IFRS

STAFF PAPER

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REG IASB Meeting

Project	**Insurance Contracts**
Paper topic	Cover Note

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Introduction

1. This cover note:

   (a) introduces the papers for this meeting (in paragraphs 2-6);

   (b) sets out the next steps of the project (in paragraph 7); and

   (c) presents a summary of tentative decisions made in the redeliberations phase in 2014 and 2015 (in Appendix A).

Papers for this meeting

Agenda papers 2A-2D Disaggregation of the insurance contract's changes arising from changes in market variables in the statement of comprehensive income

2. Agenda papers 2A-2D address the disaggregation of changes arising from changes in market variables in the statement of comprehensive income.

3. In accordance with the IASB's tentative decisions, insurance contracts are measured using current assumptions, and the effect of changes in market variables[1] is recognised in the statement of comprehensive income. In March 2014, the IASB tentatively decided that for contracts without participation

[1] Changes in the discount rate and changes in the amounts of some cash flows are the result of changes in the market variables.

features, the entity may choose as its accounting policy to disaggregate changes in discount rates between profit or loss and other comprehensive income (OCI). If so:

(a) the presentation of the insurance investment expense should be determined using the discount rate locked in at inception (ie a cost measurement basis in profit or loss);[2] and

(b) accordingly the difference between the insurance investment expense determined using a cost and a current measurement basis is presented in OCI.

4. The IASB has not yet made any decisions on the approach(es) to be required when disaggregating changes in the liability arising from changes in discount rates between profit or loss and OCI for contracts with participation features. The staff's approach for the deliberations has been to consider what adaptations to the tentative decisions for contracts without participation features would be needed for contracts with participation features.

5. Accordingly:

(a) Agenda Paper 2A provides a reminder about contracts with participation features and how those contracts are accounted for, and summarises the IASB's previous considerations on the disaggregation of changes arising from changes in market variables between profit or loss and OCI. (Agenda paper 2A does not ask for decisions).

(b) Agenda Papers 2B–2D consider questions for contracts with participation features on the disaggregation of changes in discount rates between profit or loss and OCI as follows:

(i) Agenda Paper 2B considers what the practical mechanics could be when disaggregating changes in market variables between profit or loss and OCI. This would apply to all

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[2] The term 'insurance investment expense' is intended to be synonymous with the term 'interest expense', which had been used in previous papers. The new term is a better descriptor of the changes that are presented in profit or loss, because those changes may arise from more causes than solely changes in interest rates. For reasons of brevity, the rest of the agenda papers refer to the insurance investment as being an expense. Nevertheless, the decisions are meant to apply equally to when there is insurance investment income.

contracts accounted for under the general model and the variable fee approach.

(ii) Agenda Paper 2C considers whether different requirements (ie current period book yield) are needed for contracts in which economic mismatches do not exist with the items held. This would apply to a specified subset of contracts accounted for under the variable fee approach.

(c) Agenda Paper 2D discusses other issues for contracts with participation features related to disaggregating changes in market variables between profit or loss and OCI as follows:

(i) whether such a disaggregation between profit or loss and OCI should be an accounting policy choice; and

(ii) simplified transition requirements for the determination of the insurance investment expense and the accumulated balance of OCI when retrospective application is impracticable.

Agenda Paper 2E Hedging for insurance liabilities

6. This paper considers whether the IASB should enable an entity to avoid accounting mismatches that could arise when the entity:

(a) uses the variable fee approach to account for insurance contracts that have embedded guarantees; and

(b) hedges itself against (protects itself from) the risk from the guarantees embedded in the insurance contracts by using a derivative measured at fair value through profit or loss.

Next steps

7. The staff expect the IASB to consider the remaining technical decisions on Insurance Contracts in 2015, with a view to issuing the new Standard on Insurance Contracts in 2016. In particular, the staff plan to consider at a future meeting the differences between the IASB's general model and the variable fee approach and the presentation and disclosure requirements. The staff do not

expect 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 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.	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
	(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 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.	

	Tentative decisions	Change from 2013 Exposure Draft
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); (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.	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
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 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	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 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
	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 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	

	Tentative decisions	Change from 2013 Exposure Draft
	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	***Targeted issue: Contracts with participation features*** (a) Modify the general measurement model for accounting for insurance contracts with direct participation features so that changes in the estimate of the fee that the entity expects to earn from the contract are adjusted in the contractual service margin. The fee that the entity expects to earn from the contract is 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) Contracts with direct participation features should be defined as contracts for which: (i) the contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items; (ii) the entity expects to pay to the policyholder an amount equal to a substantial share of the returns from the underlying items; and (iii) a substantial proportion of the cash flows that the entity expects to pay to the policyholder should be expected to vary with the cash flows from the	The 2013 Exposure Draft proposed a measurement exception (sometimes referred to as the 'mirroring approach') that would measure part of the fulfilment cash flows on a cost basis, if the underlying items were measured on a cost basis. The variable fee approach would apply to a wider range of contracts than the mirroring approach. The variable fee approach would measure all of the fulfilment cash flows on a current basis. The 2013 Exposure Draft proposed

	Tentative decisions	Change from 2013 Exposure Draft
	underlying items. (c) For all insurance contracts with participation features, an entity should recognise the contractual service margin in profit or loss on the basis of the passage of time.	only the principle that an entity should recognise the remaining CSM in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract.
6	***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 initial recognition.	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 in the 2013 Exposure Draft. Added additional guidance and clarification
7	***Non-targeted issue: Discount rate for long-term contracts when there is little or no observable market data***	Added clarification of how the principle should be applied in

	Tentative decisions	Change from 2013 Exposure Draft
	(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.	determining discount rates for insurance contracts.
8	***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 recognised immediately in profit or loss.	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 offset to the contractual service margin.

	Tentative decisions	Change from 2013 Exposure Draft
9	***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.
10	***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.
11	***Non-targeted issue: Portfolio transfers and business combinations*** (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	Clarification of requirements in the 2013 Exposure Draft to avoid difference in interpretation.

	Tentative decisions	Change from 2013 Exposure Draft
	contracts should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or business combination.	
12	***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.
13	***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	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 determined using the discount rates that applied at the date that the contract was initially recognised.

	Tentative decisions	Change from 2013 Exposure Draft
	incurred claims is recognised. This 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.	
14	***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