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IFRS-FA – öffentliche SITZUNGSUNTERLAGE

Sitzung:	13. IFRS-FA / 08.02.2013 / 09:00 – 11:00 Uhr
TOP:	06 – Insurance Contracts
Thema:	Targeted re-exposure draft
Papier:	13_06a_IFRS-FA_Insurance_Präsentation

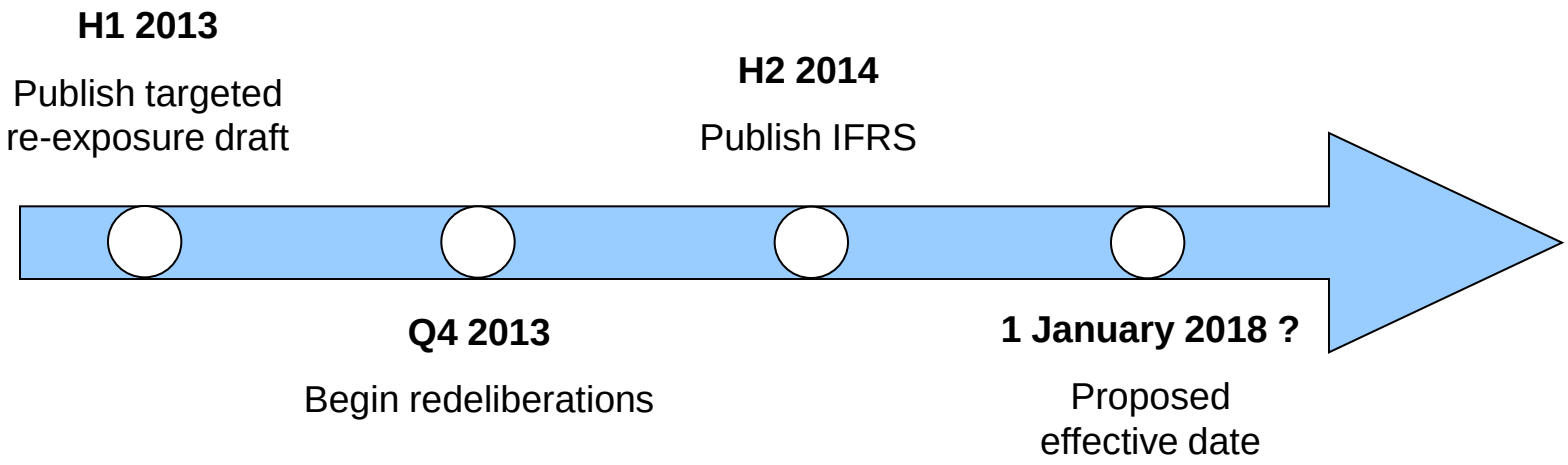
Agenda

1. **Targeted re-exposure draft: overview and timeline**
2. Residual margin
3. Participating contracts
4. Presentation
5. Transition
6. Next steps DRSC

Wird im Rahmen einer späteren Sitzung behandelt

Targeted re-exposure draft: overview and timeline

IASB expects to publish re-ED in H1 2013



- The ED will include the full text of the proposed standard.
- The ED will only include limited questions to avoid re-opening issues which have already been decided and sufficiently redeliberated.
- The IASB does not intend to revisit other aspects of the proposed standard after re-exposure.

Targeted re-exposure draft: overview and timeline

Focus of targeted re-exposure

Measurement proposals

Unearned profit/ residual margin

Participating contracts

Focus of this presentation

Presentation proposals

Volume information

Effect of changes in discount rate in OCI

Approach to transition

Agenda

1. Targeted re-exposure draft: overview and timeline
2. **Residual margin**
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4. Presentation
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2. Residual margin

Overview

Quantifies the unearned profit the insurer expects to earn as it fulfils the contract.

Unit of account: portfolio level

Key questions:

1. How should the residual margin be allocated?
2. Should interest be accreted?
3. Should the residual margin be unlocked for changes in estimates of cash flows and/or in changes in risk adjustment?

2. Residual margin
How should the residual margin be allocated?

- 2011 ED *Revenue from Contracts with Customers* proposal: If the amount of consideration to which an entity expects to be entitled is variable, revenue is constrained to the amount to which the entity is reasonably assured to be entitled.
- If this guidance were to be applied to the allocation of the residual margin, most insurance contracts with variable consideration would release the margin only on termination/maturity of the contract.
- This does not reflect the pattern of services provided for the majority of insurance contracts.

Tentative decision (December 2012 IASB meeting):

The constraint on recognising revenue proposed in the revenue recognition project shall not be applied to the allocation of the residual margin for insurance contracts.

2. Residual margin

How should the residual margin be allocated?

ED proposal	Tentative decisions

Residual margin shall be allocated:
• over the coverage period,
• on a systematic basis:
  • on the basis of the passage of time, but
  • on the basis of the expected timing of incurred claims and benefits, if that pattern differs significantly from the passage of time.
	Residual margin shall be allocated:
	• over the coverage period,
	• on a systemic basis that is consistent with the pattern of transfer of the services provided.

DRSC Comment Letter:

- An insurer shall recognise the residual margin as income in profit or loss over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage.
- To determine the release pattern on the basis of an insurer's performance seems appropriate. The level of performance is generally the coverage the insurer provides for the duration of the contract.
- To base the release on performance is consistent with the proposed approach in the revenue recognition project.

2. Residual margin
Should interest be accreted?

Arguments for accretion of interest:

- It is consistent with the proposals on revenue recognition.
- It ensures that revenue is recognised at an amount that reflects what the cash selling price would have been if the customer had paid cash for the promised services at the point that they are transferred to the customer.
- It is consistent with the fact that all other components of the liability reflect the time value of money.
- If interest is not accreted on the residual margin, the amount recognised as income in future periods would be understated, in particular for long-term contracts.

Arguments against accretion of interest:

- The tracking of the interest accreted and released would be complex, particularly if the residual margin is unlocked for changes in expected future cash flows.
- The DRSC and other respondents to the ED disagreed conceptually with the accretion of interest on the residual margin.

2. Residual margin

Should interest be accreted?

Example:

- At inception, a residual margin of CU5 000 is recognised on a portfolio of 5-year insurance contracts.
- Upfront premium: CU12 000; estimated net present value of expected cash flows: CU7 000.
- There are no changes in assumptions, and no changes in discount rates.
- The discount rate of the liability is 5% and assumes a flat yield curve.
- Services are delivered evenly over the 5-year period.

No accretion of interest:

	Y1	Y2	Y3	Y4	Y5	Total
Amount of residual released to profit or loss for the period	1 000	1 000	1 000	1 000	1 000	5 000
Impact on profit or loss for the period	**1 000**	**1 000**	**1 000**	**1 000**	**1 000**	**5 000**

Accretion of interest:

	Y1	Y2	Y3	Y4	Y5	Total
Amount of residual released to profit or loss for the period (A)	1 155	1 155	1 155	1 155	1 155	5 775
Amount of interest expense recognised due to the accretion of interest on the residual margin (B)	(250)[1]	(205)[2]	(158)[3]	(107)[4]	(55)[5]	(775)
Impact on profit or loss for the period [C = A – B]	**905**	**950**	**997**	**1 048**	**1 100**	**5000**

[1] = 5 000 * 5% [2] = (5 000 + 250 – 1 155) * 5%

2. Residual margin

What interest rate should be used for accretion of interest?

Current rate	Locked-in rate determined at inception
+ The current rate would treat the residual margin consistently with the other components of the insurance liability.	+ The locked-in rate treats the residual margin similar to a pre-payment in the proposals on revenue recognition.
+ As the residual margin is no longer locked, it could be argued that the discount rate should also be updated.	+ It is less complex and avoids some of the problems associated with using a current rate.
- To be consistent with the decision to present the effects of changes in the discount rate in OCI, the interest accreted needs to split between profit of loss and OCI. This would be very complex.	- When the margin is measured inconsistently from the rest of the cash flows, an accounting mismatch may arise.

Confirmation of the ED proposal in the September 2012 IASB meeting:

An insurer shall accrete interest on the residual margin using a locked-in rate.

2. Residual margin

Should the residual margin be unlocked?

Exposure draft proposal:

- The residual margin shall be locked-in at inception.

Problems with the ED proposals (DRSC Comment Letter):

- There is a logical break between the methodology used at initial recognition and subsequent measurement.
  - Initial measurement is consistent with the proposals on revenue recognition whilst subsequent measurement is based on the principle proposed in the project on liabilities.
- As the residual margin is locked-in, changes in the present value of the fulfilment cash flows will be immediately recognised in profit or loss upon subsequent measurement.
  - An adverse change in assumptions or estimates impacting the present value of fulfilment cash flows can cause counterintuitive profit or loss impacts.
  - For example, if the interest rate decreases, the lock-in of the residual margin results in losses that are recognised immediately, even though there is still a residual margin storing profit and the contract is still profitable.

2. Residual margin

Should the residual margin be unlocked?

Example:

- Premiums CU200 per year for 5 years
- Expected claims CU100 per year for 5 years
- Time value of money, risk, and expenses are all immaterial.
- At the end of year 2, the insurer revises its estimates: in years 3, 4 and 5, claims will increase by CU40.

Initial estimates:

	Year					
	1	*2*	*3*	*4*	*5*	*Total*
	CU	*CU*	*CU*	*CU*	*CU*	*CU*
Insurance contract revenue	200	200	200	200	200	1,000
Incurred claims	(100)	(100)	(100)	(100)	(100)	(500)
Underwriting result (Initial allocation of residual margin)	100	100	100	100	100	500

No unlocking of residual margin:

	Year					
	1	2	3	4	5	Total
	CU	*CU*	*CU*	*CU*	*CU*	*CU*
Insurance contract revenue	200	200	200	200	200	1,000
Incurred claims	(100)	(100)	(140)	(140)	(140)	(620)
Change in estimates	-	(120)	-	-	-	120
Unwind of change in estimates as higher claims are incurred	-	-	40	40	40	(120)
Underwriting result (Allocation of locked residual margin minus change estimate in year 2)	100	(20)	100	100	100	380

2. Residual margin

Should the residual margin be unlocked?

Tentative IASB decisions (through November 2012):

- An insurer should subsequently adjust the residual margin for favourable and unfavourable changes in the present value of the fulfilment cash flows.
  - There should not be a limit on the amount by which the residual margin could be increased as a result of favourable changes.
  - The residual margin recognised by the insurer should not be negative.
- The residual margin should be adjusted only for changes in estimates of future cash flows.
  - Experience differences should be recognised immediately in profit or loss.
  - All changes in the risk adjustment should be recognised immediately in profit or loss.
- Adjustments should be recognised prospectively in profit or loss as the residual margin is released.

2. Residual margin

Should the residual margin be unlocked?

Example:

- Premiums CU200 per year for 5 years
- Expected claims CU100 per year for 5 years
- Time value of money, risk, and expenses are all immaterial.
- At the end of year 2, the insurer revises its estimates: in years 3, 4 and 5,claims will increase by CU40.

Initial estimates:

	Year					
	1	*2*	*3*	*4*	*5*	*Total*
	CU	*CU*	*CU*	*CU*	*CU*	*CU*
Insurance contract revenue	200	200	200	200	200	1,000
Incurred claims	(100)	(100)	(100)	(100)	(100)	(500)
Underwriting result (Initial allocation of residual margin)	100	100	100	100	100	500

Unlocking of residual margin:

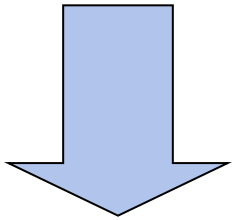
	Year					
	1	2	3	4	5	Total
	CU	*CU*	*CU*	*CU*	*CU*	*CU*
Insurance contract revenue	200	200	200	200	200	1,000
Incurred claims	(100)	(100)	(140)	(140)	(140)	(620)
Underwriting margin (Allocation of residual margin, as adjusted prospectively at end of year 2)	100	100	60	60	60	380

2. Residual margin

Should the residual margin be unlocked?

Possibly unintended consequences of the tentative unlocking decisions:

- The proposed requirements seek to distinguish purely between past cash flows and future cash flows.
- Although this distinction works well for changes in estimates of claims for future insured events, it could have unintended consequences for other changes in estimate.



Refinement of tentative decision in the December 2012 IASB meeting:

The residual margin should be unlocked for differences between current and previous estimates of cash flows *relating to future coverage or other future services*.

2. Residual margin

Should the residual margin be unlocked?

Example 1: Incurred claims:

- An insurer re-estimates the amount required to settle claims that have been incurred in the current or previous periods, which is a change in estimate of future cash flows that relates to past coverage.
- Old wording: Insurers should offset such changes against the residual margin.
- New wording: The changes should be recognised immediately in profit or loss.

Example 2: Asset-dependent cash outflows

- For some contracts, the amounts paid to policyholders are dependent on asset returns. A higher-than-expected gain in the assets in the current year could result in an increase in estimates of the cash outflows in future periods.
- Old wording: The increase should be offset against the residual margin.
- New wording: The increase would be recognised immediately in profit or loss.

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3. Participating contracts

Types of contracts

	Performance-sharing mechanism			
	Guaranteed fixed by formula	**Discretionary** determined/paid at the discretion of the entity	**Terminal** determined/paid when the contract terminates	**Unit-linked** benefit linked to unit prices of an investment fund
Discretionary 90/10	✓	✓		
Fixed 90/10	✓			
With profits	✓		✓	
No guaranteed participation rate		✓		
Variable/Unit-linked				✓

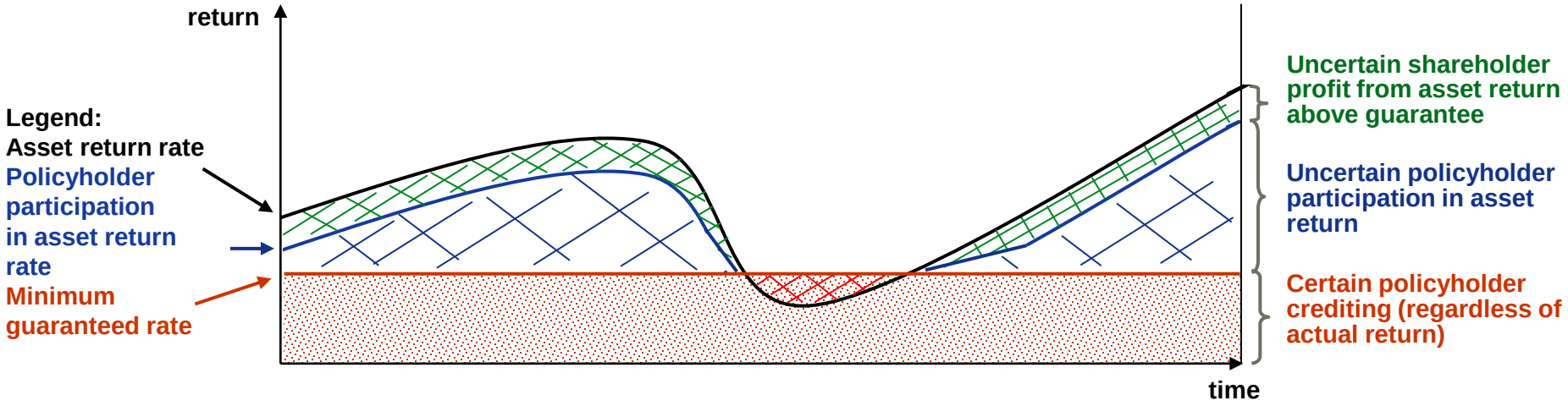
Source: Agenda Paper 2B for December 2012 IASB meeting

3. Participating contracts

Example: Discretionary 90/10 contract (traditional German life insurance)

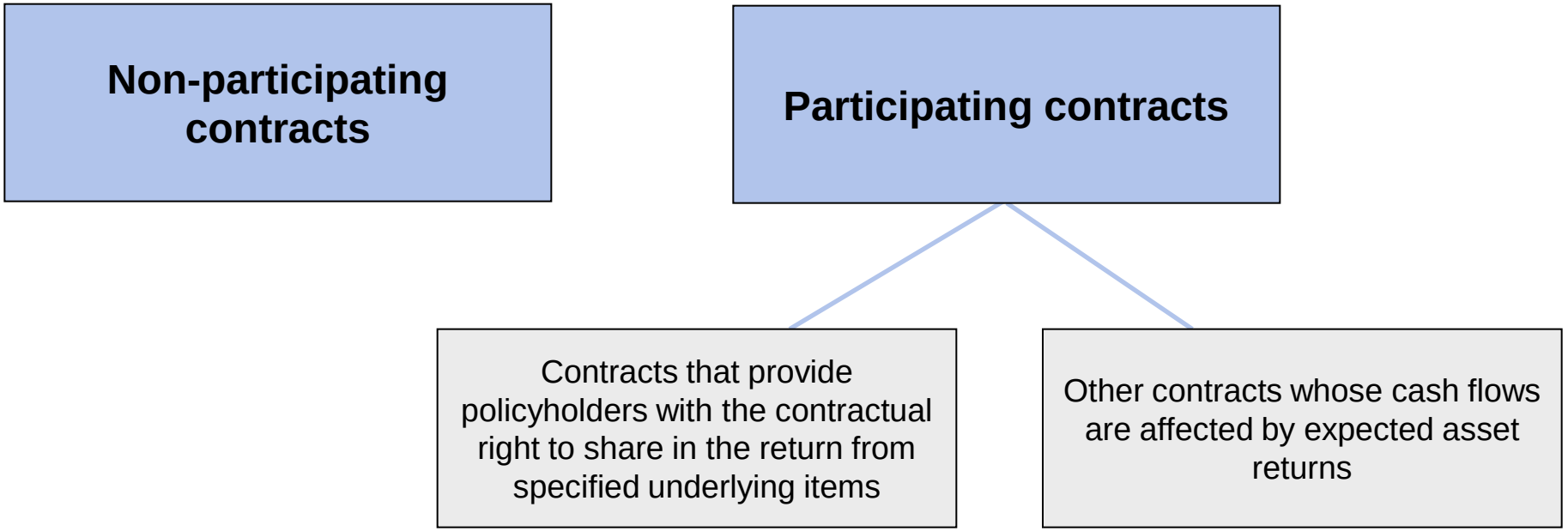
- The subsequent allocation of the amount set aside to individual policyholders is at the discretion of the insurer.
- The annual crediting decision fixes the shareholders' profit. The profit margin can be partly seen as an asset management fee.
- Losses of a period are generally borne by the insurer (minimum guaranteed rate).
- Unallocated amounts can be used to cover subsequent losses if otherwise the insurer would be in financial danger.
- If contracts terminate for any reason, the policyholder receives an appropriate share of unrealised gains allocable to its contract.

Discretionary 90/10 par contract with minimum guarantee



3. Participating contracts

IASB classification



3. Participating contracts

Recap: Accounting model for non-participating contracts

Current fulfilment value concept

- Current and updated cash flow assumptions
- Discount rate:
  - Reflects only the characteristics of the insurance contract liability
  - Current and updated each reporting period
- Current and updated risk adjustment
- Residual margin is adjusted prospectively for changes in estimates of cash flows related to future coverage / future services (unlocking).
- Changes in the insurance liability arising from changes of the discount rate are presented in OCI (use of a locked-in discount rate for the P&L).

3. Participating contracts

Contracts with the contractual right to share in return from underlying items

Insurance contracts that provide policyholders with the contractual right to share in:

- the performance of a specified pool of insurance contracts,
- the performance of a specified pool of assets, or
- the profit or loss of the entity that issues the contract.

Such contracts include the following features:

- The policyholder transfers insurance risk to the insurer or to a pool in exchange for a premium.
- The insurance risk and the investment risk on the assets purchased with the premium are managed together.
- The overall performance of the pool or insurer is shared with the community of policyholders.
- The insurer may have discretion over the amount and timing of cash flows that result from the participation feature.
- The insurer includes in its financial statements the underlying assets and liabilities on which the participation is based.

3. Participating contracts

Contracts with the contractual right to share in return from underlying items

Tentative IASB decisions:

- Mirroring approach:
  - The measurement of the fulfilment cash flows relating to the policyholder's participation should be based on the measurement in the IFRS financial statements of the underlying items in which the policyholder participates.
  - Any changes in the liability for the performance-linked participating features should be presented in the same way within the statement of comprehensive income as the changes in the underlying item.
- The discount rate for cash flows arising from a participating contract should reflect the dependence of those cash flows on the performance of those assets, if any, that affect the amount, timing or uncertainty of those cash flows.
- Include in the measurement of the insurance liability contractual cash flows (both guaranteed and discretionary) arising from current contracts, regardless of whether they are paid to current or future policyholders.

3. Participating contracts

Contracts with the contractual right to share in return from underlying items

Interpretation of the tentative decisions:

- In October 2012, the IASB noted that the mirroring decisions take precedence over the decision to present in OCI changes in the insurance liability arising from changes in discount rate.
- The mirroring decisions do not apply to cash flows that are not dependent on the underlying assets.
- Effectively bifurcation of the insurance liability necessary, i.e. a German 90/10 contract with a minimum interest rate guarantee would be split into:
  - an asset dependent part (mirroring), and
  - a non-asset dependent part (fixed payment because of the guarantee).
- Interest expense on the non-asset dependent cash flows is presented in profit or loss using the rate locked-in at inception of the contract.
- The effects of changes in discount rate on the present value of the non-asset dependent cash flows are presented in OCI.

3. Participating contracts

Other contracts whose cash flows are affected by expected asset returns

Index-linked contracts:

- These contracts provide a contractual right to the performance of specified investments (e.g. stock market indices).
- However, that right is not linked to underlying assets that the insurer holds.

Contracts which provide returns affected by the performance of assets but are credited to the policyholder at the insurer's discretion:

- The insurer has a right to change the amount or timing of cash flows.
- Due to competition, the result of the insurer applying discretion may result in cash flows that are comparable to those arising from non-discretionary performance-linked participation features.
- However, there is no contractually enforceable requirement to pass on the performance of the underlying assets and liabilities to the policyholder.

3. Participating contracts

Other contracts whose cash flows are affected by expected asset returns

Tentative decision on determination of the current discount rate (November 2012 IASB meeting):

- The discount rate that reflects the characteristics of the contract's cash flows shall reflect the extent to which the estimated cash flows are affected by the return from assets.
- This would be the case regardless of whether:
  - the transfer of the expected returns of those assets are the result of the exercise of insurer's discretion; or
  - the specified assets are not held by the insurer.

→ Top-down approach to determine the discount rate: The adjustments to the asset yield curve for defaults should be limited to the amount of risk associated with defaults that is not borne by the policyholder.

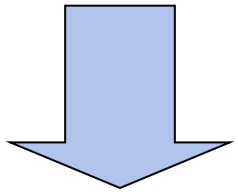
3. Participating contracts

Other contracts whose cash flows are affected by expected asset returns

Presentation of changes in discount rate

- Movements in market interest rates might affect both:
  - the cash flow amounts, and
  - the discount rate used to measure the insurance contract.

→ Presenting the interest expense in profit or loss at the discount rate locked-in at inception may not be useful.



- Resetting the discount rate used to present interest expense
- Not affected: Measurement of the insurance contracts liability recognised on the statement of financial position that is based on a current, updated discount rate

3. Participating contracts

Other contracts whose cash flows are affected by expected asset returns

Alternative 1:

Upon any change in expectations of the crediting rate…

… reset the locked-in rate used to present interest expense to the current discount used to determine the liability's amount on the statement of financial position.

- The change in the expected asset returns will contemporaneously affect:
  - the discount rate used to measure the liability in the statement of financial position, and
  - the discount rate used to present the interest expense in profit or loss.
- The effects of changes in discount rate for these cash flows will be fully presented in profit or loss rather than OCI.

3. Participating contracts

Other contracts whose cash flows are affected by expected asset returns

Alternative 2:

Reset upon any change in the portfolio book yield… **… to the current portfolio book yield.**

- The current portfolio book yield:
  - is consistent with how assets are reported in the SCI,
  - includes adjustments for expected/unexpected defaults and expected reinvestment rates in situations of an asset-liability mismatch,
  - is conceptually consistent with the "mirroring" approach, as it leads to a consistent reporting of assets and liabilities in profit or loss.
- This rate is likely to be different than the discount rate used for measurement of the liability on the balance sheet.
- Implicit assumption: Changes in the book yield will trigger a change in the interest credited to policyholders.

In the November 2012 meeting, the IASB tentatively decided on alternative 1.

3. Participating contracts

Tentative IASB decisions – Summary

	Asset dependent/affected cash flows	**Non-asset dependent/affected cash flows**
Contracts that provide policyholders with the contractual right to share in the return from specified underlying items	***Balance sheet:*** • No current value measurement • Measurement of the fulfilment cash flows on the same basis as the underlying items (mirroring) ***Statement of comprehensive income:*** • Present changes in the liability in the same way as the changes in the underlying item (mirroring)	
Other contracts whose cash flows are affected by expected asset returns	***Balance sheet:*** • Current value measurement • Adjust discount rate for credit risk to the extent it is not borne by the policyholder ***Statement of comprehensive income:*** • Reset the discount rate used to present interest expense to the current rate upon any change in the expected crediting rate • Do not present effects arising from changes in discount rate in OCI	***Balance sheet:*** • Current value measurement • Adjust discount rate for credit risk ***Statement of comprehensive income:*** • Present interest expense using the interest rate locked-in at inception • Present effects arising from changes in discount rate in OCI

3. Participating contracts

Other contracts whose cash flows are affected by expected asset returns

Example (Agenda Paper 2A for November 2012 meeting):

- Contract term: 1 year
- Premium: CU100 000 upfront
- Crediting rate:
  - Determined based on the return of an asset with a 7% coupon less a spread.
  - The insurer has no contractual obligation to pass through an asset return.
- Guaranteed minimum crediting rate: 6%

Asset scenarios	*Scenario 1*	*Scenario 2*	*Scenario 3*	*Scenario 4*	Mean
scenario probability:	25%	25%	25%	25%	
Asset gross redemption yield (i.e., YTM based on contractual cash flows)	7.00%	7.00%	7.00%	7.00%	7.00%
Expected defaults	0.00%	0.60%	0.90%	1.50%	0.75%
Expected asset return	7.00%	6.40%	6.10%	5.50%	6.25%

3. Participating contracts

Other contracts whose cash flows are affected by expected asset returns

Crediting Rate Determination	*Scenario 1*	*Scenario 2*	*Scenario 3*	*Scenario 4*	Mean
Expected asset return	7.00%	6.40%	6.10%	5.50%	6.25%
Targeted spread	0.80%	0.80%	0.80%	0.79%	0.80%
Any other adjustments (e.g., due to assessment of competition)	0.00%	0.00%	0.00%	0.00%	0.00%
Adjustment due to guaranteed minimum	0.00%	-0.40%	-0.70%	-1.29%	-0.60%
Expected crediting rate	6.20%	6.00%	6.00%	6.00%	6.05%
Expected cash outflow	106,198	106,000	106,000	106,000	106,049
Expected cash inflow from asset	107,000	106,400	106,100	105,500	106,250
Insurer expected spread	803	400	100	(500)	201
Spread as a % of expected asset CF	0.75%	0.38%	0.09%	-0.47%	0.19%
Credit losses absorbed by insurer	0.00%	0.00%	0.00%	-0.47%	-0.12%
Expected cash outflow for scenarios where policyholder return greater than guarantee	106,198	-	-	-	26,549

3. Participating contracts

Other contracts whose cash flows are affected by expected asset returns

- Cash flows need to separated into an asset affected and a non-asset affected part.
- The expected cash outflows for the scenario where the return exceeds the guaranteed minimum return are characterized as asset affected (i.e., CU 26 549) and discounted at the expected asset return of 6.25%.
- The remaining cash flows (i.e., CU 79 500 or CU 106 049 less CU 26 549) are characterized as non-asset affected and discounted at the non-asset affected discount rate of 6.0%.

(Discount rate based on…)	asset affected	non-asset affected
Expected cash outflow	26,549	79,500
Discount rate	6.25%	6.00%
	24,988	75,000
Insurance liability		99,988

3. Participating contracts

Insurance industry proposals discussed in December 2012 IASB meeting

- In the December 2012 meeting, the IASB discussed an accounting model for participating contracts suggested by the global insurance industry (The HUB Global Insurance Group, the European Insurance CFO Forum and Insurance Europe).

Current/Current/OCI with a floating residual margin:

- The Best Estimate Liability (BEL) is presented in the balance sheet on a current market rate basis.
- The difference between the BEL at the current portfolio book yield and the BEL at the current market rate is recognised in OCI.
- The unwind of the BEL at the current portfolio book yield is recognised in the P&L account.
- Changes in the BEL as a result of changes in the current portfolio book yield may be offset by a change in the residual margin as these are in essence changes in estimated profits that are deferred and recognised over the life of the contract (**“floating” residual margin**).

3. Participating contracts

Insurance industry proposals discussed in December 2012 IASB meeting

Current portfolio book yield

- The current portfolio book yield enables to distinguish between:
  - changes of interest rates relevant for insurers and policyholders (recognised in profit or loss), and
  - short term fluctuations in current interest rates (stored in OCI).

Floating residual margin

- The residual margin should represent the unearned profit of an insurance contract.
- Following the proposal, the unearned profit represents the difference between the cumulative level of investment returns on assets (including the insurer's share of those returns) less the cumulative level of returns allocated to the policyholders.
- The floating residual margin involves recalibrating the residual margin in order to reflect changes in future profit expectations and unapportioned surplus.
- It can be viewed as a prospective measurement of the residual margin.

3. Participating contracts

Insurance industry proposals discussed in December 2012 IASB meeting

The industry‘s rationale behind the proposal:

- The proposal is consistent with the measurement of the rest of the building block approach.
- Adjusting the margin for those gains or losses is consistent with the IASB’s reasons for not recognising a day one gain:
  - Changes in future gross profit expectations would not be recognised in P&L immediately, but would be deferred and allocated through the residual margin.
- The proposal is consistent with the application of the IASB’s revenue recognition proposals to revenue contracts for asset management services.
- Gains are only earned when the bonuses are declared, i.e. when the asset returns are sustainable in the long term.
- The mirroring principle is reflected in the proposal without separation of cash flows by reflecting the asset dependency in the cash flow projections and the current portfolio book yield for all liability cash flows.

3. Participating contracts

Insurance industry proposals discussed in December 2012 IASB meeting

The IASB staff‘s interpretation of the proposal (allocation of the residual margin):

- Under the floating margin proposal, the profit driver for the allocation of the residual margin would be consistent with the performance-sharing mechanism between the policyholder and insurer.
- A reasonable pattern for the allocation of the margin:
  - views the provision of services as satisfied over the life of the contract, and
  - is based on the insurer’s expectations of total unearned profit.
- If the bonuses are allocated in the same pattern as the estimate of the provision of services, the pattern of bonuses may be an acceptable proxy for the provision of services under those contracts.
- There may be an element of discretion in the performance-sharing mechanism and thus in the allocation of the residual margin, but:
  - The level of discretion will typically be constrained by contract terms, laws and regulations.
  - The key feature is not the discretion, but the sharing of returns from the underlying items over the contract duration.
  - Because many participating contracts are long-term in nature, the insurer will often use the discretion to achieve a targeted long-term return for the policyholder and, as a result, for the insurer.

3. Participating contracts

Insurance industry proposals discussed in December 2012 IASB meeting

The IASB staff‘s interpretation of the proposal (accretion of interest, unlocking):

- Adjusting the margin to reflect changes in the value of the premium that would have been charged at the reporting date is consistent:
  1. with the IASB’s rationale underlying the accretion of interest on the margin; and
  2. with the depiction of the residual margin as an updated measure of the unearned profit in the contract.
- The second approach:
  - significantly reduces the accounting mismatch that may arise from accreting interest at the discount rate at inception.
  - is consistent with estimating the amount of premiums that would have been charged each period had the insurer written that contract in that period.

3. Participating contracts

Insurance industry proposals discussed in December 2012 IASB meeting

The IASB staff‘s interpretation of the proposal (accretion of interest, unlocking):

- For participating contracts, the value of the linked items could serve as a proxy for the updated value of the premiums.
- The floating residual margin is remeasuring the carrying amount of the unearned profit for the provision of services as represented in the margin.

The staff recommended adjusting the margin by the gains or losses arising from the changes in the value of the underlying items potentially attributable to the insurer.

Side remark:

- Unlike the insurance industry propsal, the IASB staff proposition does not take reinvestment risk explicitly into account (maybe included in the unlocking decision).

3. Participating contracts

Insurance industry proposals discussed in December 2012 IASB meeting

Opponents	• If the policyholder terminates early, the insurer keeps the 10% share in a typical 90/10 participating contract. Therefore, the insurer profit has been earned. • If an insurer is exposed to investment risk, the uncertainty in asset returns should be reflected in profit or loss each year as would be the case with any other business. • Major concern: Bonus declaration is within the control of the insurer. The floating residual margin could thus be used as a smoothing mechanism.
Supporters	Revenue recognition perspective: • No day one recognition of gain or loss (residual margin) and allocation of earnings over time. • While the revenue recognition proposal in itself does not really work for insurance contracts, by using a floating residual margin, the model is moving towards revenue recognition**.**

The IASB rejected the staff proposal with 7 in favour and 8 against.

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