STAFF PAPER

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IASB Meeting

Project	**Insurance Contracts**
Paper topic	Premium-allocation approach: revenue recognition pattern

CONTACT(S)	Milena Lacheta	mlacheta@ifrs.org	+44(0)20 7246 6494
	Joanna Yeoh	jyeoh@ifrs.org	+44(0)20 7246 6481

Purpose of this paper

1. The IASB has recently decided to clarify that the allocation pattern for the contractual service margin in the general measurement model for insurance contracts should be based on the provision of insurance coverage. This paper considers whether to provide similar guidance on the pattern of recognition of the insurance contract revenue in the premium-allocation approach.

Staff recommendation

2. Under the premium-allocation approach, an entity should allocate insurance contract revenue in profit or loss in the systematic way that best reflects the transfer of services. The staff recommend that the IASB should clarify that the transfer of services occurs:

   (a) on the basis of the passage of time and the expected number of contracts in force; but

   (b) if the expected pattern of release of risk differs significantly from the passage of time, then on the basis of the expected timing of incurred claims and benefits.

Background

3. Both the 2010 Exposure Draft *Insurance Contracts* (the 2010 ED) and the 2013 Exposure Draft *Insurance Contracts* (the 2013 ED) proposed two approaches to account for contracts, namely:

   (a) the general model: in this model the profit for the period comprises the release of the risk adjustment and the contractual service margin (CSM); and

   (b) the premium-allocation approach (PAA): this is a simplification of the general model, in which the profit for the period is determined as the revenue less expenses for the period. The revenue for the period is determined as the amount of the expected premium receipts allocated in the period.

Proposals in the 2010 Exposure Draft

4. The 2010 ED proposed that an entity should recognise:

   (a) the CSM (then called 'the residual margin') in the general approach; and

   (b) insurance contract revenue in the premium-allocation approach (then called the 'premium allocation model');

   in profit or loss in a systematic way that best reflects the exposure from providing insurance coverage.

5. The 2010 ED explained that, for both the CSM in the general model and insurance contract revenue in the premium-allocation approach, the systematic way that best reflects the exposure from providing insurance coverage was:

   (a) on the basis of the passage of time; but

   (b) if that pattern differs significantly from the passage of time, then on the basis of the expected timing of incurred claims and benefits.

6. The 2010 ED proposals for the recognition of the CSM received mixed feedback from comment letters and outreach activities. Many constituents believed that neither the passage of time nor the expected pattern of incurred claims and

benefits would reflect the exposure from insurance coverage for all insurance contracts. The IASB did not receive many specific comments on the 2010 ED proposals that addressed the revenue allocation pattern in the premium-allocation approach.

Proposals in the 2013 Exposure Draft

7. The 2013 Exposure Draft *Insurance Contracts* (the 2013 ED) included principle-based proposals related to the allocation of the CSM in the general model and recognition of revenue in the premium-allocation approach. According to those proposals, an entity should recognise in profit or loss the remaining CSM (for the general model) or revenue (for the premium-allocation approach) over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract.

8. Some respondents to the 2013 ED were concerned that, without further guidance, the subjectivity in determining the pattern of underlying services will create significant diversity in the pattern of recognition of the CSM and insurance contract revenue in profit or loss. However, the IASB did not receive many specific comments on the 2013 ED proposals that addressed the revenue allocation pattern in the premium-allocation approach.

Redeliberations in 2014

9. At its May 2014 meeting, the IASB tentatively decided to confirm the 2013 ED proposals on the allocation of the CSM in the general model. The IASB also tentatively decided to clarify that the service provided by an entity, as represented in the general model by the CSM, is insurance coverage. That service is provided on the basis of the passage of time. The reason for the IASB's decision was to enhance consistent application in an area that would have a material impact on the profit reported by entities.

10. Following the clarification on the allocation pattern for the CSM for the general model, this paper considers whether to provide similar clarification for the premium-allocation approach.

Staff analysis

11. As a consequence of the May 2014 tentative decisions, under the general model the profit in each period would be recognised in line with changes in both the contractual service margin and the risk adjustment. This means that the profit for the period would reflect both:

    (a) the allocation of the contractual service margin, which is according to the pattern of transfer of services, ie, according to the passage of time and the expected number of contracts in force; and

    (b) the release of risk in the period as measured by the risk adjustment.

12. The staff believe that the concerns raised by constituents about the allocation of the CSM under the general model, discussed in paragraph 8, apply equally to the pattern of revenue recognition under the PAA. Given the conclusions of the May 2014 tentative decisions for the general measurement model presented in paragraph 11, the staff recommend that the pattern for recognising insurance contract revenue in profit or loss should accordingly also be clarified for the PAA.

13. Consequently, under the PAA the revenue would be recognised according to a combination of:

    (a) the passage of time and the expected number of contracts in force, to be consistent with recognition of the CSM in the general model; and

    (b) the expected release of the risk, to be consistent with the risk adjustment in the general model (as explained in paragraphs 14-16).

14. Because the PAA is a simplification of the general model, the staff do not think that entities should be required to measure the risk adjustment in the coverage period to determine the expected release of risk during the coverage period. Instead, to reduce complexity, the staff are proposing a rebuttable presumption that revenue should be recognised according to the passage of time, taking into account the expected number of contracts in force. This presumes that the release of risk is linear over the expected coverage period.

15. However, when the entity expects that the release of risk would be significantly different from a linear pattern, the entity should recognise revenue according to

the pattern of the release of risk. The staff think that an acceptable proxy would be the expected pattern of incurred claims and benefits.

16. For example, the release of risk would not be expected to be linear for hurricane insurance, because the probability of damage caused by hurricanes is significantly higher during the hurricane season. Consequently, the revenue for such insurance coverage would have to reflect that the risk of incurring a claim is significantly higher in the hurricane season and lower in others. The difference in risk during and outside the hurricane season would be captured using the expected pattern of incurred claims as a proxy.

Question : recognition of revenue in the premium-allocation approach

Does the IASB agree to clarify that, in the premium-allocation approach, an entity should recognise insurance contract revenue in profit or loss:

(a) on the basis of the passage of time and the expected number of contracts in force; but

(b) if the expected pattern of release of risk differs significantly from the passage of time, then on the basis of expected timing of incurred claims and benefits?