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www.drsc.de - info@drsc.de

IFRS-FA – öffentliche SITZUNGSUNTERLAGE

Sitzung:	04. IFRS-FA / 27.04.2012 / 13:45 – 15:45 Uhr
TOP:	04 – Insurance Contracts
Thema:	Stand des IASB Projekts
Papier:	04_05a_IFRS-FA_IC

Inhalt

- What the standard applies to
- Identifying the cash flows in the contract
- How the standard measures the contract
- Special applications
- Communication

What the standard applies to

- ED proposal
  - Insurance contracts with specified exceptions
  - Reinsurance assets that insurer holds
  - Financial instruments with discretionary participation features
- Tentative decisions
  - Confirm proposed definition of insurance contract
  - Confirm standard would apply to financial instruments with discretionary participation feature (“minor change”: but only if issued by insurers)
  - Confirm most scope exceptions (“additional guidance”: additional criteria for fixed fee service contracts)
  - “Minor change”: exclude financial guarantee contracts unless previously regarded as an insurance contract (as in IFRS 4)

Unbundling

- ED proposal
  – Unbundle components not closely related to insurance contract
    - Some account balances, embedded derivatives, some goods and services
- Tentative decisions
  – Unbundle
    - Embedded derivatives not closely related to host insurance contract (confirmed)
    - Distinct goods and services identified using revenue recognition approach (minor change)
  – Disaggregate amounts the insurer is obligated to pay policyholders regardless of whether an insured event occurs (minor change)

  Yet to conclude whether to (1) unbundle investment components that are not interrelated to the insurance contract, (2) permit unbundling that is not required

Which cash flows? (1)

- ED proposal: fulfilment cash flows
  - Expected value of cash flows incurred in fulfilling the contract, considering all relevant information
- Tentative decisions: fulfilment cash flows
  - Confirm use of expected value + add guidance that not all possible scenarios need to be identified and quantified
- ED proposal: acquisition costs (IASB ≠ FASB)
  - Include only acquisition costs incremental at *contract* level
- Tentative decisions: acquisition costs
  - include all direct costs incurred in originating a *portfolio* of insurance contracts ("minor change")

Which cash flows? (2)

- ED proposal: recognition point
  - Recognise when insurer is bound or first exposed to risk from contract
- Tentative decisions: recognition point
  - Minor change: recognise when coverage period begins, onerous test before then
- ED proposal: contract boundary
  - Ends when insurer
  - Can set price that fully reflects risk of *particular policyholder*
- Tentative decisions: contract boundary
  - Confirm ED proposal + add clarification: risk can be assessed at *portfolio* level in some cases

Time value of money: discount rate

- ED proposal:
  - Adjust future cash flows for time value of money
  - Reflects only the characteristics of the insurance contract liability
  - Current and updated each reporting period
- Tentative decisions:
  - Confirm discount rate
  - Do not prescribe method
  - + add guidance
    - Top-down and bottom-up both acceptable
    - Remove any factors that influence observable rates not relevant to the liability
  - Minor change: disclose yield curve or range of yield curves used

Risk adjustment (1) (IASB ‡ FASB)

- ED proposal: risk adjustment vs composite margin
  - Include explicit estimate of the effects of uncertainty about future cash flows
- Tentative decisions: risk adjustment vs composite margin
  - Confirm: measurement of liability should include explicit risk adjustment
- ED proposal: objective
  - "the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate cash flows exceed those expected"
- Tentative decisions: objective
  - Minor change: the compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfils the insurance contract
  - + supplemented by application guidance

Risk adjustment (2) (IASB ǂ FASB)

- ED proposal: techniques for determining risk adjustment
  - Restricted to one of three / disclose confidence level equivalent disclosure
- Tentative decisions: techniques for determining risk adjustment
  - Minor change: no specification of technique to be used to meet objective
  - Confirm: disclose confidence level equivalent disclosure
- ED proposal: diversification
  - Reflects only those effects of diversification that arise within a portfolio
- Tentative decisions: diversification
  - Minor change: reflects diversification to the extent considered by the insurer in assessing the compensation it requires for bearing risk

Residual margin (1) (IASB ǂ FASB)

- ED proposal: gains at inception
  - Include residual margin to eliminate gains at inception
- Tentative decisions: gains at inception
  - Confirm no gain at inception
- ED proposal: residual margin after inception: unlocking
  - Residual margin locked-in at inception
- Tentative decisions: residual margin after inception: unlocking
  - Significant change: adjust residual margin prospectively for changes in estimates of cash flows (unlocking)
  - Confirm: do not unlock for risk adjustment

Residual margin (2) (IASB ≠ FASB)

- ED proposal: residual margin after inception: allocation
  - Residual margin allocated over coverage period on a systematic basis
    - On the basis of the passage of time, bur
    - On the basis of the expected timing of incurred claims and benefits, if that pattern differs significantly from the passage of time
- Tentative decisions
  - Residual margin allocated.
    - Confirmed: over coverage period
    - Minor change: on a systematic basis that is consistent with the pattern of transfer of the services provided
- To complete:
  - Whether changes in discount rate adjust residual margin or are recognised in profit or loss

Special applications: participating features

- Introduction of ‘mirroring approach’:
  - Measurement and presentation should be consistent with underlying item (even if underlying item not measured at fair value through profit and loss)ecognise when insurer is bound or first exposed to risk from contract
- Tentative decisions:
  - Confirm discount rate reflects dependence of cash flows on specific assets
  - Minor change: require adjustment to cash flow to reflect the measurement basis of the items underlying participation
  - Minor change: require presentation of changes in estimates consistent with equivalent changes in underlying item

Special applications: reinsurance assets

- ED proposal: symmetry with underlying liability
  - Losses at inception recognised over contract term
  - Gains at inception recognised immediately
- Tentative decisions:
  - Confirm use of the same estimates for reinsurance asset and underlying direct insurance liability
  - Minor change: losses recognised immediately if for past events, otherwise recognised over contract term
  - Minor change: gains recognised over contract term
- To be discussed: interaction with other requirements in standard

Special applications: premium allocation approach - eligibility

- ED proposal:
  - Premium allocation approach *required* for contracts with coverage period of approximately 12 months
- Tentative decisions: recognition point
  - Minor change: premium allocation approach *permitted*
    - When reasonable approximation to the building block approach, ie if
      Significant change not likely to occur before the claims are incurred; and
      Significant judgement needed to allocate premium
    - Confirmed: if coverage period is 12 months or less

Special applications: premium allocation approach - measurement

- ED proposal: liability for remaining coverage
  - Require discounting and accretion of interest
  - Recognise all onerous contracts
- Tentative decisions: liability for remaining coverage
  - Minor change: reflect time value of money if financing element significant
  - Minor change: no discounting required when period between payment and satisfying obligation shorter than 12 months
  - Minor change: onerous contract test when facts and circumstances indicate contract might be onerous
- ED proposal: liability for incurred claims
  - Discounted
- Tentative decisions: liability for incurred claims
  - Minor change: no discounting required if claims expected to be settled within 12 months

How to present changes in the insurance contract liability

• **ED proposals** – All premiums treated as deposits, all payments as return of deposits	• **Tentative decisions** – Minor change: volume information on face of statement of comprehensive income

	20xx
Income statement	
Risk adjustment	
Residual margin	
Experience adjustment	
Changes in estimates	
Underwriting result	
Investment income	
Interest on insurance liability	
Net interest and investment	
Profit or loss	

	20xx
Income statement	
Premiums	
Changes in insurance liability	
Claims and expenses	
Underwriting result	
Investment income	
Interest on insurance liability	
Net interest and investment	
Profit or loss	

Complete remaining topics: key issues

- Volume information
  - How to present volume information in the statement of financial income
- Residual margin
  - Which changes in the insurance contracts liability are offset in residual margin?
  - Whether to accrete interest on residual margin
- OCI
  - Which changes in the insurance liability, if any, should be presented in other comprehensive income
  - Should the use of OCI be permitted or required?
  - Should there be a loss recognition test? If so, when should it be triggered and what should happen?
- (important) details in other areas
  - Transition
  - Disclosures

IASB / FASB areas for reconciliation (1)

- Risk adjustment
  - IASB: risk explicitly determined / remeasured each period through P&L
  - FASB: risk included implicitly in single margin / not remeasured over the contract term
- Residual / single margin
  - IASB: released over the coverage and settlement period based on pattern of service / some changes in estimates offset in the measurement of the residual margin
  - FASB: for BBA released over the coverage and settlement period based on the release from risk / for PAA released over the coverage period only based on release from risk / all changes in estimates recognised in P&L (or OCI)

IASB / FASB areas for reconciliation (2)

- Acquisition costs
  - IASB: residual margin shows expected profit after deducting all costs that are necessarily incurred in acquiring and fulfilling the insurance contract liability
  - FASB: residual margin shows the expected profit after deducting all costs that are necessarily incurred in acquiring and fulfilling the insurance contract liability except those costs that are deemed to not have resulted in issued contracts
- Premium allocation approach
  - IASB: **permit** premium allocation approach for contracts when it produces similar measurements to building block approach
  - FASB: **require** premium allocation approach for all contracts meeting specified criteria

Nächste Schritte

The boards expect to work through the remaining topics and plan to evaluate any differences between the boards in the context of a near-final model. The boards would then assess whether they can come together on some or all of those differences. After that point, the FASB would publish an exposure draft. However, the next steps after that point for the IASB are less clear because ist due process is further forward and because of the urgent need for an IFRS on insurance contracts. Thus, the IASB would need to consider whether to move straight to a staff review draft with the aim of finalising an IFRS, publish an exposure draft with questions focussed on a narrow set of issues, or publish a comprehensive joint exposure draft with the FASB. Both boards expect to complete technical discussions by mid-2012. (April 2012)

Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany ®

Liesel Knorr

DRSC e.V.

Zimmerstr. 30

10969 Berlin

Tel. 030 / 20 64 12 11

Fax 030 / 20 64 12 15

www.drsc.de

knorr@drsc.de