

# AGENDA PAPER

IFRS Foundation Trustees' meeting—Due Process Oversight Committee

Singapore

11-12 January 2012

Agenda ref 3C-appendix 1

---

## **Correspondence with the Hub Global Insurance Group: Accounting for short-duration insurance contracts**

**The IFRS Foundation promotes the adoption of IFRSs and is the oversight body of the IASB**

IFRS Foundation premises | 30 Cannon Street, London EC4M 6XH UK | Tel: +44 (0)20 7246 6410 | Fax: +44 (0)20 7246 6411

info@ifrs.org | [www.ifrs.org](http://www.ifrs.org)



By email for the attention of:

**HUB Global Insurance Group (“HGIG”)**

19 December 2011

**International Accounting  
Standards Board (IASB)**

30 Cannon Street  
London EC4M 6XH | UK

Tel: +44 (0)20 7246 6410  
Fax: +44 (0)20 7246 6411  
info@ifrs.org

www.ifrs.org

Dear Sir/Madam,

I received your unsigned memo dated 9 December 2011.

I am troubled by the implication in your memo that the boards have not adequately considered the information value of discounting in the reporting of short duration contracts, and that the boards have not engaged with constituents on this issue.

#### **Discounting of short duration contracts**

The IASB began considering the different accounting models used throughout the world in 2001, building on the work of the IASC that began in 1997. As a result of those considerations, the IASB decided that a single accounting model would be appropriate for all insurance contracts.

Even so, the boards have continued to consider how its proposals would affect short duration insurance contracts and have discussed short duration contracts specifically on four occasions since the exposure draft was published – in March, April, July and October 2011. The papers for those meetings included specific consideration of the arguments submitted to the boards, including those submitted by HGIG on the subject of business model and discounting.

In addition, the specific issue of whether to discount short duration contracts has been discussed by the boards on numerous occasions, including April 2005, May 2005 and March 2011, as well as in the Basis for Conclusions to the IASB’s 2007 discussion paper (paragraphs 64-66) and 2010 exposure draft (BC89-BC94).

While it is true that the boards did not agree with all of your conclusions, it is inaccurate to say that they have not adequately evaluated their proposed accounting for short duration contracts or that they do not have a basis on which to make decisions on short duration contracts.

#### **Public dialogue**

I disagree with your assertion that we have had an inadequate public dialogue on the issues relating to short duration contracts. A public dialogue began with the publications of the Issues Paper by the IASC Steering Committee (and the ensuing Draft Statement of Principles), ED 5 *Insurance contracts* and IFRS 4 *Insurance contracts*. Both IFRS 4 and ED 5 stated that although insurers would be permitted to continue to measure insurance contract liabilities on an undiscounted basis, any new accounting policy that changed from a discounted to undiscounted basis would not make the financial statements more relevant to the decision-making needs of users. Those documents helped stimulate an active debate amongst interested parties.

There has been a continuation of this broad consultation as a result of the 2007 discussion paper *Preliminary Views on Insurance Contracts* (by the IASB) and the more recent exposure draft

*Insurance Contracts* (by the IASB) and Discussion Paper (*Preliminary Views on Insurance Contracts* (by the FASB)). In addition, the boards have conducted field visits, roundtables, field tests and an extensive schedule of meetings with constituents, and engaged with interested parties through the formation of its insurance working group and ongoing dialogue with the insurance working group, including a discussion of the discounting of non-life insurance contracts in September and November 2004. Further input was received in the form of education sessions on the accounting for short duration contracts presented by constituents as follows:

- January 2005: *Methods for estimating non-life claims liabilities* by representatives of the International Actuarial Association
- February 2005: *Measurement of non-life claims liabilities, focusing on discounting and risk margins* by representatives of the Casualty Actuarial Society, General Insurance Association of Japan and Group of North American Insurance Enterprises (who later became a member of the HGIG).
- April 2005: *Measurement of non-life claims liabilities, focusing on discounting and risk margins* by Australian and Canadian members of the Insurance Working Group: Tony Coleman of Insurance Australia Group and Phil Arthur of Ernst & Young
- September 2006: *Briefing on recommendations those organisations had made on the accounting model for insurance contracts* by representatives of the CFO Forum, the Group of North American Insurance Enterprises and four major Japanese life insurers.

The benefit of all the information gathered by the boards through education sessions, comment letters on due process documents, field visits, individual and group meetings, roundtables and insurance working group meetings was reflected in the axioms and assumptions paper to which you refer.

### **Business model**

Regardless of whether an insurer considers the effect of time value of money in making business decisions, we believe that investors gain useful information about the financial position, performance and changes in financial position of an entity when the financial statements reflects the time value of money. This provides information that is useful in evaluating the ability of an entity to generate cash and cash equivalents and of the timing and certainty of their generation. This is particularly true if the effect of discounting is material. As a result IASB standards already require discounting for all comparable items, such as long-term provisions, employee benefit obligations and finance leases.

In summary, I believe that the boards' deliberations on short duration contracts have been extensive, transparent and considered. As a result, we discussed these issues as planned. We are satisfied that the boards have received enough information to reach an informed conclusion on this issue. Of course, we will always consider any new information that arises.

Sincerely,



Hans Hoogervorst  
Chairman IASB

Cc: Ms Leslie Seidman, Financial Accounting Standards Board  
Mr Robert Glauber, IFRS Trustee  
Mr Jack Brennan, Financial Accounting Foundation

**Date:** December 9, 2011

**To:** Hans Hoogervorst, Chair International Accounting Standards Board  
Leslie Seidman, Chair Financial Accounting Standards Board

**Copy:** Mr. Robert Glauber, IFRS Trustees  
Mr. Jack Brennan, Financial Accounting Foundation

**From:** HUB Global Insurance Group (“HGIG”)

**Subject:** IASB/FASB Joint Meeting December 12 – 16 – Discussion of Accounting for Short Duration Insurance Contracts

The IASB and FASB recently issued a series of staff papers for discussion at its meetings on December 12<sup>th</sup> through December 16<sup>th</sup>. We have concerns with the staff papers that reference the accounting for short-duration insurance contracts, including the following:

- Insurance Contracts – Cover Note (provides project status information)
- Insurance Contracts – Onerous Contracts
- Insurance Contracts – Discounting the Liability for Incurred Claims

The HGIG was formed with the objective of facilitating the development of a high quality global accounting standard for insurance contracts. In fulfilling that objective as it relates to short-duration insurance contracts, the HGIG determined that two basic, but distinct, business models are applied globally. The business models differ in that in many parts of the world, an Undiscounted Continuous Risk Re-underwriting Business Model (“Undiscounted CRR-BM”) is utilized whereas in others, a discounted (typically with a risk margin) or “Discounted CRR-BM” is utilized.

The HGIG concluded that because the business model is entirely consistent with the concept of stewardship (as set forth in the IFRS Conceptual Framework), is a fact and not a choice (as set forth in BC 4.20 of IFRS 9), and aligning the accounting and reporting of short-duration insurance contracts with an insurer’s business model enhances investors’ ability to predict future cash flows (as set forth in BC 4.15 of IFRS 9), it could serve as the mechanism to determine whether insurers should apply the Undiscounted or Discounted CRR-BM to their short-duration insurance contracts.

Our concern with the staff papers is that they would effectively preclude application of the Undiscounted CRR-BM, as set forth in the HUB Technical Papers, based on assertions which we believe lack a historical factual basis. Moreover, the primary support for discounting referenced by staff is in part attributable to jurisdictions anticipating changes to solvency requirements and not based on existing global practices, which is predominantly an application of the Undiscounted CRR-BM. Accordingly, we believe the Boards, in pursuing the objective of a high quality global accounting standard for short-duration insurance contracts, must undertake a comprehensive evaluation of information produced by both the Undiscounted and Discounted CRR-BM against the critical criteria such as the needs of investors and whether the information is relevant, understandable, comparable and decision-useful.

We believe any decision to eliminate the Undiscounted CRR-BM as an accounting alternative for short-duration insurance contracts at the present time would be premature, inconsistent with the needs and desires of many investors, and not based on the type of formal, open, substantive discussion between the Boards and its constituents that should be required before any significant change to global accounting standards is implemented.

In support of our request to retain the Undiscounted CRR-BM until such time as the Boards can engage in a more comprehensive evaluation of the accounting for short-duration insurance contracts, the following should be considered:

- The Boards have yet to engage in an open, formal, substantive dialogue with insurers around the globe that apply the Undiscounted CRR-BM and their investors to fully understand the underlying mechanics and benefits to investors in terms of relevance, understandability, and decision-usefulness of the Undiscounted CRR-BM. Many preparers and investors around the globe are not convinced that discounting short-duration contracts produces decision-useful information and staff has not supported its assertions about the usefulness of discounted information with any empirical information specific to short-duration contracts.
- The International Actuarial Association (“IAA”) recently commissioned Milliman, Inc. to prepare a monograph on Issues Associated with the Determination of Discount Rates for Financial Reporting Purposes. We believe that the contents of this Monograph will be helpful in identifying potential issues and problems in implementing this proposal.
- There has been very limited field testing undertaken as it relates to discounting short-duration insurance contracts and for those companies that have engaged in field testing there has been no formal dialogue held with Boards in an open session to discuss the results.
- There has been no formal discussion of how to develop discount rates for short-duration insurance contracts. The focus of the discount rate discussions has been on long-duration contracts. We believe it would be premature to require the discounting of all short-duration insurance contracts before critical issues such as determination of discount rates is initiated.
- We note that the principal reasons the staffs are supporting a vote by the Boards to confirm a prior tentative decision to require discounting is based on (a) decisions coming from the Boards’ Axioms and Assumptions paper that was voted on without the benefit of any open discussion or deliberation with constituents, (b) premise that IASB’s proposals would result in relatively little changes for many non-life contracts (which is not accepted by us), and (c) other industries not being granted discounting exceptions (which is not the case for Banking – **demand deposits**, and the Oil & Gas - Extractive Industries - **reserves**)

Based upon the preceding we are concerned that the Boards’ current redeliberation plans may not provide for sufficient further discussion of critical issues raised about the accounting for short-duration insurance contracts in comment letters, at the IASB and FASB Roundtables, and subsequently. We recommend the Boards withdraw the staff papers (or portions of staff papers) related to the accounting for short-duration insurance contracts and allow the redeliberation process to evolve and substantively address all of the significant issues identified by constituents in a formal, open dialogue.

With nearly one trillion of annual earned premiums on a global basis, we believe the accounting for short-duration insurance contracts warrants a more substantive discussion between the Boards and constituents and a satisfactory resolution of outstanding issues before any final decisions on measurement and reporting, or significant components thereof, are rendered.