IASB Meeting

Project	**Insurance Contracts**		
Paper topic	Comparison of the IASB's tentative decisions to the comment letter summary		
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Introduction

1. The purpose of this paper is to describe the ways in which the IASB has addressed the significant issues raised by respondents to the 2010 Exposure Draft *Insurance Contracts* (ED). This paper provides background information to assist the IASB in deciding on the questions posed in Agenda paper 2A *Permission to ballot a targeted revised Exposure Draft on accounting for insurance contracts* at this meeting. Consequently, this paper does not have any staff recommendations.

2. AP3E *Summary of comment letters on the IASB ED* was discussed at the January 2011 meeting. That paper is reproduced as AP2D *Summary of comment letters on the IASB ED* for this meeting. This paper follows the order in which the issues were discussed in AP2D to assist comparison to the comment letter summary.

3. For each issue, we have provided:

    (a) references to the agenda paper(s) addressing the issue in re-deliberations; and

    (b) an overview of the IASB's response to the comments during re-deliberations.

4. In February 2011, the IASB set out its axioms and assumptions for the insurance contracts project. Appendix A to this paper also evaluates the IASB's decisions against those axioms and assumptions.

Significant issues raised in the respondents to the 2010 Exposure Draft

5. In general, respondents to the 2010 Exposure Draft showed support for a building block approach that measures an insurance contract directly using current, discounted estimates of future cash flows arising from the contract, revised at each reporting date. However, respondents raised a number of significant issues with the proposed model.

6. These issues were related to:

   (a) volatility in profit or loss (paragraphs 7-8 of this paper).

   (b) discount rate (paragraphs 9-15 of this paper).

   (c) residual vs composite margin (paragraphs 16-26 of this paper).

   (d) remeasurement of the residual margin (paragraphs 27-29 of this paper).

   (e) unbundling (paragraphs 30-37 of this paper).

   (f) presentation (paragraphs 38-46 of this paper).

   (g) short-duration contracts (paragraphs 47-51 of this paper).

Volatility in profit or loss (paragraphs 19-24 in AP2D)

7. Many comment letters expressed concern about the volatility that would result from reporting in profit or loss changes in the current value measurement of the insurance contracts liability.

8. The IASB's decisions have an effect on the volatility reported in the financial statements in a number of ways:

   (a) The boards confirmed that the discount rate used to discount the insurance contract liability should be a rate that reflects only the characteristics of the liability. As a clarification, the boards confirmed that both a top-down and a bottom-up approach can achieve the objective of the discount rate and that the insurer can decide which approach is best in its circumstances. The top-down approach significantly reduces accounting mismatch arising from the effect of credit spread changes by reflecting the effect of credit spread changes in

both the asset and liability measurement (discussed in paragraphs 9-15 of this paper).

(b) The IASB decided to unlock the residual margin for differences between current and previous estimates of cash flows relating to future coverage or other future services (discussed in paragraphs 27-29 of this paper).

(c) The IASB decided to present the change in the insurance contract liability arising from changes in the discount rate in other comprehensive income (discussed in paragraphs 43-46 of this paper).

(d) The IASB decided that, for contracts which create a contractual link between the underlying items and the insurance contract liabilities, the measurement and presentation of the liabilities should mirror the measurement and presentation of the assets. Consequently, accounting mismatch is reduced for such contracts.

Main issues relating to the discount rate (paragraphs 25-32 in AP2D)

Agenda papers relevant to main issues relating to the discount rate	
January 2011	AP3A *Educational session discount rate*
January 2011	AP3B *Educational session discount rate—presentation from Rob Esson, NAIC*
January 2011	AP3C *Educational session discount rate—presentation from Francesco Nagari and Andrew Smith, Deloitte*
January 2011	AP3D *Educational session discount rate—presentation from Nicholas Bauer, Eckler*
February 2011	AP3D *Discount rate for non-participating contracts (alternative constructs for the discount rate)*
March 2011	AP2A *Locking in the discount rate*
March 2011	AP3G *Practical expedient for the discount rate*
March 2011	AP12E *Discounting for ultra-long duration cash flows*
April 2011	AP5A *Top-down approaches to discount rates*
September 2011	AP3D *Disclosures*

9. The IASB confirmed that the purpose of the discount rate is to reflect the time value of money of cash flows needed to fulfil the liability. The following paragraphs explain the IASB's response to comments on the discount rate.

Determining the liquidity premium

10. In the comment letters to the IASB's 2010 Exposure Draft, some noted difficulty in determining a discount rate that reflects only the characteristics of the liability, particularly in estimating the liquidity premium. Accordingly, the IASB provided

additional clarification about how an insurer should determine the discount rate used to discount the liability cash flows, as follows:

(a) The IASB confirmed that a top-down approach to determining the discount rate would meet the objective for determining the discount rate. A top-down approach would be based on the expected returns of a reference portfolio, adjusted to eliminate the factors not relevant to the liability.

(b) The IASB provided clarification that if there are no observable inputs (eg market data) for determining the discount rate, the insurer shall use an estimate that is consistent with the IASB's guidance on fair value measurement, in particular fair value measurements categorised within Level 3 of the fair value hierarchy.

11. Those clarifications also had the effect of reducing the amount of reported volatility arising from changes in discount rates:

(a) The top-down approach would significantly reduce accounting mismatch (and hence volatility) arising from credit spread changes because it adjusts a reference rate in a way that eliminates from that rate factors that are not relevant to the insurance contract liability. In a top-down approach, an insurer need not make adjustments for some differences between the liquidity inherent in the liability cash flows and the liquidity interest in the asset cash flows. This means that the effect of liquidity spread changes would affect the measurement of both the assets and the liability. Thus, to the extent that an insurer is duration matched, and changes in spreads are driven by liquidity or sentiment, then the top-down approach eliminates the effect of spread changes from profit or loss. However, the top-down approach does not eliminate the effect of estimated credit defaults from profit or loss.

(b) Applying the guidance on fair value measurement, an insurer would adjust an observable input if that input relates to a liability whose characteristics differ from the characteristics of the liability being measured. Because forecasts of unobservable inputs tend to put more weight on longer term estimates than on short term fluctuations, this

counteracts concerns that current period fluctuations in discount rates exaggerate the volatility of very long-dated liabilities.

12. Some respondents thought that an observable market rate should be permitted or required as a practical proxy. However, the IASB chose not to introduce an observable market rate as a practical proxy because the IASB could not identify a suitable proxy that would be easier to determine than the required discount rate, while still accomplishing the objective of reflecting the characteristics of the liability.

Asset based discount rate

13. Some respondents requested a discount rate that would reflect the investment income an insurer earns over time. The IASB notes that these concerns arose partly because respondents had interpreted the 2010 Exposure Draft proposals to mean that the adjustment for illiquidity in a bottom-up approach would significantly understate the degree of illiquidity present in the insurance contract liability. Bottom-up approaches are based on risk-free rates, adjusted to include a liquidity premium. The staff believes that allowing a top-down approach should reduce these concerns. However, the IASB has confirmed its view that the measurement of a liability should not reflect in advance the additional returns that the insurer expects to earn from its assets as a reward for bearing the risk associated with those assets.

Locked in discount rate

14. Some suggested that the discount rate used to measure the insurance contract liability should be the rate determined at inception. However, the IASB's view is that 'locking in' the discount rate in this way would omit information about the economic effect of embedded options and guarantees.

15. Although the IASB has confirmed that discount rates used to measure the insurance contract liability should not be locked in, the IASB has decided that the difference between the current rate and the locked in rate should be presented in other comprehensive income. This is discussed further in paragraphs 43–46 of this paper.

Issues relating to the residual versus composite margin (paragraphs 33-38 in AP2D)

Agenda papers relevant to issues relating to the residual versus composite margin	
February 2011	AP3G *Risk margin provides useful information*
March 2011	AP3H *Objective of the risk assessment (ALR rate)*
March 2011	AP12D *Objective of the risk assessment*
May 2011	AP3E *Composite margin—overview*
May 2011	AP3F *Composite margin—conceptual analysis*
May 2011	AP3G *Composite margin—profit realisation*
May 2011	AP3H *Risk adjustment or composite margin*
May 2011	AP3K *Composite margin—a comparison to risk adjustment*
April 2012	AP2I *Single margin approach*
May 2012	AP14C *Should IASB change its tentative decision on risk adjustment and residual margin*

16. The IASB's model includes an explicit risk adjustment in the measurement of the insurance contract liability and allocates the residual margin on a systematic basis in line with the pattern of services provided under the contract.

Need for a risk adjustment

17. Some respondents questioned the need for a risk adjustment. The IASB believes that assessing and quantifying risk is an essential part of an insurer's business and, for some contracts, the degree of uncertainty can change dramatically at or after the time a claim is incurred. The IASB confirmed its view that transparent and useful information should include:

    (a) information about different degrees of riskiness inherent in different types of insurance liabilities;

    (b) information about changes in the amount of risk, identified on a timely basis; and

    (c) information about when risk diverges from pricing assumptions (eg that are affected by supply/demand factors).

18. The IASB has confirmed its view that an explicit risk adjustment provides this information and thus provides a more complete depiction of the risk inherent in the insurance contract liability. Furthermore, an explicit, re-measured risk adjustment improves comparability by exposing differences between contracts with similar expected cash flows but very different risk profiles.

19. Although the determination of the risk adjustment may require complicated statistical techniques, the IASB believes that the outcome of these techniques helps users of financial statements to better understand the risks inherent in the insurance contract liabilities. The IASB decided to clarify the objective of the risk adjustment and to retain the proposed confidence level equivalent disclosure to enable users of financial statements to better understand the subjectivity inherent in determining risk adjustments (described in paragraphs 22 and 64-67).

Subjectivity

20. The IASB received comments expressing concern about the subjectivity of the risk adjustment. A number of comment letters stated that an explicit risk adjustment is not observable, making it difficult to determine whether the assumptions are reasonable and the objective of its measurement is met.

21. In its re-deliberations the IASB has taken a number of decisions that, one might argue, contribute to the subjective nature of the risk adjustment. The IASB decided:

    (a) not to limit the range of available techniques and the related inputs to estimate the risk adjustment; and

    (b) not to specify the unit of account for the risk adjustment (see paragraphs 68-69 of this paper), but to rely on the notion that the risk adjustment is the compensation *the insurer* requires for bearing risk (see paragraph 23 of this paper). This means that an entity would take diversification benefits between portfolios into account when estimating the risk adjustment, to the extent it has considered such diversification benefits in pricing.

22. However, the IASB has responded to concerns about subjectivity by deciding:

    (a) to retain the confidence level equivalent disclosure that had been proposed in the 2010 Exposure Draft in addition to more general requirements about the methods and assumptions used to determine amounts in the financial statements (see paragraphs 64-67 of this paper); and

(b) to retain in the application guidance the list of characteristics, as proposed in the 2010 Exposure Draft, that a risk adjustment technique should exhibit if that technique is to meet the objective of the risk adjustment (see paragraphs 62-63 of this paper).

Objective

23. Some respondents questioned whether the objective of the risk adjustment was consistent with the notion of fulfilment value. In response to comments received, the IASB aligned the risk adjustment objective with the risk adjustment objective in IFRS 13 *Fair Value Measurement*, as follows: 'The risk adjustment is the compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfils the insurance contract'.

24. The IASB intends to add application guidance to clarify that the risk adjustment measures the compensation that the insurer would require to make it indifferent between:

    (a) fulfilling an uncertain insurance contract liability which would have a range of possible outcomes; or

    (b) fulfilling a fixed liability that has the same expected present value of cash flows as the insurance contract.

25. For example, the risk adjustment would measure the compensation that the insurer would require to make it indifferent between (a) fulfilling a liability with an expected present value of 100 that has a 50 per cent probability of being 90 and a 50 per cent probability of being 110 or (b) fulfilling a fixed liability of 100.

26. The IASB also intends to add application guidance that, in estimating the risk adjustment, the insurer should consider both favourable and unfavourable outcomes in a way that reflects its degree of risk aversion. The IASB noted that a risk-averse insurer would place more weight on unfavourable outcomes than on favourable outcomes.

Re-measurement of the residual margin (paragraphs 39-42 in AP2D)

Agenda papers relevant to re-measurement of the residual margin	
February 2011	AP3L *Unlocking residual margin*
February 2011	AP3M *Unlocking residual margin (methods of unlocking)*
March 2011	AP1A *Considerations in unlocking the margin*
June 2011	AP3B *Whether to unlock the residual margin*
June 2011	AP3C *How to unlock the residual margin*
November 2011	AP6A *Which changes in estimates adjust residual margin*
November 2011	AP6B *Residual margin—2 approaches*
December 2012	AP2A *Unlocking the residual margin*

27. A number of respondents expressed disagreement with the proposal to lock in the residual margin at inception of the contract.

28. In response, the IASB revised its proposal to lock in the residual margin at inception because it was persuaded that unlocking the residual margin for differences between current and previous estimates of cash flows relating to future coverage or other future services would provide a better depiction of the unearned profit in the contract.

29. An effect of unlocking the residual margin in the manner summarised in the previous paragraph is that it ‘locks’ the liability as a whole (except to the extent that the contract becomes onerous). The liability is locked at an amount equal to the premiums received from the policyholder for services not yet provided. Thus, the effect of ‘unlocking’ the residual margin is to make the building block approach more like the model proposed in the revenue recognition project.

Unbundling (paragraphs 43-47 in AP2D)

Agenda papers relevant to unbundling	
February 2011	AP3H *Unbundling*
February 2011	AP3I *Unbundling*
February 2011	AP3J *Unbundling insurance contracts*
March 2011	AP12F *Unbundling—overall considerations*
March 2011	AP12G *Bifurcation of embedded derivatives*
May 2011	AP1C *Background material on unbundling*
May 2011	AP1D *Unbundling goods and services*
May 2011	AP1E *Unbundling investment components*
November 2011	AP9A *Disaggregation of explicit account balances*
February 2012	AP3D *Unbundling goods and services*
March 2012	AP2F *Separation of investment components from insurance contracts—background*
March 2012	AP2G *Separation of investment components from insurance contracts—determining aggregate premiums for the insurance component*
March 2012	AP2H *Separation of investment components from insurance contracts—presentation in the statement of financial position*
April 2012	AP2H *Riders and policy loans*
May 2012	AP2E *Unbundling investment components*
May 2012	AP2F *Separation of components in insurance contracts—summary of tentative decisions so far*
June 2012	AP2A *Unbundling—allocation of cash flows*

30. Some respondents asked for more clarity on:

    (a) what components would be unbundled (that is, measured separately from the insurance contract using other IFRSs); and

    (b) how unbundling would be performed.

31. Some respondents questioned the practicality and complexity of unbundling. The IASB reconsidered the proposals on unbundling and determined that the benefits of unbundling outweigh the costs when the non-insurance component is distinct. In doing so, the IASB confirmed the principle that a non-insurance component should not be unbundled if the non-insurance component and the insurance component are highly interrelated. This is consistent with the IASB's view of an insurance contract as a bundle of interrelated rights and obligations that should be accounted for together.

Goods and services components

32. Some respondents stated that the unbundling proposals are unclear and could be interpreted differently. The IASB proposes to clarify the requirements and require that an insurer should determine which goods and non-insurance services should be unbundled using criteria based on those used for identifying distinct performance obligations in the 2011 Exposure Draft on revenue recognition.

Thus, a good or service would be unbundled if there is a distinct performance obligation to provide that good or service.

Deposit components

33. Respondents' concerns about unbundling deposit components included:

    (a) including deposit receipts in premiums and deposit repayments in claims expenses for presentation purposes;

    (b) the implementation cost of unbundling the deposit component from the insurance contract for measurement purposes; and

    (c) the limited benefit of separating cash flows that are highly interrelated for measurement purposes.

34. In response, the IASB decided that:

    (a) an insurer should unbundle investment components from insurance contracts only where the cash flows are *not* highly interrelated with the cash flows from the insurance component;

    (b) for investment components that are measured as part of the insurance contract (ie not unbundled), premiums and claims expenses presented in the statement of comprehensive income should exclude any amounts that the insurer is obligated to pay to policyholders regardless of whether an insured event occurs.

35. The IASB has also addressed the concern in 33(a) in its tentative decisions on insurance contract revenue.

Policy loans and riders

36. Some requested clarification of whether particular components, such as policy loans and riders, should be unbundled. In response, the IASB decided that:

    (a) in applying the general decisions on accounting for investment components present in an insurance contract, policy loans form part of the investment component to which they relate;

(b) the general decisions on accounting for non-insurance components should apply to riders that are part of the contractual terms of an insurance contract at inception; and

(c) riders that are added to a contract after inception should be treated as contract modifications.

Unbundling where not required

37. The IASB noted concerns about the proposed prohibition of unbundling when unbundling is not required. However, the IASB believes that permitting an option to unbundle would reduce comparability among insurers. We also note that insurers could separately present the investment component and an insurance component in an insurance contract liability (both measured in accordance with the insurance contracts standard), because IAS 1 *Presentation of Financial Statements* permits entities to provide further line items. Thus, the IASB confirmed that unbundling would be prohibited when it is not required.

Presentation (paragraphs 48-56 in AP2D)

Agenda papers relevant to presentation	
	Format of statement of comprehensive income
February 2011	AP3K *Refresher of presentation models*
March 2011	AP3A *Alternative presentation models*
June 2011	AP3A *Statement of comprehensive income*
October 2011	AP4D *Presentation—statement of comprehensive income*
June 2012	AP2B *Background to 2C—presentation of premiums and earned premium approach*
June 2012	AP2C *Methods for determining earned premium*
June 2012	AP2D *Timing of recognition of acquisition costs and related premiums*
October 2012	AP2A *Presentation in statement of comprehensive income—comparison of methods*
October 2012	AP2B *Presentation in statement of comprehensive income—non-claims fulfilment costs*
October 2012	AP2F *Overview of decisions on participating contracts*
October 2012	AP10F *An introduction to agenda paper 2A*
November 2012	AP3A *Presentation and disclosures—proposed drafting*
November 2012	AP3B *Presentation and disclosures—presentation of insurance contracts in the financial statements*
January 2013	AP2A *Allocation of insurance contract revenue—change in pattern of expected claims*
	Segregation of information about sources of earnings using OCI
May 2011	AP6A *Assets backing insurance contracts*
May 2011	AP6B *Presentation—eliminating accounting mismatches*
May 2011	AP6C *Practical implications of using OCI for changes in the insurance contract liability arising from changes in the discount rate*
May 2011	AP6D *Illustrative examples for use of OCI*
March 2012	AP2B *Recognition of changes in liability in OCI—background*
May 2012	APG *Summary of questions and staff recommendations for use of OCI*
May 2012	AP2H *Background on use of OCI*
May 2012	AP2I *Use of OCI for presenting changes in specified assumptions*
May 2012	AP2J *Mechanics of OCI in presenting changes in specified assumptions*
May 2012	AP 2K *Loss recognition test*
May 2012	AP2L *Examples to illustrate the use of OCI*
May 2012	AP2M *Additional background on use of OCI*
May 2012	AP14A *Use of OCI*
May 2012	AP14B *Use of OCI—interaction of FI Classification and Measurement*

38. The 2010 Exposure Draft proposed a summarised margin presentation approach in the statement of comprehensive income. The summarised margin approach would require presentation of underwriting performance disaggregated to show the sources of changes in the insurance liability, but it would not require presentation of premiums, claims or other expenses.

39. The 2010 Exposure Draft also proposed to present all income and expense from insurance contracts in profit or loss.

Format of statement of comprehensive income: General consistency with other IFRSs

40. Respondents to the 2010 Exposure Draft, including many users, requested a statement of comprehensive income that would include premiums, claims and other expenses. That view was supported in the outreach meetings conducted with

users across the world. Many stakeholders thought that a statement of comprehensive income focussed on liability movement would be too radical. Accordingly, the boards decided that insurers should present information about premiums, claims and other expenses in a way that would be consistent with the general revenue recognition principles that the boards are developing in their project on revenue recognition.

41. We believe that presentation of premiums, claims and other expenses in a way that is consistent with commonly understood notions of revenue and expenses will assist non-specialist users of financial statements in understanding and analysing an insurer's business.

42. However, we note the perceived complexity of providing revenue information for insurance contracts and plan to consult whether the costs of that complexity outweigh the benefits of providing such information.

Segregation of information about sources of earnings using OCI

43. Respondents to the ED suggested that presenting all changes in current value measurement of the insurance contract liability in profit or loss would dominate profit or loss and make it difficult to assess underwriting performance.

44. The IASB sought to display the different sources of an insurer's earnings and to present changes in the insurance liability in a way that provides useful information to users. We believe that information is useful when:

    (a) underwriting performance is presented clearly and not overshadowed by other information;

    (b) changes in the insurance liability that reverse over time are presented separately from other changes; and

    (c) accounting mismatches are eliminated or reduced, to the extent possible.

45. Consequently, the IASB introduced a proposal that insurers should segregate the effects of changes in discount rates by presenting:

    (a) interest expense determined using the locked in discount rate in profit or loss; and

(b) interest expense determined using the current discount rate in total comprehensive income.

The difference between (a) and (b), which reverses over time, would be presented in OCI.

46. The IASB's proposals for the introduction of the fair value through other comprehensive income (FVOCI) measurement category for financial assets, in conjunction with the proposal that some changes in the insurance contract liability be presented in OCI, does not fully eliminate accounting mismatch but reduces it in practice for many contracts. For example, if a financial asset is managed within the 'both hold and sell' business model (which is often the case with assets backing insurance liabilities) and has payments of principal and interest only, it will be measured at FVOCI and an accounting mismatch will not arise. If, however, the asset is managed under a different business model or does not qualify for FVOCI due to its contractual cash flow characteristics (eg equity investments, derivatives, some hybrid contracts and non-financial assets such as investment properties), a mismatch will still arise either in OCI (if the asset is measured at amortised cost) or both OCI and P&L (if the asset is measured at FVPL). The IASB's decision arises from trying to improve comparability and minimise the complexity in using OCI when insurers hold portfolios of assets with mixed measurement attributes. Therefore we think that a full picture of an insurer's performance can only be gained by considering all components of total comprehensive income, including those components included in profit or loss and those included in OCI.

Short-duration contracts (paragraphs 57-67 in AP2D)

Agenda papers relevant to short-duration contracts	
April 2011	AP1 *Short-duration contracts—modified approach*
July 2011	AP8A *Premium allocation approach—overview*
July 2011	AP8B *Premium allocation approach—a simplification model of the building block approach*
July 2011	AP8C *Premium allocation approach—a 2 model solution*
October 2011	AP4B *Premium allocation approach—eligibility criteria*
December 2011	AP7D *Onerous contracts*
December 2011	AP7H *Discounting—liability for incurred claims*
February 2012	AP3A *Onerous contracts*
February 2012	AP3B *Onerous contracts—implications of tentative decisions*
February 2012	AP3E *PAA—amendments to the Jan staff recommendations on eligibility on mechanics*
February 2012	AP3F *PAA—eligibility criteria*
February 2012	AP3G *PAA mechanics*
February 2012	AP3H *PAA IASB staff recommendations on eligibility*
February 2012	AP3I *PAA FASB staff recommendations on eligibility*
May 2012	AP2D *Acquisition costs in the PAA*
October 2012	AP2F *Premium allocation approach—discount rate follow up*

47. The 2010 Exposure Draft proposed a modified, premium allocation approach (PAA) for some short-duration contracts.

Sufficiency of the premium allocation approach

48. Applying different accounting models for different types of contracts creates problems when contracts blend activities because it is not clear which model should be applied to the contract as a whole. A comprehensive framework for insurance contracts that reflects the significant features of any given contract at any given time avoids that problem because it does not create the sudden discontinuities that would occur if different models were used to reflect the different features.

49. The IASB acknowledged that, in some circumstances, the unearned premium is a reasonable approximation of the present value of the fulfilment cash flows plus the residual margin and achieves a similar result at a lower cost. However, because the IASB is convinced about the benefits of a single model for all insurance contracts, the IASB decided to permit, but not require, the premium allocation approach only when it produces measurements that are a reasonable approximation to those that would be produced by the building block approach. That principle would apply to the measurement of both insurance contract liabilities and reinsurance assets.

Eligibility for the PAA

50. Many respondents commented that the proposed 12 month eligibility criterion for the PAA was unduly arbitrary. In response to these concerns, the IASB proposes that entities may apply the PAA if it is expected that the results of doing so are a reasonable approximation to those that would be produced by the building block approach.[1] The IASB intends to provide application guidance on determining whether this principle is met.

Simplifications to the PAA as proposed in the 2010 Exposure Draft

51. In response to concerns that the premium allocation approach should be more like the unearned premium reserve approach applied by some insurers at present, the IASB made several simplifications to the premium allocation approach:
    (a) Discounting and interest accretion are required only for contracts that have a significant financing component and are not required if the period between premiums being due and the provision of coverage is one year or less.
    (b) Discounting is not required for incurred claims that are expected to be paid within one year.
    (c) The onerous contract test is needed only when facts and circumstances indicate that contracts have become onerous in the coverage period.
    (d) For contracts with a coverage period of one year or less, an insurer is permitted to recognise all acquisition costs as an expense when incurred.

Summary of responses on other proposals in the 2010 Exposure Draft

52. In paragraphs 53-106 of this paper we discuss the remaining main areas in the 2010 Exposure Draft, as discussed in the comment letter summary in agenda paper 2D, as follows:

[1] If the coverage period of a contract is 12 months or less, the contract is deemed to meet this condition.

(a) Unbiased probability-weighted average of fulfilment cash flows (paragraphs 53-58 of this paper).

(b) Contract boundary (paragraph 59 of this paper).

(c) Discount rate issues other than volatility (paragraphs 60-61 of this paper).

(d) Risk adjustment and margin issues other than residual vs composite (paragraphs 62-73 of this paper).

(e) Scope (paragraphs 74-80 of this paper).

(f) Definitions (paragraphs 81-84 of this paper).

(g) Discretionary participation features (paragraphs 85-86 of this paper).

(h) Recognition (paragraph 87 of this paper).

(i) Reinsurance (paragraphs 88-93 of this paper).

(j) Disclosure (paragraphs 94-100 of this paper).

(k) Unit-linked contracts (paragraph 101 of this paper).

(l) Unit of account (paragraph 102 of this paper).

(m) Transition (paragraphs 103-105 of this paper).

(n) Implementation period (paragraph 106 of this paper).

Unbiased probability weighted average of fulfilment cash flows (paragraphs 70-80 in AP2D)

Agenda papers relevant to unbiased probability weighted average of fulfilment cash flows	
February 2011	AP3B *Acquisition costs*
February 2011	AP3F *Cash flows—measurement and costs inclusion*
March 2011	AP2G *Follow up on acquisition costs*
March 2011	AP3I *Timing of initial recognition*
March 2011	AP12C *Contract boundary*
June 2011	AP3E *Acquisition costs revisited*
June 2011	AP3F *Cross-cutting considerations on acquisition costs*
December 2011	AP7G *Cash flows that existing contracts require to be paid to future policyholders*
	AP2B *Acquisition costs—the story so far*
May 2012	AP2C *Acquisition costs—in the building block approach*
May 2012	AP2D *Acquisition costs—in the premium allocation approach*
September 2012	AP2A *Acquisition costs—accounting in the pre-coverage period*
October 2012	AP2C *Presentation in statement of comprehensive income—acquisition costs*
January 2013	AP2C *Sweep issues*

Recognition point

53. In response to concerns that it would be onerous and burdensome to recognise insurance contracts as proposed in the 2010 Exposure Draft, the IASB changed the recognition point so that entities recognise an insurance contract liability or insurance contract asset at the beginning of the coverage period. The IASB proposes to ensure that any significant liabilities are captured using an onerous contracts test.

Expected value

54. Some considered the wording for calculating cash flows to be too restrictive, as some believed the reference to probability weighted cash flows would automatically point to a stochastic modelling type of technique for estimates of future cash flows. In response, the IASB confirmed the use of expected value but noted its intention to emphasise that:

    (a) expected value refers to the mean that considers all relevant information; and

    (b) not all possible scenarios need to be identified and quantified, provided that the estimate is consistent with the objective of determining the mean.

Overhead costs

55. In response to queries about which overhead costs to include in the measurement of the insurance contract liability, the IASB confirmed that the costs included in the cash flows that are used to measure a portfolio of insurance contracts should be all the costs that the insurer will incur in fulfilling the contracts, including:
    (a) costs that relate directly to the fulfilment of the contracts in the portfolio, such as payments to policyholders, claims handling, etc;
    (b) costs (including fixed and variable overheads) that are attributable to contract activity as part of fulfilling that portfolio of contracts and that can be allocated to those portfolios; and
    (c) such other costs as are specifically chargeable to the policyholder under the terms of the contract.
56. The IASB also confirmed that costs that do not directly relate to the insurance contracts or contract activities should be recognised as expenses in the period in which they are incurred.

Acquisition costs

57. Many respondents proposed that acquisition costs should be those which are incremental at a portfolio level. In response, the IASB decided that an insurer should include in the fulfilment cash flows all the direct costs that the insurer will incur in acquiring the contracts in the portfolio. The IASB's view is that both successful and unsuccessful costs are incurred in assembling a portfolio of insurance contracts.

Tax

58. Some respondents suggested that the fulfilment cash flows should include the amounts that insurers pay in some jurisdictions as a proxy for investment returns being taxed in the hands of policyholders. The IASB decided to clarify that the cash flows excluded from the fulfilment cash flows are the income tax payments and receipts attributable to policyholders that do not arise directly as the insurer fulfils the contracts.

Contract boundary (paragraphs 81-83 in AP2D)

Agenda papers relevant to contract boundary	
March 2011	AP12C *Contract boundary*
February 2012	AP3C *Measurement of liabilities for infrequent high-severity events*
April 2012	AP2G *Contract modifications*

59. Respondents commented that the contract boundary would not be appropriate if the insurer could re-price at the portfolio level. The IASB decided to amend the contract boundary accordingly. As a result, the insurer is not deemed to grant substantive rights to the policyholder when it can set a price that fully reflects the risk of a portfolio of contracts the contract belongs to because it has the right or practical ability to reassess the price of that portfolio.

Discount rate issues other than volatility (paragraphs 84-85 in AP2D)

Agenda papers relevant to discount rate issues other than volatility	
March 2011	AP2B *Discounting nonlife contract liabilities*
March 2011	AP3F *Discount rate for participating contracts*
December 2011	AP7H *Discounting—liability for incurred claims*
February 2012	AP3E *PAA—amendments to the Jan staff recommendations on eligibility and mechanics*
February 2012	AP3G *PAA Mechanics*
November 2012	AP2A *Contracts whose cash flows to which mirroring does not apply but are affected by expected asset returns*

Discount rate for participating contracts

60. Some respondents thought that the 2010 Exposure Draft proposed to apply an asset based discount rate to all cash flows arising from participating contracts. To address this misinterpretation, the IASB clarified that the objective of the discount rate used to measure participating insurance contracts should be consistent with the objective of the discount rate used to measure non-participating insurance contracts. The IASB also decided to provide guidance that, to the extent that the amount, timing or uncertainty of the cash flows arising from insurance contracts arising from insurance contracts depends wholly or partly on the performance of specific assets, the insurer should adjust those cash flows using a discount rate that reflects that dependency.

Discounting for short-duration contracts

61. Some respondents expressed the view that discounting should not be applied to short-duration contracts. In response to these comments, the IASB proposed practical expedients in regard to discounting, as listed in paragraph 51 of this paper.

Risk adjustment and margin issues other than residual versus composite (paragraphs 86-100 in AP2D)

Agenda papers relevant to risk adjustment and margin issues other than residual versus composite	
March 2011	AP3B *Risk adjustment education session cover note*
March 2011	AP3C *Explicit risk adjustment—Jo Oechslin*
March 2011	AP12A *Explicit risk adjustment—Tony Coleman*
March 2011	AP12B *Explicit risk adjustment—Mark Swallow*
May 2011	AP3A *Risk adjustment—the story so far*
May 2011	AP3B *Risk adjustment—useful financial information*
May 2011	AP3C *Risk adjustment—techniques to meet the objective*
May 2011	AP3D *Risk adjustment—comparability and verifiability through disclosure*
June 2011	AP3D *Allocation of the residual margin*
September 2011	AP3B *Risk adjustment—objective and disclosures*
September 2011	AP3C *Risk adjustment—techniques and inputs*
November 2011	AP6C *Allocation of the residual margin*
November 2011	AP6D *Interest accretion on residual margin*
December 2011	AP7B *Unit of account—residual/single margin and onerous contracts*
December 2011	AP7C *Unit of account—risk adjustment*
March 2012	AP2A *Unit of account—portfolio*
September 2012	AP16B *Residual margin—accretion of interest*
September 2012	AP16C *Residual margin—rate of accretion of interest*

Methods used to estimate the risk adjustment

62. In response to concerns that the methods used to estimate the risk adjustment were unduly restrictive, the IASB decided not to limit the range of available techniques to determine the risk adjustment. Instead, the IASB decided to retain in the application guidance the following list of characteristics that a risk adjustment technique should exhibit if that technique is to meet the objective of the risk adjustment:

    (a) Risks with low frequency and high severity will result in higher risk adjustments than risks with high frequency and low severity.

    (b) For similar risks, contracts with a longer duration will result in higher risk adjustments than those of a shorter duration.

    (c) Risks with a wide probability distribution will result in higher risk adjustments than risks with a narrower risk distribution.

    (d) The less that is known about the current estimate and its trend, the higher the risk adjustment shall be.

    (e) To the extent that emerging experience reduces uncertainty, risk adjustments will decrease and vice versa.

63. The IASB also decided to retain as examples the three techniques that were proposed in the 2010 Exposure Draft, together with the related application guidance.

Confidence level equivalent disclosure

64. In response to comments on the proposed confidence level equivalent disclosure, the IASB notes that the amount of the risk adjustment considers both the probability distribution of cash flows and the entity-specific risk aversion of the insurer.

65. The IASB believes that if the insurer uses a risk adjustment technique other than the confidence level technique, disclosure of the confidence level to which the risk adjustment corresponds will allow users to understand how the entity specific assessment of risk aversion might differ from entity to entity.

66. Before confirming the confidence level equivalent disclosure, the IASB considered the following alternative disclosures:

    (a) quantitative disclosure of the range of values of key inputs used to determine the risk adjustment, determined from a market participant's perspective or a statement that those inputs do not differ from those of a market participant; and

    (b) information regarding the relative magnitude of the risk adjustment compared to total insurance liabilities, at a suitable level of disaggregation.

67. However, the IASB was not persuaded by the practical arguments against the confidence level equivalent disclosure and believes that it provides information about the relative risk aversion of the insurer, even if that information is imperfect.

Unit of account

68. Some respondents thought that the risk adjustment should reflect the effect of diversification between portfolios. In response, the IASB noted that the objective of the risk adjustment is to reflect the economic burden to the entity of bearing

risk. It would contradict that objective to specify a level of aggregation for determining the risk adjustment that was not consistent with the way the entity determines its risk. To the extent that an entity considered a degree of fungibility in estimating the probability distribution between portfolios, that would be reflected in the degree of entity-specific risk aversion.

69. As a result, the draft IFRS proposes to state only a principle that the risk adjustment should be the compensation the entity requires for bearing the uncertainty inherent in the cash flows that arise as the entity fulfils the portfolio of insurance contracts.

Allocation of the residual margin

70. Some respondents questioned the proposed release pattern for the residual margin, believing it would not necessarily align with:

    (a) the manner in which risk protection and services are provided; or

    (b) the timing of overhead costs.

71. In response, the IASB decided that an insurer should allocate the residual margin over the coverage period on a systematic basis that is consistent with the pattern of transfer of services provided under the contract.

Accretion of interest on the residual margin

72. Some respondents thought that accretion of interest on the residual margin would be overly complex and would not provide relevant information to users. Others agreed with accretion of interest on the residual margin. Some thought that a current rate of interest should be applied to the residual margin.

73. On reflection of these comments, the IASB confirmed its proposal to accrete interest on the residual margin at a locked in rate.

Scope (paragraphs 101-108 in AP2D)

Agenda papers relevant to scope	
March 2011	AP2D *Scope*
March 2011	AP2E *Financial guarantee contracts(IASB only considerations)*
October 2011	AP4A *Scope—fixed fee contracts*
February 2012	AP14A *Background to discretionary participation feature (DPF) contracts*
February 2012	AP14B *DPF—applicable standard analysis*
February 2012	AP14C *DPF—proposed definition*
January 2013	AP2C *Sweep issues*

Financial guarantee contracts

74. Some respondents expressed the view that financial guarantees that meet the definition of an insurance contract should be in the scope of the insurance contracts standard. Others, however, thought that these contracts should be excluded from the scope of the insurance contracts standard.

75. After considering the comments and the difficulties the IASB has previously had in distinguishing financial guarantee contracts from insurance contracts, the IASB decided to carry forward the existing option in IFRS 4 *Insurance Contracts* that:

    (a) permits an issuer of a financial guarantee contract to account for the contract as an insurance contract if it had previously asserted that it regards the contract as an insurance contract; and

    (b) requires an issuer to account for a financial guarantee contract in accordance with the financial instruments standards in all other cases. Such contracts would be measured initially at fair value, with subsequent amortisation of that amount, coupled with a test for credit losses.

Financial instruments with discretionary participation features

76. Most respondents thought that financial instruments with discretionary participation features should be included in the scope of the insurance contracts standard, though some respondents expressed the view that such contracts should be in the scope of the financial instruments standards.

77. After considering these comments, the IASB modified its proposal to include financial instruments with discretionary participation features that are issued by insurers in the scope of the final insurance standard.

Fixed fee service contracts

78. Some respondents thought that fixed fee service contracts should be in the scope of the insurance contracts standard. Some respondents requested clarification of which fixed fee service contracts would be excluded from the scope of the insurance contracts standard.

79. In response, the IASB provided additional criteria for entities to assess if a contract is a fixed fee service contract to be excluded from the scope of the insurance contracts standard.

Takaful

80. Some respondents noted that takaful contracts have distinct features that warrant further discussion. The IASB has decided not to create specific guidance on takaful. Instead, the IASB noted that its to-be-established consultative group on shariah-compliant transactions may be best placed to consider takaful transactions.

Definitions (paragraphs 109-112 in AP2D)

Agenda papers relevant to definitions	
March 2011	AP3D *Definition of an insurance contract*
December 2011	AP2E *Definition of a portfolio of insurance contracts*
March 2012	AP2A *Unit of account—portfolio*

Definition of an insurance contract

81. The 2010 Exposure Draft proposed to carry forward the definition of an insurance contract from IFRS 4 with two modifications. Respondents were generally supportive of the proposed definition of an insurance contract, but some were concerned that a change to the definition would require substantial additional work to assess whether contracts meet the new definition.

82. The IASB confirmed its proposal to define an insurance contract as 'a contract under which one party accepts significant risk from another party by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder'.

83. The IASB also confirmed the proposed application guidance, with some modifications to address the specific concerns relating to whether significant insurance risk is transferred by some reinsurance contracts, which were raised by some respondents.

Definition of a portfolio

84. Participants interpreted the notion of a portfolio differently depending on different existing local practices or regulatory regimes. As a result, the IASB decided to clarify that a portfolio should be defined as contracts that are:

   (a) subject to similar risks and priced similarly relative to the risk taken on; and

   (b) managed together as a single pool.

Discretionary participation features (paragraphs 113-114 in AP2D)

Agenda papers relevant to discretionary participation features	
December 2011	AP7G *Cash flows that existing contracts require to be paid to future policyholders*

85. Some respondents thought that unallocated surplus should be included in the measurement of the insurance contract liability, while others thought that unallocated surplus represents equity.

86. The IASB clarified that, when an insurer measures an obligation, which was created by an insurance liability, that requires payment depending wholly or partly on the performance of specified assets and liabilities of the insurer, that measurement should include all such payments that result from that contract, whether paid to current or future policyholders. Unallocated surplus would therefore be included in the measurement of the liability.

Recognition (paragraphs 115-118 in AP2D)

Agenda papers relevant to recognition	
March 2011	AP3I *Timing of initial recognition*
January 2013	AP2C *Sweep issues*

87. Some respondents were concerned that significant changes to systems would be required to identify those contracts to which an insurer is bound, but which have not been entered into the accounting system. In response, the IASB decided that insurance contract assets and liabilities should initially be recognised at the earlier of the start of the coverage period or the date on which the first premium becomes due. In addition an onerous contract liability should be recognised in the pre-coverage period if management becomes aware of onerous contracts during that period.

Reinsurance (paragraphs 119-124 in AP2D)

Agenda papers relevant to reinsurance	
May 2011	AP3A *Reinsurance contracts*
December 2011	AP7C *Unit of account—risk adjustment*
April 2012	AP2F *Separation of investment components from insurance contracts—background*
December 2012	AP2C *Impairment of reinsurance contracts held by insurer*

Interaction with impairment

88. Some respondents requested the IASB to coordinate the development of an expected loss model for reinsurance and the IASB's project on impairment of financial assets. The IASB has decided that a cedant would not apply the proposals of the impairment project that are being developed by the IASB to reinsurance contracts. However, similar to the impairment project, an entity shall consider expected credit losses in the measurement of the reinsurance asset.

Recognition and measurement on day one

89. Some respondents disagreed with the proposal in the 2010 Exposure Draft to recognise day one gains on reinsurance contracts. In response to these concerns, the IASB decided that both day one gains and day one losses arising when a reinsurance contract is purchased should be recognised over the coverage period.

Thus, the net cost of purchasing reinsurance is recognised as an expense/income over the coverage period of the reinsurance contract.

90. Some comment letters stated their view that the amount of the residual margin included in the measurement of the reinsurance contract should be proportionate to the residual margin on the underlying contract rather than being calculated separately. However, such an approach would contradict the IASB's view that a reinsurance contract is a separate contract from the underlying contract, because it would offset the expense incurred in buying reinsurance with the profit earned on the underlying contract.

Coverage periods

91. Some were concerned about how to measure the reinsurance contract when the coverage period for reinsurance contracts does not match the coverage period of the underlying contract or the reinsurance contract is non-proportional. In particular, respondents cite the example of a reinsurance contract that the cedant has already entered into, but for which the underlying direct contracts have not yet been issued. The IASB's tentative decisions would mean that a cedant recognises a reinsurance contract:

    (a) when the underlying contract is recognised, if the reinsurance contract is not based on aggregate losses; or

    (b) when the coverage period of the reinsurance contract begins, if the reinsurance contract is based on aggregate losses.

Interaction with the PAA

92. Respondents generally wanted more information about the interaction between the accounting for reinsurance contracts and the premium allocation approach. The staff intends to clarify the IASB's decisions in drafting.

Risk adjustment

93. In response to questions about whether the risk adjustment should be determined taking into account the effect of reinsurance, the IASB noted that the objective of

the risk adjustment is to reflect the compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfils the contract.

Disclosure (paragraphs 125-129 in AP2D)

Agenda papers relevant to disclosure	
September 2011	AP3D *Disclosures*
September 2012	AP16F *Disclosures—overview and proposed drafting*
September 2012	AP16G *Disclosures—staff analysis*
November 2012	AP3A *Presentation and disclosures—proposed drafting*
November 2012	AP3C *Presentation and disclosures—disclosures relating to participating contracts, earned premium presentation and transition*
January 2013	AP2C *Sweep issues*

94. Some respondents expressed concern over the volume and complexity of the disclosure requirements proposed in the 2010 Exposure Draft. They thought that the proposed disclosures were not consistent with the objective based approach articulated in the 2010 Exposure Draft.

Level of disaggregation

95. Paragraph 81 of the 2010 Exposure Draft proposed that an insurer shall aggregate or disaggregate information so that information that is useful is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics. Paragraph 83 of the 2010 Exposure Draft proposed that the disclosures shall not aggregate information relating to different reportable segments, as defined in IFRS 8 *Operating Segments*.

96. Many respondents thought that this level of disaggregation would be overly burdensome. In response, the IASB decided that the principle regarding the level of aggregation of information as described in paragraph 81 of the 2010 Exposure Draft is sufficient and that it is consistent with other projects, such as revenue recognition and leases. As a result, the IASB decided not to retain the proposed requirement of paragraph 83 of the 2010 Exposure Draft as a general principle.

Measurement uncertainty analysis

97. In addition, the IASB noted that the feedback received on the proposed measurement uncertainty analysis disclosure was consistent with the comments received on a similar requirement for unobservable inputs in the fair value measurement project. In that project, the IASB did not require a measurement uncertainty analysis disclosure because of concerns about costs relative to benefits.

98. However, the IASB asked the staff to assess, after issuing IFRS 13 *Fair Value Measurement*, whether a quantitative measurement uncertainty analysis disclosure would be practical, with the aim of deciding at a later date whether to require such a disclosure.

99. The IASB believes that there should be similar requirements for disclosure about measurement uncertainty in the insurance contracts standard as in IFRS 13. Consequently, the IASB decided to eliminate the measurement uncertainty analysis disclosure proposed in the 2010 Exposure Draft, with the intention of aligning this disclosure (in due course) with the disclosure for fair value measurement.

100. The IASB notes that some of the information on the uncertainty of the inputs is provided by the disclosures of the methods and inputs used to estimate the discount rate and the risk adjustment, and by the sensitivity analysis on insurance risk.

Unit linked contracts (paragraphs 130-132 in AP2D)

Agenda papers relevant to unit linked contracts	
March 2011	AP3F *Discount rate for participating contracts*
May 2011	AP5A *Participation features—topic overview*
May 2011	AP5B *Measurement of policyholder participation*
November 2012	AP3A *Presentation and disclosures—proposed drafting*
November 2012	AP3B *Presentation and disclosures—presentation of insurance contracts in the financial statements*

101. Although respondents generally supported the 2010 Exposure Draft proposals on unit linked contracts, the IASB decided that the same measurement and presentation approach should apply to unit linked and participating contracts. Specifically, the IASB:

(a) decided to provide guidance that to the extent that the amount, timing or uncertainty of the cash flows arising from an insurance contract depends wholly or partly on the performance of specific assets, the insurer should adjust those cash flows using a discount rate that reflects that dependency.

(b) decided that an insurer should present changes in the insurance liability in the statement of comprehensive income consistently with the presentation of changes in the linked items (that is, in profit or loss or in OCI).

Unit of account (paragraphs 133-134 in AP2D)

Agenda papers relevant to unit of account	
February 2011	AP5A *Participation features—topic overview*
March 2011	AP5B *Measurement of policyholder participation*
December 2011	AP7B *Unit of account—residual/single margin and onerous contracts*
December 2011	AP7C *Unit of account—risk adjustment*
March 2012	AP2A *Unit of account—portfolio*

102. In response to requests for a consistent unit of account across the standard, the IASB established the portfolio as the unit of account for the fulfilment cash flows, residual margin and acquisition costs. Relevant decisions included the following:

(a) The unit of account for the risk adjustment will not be specified as the objective of the risk adjustment is to reflect the compensation the insurer requires for bearing the uncertainty inherent in the cash flows of a portfolio that arise as the insurer fulfils the contract. As a result, the risk adjustment can reflect the effect of diversification between portfolios.

(b) The unit of account used to determine the residual margin should be the portfolio.

(c) The unit of account used to release the residual margin should not be prescribed. However, the release of the residual margin should be performed in a manner consistent with the objective of releasing the residual margin over the coverage period to the period(s) in which the service is provided.

Transition (paragraphs 135-137 in AP2D)

Agenda papers relevant to transition	
September 2012	AP2B *Transition requirements*
September 2012	AP2C *Transition—determination of the discount rate*
October 2012	AP10B *Transition—overview and proposed drafting*
October 2012	AP10C *Transition—redesignation and reclassification of financial assets*
October 2012	AP10D *Transition—ancillary issues*
January 2013	AP2B *Considering the transition proposals in the light of subsequent decisions on insurance contract revenue*

Determination of the residual margin

103. Almost all respondents disagreed with the proposal that, on transition, an insurer would measure each portfolio of insurance contracts at the present value of the fulfilment cash flows, without any residual margin. In response, the IASB proposes a modified retrospective approach that would require an entity to estimate the residual margin on transition using specified simplifications. Entities would apply retrospective application when required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

104. Determination of the residual margin on transition for contracts acquired in a business combination will be discussed at this meeting.

Interaction with IFRS 9

105. Some respondents noted the interaction between IFRS 9 *Financial Instruments* and the new insurance standard. They requested specific arrangements to ease transition to the insurance contracts standard in the context of the new requirements in IFRS 9. In response, the IASB decided that an insurer shall follow the reclassification guidance in IFRS 9 except that an insurer should be:

    (a) permitted to designate eligible financial assets under the fair value option where new accounting mismatches are created by the application of the new insurance contracts standard.

    (b) required to revoke previous designations under the fair value option where the accounting mismatch no longer exists because of the application of the new insurance contracts standard.

    (c) following earlier application of IFRS 9, permitted 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, or revoke a previous election if applicable.

Implementation period (paragraphs 138-141 in AP2D)

Agenda papers relevant to implementation period	
October 2012	AP210E *Transition—effective date, comparative financial statements and early application*

106. Some respondents suggested a period of time that would be necessary to implement the insurance standard. The IASB has stated its intention to allow approximately three years between the date of publication of the final insurance contracts standard and the mandatory effective date.

Appendix A—Assessment against project axioms and assumptions

A1. In February 2011 the IASB set forth the axioms and assumptions that would underlie the development of the project's future direction. The IASB's intentions in establishing these axioms and assumptions were:

(a) to provide a common understanding of the factors that would influence the staff in their analysis; and

(b) to create a starting point for further decisions.

A2. As the IASB has nearly completed its re-deliberations, the staff would like to evaluate the IASB's decisions against these axioms and assumptions.

A3. The table below:

(a) lists each of these axioms and assumptions; and

(b) notes any departures the IASB has made from these axioms and assumptions in re-deliberations.

Axiom or assumption	Staff comment
Axioms	
An ideal measurement model would report all economic mismatches (including duration mismatches) that exist and would not cause any accounting mismatches.	**Economic mismatches** The IASB has confirmed reporting of economic mismatches, including: (a) changes in expected credit losses on assets if those credit losses do not affect the amounts payable to policyholders; (b) changes in the risk premium that investors charge for bearing the risk that credit losses might exceed expectations if those credit losses do not affect the amounts payable to policyholders; (c) changes in the premium that investors pay (by receiving a reduced return) to invest in assets that provide liquidity, if the amounts paid to policyholders do not include a similar reduction because the liabilities do not provide similar liquidity for policyholders; (d) duration mismatches between assets and liabilities if assets are reported at current value; and (e) any guarantees written by the insurer, eg any requirement in a contract that the insurer will pay policyholders the higher of a return based

Axiom or assumption	Staff comment
	on actual asset returns and a specified minimum return. **Accounting mismatches** The combined effect of the proposal to present changes in insurance contract liabilities that arise as a result of changes in discount rate, and the proposed introduction of the fair value through other comprehensive income (FVOCI) measurement category for financial assets does not fully eliminate accounting mismatch but reduces it in practice for many contracts. For example, if a financial asset is managed within the 'both hold and sell' business model (which is often the case with assets backing insurance liabilities) and has payments of principal and interest only, it will be measured at FVOCI and an accounting mismatch will not arise. If, however, the asset is managed under a different business model or does not qualify for FVOCI due to its contractual cash flow characteristics (eg equity investments, derivatives, some hybrid contracts and non-financial assets such as investment properties), a mismatch will still arise either in other comprehensive income (OCI) (if the asset is measured at amortised cost) or both OCI and profit or loss (P&L) (if the asset is measured at FVPL). However, in some cases such reported mismatch will not only result from accounting mismatch but rather will also reflect the underlying economic mismatch. That would be the case when the values of, or cash flows from, financial assets and insurance contract liabilities respond differently to changes in economic conditions.
An ideal accounting model should reflect both the intrinsic value and the time value of options and guarantees embedded in insurance contracts.	Current value measurement of the insurance contract liability results in the reporting of both the intrinsic value and the time value of options and guarantees embedded in insurance contracts. However, there are two modifications from the 2010 Exposure Draft: (a) because changes in the liability arising from changes in discount rate are presented in OCI, some of the time value of options and guarantees will be presented in OCI. (b) the IASB proposes that cash flows that are linked to underlying items should be measured on the same basis as the underlying items.

Axiom or assumption	Staff comment
	However, the IASB also proposes that all options and guarantees in such cases should be measured at fair value through profit or loss.
Money has a time value, and an entity more faithfully represents its position when it measures its liabilities in a way that includes the time value of money.	The IASB confirmed that insurer should reflect the time value of money in the measurement of insurance liabilities as follows: (a) accretion of interest on the residual margin; and (b) discounting of all insurance contract liabilities that do not meet one or both of the following practical expedients for contracts accounted for using the premium allocation approach: (i) an entity need not discount or accrue interest on the liability for remaining coverage if the period between premium payment and satisfaction of the obligation to provide insurance coverage is expected to be one year or less. (ii) an entity need not discount liabilities for incurred claims which are expected to be paid within 12 months.
Assumptions	
The IASB will develop a standard specifically for insurance contracts, rather than requiring current or proposed generic guidance that might otherwise apply (for example, revenue recognition or financial instruments guidance).	The draft IFRS applies to insurance contracts as defined.
The standard will deal with the accounting for insurance contracts from the perspective of the insurer, and not for the assets backing the contracts. For the IASB, the financial assets backing the contracts would be measured in accordance with IFRS 9.	The draft IFRS applies to: (a) insurance contacts an entity issues; (b) reinsurance contracts an entity holds; and (c) financial instruments with discretionary participation features issued by insurers
The IASB will develop a standard based on an accounting model that regards insurance contracts as creating a bundle of rights and obligations that work together to generate a package of cash inflows and outflows.	Confirmed. The proposals on unbundling, which specify that an insurer should unbundle investment components, goods or services from insurance contracts only if they are distinct from the insurance component, are consistent with this assumption.
In general, the final standard will measure insurance contracts at the portfolio level.	The unit of account in the model is the portfolio overall. The relevant decisions include the following:

Axiom or assumption	Staff comment
	(a) The unit of account for the risk adjustment will not be specified as the objective of the risk adjustment is to reflect the compensation the insurer requires for bearing the uncertainty inherent in the cash flows of a portfolio that arise as the insurer fulfils the contract. As a result, the risk adjustment can reflect the effect of diversification between portfolios. (b) The unit of account used to determine the residual margin should be the portfolio. (c) The unit of account used to release the residual margin should not be prescribed. However, the release of the residual margin should be performed in a manner consistent with the objective of releasing the residual margin over the coverage period to the period(s) in which the service is provided. (d) An insurer should include in the fulfilment cash flows all the direct costs that the insurer will incur in acquiring the contracts in the portfolio.
The accounting model should be based on current estimates, rather than carrying forward estimates made at contract inception, and inputs that are consistent with observable market data, where available.	The measurement of the insurance contract liability will be updated to reflect current estimates in the statement of financial position at each reporting date. However, amounts presented in profit or loss will be determined using the discount rate at contract inception.
The cash flows incorporated in the measurement of the insurance liability are those that arise as the insurer fulfils the insurance contract.	Confirmed. In particular, the following decisions are consistent with this principle: (a) the acquisitions costs included in the initial measurement of a portfolio of insurance contracts are all the direct costs the insurer will incur in acquiring the portfolio (b) the measurement of an obligation that requires payment depending wholly or partly on the performance of specified assets and liabilities of the insurer should include all payments resulting from the contract, whether paid to current or future policyholders. (c) the cash flows relating to tax payments should be evaluated and treated like any other cash flows
The model will use the expected value of future cash flows rather than a single, most likely outcome.	Confirmed. In particular, the board confirmed that an insured event that was impending at the end of the reporting period should not adjust the measurement of the liability at the reporting date when it occurs or does not occur after that date.
The measurement of the liability	Confirmed.

Axiom or assumption	Staff comment
will not reflect changes in the insurer's own credit standing.	