STAFF PAPER

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Accounting Standards Advisory Forum

Project	**Insurance contracts**
Paper topic	Project update

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1. This paper provides an Update to ASAF members on the IASB's tentative decisions to date. The staff are not seeking advice from the ASAF at this meeting.

Overview of project progress

2. Since January 2014, the IASB has been deliberating issues raised in its third consultation document, a revised Exposure Draft issued in June 2013. The 2013 ED *Insurance Contracts* builds on the proposals previously set out in:

   (a) the Discussion Paper *Preliminary Views on Insurance Contracts*, published in May 2007, which explained the IASB's initial views on insurance contracts; and

   (b) the Exposure Draft *Insurance Contracts*,, published in July 2010, which developed those initial views into a draft Standard.

3. In its deliberations, the IASB has sought to balance many diverse views and develop an approach that provides useful financial information and that can be applied in all jurisdictions that apply IFRS.

4. So far, the IASB has completed its discussions on the model for insurance contracts without participation features. Appendix A provides an overview of the tentative decisions made to date.

5. However, a significant challenge for the IASB has been the accounting approach for contracts with participation features. A participation feature causes the cash flows to the policyholder to vary with the returns on assets.

6. The IASB has held numerous education sessions on the accounting for contracts with participation features between May 2014 and May 2015. The IASB is considering the accounting for contracts with participation features in the context of adaptations that might be needed to the general model for contracts with no participation features. Accordingly, during those education sessions, the IASB directed the staff in developing proposals for the application of the general model to contracts with participation features.

7. At the June 2015 IASB meeting, the IASB is expected to make tentative decisions on contracts with participation features, in particular:

   (a) whether the IASB should modify its general measurement model for accounting for insurance contracts with direct participation features so that changes in the estimate of the fee the entity expects to earn from the contract are adjusted in the contractual service margin. That fee is an amount equal to the entity's expected share of the returns on underlying items less any expected cash flows that do not vary directly with the underlying items.

   (b) how contracts with direct participation features should be defined.

   (c) the recognition of the contractual service margin in profit or loss for contracts with participation features.

8. In addition, the IASB will hold education sessions in which it considers:

   (a) the hedging of insurance activities. One of the consequences of the variable fee approach described in paragraph 7(a) is that when an entity hedges interest rate risk in insurance contracts using derivatives, changes in interest rates would be recognised in profit or loss for the derivative and as an adjustment to the contractual service margin for the insurance contract.

   (b) the interaction of the effective date of IFRS 9 and the forthcoming insurance contracts standard, including:

(i) the feedback the IASB received on applying IFRS 9 prior to the new insurance contracts Standard*;*

(ii) how entities would apply IFRS 9 in conjunction with existing IFRS 4; and

(iii) the complexities that would arise if the IASB were to defer the effective date of IFRS 9 *Financial Instruments* for the insurance industry until the effective date of the new insurance contracts Standard.

9. The staff will provide an oral update to ASAF members on the IASB's discussions at the June 2015 meeting. The IASB staff will also provide an oral update on the papers that will be provided for the IASB's July 2015 meeting.

Next steps

10. During the remainder of 2015, the staff expect the IASB to consider the remaining technical decisions. The staff expect that the new Standard will not be published before the end of 2015. The staff do not expect the IASB to consider the mandatory effective date of the new insurance contracts Standard until after the IASB has otherwise concluded its deliberations.

Appendix A: Tentative decisions to date

A1. The following table presents a summary of tentative decisions made in the redeliberations phase in 2014 and 2015:

	Tentative decisions	Change from 2013 Exposure Draft
1	***Targeted issue: Unlocking the contractual service margin*** (a) Differences between the current and previous estimates of the present value of expected cash flows and the risk adjustment related to future coverage and other future services should be added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative. (b) Differences between the current and previous estimates of the present value of cash flows and the risk adjustment that do not relate to future coverage and other future services should be recognised immediately in profit or loss. (c) Favourable changes in estimates that arise after losses were previously recognised in profit or loss should be recognised in profit or loss to the extent that they reverse losses that related to coverage and other services to be provided in the future. (d) An entity should use the locked-in rate at inception of the contract for accreting interest and for determining the change in the present value of expected cash flows that offsets the contractual service margin.	The 2013 Exposure Draft would: • recognise all changes in estimates of risk adjustment immediately in profit or loss. • rebuild the contractual service margin from zero without first reversing previously recognised losses in the profit or loss.

	Tentative decisions	Change from 2013 Exposure Draft
2	***Targeted issue: Presentation of interest expense in the Statement of Comprehensive Income*** (a) An entity should choose to present the effect of changes in discount rates in profit or loss, or in other comprehensive income as its accounting policy and should apply that accounting policy to all contracts within a portfolio (b) If the entity chooses to present the effect of changes in discount rates in other comprehensive income, the entity should: (i) Recognise in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised; and (ii) Recognise in other comprehensive income, the differences between the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date and the carrying amount of the insurance contract was initially recognised. (iii) Disclose an analysis of total interest expense included in total comprehensive income disaggregated at a minimum to: 1. interest accretion at the discount rate that applied at initial recognition of insurance contracts reported in profit or loss for the period; and 2. the movement in other comprehensive income for the period. (c) An entity should disaggregate total interest expense included in total comprehensive income to: (i) the amount of interest accretion determined using current discount rates; (ii) the effect on the measurement of the insurance contract of changes in discount rates	The 2013 Exposure Draft proposed that the effect of changes in discount rates should be required to be presented in OCI.

	Tentative decisions	Change from 2013 Exposure Draft
	in the period; and (iii) the difference between the present value of changes in expected cash flows that adjust the contractual service margin in a reporting period when measured using discount rates that applied on initial recognition of insurance contracts, and the present value of changes in expected cash flows that adjust the contractual service margin when measured at current rates. (d) For contracts without participation features, an entity should use the locked-in rate at inception of the contract for accreting interest and for determining the change in the present value of expected cash flows that offsets the contractual service margin. (e) An entity should apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to changes in accounting policy relating to the presentation of the effect of changes in discount rates.	
3	***Targeted issue: Insurance contracts revenue*** (a) An entity should present insurance contract revenue and expense in the statement of comprehensive income, as proposed in paragraphs 56–59 and B88–B91 of the 2013 Exposure Draft; and (b) An entity should disclose the following: (i) a reconciliation that separately reconciles the opening and closing balances of the components of the insurance contract asset or liability (paragraph 76 of the 2013 Exposure Draft);	The 2013 Exposure Draft did not explicitly prohibit presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue.

	Tentative decisions	Change from 2013 Exposure Draft
	(ii) a reconciliation from the premiums received in the period to the insurance contract revenue in the period (paragraph 79 of the 2013 Exposure Draft); (iii) the inputs used when determining the insurance contract revenue that is recognised in the period (paragraph 81(a) of the 2013 Exposure Draft); and (iv) the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position (paragraph 81(b) of the 2013 Exposure Draft). (c) An entity should be prohibited from presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue.	
4	**Targeted issue: Transition** **(for contracts without participation features)** (a) an entity should apply the Standard retrospectively in accordance with IAS 8 unless impracticable; and (b) if retrospective application of the Standard is impracticable, an entity should apply the simplified approach proposed in paragraphs C5 and C6 of the 2013 Exposure Draft with the following modification: instead of estimating the risk adjustment at the date of initial recognition as the risk adjustment at the beginning of the earliest period presented, an entity should estimate the risk adjustment at the date of initial recognition by adjusting the risk adjustment at the beginning of the earliest period presented by the assumed release of the risk before the beginning of the earliest period presented. The assumed release of risk should be determined by reference to release of risk	For contracts without participation features: • Simplified the practical expedients when retrospective application in accordance with IAS 8 is impracticable. • In addition, added a way for the entity to estimate the contractual service margin on transition when neither

	Tentative decisions	Change from 2013 Exposure Draft
	for similar insurance contracts that the entity issues at the beginning of the earliest period presented. (c) if the simplified approach described in paragraph (b) above is impracticable, an entity should: (i) determine the contractual service margin at the beginning of the earliest period presented as the difference between the fair value of the insurance contract at that date and the fulfilment cash flows measured at that date; and (ii) determine interest expense in profit or loss, and the related amount of other comprehensive income accumulated in equity, by estimating the discount rate at the date of initial recognition using the method in the simplified approach proposed in paragraph C6(c) and (d) the 2013 Exposure Draft. (d) for each period presented for which there are contracts that were measured in accordance with the simplified approach or the fair value approach, an entity should disclose the information proposed in paragraph C8 of the 2013 Exposure Draft (ie the disclosures for contracts for which retrospective application is impracticable) separately for: (i) contracts measured using the simplified approach; and (ii) contracts measured using the fair value approach. **(On initial application of the new insurance contracts Standard after implementation of IFRS 9 Financial Instruments)** (a) An entity is permitted to newly designate financial assets under the fair value option as measured at fair value through profit or loss to eliminate (or significantly reduce) an accounting mismatch	retrospective application nor the simplified approach are impracticable. For initial application of the new standard after implementation of IFRS 9, the 2013 Exposure Draft did not allow or require an entity to reassess the business model for financial assets at the date of initial application of the new insurance contracts Standard.

	Tentative decisions	Change from 2013 Exposure Draft
	according to paragraph 4.1.5 of IFRS 9; (b) An entity is required to revoke previous fair value option designations for financial assets if the accounting mismatch that led to the previous designation according to paragraph 4.1.5 of IFRS 9 no longer exists; and (c) An entity is permitted to newly designate an investment in an equity instrument as measured at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9 and is permitted to revoke previous designations. (d) To provide further transition relief to permit or require an entity to reassess the business model for financial assets at the date of initial application of the new insurance contracts Standard. This reassessment would be based on the conditions for assessing the business model in paragraphs 4.1.2(a) or 4.1.2A(a) of IFRS 9 and the facts and circumstances that exist at the date of the first application of the new insurance contracts Standard.	
5	***Non-targeted issue: Level of aggregation and portfolio definition*** (a) Clarify that the objective of the proposed insurance contracts Standard is to provide principles for the measurement of an individual insurance contract, but that in applying the Standard an entity could aggregate insurance contracts provided that it meets that objective. (b) Amend the definition of a portfolio of insurance contracts to be: "insurance contracts that provide coverage for similar risks and are managed together as a single pool". (c) Add guidance to explain that in determining the contractual service margin or loss at initial recognition, an entity should not aggregate onerous contracts with profit-making contracts. An entity should consider the facts and circumstances to determine whether a contract is onerous at	The definition of a portfolio in the 2013 Exposure Draft is modified to eliminate the reference to "priced similarly relative to the risk taken on". The definition of portfolio now applies more narrowly than the 2013 Exposure Draft. Added additional guidance and

	Tentative decisions	Change from 2013 Exposure Draft
	initial recognition.	clarification
6	***Non-targeted issue: Discount rate for long-term contracts when there is little or no observable market data*** (a) Confirm the principle that the discount rates used to adjust the cash flows in an insurance contract for the time value of money should be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract. (b) Provide additional application guidance that, in determining those discount rates, an entity should use judgement to: (i) ensure that appropriate adjustments are made to observable inputs to accommodate any differences between observed transactions and the insurance contracts being measured. (ii) develop any unobservable inputs using the best information available in the circumstances, while remaining consistent with the objective of reflecting how market participants assess those inputs. Accordingly any unobservable inputs should not contradict any available and relevant market data.	Added clarification of how the principle should be applied in determining discount rates for insurance contracts.
7	***Non-targeted issue: Asymmetric treatment of contractual service margin between insurance contracts issued and reinsurance contracts held*** (a) After inception, an entity should recognise in profit or loss any changes in estimates of fulfilment cash flows for a reinsurance contract that an entity holds when those changes arise as a result of changes in estimates of fulfilment cash flows for an underlying direct insurance contract that are	The 2013 Exposure Draft proposed that, for a reinsurance contract that an entity holds, all changes in estimates of fulfilment cash flows relating to future service should be recognised and

	Tentative decisions	Change from 2013 Exposure Draft
	recognised immediately in profit or loss.	offset to the contractual service margin
8	***Non-targeted issue: Allocation of the contractual service margin to the profit or loss*** ***(for contracts without participation features)*** (a) Confirm the principle in the 2013 Exposure Draft that an entity should recognise the remaining contractual service margin in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of the services that are provided under an insurance contract. (b) Clarify that, for contracts without participation features, the service represented by the contractual service margin is insurance coverage that: (i) is provided on the basis of the passage of time; and (ii) reflects the expected number of contracts in force.	The 2013 Exposure Draft stated only that an entity should recognise the remaining contractual service margin in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of the services that are provided under an insurance contract.
9	***Non-targeted issue: Significant insurance risk*** (a) Clarify the guidance in paragraph B19 of the 2013 Exposure Draft that significant insurance risk only occurs when there is a possibility that an issuer will incur a loss on a present value basis.	The 2013 Exposure Draft referred more specifically to the need for a scenario with commercial substance in which the present value of the net cash outflows can exceed the present value of the premiums.
10	***Non-targeted issue: Portfolio transfers and business combinations***	Clarification of requirements in the

	Tentative decisions	Change from 2013 Exposure Draft
	(a) Clarify the requirements for the contracts acquired through a portfolio transfer or a business combination in paragraphs 43-45 of the 2013 Exposure Draft, that such contracts should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or business combination.	2013 Exposure Draft to avoid difference in interpretation.
11	***Non-targeted issue: Fixed fee service contracts*** (a) Entities should be permitted, but not required, to apply the revenue recognition Standard to the fixed-fee service contracts that meet the criteria stated in paragraph 7(e) of the 2013 Exposure Draft.	The 2013 Exposure Draft excluded all fixed fee service contracts from its scope.
12	***Non-targeted issue: Premium-allocation approach*** (a) Clarify that when an entity applies the premium-allocation approach to account for an insurance contract, it should recognise insurance contract revenue in profit or loss: (i) on the basis of the passage of time; but (ii) 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. (b) When an entity applies the premium-allocation approach to contracts for which the entity: (i) discounts the liability for incurred claims; and (ii) chooses to present the effect of changes in discount rates in OCI; the interest expense in profit or loss for the liability for incurred claims should be determined using the discount rate that is locked in at the date the liability for incurred claims is recognised. This	The 2013 Exposure Draft required that an entity should allocate the expected premium receipts as insurance contract revenue to each accounting period in the systematic way that best reflects the transfer of services that are provided under the contract. The 2013 Exposure Draft required that interest expense on insurance liabilities should be

	Tentative decisions	Change from 2013 Exposure Draft
	tentative decision also applies to the presentation of interest expense for any onerous contract liability that is recognised when the entity applies the premium-allocation approach.	determined using the discount rates that applied at the date that the contract was initially recognised.
13	***Non-targeted Issues that will not be addressed*** (a) In April 2014 the IASB tentatively decided not to consider in future meetings other non-targeted issues, including those relating to: (i) disclosures; (ii) combination of insurance contracts; (iii) contract boundary for specific contracts; (iv) unbundling—lapse together criteria; (v) treatment of ceding commissions; (vi) discount rate—top-down and bottom-up approaches; (vii) tax included in the measurement; and (viii) combining the contractual service margin with other comprehensive income.	None