STAFF PAPER

15 – 19 October 2012

IASB Meeting

Project	**Insurance Contracts**
Paper topic	Transition: Overview and proposed drafting

CONTACT(S)	Andrea Pryde	apryde@ifrs.org	+44 (0)20 7246 6491
	Izabela Ruta	iruta@ifrs.org	+44 (0)20 7246 6957
	Andrea Silva	asilva@ifrs.org	+44 (0)20 7246 6961

Introduction

1. This paper sets out the proposed drafting for the IASB's previous decisions and current staff recommendations for transition for the proposed Insurance Contracts Standard.

2. It incorporates the decisions made in September 2012 (see Appendix A) and the recommendations in the following staff papers:

   (a) Agenda Paper 10C *Redesignation and reclassification of financial assets*;

   (b) Agenda Paper 10D *Transition—Ancillary issues*; and

   (c) Agenda Paper 10E *Transition—Effective date*, *comparative financial statements and early application*.

3. This paper does not include any transition requirements that may be needed relating to the presentation of premiums, claims and expenses in the statement of comprehensive income. This topic will be discussed at a future meeting subject to the boards' decision on the presentation of premiums, claims and expenses in the statement of comprehensive income.

4. This paper provides an overview of the proposed requirements but does not include any questions.

A reminder of the transition issues

5. If an insurer were to apply the new Insurance Contracts Standard retrospectively, an insurer would need to:

   (a) measure the insurance contracts in force at the beginning of the earliest period presented (with the corresponding adjustment to retained earnings at the beginning of the earliest period presented); and

   (b) determine the amount of the cumulative adjustment in other comprehensive income (OCI) at the beginning of the earliest period presented.

6. The present value of fulfilment cash flows is a current value measurement, and can be determined directly. However, the measurement of the residual margin and the amount of the cumulative adjustment in OCI are not current value measurements. Accordingly, the staff has proposed (in papers for both the September 2012 and this month's meetings) specific requirements that relate to those items.

Residual margin

7. Determining the residual margin at the beginning of the earliest period presented would require that an insurer:

   (a) determine what the residual margin would have been when the contract would have been recognised. The IASB's decisions in September 2012 (see Appendix A) addressed this issue (see Agenda Paper 2B/89B *Transition requirements* for the September meeting).

   (b) determine the changes of the margin from initial recognition to the transition date, as follows:

      (i) determine the release pattern for the margin for the period between initial recognition and the transition date; and

      (ii) determine the amount and timing of all changes in estimates of cash flows at the end of each reporting period after initial recognition.

   (c) separate the changes in paragraph 7(b)(ii) into:

(i) changes related to the future cash flows which adjust the margin prospectively from the date of the change in estimate; and

(ii) differences between actual cash flows and previous estimates of those cash flows (experience adjustments) which are recorded in the statement of comprehensive income in the year of the change in estimate.

This issue is discussed in agenda paper 10D *Transition—Ancillary issues*.

Cumulative adjustment in OCI

8. Determining the cumulative adjustment in OCI would require an insurer to know what the discount rate was when the insurer would have recognised the contract. The IASB's decisions in September 2012 (see Appendix A) addressed this issue (see Agenda Paper 2C/89C *Transition: Determination of the discount rate* for the September meeting).

Proposed drafting

9. The following text proposes drafting to implement the IASB's tentative decisions to date and the staff recommendations in Agenda Papers 10C *Redesignation and reclassification of financial assets*, 10D *Transition—Ancillary issues* and 10E *Transition—Effective date, comparative financial statements and early application*.

Effective date and transition

98	The transition requirements in paragraphs 99–102 apply both to an insurer that applies IFRSs when it first applies this [draft] IFRS and to an insurer that applies IFRSs for the first time (a first-time adopter).	Staff recommendation in Agenda Paper 10D.
99	An insurer shall apply this [draft] IFRS for annual periods beginning on or after [date at least three years from date of publication ~~to be inserted after exposure~~]. ~~If an insurer applies this [draft] IFRS for an earlier period, it shall disclose that fact.~~	Staff recommendations in Agenda Paper 10E. Disclosure moved to transition disclosure section.
100	At the beginning of the earliest period presented, an insurer shall, with a corresponding adjustment to retained earnings:	
	(a) measure each portfolio of insurance contracts at the sum of (i) present value of the fulfilment cash flows and (ii) a residual margin that is determined in accordance with paragraphs 100A–100B. ~~It follows that for insurance contracts to which these transitional provisions are applied, the measurement, both at transition and subsequently, does not include a residual margin.~~	IASB decision from the September 2012 meeting. As noted in the Agenda Paper for that meeting, it is straightforward to determine the present value of the fulfilment cash flows because it is a current value measurement.

(b) derecognise any existing balances of deferred acquisition costs.	Confirmed at the September 2012 meeting.
(c) derecognise any intangible assets arising from insurance contracts assumed in previously recognised business combinations. That adjustment does not affect intangible assets, such as customer relationships and customer lists, which relate to possible future contracts.	We intend to carry forward this paragraph, which was not widely commented on in the ED.
(d) recognise, in other comprehensive income, the cumulative effect of the difference between (i) the discount rate at the date of transition, and (ii) the discount rate that would have applied when the portfolio of contracts was recognised, as determined in accordance with paragraph 100C.	Retrospective application of the proposed Standard would result in an adjustment to other comprehensive income.
100A An insurer shall determine the residual margin at the beginning of the earliest period presented by:	Recommended in Agenda Paper 10D *Transition—Ancillary issues*
(a) determining the residual margin at initial recognition of the portfolio of contracts in accordance with paragraph 100B, assuming that all changes in the estimates of cash flows between initial recognition and the beginning of the earliest period presented were already known at initial recognition.	
(b) determining how much residual margin would have been released before the beginning of the earliest period presented.	
100B In applying paragraph 100A, an insurer shall determine the residual margin at initial recognition of the portfolio of contracts as follows:	IASB decision from the September 2012 meeting. As discussed at that meeting, retrospective application may not be feasible for contracts that were initially recognised many years ago. These

(a) the insurer shall determine the residual margin at initial recognition of the portfolio of contracts by applying this [draft] IFRS retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to portfolios for which it is practicable to do so.	proposals provide a means for insurers to estimate the amount of residual margin.
(b) for some portfolios, it may be impracticable to determine the residual margin at initial recognition of the portfolio by applying this [draft] IFRS retrospectively in accordance with IAS 8 because it would require significant estimates that are not based solely on objective information. For such portfolios, an insurer shall estimate what the margin would have been had the insurer been able to apply the [draft] IFRS retrospectively. In such cases, an insurer need not undertake exhaustive efforts to obtain objective information but shall take into account all objective information that is reasonably available.	
(c) for all other portfolios, an insurer shall determine the residual margin as the excess, if any, of the carrying amount of the insurance liability immediately before transition over the present value of the fulfilment cash flows at that date.	The staff believe that the “general requirements of IAS 8 that are relevant to situations in which there are limitations on retrospective application (ie measure the margin by reference to the carrying value before transition)” is insufficiently clear. Accordingly the staff have drafted this as an explicit instruction to determine the residual margin by reference to the carrying amount of the insurance liability immediately before transition.
100C Paragraph 100 requires an insurer to determine the cumulative adjustment in other comprehensive income. For this purpose, an insurer shall determine the yield curve that applied when portfolios were initially recognised as	When contracts are recognised, the discount rate is needed to determine the adjustment to other comprehensive income for transition to the new Standard. The discount rate when the contracts are recognised could also be

follows: (a) an insurer shall apply paragraphs 30–33 [that deal with the discount rate] retrospectively in accordance with IAS 8 to portfolios for which it is practicable to do so. (b) for contracts where it is not practicable to apply those paragraphs, an insurer shall: (i) determine the yield curve using an observable yield curve that, for at least three years before the date of transition, approximated the yield curve determined in accordance with paragraphs 30–33 and B66A–B66F [that deal with the discount rate]; or	used to determine the residual margin at initial recognition of the contract, if the insurer does not estimate the residual margin directly. However the IASB's decisions mean that an insurer may determine the residual margin (eg using ratios determined from retrospective application).
(ii) if the yield curve in (i) does not exist, apply to the observable yield curve that most closely approximates the yield curve determined in accordance with paragraphs 30–33 and B66A–B66F a spread (averaged over at least three years if possible) between that observable yield curve and the yield curve determined in accordance with those paragraphs.	Modified from the September 2012 decision to avoid the possibility that *any* yield curve could be used.
Disclosure	
100D An insurer applying this [draft] IFRS for periods beginning before [date at least three years from date of publication] shall disclose that fact.	Moved from paragraph 99.
100E For each period in which there is a material effect in the financial statements arising for contracts measured in accordance with paragraphs 100–100C, an insurer shall	IASB decision from the September 2012 meeting. We think it is important that insurers disclose the effects of transition, as these are likely to be significant.

disclose, in addition to the disclosures required by IAS 8:

(a) the date of initial recognition of the earliest portfolios for which the insurer applied this standard retrospectively.

(b) the disclosures required by 90–90B [which deal with significant judgements in the application of the [draft] IFRS] separately for portfolios to which paragraphs 100–100C apply. At a minimum, an insurer shall provide those disclosures for:

   (i) the residual margin as determined in accordance with paragraph 100A, including a description of the extent to which the insurer used information that is not objective in determining the margin; and

   (ii) the discount rate as determined in accordance with paragraph 100C.

101	In applying paragraph 92(e)(iii), an insurer need not disclose previously unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it first applies this [draft] IFRS. Furthermore, if, when an insurer first applies this [draft] IFRS, it is impracticable to prepare information about claims development that occurred before the beginning of the earliest period for which the insurer presents full comparative information that complies with this [draft] IFRS, it shall disclose that fact.	Confirmed at the September 2012 meeting.

Redesignation of financial assets

102 At the beginning of the earliest period presented, when an insurer first applies this [draft] IFRS, it is permitted, but not required~~,~~:

(a) to redesignate a financial asset as measured at fair value through profit or loss if doing so would eliminate or significantly reduce a new inconsistency in measurement or recognition created by the application of this IFRS.

(b) if the insurer has previously applied IFRS 9:

(i) to newly elect to use other comprehensive income for the presentation of changes in the fair value of some or all equity instruments that are not held for trading; and

(ii) to revoke a previous election to use other comprehensive income to present such changes.

~~The reclassification is a change in accounting policy and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* applies. The insurer shall recognise the cumulative effect of that redesignation as an adjustment to opening retained earnings of the earliest period presented and remove any related balances from accumulated other comprehensive income.~~

Recommended in Agenda Papers 10C *Redesignation and reclassification of financial assets* and 10D *Transition—Ancillary issues*.

102A An insurer is required to revoke previous designations as measured at fair value through profit or loss where

Recommended in Agenda Paper 10C *Redesignation and reclassification of financial assets*.

the initial application eliminates an accounting mismatch that led to that previous designation.

102B The application of paragraphs 102 and 102A are changes in accounting policy to which IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* applies. An insurer shall recognise the cumulative effect of such changes in accounting policy as an adjustment, at the beginning of the earliest period presented, to opening retained earnings and, if applicable, the opening balance of accumulated other comprehensive income.

Appendix A: Previous decisions on transition

At the joint September meeting, the IASB and FASB tentatively decided:

Measurement

The boards tentatively decided that when an insurer first applies the new Insurance Contracts Standard, the insurer shall:

(a) At the beginning of the earliest period presented:

(i) measure the present value of the fulfilment cash flows using current estimates at the date of transition (ie as of the earliest period presented); and

(ii) account for the acquisition costs in accordance with the IASB's existing tentative decisions for acquisition costs and derecognise any existing balances of deferred acquisition costs.

(b) Determine the single or residual margin at the beginning of the earliest period presented, as follows:

(i) Determine the margin through retrospective application of the new accounting principle to all prior periods, unless it is impracticable to do so.

(ii) If it is impracticable to determine the cumulative effect of applying that change in accounting principle retrospectively to all prior periods, the insurer is required to apply the new policy to all contracts issued after the start of the earliest period for which retrospective application is practicable (ie apply retrospectively as far back as is practicable).

(iii) For contracts issued in earlier periods for which retrospective application would normally be considered impracticable because it would require significant estimates that are not based solely on objective information, an insurer shall estimate what the margin would have been had the insurer been able to apply the new Standard retrospectively. In such cases, an insurer need not undertake exhaustive efforts to obtain objective information but shall take into account all objective information that is reasonably available.

(iv) If it is impracticable to apply the new accounting policies retrospectively for other reasons, an insurer shall apply the general requirements of ASC Topic 250-10/IAS 8 that are relevant to situations in which there are limitations on retrospective application (ie measure the margin by reference to the carrying value before transition).

The boards asked the staff to consider developing a constraint or set of constraints on the estimated amount of the single or residual margin. In addition, the FASB asked the staff to explore a practical expedient that may allow insurers to determine the margin based on the definition of portfolios during the retrospective period.[1]

Determining the discount rate

The boards tentatively decided that, for those periods for which it would be impracticable to determine the discount rate that would reflect the characteristics of the liability, insurers shall determine the discount rate as follows:

(a) Calculate the discount rate in accordance with the Standard for a minimum of three years and, if possible, determine an observable rate that approximates the calculated rates. If there is not an observable rate that approximates the calculated rate then determine the spread between the calculated rate and an observable rate.

(b) Use the same observable reference point to determine the rate (plus or minus the spread determined in (a) if applicable) to be applied at the contract inception for contracts that were issued in the retrospective period.

(c) Apply the yield curve corresponding to that rate to the expected cash flows for contracts recognised in the retrospective period to determine the single or residual margin at contract inception.

(d) Use the rate from the reference yield curve reflecting the duration of the liability for recognising interest expense on the liability.

(e) Recognise in other comprehensive income the cumulative effect of the difference between that rate and the discount rate determined at the transition date.

[1] The IASB staff do not intend to consider further possible constraints on the estimated amount of the residual margin. As discussed in the September meeting, any such constraints would require insurers to calculate the transition adjustment twice, adding additional work to an already onerous calculation.

Transition disclosures

The boards tentatively decided that insurers shall make the disclosures required by ASC Topic 250-10/IAS 8. In addition, insurers shall make the following more specific disclosures:

(a) If full retrospective application is impracticable, the earliest practicable date to which the insurer applied the guidance retrospectively.

(b) The method used to estimate the expected remaining residual or single margin for insurance contracts issued before that earliest practicable date including the extent to which the insurer has used information that is objective and, separately, the extent to which the insurer has used information that is not objective, in determining the margin.

(c) The method and assumptions used in determining the initial discount rate during the retrospective period.

The boards also tentatively decided that an insurer need not disclose previously unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it first applies the new guidance. Furthermore, if it is impracticable when an insurer first applies the guidance to prepare information about the claims development that occurred before the beginning of the earliest period for which the insurer presents full comparable information, it shall disclose that fact. (This decision confirms the proposal in the IASB's ED.)