

Issues paper – a broad outline of progress to date on Insurance Contracts

Where considered relevant this broad outline mentions:

- the existing Australian requirements (AASB 4 *Insurance Contracts*; AASB 1023 *General Insurance Contracts*; and AASB 1038 *Life Insurance Contracts*);
- the proposals in ED/2010/8 *Insurance Contracts*;
- Australian constituents' comments¹ on the proposals;
- the AASB's comments to the IASB on ED/2010/8; and
- recent IASB tentative decisions (some of which confirm the ED/2010/8 proposals and some of which are changes from those proposals).

AASB staff comments are interspersed in this outline where relevant.

Those issues that AASB staff regard as being of particular significance are indicated with an asterisk (*) in the topic heading. Those topics are:

- 4 Contract Boundary;
- 6 Risk Adjustment/Margin – Initial and Subsequent Measurement;
- 10 Residual Margin Unit of Account; and
- 11.6 Presentation – Other Comprehensive Income.

1 Contract Recognition

Currently

- 1.1 AASB 1023 and AASB 1038 do not explicitly address initial recognition of insurance contract liabilities and assets. However, paragraph 4.2 of AASB 1023 requires premium revenue to be recognised from the date the insurer accepts risk under an insurance contract (attachment date) as soon as there is a basis on which it can be reliably estimated.

Proposed

- 1.2 Paragraphs 13 and 14 of ED/2010/8 propose the recognition of a liability (or asset) when the insurer becomes a party to the insurance contract being the earlier of the time when the insurer is bound by the contract terms and when the insurer is first exposed to risk under the contract. Exposure to risk occurs when the insurer can no longer withdraw from its obligation to provide insurance coverage and no longer has the right to reassess the risk of a particular policyholder.

¹ The AASB received written comment on ED/2010/8 from seventeen constituents, conducted two roundtable discussions (Melbourne – Auckland and Sydney) and discussed the ED proposals and subsequent IASB deliberations with AASB Insurance Contracts Project Advisory Panel members.

AASB staff comment

- 1.3 The proposal and the notion of ‘attachment date’ for general insurance contracts are likely to be the same in practice; however, the ED/2010/8 proposal could cause life insurers to bring forward some liability recognition.

Constituent comment

- 1.4 No significant comments were made.

AASB to IASB

- 1.5 No significant concerns were raised.

IASB tentative decisions

- 1.6 Insurance contract assets and liabilities initially are to be recognised when the coverage period begins (March 2011).
- 1.7 If management becomes aware of an onerous contract liability in the pre-coverage period, the onerous contract shall be recognised (March 2011).

Further AASB staff comment

- 1.8 The IASB’s recent tentative decisions bring the proposals more in line with AGAAP.

2. Initial Contract Measurement

Currently

- 2.1 Under AASB 1023, paragraph 7.1, claims liabilities are measured as the present value of expected cash inflows and outflows to fulfil the contract, adjusted for inherent uncertainty in the central estimate with an additional risk margin.
- 2.2 AASB 1038, paragraph 8.1, requires contract liabilities to be measured as the present value of best estimate cash flows plus a planned margin that eliminates any gain at inception. If the result would not be materially different, paragraph 8.1(b) measurement at the accumulated benefit after allowing for acquisition costs expected to be recouped.

Proposed

- 2.3 Paragraph 17 of ED/2010/8 proposes an insurance contract be measured as the present value of the expected cash inflows and outflows to fulfil the contract, adjusted for uncertainty of amount and timing; plus a residual margin that eliminates any gain at inception.

AASB staff comment

- 2.4 The measurement proposal in ED/2010/8 is similar to the requirements in AASB 1023 (for claims liabilities) and AASB 1038 in terms of using the present value of future cash flows, margins for uncertainty and not permitting day one gains.
- 2.5 The proposed residual margin is similar to the planned margin under AASB 1038, but AASB 1023 is probably better described as having a ‘composite margin’ (risk margin plus residual margin).

Constituent comment

- 2.6 Most constituents agreed with the proposals.
- 2.7 Several constituents commented that aspects of the proposed measurement model make the information provided less useful and more complex to understand, including expensing all acquisition costs, having two margins and the transition requirements. These topics are addressed separately later in this paper.
- 2.8 One constituent considered it 'excessive' for the present value of the fulfilment cash flows to be based on the 'full range of possible outcomes' rather than a 'reasonable' range.

AASB to IASB

- 2.9 The AASB agreed with the proposals.

IASB tentative decisions

- 2.10 February 2011 meeting:
- (a) The measurement objective of expected value refers to the mean that considers all relevant information.
 - (b) Costs not directly related to the contract or contract activities are required to be recognised as an expense in the period they are incurred.
 - (c) Gains are not to be recognised at inception of a contract.
 - (d) Day one losses are required to be recognised immediately.

3. Future Cash Flows

Currently

- 3.1 Under paragraphs 5.1.4 and 5.1.5 of AASB 1023, a central estimate (being the mean of the distribution of possible cash flow scenarios) is used to estimate the outstanding claims liabilities and paragraphs 8.1, 8.1.5 and 8.1.6 of AASB 1038 require assumptions to be best estimates.

Proposed

- 3.2 Paragraph 23 of ED/2010/8 proposes incremental cash flows for a portfolio:
- (a) be explicit, unbiased, probability-weighted estimates;
 - (b) reflect the perspective of the entity but, for market variables, be consistent with observable market prices;
 - (c) reflect all available information at the measurement date; and
 - (d) include only cash flows arising from existing contracts.
- 3.3 In addition, paragraph 24 proposes that, at initial recognition, an estimate of all cash flows that will arise as the insurer fulfils the insurance contract over contract life should be included. Those cash flows may result in a change in the carrying amount of the

insurance contract liability on the day the insurance contract is initially recognised, but immediately after the moment of initial recognition.

AASB staff comment

3.4 The requirements under AASB 1023 and AASB 1038 are less detailed, however, the proposals in ED/2010/8 are close to current Australian practice.

Constituent Comment

3.5 No significant comments were made.

AASB to IASB

3.6 The AASB agreed with the proposals.

IASB tentative decisions

3.7 February 2011 meeting:

- (a) The accounting model should be based on current estimates and inputs that are consistent with observable market data.
- (b) Cash flows are those that will arise as the insurer fulfils the insurance contract.
- (c) Expected value of future cash flows will be used in the model.
- (d) Expected value refers to the mean that considers all relevant information.
- (e) Not all possible scenarios need to be identified and quantified, provided the estimate is consistent with the measurement objective of determining the mean.
- (f) All costs incurred directly by an insurer in fulfilling a portfolio of insurance contracts should be included in the cash flows used to determine the insurance liability. The costs include:
 - (i) those related directly to the fulfilment of the contracts in the portfolio, e.g. payments to policyholders, claims handling, etc.
 - (ii) those directly attributable to contract activity, that can be allocated to those portfolios as part of fulfilling that portfolio; and
 - (iii) other costs specifically chargeable to the policyholder under the contract.
- (g) Costs not directly related to contract activities are to be expensed.

4. Contract Boundary*

Currently

4.1 AASB 1023 does not explicitly deal with the contract boundary, although it notes that most direct general insurance contracts are annual [paragraphs 4.3 and 4.3.4]. Australian health insurers usually apply AASB 1023. AASB 1038 states that future cash flow estimates take into account expected renewal premiums/lapse rates

[paragraph 8.1], so the boundary for life insurance contracts is framed by the insurer's expectations about whole portfolios.

Proposed

- 4.2 ED/2010/8 distinguishes future cash flows relating to the existing contract from those relating to the future contracts based on the point at which an insurer either is no longer required to provide coverage or has the right or the practical ability to reassess risks and pricing for individual contracts.

AASB staff comment

- 4.3 AGAAP for (non-health) general insurance appears to result in outcomes that are broadly consistent with the ED/2010/8 proposals.
- 4.4 Due to the focus on individual contracts, some life insurance contracts (including yearly-renewable term contracts) may be treated as short-duration under ED/2010/8, but which are currently long-term under AASB 1038.
- 4.5 ED/2010/8 poses issues for Australian health insurers because they are legally bound to accept policyholders wishing to renew, and accept new policyholders who have had a similar policy with another insurer at the same prices as renewing policyholders (so-called 'portability'). In addition Australian health insurers can only adjust pricing approved by government and that price adjustment may not fully reflect the insurer's risks. These conditions apply whether customers renew monthly, yearly or at some other interval.
- 4.6 For health insurers, some of the issues involve determining the extent to which requirements outside explicit terms of a contract (such as some legal requirements) form part of the contract terms.

Constituent comment

- 4.7 Most constituents with an interest in health insurance who commented to the AASB express concern about the ED/2010/8 proposals extending contract periods beyond the point where the resulting information would be meaningful. They considered it particularly unreasonable for the proposals to focus on re-pricing at the individual contract level. Some constituents indicated they would prefer an approach based on the ability to re-price risk at a portfolio level.
- 4.8 Some of these constituents noted that globally, there are many contractual variations based on particular statutory requirements that, by default, may deem a contract as having a long duration when industry practice and management of such risks indicate otherwise.
- 4.9 Some constituents with an interest in life insurance commented that the ED/2010/8 proposals may not be applied consistently in practice due to the focus on individual contracts with the potential outcome that yearly renewable term business may be considered an annual contract since the portfolio is subject to repricing each year. These constituents considered that such contracts should result in long-term contracts as

the insurer is obligated to continue the contract as a multi-year policy provided premiums are paid.

- 4.10 Some constituents noted trustees of superannuation plans often acquire group life policies for members of superannuation plans, which are usually re-rated annually on a portfolio basis.

AASB to IASB

- 4.11 The AASB agrees with the proposed principles regarding the proposed insurance contract boundary, however, recommends the IASB give further consideration to the interaction between contract terms and the legal and regulatory environment in jurisdictions with the view to assisting insurers to identify contract boundaries consistently.
- 4.12 In addition, the AASB noted that regulation of health insurance in Australia prevents insurers from re-underwriting the contracts of continuing policyholders, and re-pricing occurs at the portfolio level.
- 4.13 Furthermore, the AASB notes defining the boundary of an insurance contract as the point at which an insurer has the right to re-price the portfolio of insurance contracts to which the policy belongs would be consistent with the proposed levels of aggregation that would be applicable to other aspects of insurance contract accounting under ED/2010/8, including cash flows and risk adjustments.

IASB tentative decisions

- 4.14 March 2011 meeting:
- (a) Contract renewals are only to be treated as a new contract when the insurer is no longer required to provide coverage or when the existing contract does not confer any substantive rights on the policyholder.
 - (b) Substantive rights of the policyholder do not occur when the insurer has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects the risk.
 - (c) A contract does not confer on the policyholder any substantive rights when the insurer has the right or the practical ability to reassess the risk of the portfolio the contract belongs to and, as a result, can set a price that fully reflects the risk of that portfolio.
 - (d) All renewal rights should be considered in determining the contract boundary whether arising from a contract, from law or from regulation.

Further AASB staff comment

- 4.15 The IASB's recent tentative decision to add a portfolio-based boundary condition will overcome many of the concerns of Australian constituents.

5. Discount Rates

Currently

- 5.1 Under AASB 1023 outstanding claims liabilities are discounted for the time value of money using risk-free discount rates based on current observable, objective rates that relate to the nature, structure and term of obligations.
- 5.2 The same applies under AASB 1038 for liabilities that are not contractually linked to the performance of assets. To the extent liabilities are contractually linked to the performance of assets, the discount rates are based on market returns on assets backing life insurance liabilities.

Proposed

- 5.3 Paragraph 30 of ED/2010/8 proposes the future cash flows from insurance contracts be adjusted for the time value of money using discount rates consistent with observable current market prices for instruments with similar cash flows (timing and currency), plus adjustment for liquidity risks.
- 5.4 The discount rate excludes credit risk and factors that influence the observed rates but are not relevant to the insurance contract liability. This is because the model is based on the insurer fulfilling its contractual obligations.
- 5.5 Under paragraph 32, if the amount, timing or uncertainty of the cash flows depend wholly or partly on the performance of specific assets, the measurement would reflect that linkage.

AASB staff comment

- 5.6 The key difference between the proposals compared to AASB 1038 and AASB 1023 is the explicit consideration of liquidity risk. However, staff note that some life insurers incorporate liquidity risk in their discount rate.

Constituent comment

- 5.7 Most constituents agreed with the proposals.
- 5.8 One constituent advocated having an option to lock-in the discount rate at inception of the contract when, at the portfolio level it eliminates or significantly reduces an accounting mismatch and is consistent with the business model of the insurer.
- 5.9 One constituent believes including the impact of liquidity risk should be at the discretion of the insurer due to the level of difficulty in measuring liquidity effects, even with additional guidance.
- 5.10 Some constituents commented on the need for robust guidance on estimating a liquidity premium.

AASB to IASB

- 5.11 The AASB agreed with the proposals.

- 5.12 The AASB noted the proposals are inconsistent with the requirements for determining discount rates under other IFRSs, such as IAS 19 *Employee Benefits*, and that work on discount rates more generally would be helpful in achieving consistency.
- 5.13 The AASB concurred that a change in an insurer's own credit risk is not relevant under the proposed fulfilment cash flows approach.

IASB tentative decisions

- 5.14 The objective is to adjust the future cash flows for the time value of money and to reflect the characteristics of the insurance contract liability (February and March 2011).
- 5.15 A method for determining the discount rate would not be prescribed and the discount rate should only reflect the effect of risks and uncertainties that are not reflected elsewhere in the measurement of the insurance contract liability (February 2011).
- 5.16 The discount rate used to measure all insurance contracts should be a current rate that is updated each reporting period and therefore not locked in (March 2011).
- 5.17 The cash flows arising from an insurance contract depend wholly or partly on the performance of specific assets, be adjusted using a discount rate that reflects that dependency (March 2011).
- 5.18 In applying a top-down (replicating portfolio²) approach in determining the discount rate (March 2011):
- (a) the appropriate yield curve must be based on current market conditions;
 - (b) where there are no observable market prices for some points on the yield curve, use an estimate consistent with the guidance on fair value measurement, in particular, Level 3;
 - (c) cash flows are required to be adjusted for timing and inherent risk to reflect the characteristics of the cash flows of the insurance contract liability; and
 - (d) adjustments are not required for differences between liquidity inherent in the liability cash flows.

6. Risk Adjustment/Margin – Initial and Subsequent Measurement*

Currently

- 6.1 Under AASB 1023, paragraphs 5.1 and 9.1.1, a risk margin is required to allow for the inherent uncertainty in the central estimate for claims liabilities, which is usually determined on a probability of adequacy basis. The risk margin must be remeasured at each reporting date.
- 6.2 AASB 1038, paragraph 8.1, requires an insurer to initially measure and to remeasure the present value of expected cash inflows and outflows to fulfil a contract at each reporting

² The idea of a replicating portfolio is to identify traded assets that match the term and general risk characteristics of a liability (in an equal and opposite way).

date, plus a planned margin that eliminates any gain at inception; or, if not materially different, the accumulated benefit after allowing for acquisition costs expected to be recouped. Paragraph 8.2 requires planned margins to be recognised in income as services are rendered based on one or more ‘profit carriers’. In accordance with paragraph 8.3 the insurer is required to adjust for subsequent changes to assumptions and the differences between actual and assumed experience in relation to insurance risk are recognised in as income or expense.

- 6.3 Under AASB 1023 diversification across portfolios is factored into the calculation.
- 6.4 Under AASB 1038 the diversification factored into the calculation would be limited to products within each statutory fund.

Proposed

- 6.5 Paragraph 35 of ED/2010/8 proposes the risk adjustment be the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate cash flows exceed those expected. Paragraphs B68 – B103 provide further guidance on the risk adjustment.
- 6.6 Paragraphs 47, 48, 50 and 53, propose an insurer remeasure the insurance contract as the present value of fulfilment cash flows at each reporting date, reflecting current estimates of cash flows, discount rates and the risk adjustment, plus the remaining residual margin. It is proposed that an insurer systematically recognise residual margin over the coverage period based on passage of time; but on the basis of the expected pattern of claims and benefits if that differs significantly from the passage of time.
- 6.7 It is proposed that only diversification within a portfolio can be factored into the calculation.

AASB staff comment

- 6.8 ED/2010/8 proposes, and both AASB Standards require remeasurement of cash flows and risk margins at each reporting date. AASB 1038 treats the impact of actual versus assumed experience differently from the impact of changed assumptions, with the latter being adjusted against the planned margin, rather than impacting immediately on income or expense.
- 6.9 Appendix B of ED/2010/8 includes ‘confidence levels’ (which in Australia tend to be known as ‘probabilities of adequacy’) as one technique for determining a risk adjustment. Most Australian general insurers use this ‘technique’.

Constituent comment

- 6.10 Some constituents expressed concern that the phrase “the maximum amount the insurer would rationally pay to be relieved of the risk” might imply an exit value basis of measurement and it is not appropriate to combine this with a fulfilment objective.
- 6.11 Some noted the word ‘maximum’ implies an insurer would need to select a margin at the top end of a range of available outcomes and implies inappropriate conservatism in the calculation (although paragraph BC110 guidance clarifies this is not the intention).

- 6.12 Some constituents expressed concern that defining portfolios in terms of when policies incept ignores how insurers price and manage risk and has the potential to give rise to a large number of portfolios, which would mean that diversification benefits are only narrowly focused (if not eliminated).
- 6.13 Another constituent felt that it is more appropriate to define the risk adjustment as the amount of capital that would be required to cover the uncertainty associated with risks arising from the insurance portfolio.
- 6.14 Many constituents support the proposal for remeasuring the risk margin to take account of up-to-date information each time an insurer reports, and consider the same should be the case for the residual margin. In addition, they disagreed with the proposed method of releasing residual margins because:
- (a) it is inconsistent with the proposed treatment of such margins at inception;
 - (b) profit recognition would potentially be influenced more by the assumptions used to measure insurance contract liabilities than actual experience;
 - (c) it would give rise to anomalous outcomes in some relatively common circumstances; and
 - (d) reliable information for measuring residual margins in the form of market prices would be readily available for most types of insurance contracts.
- 6.15 Several constituents suggested that requiring the residual margin to be remeasured would allow insurers less scope to manipulate profits as current profits would not be subject to changes in assumptions regarding future conditions. In addition it was noted that assumption changes normally have a relatively greater impact on insurer's profits than other changes in components of insurance liabilities, including losses at inception and experience adjustments.
- 6.16 Many constituents strongly disagree with measuring the risk adjustment at the portfolio level without also reflecting benefits of diversification that exist between portfolios. In any case, portfolios differ across entities and accordingly, portfolio-level information may not be comparable across insurers.
- 6.17 Many constituents believe limiting the suggested techniques for estimating risk adjustment (confidence level, cost of capital and conditional tail expectation) limits the possibility of a future method being developed and used. In contrast one constituent noted that consistency and comparability is best achieved if only one technique is allowed (and favoured the cost of capital technique) but conceded for practical reasons limiting the choice to three techniques is appropriate to cater different insurers and types of insurance contracts.
- 6.18 One constituent argued against requiring disclosure of the confidence level when the insurer applies the cost of capital technique.

AASB to IASB

- 6.19 The AASB agreed with many of the proposals, but also concurred with many of the constituent concerns.
- 6.20 The AASB supported remeasuring risk margins and advocated remeasuring residual margins. This is on the basis that up-to-date information would generally be available for both margins and remeasurement would provide more useful information.
- 6.21 In addition the AASB noted in applying the cost of capital technique it appears the insurer would be required to estimate the risk adjustment on the basis of an annual rate of return that reflects the cost to the insurer of holding sufficient capital to provide a high degree of certainty that it will be able to fulfil its obligations to policyholders. As this annual rate of return is likely to implicitly incorporate entity-wide factors, such an approach is arguably inconsistent with the proposals in paragraph 36 of ED/2010/8 to measure the risk adjustment at the portfolio level.
- 6.22 Furthermore, the AASB did not consider a lack of ‘fungibility’ to be a valid reason for not permitting an insurer to measure risk adjustments at the entity level. This is particularly the case as ED/2010/8 proposes a portfolio of insurance contracts be largely determined on the basis of how the insurer groups its insurance contracts for management purposes noting that, most insurers, even those with statutory funds, can generally mitigate the effects of having surpluses and deficits across their portfolios. The AASB recommends the IASB give further consideration to its reasons for proposing that an insurer not be permitted to measure risk adjustments at the entity level.

IASB tentative decisions

- 6.23 February 2011 meeting:
- (a) The cash flows incorporated in the measurement of the insurance liability are those that will arise as the insurer fulfils the insurance contract.
 - (b) The model will use the expected value of future cash flows.
 - (c) The measurement objective of expected value refers to the mean that considers all relevant information.
 - (d) Clarified that all costs an insurer will incur directly in fulfilling a portfolio of insurance contracts should be included in the cash flows used to determine the insurance liability, including:
 - (i) costs that relate directly to the fulfilment of the contracts in the portfolio, such as payments to policyholders, claims handling, etc. (described in paragraph B61 of the ED);
 - (ii) costs that are directly attributable to contract activity as part of fulfilling cash flows under that portfolio of contracts and that can be allocated to that portfolio; and

- (iii) such other costs as are specifically chargeable to the policyholder under the terms of the contract.
- (e) The accounting model should be based on current estimates and inputs that are consistent with observable market data, where available.

6.24 March 2011 meeting:

- (a) Amend the objective of the risk adjustment to ‘the compensation the insurer requires to bear the risk that the ultimate cash flows could exceed those expected.’
- (b) Provide application guidance that the risk adjustment would reflect both favourable and unfavourable changes in the amount and timing of fulfilment cash flows.

6.25 IASB Staff Paper 5/63 (April 2011) states the following points concerning risk adjustments remain open:

- (a) Techniques
- (b) Disclosures
- (c) Level of aggregation (including diversification benefits).

6.26 May 2011 – the IASB has tentatively re-confirmed its view that there should be an explicit risk margin determined independently of the premium (which is separate from the residual margin) that is remeasured at each reporting date. In contrast, at the same meeting the FASB decided to confirm its view that there should be only one margin that is not remeasured other than for onerous contracts.

Further AASB staff comment

6.27 The IASB’s recent tentative re-confirmation of its view that there should be an explicit risk margin determined independently of the premium (which is separate from the residual margin) that is remeasured at each reporting date was supported by 11 members and opposed by two. However, staff remain concerned that the IASB seems to feel the need to re-debate this key aspect of the proposals on so many occasions and that the FASB’s position seems to be completely at odds with lessons evident from the Global Financial Crisis about taking into account up-to-date price information for risk at each reporting date.

7. Acquisition Costs

Currently

7.1 Under AASB 1023, paragraph 8.1, acquisition costs are deferred and recognised as assets where they can be reliably measured and it is probable they will give rise to future premium revenue in subsequent periods. The assets are amortised systematically in accordance with the expected pattern of the incidence of risk of the related insurance contracts.

- 7.2 Under AASB 1038, paragraphs 8.1.7 and 8.1.8, acquisition costs are recognised as expenses as incurred and are offset by including cash flows in determining insurance liabilities that relate to recovery of acquisition costs.

Proposed

- 7.3 Paragraph 39 of ED/2010/8 proposes all acquisition costs be expensed when they occur and be offset to the extent of incremental acquisition costs by being included in the present value of contract liability (or asset) cash flows.
- 7.4 Appendix A proposes incremental acquisition costs are the direct and indirect costs of selling, underwriting and initiating costs of an (individual) insurance contract.

AASB staff comment

- 7.5 Acquisition costs under AGAAP include far more than ‘incremental acquisition costs’ and accordingly, growing insurance businesses will be more likely to show initial losses than contracting businesses under the ED/2010/8 proposals.

Constituent comment

- 7.6 Many constituents are concerned that ‘incremental’ acquisition costs have been too narrowly defined, which may result in different accounting outcomes arising from different organisational structures (such as agents versus in-house salespeople) when the overall costs may be very similar. This may subsequently drive companies to set up structures to achieve a desired outcome.
- 7.7 They also commented that insurance contracts are typically priced to recover non-incremental costs and the proposals could give rise to day one losses when this does not reflect the commercial reality.
- 7.8 Many constituents suggested incremental acquisition costs that are ‘offset’ should be determined at a portfolio level. Others consider all acquisition costs necessarily incurred in securing insurance contracts should be allowed to be offset.
- 7.9 One constituent noted a significant portion of the residual margin of most general insurance contracts would arise from acquisition costs.
- 7.10 One constituent noted the apparent inconsistency between the ED/2010/8 approach and the proposals relating to investment contracts under the revenue recognition ED in which incremental transaction costs are not addressed.

AASB to IASB

- 7.11 The AASB agrees that non-incremental acquisition costs and acquisition costs relating to unsuccessful underwriting efforts should be recognised as expenses when incurred however disagrees with identifying those costs at the individual contract level and believes the initial measurement should include incremental acquisition costs at the portfolio level.
- 7.12 The AASB believes the proposed approach raises several significant conceptual and practical issues, including:

- (a) consistency with the levels of aggregation (units of account) proposed in relation to other aspects of insurance contract accounting;
- (b) consistency with the overriding measurement objective; and
- (c) reliability and comparability of reported outcomes.

IASB tentative decisions

- 7.13 Contract cash flows should include those acquisition costs that relate to a portfolio of insurance contracts (February 2011).
- 7.14 The acquisition costs to be included in the initial measurement of a portfolio of insurance contracts should be all the costs that the insurer will incur in acquiring the portfolio, including costs that relate directly to the acquisition of the portfolio, such as commissions. No distinction would be made between successful efforts and unsuccessful efforts (March 2011).
- 7.15 In contrast, the FASB decided acquisition costs should be limited to costs related to successful acquisition efforts and direct costs related to the acquisition of a portfolio of contracts.

8. Outwards reinsurance contract measurement

Currently

- 8.1 This topic and reinsurance gains are not explicitly addressed in AASB 1023 or AASB 1038.
- 8.2 AASB 1023, paragraphs 10.1 to 11.1.3, requires the recognition of reinsurance premiums as expenses from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of the incidence of risk and reinsurance recoveries to be recognised as income. Paragraph 11.1.1 requires reinsurance recovery receivables to be recognised as assets to be discounted on the same basis as for claims liabilities and the insurer is required to impair claim recovery assets if there is objective evidence and the impact can be reliably measured.
- 8.3 AASB 1038, paragraph 6.1, requires the insurer to recognise reinsurance premiums as expenses, claim recoveries as income and claim recoveries receivables as assets.

Proposed

- 8.4 ED/2010/8, paragraphs 43 to 45, proposes that reinsurance contract assets be measured as the present value of fulfilment cash flows, including consideration of non-performance risk. If the present value is less than zero, establish a residual margin. If the present value is greater than zero, recognise a gain, which in some cases will offset an upwards revision to claims liabilities on related direct insurance contracts.

AASB staff comment

- 8.5 The gain that might be recognised in some cases under ED/2010/8 seems inconsistent with prohibiting day one gains on direct insurance contracts.

- 8.6 The IASB thinks reinsurance gains will be rare (although that's not necessarily been the case in Australia and New Zealand) and ironically they may be more likely under ED/2010/8 proposals because they mainly arise from the reinsurer having greater diversification, yet direct insurers would be restricted to diversification within portfolios.
- 8.7 The IASB's logic is that there cannot be a 'negative residual margin' (on the balance sheet) so a gain should be recognised.
- 8.8 The impairment of reinsurance claim recoveries under AASB 1023 is consistent with the incurred loss model, and the ED/2010/8 proposals are consistent with the IASB's proposed expected loss model for financial assets at amortised cost.

Constituent comment

- 8.9 Most constituents agreed with the proposal for an expected loss model for reinsurance contracts.
- 8.10 Some constituents argued that consistent assumptions should be applied in measuring reinsurance contract assets and related insurance contract liabilities and any gain initially recognised on a reinsurance contract should be capped at the amount of a loss recognised on initial recognition of the underlying direct contracts.
- 8.11 Others did not support recognising a day-one gain on purchasing a reinsurance contract, consistent with the accounting for the underlying direct insurance contracts. Concern was expressed that the proposal could encourage the structuring of reinsurance transactions to allow cedants to recognise immediate gains.
- 8.12 One constituent noted that the use of the simplified model should be permitted when the cedant applies this model to the underlying direct insurance contracts.

AASB to IASB

- 8.13 The AASB expressed concerns about the IASB's justifications for proposing that negative residual margins arising from insurance contracts be recognised by the direct insurer as a gain noting that, in contrast to the reasons outlined in paragraph BC236, in some jurisdictions, such as Australia and New Zealand, reinsurance arrangements often give rise to negative residual margins on the inception of reinsurance contracts. In addition, under the proposals, insurers would not be permitted to reflect diversification benefits across their portfolios in accounting for direct insurance contracts, but would paradoxically be required to reflect the effects of the diversification benefits experienced by insurers in accounting for their reinsurance arrangements.
- 8.14 The AASB also expressed concern regarding the consistent treatment of direct contracts and underlying reinsurance contracts noting, in some cases, insurance contracts that would be considered short-duration in nature are covered by 'umbrella' or 'risk-attaching' reinsurance contracts, which run for more than one year. An accounting mismatch could arise under the proposals if the direct insurance contracts were measured using a premium allocation approach whereas the associated reinsurance contract were measured using the comprehensive measurement model.

IASB tentative decisions

8.15 No further decisions have been made by the IASB.

9. Pre-claims liability for short-duration contracts

Currently

- 9.1 AASB 1038 does not distinguish between pre-claim liabilities and claims liabilities and an 'accumulation' approach is only permitted when it gives the same outcome as a prospective cash flows approach.
- 9.2 AASB 1023, paragraph 4.3, requires premium revenue to be initially measured at the amount of deferred premium, which is recognised in the income statement over the contract period in accordance with the pattern of the incidence of risk expected. Paragraph 9.1 imposes a liability adequacy test and, if the present value of expected cash flows exceeds unearned premium, a loss is recognised immediately.

Proposed

- 9.3 Paragraphs 54 to 60 of ED/2010/8 identify short-duration contracts as having a coverage period of approximately one year or less, and the contract must not contain an embedded option. An insurer would be required to initially measure the pre-claims liability as the premiums received less incremental acquisition costs. Subsequently the pre-claims obligation would be 'amortised' to income over the coverage period based on the passage of time or the expected pattern of claims and benefits when that differs significantly from the passage of time. This is called the 'modified measurement approach'.
- 9.4 An insurer would accrete interest on the pre-claims liability using the time value discount rate.
- 9.5 If the present value of the fulfilment cash flows exceeds the remaining liability (deferred premiums), the insurer would need to recognise the loss immediately.

AASB staff comment

- 9.6 The AASB 1023 premium deferral approach to pre-claims liabilities is highly similar to the ED/2010/8 approach to short-duration contracts.
- 9.7 A key difference is the ED/2010/8 proposal that interest be accreted to the deferred premiums, which is based on the theory that policyholders are helping to fund the insurer by paying premiums in advance.

Constituent comment

- 9.8 A number of constituents are concerned insurers with both short and long-duration contracts would need to apply two measurement models for pre-claims liabilities, and that this would give rise to unnecessary complexity and cost.
- 9.9 Some constituents expressed concern about highly similar contracts with coverage periods that are slightly shorter or longer than 12 months being treated differently.

- 9.10 There was considerable support expressed for requiring insurers to apply the comprehensive measurement model, but permitting them to apply the unearned premium approach where it would give the same or similar reporting outcomes. In contrast, others supported requiring the modified measurement approach when the relevant criteria are achieved to help ensure comparability of financial information between companies with broadly similar portfolios and so that insurers with only short-duration contracts need not worry about the comprehensive measurement model in relation to pre-claims liabilities.
- 9.11 Some constituents are concerned about having different measurement models for short-term direct insurance and reinsurance contracts.
- 9.12 Some constituents consider accreting interest on short-duration insurance contracts is inconsistent with the view that a premium allocation approach is simplified or short-cut method for measuring particular types of insurance contracts and is unlikely to significantly affect reported amounts because the discounting period will be short.
- 9.13 One constituent noted that insurers applying the modified approach should be able to add a risk adjustment to the assessment of future cash flows in considering whether or not the contract is onerous, consistent with the notion of fulfilment.

AASB to IASB

- 9.14 The AASB agreed with the proposal to introduce a modified measurement approach however disagreed with requiring such an approach to be applied to some short-duration insurance contracts. The AASB noted that requiring such an approach is inconsistent with principles-based standard setting and a premium allocation approach is generally regarded as a short-cut method of accounting for short-duration insurance contracts that provides a cost-beneficial measure of the pre-claims liabilities for such contracts. Therefore requiring insurers to use such an approach for short-duration insurance contracts introduces an inappropriate 'bright line' into the accounting requirements which, in turn, is likely to give rise to inconsistencies in the treatment of similar types of insurance contract.
- 9.15 The AASB notes the proposals would prevent an insurer from applying the proposed comprehensive measurement approach even when the comprehensive approach would provide more relevant and/or reliable information for users. The current proposals would also prevent an insurer with both short-duration and long-duration insurance contracts from using the same measurement model for all of its pre-claims liabilities, even when their short-duration (or alternatively long-duration) contracts comprise a relatively small proportion of their overall insurance business.
- 9.16 The AASB also noted concerns regarding criteria for recognising onerous contracts and the implications of requiring short-duration insurance contracts to be aggregated into a portfolio and, within a portfolio, by similar dates of inception. These proposals could increase the volatility of an insurer's reported results above what might otherwise be case if they were required to apply the proposed onerous contract test to groups of contracts that are subject to broadly similar risks and managed together as a single pool.

- 9.17 The AASB also disagreed with requiring accretion of interest on the pre-claims liabilities of all short-duration insurance contracts measured using a premium allocation approach stating the approach is inconsistent with the view that a premium allocation approach is a simplified or short-cut method for measuring particular types of insurance contracts; and it is unlikely to significantly affect the amounts reported by insurers in relation to insurance contracts because the discounting period will generally be short.
- 9.18 The AASB expressed concern about applying the premium allocation approach to contracts written on a 'claims made' basis, such as some professional indemnity insurance contracts. The coverage period may be one year or less but claims may arise many years after the insured event has occurred. The AASB recommends the IASB clarify how insurance contracts written on a claims-made basis would be treated.

IASB tentative decisions

- 9.19 Discounting of insurance liabilities should not be required when the effect of discounting would be immaterial (March 2011).
- 9.20 April 2011 meeting:
- (a) Consider whether the pre-claims obligation should reflect the time value of money, based on the tentative decision in the revenue recognition project on reflecting the time value of money.
 - (b) Reduce the measurement of the pre-claims obligations over the coverage period as follows:
 - (i) on the basis of time, but
 - (ii) on the basis of the expected timing of incurred claims and benefits if that pattern differs significantly from the passage of time.
 - (c) Perform an onerous contract test if facts and circumstances indicate that the contract has become onerous in the pre-claims period.
 - (d) Deduct from the pre-claims obligation measurement the acquisition costs that would be included in the measurement of the insurance contract liability under the building block approach.

10. Residual Margin Unit of Account*

Currently

- 10.1 The unit of account of the residual margin is not directly relevant in AASB 1023 but based on paragraph 9.1, the unit of account more generally is by portfolio (contracts subject to broadly similar risks and managed together as a single portfolio) – often based on APRA categories.
- 10.2 Similarly in AASB 1038, though the unit of account is not directly relevant based on paragraph 8.6.2, the unit of account is each group of related products, being products

that have substantially the same contractual terms and were priced on the basis of substantially the same assumptions.

Proposed

10.3 ED/2010/8, paragraph 20, proposes the residual margin is determined at the portfolio of contracts level and, within a portfolio, by similar date of inception and coverage period.

AASB staff comment

10.4 The proposal in ED/2010/8 is consistent with a general theme in recent IASB EDs (such as ED/2009/12 on financial asset impairment) that date of inception is important in determining the relevant unit of account. This kind of ‘closed portfolio’ approach may not always match the manner in which insurers do business.

Constituent comment

10.5 Many constituents believed that recognising the determination of the residual margin at the contract level is impracticable and the proposed approach virtually equates to the contract level in practice, and may involve further analysing thousands of individual portfolios to a great level of detail. The focus should be on establishing principles which practically reflects how a company or group manages and prices its insurance risks.

10.6 Some constituents noted the measurement of the residual margin at a cohort level is inconsistent with the measurement of the risk adjustment which is calculated at the portfolio level and the measurement of insurance contracts at each level of the building block approach should be the same level of aggregation.

10.7 One constituent noted that estimating the residual margin based on ‘time cohorts’ would become increasingly unwieldy over time for contracts that can be as long as 20 years and that very few existing IT systems would be able to cope.

AASB to IASB

10.8 Strongly disagree with the proposed subsequent treatment of residual margins for the following reasons

- (a) the proposed treatment of residual margins is inconsistent with the proposed treatment of residual margins at inception;
- (b) the proposed treatment would potentially cause profit recognition to be influenced more by the assumptions used to measure insurance contract liabilities than actual experience; and
- (c) The proposed approach would give rise to anomalous outcomes in some relatively common circumstances.

10.9 The proposal to aggregate residual margins on the basis of portfolios of contracts that have similar dates of inception and similar coverage periods is probably necessary to enforce the notion that residual margins are locked in. However, the AASB notes that these proposals have a number of other consequences, in particular, restricting portfolios to groups of contracts that:

- (a) are subject to broadly similar risks and managed together by the insurer as a single pool; and
- (b) have similar dates of inception (short-duration insurance contracts); or
- (c) have similar dates of inception and similar coverage periods (all insurance contracts other than those measured using a premium allocation approach);

is likely to cause insurers to recognise a significantly larger number of portfolios than they otherwise would if they were only required to group insurance contracts on the basis of similar risks. This is because insurers often identify and manage portfolios that comprise contracts with similar risks and have similar durations (a form of ‘open’ portfolio) rather than similar dates of inception.

10.10 Whilst the proposals may seemingly have the potential to increase comparability between insurers’ portfolios, it is likely that the phrase ‘similar dates of inception’ will garner a broad range of meanings in practice, thereby undermining any potential comparability benefits.

IASB tentative decisions

10.11 February 2011 meeting:

- (a) The IASB confirmed that an insurer should not recognise any gain at inception of an insurance contract.
- (b) An insurer should recognise any loss on day one immediately when it occurs, in profit or loss.
- (c) In general the final standard will measure insurance contracts at the portfolio level and will consider the level of aggregation for the residual margin at a future meeting.

11.1 Presentation and Disclosure – Statement of Financial Position

Currently

11.1.1 AASB 1023 and AASB 1038 each require a substantial number of disclosures relating to the statement of financial position and they are too numerous to list here. Suffice to say, the focus of most of the disclosures is on the make-up of the claims liabilities.

11.1.2 With the exception of mandating that reinsurance assets and liabilities need to be presented gross, neither Standard is specific about whether the required disclosures must be made on the face of the statement or in the notes.

11.1.3 AASB 1038 also requires disaggregated information by statutory fund and by unit-linked versus non-unit linked and retained earnings to be split between the amount wholly attributable to shareholders and the amount for which the allocation between policyholders and shareholders is yet to be determined.

Proposed

11.1.4 ED/2010/8, paragraphs 69 to 71, proposes to require the following on the face of the statement of financial position:

- each portfolio as a single line item within insurance contract assets or liabilities;
- reinsurance is shown gross;
- pool of assets underlying unit-linked contracts shown as a single line item and not commingled with other assets;
- portion of unit-linked liabilities linked to pool of assets as a single line item and not commingled with the insurer's other insurance contract liabilities.

AASB staff comment

11.1.5 The level of proposed disclosure is similar to that currently required by AGAAP, but the ED/2010/8 proposals are more definitive about where it must be presented.

11.2 Presentation – Statement of Comprehensive Income

Currently

11.2.1 AASB 1023, paragraph 17.1, requires the following, and implies that they should be presented on the face of the income statement:

- premium revenue (direct)
- reinsurance premium revenue
- reinsurance and other recoveries
- net claims incurred showing separately:
 - amount for risks borne in current period
 - amount for reassessment of risks borne in previous periods
- underwriting result
- gross claims incurred (undiscounted)
- reinsurance and other recoveries (undiscounted).

11.2.2 AASB 1038, paragraphs 16.1, 17.1, 17.2 and 18.1, require a substantial number of disclosures relating to the statement of income and they are too numerous to list here. Suffice to say, the focus of most of the disclosures is on the components of the changes in claims liabilities and disaggregations by statutory fund.

Proposed

11.2.3 ED/2010/8, paragraphs 72 to 78, proposes to require the following line items on the face of the statement of comprehensive income:

- underwriting margin, showing separately either in the statement or the notes:

- change in risk adjustment
- release of residual margin
- gains and losses at initial recognition disaggregated either in the statement or in the notes into:
 - losses on portfolio transfers
 - gains on reinsurance contracts bought by a cedant
 - losses at initial insurance contract recognition
- non-incremental acquisition costs
- experience adjustments and changes in estimates, disaggregated either in the statement or in the notes into:
 - differences between actual cash flows and estimates (experience adjustments)
 - changes in estimates (cash flows and discount rates)
 - reinsurance impairments
- interest on insurance contract liabilities
- Separately for short-duration contracts accounted for using a deferred premiums approach:
 - underwriting margin disaggregated by premiums, claims, expenses, and acquisition cost amortisation
 - changes in additional liabilities for onerous contracts.
- present all income and expense from insurance contracts in profit or loss.
- separately, income / expense for:
 - unit-linked contract liabilities
 - assets underlying unit-linked contracts
- reinsurance – show gross.

AASB staff comment

11.2.4 The emphasis in ED/2010/8 is on presenting the components of profit on the face of the income statement.

Constituent comment (relating to sub-sections 11.1 and 11.2)

11.3.1 Whilst there was general support expressed for the summarised margin presentation the following concerns were raised by constituents.

- (a) The value of the financial reporting would be weakened if diversified groups that include insurers are required to present parts of their business on a summarised margin basis.

- (b) Volume information such as gross written premiums, earned premiums, claims incurred, commissions and expenses is very important for analysts and other users monitoring entity growth and business performance and should be presented in the income statement.
- (c) The summarised margin information provides more of an actuarial view and could be presented in the notes.
- (d) Margin presentation may not be relevant to general insurers as explicit margins are not required for pre-claims liabilities under the modified approach.
- (e) The proposed standard should indicate how reinsurance balances should be presented in the statement of comprehensive income to ensure a consistent approach.
- (f) For short-duration contracts where the underwriting margin is expanded in the statement of comprehensive income, it needs to be clear whether differences in the initial estimate of claims incurred are presented in the claims incurred line within the underwriting margin or in the experience adjustment line.
- (g) Small changes in gross items could have significant impacts on the net amounts, notwithstanding that the long-term trends remain relatively constant and therefore users might be misled by insurers putting too much emphasis on net rather than gross information.

AASB to IASB (relating to sub-sections 11.1 and 11.2)

- 11.4.1 The AASB agrees the summarised margin information would be useful to users as it would link clearly with the proposed comprehensive measurement model.
- 11.4.2 However, the AASB is concerned that some diversified financial institutions would face significant challenges in integrating summarised margin information on the face of the income statement with the results from their other (non-insurance) activities. The AASB recommends an insurer be permitted to disclose the summarised margin information on the face or in the notes. Accordingly, 'volume' type information in relation to premiums, claims, benefits and other insurance-related expenses could be presented on the face of the statement of comprehensive income.

IASB tentative decisions (relating to sub-sections 11.1 and 11.2)

- 11.5.1 No further decisions have been made by the IASB.

11.6 Presentation – Other Comprehensive Income*

Currently

- 11.6.1 Under AASB 1023 and AASB 1038 all changes in insurance liabilities that are recognised as they occur are presented in profit or loss.

Proposal

11.6.2 ED/2010/8, paragraph 76, proposes that an entity present all income and expense from insurance contracts in profit or loss.

AASB staff comment

11.6.3 The proposal in ED/2010/8 and AGAAP are consistent.

Constituent comment

11.6.4 No specific comments were received on this topic.

AASB to IASB

11.6.5 The AASB made no comments on this topic.

IASB tentative decisions

11.6.6 In May 2011 the IASB has been considering concerns expressed by (mainly European) constituents that ED/2010/8 about the accounting mismatch that would arise when the assets backing insurance contracts are measured at amortised cost or FVTOCI under IFRS 9, and similarly when the assets are non-financial assets, especially investment property, measured at cost.

11.6.7 The IASB has noted that the Basis for Conclusions to ED/2010/8 concludes an insurer could avoid accounting mismatches by using the options provided in IFRSs to measure assets at fair value. However, many constituents disagreed with forcing insurers to use fair value options to remove a mismatch when other entities can use cost for their assets.

11.6.8 The IASB has considered an IASB staff proposal to address these concerns. The proposal is to present changes in insurance liabilities using a locked-in discount rate in profit or loss, with the effects of the difference between the current discount rate and the locked-in rate presented in OCI.

11.6.9 The IASB has not yet made any decisions on this matter.

Further AASB staff comment

11.6.10 The IASB staff paper on the proposal argues that some would consider the change in insurance liabilities without the impact of interest (discount) rate changes would represent underlying performance from insurance contracts (in profit or loss).

11.6.11 AASB staff oppose the proposal on the basis that:

- (a) discount rates and changes in those rates are an integral part of insurance business and should be reflected in the measurement and remeasurement of insurance liabilities to show the impact of economic conditions on insurers;
- (b) it would complicate the measurement of insurance liabilities and entrench the idea that portfolios of insurance contracts need to be tracked by date of inception; and
- (c) it would discourage the use of fair value for measuring assets.

12. Other General Disclosures

Currently

12.1 AASB 1023, paragraphs 17.6 to 17.6.6 and 17.7 to 17.7.5, currently requires general insurers to disclose the following:

- information that identifies and explains amounts arising from insurance contracts, including gross claims, deferred acquisition costs, direct premiums, direct claims expense, acquisition costs expense to be disclosed in the financial accounts; and
- information that enables users to evaluate nature and extent of risks arising from insurance contracts, including information about sensitivity to various assumptions, concentrations of risk and claims development (comparing actual with estimated claims)

12.2 AASB 1038, paragraphs 14.1 to 15.1.3, currently requires life insurers to disclose the following:

- information that identifies and explains amounts arising from insurance contracts, including gross claims, deferred acquisition costs, direct premiums, direct claims expense, acquisition costs expense
- information that enables users to evaluate the nature and extent of risks arising from insurance contracts, including information about sensitivity to various assumptions, concentrations of risk.

12.3 AASB 4, paragraph 39(c)(iii), requires a claims development table covering up to ten years when the uncertainty about the amount and timing of claims typically remains unresolved beyond one year (that is, some general insurance contracts).

Proposal

12.4 ED/2010/8, paragraphs 79 to 97, proposes insurers to include the following disclosures in their financial statements:

- qualitative and quantitative information about:
 - amounts arising from insurance contracts
 - nature and extent of risks arising from insurance contracts
- information to help users evaluate the timing, amount and uncertainty of future cash flows from insurance contracts, including [LISA, IS THIS BY PORTFOLIO?]:
 - reconciliation from opening to closing contract balances
 - methods and inputs used for measurement
 - confidence levels
- this includes sensitivities to changes of variables and concentrations of risks, and other disclosures similar to those required by IFRS 7

- claims development for no longer than 10 years.

AASB staff comment

12.5 Although the wording is different between the AASB Standards and ED/2010/8, they share many of the same disclosure notions.

12.6 It is relevant to note that the IASB developed its ED/2010/8 proposals from the existing IFRS 4 disclosures.

Constituent comment

12.7 Whilst there was general support expressed for the proposed disclosure principles in the ED, as outlined below, many constituents believed the level of disclosure to be onerous and that many of the disclosures would be of little value to users.

- (a) There appears to be a significant amount of overlap with the disclosures required by IFRS 7 and that disclosure seems excessive. The proposed level of disclosure may make it more difficult for the user of the financial statements to identify the more useful disclosures, e.g. insurance risk disclosures.
- (b) Disclosing reconciliations on a portfolio-by-portfolio basis [LISA, SEE COMMENT ABOVE] because some insurers would have hundreds of portfolios (based on the proposals).
- (c) One constituent recommended requiring disclosures of:
 - (i) a reconciliation of deferred acquisition costs;
 - (ii) the impact of assumption changes, quantified where feasible, for life insurance contracts;
 - (iii) the termination rate versus the incident rate for life insurance contracts; and
 - (iv) the five key assumptions that have the most significant impact on an insurer's reported results.
- (d) Several constituents felt the disclosures need to be field tested.
- (e) The differing degrees of risk between entities where the insurance is core and non-core should be considered and the level and type of disclosure should reflect this.
- (f) Elements related to discretionary participating contracts included in equity should be disclosed separately.
- (g) The IASB needs to align the disclosure requirements in the replacement standard in relation to the sensitivity analysis with the corresponding disclosure principles in the revised versions of IAS 19 *Employee Benefits* for defined benefit obligations and IFRS 7 *Financial Instruments: Disclosure* for level 3 fair value measurements.
- (h) It may be simpler and clearer for users to require a sensitivity analysis of the impact on profit or loss of changes in relevant risk variables (such as mortality,

morbidity and maintenance assumptions), and rely on the disclosure requirements of AASB 101 on sources of estimation uncertainty.

- (i) The IASB should consider whether the disclosure of undiscounted claims should be net or gross of reinsurance or whether both should be required.

AASB to IASB

12.8 The AASB agrees with the proposed disclosure principles, but recommends the IASB seek to align, to the extent feasible, the disclosure requirements in the replacement Standard for IFRS 4 in relation to sensitivity analysis with the corresponding disclosure principles in the revised versions of IAS 19 for defined benefit obligations and IFRS 7 for level 3 fair value measurements.

IASB tentative decisions

12.9 March 2011 meeting:

- (a) align the wording of the disclosure objectives in active projects (revenue recognition, leases and insurance contracts).
- (b) ‘An entity would be required to present in tabular format any roll forward retained by or added to disclosure requirements.’

13. Transition

Proposed

- 13.1 ED/2010/8, paragraphs 98 – 100, proposes requiring, as at the beginning of the earliest period presented, with a corresponding adjustment to retained earnings, measurement of each portfolio of insurance contracts at the present value of the fulfilment cash flows with no residual margin on existing business and derecognition of any existing balances of deferred acquisition costs and any intangibles arising from insurance contracts assumed in previously recognised business combinations.
- 13.2 Redesignation of financial assets as measured at FVTPL would be permitted if this would eliminate mismatch or reduce inconsistency in measurement or recognition.

AASB staff comment

- 13.3 The proposals are effectively a mixture of retrospective and prospective transitional adjustments. Some life insurers will have business carried forward that incorporates profits that would otherwise be recognised over the remaining lives of the contracts but that, on transition, would need to be taken direct to retained earnings.
- 13.4 IASB has discussed that periods beginning on or after 1 January 2013 would be the earliest that a new Standard would apply, and it could be later, particularly if the IASB timeline of issuing a Standard by the end of calendar 2011 is not met. An effective date of 1 January 2014 or beyond seems more likely

Constituent comment

- 13.5 Several constituents believe eliminating existing residual margins against opening retained earnings would have a detrimental effect on short to medium term profitability, significantly artificially understating the profitability of the transition portfolio. The proposed approach may result in a life insurance business appearing less profitable, adversely impact insurance company valuations and impact the ability of insurers to raise capital.
- 13.6 Constituents noted the proposed transition provisions may result in investors having difficulties assessing the true profitability of an insurer and limit the investor's ability to accurately value the company or identify better performing insurers.
- 13.7 Most constituents prefer the IASB's 'normal' position under IAS 8 (retrospective application, subject to impracticability), or at least an option to use IAS 8.
- 13.8 One constituent noted that if the contract boundary definition as currently proposed is adopted, it is expected that 40 – 50% of private health insurance businesses will not report a material profit, even after 10 years, which would not be meaningful.
- 13.9 Several constituents noted that the proposed provisions may have tax and prudential reporting consequences.
- 13.10 A constituent noted transition arrangements should provide guidance for past business combinations where the present value of fulfilment cash flows exceeds the fair value of the insurance contract liability and recommends the positive difference between the fair value and the fulfilment value on past acquisitions treated as an adjustment to goodwill.
- 13.11 Several constituents noted that grandfathering the accounting for residual margins under IFRS 4 would not achieve consistency because IFRS 4 permits different practices, depending on national GAAPs.
- 13.12 Several constituents noted that comparability across jurisdictions is arguably ambitious in the context of insurance contracts and in some respects not justified, particularly as the results from in-force and new business are generally not comparable and felt the IASB should be more concerned about whether insurers can apply the proposed model in a way that facilitates the provision of reliable information.
- 13.13 Many constituents felt the effective dates of IFRS 4 and IFRS 9 should be aligned due to the two standards being interrelated. Others disagreed because this would mean that an entity with insurance and non-insurance activities could have two IFRS 9 adoption dates.

AASB to IASB

- 13.14 The AASB noted its preference for the IASB's 'normal' position under IAS 8, namely retrospective application where practicable, even though it would potentially reduce comparability.

- 13.15 In regards to determining the remaining amount of residual margins in relation to in-force business at the date of transition, the AASB agreed it would be inappropriate for insurers to use hindsight to determine prior period assumptions to measure insurance liabilities. However, it may be possible for some insurers to apply the proposed model to in-force business on the date of inception.
- 13.16 The AASB further noted the IASB should consider whether insurers could be permitted to transition into the new reporting requirements by using a fair value measurement of the residual margins in their insurance liabilities for the first day of the earliest comparative period presented.
- 13.17 The AASB agrees that insurers should not face two rounds of major changes in a short period and be able to avail themselves of the measurement choices under IFRS 9 to avoid potential accounting mismatches that might arise as a consequence of transitioning from their domestic GAAP to the replacement standard for IFRS 4. However the AASB noted the proposal to delay the effective date of IFRS 9 would potentially impose two effective dates for IFRS 9 on entities with both insurance and non-insurance activities and accordingly the AASB considers that, if IASB were to delay the effective date of IFRS 9 for insurers, the replacement IFRS 4 standard should permit an insurer to apply IFRS 9 earlier in accordance with the requirements of IFRS 9.

IASB tentative decisions

- 13.18 At the March 2011 meeting the IASB indicated they would determine the effective date by taking into account the significance of the accounting changes required and the methods of transition and would provide adequate time for stakeholders to apply the new requirements.