Project	**Insurance Contracts**
Topic	**Locked-in discount rate**

Objective

1. Some insurers have indicated they would like to measure assets held to back insurance liabilities at amortised cost, when this is permitted by IFRS 9 *Financial Instruments*. To avoid accounting mismatches, they suggest permitting or requiring insurers to use a locked in discount rate for insurance liabilities.

2. We seek the IWG's feedback on whether the discount rate should be locked in at inception.

Amortised cost

3. Under IFRS 9 *Financial Instruments* insurers would measure assets at amortised cost if those assets have contractual cash flow characteristics representing principal and interest and are held principally to collect those cash flows. Other financial assets (including hybrids) are measured at fair value. In deliberating IFRS 9, the board decided that amortised cost provides useful information when the cash flows are predictable and those instruments are managed on the basis of their contractual cash flows. For financial assets with unpredictable cash flows, fair value provides more useful information.

A locked-in discount rate for insurance contracts?

4. To avoid an accounting mismatch, some suggest that the discount rates for insurance liabilities should be locked in at inception, and not adjusted subsequently, if the assets backing those liabilities are measured at amortised cost.

5. Under that proposal, all other inputs – for example those used to determine the frequency and severity of insured events – would be updated so that they are current at each reporting date.

Concerns about a locked-in discount rate

6. Some issues would arise if the discount rates for insurance liabilities are locked in:

    (a) A locked in discount rate would not reveal the effect of differences between the duration of liabilities and the duration of assets. Such duration mismatches might be either avoidable (eg because of a deliberate strategy by management) or unavoidable (eg because no assets available in the market have a long enough duration to match the duration of the liabilities).

    (b) Minimum interest rate guarantees would not be reported at a current value, unless the guarantees require separation ('bifurcation') at fair value under the requirements for embedded derivatives. Currently IAS 39/IFRS 9 requires separation of an embedded minimum guarantee on the interest rate of an insurance contract only when that is above the market rate of interest or is leveraged in relation to the insurance contract. Bifurcation requirements apply on inception only (ie reassessment during the life of the contract is prohibited).

    (c) Some might feel that a locked-in discount rate should, nevertheless be unlocked in particular circumstances, for example if there is a significant and persistent decline in either interest rates or in the expected return on assets backing the insurance liabilities.

    (d) A locked-in discount rate may be difficult to apply if some other inputs are sensitive to interest rates, for example if lapses are interest-sensitive.

    (e) A locked-in discount rate might create a need to distinguish new contracts (with a new discount rate) from amendments to an existing contract (which would continue to use the same discount rate) in the same portfolio. For example, sometimes existing insurance contracts are replaced by new insurance contracts, or riders are added to existing contracts.

    (f) Not all assets are eligible for amortised cost under IFRS 9 (discussed in paragraph 3).

Question
Q1. Should the boards explore the possibility of locking in the discount rate for insurance liabilities backed by assets measured at amortised cost? Why or why not? Q2. If you answered yes to question 1: (a) how would address the issues noted in paragraph 6? (b) have you identified any other issues that the boards should consider in such a model?