STAFF PAPER

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[REG] IASB Meeting

Project	**Investment Entities**		
Paper topic	Request for extension of exception to consolidation		

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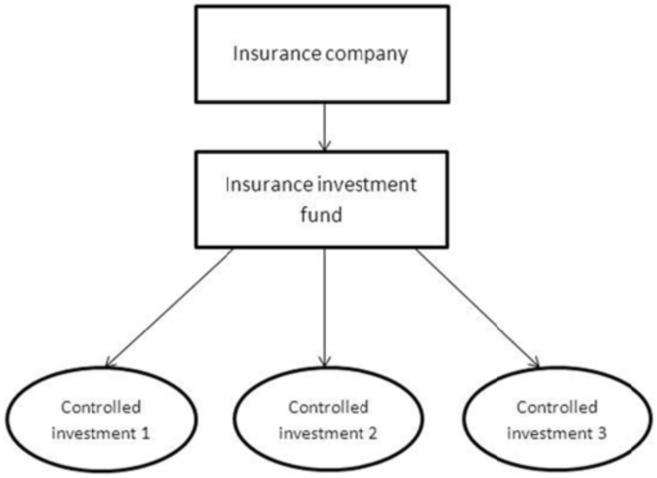
Objective

1. This paper discusses the request raised by some insurers for an extension of the exception to consolidation proposed in the *Investment Entities* exposure draft ('the ED').

Background

2. The ED proposed an exception from consolidation for the controlled investees of investment entities.

3. Many insurance companies have controlling interests in investment funds. These funds have different names in different jurisdictions ('separate accounts' in the U.S., 'segregated accounts' in Canada, 'unit-linked funds' or 'with-profit funds' in Europe, 'investment-linked insurance funds' in Asia, etc.). This paper will refer to these funds collectively as 'insurance investment funds'. The relationship can be depicted as follows:



4. Insurance investment funds represent assets that are usually maintained by a life insurance company in order to fund obligations to policyholders. These assets are due to the policyholders but held through the life insurance company. These funds are established through an insurance contract agreement or annuity.

5. While in some cases insurance investment funds are wholly owned by a single insurer, in other cases there are external investors in insurance investment funds. In addition, in some cases the asset management function is performed within the insurance company, while in other cases there is an unrelated asset manager.

Feedback received

6. Many insurance companies agreed with the exception to consolidation proposed for investment entities in the ED. They argued that insurance investment funds should qualify as investment entities and that those insurance investment funds should not consolidate their controlled investments (ie controlled investments 1-3 in the diagram above).

7. However, some insurance companies also requested an additional extension of the exception from consolidation proposed in the ED. These entities argued that they should be required to measure their controlling interest in the actual insurance investment funds at fair value rather than consolidating them. They argued that the most useful information would be to have a single line item for the fair value of their interest in the insurance investment fund, along with a single line item for the current

value of their liability to policyholders who receive the returns from those investment funds[1].

8. These entities argued that, just as fair value information represents more useful information than consolidated information for investment entities' controlled investees, fair value information represents more useful information than consolidated information for insurers' interests in controlled insurance investment funds. These entities gave a number of supporting arguments to make this point:

   (a) Although the insurer might control the insurance investment fund, the assets in that fund are held to back obligations to policyholders and the returns from the assets in the insurance investment fund will be distributed to policyholders. The insurer exercises its control over the insurance investment fund on a fiduciary basis for the policyholders.

   (b) Recognising 100 per cent of the insurance investment fund's assets on the balance sheet, along with a non-controlling interest, when the insurance investment fund is not wholly-owned does not present useful information and grosses up the balance sheet. Policyholders and other investors in the insurer are interested only in the assets backing the obligations due to the insurer's policyholders and not in any assets representing external parties' interest in the fund. This problem is exacerbated by the fact that such external funding is often classified as a financial liability.

   (c) Insurers may flip in and out of consolidation in some cases because the level of external ownership interest in the insurance investment fund changes frequently. Having the amount of assets recognised changing significantly from period to period because of external factors that the insurer cannot control would also not represent useful information to the users of the insurer's financial statements.

   (d) Providing an exception from consolidation for an insurer's interest in an insurance investment fund would solve any problems associated with

[1] It is noted that this is different to the 'roll up' question previously considered by the IASB, which considered whether the fair value measurement of controlled entities should be retained by a non-investment entity parent. In this case, some respondents are questioning whether the parent's investment in an investment fund subsidiary should be exempt from consolidation.

consolidating that investment fund's underlying controlled investments because the insurance company would not be required to consolidate the fund.

(e) Some insurers stated that the implementation of the requirements of IFRS 10, particularly the agent/principal guidance, would cause insurers to consolidate more funds than they were previously doing, which would further exacerbate the issue.

(f) Insurers expressed the view that the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*, IFRS 12 *Disclosure of Interests in Other Entities* and IFRS 13 *Fair Value Measurement* are onerous and meaningless when an insurance investment fund is not wholly-owned. They argued that users of their financial statements are not interested in disclosures about assets that do not relate to the assets invested on behalf of the insurer's policyholders themselves. Moreover, some argued that it is more difficult to gather the information required to make those disclosures when there is an external asset manager.

Consequences of decisions made to date

9. The staff think that there are insurance investment funds that will qualify as an investment entity at the fund level given the proposed definition of an investment entity. However, at the June 2012 board meeting, the IASB tentatively decided that the fair value accounting used by an investment entity subsidiary to account for its controlled investments should not be retained at a non-investment entity parent level. Consequently, following the current tentative decisions and the requirements in IFRS 10, insurers would be required to consolidate their controlling interests in insurance investment funds. In addition, insurers would be required to consolidate any controlled investees of those insurance investment funds.

Staff analysis and recommendation

10. Some staff think that there is a strong argument that a single line item representing the fair value of an insurer's investment in an insurance investment fund (along with a line item depicting the current value of the insurer's liability to policyholders) would present more useful information than consolidating the insurer's interest in the insurance investment fund.

11. The proposed extension of the exception from consolidation would not necessarily conflict with the IASB's recent decision that a non-investment entity parent should not retain the fair value accounting used by an investment entity subsidiary. It raises a different question. The exception to consolidation would be moved one level up, to an insurer's interest in an investment entity itself, so an insurer would not have to consider whether or not to retain the fair value accounting used by its investment entity subsidiaries to account for those investment entity subsidiaries' controlled investments.

12. However, the staff think that this topic is outside the scope of the Investment Entities project. The purpose of this project is to provide an exception to consolidation for investment entities. The staff think that extending this exception to consolidation would require re-exposure of the proposals. The staff note that the IASB has prioritized the completion of the investment entities project given the 1 January 2013 effective date of IFRS 10.

13. The staff also note that the IASB had previously discussed, in its deliberations on IFRS 10, whether there should be specific consolidation requirements (specifically agent/principal guidance) for regulated funds, which would have helped to address this issue. The IASB decided that there should be no specific guidance for regulated funds and that the consolidation guidance, including the agent/principal guidance, should be applied equally to all investments regardless of their nature.

14. Moreover, the IASB would have to do further work to define the scope of the exception. The exception would require particular non-investment-entity parents of investment entities to measure those investment entities at fair value rather than consolidating them. The IASB could either provide the extension of the exception to consolidation specifically to insurance companies (and would therefore have to define

an insurance company) or would have to come up with certain factors that described the characteristics of the relationship between the non-investment-entity parent and investment entity subsidiary that justified the extension of the exception to consolidation.

15. Consequently, the staff do not recommend extending the exception to consolidation to interests in insurance investment funds held by insurance companies as part of the Investment Entities project.

16. If the IASB is interested in pursuing the proposed extension of the exception to consolidation, the staff would recommend that they do so as part of a separate project. This would be subject to the usual process for adding a new project to our agenda.

Question for the IASB
Does the IASB agree with the staff's recommendation not to extend the exception to consolidation for insurers' insurance investment fund subsidiaries?