenting interest expense in statement of comprehensive income were proposed:

(a) Effective yield approach, which is similar to that used in IFRS 9, Financial Instruments. If the Board will decide to adopt an effective yield approach for determining interest expense in the statement of comprehensive income, the Staff will consider at a future meeting whether level yield method or projected crediting method should be used. Please refer to 'Tentative decisions from 23 September 2014 meeting' for details of the mechanics of these approaches.

(b) Current period book yield approach, which takes into consideration the proposals of the European CFO Forum during the 14 November 2014 education session, but more restrictive in its application.

The current book yield approach, as proposed in this meeting, would be applicable only when there is no possibility of economic mismatch and where the insurer, at initial recognition intends to hold the underlying items and continues to do so at subsequent measurement, either by choice or because it is required to. The difference between the book yield determined when the underlying items are not on a current measurement basis and the current book yield would be recognised in OCI.

Reassessment of eligibility for accounting approaches

The Staff proposed not to require the insurer to reassess the eligibility of participating contracts for the variable fee accounting approach after initial recognition. This condition depends on the contracts to have a substantial proportion of cash flows to vary with the changes in specified underlying items or the insurer expecting the policyholder to receive a substantial share of returns from underlying items.

The Staff also proposed to introduce an additional requirement for when the insurer holds the underlying items for the purpose of applying the current period book yield approach. In that situation the insurer will be required to discontinue using the current period book yield approach and instead apply the effective yield approach when the insurer no longer holds the underlying items after originally doing so.

Recognition of contractual service margin

Pattern of delivery of investment-related service

For participating contracts in which the insurer provides an investment-related service to the policyholder, the pattern of service provided to the policyholder could be determined through a combination of the passage of time and the amount of assets under management.

Allocation when there is more than one type of service

The Staff considered using the predominant component approach to determine how an entity should measure the pattern of transfer of the combined services over the life of the contract when more than one service is rendered from the same contract. However, due to operational complexities this approach could introduce, the least complex and the least subjective approach would be to require the insurer to recognise CSM on the basis of passage of time.

1. The Staff indicated during the meeting that they will revisit the terminology used as it is not always the case that the change in the underlying items relates to interest expense nor in the nature of interest expense.

Tentative decisions in redeliberating the 2013 ED: Accounting for non-participating contracts

The following summarises the Board's tentative decisions taken in redeliberating the proposals in the 2013 ED. The tentative decisions reached to-date apply only to non-participating contracts. The Staff plans to ask the Board for decisions on participating contracts as a whole at a future meeting. Once the Board has completed its redeliberations on participating contracts, the Board plans to revisit prior decisions against the final accounting model for participating contracts.

Tentative decisions from 22 January 2015 IASB meeting

Initial application of the new insurance contracts Standard after implementation of IFRS 9, *Financial Instruments*

The Board tentatively confirmed the 2013 ED proposals that allow insurers to redesignate their financial assets upon initial application of the new Insurance Contracts Standard under specified circumstances.

The Board also tentatively decided to consider providing additional transition relief to either permit or require an insurer to reassess its business model for financial assets at the date of initial application of the new Insurance Contracts Standard using facts and circumstances that exist at that date. The reassessment will effectively consider for a second time the existence of the conditions set out in paragraphs 4.1.2(a) and 4.1.2(A) of IFRS 9 which respectively lead to the classification of the asset at amortised cost or at fair value through other comprehensive income.

Extracts from the 2013 ED on Redesignation of financial assets

C11 At the beginning of the earliest period pre-sented, when an entity first applies this [draft] Standard, it is permitted, but not required:

(a) to redesignate a financial asset as measured at fair value through profit or loss if that finan-cial asset meets the condition in paragraph 4.1.5 of IFRS 9, as applicable, at the date when the entity first applies this [draft] Standard.

(b) if the entity has previously applied IFRS 9:

(i) to designate an investment in an equity in-strument as at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9; or
As indicated in the Staff Paper, the following topics relating to the proposed additional transition relief as discussed in the preceding paragraph will be considered at a fu-ture meeting:

(ii) to revoke a previous designation of an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9.

C12 An entity is required to revoke previous des-ignations of financial assets as measured at fair value through profit or loss if the initial applica-tion of this [draft] Standard eliminates the ac-counting mismatch that led to that previous designation.

a) the financial assets for which the transition relief would apply;

b) when there is a change in the classification of the financial assets at transition date as a result of applying the transition relief:

   i. whether such a change should be applied prospectively or retrospectively;

   ii. how any resulting gains or losses should be treated; and

   iii. disclosures required if the business model for financial assets is changed upon initial application of the new Insurance Contract Standard.

The Board also tentatively decided not to defer the mandatory effective date of 1 January 2018 for IFRS 9 for entities issuing insurance contracts.

Tentative decisions from 23 October 2014 IASB meeting

Transition for contracts with no participating features

The Board tentatively confirmed the 2013 ED proposals that, at the beginning of the earliest period presented ("transition date"), an insurer should apply the proposed Insurance Contracts standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, unless impracticable.

Simplified approach

The Board has also tentatively confirmed the 2013 ED proposals on using a simplified approach to transition in instances where a retrospective application is deemed impracticable. The insurer will be required to apply all the proposed simplifications as detailed in paragraphs C5 and C6 of the 2013 ED, with a modification on the proposed method of determining the risk adjustment at transition date as discussed below. Refer to 'Summary of the 2013 ED *Approach to Transition*' section for details of the original 2013 ED proposals on transition requirements.

Where an insurer applies the simplified approach to transition, the Board tentatively decided that the insurer should estimate the risk adjustment at the date of initial recognition by adjusting the risk adjustment at the transition date by the expected release of the risk from initial recognition to transition date. The expected release of the risk should be determined by reference to similar insurance contracts that the insurer issues at the transition date.

Fair value approach

The Board tentatively agreed that, if the simplified approach is impracticable, the insurer should apply a "fair value approach". It should be noted that the fair value approach is not an alternative approach to the simplified approach but an approach to be applied only in circumstances where a simplified approach is deemed impracticable.

Under the fair value approach, the insurer shall determine the contractual service margin at the transition date as the difference between the fair value of the insurance contract and the fulfilment cash flows measured at that date.

The discount rate to be used for determining interest expense in profit or loss and the related amount of Other Comprehensive Income accumulated in equity will be determined by estimating the discount rate at the date of initial recognition of the insurance contract using the method in the simplified approach proposed in paragraph C6 (c) and (d) of the 2013 ED.

Disclosure requirements

The Board tentatively agreed that for each period presented for which there are contracts that were measured in accordance with the simplified approach or the fair value approach, an insurer should disclose separately the information proposed in paragraph C8 of the 2013 ED for contracts measured using the simplified approach and for contracts measured using the fair value approach.

Tentative decisions from 23 September 2014 IASB meeting

Book yield and effective yield approaches to present interest expense in profit or loss

During previous Board meetings, the Board directed the Staff to explore two approaches, the book yield approach and the effective yield approach, in determining the interest expenses presented in profit or loss. During this meeting, the Staff presented to the Board the different views in how the book yield and effective yield approaches would be applied and proposed how to define each approach. The Staff also provided illustrative examples using different scenarios to illustrate the consequences of each approach. It is to be noted that neither approaches will impact the measurement of the insurance contract liability on the statement of financial position.

No decisions were required from the Board on these topics.

Book yield approach

The objective of the book yield approach is to reduce accounting mismatches between the presentation of the interest expense in the profit or loss and interest income on the underlying items when there is an economic match between the underlying item and the insurance contract liability.

The four steps in applying a book yield approach are as follows:

(1) *Identifying the underlying items.* The book yield approach is applicable only where the insurer holds the underlying items and for which the policyholders receive a substantial proportion of the returns from these underlying items.

(2) *Determine the book yield for the underlying items.* The book yield is derived from the accounting returns of the underlying items which may be determined on a cost, amortised cost or fair value basis depending on the accounting treatment of the underlying returns.

    The Board considered and discussed their views on the Staff's analysis on the determination of the book yield for common types of underlying items.

(3) *Construct a yield curve.* A five-step approach was presented by the Staff for constructing a yield curve.

(4) *Adjust the yield curve to eliminate any differences arising on initial recognition of the insurance contract.* An example of this adjustment is adjusting the yield curve to reflect the following:

- premiums received from new policyholders is used to settle claims of existing policyholders; and
- new policyholders 'inherit' the underlying items previously held to back the liability of pre-existing policyholders.

The Staff noted that in these cases the book yield will reflect the market interest rates from the purchase date of the underlying items rather than the initial recognition date of the new contracts.

Given the book yield will only operate for presentation purposes, the consequence of applying it as explained above is the recognition of an amount in OCI at initial recognition. The Staff proposed to always adjust the book yield at initial recognition such that there is no OCI amount being recognised in the financial statements on that date.

The Board discussed the Staff's proposed book yield approach that aims to minimise accounting mismatches and is applicable where:

(a) the underlying items are bonds and the insurer reflect in the book yield the expected credit loss on the bonds accounted for at cost or fair value through other comprehensive income ('FVOCI');

(b) the underlying items are investment properties measured at cost where the policyholders only benefit from a share in the rental income; and

(c) when the underlying items, other than bonds and investment properties described in b) above, are accounted for at fair value through profit or loss ('F VT PL').

The Staff's version of the proposed book yield approach will not be permitted when the underlying items include equity instruments measured at fair value through OCI and investment properties measured at cost with the policyholder receiving a share of capital gains. The Staff argued that there would be accounting mismatches in these circumstances if the book yield approach is used.

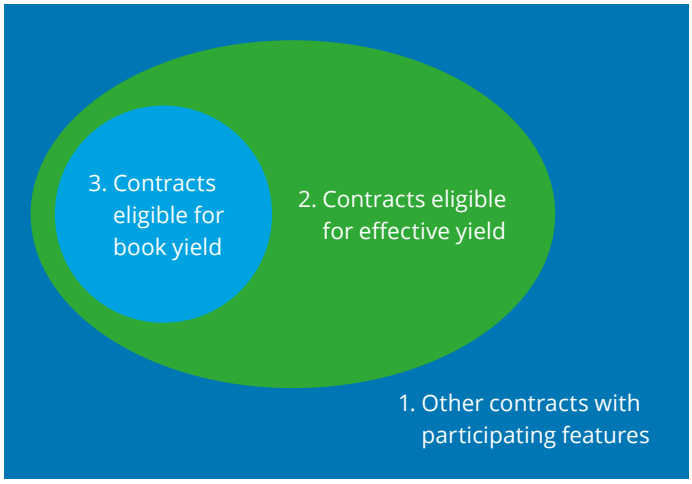
Effective yield approach

The Staff presented for consideration to the Board two variations of the effective yield approach to present interest expense in profit or loss. These are the level yield method and the projected crediting method. The former is akin to that proposed previously by the FASB for its Insurance Contracts project. Under this method, an effective yield is determined on initial recognition as a single rate that exactly discounts estimates of future cash flows to the carrying amount of the insurance contract liability determined on an amortised cost basis at the reporting date and will be reset for changes in amounts expected to be paid to policyholders due to changes in the estimated investment returns.

The Staff recommends to the Board the second variation of the effective yield approach, the projected crediting method, as this method will result in the interest expense being more closely matched to the investment income than under the level yield method, thereby reducing accounting mismatches more effectively.

Under this method, the discount rates to be used should be the rates that an insurer intends to use to determine the policyholder cash flows that reflect amounts credited to policyholders as they share in the returns from underlying items.

Applicability of book yield and effective yield approaches



Use of OCI for contracts with participating features

The Board also discussed whether, similar to what they decided for non-participating contracts, insurers should have an accounting policy choice at a portfolio level for presenting the effects of changes in discount rates either in profit or loss or OCI for participating contracts.

The diagram below illustrates that the book yield approach is applicable to a narrower set of participating contracts than those that will be eligible for effective yield approach. It is to be noted, however, that there would be other participating contracts not eligible for either book yield or effective yield approaches. These are contracts that fail the test of transferring to policyholders "substantially all of the return from the underlying items".

Sector 3: Participating contracts eligible for book yield approach

In its 17 June meeting, the Board tentatively decided to restrict the circumstances in which book yield approach to present interest expense to profit or loss can be applied to participating contracts (refer to *'Tentative decisions from 17 June IASB meeting'* section for further details). In addition, the Staff recommended to the Board to consider permitting the use of the book yield approach only when doing so will reduce accounting mismatches.

Where using book yield approach will result to or increase accounting mismatch between the insurance contract and the underlying items, the insurers will apply the effective yield method.

Should there be a book yield approach for determining interest expense in profit or loss The Board also discussed their views over the Staff's proposal to further restrict the use of book yield approach to presenting interest expense in profit or loss by not permitting insurers to use the book yield approach where the insurer presents the effect of changes in discount rates in OCI for participating contracts.

Sector 2: Participating contracts eligible for effective yield approach
The Staff proposed that the effective yield approach to present interest expense to profit or loss is applicable to participating contracts where the cash flows that vary with the underlying items are a substantial proportion of the total benefits the policyholders will receive over the life of the contracts. However, unlike those participating contracts that are eligible for book yield approach, the insurer does not need to hold the underlying items.

Sector 1: Participating contracts not eligible for either book yield or effective yield approaches
For those contracts which do not meet the criteria for either the book yield approach or the effective yield approach, the insurer will apply the general model as applied to non-participating contracts for presenting interest expense to profit or loss which requires using discount rates locked-in at the inception of the insurance contract (refer to 'Tentative decisions from 18 March IASB meeting, *Use of OCI to present changes in discount rates'* section for further details).

Premium allocation approach: revenue recognition pattern
In its 21 May meeting, the Board tentatively decided to provide additional guidance on the allocation pattern for the contractual service margin ('CSM') using the building blocks approach ('BBA') for non-participating contracts (see section on *'Tentative decisions from 21 May IASB meeting'* section for further details). During this meeting, the Board discussed whether to provide similar guidance for PAA.

Under PAA, the insurance contract revenue for the period is measured as the amount of expected premium receipts allocated for the period.

The Board tentatively decided to clarify that, under PAA, an insurer should recognise insurance contract revenue in profit or loss on the basis of the passage of time and the expected number of contracts in force. There is a presumption that, under PAA (being a simplification of BBA) the release of risk is on a straight-line basis over the period of insurance coverage.

However, the Board also tentatively decided that, where the expected pattern of the release of risk significantly differs from that of passage of time, then the insurance contract revenue will be recognised in profit or loss on the basis of the expected timing of incurred claims and benefits.

This would be the case, for example, for a catastrophe insurance covering against losses arising from hurricanes. The risk of incurring a loss is greater during the hurricane season than outside the hurricane season and the difference in the risk would be captured in the revenue allocation using the expected timing of incurred claims as a proxy.

Determination of interest expense in the premium allocation approach
Under PAA, the liability for incurred claims is measured in the same way as that under BBA which requires insurers to discount the liability using a current discount rate curve.

In its 18 March meeting, the Board tentatively decided for non-participating contracts accounted for using BBA to provide insurers with an accounting policy choice at the portfolio level for presenting the effect of changes in discount rates either in profit or loss or OCI.

During this meeting, the Board tentatively decided that under PAA, when an insurer presents the effect of changes in discount rates in OCI, the discount rate that is used to determine the interest expense for the liability for incurred claims should be the rate locked-in at the date the claim was incurred. This requirement will also apply for the onerous liability recognised in the coverage period under PAA. In the case of an onerous portfolio of contracts, this will be the rate at the date the onerous liability is recognised.

Tentative decisions from 22 July 2014 IASB meeting

OCI mechanics for contracts with participating features
The Board discussed their views on the alternative approach to determining the presentation of interest expense when the issuer of participating contracts determines it would elect as its accounting policy to separate the effect of time value of money between profit or loss and OCI. The Board considered an approach similar to the effective interest rate method used for floating rate debt instruments under IFRS 9. The Board also considered whether to direct the Staff to explore the applicability of such approach to non-participating contracts.

The Board expressed their support for the Staff to explore an approach for determining interest expense (a) wherein the discount rate used for the presentation of interest expense in profit or loss should be reset for all the cash flows in the contract when the cash flows that vary with underlying items are a substantial proportion of the total benefits to the policyholder over the life of the contract; and (b) the approach being similar to the effective interest rate method. However, the Board expressed their views that the applicability of such approach to non-participating contracts be explored after the Board has decided on the approach for the participating contracts.

Rate used to accrete interest and calculate the present value of cash flows that unlock the CSM
The Board tentatively decided that locked-in rate at the inception of the contract should be used in accreting interest on CSM, and for calculating the change in the present value of expected cash flows that unlocks the CSM.

Changes in accounting policy

The Board's tentative decision during the 18 March meeting introduces an accounting policy choice at the portfolio level for presenting the effect of changes in discount rates. The policy would determine whether these changes would be presented entirely in the profit or loss or with a component in the profit or loss and another component in the other comprehensive income. The Board has tentatively decided during the 22 July meeting that insurers should apply IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, to changes in accounting policy relating to the presentation of the effect of changes in discount rates without providing further guidance to complement the IAS 8 requirements when they are applied to this particular accounting policy choice.

Tentative decisions from 17 June 2014 IASB meeting

Determining discount rates when there is lack of observable data

Paragraph B70 (a) of the 2013 ED provides that "...in some cases, the entity determines that yield curve for the insurance contract based on a yield curve that reflects the current market rates of returns either for the actual portfolio of assets that the entity holds or for a reference portfolio of assets as a starting point. The rates of return for the portfolio include market risk premiums for credit risk and liquidity risk. In a 'top-down' approach, an entity:

(i) excludes, from the observable rates of return that apply to a portfolio of assets, its estimates of the factors that are not relevant to the insurance contract. Such factors include market risk premiums for assets included in the portfolio that are being used as a starting point.

(II) adjusts for differences between the timing of the cash flows of the assets in the portfolio and the timing of the cash flows of the insurance contract. This ensures that the duration of the assets is matched to the duration of the liability.

(III) does not include, in accordance with paragraph 21, the risk of the entity's own non-performance.

While there may be remaining differences between the liquidity characteristics of the insurance contract and the liquidity characteristics of the portfolio, an entity applying the top-down approach need not make adjustments to eliminate those differences".

The Board tentatively confirmed the proposals in the 2013 ED for the discount rates used to adjust the cash flows in an insurance contract and provided clarification on how that principle should be applied when there is a lack of observable data.

Accordingly, the Board tentatively decided that in determining the discount rates used to reflect the time value of money in the measurement of insurance contract, an insurer should use judgment to:

(a) ensure that appropriate adjustments are made to observable inputs to accommodate any differences between observed transactions and the insurance contracts being measured; and

(b) develop any unobservable inputs using the best information available in the circumstances, while remaining consistent with the objective of reflecting how market participants assess those inputs. Accordingly, any unobservable inputs should not contradict any available and relevant market data.

Asymmetrical treatment of gains from reinsurance contracts

The 2013 ED requires an insurer to recognise immediately in profit or loss the amount representing the excess of the fulfilment cash flows and any pre-coverage cash flows over zero in a contract that is considered as onerous. However, any corresponding reimbursement from a reinsurance contract will adjust the CSM and will be recognised in profit or loss when the CSM is allocated in future periods. The asymmetrical treatment of the reimbursement from the reinsurance contract against the underlying insurance contract could result in an accounting mismatch.

The Board tentatively decided that an insurer should recognise in profit or loss any changes in estimates of cash flows for reinsurance contract that arise as a result of changes in estimates of cash flows for an underlying direct insurance contract that are recognised immediately in profit or loss. This tentative decision would allow the recognition of the benefit from purchased reinsurance contracts reinsuring onerous portfolios at the same time as the onerous portfolio loss is recognised through profit or loss.

This tentative decision applies to reinsurance contracts held regardless of whether the general accounting model or the premium allocation approach is applied when accounting for these contracts.

Level of aggregation

The Board tentatively agreed to clarify that the objective of the proposed insurance contract standard is to provide principles for the measurement of an individual insurance contract, but in applying the standard, an insurer could aggregate insurance contracts provided that it meets that objective.

The Board tentatively agreed to amend the definition of a portfolio of insurance contracts, as included in Appendix A, ***Defined Terms***, of the 2013 ED. The amended definition for portfolio of insurance contracts will read as follows:

"insurance contracts that provide coverage for similar risks and are managed together as a single pool."

This new version of the definition removes the requirement for a portfolio to include only insurance contracts that are "priced similarly relative to the risk taken on". This deletion clarifies that portfolio are open ended and do not need to be closed when the insurer changes the price of the risk taken on.

Also, the Board tentatively agreed to specify that in determining the CSM or loss at initial recognition, an insurer should not combine onerous contracts with profit-making contracts (e.g. profitable contracts sold in prior years and that are part of the same portfolio). An insurer should consider the facts and circumstances to determine whether a contract is onerous at initial recognition.

The Board also tentatively decided to provide additional guidance on the application of the definition of portfolio of insurance contracts by including examples that explain the principle of combining insurance contracts for the purpose of determining the CSM at subsequent measurement.

Finally, the Board tentatively agreed that, in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* an insurer should select and apply its accounting policies consistently for similar contracts, taking into consideration the portfolio in which the contracts is included and the way the assets backing the liabilities from insurance contracts in each portfolio are accounted for. The reference to the assets backing insurance liabilities becomes required because of the Board's tentative decision to elect the accounting for time value of money of insurance liabilities via the Other Comprehensive Income ("OCI") as an accounting policy choice at individual portfolio level to be formulated under IAS 8 with due consideration to the elimination or significant reduction of accounting mismatches.

Accounting for contracts with participating features

During the education session held in May 2014, the Board discussed two proposed adaptations to the accounting for participating contracts that would result in an accounting treatment that would rely on the identification of underlying items. These adaptations are the accounting through the CSM for insurer's share of the underlying items and the use of a book yield approach to present the time value of money in profit or loss.

Accounting through the CSM for insurer's share of the underlying items

The Board tentatively agreed to consider in a future meeting the introduction in the new IFRS of a requirement for an insurer to adjust the CSM for the insurer's share of the underlying items on the basis that the insurer's share represents an implicit asset management fee. An implicit management fee should be considered to exist only when:

- the returns to be passed to the policyholder arise from the underlying items the insurer holds, regardless of whether the insurer is required to hold those items;
- there is a minimum amount that the insurer must retain; and
- the policyholder will receive a substantial share of the total return on underlying items.

Book yield approach to present time value of money in profit or loss

The Board discussed the mechanics of the book yield approach as it relates to the determination of discount rates to be used in recognising the time value of money (e.g. the effect of unwinding the discount) with a portion being presented in profit or loss and a second portion in OCI.

Under this approach, the book yield curve is determined at each reporting period end date based on the following:

(a) the underlying items held as at the reporting date and their accounting treatment for the current and future years until the period these items are expected to be sold or derecognised; and

(b) for the periods after these items are sold or derecognised, the future reinvestment assumptions based on the market information as at the reporting period end date.

When it is appropriate to apply the book yield approach

The Board tentatively agreed to consider in a future meeting to require an insurer to apply the book yield approach for determining the interest expense presented in profit or loss. The book yield approach should be applied only when the following criteria are met:

(a) the returns to be passed to the policyholder arise from the underlying items that the insurer holds, regardless of whether the insurer is required to hold those items or whether the entity has discretion over the payments to policyholder; and

(b) the policyholder will receive a substantial share of the total return from the underlying items.

Tentative decisions from 21 May 2014 IASB meeting

Allocation pattern for the contractual service margin

Paragraph 32 of the 2013 ED provides that "an entity shall recognise the remaining contractual service margin in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the insurance contract."

The Board tentatively confirmed its proposals in the 2013 ED that the remaining CSM should be recognised in the profit or loss in a systematic way that reflects the provision of the service of insurance.

The Board tentatively agreed to provide additional guidance on the appropriate allocation pattern for the CSM of non-participating contracts. The Board tentatively decided that, for non-participating contracts, the service represented by the CSM is insurance coverage which is provided on the basis of the passage of time and reflects the expected number of contracts in force.

Fixed-fee service contracts

Fixed-fee service contracts with a primary purpose of providing services and that meet all conditions set out in paragraph 7 (e) of the 2013 ED are scoped out from the requirements of the proposed insurance standard and will be accounted for under IFRS 15 Revenue from Contracts with Customers.

Paragraph 7 (e) of the 2013 ED provides the following conditions:

"(i) the entity does not reflect an assessment of the risk that is associated with an individual customer in setting the price of the contract with that customer;

(II) the contract compensates customers by providing a service, rather than by making cash payments; and

(iii) the insurance risk that is transferred by the contract arises primarily from the customer's use of services."

The Board tentatively decided to permit, but not require, entities to apply IFRS 15 to fixed fee service contracts that meet all the criteria stated in paragraph 7 (e) of the 2013 ED.

Significant insurance risk

Paragraph B19 of the 2013 ED provides that: "a contract does not transfer insurance risk if there is no scenario that has no commercial substance in which the present value of the net cash outflows that is paid by the issuer can exceed the present value of the premiums."

The Board tentatively decided to provide clarification on the guidance provided in paragraph B19 of the 2013 ED that significant insurance risk occurs only when there is a possibility that an insurer incurs a loss on a present value basis.

Contracts acquired through a portfolio transfer or a business combination

Paragraphs 43-45 of the 2013 ED provides for the accounting of insurance contracts acquired through a portfolio transfer or a business combination.

Other requirements in the 2013 ED are also applicable to insurance contracts acquired through a portfolio transfer or a business combination as provided in paragraph 46 of the 2013 ED.

The Board tentatively decided to amend the requirement of paragraphs 43-45 of the 2013 ED and to provide clarification that contracts acquired through a portfolio transfer or a business combination should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or the business combination.

Tentative decisions from 25 April 2014 IASB meeting

Insurance contract revenue is calculated as the sum of the change in the risk adjustment for cash flows associated with future coverage, the release of the CSM and the amount for expected claims and benefits for the period. It reflects the insurer's progress in satisfying the obligation to provide insurance coverage and other services and is recognised over the coverage period.

Investment components that are not considered as distinct and therefore not unbundled from the insurance contract are disaggregated and excluded from the amounts of insurance revenue and expenses.

Actual claims, benefits and expenses incurred in the period and after disaggregation of non-distinct deposit components are presented in the insurance expenses line.

Presenting insurance contract revenue and expenses
The Board tentatively decided to prohibit an entity from presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue.

The Board also tentatively decided to require entities to present insurance contract revenue in the statement of comprehensive income as proposed in the 2013 ED.

The Board tentatively confirmed its proposals relating to disclosures required relating to volume information. These are:

- a reconciliation that separately reconciles the opening and closing balance of the components of the insurance contract asset or liability;
- a reconciliation from premiums received in the period to the insurance contract revenue in the period;
- the inputs used when determining the insurance contract revenue that is recognised in the period; and
- the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position.

Project plan for non-targeted issues
The Board tentatively decided to consider the following non-targeted issues raised in the comment letters in future meetings:

- fixed fee service contracts;
- significant insurance risk guidance;
- portfolio definition and unit of account;
- discount rate for long term contracts and unobservable market data;
- asymmetrical treatment of reinsurance contracts;
- recognition of contracts acquired through portfolio transfer or business combination; and
- allocation pattern for the contractual service margin.

The Board tentatively decided not to consider other non-targeted issues raised in the comment letters, apart from those listed above.

Tentative decisions from 18 March 2014 IASB meeting

Unlocking the CSM
The Board tentatively confirmed its proposal in the 2013 ED that after inception, the CSM should be adjusted for the differences between the current and previous estimates of the present value of cash flows relating to future coverage and/or future services, subject to the condition that the CSM should not be negative.

The Board also tentatively confirmed its proposal in the 2013 ED that differences between the current and previous estimates of the present value of cash flows that do not relate to future coverage and other future services (e.g. development of incurred claims) should be recognised immediately in profit or loss.

Treatment of previously recognised losses
The Board tentatively decided that favourable changes in the estimates of the present value of future cash flows that arise after losses were previously recognised in profit or loss because a portfolio of insurance contracts had been deemed onerous (i.e. the probability weighted present value of cash outflows plus risk adjustment exceed that of cash inflows) should be recognised in profit or loss to the extent that they reverse losses related to coverage and other services in the future. Any excess of favourable changes in cash flow estimates over losses previously recognised in profit or loss would rebuild the CSM component of the insurance portfolio liability.

Unlocking of CSM for changes in the risk adjustment
The Board tentatively decided that differences in the current and previous estimates of the risk adjustment that relate to coverage and other services for future periods should adjust the CSM subject to the condition that the CSM should not be negative. Consequently, changes in the risk adjustment that relate to the coverage and other services provided in the current and past periods should be recognised in profit or loss.

Use of OCI to present the effect of changes in discount rates
The Board tentatively decided to provide an option for insurers to present the effect of changes in discount rates in profit or loss or in OCI as an accounting policy choice at the portfolio level.

The IASB Staff has been requested to develop guidance to ensure that insurers apply consistently the same accounting policy to groups of similar portfolios and also to develop guidance on when insurers could make subsequent changes to the accounting policies based on IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The Board tentatively decided that if the insurer chooses to present the effect of changes in discount rates in OCI, the insurer should recognise:

- in profit or loss, the interest expense determined using the discount rates applied at the initial recognition of the contract ("locked-in discount rates"); and

- in other comprehensive income, the difference between the carrying amount of the insurance contract measured using the discount rates applied at the reporting date and the carrying amount of the insurance contract measured using the locked-in discount rates.

These decisions were tentatively reached for insurance contracts other than those where "the amount, timing or uncertainty of the cash flows that arise from an insurance contract depends wholly or partly on the returns on underlying items". These contracts are often referred to as participating contracts.

The Board will revisit this decision when the redeliberations on participating contracts are completed in its future meetings.

Disclosures – OCI Solution

The Board tentatively decided that additional disclosures are considered necessary for users to understand how interest expense and changes in discount rates are recognised.

The additional disclosures will require insurers to disclose an analysis of total interest expenses included in total comprehensive income disaggregated into:

- the amount of interest accretion determined with current discount rates;

- the effect on insurance liabilities of discount rate changes in the period; and

- the difference between the present value of changes in expected cash flows that adjust the CSM in the reporting period, measured using locked-in discount rates and current discount rates.

The Board also tentatively decided to require insurers to make additional disclosures for portfolios of insurance contracts for which the effect of changes in discount rates are presented in OCI. An analysis of the total interest expenses included in total comprehensive income disaggregated at a minimum into:

- interest accretion at the locked-in discount rate reported in profit or loss for the period; and

- the movement in OCI for the period.

Proposed alternative model by European CFO Forum: accounting for participating contracts

Key principles of the alternative model

The alternative accounting model for participating contracts was developed using certain principles as enumerated below.

1. The accounting model is applicable to all types of participating contracts

The alternative accounting model will have a broader scope than that for the 'mirroring' approach as this model is designed to be applicable to all participating contracts, not just a subset of these contracts. In comparison, the 'mirroring' approach proposed in the 2013 ED is applicable only to participating contracts where an insurer is required to hold (by virtue of a contractual or statutory obligation) the underlying items that will affect the level of benefits due to the policyholder and this linkage to the returns of the underlying items is part of the contractual terms.

2. Single measurement basis for all insurance contracts

The alternative accounting model will follow the general building block approach for non-participating contracts, consequently removing the requirement to separate cash flows as required under the 'mirroring' approach. Also, options and guarantees will be treated in a similar way to other elements of the contract (e.g. insofar as the unlocking of the CSM is concerned, as explained in the third principle).

3. Contractual service margin is fully unlocked

For participating contracts, the contractual service margin ("CSM") will be unlocked for changes in financial and non-financial assumptions, thereby incorporating the effect of the change in the estimate of the projected future allocation to policyholders of their share of the returns from the underlying items and from those that will be in place following expected reinvestment options.

Allowing the full unlocking of the CSM for participating contracts will result in consistency in the measurement of the CSM both at initial recognition and at subsequent measurement.

The CSM cannot turn negative. Any changes in the financial and non-financial assumptions in excess of the CSM will be recognised immediately to profit or loss.

4. Profit recognition in accordance with the fulfilment of the contract as services are provided

Consistent with the 2013 ED proposals, the CSM will be recognised in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of services that are provided under the insurance contract. For participating contracts, services provided by insurers to the policyholders include the provision of insurance coverage, administration of the contract and the provision of the service for the management of the underlying items.

A principle-based approach will be followed in determining the release pattern for the CSM under the alternative model. Insurers will need to determine at the inception of the contract the drivers for the release of CSM that best reflect the pattern of the services provided. Different drivers may be used for different types of participating contracts. However, regardless of which driver is used as a basis, the CSM is required to be fully released to profit or loss at the end of the life of the insurance contract.

5. The discount rate used to present interest expense in the profit or loss is determined consistently with the investment return recorded in the profit or loss for the assets which back the insurance contract liabilities

Steps in calculating the current portfolio book yield:

- Identify the underlying assets which back the portfolio;
- Determine the basis of the accounting return or book yield for those underlying items;
- Construct a yield curve based on the book yield at each reporting date covering the duration of the projected cash flows of the participating contracts; and
- Adjust the yield curve to incorporate assumed reinvestments to cover any duration mismatch between the insurance liabilities and the asset backing those liabilities.

6. Both the FVOCI and FVTPL applications are available as an accounting policy choice

This is consistent with the accounting policy choice provided for non-participating contracts in presenting the effect of changes in discount rates which the IASB tentatively decided during the 18 March 2014 meeting.

Summary of the 2013 ED

Definition and scope

An insurance contract is defined as 'a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder'.

The entity will apply the standard to its issued insurance contracts, the reinsurance contracts that it holds and the investment contracts with discretionary participating features that it issues provided the entity also issues insurance contracts.

The following contracts have been scoped out of the 2013 ED:

- product warranties issued directly by a manufacturer, dealer or retailer;
- employers' assets and liabilities under employee benefit plans, and retirement benefit obligations reported by defined benefit retirement plans;
- contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item;
- residual value guarantees embedded in a lease
- provided by lessee or lessor, or provided by
- a manufacturer, dealer or retailer;
- fixed-fee service contracts meeting specified conditions;
- financial guarantee contracts that are not explicitly regarded as insurance contracts by the insurer;
- contingent consideration payable or receivable in a business combination; and
- insurance contracts in which the entity is a policyholder, unless those are reinsurance contracts.

Unbundling

For recognition and measurement, a component of an insurance contract should be unbundled if it functions independently from other components of that contract. A component functions independently if it is not significantly interdependent with other components of the insurance contract. An insurer shall unbundle the following components of a contract that are not closely related to the insurance coverage specified in that contract:

- investment component – if a contract with equivalent terms is sold, or could be sold, separately in the same market or jurisdiction, either by insurers or other entities;
- embedded derivatives that are separated under existing bifurcation guidance; and
- performance obligations to provide goods or services where the insurer or another entity regularly sells the good or service separately in the same market or jurisdiction or where the policyholder can benefit from the goods or services either on its own or together with other resources that are readily available to the policyholder.

Recognition

The insurer would recognise an insurance contract on the earlier of the following:

(a) the beginning of the coverage period;

(b) the date on which the first payment from the policyholder becomes due; and

(c) the date on which the portfolio of insurance contracts to which the contract will belong is onerous.

Measurement

The insurer would measure an insurance contract under the building block approach ("BBA") where the insurance liability is reported with explicit components all based on current estimates. The building blocks that comprise the BBA include:

- the unbiased, probability-weighted estimate of cash flows which is discounted for the time value of money;
- a risk adjustment that measures the effects of uncertainty about the amount and timing of future cash flows; and
- a CSM which represents the unearned profit in a contract and is released through income as the insurer fulfils its performance obligations under the contract.

For pre-claims liabilities of insurance contracts with coverage shorter than 12 months or that pass certain tests on limited cash flow variability if coverage is in excess of 12 months, the insurer is permitted to use the premium allocation approach ("PAA") as a proxy to the BBA, provided that using PAA will result in a reasonable approximation to the BBA.

Estimation of cash flows
The measurement of a portfolio of insurance contracts should include current, unbiased probability weighted present value of all cash flows that relate directly to the fulfilment of the portfolio of contracts. The estimates of the cash flows should be explicit from the discount and risk adjustments. This amount is based on the insurer's own estimates of cash flows and probabilities, provided that the estimates of any relevant market variables do not contradict the observable market prices (e.g. the market prices of assets used to determine cash flows of asset-linked insurance benefits). Additionally, the estimates must reflect all available information and relate to all the cash flows within the contract boundary of each contract in the portfolio.

An insurer should include, among the costs necessary to fulfil the contract, all costs directly associated with it (direct costs) and a systematic allocation of cost that relate to the contract or contract activities (indirect costs).

Discount rate
The discount rate should reflect the characteristics of the cash flows of the insurance contract liability, e.g. timing, currency and liquidity and should exclude factors that are not relevant to the insurance contract liability, e.g. insurer's own credit risk.

Approaches to calculating the discount rate
Two approaches in calculating the discount rate were provided in the application guidance to the 2013 ED. These are:

(a) Top-down approach – An appropriate yield curve is determined based on current market information and can reflect the actual assets that the insurer holds or be based on a reference asset portfolio adjusted for any effects or factors influencing the observable market prices but not relevant to the cash flows of the insurance contract. These for example include: (i) duration mismatches between the cash flows in the reference asset portfolio and those of the liability, (ii) market risk premiums, and (iii) credit risk.

(b) Bottom-up approach – The discount rate is determined as the risk-free yield curve adjusted for the liquidity characteristics of the insurance contract.

Contractual service margin
At initial recognition, the CSM is calculated as an amount equal and opposite to the sum of the amount of fulfilment cash flows and any pre-coverage cash flows.

Subsequently, the CSM is recognised through profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of services that are provided under the contract and it is adjusted for the differences between the current and previous estimates of the present value of cash flows relating to future coverage and/or future services, subject to the condition that the CSM should not be negative.

Acquisition costs
Directly attributable acquisition costs form part of the insurance contract cash outflows, with the attribution done at the portfolio level, rather than at individual contract level.

Measuring and presenting cash flows from contracts with a contractual link to underlying items
For contracts with a contractual link to underlying items, e.g. participating contracts, the insurer is required to decompose the cash flows within the contract and apply the accounting treatment specified in the 2013 ED depending on the cash flow behaviour.

Where the contractual cash flows vary directly with the underlying items, these cash flows will be measured and presented with reference to the asset's carrying amount.

Where the contractual cash flows vary indirectly with the underlying items, the cash flows are measured under the general BBA, discounted at a current discount rate. Any interest-related changes are always recognised in the profit or loss. Changes of future cash flows associated with this component of contractual cash flows will not unlock the CSM and will also be always recognised in the profit or loss.

Where the contractual cash flows do not vary with the underlying items, the cash flows are measured under the general BBA including the unlocking of the CSM.

Asset dependent cash flows in non-participating contracts
For insurance contracts where the cash flows are expected to vary directly with returns on the underlying items but for which the insurer is not contractually required to hold the underlying item, the insurer is not required to decompose the contractual cash flows. Instead, the insurer is required to account for the entire contract under the BBA. The discount rate used should reflect the dependence of the cash flows on the returns of the underlying items. An insurer is required to reset the discount rate if based on its revised expectations it expects that changes in the returns of the underlying items would affect the amount of the cash flows from the contract. Any difference between the reset rates and the current discount rates used to measure the liability in the statement of financial position would be accounted for through OCI.

Reinsurance contracts held
The point of recognition for reinsurance contracts held is from the beginning of the coverage period, if the reinsurance contract provides coverage for the aggregate losses of a portfolio of underlying contracts; and when the underlying contracts are recognised in all other cases.

Reinsurance contracts held are measured using the BBA. Similar to insurance contracts, the PAA may be applied only during the coverage period where it is a reasonable approximation of the BBA.

In determining the fulfilment cash flows for reinsurance contracts, the assumptions used are consistent with those used for underlying insurance contracts and will need to reflect the risk of non-performance by the issuer.

The risk adjustment reflects the risk being transferred by the holder of the reinsurance contract (the cedant) thus requiring it to be measured with reference to the reinsured insurance contracts' risk adjustment.

The CSM is calibrated against the reinsurance premiums due to the reinsurer, resulting in no day 1 gain for the cedant at initial recognition of the reinsurance contract. This CSM reduces the reinsurance asset and it is recognised as income based on the cedant's receipt of the reinsurance coverage purchased.

In addition, only for prospective reinsurance (i.e. reinsurance purchased for unexpired insurance contracts coverage) the cedant will not recognise a day 1 loss if the reinsurance premiums due are higher than the expected recoveries. It would instead amortise this CSM component of the reinsurance asset over the reinsurance coverage period. In all other cases the difference will be recognised as a day 1 loss on purchase of a reinsurance contract.

Modification and derecognition
The following modifications in an insurance contract are considered substantial and will result in the derecognition of the existing contract and the recognition of a new contract based on the modified terms, either under the future IFRS on insurance contracts or other applicable standards:

(a) if the modified contract would be out of scope of the IFRS for insurance contracts;

(b) if the modified contract would have been included in a different portfolio if written at inception; and

(c) if the modified contract is no longer eligible for applying the PAA.

For modifications that will result in additional benefits, a new contract will be recognised for the additional benefits only, with the CSM being determined by reference to the additional premium received.

If the modification will result in the reduction of benefits, that portion of the contract related to the reduction of benefits is derecognised.

Any changes in the cash flows that do not affect the level of benefits will be accounted for as a change in cash flow estimates.

Presentation
Statement of financial position
The insurer is required to present separately portfolios of insurance contracts that are in an asset position from portfolios of insurance contracts that are in a liability position. Similarly, the insurer is required to present reinsurance contract assets separately from reinsurance contract liabilities.

Statement of comprehensive income
The components of comprehensive income are specified in the 2013 ED.

The insurer is not allowed to offset (a) income or expense from reinsurance contracts against the expense or income from insurance contract; and (b) present income and expense from underlying items against income and expense from the insurance contract.

Disclosures
Key disclosures required include explanation of amounts recognised in the financial statements, significant judgement used and the nature and extent of risks arising from insurance contracts.

Disclosures relating to amounts recognised include the expected present value of future cash flows, changes in risk during the period, changes in CSM and the effects of new contracts written in the period.

Insurers are required to disclose information about significant judgements used. In particular the entity would be required to disclose the processes used for estimating inputs and the methods used, the effect of changes in the methods and inputs used and an explanation of the reason for the changes, identifying types of contracts affected.

Disclosures about risk include the nature and extent of risks arising from insurance contracts, the extent of mitigation of risks arising from reinsurance and participation features and the quantitative information about exposure to credit, market and liquidity risk.

Approach to transition
Insurers are required to apply the standard retrospectively and to maximise the use of objective data.

The 2013 ED provides practical expedients to insurers where retrospective application is deemed impracticable. These are:

Expected cash flows at initial recognition
In determining expected cash flows at initial recognition, the insurer assumes that all subsequent changes in cash flows were known in advance at the date of initial recognition and restate prior periods with the benefit of hindsight.

Discount rate at inception
Determining the locked-in discount rates retrospectively depends on whether there is a an observable yield curve that approximates the yield curve that would have been applied in accordance with the standard for at least three years before the date of transition. If there is such rate insurers would be required to use that observable yield curve. Where there is no market-observable yield curve, the discount rates can be determined using the closest market-observable yield curve. The same market-observable reference point must be used to determine the locked-in discount yield curve for each of the years in the retrospective period.
The yield curve determined above is used for recognising interest expense on the accretion of the discount rates. The cumulative effect of the difference between those yield curves and the discount rate yield curve determined at the transition date is recognised in the accumulated OCI for all those portfolios for which the insurer has elected the use of the OCI solution.

Risk adjustment
The insurer can assume that the risk adjustment determined at initial recognition is the same as the risk adjustment determined on the date of transition.

Contractual service margin
For contracts with remaining coverage at transition date, insurers would need to determine the portion of CSM that relate to future coverage and/or service, with the difference recognised in retained earnings.

Thinking ahead

- Insurers should prepare for an implementation work that is likely to be long and complex. The decision of the IASB to give up to the year beginning on or after 1 January 2021 to make the new IFRS mandatory is one of the indicators of the expected demands the adoption of this new IFRS will have on the insurance industry

- Insurers should evaluate whether their current actuarial and accounting systems are flexible enough to be enhanced to address the new data and measurement requirements of the insurance contract standard.

- Another aspect that insurers should consider is whether they have enough staff resources to manage both the transition process and maintain 'business as usual' operations.

- Various stakeholders, such as policyholders, analysts, investors, regulators and provider of credit would need to be educated on the implications of the new standard.

- In parallel with the adoption of the new IFRS for insurance contracts insurers would need to ensure they have clear implementation plans on the adoption of the other major IFRS that have been released since 2014 and that are not yet effective: IFRS 15 *Revenue from Contracts with Customers* (effective from periods beginning on or after 1 January 2018), IFRS 16 *Leases* (effective from periods beginning on or after 1 January 2019) and, particularly, IFRS 9 *Financial Instruments* which could be effective from periods beginning on or after 1 January 2018 unless an insurer has to option to defer its application to no later than periods beginning on or after 1 January 2021 if it qualifies as having predominantly insurance activities.

Next steps

The Board is not expected to hold additional meetings on its insurance contracts project and the publication of the new Standard (which will be published as IFRS 17 *Insurance Contracts*) is expected in the first half of 2017 (March 2017 according to the latest IASB Technical Plan). If that goal is achieved the Board has unanimously agreed to make IFRS 17 effective from periods beginning on or after 1 January 2021.

The creation of a Transition Resource Group dedicated to facilitate the discussion of the new requirements of IFRS 17 and aid its smooth implementation has been discussed with several stakeholders. However, no decision on its formation has been reached at this stage

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