STAFF PAPER

February 2016

IASB Meeting

Project	Insurance Contracts		
Paper topic	The development of the accounting model for insurance contracts		

CONTACT(S)	Andrea Pryde	apryde@ifrs.org	+44 (0)20 7246 6491
	Joanna Yeoh	jyeoh@ifrs.org	+44 (0)20 7246 6481

Introduction

1. This paper sets out the development of the Board's proposals for the accounting of insurance contracts. Pages 2-5 provide a high-level summary of the changes in the proposals between:

   (a) the 2007 Discussion Paper *Preliminary Views on Insurance Contracts* (the 2007 DP);

   (b) the 2010 Exposure Draft *Insurance Contracts* (the 2010 ED);

   (c) the 2013 Exposure Draft *Insurance Contracts* (the 2013 ED); and

   (d) the Board's current decisions.

2. Pages 6-8 provide a summary of the respondents' views on the proposals in Board's:

   (a) 2007 DP;

   (b) 2010 ED; and

   (c) 2013 ED.

3. 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.

Proposals in the Board's previous due process documents

	2007 Discussion Paper	2010 Exposure Draft	2013 Exposure Draft	Current tentative decisions
Scope				
1. Insurance contracts	All types of insurance contracts throughout the life of the contract. Insurance contract defined, as in IFRS 4 *Insurance Contracts* (IFRS 4), as a 'contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder'. Also, includes reinsurance contracts an entity holds.			
- Fixed-fee service contracts with significant insurance risk - Financial guarantees with significant insurance risk	• Not discussed in the Discussion Paper. • Not discussed in the Discussion Paper.	• Excluded when the primary purpose is the provision of services. Otherwise included in the scope. • Included in the scope.	• Excluded when the primary purpose is the provision of services. Otherwise included in the scope. • Retained existing accounting policy choice in IFRS 4.	• Accounting policy choice for contracts when the primary purpose is the provision of services. Otherwise included in the scope. • Retained existing accounting policy choice in IFRS 4.
2. Investment contracts with DPF	Not included in scope.	Included in scope. Used the definition in IFRS 4 with an additional criterion.	Included in scope. Used the definition in IFRS 4 unamended.	
3. Unbundling	Unbundle deposit components if not interdependent, or they can be measured separately on a basis that is not arbitrary.	Unbundle where there is: (a) an embedded derivative that is separated from its host in accordance with financial instruments requirements. (b) an investment component reflecting an account balance meeting specified criteria. (c) contractual terms relating to goods and services that are not closely related to the insurance coverage but have been combined in a contract with that coverage for reasons that have no commercial substance.	Unbundle where there is: (a) an embedded derivative that is separated from its host in accordance with financial instruments requirements. (b) distinct investment components. (c) distinct goods and services.	
Recognition and derecognition				
4. Recognition	Recognise when the entity becomes party to the contract.		Recognise at the earliest of: (a) the beginning of the coverage period; (b) the date on which the first payment from the policyholder becomes due; or (c) if applicable, the date on which the portfolio of insurance contracts to which the contract will belong becomes onerous.	
5. Derecognition	Derecognise when contract is extinguished.			
Measurement				
6. Measurement objective	Current exit value.	Use an approach that considers the present value of the cash flows that will arise as the entity fulfils the contract.		
7. Type of cash flow used to measure insurance contract	Use estimates that market participants would make of cash flows arising from contractual/constructive obligations. For financial market inputs, such as interest rates and equity prices, use observable market prices.	For market variables, use estimates of cash flows consistent with observable market prices. For other inputs, use entity-specific inputs.		

	2007 Discussion Paper	2010 Exposure Draft	2013 Exposure Draft	Current tentative decisions
8. Identifying the limit of the contract (contract boundary)	An asset is recognised relating to the entity's ability to derive net economic benefits from future premiums that the policyholder must pay to retain guaranteed insurability. Guaranteed insurability test for inclusion of future cash flows, coupled with onerous contracts test: Include premiums that policyholder must pay to retain right of continued coverage without reconfirmation of the policyholder's risk profile and at a price that is contractually constrained.	Contract boundary test for inclusion of future cash flows: Include all cash flows within the contract boundary, defined as point at which an entity either: (a) is no longer required to provide coverage; or (b) has the right or the practical ability to reassess the risk of the policyholder and, as a result, can set a price that fully reflects that risk.	Contract boundary test for inclusion of future cash flows: Include all cash flows within the contract boundary, defined as point at which an entity can compel the policyholder to pay premiums or has a substantive obligation to provide coverage or other services. A substantive obligation to provide coverage or other services ends when: (a) the entity has the right or the practical ability to reassess the risk of the policyholder and, as a result, can set a price that fully reflects that risk; or (b) Both the following criteria are satisfied: (i) the entity has the right or the practical ability to reassess the risk of the portfolio of insurance contracts that contains the contract and, as a result, can set a price that fully reflects the risk of that portfolio; (ii) the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to future periods.	
9. Treatment of cash flows related to acquisition costs	Acquisition costs are not included in cash flows. They are recognised as an expense when incurred, at the same time as income reflecting the portion of the premium from which the insurer has recovered (or expects to recover) its acquisition costs.	Included in cash flows: incremental acquisition costs, all other acquisition costs recognised as expenses when incurred.	Included in cash flows: directly attributable acquisition costs that can be allocated on a rational and consistent basis to the individual *portfolios* of insurance contracts, even if those costs cannot be attributed directly to *individual insurance contracts* in the portfolio.	
10. Treatment of cash flows related to policyholder participation	• For each cash flow scenario, include policyholder dividends to the extent the entity has a contractual/constructive obligation at reporting date to pay a dividend in that scenario. • Use option pricing techniques that capture, on a market-consistent basis both the intrinsic value and time value of the asymmetric pay-offs resulting from the participating feature.	• Include policyholder dividends based on entity's expectations and any market variables assumptions should be consistent with observable market variables. • Use option pricing techniques that capture, on a market-consistent basis both the intrinsic value and time value of the asymmetric pay-offs resulting from the participating feature.		
11. Discount rate	• Reflect characteristics of the insurance contract. Consistent with observable market information where available.	• Reflect characteristics of the insurance contract. Consistent with observable market information where available. • Clarified that the entity should consider the effect of liquidity.	• Reflect characteristics of the insurance contract liability. Consistent with observable market information where available. • Consider effect of liquidity—clarify both top-down and bottom-up methods are permitted.	
12. Margins	Include in measurement an explicit and unbiased estimate of the margin that market participants require for: • bearing risk (ie a risk margin); and • providing other services, if any (a service margin). The margin is not calibrated to observed price for the transaction with the policyholder, therefore Day One gains and losses may arise.	Include in measurement: • a risk adjustment, that represents the maximum amount that the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected. • a residual margin that eliminates any gain at inception of the contract.	Include in measurement: • a risk adjustment, that represents the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract. • a contractual service margin which eliminates any gain at inception of the contract.	

	2007 Discussion Paper	2010 Exposure Draft	2013 Exposure Draft	Current tentative decisions
13. Subsequent measurement—margins	• Recognise all change in fair value of risk margin and service margin in profit or loss. • Recognise all changes in cash flow estimates and discount rates in profit or loss in the period they are known.	• Recognise change in measured risk adjustment and allocation of residual margin in profit or loss. • Recognise all changes in cash flow estimates and discount rates in profit or loss in the period when those estimates are updated.	• Recognise change in measured risk adjustment and allocation of contractual service margin in profit or loss. • Changes in cash flows related to future service adjust the contractual service margin. • Changes in cash flows related to current period or past service (experience adjustment) recognised in profit or loss.	• Recognise experience adjustment in measured risk adjustment and allocation of contractual service margin in profit or loss. • Changes in expected cash flows and risk adjustment related to future service adjust contractual service margin. • For some participating contracts, the margin is also adjusted for changes in estimate of the variable fee for service.
14. Non-performance risk	• Included in measurement	• Excluded from measurement		
15. Level of aggregation	• Level of aggregation does not affect expected present value of future cash flows. However aggregation can be used to make estimates from a practical point of view. • Risk margin should be determined for a portfolio of insurance contracts that are subject to broadly similar risks and are managed together as a single portfolio. Risk margins should not reflect the benefits of diversification between portfolios and negative correlation between portfolios.	• Level of aggregation does not affect expected present value of future cash flows. However aggregation can be used to make estimates from a practical point of view. • Measure risk adjustment at portfolio level of aggregation (ie a group of contracts that are subject to similar risks and managed together as a pool). • Residual margin determined by cohort within a portfolio, ie by similar date of inception of the contract and by similar coverage period.	• Level of aggregation does not affect expected present value of future cash flows. However aggregation can be used to make estimates from a practical point of view. • Risk adjustment measured by incorporating diversification benefits to the extent that the entity considers those benefits in setting the amount of compensation it requires to bear risk. • Contractual service margin measured at a portfolio level, but recognised in profit or loss at a level of aggregation such that once the coverage period of the insurance contract has ended, the related contractual service margin has been fully recognised in profit or loss.	• Level of aggregation does not affect expected present value of future cash flows. However aggregation can be used to make estimates from a practical point of view. • Risk adjustment measured by incorporating diversification benefits to the extent that the entity considers those benefits in setting the amount of compensation it requires to bear risk. • Contractual service margin measured so that: ○ a loss for onerous contracts should be recognised only when the contractual service margin is negative for a group of contracts that, at inception, had similar expected profitability and were expected to respond in similar ways to key drivers of risk. ○ the contractual service margin for an individual contract, or groups of homogenous contracts, recognised in profit and loss over the coverage period of the contract in a way that best reflects the service to be provided by the contract.
Measurement adaptations				
16. Exception for contracts with participation features	• Some discussion of whether and how to eliminate accounting mismatches that arise if unit-linked or participating liabilities are contractually linked to assets that cannot be classified as 'at fair value through profit or loss' (treasury shares, owner-occupied property, investments in subsidiaries). No other views discussed on this topic.	• Measurement exception to permit an entity to measure at fair value through profit or loss owner occupied property and own shares, if they are linked to unit-linked insurance contracts.	• Measurement exemption to permit an entity to measure at fair value through profit or loss owner occupied property, own debt and own shares if they are linked to unit-linked insurance contracts. • Measurement and presentation exception for specified contracts with participation features.	• Measurement exemption to permit an entity to measure at fair value through profit or loss investment properties, investments in associates, owner occupied property, own debt and own shares if they are the same underlying items on which the obligation in the direct participation contract is based. • Apply variable fee approach to specified contracts with participating features.
17. Accommodations for the reinsurance contracts held	• Measurement includes non-performance risk of the reinsurer. • No special accommodation.	• Measurement includes non-performance risk of the reinsurer. • Adaptations for the residual margin. On Day One, the residual margin calibrated to the premiums paid to the reinsurer. Consequently,	• Measurement includes non-performance risk of the reinsurer. • Adaptations for the contractual service margin on Day One. The contractual service margin is calibrated to the higher of the	• Adaptations for the contractual service margin for subsequent measurement. An exception for recognising changes in profit or loss in specified circumstances

	2007 Discussion Paper	2010 Exposure Draft	2013 Exposure Draft	Current tentative decisions
		a Day One gain is recognised when the premiums paid to the reinsurer is less than the cash flows received from the reinsurer.	premiums paid or cash in-flow. No Day One gain may be recognised.	
18. Expedient for short-duration contracts	No special accommodation.	Simplified version of the building block approach for most short-duration insurance contracts: - During the coverage period the approach would be similar to the unearned premium approach used in many jurisdictions today - The general model would apply to the claims liability		
		Required, specified eligibility criteria.	Optional, principle-based eligibility criteria.	
Presentation				
19. Presentation approach	No preliminary view on presenting premiums as revenue or as deposit receipts or specified components of the changes in the carrying amount of insurance liabilities.	Summarised margin presentation that highlights - Underwriting margin (ie changes in the risk adjustment and release of the residual margin). - Experience adjustments (ie differences between actual cash flows and previous estimates) and changes in estimates (ie changes in current estimates of cash flows and discount rates).	Present revenue and expense consistent with non-insurance contracts and most existing non-life contracts; for example, exclude deposit components.	
20. Amounts recognised in other comprehensive income (OCI)	All changes in the carrying amount of insurance liabilities included in profit or loss		Requirement to present the effect of changes in discount rates in OCI.	An accounting policy choice: (a) disaggregate changes arising from market variables between profit or loss and OCI; or (b) all in profit or loss.
Transition				
21. Transition	• Not discussed in the Discussion Paper.	• Residual margin set to zero, for simplicity.	• Retrospective application, if not impracticable. • Otherwise, simplified transition.	• Retrospective application, if not impracticable. • Further simplifications to the simplified transition approach, if simplified approach impracticable. • Introduction of fair value approach for determining CSM, if simplified approach is impracticable.
22. Related financial assets	• Not discussed in the Discussion Paper.	• Permitted to designate a financial asset as fair value through profit or loss in accordance with the financial instrument requirements.	• Permitted to designate a financial asset as fair value through profit or loss in accordance with the financial instrument requirements. • Required to revoke previous designations of financial instruments at fair value through profit or loss when the accounting mismatch is no longer present. • Permitted to reclassify investments in equity instruments in accordance with the financial instrument requirements.	• Permitted to designate a financial asset as fair value through profit or loss in accordance with the financial instrument requirements. • Required to revoke previous designations of financial instruments at fair value through profit or loss when the accounting mismatch is no longer present. • Permitted to reclassify investments in equity instruments in accordance with the financial instrument requirements. • Permitted to classify the business model of specified financial assets based on the fact and circumstances at initial application of the Standard.

Summary of respondents' comments received on the Board's previous due process documents

4. The following table summarises the respondents' comments received on the Board's previous due process documents.

	2007 Discussion Paper	2010 Exposure Draft	2013 Exposure Draft
Scope			
1. Insurance contracts	Respondents supported continuing to use the definition of an insurance contract that is currently used in IFRS 4. In addition, respondents supported including reinsurance contracts that an entity holds within the scope of IFRS 4.		
- Fixed-fee service contracts with significant insurance risk - Financial guarantees with significant insurance risk	• Mixed views on whether all fixed fee services should be included in the scope. • Mixed views on whether financial guarantees should be within the scope	• Supported the scope exclusion with clarification required. • Mixed views on whether such financial guarantees should be within the scope.	• Some supported the exclusion of the specified fixed-fee contracts. However, some general insurers believed that such contracts should be within the scope. • Some support for retained existing accounting policy choice in IFRS 4.
2. Investment contracts with DPF	Some support for inclusion within the scope.	Some support for inclusion within the scope. Disagreement with the additional criterion proposed.	Some support for using the same definition as the existing IFRS 4.
3. Unbundling	Most supported the proposal to unbundle deposit components if not interdependent. Many opposed the proposal to unbundle components that are interdependent but can be measured separately on a basis that is not arbitrary.	Most supported the proposals except for the proposal to separate the specified account balance. Some requested clarification of the proposals.	Most supported the proposals.
Recognition and derecognition			
4. Recognition	Many acknowledged the conceptual merit of the proposals but believed that they would be too costly to implement.		Most supported the proposal that would result in the majority of contracts being recognised at the beginning of the coverage period.
5. Derecognition	Many supported the proposal to derecognise when contract is extinguished.		
Measurement			
6. Measurement objective	Many disagreed with current exit value because an insurance contract is rarely transferred.	Most support an approach that considers the cash flows that will arise as the entity fulfils the contract.	
7. Type of cash flow used to measure insurance contract	Many disagreed in principle with using a market participant view.	Most support using market variable estimates of cash flows consistent with observable market prices. For other inputs, use entity-specific inputs.	
8. Identifying the limit of the contract (contract boundary)	Many felt the guaranteed insurability test would not create a useful distinction. Mixed views on whether the appropriate cash flows are included.	Many supported the contract boundary test. However, some, mainly health insurers, believed that the test should apply at portfolio level.	Most supported the revised contract boundary test.
9. Treatment of cash flows related to acquisition costs	Respondents generally agreed that acquisition costs should be recognised as an expense when incurred, if the measurement reflects all future cash flows from which acquisition costs would be expected to be recovered. Some respondents preferred to recognise acquisition costs as (the cost of) an intangible asset, to be amortised in line with the recognition of premium revenue.	Most agreed with the inclusion of acquisition costs within the cash flows. However, they recommended the inclusion of more acquisition costs than that proposed in the 2010 ED.	Most supported the inclusion of further cash flows.

	2007 Discussion Paper	2010 Exposure Draft	2013 Exposure Draft
10. Treatment of cash flows related to policyholder participation	• Most disagreed with limiting the inclusion of policyholder dividends to cases where the entity has a contractual/constructive obligation at reporting date. • Some support for using option pricing techniques that capture, on a market-consistent basis both the intrinsic value and time value of the asymmetric pay-offs resulting from the participating feature.	• Most agree with the proposal to include policyholder dividends based on entity's expectations and any market variables assumptions should be consistent with observable market variables. • Some support for using option pricing techniques that capture, on a market-consistent basis both the intrinsic value and time value of the asymmetric pay-offs resulting from the participating feature.	
11. Discount rate	Some support: • reflect characteristics of the insurance contract; and • consistency with observable market information where available.	Most: • support that the discount rate of the liability should reflect the contract's illiquidity; and • disagreed with using solely the bottom-up approach.	• Most agree with the clarification that both top-down and bottom-up methods are permitted.
12. Margins	Many disagreed with a market participant view in estimating the margins. Most: • supported a margin for bearing risk (ie a risk margin); and • did not understand the purpose of a margin for providing other services, if any (a service margin). Many disagreed with the recognition of Day One gains.	Most supported: • a risk adjustment that represents the maximum amount that an insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected. • a residual margin that eliminates any gain at inception of the contract.	Most supported: • a risk adjustment that represents the compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract. • a contractual service margin that eliminates any gain at inception of the contract.
13. Subsequent measurement—margins	• Mixed views were expressed on whether to recognise all change in the fair value of risk margin and service margin in profit or loss.	• Most support allocation of residual margin in profit or loss. • Mixed views on whether to recognise changes in the measured risk adjustment in profit or loss. • Most do not support all changes in estimates of future cash flows in profit or loss and instead recommended that those changes be recognised in the residual margin.	• Most support allocation of residual margin in profit or loss. • Most support recognising changes in the risk margin related to future service as an adjustment to the contractual service margin. • Most supported that: ○ changes in cash flows related to future service adjust the contractual service margin. ○ changes in cash flows related to current period or past service (experience adjustment) recognised in profit or loss. • Some support that changes in some market variables should adjust the contractual service margin for contracts with participating features.
14. Non-performance risk	• Most disagreed that non-performance risk of the insurer should be included in measurement of an insurance liability.	• Most agreed with its exclusion from measurement.	
15. Level of aggregation	• Most agreed with reflecting the diversification within a portfolio but had different views on how to define a portfolio. Mixed views on whether the risk margins should reflect the benefits of diversification between portfolios and negative correlation between portfolios.	• Many believed that the risk margin should reflect the benefits of diversification between portfolios and negative correlation between portfolios. • Mixed views on determining the residual margin by cohort within a portfolio, ie by similar date of inception of the contract and by similar coverage period. Alternatives suggested were portfolio, individual contracts or that the level of aggregation should not be prescribed.	• Many asked the IASB to clarify the level of aggregation. Mixed views were expressed on the appropriate level of aggregation; in particular, whether contracts with different profitability level should or should not be allowed to be added to an existing portfolio of contracts.

	2007 Discussion Paper	2010 Exposure Draft	2013 Exposure Draft
Measurement adaptations			
16. Exception for contracts with participation features	Respondents generally favoured eliminating accounting mismatches that arise if the assets of a unit-linked or participating fund are not recognised (eg treasury shares) or are not carried at fair value through profit or loss (owner occupied property and investments in subsidiaries). Most favoured permitting or requiring the use of fair value for the assets, rather than adjusting the carrying amount of the liability.	Most respondents agreed with the measurement exception but recommended further elimination of accounting mismatches between assets and contracts with participation features.	• Some agreement with the measurement exception for the assets linked to unit-linked contracts. • Many agreed with the objective of eliminating accounting mismatch but did not think that there should be an exception to the determination of the fulfilment cash flows. Some recommended alternative proposals for contracts with participating features in relation to the determination of the margin.
17. Accommodations for the reinsurance contracts held	No special accommodation.	Most supported including the non-performance risk of the reinsurer in the measurement. Mixed views on whether a Day One gain should be recognised when the premiums paid to the reinsurer is less than the cash flows received from the reinsurer.	Mixed views on the no recognition of a Day One gain in all circumstances. Some recommended adaptations to increase symmetry on the recognition of gains and losses between the direct insurance and reinsurance contract held.
18. Expedient for short-duration contracts	Some preferred to use existing requirements for these contracts (unearned premium, no discounting, no risk adjustment).	Most welcomed a simplified version of the building block approach for most short-duration insurance contracts, which was similar to the unearned premium approach used in many jurisdictions today. Some disagreed that the general model should apply to the claims liability.	
		Some requested different eligibility criteria.	Most agreed with the principle based eligibility criteria. Some asked that the approach should be optional instead of mandatory.
Presentation			
19. Presentation approach	Mixed views on the presentation of revenue or premiums for life contracts. Most supported a continuation of existing practices for non-life contracts, which is to recognise premiums as revenue and claims incurred as expense.	Many agreed that the summarised margin presentation provided useful information. However, most did not agree that there should be no revenue or expenses presented.	Mixed views on the proposal to present revenue and expense consistent with non-insurance contracts and most existing non-life contracts; for example, exclude deposit components.
20. Amounts recognised in other comprehensive income (OCI)	Most supported recognising all changes in discount rate in the statement of comprehensive income. However, there were mixed views about whether those changes should be reported in profit or loss or OCI.		Most welcomed the proposal to present the effect of changes in discount rates in OCI but some strongly objected to that presentation being mandatory.
Transition			
21. Transition	• Not discussed in the Discussion Paper.	• Many disagreed with the proposal to set the residual margin to zero on initial application of the Standard.	• Most supported retrospective application, if practicable and when impracticable, simplified transition proposals. • Some requested further simplifications when retrospective application is impracticable.
22. Related financial assets	• Not discussed in the Discussion Paper.	• Most supported permitting a financial asset to be designated as fair value through profit or loss in accordance with the financial instrument requirements. • Some recommended that entities should be permitted to redesignate financial assets at amortised cost.	• Most supported the proposals and recommended further ability for entities to redesignate financial assets based on the business model.