STAFF PAPER

July 2012

REG IASB Meeting]

Project	**Insurance contracts**		
Paper topic	Update from Insurance Working Group meeting on 25 and 26 June 2012		
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Purpose of this paper

1. The Insurance Working Group (IWG) met for one and a half days on 25 and 26 June 2012. 21 members and alternatives, 4 official observers, 10 IASB members and 1 FASB member attended the meeting.

2. The papers for the meeting:

   (a) Outlined the board's progress on its agenda

   (b) Reported to the working group the board's tentative decisions on:

      (i) Premium allocation approach

      (ii) Use of OCI to present the effects of discount rate changes

      (iii) Accounting for non-insurance components in an insurance contract

      (iv) Definition of an insurance contract and the scope of the insurance contracts standard

   The papers shared with Working Group participants the staff's working drafts on these issues.

   (c) Sought the views of the working group on the relatively few remaining areas that the board has yet to come to decisions on:

      (i) Adjusting the residual margin for changes in estimates

      (ii) Presenting 'earned premiums' in the statement of comprehensive income

(iii) Estimating the residual margin on transition

General observations

3. The meeting started with a general discussion on project progress and future plans.

4. Participants asked about our intentions to converge with the FASB's proposals. All those present agreed that one single converged standard is desirable. However, we also noted the need to balance convergence, quality and timeliness, and we heard the usual mixed messages about how we should balance these three considerations.

5. The staff observed that there is convergence on many aspects of the proposals, particularly on the overarching framework of a current, market consistent model. Some participants stated it was difficult to understand why the boards could not compromise on their differing views. However, there remain differing views on most of these topics amongst participants.

6. In terms of process going forward, participants suggested that the Board should allow opportunity to check for unintended consequences. Some expressed fears that a current value model may affect the availability of some insurance products. However there are divergent views on how much incremental knowledge would be added by an extensive field testing exercise. Previous field tests have provided confirmatory information, rather than indicating anything new. However, most believe that some testing needs to be performed and urged participants to communicate any issues already identified to the IASB staff as soon as possible.

7. Some participants noted that there the Board should assess whether changes to its model make it more or less complex to understand the amounts that will be reported.

Reporting back

Financial instruments update

8. The session on financial instruments provided the opportunity for participants to obtain a better understanding of the board's intention on its financial instruments projects, particularly on the classification of financial assets. The staff confirmed the board's intention that the fair value through OCI category would be required for an instrument with cash flows that are solely principal and interest if the instrument is held within a business model to manage assets to both hold to collect contractual cash flows and sell. The fair value through OCI category would not be available for any other financial assets[1]. The staff also reported that we would propose a fair value option for financial assets to enable entities to eliminate or substantially reduce accounting mismatches. (Later in the meeting, the working group discussed the fact that the Board does not intend to provide a similar option for insurance contract liabilities.)

9. Some questioned whether the fair value through OCI category should be available for other financial assets that an insurer might hold. Some expressed concern that because the use of OCI is not well defined generally, the Board may after completing this project revisit its conclusions in this project.

Reporting back – Premium allocation approach

10. In general, we heard support for the decisions the IASB has made. There were also some specific issues raised, including a reiteration that the board should consider carefully whether the economics of specific contracts justified a separate accounting model for them.

Reporting back – Other comprehensive income

11. There was general acknowledgement that IASB has listened in considering an OCI approach for some changes in the insurance contract liability.

[1] The staff notes that IFRS 9 will retain the existing option to classify equity investments at fair value through other comprehensive income.

12. Some participants expressed concerns about the treatment of loss sensitive cash flows and about the fact that the Board does not intend to include a test that would, without changing the measurement of the insurance contract liability, accelerate the recognition in profit and loss of some losses already recognised in OCI in the event that the assets provide lower than expected returns (sometimes called a ‘loss recognition test’).

13. Most importantly, many were concerned that an accounting mismatch would arise from requiring changes in the insurance liability to be presented in OCI, while the assets will be measured using a mixture of fair value through OCI, fair value through profit and loss and amortised cost. Participants stated that this approach would not measure assets and liabilities on a consistent basis. Many participants suggested this problem could be dealt with through an option to present all changes in the insurance contract liability in profit and loss. However, an option to present all changes in profit and loss was not universally supported, especially by the users. However, though they believed that there should be no optionality in the accounting treatments they were also concerned that the board’s tentative decisions would not provide useful information if the resulting accounting mismatch caused two volatile numbers: one in profit and loss and one in OCI.

Reporting back – accounting for non-insurance components

14. Participants generally welcomed the proposals for unbundling to be limited because unbundling is considered to be difficult. However, though most acknowledge that long duration contracts have an investment component, many also noted that there some users do not seem to have a need for insurers to separate the investment component from the premium amounts, Again, however, we heard divergent views.

15. Many users were concerned about whether the cost of excluding investment components from premiums in the statement of comprehensive income is proportionate to the benefit provided to users, except in fairly limited situations such as explicit account balances. We also noted that we need to consider how the board’s decision to exclude investment components from the premiums presented on the statement of comprehensive income would apply when estimates change.

Reporting back – residual margin

16. There was general support on offsetting in the residual margin changes in estimates in cash flows, but many question whether changes in risk adjustments and discount rates should also be offset in the residual margin.

Reporting back – Scope of the standard and definition of an insurance contract

17. In general, we heard support for the decisions the IASB has made on scope and definition of an insurance contract.

Seeking input

Seeking input - Earned premiums

18. There was sympathy for the desire to show volume that is consistent with revenue recognition principles.

19. We also heard that there are very many volume indicators which are important for insurance contracts, with some saying that, as for similar activities undertaken by banks, the assets under management is the most critical indicator. In common with other industries, users look to a variety of volume indicators as a tool to seek to understand profitability, growth and new business.

20. However, there are concerns that determining earned premium would have costs disproportionate to the benefits given that, for insurance, revenue as understood elsewhere is less important than other indicators of profitability. Instead, participants suggested that the boards balance the usefulness of information with complexity by using an existing volume measure as a top line number. This would avoid creating a new measure that management does not use at the moment. On the other hand, some felt that using those existing volume measures creates a need to include other line items that may be difficult to interpret.

21. Finally, we heard that it is essential that we at least require insurers to disclose the summarised margin approach, because it provides key information about insurance contracts.

Seeking input – Estimating the residual margin on transition

22. There was support for retrospective application of a new insurance contracts standard, which would reflect current values for risk adjustment and cash flows. Participants noted that retrospective application would require judgement to determine the residual margin and there was general recognition that the board's decisions on other comprehensive income would introduce some potential complexities.

23. Participants noted that the transition adjustment would have a significant effect not only in the year of transition, but in the reported profitability for years to come.

24. There were differing views on the extent to which we should provide broad principles for preparers and auditors to apply, or that we should specify possibly arbitrary proxies for the residual margin.

Other matters

25. Participants discussed whether there could be more useful disclosure that could help users of financial statements to assess the cash available to shareholders. However, we also heard concerns about whether it would be appropriate to provide this sort of information in financial statements.

Next steps

26. We reported that we will be considering how best to seek further input from the working group as we near the end of the project, and that we had not set future insurance working group meeting dates.

27. In the meantime, we noted that we will put the reporting back papers on our website, and invite participants to provide any detailed comments on the drafting back to us. We would also seek input on the board's decisions from all interested parties, including users of financial statements.

28. We noted our intention to publish a due process document, either review draft or re-exposure draft, at the end of year.