IASB/FASB Meeting week of 19 September 2011

IASB Agenda reference **3D**

Staff Paper

FASB Agenda reference **73D**

Contact(s)	Holger Obst	hobst@ifrs.org	+44 (0) 20 7246 6947
	Matthias Zeitler	mzeitler@ifrs.org	
	Christopher Irwin	cgirwin@fasb.org	

Project **Insurance contracts**

Topic **Disclosures**

1. This paper seeks the boards' views on improvements to the proposed disclosure requirements in the exposure draft *Insurance Contracts* (the ED).

2. The paper also reflects observations and recommendations related to the cross-cutting disclosure discussion from the joint meeting in the week of 21 March 2011. At that meeting, the boards considered the disclosure objectives for the insurance contracts standard, and reached tentative agreement to align the wording with the Revenue and Leases standards. Consequently, this paper does not discuss those disclosure objectives.

3. In the light of the comment letters received and also taking into account the results of the staff outreach, the staff considered only controversial issues identified for redeliberation. However, at a future meeting the staff will ask the boards:

   (a) whether they agree with the overall disclosure package for insurance contracts.

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

(b) additional disclosures, and disclosure linked to presentation matters, including the reconciliation of contract assets and contract liabilities.

(c) to consider disclosure requirements that might be eliminated or revised if ASC 944 is replaced with the disclosure requirements within the proposed insurance contract standard (FASB only)

Summary of the staff recommendation

4. The staff recommend retaining the proposed disclosures in paragraphs 90-97 of the ED, with changes as follows:

   (a) not to retain the minimum disaggregation level for disclosures in paragraph 83-84 of the ED. The aggregation level of disclosures should be principle-based and may vary for different type of qualitative and quantitative disclosures.

   (b) to retain the requirement to disclose information about methods and inputs used and add further guidance regarding disclosure of discount rate and yield curves. In agenda paper 3B / 73B, the staff also recommend that the boards should delete the ED's proposed requirement that an insurer should disclose the confidence level disclosure corresponding to the amount of the risk adjustment if the insurer uses a technique other than the confidence level to determine the risk adjustment.

   (c) to retain the disclosure of effects of changes in inputs used to measure insurance contracts, but with more emphasis on quantitative information. Furthermore, to clarify that the disclosure would also apply to changes in methods and require an explanation of the reason for the change in methods, including the type of contracts affected.

   (d) to delete the proposed requirement to disclose a measurement uncertainty analysis and to align (in due course) that disclosure

with that for fair value measurements in IFRS 13 *Fair Value Measurement*, as appropriate.

(e) to require the maturity analysis based on expected maturities and remove the option to base maturity analysis on remaining contractual maturities. Furthermore, in context of time bands to require the insurer to disclose, at a minimum, the expected maturities on an annual basis for the first five years and in aggregate for maturities beyond five years.

Structure of the paper

5. The paper is structured as follows:

   (a) Aggregation level of disclosures (paragraphs 17-19)

   (b) Disclosures of methods and inputs and changes from previous periods (paragraphs 21-24)

   (c) Measurement uncertainty disclosures (paragraphs 31-35)

   (d) Disclosures of the nature and extent of risk arising from insurance contracts (paragraphs 36-48).

6. Appendix A of this cover note lists the disclosure proposals in the ED. Appendix B lists the disclosures of IFRS 13. Appendix C provides background relevant to the proposed disclosure about discount rate, discussed in paragraphs 26-30.

Setting the scene

7. Although respondents generally agreed with the disclosure objectives proposed in the ED, many of them stated that the disclosures specified in the ED are excessive and will probably obscure the information that financial statement users will find necessary and useful. Specifically, many respondents stated that the required aggregation level of disclosures in paragraph 83 in the ED

would be a source of voluminous disclosures whose costs might outweigh the benefits received.

Additional disclosures

8. Users generally supported the proposed disclosure package. They argued that the disclosure requirements mainly reflect disclosures that are already required under the current IFRS 4 *Insurance Contracts*. Some of the user feedback stated that the disclosures need to be more specific to reflect the new presentation requirements and the margin approach.

9. In that respect, many respondents argued that additional disclosures may be needed, depending on the outcome of the boards' redeliberation of presentation requirements, especially if the boards consider recognition of some income and expense in other comprehensive income (OCI). Furthermore, much feedback indicated that more volume information (by a few respondents also referred as activity-based disclosures) should be added if the presentation requirements in the ED remain unchanged. For example:

> […] we support the proposed summarised margin approach. However, volume information on the level of business of the insurer is typically included in the Income statement under current presentation models for both life and non-life insurers. We understand that users find volume information useful and the Board should consider requiring disclosure of appropriate volume information that depicts the level of activity of the insurer. Specifying the disclosure of volume measures such as, for example, annualised premium equivalent or gross written premium will reduce the need for disclosure of additional information by companies on an inconsistent basis. [IASB CL #94]

10. Along with a wish for presentation-related disclosures, users indicated in comment letters and outreach meetings that information on free cash flow/free capital generation would be useful. In particular, a few users indicated that

some insurers already provide such information voluntarily and that the boards should consider mandating such information.

> There is increasing focus amongst analysts and investors on free capital generation defined as the emergence of free surplus, after reflecting changes in required capital (based on the higher of economic and regulatory capital to iron out fungibility issues). While existing accounting standards require rudimentary disclosures around capital to be provided, this information is not sufficient to be able to understand the link between current operating performance and how free capital is generated. As such, we would like to see mandatory comprehensive disclosures built into accounting for insurers, with a clear reconciliation from IFRS operating earnings to free capital generation, on a segmental basis consistent with that described below. [IASB CL #175]

11. The issue regarding information of free cash flow/free capital generation also frequently raised during insurance working group meetings and in outreach in context of presentation and disclosure issues. Those performance measures would also need to reflect capital distribution restrictions arising from regulatory environment that typically exist for the insurance industry.

Staff analysis

12. On the basis of the mixed feedback, the staff think that beside clarification on specific disclosure requirements, the boards need to reflect the concerns of respondents that very detailed disclosure requirements might undermine the disclosure objectives. There may also be a need for some additional disclosures, but they would depend on the outcome of the boards' redeliberation on presentation requirements and so we will ask the boards to discuss at that time whether there is a need for such additional disclosures.

13. The boards need to consider in their discussion the existing disclosure requirements in IFRSs, such as IFRS 7 *Financial Instruments: Disclosures*, IFRS 13 *Fair Value Measurement*, IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and for US GAAP, such as, ASC Topic 820 *Fair Value Measurement*, ASC Topic 250 *Accounting Changes and Error Corrections*, and ASC Topic 275 *Risks and Uncertainties*.

14. Furthermore, the staff think that the boards should not develop additional disclosure requirements and performance measures, such as disclosure of free capital generation(see paragraph 10 in this paper), solely as part of the insurance contracts project and in isolation from other relevant standards and projects. Those disclosures may be better addressed by improving existing disclosure of regulatory capital and capital management, for example disclosure in IAS 1, paragraphs 134-136 regarding the entity's capital resources and management.

15. Much of current US GAAP disclosure is product specific and included in standards that are expected to be superseded by the new standard, which will deal with all insurance contracts. The disclosure requirements included within these existing standards (e.g., most of ASC 944 and Article 7 of Reg S-X for SEC registrants) are directed at insurance *entities* rather than insurance *contracts*.

16. Appendix D lists examples of insurance company disclosure requirements that might be eliminated or revised if ASC 944 is replaced with the disclosure requirements within the proposed insurance contract standard. The FASB should consider at a future meeting whether any of these existing disclosures are covered by the proposed insurance contract standard's principles, need to be separately addressed, or are no longer deemed necessary. As some of the existing disclosure requirements do not relate to insurance contracts, to the extent they are to be maintained, it might be more appropriate to incorporate them into the codified guidance as a separate accounting standards update.

Aggregation level of disclosures

17. A common issue raised in the comment letters relates to the ED's proposed aggregation level for disclosures about insurance contracts. Respondents perceived an inconsistency between paragraphs 81 and 83-84 of the ED:

    (a) Paragraph 81 of the ED states that the insurer shall aggregate or disaggregate information so that information that is useful is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

    (b) Paragraph 83 of the ED applies to all disclosures and requires that the disclosures shall not aggregate information relating to different reportable segments, as defined in IFRS 8 *Operating Segments*

18. Paragraph BC242 of the ED states that 'By specifying an objective [for disclosures], the Board **eliminates the need for detailed and prescriptive disclosure requirements** [emphasis added] to meet the specific information needs for the various types of insurance contracts…'. Furthermore, some preparers and regulatory bodies argued that the information provided at segment level would not be particularly useful; for example:

    > The requirement in paragraph 83 to disaggregate information relating to different reportable segments is not necessarily useful if the nature of insurance contracts within different segments is not significantly different. This is also contradictory to the principle in paragraph 81 that the insurer should judge the level of detail necessary to satisfy the disclosure principle and ensure large amounts of insignificant detail does not obscure useful information. [IASB CL #61]

19. The staff think that the principle regarding the aggregation level of information as described in paragraph 81 is sufficient and that it is consistent with other projects, such as Revenue Recognition and Leases. Any more detailed requirement on aggregation and disaggregation of information should, if

considered to be necessary, be addressed for individual disclosure requirements. For example the staff will consider addressing specific disaggregation requirements for the reconciliation from opening to closing balance of contract assets and contract liabilities arising from insurance contracts in a future meeting, after the boards finalised redeliberation on presentation issues.

20. The staff also think that a broader principle regarding disaggregation would need further research and should not be developed independently of other projects.

Question 1: aggregation of information
The staff recommend that for the disclosures of insurance contracts: (a) The final standard should only include the aggregation and disaggregation principle of disclosures in paragraph 81 that would be consistent with other projects such as Revenue recognition and Leases. In other words, an insurer shall aggregate or disaggregate information so that information that is useful is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics. The standard should not prohibit an insurer from aggregating amounts across reportable segments. (b) Detailed disaggregation requirements—if they are necessary—should be addressed for the individual disclosure requirements. Do the boards agree?

Disclosure of methods and inputs and changes from previous reporting periods

21. Most of the comment letters commented on the high degree of judgement related to the amounts recognised in the financial statements from insurance contracts and highlighted the need for disclosures about measurement and the methods and input used. Hence, they favour the corresponding disclosure proposals in the ED.

Changes in methods and inputs

22. Many comment letters emphasised that, beside understanding the methods and inputs used to measure insurance contracts, it is also of fundamental importance to understand the effects arising on changes in inputs from previous periods. Consequently, the majority strongly support the ED's proposal, in paragraph 90 (c) to require disclosure of the effect of changes in the inputs used to measure insurance contracts, showing separately the effect of each change that has a material effect on the financial statements.

23. Respondents stated that the final standard should also emphasise the requirement to disclose the reason for, and effect of, changes in methods and not only for changes in inputs, as drafted in the ED. Some of the users think that this information is necessary to address concerns that insurers might change their methods arbitrarily. Furthermore, feedback received stated that the information about the effects would be most useful if it were provided on a quantitative basis, together with qualitative information regarding the reason for the change and information of the type of contracts.

24. On the basis of the feedback received, the staff think that the final standard should include the requirements to disclose changes in inputs *and* methods from previous periods. In addition, the entity should also be required to disclose an explanation of the reason for the change, including the type of contracts affected. The staff appreciate that actuaries frequently change methods (ie in the ordinary course of accounting for insurance contract liabilities), for example, as data matures but, believe that disclosure of changes in methods will provide decision useful information.

25. Some constituents think that this information is already covered by the requirements in IAS 8.39-40 and ASC 250-10-50-4 to disclosure changes in accounting estimates. However, on the basis of the feedback received from users and their strong support, the staff think that the final standard should state this explicitly.

Discount rate for non-participating contracts

26. At the April meeting, the boards indicated that they would be willing not to prescribe a method for determining the appropriate discount rate only if there was sufficient disclosure to ensure transparency about the discount rate used. Some comment letters also suggested additional disclosure requirements about the discount rate used, such as:

> […] The ED has no guidance on extensions of the yield curve to address issues such as the appropriateness of using mechanical extrapolations and the considerations of the significant estimation risks involved with such long-term forecasting. Consequently, disclosure requirements should be introduced underlining and explaining the approaches chosen. This will assist users of financial information to better understand the effect of the extension applied and sensitivity to changes in the extension methodology.[IASB CL#115]

27. Users also raised concerns about the wide discretion regarding the calculation of the illiquidity premium and application in practice. They indicated that there was a need to include a comprehensive disclosure requirement for the calculation of illiquidity premium.

28. The staff believes that the disclosure of methods and inputs discussed in paragraphs 22-25 would already provide information about the discount rate used by entities, including the methodology used to extend the yield curve beyond observable rates. However, additional transparency could be provided by requiring preparers to disclose the yield curve applied.

29. Some have questioned whether a requirement to disclose the yield curve applied would be impractical, given that different insurance contracts have different liquidity risks and, in light of the boards' decisions that either a top-down or bottom-up approach could be used to determine the discount rate, different yield curves would inevitably be used. However, in the staff's view, any approach for calculating the discount rate is intended to achieve the same

objective , ie to determine a discount rate that reflects the time value of money for the insurance contract liability. Thus, although there may be a range of yield curves resulting from imperfections in any approach applied, the staff would not anticipate large ranges, because the differences would only stem from different liquidity characteristics. This issue is discussed further in appendix C. Accordingly, where the cash flows arising from an insurance contract do not depend on the performance of specific assets, the staff propose that the yield curve should be disclosed to improve transparency and comparability.

Discount rate for participating contracts

30. For contracts in which the cash flows depend on the performance of specified assets (participating contracts), there would be little benefit in comparing yield curves used by different insurers, as the underlying asset may significantly differ as will the expected and unexpected defaults. Different portfolios nay have different asset characteristics and thus the characteristics of the liability depending on those portfolios would have different expected yields. There would be no validity in a comparison of those yield curves. Therefore, the staff do not propose additional disclosure about the yield curve for cash flows that depend on specified assets.

Measurement uncertainty analysis

31. Many insurers questioned the requirement in paragraph 90 (d) to disclose a measurement uncertainty analysis. Primarily, they stated that the requirements would largely overlap with the requirements in paragraph 92 (e) (i) to disclose the sensitivity to insurance risk in relation to its effect on profit or loss and equity. Some respondents think that the information would be covered through the general disclosure requirement in IAS 1.125 to provide information regarding entity's assumptions about the future, and about other major sources of estimation uncertainty at the end of the reporting period that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Comparable

disclosure requirements regarding uncertainty in significant estimates are included in ASC 275-10-50-6.

32. Other insurers think that the benefits of the proposed disclosure would not outweigh the costs, especially on the proposed level of detail to provide quantitative information. It was argued by these insurers that compiling the information would require the creation of a burdensome process to run models for this disclosure under different scenarios and to update all the combinations of these inputs to arrive at a meaningful result. In most cases this type and level of quantitative information and simulation would be compiled only for financial reporting purposes.

33. Reflecting the cost arising for this disclosure, some preparers questioned its benefits. In their view, the information would be fairly complex and would probably not be useful enough to justify its cost. A few preparers even think that it would be virtually impossible to provide the disclosure for property and casualty (non-life) contracts, given the numerous variables that can affect the estimation of a claims liability for various lines of business.

Staff analysis

34. In general, the feedback received was generally consistent with the comments received on a similar requirement for unobservable inputs in fair value measurement, as described in paragraphs BC202-BC210 of the Basis for Conclusions to IFRS 13 and in paragraphs BC93-BC98 of the Basis for Conclusions to ASU 2011-04. In finalising the disclosures of IFRS 13 (Appendix B of this paper) and ASC Topic 820, the boards did not require a measurement uncertainty analysis disclosure for unobservable inputs at that time because of concerns about costs relative to benefits. However, the boards asked the staff to assess after issuing IFRS 13 whether a quantitative measurement uncertainty analysis disclosure would be practical, with the aim of reaching a conclusion at a later date about whether to require such a disclosure. As a result, the boards decided to require more quantitative information about the inputs and narrative information about how those inputs influence the measurement (as described in paragraphs BC188-BC195 and

BC206 of the Basis for Conclusions to IFRS 13 and in paragraphs BC83-BC90 and BC96 of ASU 2011-04).

35. The staff think that the boards should require similar disclosures for measurement uncertainty in the insurance contracts standard as in IFRS 13 and ASC Topic 820. Accordingly we recommend that the boards delete the uncertainty analysis at this stage, but that they should align (in due course) that disclosure with that for fair value measurements, as appropriate.

Question 2: Methods and inputs and changes from previous periods
The staff recommend: (a) to require the insurer to disclose separately the effect of each change in inputs *and* methods, together with an explanation of the reason for the change, including the type of contracts affected. (b) for contracts in which the cash flows do not depend on the performance of specified assets, to require disclosure of the yield curve (or range of yield curves) used. (c) not to retain the measurement uncertainty analysis. Do the boards agree?

Disclosure of nature and extent of risk arising from insurance contracts

Overall feedback

36. Users largely agreed in general with the proposals on risk disclosures related to insurance contracts. Many understand those disclosures as corresponding to the disclosure requirements in IFRS 7, some of which exist for US GAAP in ASC Topics 275 and 815.

37. Nevertheless, some users raised concerns that the disclosure requirements as drafted in the ED may result in qualitative and potentially boilerplate

disclosures. They think the risk disclosures need to be more closely linked to the amount recognised in the financial statements to be most useful.

Liquidity risk and maturity analysis

38. Paragraph 95(a) of the ED proposes that an insurer shall disclose a maturity analysis that shows the remaining contractual maturities *or* information about the estimated timing of cash outflows resulting from insurance liabilities.

39. Some respondents stated that in light of the fact that the measurement model proposed for insurance contracts is based on expected values, it would be more logical and consistent to provide the maturity analysis on expected maturities only. The information would be readily available because it is used for measurement of reported insurance liabilities.

40. Some users suggested that both maturity analysis based upon contractual maturities *and* the expected maturities would be needed to better understand the measurement in the statement of financial position.

41. In addition to the proposed liquidity risk disclosures, a few users suggested adding more disclosures such as:

    (a) information on the ability of policyholders to request/demand their funds.

    (b) distribution of liquidity needs between different entities within the consolidated group.

Staff analysis and recommendation

42. The staff think that the maturity analysis for insurance liabilities should be disclosed on a consistent and comparable basis across different insurers. Consequently, the staff suggest removing the option between basing the maturity analysis on remaining contractual maturities and basing it on expected maturities (expected net cash outflows resulting from recognised insurance liabilities).

43. The staff tend to agree with the respondents that the maturity analysis based on expected maturities would be logically consistent with the measurement

approach of the recognised insurance liabilities. Also, for many insurance contracts, the notion of contractual maturity is somewhat unclear, and perhaps meaningless because the timing of payment depends on the timing of the insured event.

44. However, the maturity analysis based on expected maturities would be different from the maturity analysis in IFRS 7.39 for non-derivative and derivative liabilities, which is based on remaining contractual maturities. As for lessees, the boards tentatively decided in the July 2011 meeting (July 20-22, 2011, joint meeting;- FASB Memo 190/ IASB Agenda Paper 5D) to require the maturity analysis to be based on undiscounted cash flows included in the liability to make lease payments. As the tentative decision on leases is to exclude contingent rent from the balance sheet measurement (i.e., because they are deemed executory costs), the related expected cash flows are also excluded from the maturity analysis. IAS 19 and ASC Topic 715 require the disclosure of the weighted average duration of the defined benefit obligation.

45. Furthermore, in the cross cutting paper from March 2011 (March 1-2, 2011, joint meeting;- FASB Memo 1/ IASB Agenda Paper 8) it was noted that differences exist regarding the required time bands for the maturity analysis across different IFRSs and US GAAP guidance. IFRS 7 requires judgment from preparers to determine the appropriate time intervals. For leases the boards decided in the July joint meeting (July 20-22, 2011, FASB Memo 190/ IASB Agenda Paper 5D) to require the entity showing, at the minimum, the undiscounted cash flows on an annual basis for the first five years and a total of the amounts for the remaining years.

46. The staff think there are merits in aligning the time band requirements across different liquidity risk based maturity analysis of recognised liabilities. The staff think that based on user outreach, the time band requirements from the leases project, *at a minimum* annually for each of the first five years and in aggregate for all later years, could be applied to the maturity analysis for liabilities arising from insurance contracts.

47. The staff also considered to extend the discrete time bands beyond five years to reflect cash flow profiles of insurance contracts. Due to the long term nature

of many insurance products, especially as it relates to some life insurers, the cash outflows over the next five years might be a relatively small portion of the total expected future cash outflows. It could be argued that the net cash outflows for the first five years may not be particularly meaningful for life insurers and therefore the prescriptive time bands might be extended beyond five years, for example within the next 25 years. However, the objective of the maturity analysis is based on liquidity risk - as defined in IFRS 7[1] - by providing information whether the entity will encounter difficulty in meeting obligations. Therefore the staff think that discrete time bands beyond five years would be less relevant for liquidity risk analysis.

48. The staff suggest not to include additional prescriptive disclosure requirements on liquidity as indicated in paragraph 40, because this information is not purely related to insurance contracts and would require the boards to hold discussions on liquidity in a broader perspective and not exclusively for insurance contracts. The FASB staff are currently developing some suggested risk disclosures as part of the accounting for financial instruments project. The FASB decided that these disclosures will focus on the liquidity (and interest rate) risk related to an entity's involvement in financial instruments. The FASB will consider at a future meeting the types of entities that should be required to provide expanded disclosures about those risks.

[1] liquidity risk (IFRS 7): The risk that an entity will encounter difficulty in meeting obligations associated with that are settled by delivering cash or another financial assets.

Question 3: Nature and extent of risk arising from insurance contracts

The staff recommend:

(a) to require the maturity analysis to be based on expected maturities (expected net undiscounted cash outflows resulting from recognised insurance liabilities) and remove the option to disclose an analysis based on the remaining contractual maturities;

(b) to align time bands with those of the leases project, at the minimum, the expected net cash outflows for each of the first five years and a net total for the remaining and

(c) not to require further prescriptive liquidity disclosures such as:

(i) information on the ability of policyholders to request/demand their funds.

(ii) distribution of liquidity needs between different entities within the consolidated group.

Do the boards agree?

Appendix A—ED proposals on disclosures

This appendix reproduces the disclosures proposals in the ED *Insurance Contracts*.

Disclosure

79 To help users of financial statements understand the amount, timing and uncertainty of future cash flows arising from insurance contracts, an insurer shall disclose qualitative and quantitative information about:

- **(a) the amounts recognised in its financial statements arising from insurance contracts (see paragraphs 85–90); and**
- **(b) the nature and extent of risks arising from insurance contracts (see paragraphs 91–97).**

80 If the disclosures required by this [draft] IFRS and other IFRSs do not meet that objective in a particular situation, an insurer shall disclose whatever additional information is necessary to meet that objective.

81 An insurer shall consider the level of detail necessary to satisfy the disclosure requirements and how much emphasis to place on each of the various requirements. An insurer shall aggregate or disaggregate information so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

82 An insurer shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

83 The disclosures required in this [draft] IFRS shall not aggregate information relating to different reportable segments, as defined in IFRS 8 *Operating Segments*.

84 Examples of aggregation levels that might be appropriate are:

- (a) type of contract.
- (b) geography (eg country or region).

Explanation of recognised amounts

85 An insurer shall disclose information about the amounts recognised in its financial statements in sufficient detail to help users of its financial statements evaluate the timing, amount and uncertainty of future cash flows arising from insurance contracts, including:

- **(a) reconciliation from the opening to the closing aggregate contract balances (see paragraphs 86–89).**
- **(b) the methods and inputs used to develop the measurements (see paragraph 90).**

Reconciliation of contract balances

86 To comply with paragraph 85(a), an insurer shall disclose a reconciliation from the opening to the closing balance of each of the following, if applicable:

(a) insurance contract liabilities and, separately, insurance contract assets.

(b) risk adjustments included in (a).

(c) residual margins included in (a).

(d) reinsurance assets arising from reinsurance contracts held by the insurer as cedant.

(e) risk adjustments included in (d).

(f) residual margins included in (d).

(g) impairment losses on reinsurance assets.

87 For each reconciliation required by paragraph 86, an insurer shall show, at a minimum, each of the following, if applicable:

(a) the carrying amounts at the beginning and end of the period.

(b) new contracts recognised during the period.

(c) premiums received.

(d) payments, with separate disclosure of:

(i) claims and benefits.

(ii) expenses.

(iii) incremental acquisition costs.

(e) other cash paid and, separately, other cash received.

(f) income and expense, reconciled to the amounts disclosed to comply with paragraphs 72 and 75.

(g) amounts relating to contracts acquired from, or transferred to, other insurers in portfolio transfers or business combinations.

(h) net exchange differences arising on the translation of foreign currency amounts into the presentation currency.

88 For short-duration contracts measured using the measurement described in paragraphs 54–60, an insurer shall disclose the reconciliation required by paragraph 86 separately for:

(a) pre-claims liabilities.

(b) additional liabilities for onerous insurance contracts.

(c) claims liabilities.

89 For those contracts for which uncertainty about the amount and timing of claims payments is not typically resolved fully within one year, an insurer shall disclose the claims and expenses incurred during the period.

Methods and inputs used to develop the measurements

90 To comply with paragraph 85(b), an insurer shall disclose:

(a) for the measurements that have the most material effect on the recognised amounts arising from insurance contracts, the methods used and the processes for estimating the inputs to those methods. When practicable, the insurer shall also provide quantitative information about those inputs.

(b) to the extent not covered in (a), the methods and inputs used to estimate:

(i) the risk adjustment, including information about the confidence level to which the risk adjustment corresponds. If the insurer uses a conditional tail expectation technique or a cost of capital technique, it shall disclose the confidence level to

which the risk adjustment estimated under those methods corresponds (eg that the risk adjustment was estimated at conditional tail expectation (Y) and corresponds to a confidence level of Z per cent).

(ii) discount rates.

(iii) estimates of policyholder dividends.

(c) the effect of changes in the inputs used to measure insurance contracts, showing separately the effect of each change that has a material effect on the financial statements.

(d) a measurement uncertainty analysis of the inputs that have a material effect on the measurement. If changing one or more inputs used in the measurement to a different amount that could have reasonably been used in the circumstances would have resulted in a materially higher or lower measurement, the insurer shall disclose the effect of using those different amounts and how it calculated that effect. When preparing a measurement uncertainty analysis, an insurer shall not take into account inputs that are associated with remote scenarios. An insurer shall take into account the effect of correlation between inputs if such correlation is relevant when estimating the effect on the measurement of using those different amounts. For that purpose, materiality shall be judged with respect to profit or loss, and total assets or total liabilities.

Nature and extent of risks arising from insurance contracts

91 An insurer shall disclose information about the nature and extent of risks arising from insurance contracts in sufficient detail to help users of financial statements evaluate the amount, timing and uncertainty of future cash flows arising from insurance contracts.

92 To comply with paragraph 91, an insurer shall disclose:

(a) the exposures to risks and how they arise.

(b) its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks.

(c) any changes in (a) or (b) from the previous period.

(d) information about the effect of the regulatory frameworks in which the insurer operates, for example minimum capital requirements or required interest rate guarantees.

(e) information about insurance risk on a gross and net basis, before and after risk mitigation (eg by reinsurance) including information about:

(i) the sensitivity to insurance risk in relation to its effect on profit or loss and equity. This shall be disclosed by a sensitivity analysis that shows any material effect on profit or loss and equity that would have resulted from:

(A) changes in the relevant risk variable that were reasonably possible at the end of the reporting period;

(B) the methods and inputs used in preparing the sensitivity analysis; and

(C) any changes from the previous period in the methods and inputs used.

However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as embedded value or value at risk, it can meet this requirement by disclosing that alternative sensitivity analysis.

(ii) concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (eg type of insured event, geographical area or currency). Concentrations of insurance risk can arise if an insurer has, for example:

(A) underwritten risks concentrated in one geographical area or one industry.

(B) underwritten risks that are also present in its investment portfolio, for example if an insurer provides product liability protection to pharmaceutical companies and also holds investments in those companies.

(iii) actual claims compared with previous estimates of the undiscounted amount of the claims (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose information about the development of claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year. An insurer shall reconcile the disclosure about claims development with the carrying amount of the insurance contract liabilities recognised in the statement of financial position.

93 For each type of risk, other than insurance risk, arising from insurance contracts, an insurer shall disclose:

(a) summary quantitative information about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to the key management personnel of the insurer and shall provide information about the risk management techniques and methodologies applied by the insurer.

(b) concentrations of risk if not apparent from other disclosures. Such concentrations can arise from, for example, interest rate guarantees that come into effect at the same level for an entire book of business.

94 With regard to credit risk arising from reinsurance contracts and, if applicable, other insurance contracts, an insurer shall disclose:

(a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period.

(b) information about the credit quality of reinsurance assets.

95 With regard to liquidity risk, an insurer shall disclose:

(a) either a maturity analysis that shows the remaining contractual maturities or information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities. This may take the form of an analysis, by estimated timing, of the amounts recognised in the statement of financial position.

(b) a description of how it manages the liquidity risk resulting from its insurance liabilities.

96 With regard to market risk (as defined in IFRS 7) an insurer shall disclose:

(a) a sensitivity analysis for each type of market risk to which the insurer is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date; if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, or a sensitivity analysis, such as value at risk, that reflects interdependencies between risk variables and uses it to manage *financial risks,* it may use that sensitivity analysis to meet this requirement.

(b) an explanation of the methods and main inputs used in preparing the sensitivity analysis.

(c) an explanation of the objective of the methods used and of limitations that may result in the information not fully reflecting the carrying amount of the insurance contracts involved.

(d) changes from the previous period in the methods and inputs used and the reasons for such changes.

(e) information about exposures to market risk arising from embedded derivatives

contained in a host insurance contract, including information about the levels at which these exposures begin to have a material effect on the insurers cash flows.

97 If the quantitative information about the insurers exposure to risk at the end of the reporting period is not representative of its exposure to risk during the period, it shall disclose that fact, the reasons for those conclusions and shall provide further information that is representative of the exposure during the period.

APPENDIX B: Disclosures in IFRS 13 Fair Value Measurement[2]

This appendix reproduces the disclosures in IFRS 13.

Disclosure

91 **An entity shall disclose information that helps users of its financial statements assess both of the following:**

(a) **for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.**

(b) **for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.**

92 To meet the objectives in paragraph 91, an entity shall consider all of the following:

(a) the level of detail necessary to satisfy the disclosure requirements;

(b) how much emphasis to place on each of the various requirements;

(c) how much aggregation or disaggregation to undertake; and

(d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

If the disclosures provided in accordance with this IFRS and other IFRSs are insufficient to meet the objectives in paragraph 91, an entity shall disclose additional information necessary to meet those objectives.

93 To meet the objectives in paragraph 91, an entity shall disclose, at a minimum, the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this IFRS) in the statement of financial position after initial recognition:

(a) for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement. Recurring fair value measurements of assets or liabilities are those that other IFRSs require or permit in the statement of financial position at the end of each reporting period. Non-recurring fair value measurements of assets or liabilities are those that other IFRSs require or permit in the statement of financial position in particular circumstances (eg when an entity measures an asset held for sale at fair value less costs to sell in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* because the asset's fair value less costs to sell is lower than its carrying amount).

(b) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).

(c) for assets and liabilities held at the end of the reporting period that are measured at fair value on a recurring basis, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when

[2] Except for minor differences in wording and style, these disclosure requirements and guidance are the substantially similar to those included within ASC 820-10-50

transfers between levels are deemed to have occurred (see paragraph 95). Transfers into each level shall be disclosed and discussed separately from transfers out of each level.

(d) for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (eg changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it. For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement. An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (eg when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.

(e) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:

  (i) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised.

  (ii) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in other comprehensive income in which those gains or losses are recognised.

  (iii) purchases, sales, issues and settlements (each of those types of changes disclosed separately).

  (iv) the amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 95). Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

(f) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period in (e)(i) included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised.

(g) for recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period).

(h) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy:

  (i) for all such measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying with (d).

  (ii) for financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of

those changes. The entity shall disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated. For that purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income, total equity.

(i) for recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.

94 An entity shall determine appropriate classes of assets and liabilities on the basis of the following:

(a) the nature, characteristics and risks of the asset or liability; and

(b) the level of the fair value hierarchy within which the fair value measurement is categorised.

The number of classes may need to be greater for fair value measurements categorised within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity. Determining appropriate classes of assets and liabilities for which disclosures about fair value measurements should be provided requires judgement. A class of assets and liabilities will often require greater disaggregation than the line items presented in the statement of financial position. However, an entity shall provide information sufficient to permit reconciliation to the line items presented in the statement of financial position. If another IFRS specifies the class for an asset or a liability, an entity may use that class in providing the disclosures required in this IFRS if that class meets the requirements in this paragraph.

95 An entity shall disclose and consistently follow its policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred in accordance with paragraph 93(c) and (e)(iv). The policy about the timing of recognising transfers shall be the same for transfers into the levels as for transfers out of the levels. Examples of policies for determining the timing of transfers include the following:

(a) the date of the event or change in circumstances that caused the transfer.

(b) the beginning of the reporting period.

(c) the end of the reporting period.

96 If an entity makes an accounting policy decision to use the exception in paragraph 48, it shall disclose that fact.

97 For each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed, an entity shall disclose the information required by paragraph 93(b), (d) and (i). However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorised within Level 3 of the fair value hierarchy required by paragraph 93(d). For such assets and liabilities, an entity does not need to provide the other disclosures required by this IFRS.

98 For a liability measured at fair value and issued with an inseparable third-party credit enhancement, an issuer shall disclose the existence of that credit enhancement and whether it is reflected in the fair value measurement of the liability.

99 An entity shall present the quantitative disclosures required by this IFRS in a tabular format unless another format is more appropriate.

APPENDIX C: Background on the proposed disclosure of the discount rate yield curve

This appendix provides background relevant to the proposed disclosure of the yield curve used to discount insurance contracts for which the cash flows do not depend on the performance of specified assets (ie non-participating contracts).

Discount rate decisions so far

1. At their meeting in the week commencing 14 February 2011, the boards tentatively decided to:

   (a) confirm that the objective of the discount rate for non-participating contracts is to adjust the future cash flows for the time value of money and to reflect the characteristics of the insurance contract liability.

   (b) not to prescribe a method for determining the discount rate and that the discount rate should:

      (i) be consistent with observable current market prices for instruments with cash flows whose characteristics reflect those of the insurance contract liability, including timing, currency and liquidity, but excluding the effect of the insurer's non-performance risk;

      (ii) exclude any factors that influence the observed rates but that are not relevant to the insurance contract liability (eg risks not present in the liability but present in the instrument for which the market prices are observed, such as any investment risk taken by the insurer that cannot be passed to the policyholder); and

      (iii) reflect only the effect of risks and uncertainties that are not reflected elsewhere in the measurement of the insurance contract liability.

2. At the 11 April meeting, the boards tentatively decided that in applying the top-down approach:

(a) an insurer shall determine an appropriate yield curve on the basis of current market information. The insurer may base its determination of the yield curve for the insurance contract liability on a yield curve that reflects current market returns for the actual portfolio of assets the insurer holds or for a reference portfolio of assets with characteristics similar to those of the insurance contract liability.

(b) if there are no observable market prices for some points on that yield curve, the insurer shall use an estimate that is consistent with the boards' guidance on fair value measurement, in particular for Level 3 fair value measurement.

(c) the cash flows of the instruments shall be adjusted so that they reflect the characteristics of the cash flows of the insurance contract liability. In adjusting the cash flows, the insurer shall make both of the following adjustments:

  (i) Type I, which adjust for differences between the timing of the cash flows to ensure that the assets in the portfolio (actual or reference) selected as a starting point are matched with the duration of the liability cash flows.

  (ii) Type II, which adjust for risks inherent in the assets that are not inherent in the liability. In the absence of an observable market risk premium for risks inherent in the asset but not inherent in the liability, the entity uses an appropriate technique to determine that market risk premium, consistent with (b).

(d) an insurer using a 'top-down' approach need not make adjustments for remaining differences between the liquidity inherent in the liability cash flows and the liquidity inherent in the asset cash flows.

The objectives of the building blocks

3. The component of the meausurement of the insurance contract liability that reflects the expected payments the insurer will make comprises two/three building blocks, whose objective can be summarized as follows:

(a) *Fulfilment cash flows*: the probability-weighted estimate (ie expected or mean value) of the future cash flows that will arise as the insurer fulfils the insurance contract. This estimate reflects all scenarios, including those which cause liquidity risk, eg surrenders and lapses.

(b) *Time value of money:* the effect of the time value of money. A discount rate that reflects only the time value of money should be free of all risks. However, the observable (typically government bond) rates usually used to approximate a risk-free rate are typically traded and highly liquid. Assets that are more liquid than others usually have lower yields. (Said differently, the holder of such an asset pays an implicit premium for the flexibility inherent in holding an asset that the holder can sell at short notice. The holder of an illiquid asset does not pay such a premium.) Thus, a liquidity adjustment is applied to the observable (typically government bond) rate to arrive at the fully **illiquid** risk-free discount rate.

(c) *Risk adjustment:* the probability-weighted cash flows in (a) reflect all scenarios in which cash flows arise sooner or later than expected, but do not reflect the risk that the scenarios are incomplete or should be weighted differently, ie they do not reflect the deviation risk in the distribution. In the IASB's approach, such risk of deviation in the estimates for surrenders, lapses and insured events is included in the risk adjustment In the FASB's approach, those risks would be included in the single margin that is determined by calibrating the measurement of the liability to the premium at inception, to the extent they had been reflected in the determination of the premium..

4. The following example illustrates the above:

> **Illustrative example**
>
> An insurer issues an immediate annuity. At the same time it issues an endowment contract. The contracts have the following scenarios of cash flows for one year:
> **Annuity:**
> 95%: Policyholder alive, pay-out 100
> 5%: Policyholder dies, no pay-out
> Mean (expected) cash flow 95 for this year
> This annuity contract does not permit lapse or surrender.
> **Endowment policy with life coverage:**
> 20%: Policyholder surrenders/lapses, payout after all charges applied 350
> 5%: Policyholder dies, payout 500
> 75%: policy continues, no pay-out in this year
> Mean (expected) cash flow: 95 for this year

5. Both products are very different and have different liquidity characteristics. However, the cash flows scenarios for each product would reflect the differences in liquidity characteristics because the scenarios for the annuity would include no scenarios for lapse or surrender, while the scenarios for the endowment policy would include the insurer's estimate of the likelihood that the policyholder lapses or surrenders. Both sets of scenarios would reflect the likelihood that the policyholder dies. The next step is to reflect the time value of money for each of those scenarios. To do so, the insurer would discount the scenarios using the fully illiquid risk-free rate. It would not be appropriate to apply a risk-adjusted discount rate, including a discount rate that reflects liquidity risk, to the cash flow scenarios because any risk of deviation from the estimated cash flow scenarios (eg because of mortality or surrender/lapse) would be reflected in the risk adjustment (in the IASB approach) or included in the single margin (in the FASB approach),

6. As a result, the staff believes that in concept the rate used to discount insurance contract liability should be a fully illiquid risk-free rate and that there would be only one such illiquid risk free yield curve per currency.

7. However, there are two reasons why entities may find it difficult to determine a fully illiquid risk-free rate:

(a) many entities may find it convenient to approximate the determination of both the discount rate and the risk adjustment by using a discount rate that reflects some liquidity risk, with a correspondingly lower discount rate. In doing so, the insurer would need to ensure that risks ought not be double counted, ie a liquid discount rate should not be used if the risk adjustment reflects risks relating to liquidity.

(b) the boards' decision that an insurer using a 'top-down' approach need not make adjustments for some differences between the liquidity inherent in the liability cash flows and the liquidity inherent in the asset cash flows will likely result in differences in the liquidity adjustment in practice.

8. These factors mean that, in the example above, there may be differences between the rates applied to the endowment policy and the annuity, with preparers likely to use a lower discount rate for the endowment policy than for the annuity to reflect the possibility of a deviation from the mean. However, because the difference should reflect only different liquidity characteristics, the staff does not expect such differences to be large (with the caveat that even small differences in discount rate can result in large differences in the measurement of the liability).

APPENDIX D

Examples of insurance company disclosure requirements that might be eliminated or revised if ASC 944 is replaced with the disclosure requirements within the proposed insurance contract standard

(a) the nature, and type of acquisition costs amortized (ASC 944-30-50-1) (comparable disclosure under the new standard might be the amount of acquisition costs included in contract cash flows);

(b) a loss reserve rollforward (ASC 944-40-50-3);

(c) gross presentation of reinsurance and reinsurance premium assumed and ceded (ASC 944-605-50-1);

(d) summarized separate account balances (ASC 944-80-25-3);

(e) range of interest rates used to discount short duration contract liabilities (ASC 944-40-50-5);

(f) the method for accounting for and amount of policyholder dividends on participating contracts (ASC 944-50-50-1); and

(g) an analysis of intangible assets arising from insurance contracts acquired in a business combination, including a rollforward of the balances and an estimate of each of the next 5 years of amortization (ASC 944-20-S99-2).