



# Memorandum

<b>To:</b>	<b>AASB members</b>	<b>Date:</b>	7 October 2014
<b>From:</b>	<b>Sue Lightfoot</b>	<b>Agenda Item:</b>	8.1 (M141)
<b>Subject:</b>	<b>Insurance Contracts: Consider Key Issues</b>	<b>File:</b>	

## Action

Consider key issues arising from recent IASB meetings on its Insurance Contracts project, and decide whether there are any issues that need to be raised with the IASB at this stage.

## Attachments

Agenda Paper 8.2      Appendix to Agenda Paper 8.1: Previous IASB redeliberations on ED/2013/7 *Insurance Contracts* (AASB ED 244) [for information only].

## Background

In November 2010, the AASB issued [ED 201 Insurance Contracts](#), which incorporated the IASB's exposure draft, ED/2010/8 *Insurance Contracts*. The comment period for IASB's ED/2010/8 closed on 30 November 2010 (the comment period for AASB ED 201 closed on 8 November 2010 and attracted 17 submissions).

The AASB submission to the IASB on ED/2010/8, dated 2 December 2010, can be located on the AASB website [here](#).

At AASB meetings held since 2010, AASB staff provided regular updates on the project incorporating tentative decisions made by the IASB.

The IASB subsequently decided to re-expose revised proposals. In June 2013, the AASB issued [ED 244 Insurance Contracts](#), which incorporated the IASB's revised exposure draft, ED/2013/7 *Insurance Contracts*. The comment period for IASB's ED/2013/7 closed on 25 October 2013 and 194 submissions were received (the comment period for AASB ED 244 closed on 27 September 2013 and attracted 12 submissions).

The revised ED sought input on five areas for which the IASB made significant changes in response to the feedback it received on its proposals in the 2010 Exposure Draft, as follows:

- (a) Adjusting the contractual service margin (CSM);
- (b) Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items;
- (c) Presentation of insurance contract revenue and expense;

- (d) Interest expense in profit or loss; and
- (e) Effective date and transition.

The AASB submission to the IASB, dated 31 October 2013, can be located on the AASB website [here](#).

## **IASB Redeliberations on ED/2013/7**

The IASB began redeliberations on ED/2013/7 in January 2014 and began making tentative decisions at its March 2014 meeting. An analysis of the tentative decisions made by the IASB on ED/2013/7 in its September 2014 meeting is given below. Comments and analysis regarding the March, April, May, June and July meetings are provided again for information purposes in the Appendix (Agenda Paper 8.2) to this memo.

As at the date of this memo, the IASB's tentative decisions are only in relation to contracts with no participating features. The IASB has indicated that its tentative decisions may be revisited at a later stage as a result of its consideration of participating contracts.

## September 2014 ASAF and AOSSG Meetings

Insurance Contracts was discussed at the September ASAF meeting on 25-26 September 2014 and the interim AOSSG meeting on 28 September 2014. The focus of those discussions was on participating contracts and transition.

As requested by the Board in its September meeting, AASB staff raised the concern with the IASB at the ASAF meeting in relation to the tentative decisions made at the IASB's July 2014 meeting regarding use of locked in rates for disclosure purposes and in respect of interest rate accretion on the CSM. AASB staff also met with IASB project staff prior to the ASAF meeting and raised the same concerns.

## IASB meeting – September 2014

### *Determination of interest expense for contracts with participating features*

In its March 2014 meeting, the IASB tentatively decided 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. In its September 2014 meeting the IASB discussed two approaches that could be used to determine the interest expense presented in profit or loss, and the effects of changes in discount rates presented in Other Comprehensive Income (OCI), to be used when an entity does not choose an accounting policy to recognise all changes in profit or loss. The two approaches are the book yield and effective yield approaches.

No decisions were made and the staff were instructed to consider variations on the approaches to bring back to a future meeting.

### *Premium-allocation approach (PAA)*

A clarification and a tentative decision were made in relation to the premium-allocation (simplified) approach. Refer to the appendix for the staff analysis.

## **Next steps**

The IASB will continue its redeliberations at its October meeting. Staff expect that redeliberations of the proposals will be completed in 2014, with the publication of a final IFRS in 2015.

## **Staff recommendation**

Staff consider that there are no further issues to raise with the IASB at this stage. Staff will continue to monitor the project.

## **Question to Board members:**

Does the Board agree with the staff recommendation?

IASB September 2014 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
<i>September 2014</i>		
<b>Premium-allocation approach: revenue recognition pattern</b>		
<p>The IASB clarified that when an entity applies the PAA to account for an insurance contract, it should recognise insurance contract revenue in profit or loss:</p> <ul style="list-style-type: none"> <li>a. on the basis of the passage of time; but</li> <li>b. if the expected pattern of release of risk differs significantly from the passage of time, then on the basis of expected timing of incurred claims and benefits.</li> </ul>	<p>No specific comment was made in relation to revenue recognition for the premium-allocation approach. However the following comments was made regarding the PAA:</p> <p>1.5 The AASB supports the proposals that <b>there be one measurement model for insurance contract liabilities and that the simplified approach for measuring insurance contract liabilities (i.e. the premium allocation approach or PAA) is a ‘reasonable approximation’ of the ‘full’ approach</b> for measuring insurance contract liabilities (i.e. the building block approach or BBA). The AASB also supports the proposed alignment of the related disclosures.</p>	<p>The clarification made by the IASB is consistent with the proposal in paragraph 32 of ED/2013/7 that ‘An entity shall recognise the remaining CSM in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract’.</p>
<b>Determination of interest expense in the premium-allocation approach</b>		
<p>The IASB tentatively decided that when an entity applies the PAA to contracts for which the entity:</p> <ul style="list-style-type: none"> <li>a. discounts the liability for incurred claims; and</li> <li>b. chooses to present the effect of changes in discount rates in OCI;</li> </ul> <p>the interest expense in profit or loss for the liability for</p>	<p>No specific comment in the AASB submission – however the following comments were made in the <a href="#">AASB letter</a> (dated 17 April 2014) to the IASB expressing concern about disclosures driven off locked-in rates:</p> <p>...the AASB has concerns about the tentative decision to require an entity to disclose the difference between the present value of changes in expected cash flows</p>	<p>Staff continue to be concerned about the tentative decisions to require entities to track rates at inception of contracts. The concerns are consistent with and those outlined in the 17 April 2014 letter to the IASB.</p>

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IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<p>incurred claims should be determined using the discount rate that is locked in at the date the liability for incurred claims is recognised.</p> <p>This tentative decision also applies to the presentation of interest expense for any onerous contract liability that is recognised when the entity applies the premium-allocation approach.</p>	<p>that adjust 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, for all portfolios of insurance contracts. The AASB considers this decision would be a major barrier to progress on a comprehensive IFRS on insurance contracts due to the operational problems it raises and for conceptual reasons.</p> <p>... from an operational perspective, entities would need to track the discount rate from inception of insurance contracts to determine the amount(s) to be disclosed to meet this requirement. Systems and processes would therefore need to be in place to identify and track discount rates from contract inception for the life of a policy or claims liability, which could be up to 60 years. To do this, entities would need to adopt arbitrary units of account (cohorts of policies) to track discount rates to make systems costs manageable. 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 that are hardly conducive to comparability. I note that a considerable number respondents to ED/2013/7 raised these operational issues.</p>	<p>The concern was raised by AASB staff at the September 2014 ASAF meeting and with the IASB project staff.</p>