International Financial Reporting Standards

Insurance contracts

ASAF meeting, September 2014

The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB or IFRS Foundation.

Today's discussion

- Reminder of previous ASAF discussions
- Contracts with participating features
  - Summary of IASB discussions
  - Questions for ASAF
- Transition
  - Summary of proposals and feedback
  - Questions for ASAF
- Appendix: Summary of IASB tentative decisions

Reminder of previous ASAF discussions

ASAF Discussion Topic	Related IASB decisions
September 2013 Overview of ED proposals	• NA
March 2014	
The basis for the optional use of OCI	• Effect of changes in discount rates presented in either profit and loss or in OCI as accounting policy choice for contracts within a portfolio
Unlocking for risk adjustment and reversal of losses	• CSM adjusted for changes between current and previous estimates of the risk adjustment and the present value of future cash flows • Recognise favourable changes in estimates in profit or loss to the extent that they reverse losses that relate to future services
The presentation of insurance contracts revenue and expense	• An entity should present revenue as earned and expenses as incurred in the statement of comprehensive income. Revenue excludes investment components. • Presentation of premium information in the statement of comprehensive income prohibited if that information is not consistent with commonly understood notions of revenue.
June 2014	
Contracts with participating features: • Desirability of separate model for contracts with participating features • Adjusting the CSM for the entity's share of returns from underlying items • Accounting for changes in the value of options and guarantees embedded in insurance contracts	• The IASB has yet to conclude on the accounting for contracts with participating features

Summary of IASB discussions on contracts with participating features

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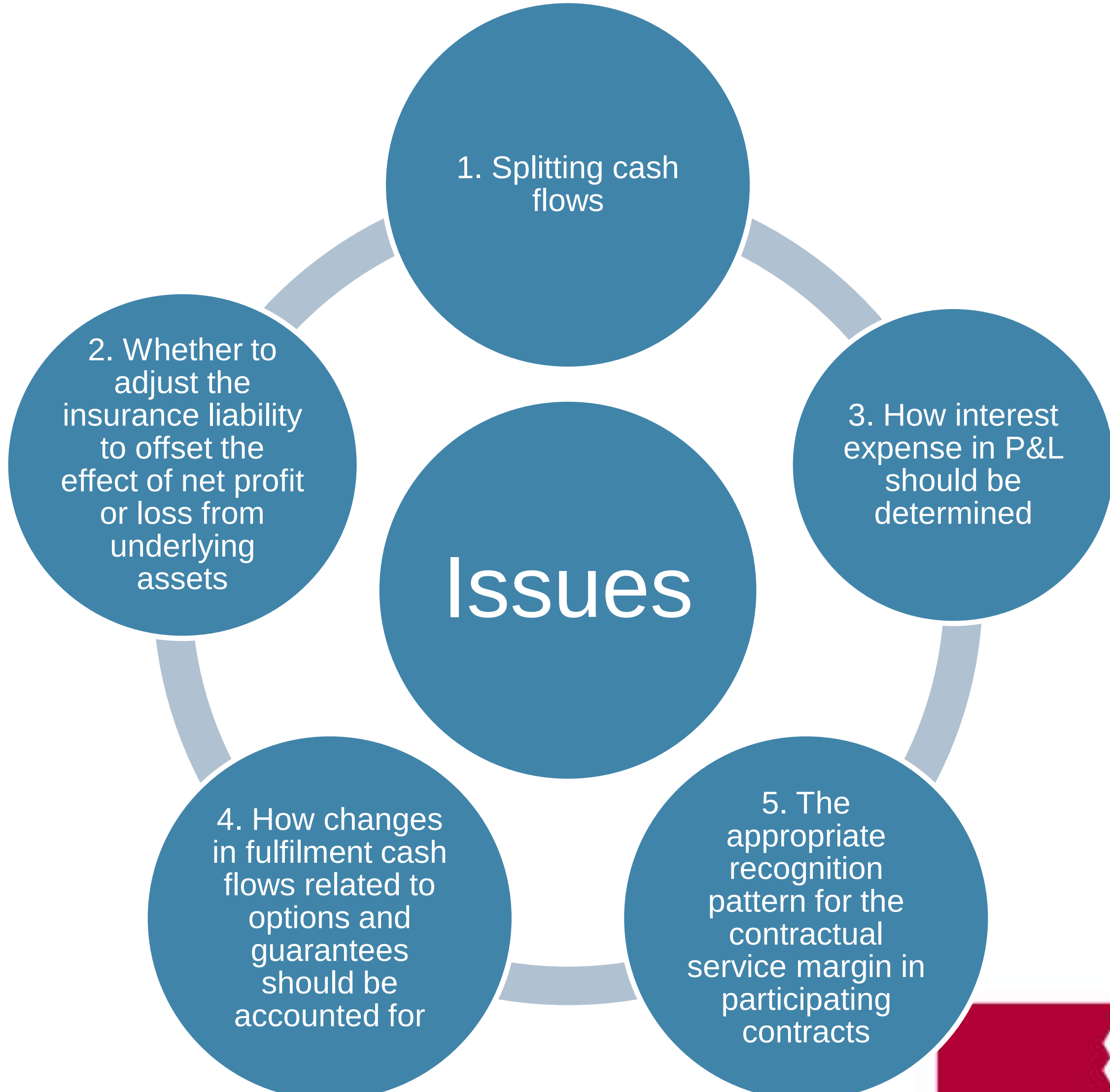
Background

- Participating features result in payments to policyholders that vary with the returns on underlying items
  - The entity shares with policyholder some of the investment risks of assets purchased with the premiums
- IASB approach for contracts with participating features is to consider what adaptations are needed to its tentative decisions to date for contracts with no participating features

Overview of issues for participating contracts



1. Splitting cash flows

- The IASB has concluded that its measurement proposals would not require splitting of cash flows.
- However the presentation of interest expense proposals in the 2013 ED would require the entity to split the cash flows and apply different applicable discount rates to those cash flows. Splitting cash flows would also be required for the mirroring exception
- The IASB has decided to explore two OCI approaches to replace this proposal that would avoid the need for bifurcation of cash flows for presentation
- The staff expect to consider whether any form of the mirroring exception should be required after evaluating the accounting model for participating contracts. Eliminating a requirement for the mirroring exception as proposed in the 2013 ED would elimination any need to bifurcate cash flows.

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2. Whether to adjust the insurance liability to offset the effect of net profit or loss from underlying assets

- The IASB directed the staff to consider adjusting changes in insurer's share of asset returns against the CSM only when those changes can be viewed as an implicit management fee. This is the case only when:
  - the returns to be passed to the policyholder arise from the underlying items the entity holds (regardless of whether the entity is required to hold those items or whether the entity has discretion over the payments to policyholders);
  - there is a minimum amount (either fixed or determinable) that the entity must retain; and
  - the policyholder will receive a substantial share of the total return on underlying items.

3. How interest expense in P&L should be determined

- The IASB asked the staff to explore two approaches for determining the discount rate used for the presentation of interest expense in profit or loss: a book yield approach and an effective interest method approach.
- The IASB directed the staff to consider the book yield approach only for contracts in which:
  - the returns passed to the policyholder arise from the underlying items the entity holds (regardless of whether the entity is required to hold those items); and
  - the policyholder will receive a substantial share of the total return on underlying items.
- The effective interest method approach would be applied to contracts for which the cash flows that vary with underlying items are a substantial proportion of the total benefits to the policyholder over the life of the contract
- The staff plan to ask the IASB to consider whether an entity should be permitted or required to present the effects of changes in discount rates in other comprehensive income (OCI) for an insurance contract with participating features.

4. How changes in fulfilment cash flows related to options and guarantees should be accounted for

- At the June 2014 ASAF meeting, most ASAF members thought that options and guarantees should be treated in the same way as other components of the insurance contract.
- This would mean:
  - changes in cash flows relating to future service (in effect, changes in non-financial assumptions relating to future service) recognised as an offset to CSM
  - changes in cash flows that do not relate to future service (in effect, changes in non-financial assumptions relating to current and past service) recognised in P&L
  - effect of discount rate changes recognised in P&L or OCI

5. The appropriate recognition pattern for the contractual service margin in participating contracts

- The IASB has concluded that for non-participating contracts, the service provided by an insurance contract is insurance coverage.
- We plan to consider how other services provided by a contract with participating features should affect the pattern of recognition of the contractual service margin.

Summary of proposed treatment of changes in estimates for participating contracts

Changes in financial assumptions	In OCI or profit or loss according to accounting policy choice	Includes effect of changes in interest rates and consequent effect eg on lapse rates and value of guarantees
Changes in non financial assumptions relating to future service	Offset in CSM	Includes eg mortality rates and lapse rates to extent not caused by interest rate changes
Changes in non financial assumptions relating to current or past periods	In profit or loss	Includes experience adjustments
Changes in investment returns of underlying items	Reported in accordance with other applicable standards.	

No effect in P&L required in period of change

Affects P&L in period of change

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Questions for ASAF on contracts with participating features

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Scope
(see pages 10 and 11, and June 2014 agenda paper 2D)

1. Do you agree with the IASB's direction for the circumstances in which an insurer's share of asset returns can be viewed as an implicit management fee? If not, which alternative circumstances would you propose?
2. Do you agree with the IASB's direction on limiting the scope when an entity might apply a book yield approach? If not, how would you limit the scope?

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OCI approach
(See September agenda papers 2A-2D)

3. What are you views on the staff recommendations and board tentative decisions on the proposals for an OCI approach in the September agenda papers 2A-2D?

Transition

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Summary of transition proposals

- At beginning of earliest period presented an entity should:
  - Measure each portfolio of insurance contracts as a sum of the fulfilment cash flows and remaining contractual service margin
  - For contracts that are accounted for through OCI, recognise in cumulative OCI the effect of discount rate changes
  - Derecognise any intangible assets that do not meet the definition of an intangible asset (eg deferred acquisition costs)
- The remaining CSM and cumulative OCI should be measured retrospectively if practicable. If not practicable, an entity should estimate those amounts using:
  - The actual cash flows that occurred
  - The risk adjustment at the transition date
  - An approximation for the yield curve determined based on the closest observable yield curve at the transition date

Feedback on transition proposals

- Widespread support for principle of retrospective application
- Suggested for further simplifications when retrospective application is impracticable to address following issues:
  – Lack of historic cash flow information, in particular, about acquisition costs
  – Lack of clarity in how to determine the discount rate at inception and thus complexity in determining accumulated OCI at transition date
  – Concern about overstatement of risk adjustment at inception
  – Need for simplification in determining the portfolio at the date of transition
- Concerns about depiction of contracts that are profitable overall, despite adverse investment experience

Questions for ASAF on transition

4. Do you think that further simplifications are needed to the transition proposals? If so, what simplifications would you propose and why?
5. When an entity has insufficient data to apply the proposed simplifications, do you think that the IASB needs to provide an alternative way to determine the CSM at the transition date, eg:
   - setting the CSM to zero
   - using fair value to determine the CSM
   - using the premium that the entity would have charged the policyholder if it had entered into a contract with equivalent terms at the date of transition

Appendix: Summary of IASB tentative decisions to date

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The story so far: Contracts with no participating features substantially complete

Revenue	• An entity should present revenue as earned and expenses as incurred in the statement of comprehensive income. Revenue excludes investment components. • Presentation of premium information in the statement of comprehensive income prohibited if that information is not consistent with commonly understood notions of revenue.
Unlocking CSM	• CSM adjusted for changes between current and previous estimates of the risk adjustment and the present value of future cash flows • Recognise favourable changes in estimates in profit or loss to the extent that they reverse losses that relate to future services
OCI	• Effect of changes in discount rates presented in either profit and loss or in OCI as accounting policy choice for contracts within a portfolio

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The story so far: Decisions on issues raised that were not targeted for input in the 2013 ED

1	Option to include fixed fee service contracts within scope of insurance contracts standard.
2	Additional guidance on use of judgement in making any necessary adjustments to observable inputs to determine the discount rate.
3	Recognise contractual service margin in profit or loss in a way that reflects the passage of time and the expected number of contracts in force
4	Symmetrical treatment for changes in estimates of fulfilment cash flows for a reinsurance contract and the underlying direct insurance contract
5	Contracts acquired in settlement period should be accounted for as if issued by entity at the date of portfolio transfer or business combination
6	Clarified objectives relating to level of aggregation
7	Clarify that significant insurance risk only occurs when there is a possibility that an issuer will incur a loss on a present value basis
8	Confirm use of locked-in rate for accreting interest and for determining the amount that unlocks the contractual service margin.

Summary of treatment of changes in estimates for non-participating contracts

Changes in financial assumptions	In OCI or profit or loss according to accounting policy choice	For non-participating contracts, the discount rate is the key financial assumption
Changes in non financial assumptions relating to future service	Offset in CSM	Includes eg mortality rates and lapse rates to extent not caused by interest rate changes
Changes in non financial assumptions relating to current or past periods	In profit or loss	Includes experience adjustments
Changes in investment returns of assets the insurer holds	Reported in accordance with other applicable standards.	

First two rows: No effect required in P&L in period of change

Last two rows: Affects P&L in period of change