Australian Government
Australian Accounting Standards Board

Memorandum

To:	AASB Members	Date:	4 April 2014
From:	Sue Lightfoot	Agenda Item:	9.2 (M137)
Subject:	Insurance Contracts: Project Update	File:	

Action

Receive an update on the IASB's *Insurance Contracts* project.

Background

At its March 2014 meeting, the IASB made tentative decisions concerning its *Insurance Contracts* project.

The tentative decisions are only in relation to non-participating contracts and concern two of the five proposals the IASB specifically sought views on in its revised Exposure Draft ED/2013/7 *Insurance Contracts*. A staff analysis of the decisions is included in the Appendix to this memo.

The AASB submission to the IASB, dated 31 October 2013, can be located on the AASB website here.

Next steps

At a later meeting the IASB will consider participating contracts (and whether there would be any impact on non-participating contracts).

The IASB expects to consider issues related to revenue, and other issues raised in the response to ED 2013/7 on which the IASB did not specifically ask for input.

The most recent IASB work plan identifies that the IASB is redeliberating on Insurance Contracts in Q1 2014. No further timing is indicated concerning finalisation of a Standard.

AASB staff will continue to monitor the IASB's progress and contribute to IASB's work when relevant.

IASB Tentative Decision on Disclosures

As noted in the analysis of the IASB's tentative decisions in the Appendix to this memo, AASB staff have concerns about one of the tentative decisions concerning disclosure.

One of the key concerns of the AASB about the proposals in ED/2013/7 was the IASB's proposal to require entities to recognise in other comprehensive income (OCI), the difference between the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date and using the discount rates that applied at the date that the contract was initially recognised (‘the amount’).

The IASB has tentatively decided to provide an accounting policy choice (i.e. not to mandate presentation of the amount in OCI). However, the IASB has tentatively decided that entities that do not present the amount in OCI would still be required to disclose the amount[1].

AASB staff are concerned that, although entities would be able to choose to present changes in the measurement of insurance contract liabilities in profit or loss, the disclosure requirements would still require the discount rate at inception of insurance contracts to be tracked for disclosure purposes. Systems and processes would therefore need to be in place to capture the amount. Furthermore, AASB staff question whether such a disclosure is consistent with the recognition and measurement accounting policy of an entity that chooses to recognise the amount in profit or loss.

AASB staff recommend that the Board writes to the IASB to express concerns over the tentative decisions on this disclosure.

Question to Board members: Does the Board agree with the staff recommendation?

1 Refer in the Appendix to this memo to IASB tentative decision c) i) 3) under the heading ‘Recognising the effects of changes in the discount rate in other comprehensive income.

IASB Tentative Decisions on Insurance Contracts (concerning non-participating contracts only)

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
Unlocking the contractual service margin (CSM)		
(a) to confirm the proposals in ED/2013/7 that after inception: (i) differences between the current and previous estimates of the present value of cash flows related to future coverage and other future services should be added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and (ii) differences between the current and previous estimates of the present value of cash flows that do not relate to future coverage and other future services should be recognised immediately in profit or loss.	1.1 The AASB supports the proposal that **the impact on the CSM of a difference between assumed and actual experience is recognised immediately in profit or loss on the basis that it relates to risks borne in the period. The AASB also supports the proposal that the impact on the CSM of a change in assumptions is recognised as an adjustment to the CSM on the basis that it relates to risks to be borne in future periods** and can be regarded as akin to a new policy being written at reporting date for the remaining period of the relevant contracts. 1.2 The AASB **supports the proposal that the CSM cannot be negative** (paragraph 30(d)(ii)) **and that any further projected deterioration is recognised immediately in profit or loss** (paragraph 31)...	The IASB tentative decisions are in line with the comments from the AASB.
(b) that favourable changes in estimates that arise after losses were previously recognised in profit or loss should be recognised in profit or loss to the extent that they reverse losses that relate to coverage and other services in the future.	1.2 …However**, the AASB recommends that the IASB also address accounting the reversal of circumstances that gave rise to losses. The AASB would expect this to involve reversing the effects of previous loss recognition,** which (depending on the extent of subsequent improvements in expected cash flows related to future coverage) **could involve recognising gains in profit or loss and** 'rebuilding' the CSM. This would be consistent with the requirements for the reversal of impairment losses in	The IASB tentative decisions are in line with the comments from the AASB.

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
	IAS 36 Impairment of Assets and the requirements for the reversal of provisions in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*	
(c) that differences between the current and previous estimates of the risk adjustment that relate to future coverage and other services should be added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative. Consequently, changes in the risk adjustment that relate to the coverage and other services provided in the current and past periods should be recognised immediately in profit or loss.	1.12 The AASB notes that a likely major source of future profits relates to bearing risk in future periods. Accordingly, the AASB recommends that an improvement be made to the proposals to require **a change in the risk margin relating to future coverage to be adjusted to the CSM**. **The change in the risk margin that relates to past coverage would continue to be required to be recognised in profit or loss immediately**. For those entities that consider it is not feasible to allocate changes in the risk margin between that which relates to past and future coverage, the AASB recommends that the IASB provides an 'impracticability' concession similar to that proposed as part of the transition requirements.	The IASB tentative decisions are in line with the comments from the AASB.
Recognising the effects of changes in the discount rate in other comprehensive income (OCI)		
(a) that an entity should choose to present the effect of changes in discount rates in profit and loss or in other comprehensive income as its accounting policy and should apply that accounting policy to all contracts within a portfolio, subject to developing: (i) guidance that entities should apply the same accounting policy to groups of similar portfolios, and (ii) guidance that this would provide rigour about when entities could change accounting policies based on the requirements for changing accounting policy in IAS 8 *Accounting Policies,*	4.1 …**the AASB recommends that the IASB 'default' requirement should be a current measurement basis for insurance liabilities with changes recognised in profit or loss (or CSM as applicable). However the AASB could support the IASB providing an option to present changes in discount rate in OCI that insurers could elect to use** for insurance activities of an entity on transition to the revised insurance contracts standard.	The IASB tentatively decided that there would be no default approach (between profit or loss or OCI) to presentation of changes in the effect of the discount rate of insurance contract liabilities. The effect of the tentative decision is similar to the recommendation of the AASB in supporting both profit or loss and OCI presentation to be available.

<table>
<tr><th>IASB Tentative Decisions</th><th>Comment from AASB Submission to IASB (emphasis added in bold)</th><th>AASB staff comment</th></tr>
<tr><td>Changes in Accounting Estimates and Errors.

(b) If the entity chooses to present the effect of changes in discount rates in other comprehensive income, that an entity should recognise:

(i) in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised; and

(ii) in other comprehensive income, the difference between the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date and the carrying amount of the insurance contract measured using the discount rates that applied at the date the contract was initially recognised.</td><td></td><td>However the AASB had a number of concerns about the use of OCI – see below.</td></tr>
<tr><td>(c) that an entity should disclose the following information:

(i) For all portfolios of insurance contracts: an analysis of total interest expense included in total comprehensive income disaggregated at a minimum into:

1 the amount of interest accretion determined using current discount rates;

2 the effect on the measurement of the insurance contract of changes in discount rates in the period; and

3 the difference between the present value of changes in expected cash flows that adjust</td><td>The comment in paragraphs 4.16 to 4.18 below were given in the context of presenting amounts in OCI, however also appears applicable to the IASB's tentative decisions on disclosure:

Tracking

4.16 The proposal would involve identifying and tracking discount rates from contract inception for the life of a policy or claims liability, which could be up to 60 years.

4.17 In theory, the unit of account should be either each contract or a portfolio of similar contracts determined by when the discount rate changes in a manner that would have a material impact, which could be many times within a reporting period. Otherwise, the objective of an amortised cost interest expense would</td><td>AASB staff are concerned that the disclosure in c) i) 3 are inconsistent with an approach of recognising changes in insurance contract liabilities in profit or loss.

A second reason for the concern is that in order to determine the amounts to disclose, an entity would need to identify and track discount rates from contract inception for the life of a policy or claims liability.

Therefore despite not being required to determine an amount to be recognised in OCI, an entity</td></tr>
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IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
the contractual service margin in a reporting period when measured using discount rates that applied on initial recognition of insurance contracts, and the present value of changes in expected cash flows that adjust the contractual service margin when measured at current rates. (ii) In addition, for portfolios of insurance contracts for which the effect of changes in discount rates are presented in other comprehensive income: an analysis of total interest expense included in total comprehensive income disaggregated at a minimum into: 1 interest accretion at the discount rate that applied at initial recognition of insurance contracts reported in profit or loss for the period; and 2 the movement in other comprehensive income for the period.	not be met. 4.18 However, presumably, entities would need to take a pragmatic view the unit of account employed for tracking discount rates to make systems costs manageable. That pragmatic view might involve quarterly or half-yearly cohorts. Even so insurers are likely to have hundreds, and possibly tens of thousands, of cohorts of contracts to track. And different entities are likely to come to different pragmatic solutions creating another source of non-comparability. **Depending on how the IASB explains the unit of account for tracking discount rates, the systems issues for insurers could be overwhelming.** 9.1 The AASB is also concerned about the proposed disclosures, which we consider are too detailed and would clutter the financial statements. **The AASB supports disclosure of the key amounts underlying the changes in insurance liabilities for the period, including that due to changes in discount rate and other significant drivers of the result if material**. In particular, the requirements for reconciliations in paragraphs 74 to79 of ED/2013/7 seem particularly burdensome. 9.2 …the AASB encourages the IASB to rationalise the extent of identified disclosures…	would still be required to put in place systems and processes to calculate that amount. The AASB comment letter supported disclosure of key amounts for the period – rather than amounts tracked from contract inception.