

STAFF PAPER

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Project	Insurance Contracts		
Paper topic	Background to the insurance contracts project		
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Purpose of this paper

1. This paper summarises the history of the International Accounting Standards Board's (the Board) project to develop an insurance contracts Standard, as follows:
 - (a) The reasons for undertaking the project (in paragraphs 3-6).
 - (b) The history of the project (in paragraphs 7-22), in the following stages:
 - (i) work of the International Accounting Standards Committee (IASC);
 - (ii) Phase I of the Board's project on insurance contracts; and
 - (iii) Phase II of the Board's project on insurance contracts, including the redeliberations on the 2013 Exposure Draft *Insurance Contracts* ('the 2013 ED').
2. This paper provides background information to assist the Board in deciding on the questions in Agenda Paper 2F *Due process summary and permission to begin the balloting process for the insurance contracts Standard* for this meeting. Consequently, this paper does not offer any staff recommendations.

Reasons for undertaking the project

3. An entity that issues insurance contracts writes contracts today that are subject to uncertain outcomes and for which the entity may not know the profit for many years. This is almost unique and the difficulties associated with measuring such contracts inevitably results in complex accounting that depends heavily on assumptions. In addition, many insurance products are often deliberately complex either for tax, regulatory or competition purposes. While accounting standards can exacerbate the complexity, no accounting standard will remove this basic and key complexity, or the need to rely on assumptions about the future.
4. At the most basic level, an entity that issues insurance contracts receives cash in the form of premiums, invests that cash into assets (generally financial assets) and promises to pay cash to the policyholder if the insured event happens, sometimes many years in the future. However, some insurance contracts are not basic, and create complex interdependencies between rights and obligations that make them difficult to account for using existing standards. There are difficulties of applying generally applicable standards, including the following:
 - (a) Interdependencies between rights and obligations can make it difficult to identify the various performance obligations provided by the contract or to allocate the consideration paid by policyholders to those individual performance obligations.
 - (b) Uncertainty of outcomes can make it difficult to make estimates. In particular, options and guarantees embedded in insurance contracts can exacerbate the uncertainty of outcomes. Thus, there can be significant changes in the estimate of cash flows that would be needed to fulfil the contracts.
 - (c) Long durations can mean that estimates made at the inception of a contract may not provide useful information throughout the life of the contract. Furthermore, there is little ability to assess whether estimates made at inception were reasonable or accurate.
5. At present, the IFRS Standards have no complete Standard that deals with the accounting for insurance contracts. IFRS 4 *Insurance Contracts* (IFRS 4) was

issued in 2004 as an interim Standard and completed only the first phase of the Board's project on insurance contracts. As an interim Standard, IFRS 4 made limited changes to previous practices, permits a wide range of practices and includes a 'temporary exemption' that states explicitly that an insurer does not need to ensure that its accounting policies are relevant to the economic decision-making needs of users or are reliable. Many of the problems associated with financial reporting for insurance contracts have continued in the meantime and there continue to be substantial differences between different companies in accounting for insurance contracts. The diversity in the current application of the IFRS Standards for insurance contracts today means that until a Standard on insurance contracts is finalised, the IFRS Standards could be regarded as incomplete.

6. Accordingly, the Board has been consistently told that there is an urgent need to finalise a Standard on insurance contracts. Most recently, users of financial statements participating in the Board's outreach on the different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts Standard urged the Board to complete the Standard on insurance contracts as quickly as possible.¹ There has also been a statement issued by the Financial Stability Board (FSB) Plenary at its meeting in September 2015, which noted the high priority of the insurance contracts project².

History of the project

7. Work on the Board's insurance contracts project began in 1997. The following paragraphs summarise:
 - (a) the work of the IASC (in paragraphs 8-12);
 - (b) Phase I of the Board's project on insurance contracts (in paragraph 13);and

¹Agenda Paper 14A for the September 2015 Board meeting
<http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/September/AP14AIFRS%209%20and%20IFRS%204.pdf>

² See press release at <http://www.fsb.org/2015/09/meeting-of-the-financial-stability-board-in-london-on-25-september/>

- (c) Phase II of the Board's project on insurance contracts, including the redeliberations on the 2013 ED (in paragraphs 15-22).

Work of the IASC

8. In 1997, the IASC set up a Steering Committee to carry out the initial work on an insurance contracts project. The Steering Committee published an Issues Paper in 1999. The first volume of the Issues Paper analysed the characteristics of different forms of insurance contract and considered the significant accounting issues. The second volume contained 82 illustrative examples, summarised relevant national standards and requirements in 17 countries and summarised the main features of the principal contracts found in eight countries.
9. The Issues Paper attracted 138 responses. The Steering Committee held two meetings of three days each to discuss the comment letters and two further meetings, totalling seven days, to develop a Draft Statement of Principles (DSOP). The Issues Paper indicated the former IASC Steering Committee's intention to publish the DSOP for formal comment. However, when the International Accounting Standards Board was formed in 2001, the Steering Committee instead used the draft DSOP as an internal report to the newly constituted Board. The role of the Steering Committee finished at that point.
10. In November 2001, the Board began discussing the project, using the DSOP as the initial basis for the discussions. Although the Board decided not to invite formal comments at that stage on a document that the Board had not yet discussed, it took the unusual step of making the DSOP available on its website. Doing so helped to stimulate an active debate, within both the insurance industry and the actuarial community.
11. Between October 2001 and June 2002, IASB staff and Board members conducted field visits to nineteen insurance companies from nine countries. The purpose of these visits was to assess the practical implications of implementing the model proposed in the DSOP.
12. The Board split this project into two phases in May 2002, in order to improve disclosures, and some recognition and measurement practices for insurance

contracts in time for the adoption of the IFRS Standards by listed companies throughout Europe and elsewhere in 2005.

Phase I of the Board's project on insurance contracts

13. The Board completed Phase I in 2004 by issuing IFRS 4, which:
 - (a) made limited improvements to accounting practices for insurance contracts;
 - (b) permitted a wide variety of accounting practices for insurance contracts to continue, thus avoiding major changes that Phase II might reverse; and
 - (c) required an insurer to disclose information about insurance contracts.

Phase II of the Board's project on insurance contracts

14. The Insurance Working Group was constituted to assist the Board to analyse the accounting issues relating to insurance contracts when the Board recommenced work on Phase II. The Insurance Working Group brought together a wide range of interests and includes senior financial executives who are involved in financial reporting.

The 2007 Discussion Paper

15. In mid-2004 the Board started work on Phase II and in September of that year, the Board created a working group to advise it on its project. The Board deliberated staff proposals on substantive issues until February 2007 and in May 2007, the Board published a discussion paper *Preliminary Views on Insurance Contracts* (the 2007 DP), setting out its preliminary views on the main components of an accounting model for an insurer's rights and obligations (ie assets and liabilities) arising from an insurance contract. The staff decided not to hold public round-table meetings after the publication of the 2007 DP, noting that the members of its Insurance Working Group would supply input from a wide range of perspectives. The Board received 162 comment letters in response to the 2007 DP.

The 2010 Exposure Draft

16. The Board began its review of the responses to the 2007 DP in February 2008. The Board undertook initial field testing between September and December 2009 to determine how the proposals could be applied consistently in practice. The deliberations on the responses to the 2007 ED led to the 2010 Exposure Draft *Insurance Contracts* ('the 2010 ED') which was published in July of that year. The 2010 ED had a comment period ending on 30 November 2010 and the Board received 250 comment letters in response.

The 2013 Exposure Draft

17. The Board undertook a second round of field testing between September 2010 and January 2011 to test the proposals made in the 2010 ED. After the comment period ended in November 2010, the Board redeliberated the proposals in the 2010 ED between December 2010 and February 2013, during which time there was extensive consultation with the Insurance Working Group. As a result, the Board modified its 2010 proposals in response to the issues identified in consultations on the 2010 ED. In seeking to address these issues, the Board acknowledged that the modified proposals were more complex than those in the 2010 ED.
18. In September 2012, the Board decided to re-expose its proposals, and the 2013 ED was published in June 2013. However, the Board was mindful that, while the changes it had made to the 2010 ED could be regarded as significant, the core principles and many aspects of the 2010 proposals had not changed. Accordingly, while the 2013 ED contained a complete draft of the proposed Standard on insurance contracts to provide interested parties with context, the Board only sought input on five targeted areas. In light of the increased complexity of the proposals, the Board also sought views on whether the costs of the revised information would be justified by the benefits of the information provided overall. In publishing the 2013 ED, the Board stated its intention not to revisit issues that it had previously rejected or reconsider consequences it had previously considered. The comment period ended on 25 October 2013 and the Board received 194 comment letters in response to the 2013 ED.

Redeliberations on the 2013 Exposure Draft

19. The Board undertook extensive outreach and detailed field testing of the operationality of the proposals set out in the 2013 ED and began considering the feedback from its 2013 ED in March 2014.

20. Although the majority of respondents to the 2013 ED welcomed the progression the Board had made from the 2010 ED and indicated broad support for the principle of current value measurement of insurance contracts, there were also significant areas of disagreement. The following key concerns were raised:
 - (a) Complexity. Most constituents expressed concern about the complexity of some specific proposals or of the proposals as a whole. These concerns were strongest where the proposals differed more significantly from existing practices, either for financial reporting, regulatory reporting or supplementary reporting.

 - (b) The treatment of contracts with participation features, which was the most difficult and contentious of the specific aspects on which the Board had sought feedback. Underlying those concerns were issues related to:
 - (i) the extent of accounting mismatches that would result from application of the proposed Standard; and

 - (ii) an underlying diversity of views about what constitutes service from an insurance contract.

21. As a consequence of the complexity of the issues relating to contracts with participating features, the Board has decided to extend its original timetable to allow it to consider the issues in detail. The Board has spent the majority of the redeliberations since March 2014 on the treatment of contracts with participation features. As many of the issues are interrelated, the staff have approached these deliberations by asking the Board for indicative leanings, instead of tentative decisions. This approach, and the extended timetable, has helped the Board and the staff to obtain feedback on the direction of the model as it was developed. Accordingly, the Board has maintained extensive dialogue with all interested parties and continues to consult its advisory bodies. In particular:

- (a) the Board has engaged extensively with preparers and other interested parties, in particular in Europe, Canada, USA, Hong Kong, Korea and Japan; and
- (b) the Board has sought advice from the Accounting Standards Advisory Forum (ASAF) at its March, June and September 2014 meetings and its March 2015 and July 2015 meetings.

22. In January 2016, the Board completed the planned technical decisions needed for the insurance contracts Standard. Accordingly, the staff asks in Agenda Paper 2F for the Board's confirmation that the necessary due process steps have been undertaken and agreement to begin the balloting process for the issuance of the insurance contracts Standard.