

21 May – 24 May 2012

International Financial Reporting Standards

Use of OCI - Overview

IASB Education session May 2012
IASB Agenda Paper 14A

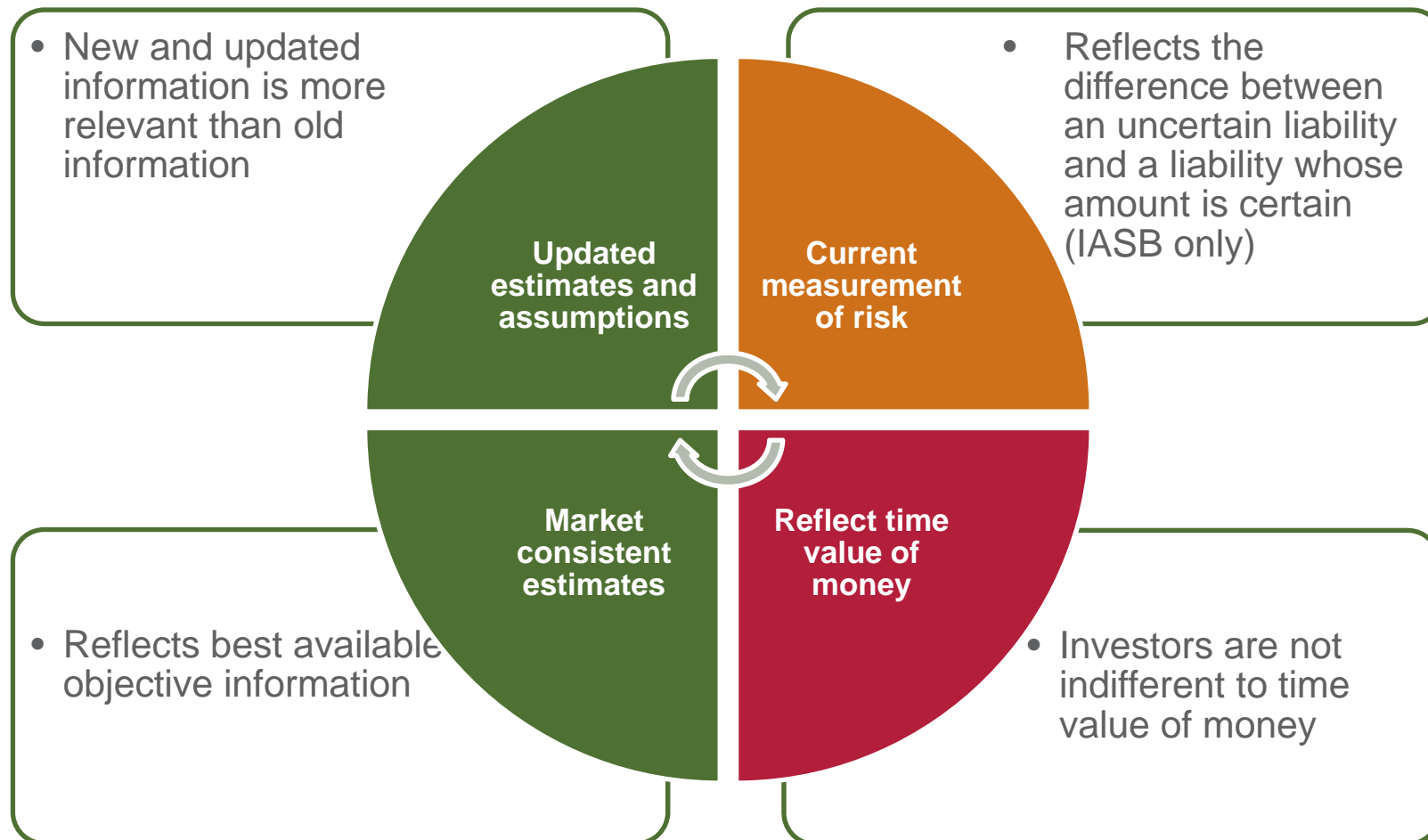
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The use of OCI

Agenda paper 21

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Current value information about the liability is useful



Where should changes in the liability be reported?

- Overall objective
 - To present changes in the insurance liability in a way that provides useful information to users
- Information is useful when
 - Underwriting performance (core operating results) is presented clearly and not overshadowed (paragraphs 32 - 35)
 - Changes in the insurance liability that reverse over time are presented separately from other changes (paragraphs 30 - 33)
 - Accounting mismatches are eliminated or reduced (paragraphs 13 - 27)

Comprehensive Income

A current view of performance

Profit or loss

Performance based on a
locked in discount rate

OCI

Effect of changes in
discount rate

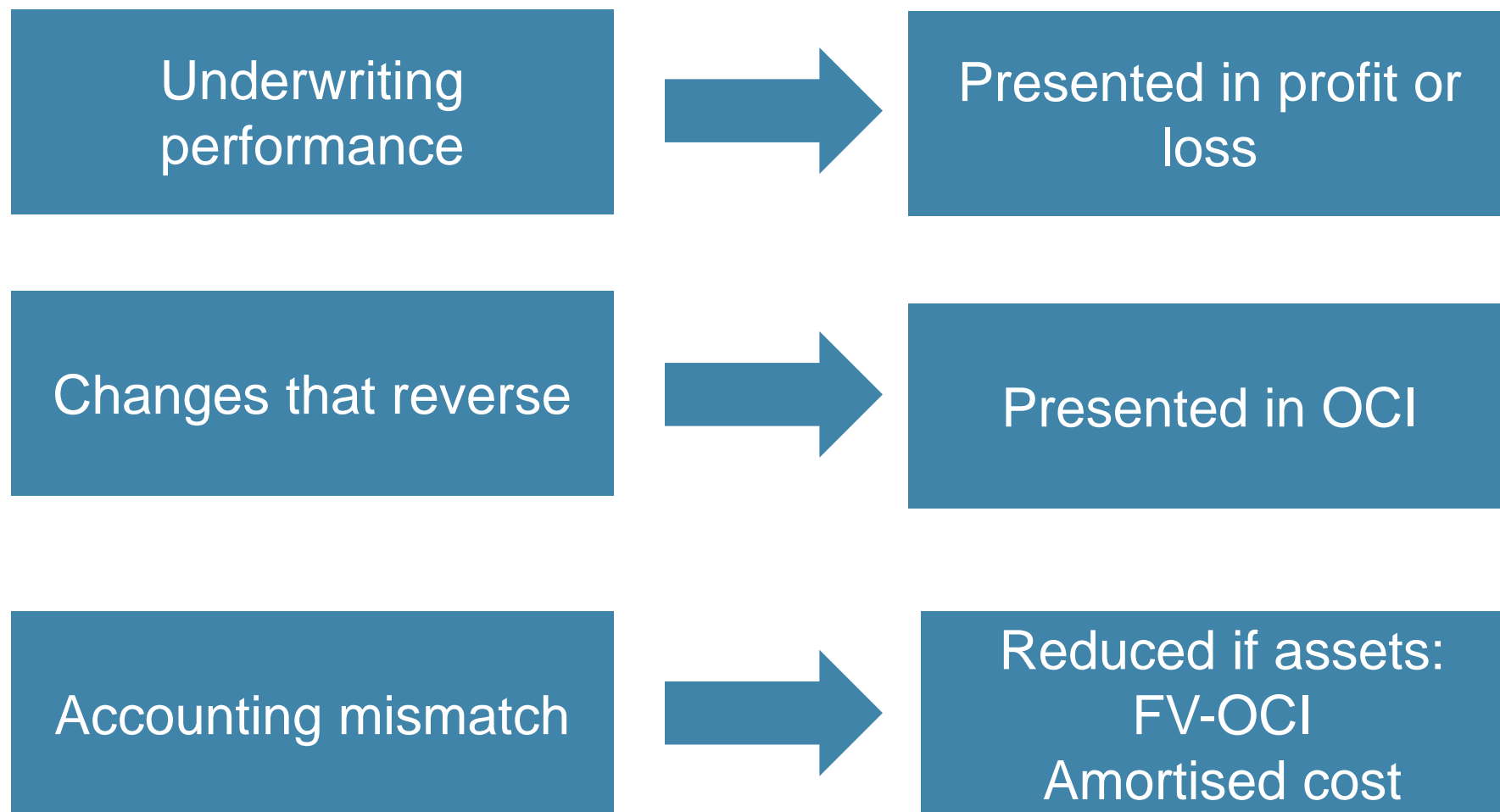
Proposed approach – What is presented in profit or loss?

- Underwriting result including:
 - Premiums and claims
 - Changes in risk adjustment (IASB only)
 - Release of margin
 - Changes in cash flow assumptions (unless absorbed by residual margin – IASB only)
- Interest expense at the locked in rate

Proposed approach – What is presented in OCI?

- Cumulative OCI:
 - difference between liability discounted at the current rate and the liability discounted at the locked in rate
- Current period OCI:
 - Effect of discount rate change in current period
 - Unwind of amounts previously recognised in OCI (= interest expense at current rate – interest expense at locked in rate)

Proposed approach – How does it achieve our objective?



AP 2I - Question 1

The staff recommend that Changes in the insurance liability arising from changes in discount rate should be presented in OCI.

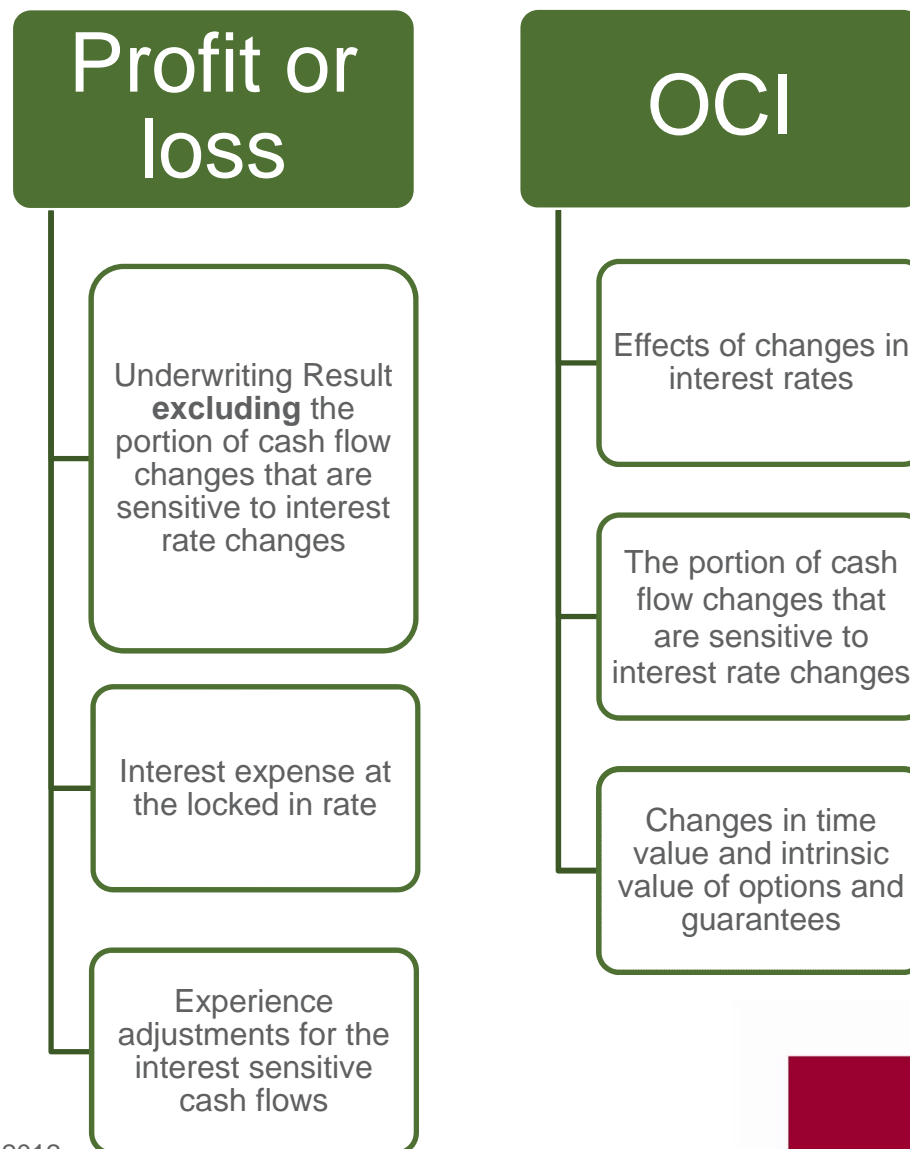
Do the boards agree?

Presenting changes in interest sensitive assumptions

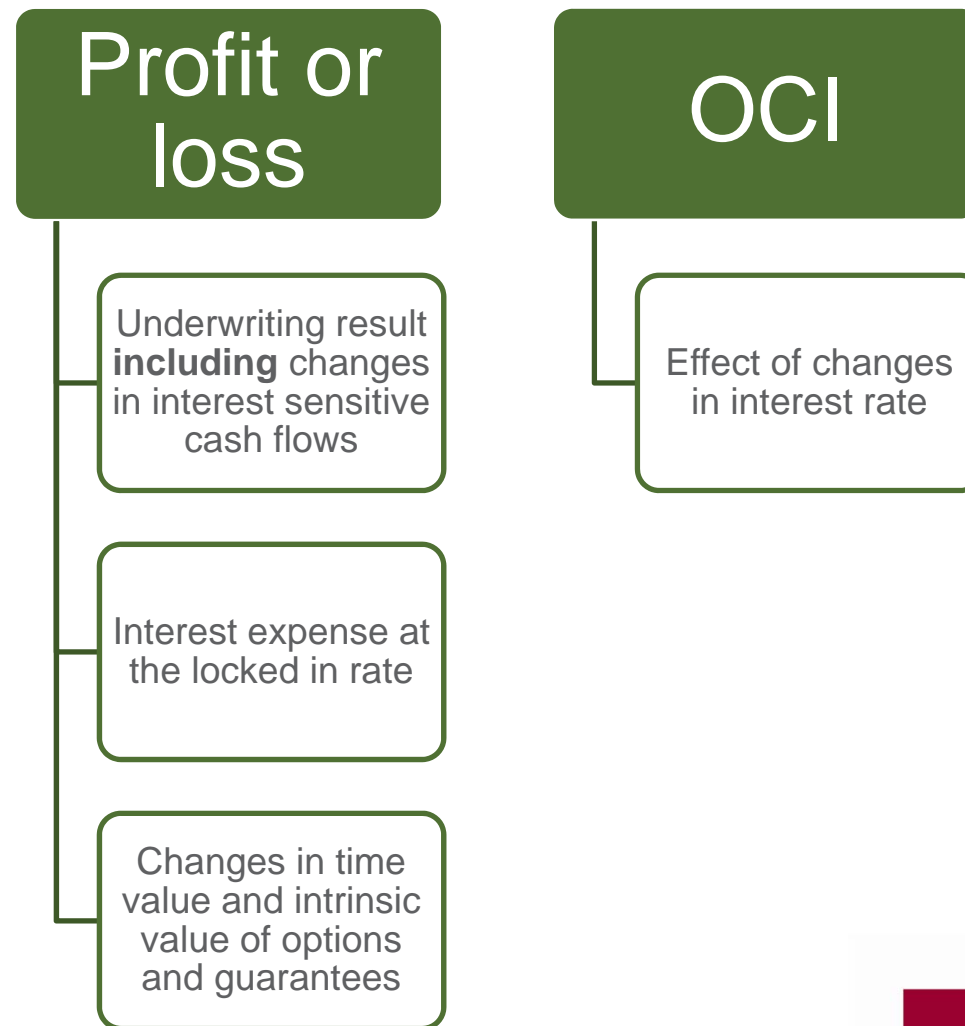
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- Effects of changes in interest rates include:
 - Interest sensitive features (eg. interest rate guarantees and options)
 - Interest sensitive assumptions (eg. lapse surrender rates)
- Where should these changes in interest be presented:
 - OCI (paragraphs 52 - 56)?
 - Profit or loss (paragraphs 49 - 51)?

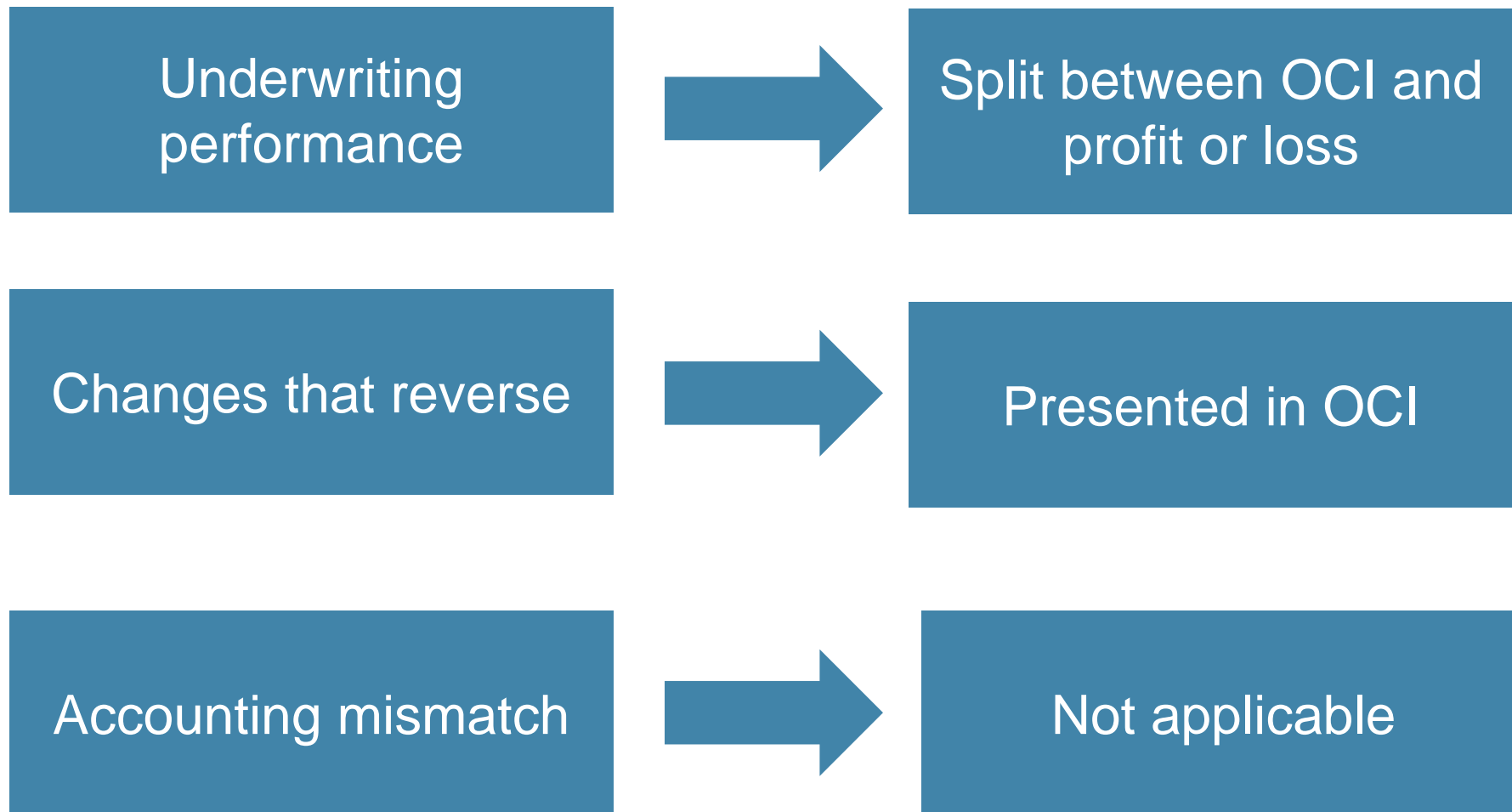
Present changes in interest sensitive assumptions OCI



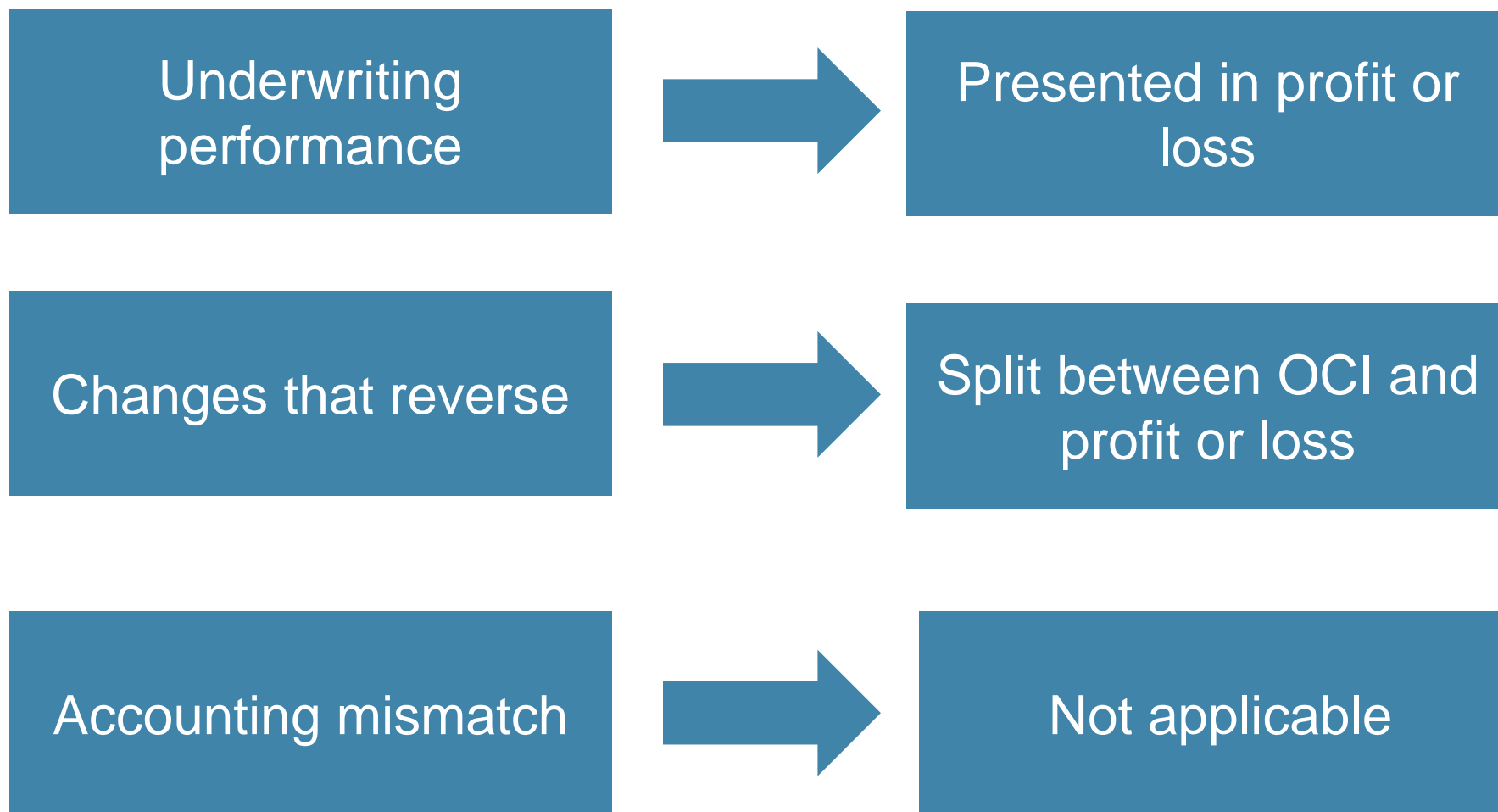
Present changes in interest sensitive assumptions in profit or loss



Presenting changes in interest sensitive assumptions in OCI



Presenting changes in interest sensitive assumptions in profit or loss

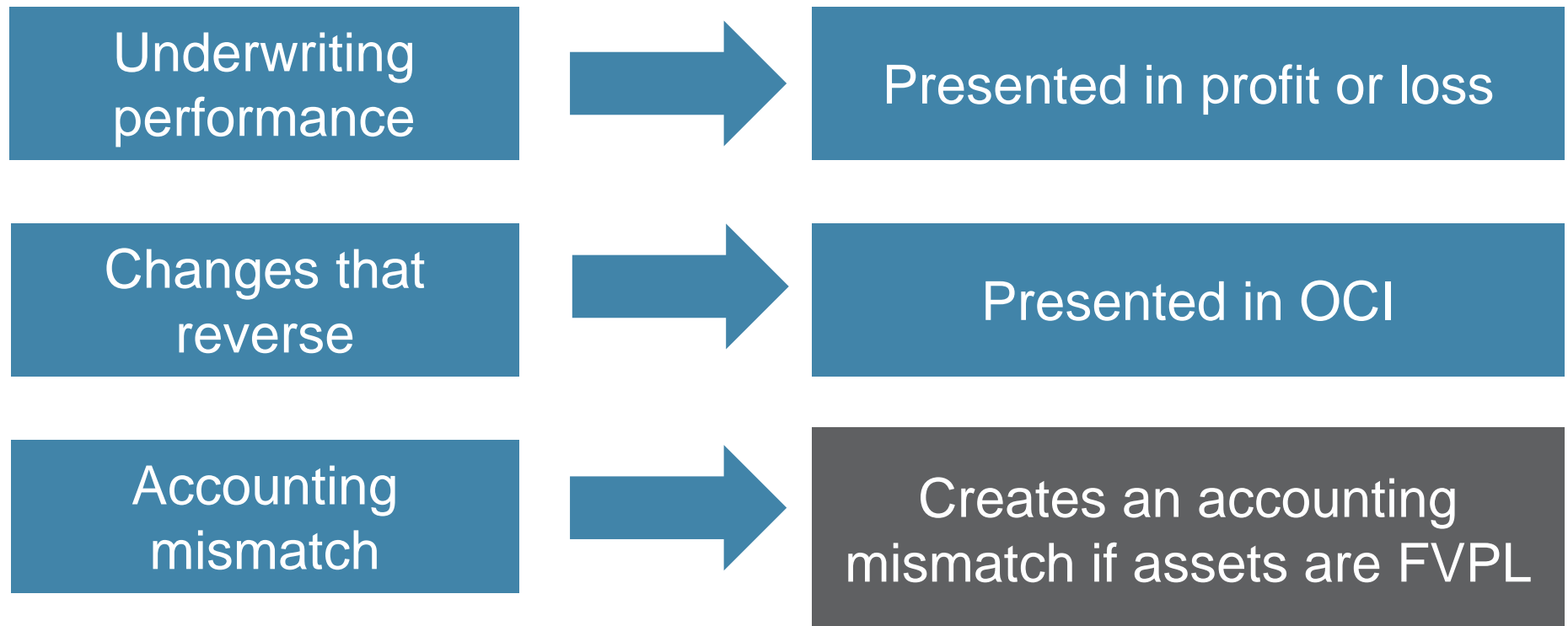


Should changes in the insurance liability arising from changes in interest sensitive cash flow assumptions be presented in:

- OCI (FASB staff view)?
- Profit or loss (IASB staff view)?

Permit or require use of OCI

- Requiring use of OCI creates accounting mismatch (paragraph 63)



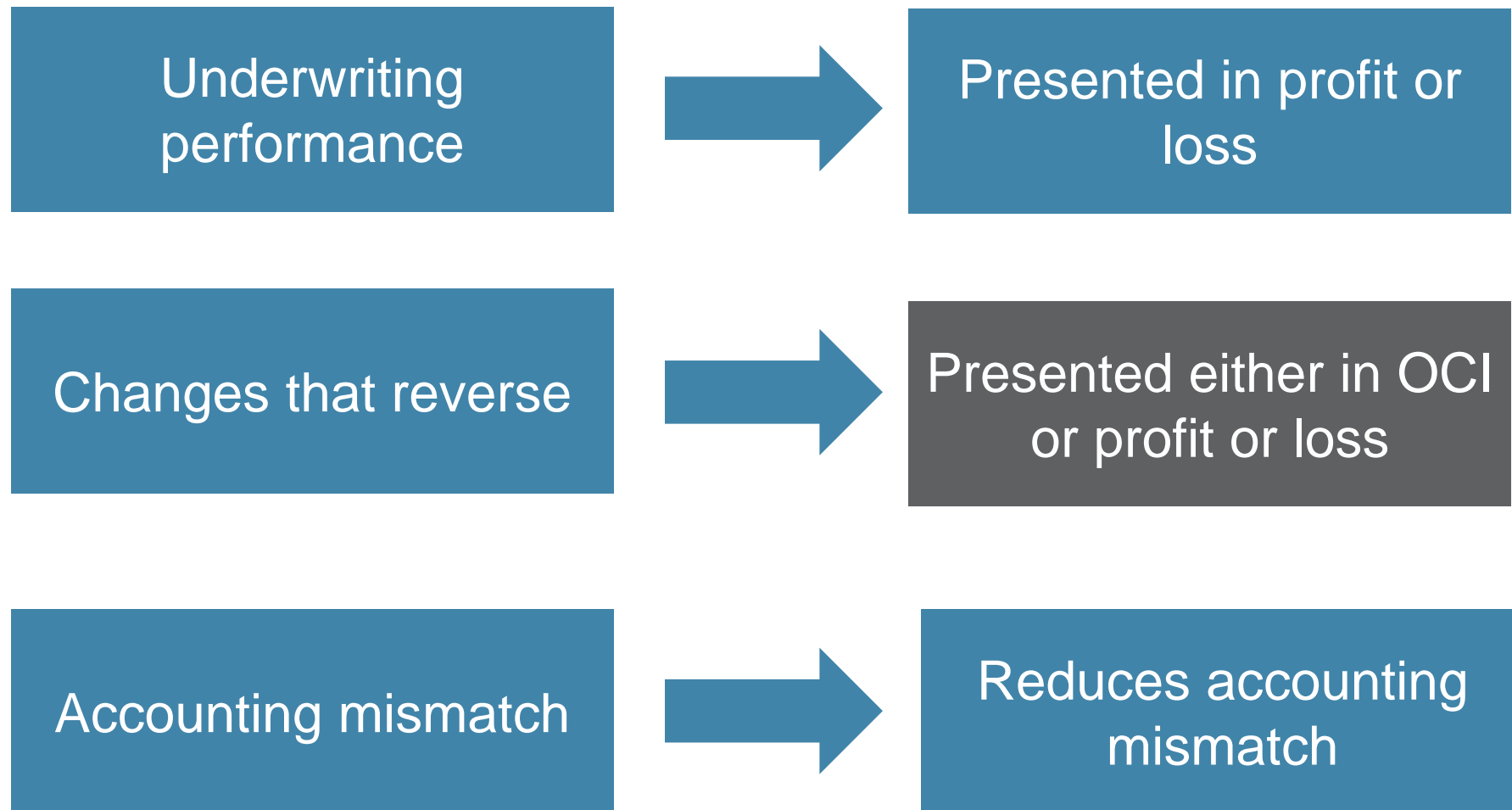
Permit or require use of OCI

- Require use of OCI plus option to present in profit or loss:
 - in all situations
 - If eliminates or significantly reduces accounting mismatch (paragraphs 64 - 71)
- Require use of profit or loss plus option to present in OCI:
 - in all situations
 - If eliminates or significantly reduces accounting mismatch (paragraphs 72 - 75)

Staff recommendation – Require use of OCI unless recording change in profit or loss would eliminate or reduce an accounting mismatch (paragraphs 76 - 78)

Permit or require – How does staff recommendation achieve our objective?

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AP 2I - Question 3

The staff recommend that changes in the insurance liability arising from changes in discount rates should be presented in OCI unless presenting those changes in profit or loss would eliminate or significantly reduce an accounting mismatch.

Do the boards agree?

Unit of account

- In determining whether changes in the insurance liability arising from changes in discount rates should be presented in OCI or profit or loss what unit of account should be used (paragraphs 80 - 90)?

**FASB Staff
recommendation:**

Portfolio

**IASB Staff
recommendation:**

Allocation based on asset mix

In determining whether changes in the insurance liability arising from changes in discount rates should be presented in OCI or profit or loss what unit of account should be used:

- Portfolio (FASB staff view)?
- Allocation based on asset mix (IASB staff view)?

AP 2I - Question 5

- When (if ever) should the determination to present changes in the insurance liability in OCI or profit or loss be changed (paragraphs 91 - 97)?

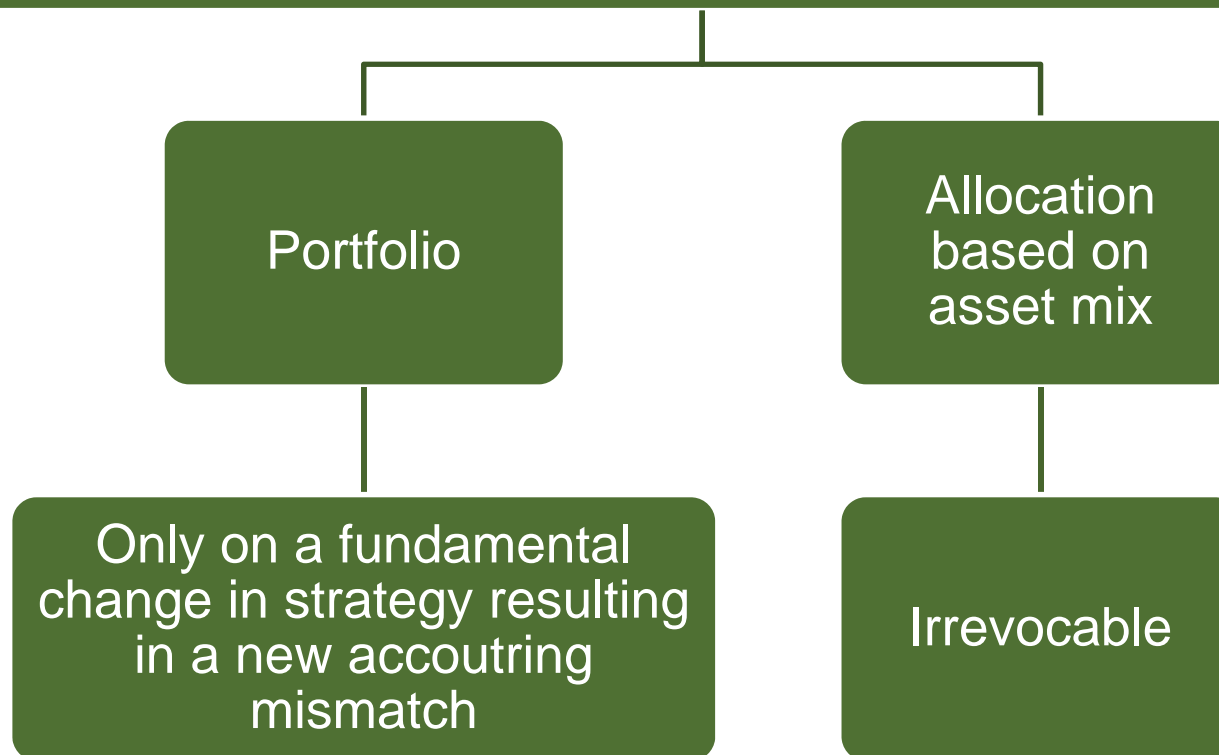
The staff recommend that the decision to present changes in the insurance liability in OCI or profit or loss should be:

- Irrevocable if the unit of account is an allocation of individual contracts
- Changed if the fundamental strategy for the portfolio were to change resulting in a new accounting mismatch (expected to be rare).

Do the boards agree?

Interaction Questions 3-5

Changes in the insurance liability arising from changes in discount rates should be presented in OCI unless presenting those changes in profit or loss would eliminate or significantly reduce an accounting mismatch



Mechanics of OCI

Agenda paper 2J

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Mechanics—What should be presented in profit or loss?

Alternative A (paragraphs 16 - 19)

- Present in:
 - profit or loss interest expense using the locked in rate
 - OCI changes in the insurance liability arising from changes in the discount rate

Alternative B (paragraphs 20 - 24)

- Present in:
 - Profit or loss interest expense using the current rate and an amount transferred to/from OCI
 - OCI changes in the insurance liability arising from changes in the discount rate split into:
 - The effect of the discount rate change in the current period
 - Unwind of amounts previously recognised in OCI

Mechanics

	Alternatives	
	A	B
<i>Extracts from profit or loss</i>		
Interest expense @ current rate		(98.1)
Amounts presented in OCI		25.9
Interest expense @ locked-in rate	(72.2)	(72.2)

Net profit (loss)	19.3	19.3
<i>Extracts from OCI</i>		
Effects of disc rate changes - ins liability	(25.9)	(25.9)

Net OCI	(2.3)	(2.3)
Total comprehensive income	17.0	17.0

Numbers for this example are taken from example 1 in AP 14B

Mechanics – What should be presented in profit or loss

- Both alternatives A and B result in the same net answer in profit or loss and OCI
- Alternative A is less complex and easier to understand
- Alternative B provides information about:
 - Interest expense at current rates
 - The effect of changes in rates on the liability

AP 2J - Question 1

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The staff recommend that Insurers present in:

- Profit or loss interest expense using the discount rate locked in at inception of the insurance contract;
- OCI changes in the liability arising from changes in discount rate (Alternative A).

Do the boards agree?

What locked-in discount rate should be used for changes in expected cash flows?

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Rate at inception

- Less complex
- Consistent with effective interest rate method under IFRS

Rate on the date of the change

- More complex
- Consistent with some aspects of US GAAP

AP 2J - Question 2

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The staff recommend that Insurers present interest expense in profit or loss in respect of changes in expected cash flows based on the discount rate locked in at inception of the insurance contract.

Do the boards agree?

Loss recognition test

Agenda paper 2K

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What is a loss recognition test?

- Some consider a contract to be loss making when asset returns are lower than expected. Consequently, they would accelerate the recognition of losses in profit or loss when asset returns are lower than expected
- What is a loss recognition test? (paragraphs 5 - 8)
- Arguments for (paragraphs 16 - 25)
- Arguments against (paragraphs 26 - 34)

AP 2K - Question 1

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The FASB staff recommend a loss recognition test.

The IASB staff do not recommend a loss recognition test.

Which approach do the boards support?