



To:	AASB members	Date:	2 December 2014
From:	Sue Lightfoot	Agenda Item:	15.2 (M142)
Subject:	Appendix to Agenda Paper 15.1 – IASB Previous Tentative Decisions on ED/2013/7 Insurance Contracts	File:	

Action

This Appendix to Agenda Paper 15.1 includes the previous comments on the IASB's redeliberations on its ED/2013/7 *Insurance Contracts* and is provided to Board members for reference purposes only.

Previous IASB Redeliberations on ED/2013/7

The tentative decisions made by the IASB as at the date of this memo concern non-participating contracts only.

March 2014 (pages 6-9)

In its March 2014 the IASB discussed:

- unlocking the CSM; and
- recognising the effects of changes in the discount rate in other comprehensive income.

The Board had written a [letter](#) to the IASB in late April expressing concern about the IASB's tentative decision to require, for all portfolios of insurance contracts, disclosure of the difference between the present value of changes in expected cash flows that adjust the CSM in a reporting period:

- a) when measured using discount rates that applied on initial recognition of insurance contracts; and
- b) when measured at current rates.

The response ([agenda paper 3.6](#) of the May AASB meeting) from the IASB Chairman indicated that the IASB intends to reconsider the use of discount rates that applied on initial recognition of insurance contracts, which may lead to a change in the disclosure requirements. As at the date of this memorandum, that reconsideration has not yet taken place.

April and May 2014 (pages 10-16 and pages 17-18)

In its April 2014 meeting, the IASB considered:

- presentation of insurance contract revenue; and
- the proposed approach to other issues raised in the response to the 2013 ED that were unrelated to the five specific areas focussed on by ED/2013/7.

In its May 2014 meeting, the IASB considered:

- recognising the CSM in profit or loss; and
- fixed-fee service contracts, significant insurance risk, portfolio transfers and business combinations.

At its May 2014 meeting, the AASB decided to raise concerns with the IASB in relation to three tentative decisions made at the IASB's April and May 2014 meetings regarding non-participating contracts. Those tentative decisions were:

1. not to re-consider disclosures in future meetings;
2. not to consider the unbundling-lapse together 'rule' in future meetings; and
3. to clarify that the service represented by the CSM is insurance coverage that is provided on the basis of the passage of time and reflects the number of contracts in force.

In relation to the third concern above, the Board expressed the view that the IASB's decision to use coverage period for allocating CSM (for non-participating businesses) has three flaws or weaknesses:

- a) the allocation would not reflect a pattern of meeting a stand-ready obligation (for example, for Lenders Mortgage Insurance where the service is typically non-linear);
- b) the allocation would be inconsistent with the outcome under the simplified premium allocation approach; and
- c) insurers do not currently perform this calculation.

The Board considered that using value of expected claims would address all of the above flaws or weaknesses.

The above concerns were raised with the IASB and IASB staff at the Accounting Standards Advisory Forum (ASAF) on 2 June 2014 and a follow up [letter](#) dated 14 July was sent to the IASB reiterating the concern about allocation of the CSM.

The AASB determined that there were no other issues it wished to raise with the IASB at that stage.

June 2014 (pages 19-21)

The IASB met on 17 June 2014 and, in particular, discussed the following:

- contracts with participating contracts¹;
- discount rates when there is no observable market;
- asymmetric treatment of reinsurance gains; and
- level of aggregation.

In its July meeting the AASB determined that there were no other issues it wished to raise with the IASB at that stage.

July 2014 (pages 22-23)

The IASB met on 22 July 2014 and, in particular, discussed the following:

- the approach for determining interest expense in profit or loss for participating contracts² (education session – no tentative decisions made)
- the rate used to accrete interest and calculate the present value of cash flows that offset the CSM; and
- the restrictions on changes in accounting policy relating to the presentation of the effect of changes in discount rates.

In its May meeting the AASB indicated its concern about the IASB's tentative decision to clarify that the service represented by the CSM is insurance coverage that is provided on the basis of the passage of time and reflects the number of contracts in force. The Board expressed the view that the

1 The IASB continued its discussions on contracts with participating features by considering how it might limit the application of any alternative adaptations that it might make to its general model for insurance contract, when those adaptations would rely on the identification of the underlying items. IASB staff were directed to consider whether an entity should adjust the CSM for changes in the insurer's share of the underlying items on the grounds that the insurer's share represents an implicit management fee, and whether an entity should apply a 'book yield' approach for determining the interest expense presented in profit or loss. The mechanics of the book yield approach were also to be further explored by staff.

2 The IASB continued its discussions on contracts with participating features. As well as considering the book yield approach for determining the interest expense presented in profit or loss, the IASB would also consider a second approach where:

- a. the discount rate for the presentation of interest expense in profit or loss should be reset for *all* the cash flows in the contract whenever there are changes in estimates of investment returns that result in changes in the amounts paid to policyholders (ie. cash flows that vary with returns on underlying items). That approach would apply when the cash flows that vary with underlying items are a substantial proportion of the total benefits to the policyholder over the life of the contract. Resetting the discount rate for all cash flows would replace the proposal in the 2013 Exposure Draft *Insurance Contracts* (2013 ED) for the presentation of interest expense in profit or loss, which would require the entity to split the cash flows and apply applicable discount rates to those cash flows; and
- b. the discount rate used for the presentation of interest expense in profit or loss should be determined using an approach similar to the effective interest method. This method would replace the 2013 proposal to lock in the yield curve.

This approach could be applied to all contracts with participating features or, if there is a book yield approach, to contracts that do not meet the specified criteria to apply the book yield approach.

IASB's tentative decision to use coverage period for allocating CSM (for non-participating businesses) has three flaws or weaknesses (refer above):

The concern was raised with the IASB and IASB staff at the Accounting Standards Advisory Forum (ASAF) on 2 June 2014 and a follow up [letter](#) dated 14 July was sent to the IASB.

A response dated 24 July 2014 (agenda paper 12.3) was received from the IASB Chairman. The letter confirms the IASB's support for its tentative decision, however indicates that the IASB is investigating concerns about application of the decision to contracts where the CSM is high relative to the risk adjustment and coverage extends well beyond the period in which significant risk remains. The letter goes on to indicate that the IASB intends to discuss the allocation of the premium under the PAA in its September meeting.

In response to the AASB's letter concerning costs to insurers, the IASB letter indicates that they do not expect straight-line allocation of CSM to add significant costs and that whatever method is applied new systems and processes will be required. Staff continue have concerns about this issue and will monitor the IASB's developments in this area.

In its September meeting the AASB decided to raise concerns with the IASB at the next ASAF meeting in relation to the tentative decisions made at the IASB's July 2014 meeting regarding use of locked in rates for disclosure and interest rate accretion.

Other than this concern, the Board decided there were no further issues that need to be raised again with the IASB at this stage.

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 (pages 24-25)

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 following table for the staff analysis.

Previous IASB Redeliberations on IASB ED/2013/7 *Insurance Contracts*

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<i>March 2014</i>		
Unlocking the contractual service margin (CSM)		
<p>(a) to confirm the proposals in ED/2013/7 that after inception:</p> <p>(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 CSM, subject to the condition that the CSM should not be negative; and</p> <p>(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.</p>	<p>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.</p> <p>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)...</p>	<p>The IASB tentative decisions are in line with the comments from the AASB.</p>
<p>(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.</p>	<p>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 IAS 36 Impairment of Assets and the requirements for</p>	<p>The IASB tentative decisions are in line with the comments from the AASB.</p>

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
	the reversal of provisions in IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> .	
(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 CSM, subject to the condition that the CSM 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: <ul style="list-style-type: none"> <li data-bbox="219 1129 862 1225">(i) guidance that entities should apply the same accounting policy to groups of similar portfolios, and <li data-bbox="219 1265 862 1393">(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 <i>Accounting Policies</i>, 	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. However the AASB had a number

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<p style="text-align: center;"><i>Changes in Accounting Estimates and Errors.</i></p> <p>(b) If the entity chooses to present the effect of changes in discount rates in other comprehensive income, that an entity should recognise:</p> <p style="margin-left: 20px;">(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</p> <p style="margin-left: 20px;">(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.</p>		<p>of concerns about the use of OCI – see below.</p>
<p>(c) that an entity should disclose the following information:</p> <p style="margin-left: 20px;">(i) <i>For all portfolios of insurance contracts:</i> an analysis of total interest expense included in total comprehensive income disaggregated at a minimum into:</p> <p style="margin-left: 40px;">1 the amount of interest accretion determined using current discount rates;</p> <p style="margin-left: 40px;">2 the effect on the measurement of the insurance contract of changes in discount rates in the period; and</p> <p style="margin-left: 40px;">3 the difference between the present value of changes in expected cash flows that adjust</p>	<p>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:</p> <p><i>Tracking</i></p> <p>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.</p> <p>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</p>	<p>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.</p> <p>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.</p> <p>Therefore despite not being required to determine an amount to be recognised in OCI, an entity</p>

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<p>the CSM 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 CSM when measured at current rates.</p> <p>(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:</p> <ol style="list-style-type: none"> 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. 	<p>not be met.</p> <p>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.</p> <p>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 to 79 of ED/2013/7 seem particularly burdensome.</p> <p>9.2 ...the AASB encourages the IASB to rationalise the extent of identified disclosures.</p>	<p>would still be required to put in place systems and processes to calculate that amount.</p> <p>The AASB comment letter supported disclosure of key amounts for the period – rather than amounts tracked from contract inception.</p>

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<i>April 2014</i>		
Insurance Contract Revenue		
<p>to confirm the 2013 ED proposals that an entity:</p> <p>(a) should present insurance contract revenue and expense in the statement of comprehensive income, as proposed in paragraphs 56–59 and B88–B91 of the 2013 ED; and</p>	<p>3.1 Current Australian GAAP³ bears some similarities to the ED/2013/7 proposals (at a high level with BBA being analogous to AASB 1038 <i>Life Insurance Contracts</i>⁴ and PAA being analogous to AASB 1023 <i>General Insurance Contracts</i>)⁵. However, Australian life insurers would be particularly affected by the proposals as they would need to change their systems to recognise only revenue related to risks borne in the period.</p> <p>3.2 The AASB supports the proposals as the presentation proposed would generally bring all insurers in line with non-insurers. As noted in paragraph BC76, of ED/2013/7 the proposals should be broadly consistent with the general principles in the IASB’s 2011 Exposure Draft <i>Revenue from Contracts with Customers</i>, such that an entity would recognise the consideration to which the entity expects to be entitled in exchange for the coverage and other services, as it satisfies its performance obligations. Furthermore, aligning presentation with non-insurers allows</p>	<p>The IASB tentative decisions are in line with the comments from the AASB.</p>

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- 3 Under AASB 1038 premiums received are recognised as revenue and a claims liability (and related expense) is also recognised based on a prospective cash flows approach (similar to BBA under ED/2013/7). Under AASB 1023 premium revenue is recognised over the period of the contract based on the pattern of the incidence of risk expected. The initial claims liability is the deferred premium (similar to PAA under ED/2013/7). Paragraph 9.1 of AASB 1023 imposes a liability adequacy test and, if the present value of expected cash flows exceeds unearned premium, a loss is recognised immediately.
- 4 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 income statement includes revenues recognised and the focus of most of the note disclosures is on the components of the changes in claims liabilities.
- 5 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: a) the amount for risks borne in current period; and b) the amount for reassessment of risks borne in previous periods; underwriting result; gross claims incurred (undiscounted); and reinsurance and other recoveries (undiscounted).

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
	<p>diversified financial institutions to present information on a similar basis, rather than presenting insurance related items in a different manner.</p> <p>3.3 Feedback from Australian constituents indicates that there is broad support for these proposals and this approach is preferred to the ‘summarised margin’ approach of ED/2010/8.</p>	
<p>to confirm the 2013 ED proposals that an entity:</p> <p>(b) should disclose the following:</p> <p>(i) a reconciliation that separately reconciles the opening and closing balances of the components of the insurance contract asset or liability (paragraph 76 of the 2013 ED);</p> <p>(ii) a reconciliation from the premiums received in the period to the insurance contract revenue in the period (paragraph 79 of the 2013 ED);</p> <p>(iii) the inputs used when determining the insurance contract revenue that is recognised in the period (paragraph 81(a) of the 2013 ED); and</p> <p>(iv) the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position (paragraph 81(b) of the 2013 ED).</p>	<p>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 to 79 of ED/2013/7 seem particularly burdensome.</p> <p>9.2 ...the AASB encourages the IASB to rationalise the extent of identified disclosures to alleviate this burden. For example, in paragraph 74, there seems little justification for requiring separate reconciliations for insurance contracts in a liability position and insurance contracts in an asset position. One portfolio might give rise to a small asset and could change from an asset to a liability position from period to period. Also, given the number of portfolios that would be aggregated into a reconciliation in a large insurer, the presentation of two reconciliations would have little or no information value.</p>	<p>The IASB tentative decisions appear to result in reduced mandated disclosure than was proposed in ED/2013/7.</p> <p>This reduction in disclosure is in line with the comments from the AASB.</p> <p>[For example, the following disclosures were included in the ED but the IASB <u>has not</u> specified that they would be retained:</p> <p>Pgh 74 – reconciliations showing how the carrying amounts of insurance contracts that are in a liability position and insurance contracts that are in an asset position are affected by cash flows and income and expenses recognised in profit or loss and other comprehensive income.</p> <p>Pgh 75 – reconciliations showing how the aggregate carrying amounts of reinsurance contracts held in an asset position and</p>

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IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
		<p>reinsurance contracts held in a liability position are affected by cash flows and income and expense presented in profit or loss.</p> <p>Pgh 81(a) - For contracts to which the premium allocation approach is not applied the entity shall disclose:</p> <ul style="list-style-type: none"> (a) the following inputs that are used when determining the insurance contract revenue that is recognised in the period: <ul style="list-style-type: none"> (i) the expected cash outflows for the period, excluding investment components; (ii) the acquisition costs that are allocated to the period; (iii) the change in risk adjustment in the period; and (iv) the amount of the CSM recognised in the period.]
<p>an entity should be prohibited from presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue.</p>		<p>AASB staff consider that it is not clear what this tentative decision means in practice as commonly understood notions of revenue' is not defined and there may be a variety of commonly understood notions of revenue in existing</p>

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		GAAP. However, the AASB staff support the principle that revenue from insurance contracts should be recognised in a manner consistent with the forthcoming Standard IFRS 15 <i>Revenue from Contracts with Customers</i> .
Project plan for the non-targeted issues		
<p>(a) to consider in future meetings the following non-targeted issues:</p> <ul style="list-style-type: none"> (i) references to ‘unit of account’ and ‘portfolio’ in the 2013 ED and whether it will be possible to clarify the IASB’s intentions and provide more consistency; (ii) whether to provide further guidance regarding discount rate for long-term contracts when there is little or no observable market data; (iii) whether in some circumstances there is an accounting, rather than an economic mismatch between insurance contracts and reinsurance contracts because of the asymmetrical treatment of their CSMs, and if so, whether such a mismatch could be mitigated; (iv) whether to provide more guidance on an appropriate allocation pattern for the CSM; (v) whether to provide guidance for the significant insurance risk definition for a specific contract; (vi) whether the requirements for portfolio transfers and business combinations could be simplified 		AASB staff agree that the IASB should consider these topics in future meetings.

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<p>and clarified; and</p> <p>(vii) whether to provide an option for fixed-fee service contracts.</p>		
<p>(b) not to consider in future meetings other non-targeted issues, including those relating to:</p> <p>(i) disclosures;</p> <p>(ii) premium allocation approach;</p> <p>(iii) combination of insurance contracts;</p> <p>(iv) contract boundary for specific contracts;</p> <p>(v) unbundling—lapse together criteria;</p> <p>(vi) treatment of ceding commissions;</p> <p>(vii) discount rate—top-down and bottom-up approaches;</p> <p>(viii) tax included in the measurement; and</p> <p>(ix) combining the CSM with other comprehensive income.</p>	<p>ED/2013/7 Other issues: Disclosure</p> <p>Refer paragraph 9.1 to 9.2 above.</p> <p>ED/2013/7 Other issues: Separating insurance contracts from investment contracts (‘unbundling’)</p> <p>8.1 Insurance and investment services are often bundled together with investment contracts. ED/2013/7 paragraph 10(b) requires an entity to separate a distinct investment component from a host insurance contract on the basis set out in Appendix B.</p> <p>8.2 Paragraph B31 sets out a principle that ‘unless the investment component and insurance component are highly interrelated, an investment contract is distinct if a contract with equivalent terms is sold, or could be sold, separately in the same market or jurisdiction by the entity or any other entity’. Paragraph B32 goes on to provide indications of when an investment component and insurance component would be considered highly interrelated.</p> <p>8.3 The AASB supports this proposed principle. However, sub-paragraph 32(b) introduces a proposed rule that overrides the principle – that if the lapse or maturity of one component in a contract causes the lapse or maturity of the other, the entity must treat the whole contract as an insurance contract. The AASB considers that this condition should only be an indicator that helps elucidate the principle.</p>	<p><u>(i) Disclosures</u></p> <p>In paragraphs 9.1 to 9.2 of the AASB’s submission to the IASB on ED/2013/7, the AASB expressed concerns with the proposed disclosures. AASB staff also note that the letter from Hans Hoogervorst dated 29 April 2014 indicated that disclosure decisions may be revised in due course.</p> <p>AASB staff think that the IASB should consider disclosures at the end of its redeliberations, in light of the collective decisions made to that point.</p> <p><u>(v) Unbundling</u></p> <p>As set out in paragraphs 8.1 to 8.5 of the AASB’s submission to the IASB on ED/2013/7, AASB staff consider that the IASB should also reconsider the lapse together criteria for unbundling.</p>

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
	<p>8.4 The proposed rule would mean that some contracts in Australia that are currently unbundled into their insurance and investment components would not be able to be unbundled. An example is a product that involves an investment account that is charged with the relevant insurance premiums, and when a client terminates the investment contract element there is no longer an account from which premiums are charged. Accordingly, the whole contract lapses and clients wishing to continue the insurance component are sold a 'new' policy. However, for the duration of the bundled policy, there are two distinct components that are quite capable of being separately recognised based on their natures.</p> <p>8.5 ED/2013/7 paragraph B25 includes a further proposed rule that compounds the problem caused by the rule in sub-paragraph B32(b). The further rule states: a contract that meets the definition of an insurance contract remains an insurance contract until all rights and obligations are extinguished. That would mean a contract that is regarded as an insurance contract at inception must always be treated as an insurance contract, even though there are products that at inception are substantially insurance contracts which, over time, become substantially investment contracts.</p> <p>8.6 The proposals have the potential to seriously distort the financial statements of insurers by requiring investment components of contracts to be treated as insurance contracts. This would be a particular problem for entities that have multiple activities such as banking, wealth management and insurance. The same product sold by the entity as a stand-alone wealth management product to one customer and as</p>	

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	<p>part of a contract that includes an insurance component to another customer could be treated differently.</p> <p>8.7 The distortion might be revealed in a reconciliation to segment disclosures (required by paragraph 28 of AASB 8 Operating Segments) because Australian entities that sell bundled products generally unbundle them into their insurance segments and wealth segments for management information purposes. However, the AASB considers that it is inappropriate to have potentially misleading accounting in the primary financial statements and then have to effectively correct the picture provided through segment disclosure.</p>	

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<i>May 2014</i>		
Recognising the CSM in profit or loss		
<p>(a) confirm the principle in the 2013 ED that an entity should recognise the remaining CSM in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of the services that are provided under an insurance contract.</p> <p>(b) clarify that, for contracts with no participating features, the service represented by the CSM is insurance coverage that:</p> <ul style="list-style-type: none"> (i) is provided on the basis of the passage of time; and (ii) reflects the expected number of contracts in force. 	<p>No specific comments in the AASB submission other than the comment below:</p> <p>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.</p>	<p>As noted in the Action Alert for the May 2014 AASB meeting, the Board decided to raise its concerns in relation to the IASB’s tentative decision to clarify that the service represented by the CSM is insurance coverage that is provided on the basis of the passage of time and reflects the number of contracts in force.</p> <p>The AASB expressed the view that the IASB's decision to use coverage period for allocating CSM (for non-participating businesses) has three flaws or weaknesses:</p> <ul style="list-style-type: none"> (a) the allocation the allocation would not reflect a pattern of meeting a stand-ready obligation (for example, for Lenders Mortgage Insurance where the service is typically non-linear); (b) the allocation would be inconsistent with the outcome under the simplified premium allocation approach; and

Appendix

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
		<p>(c) insurers do not currently perform this calculation.</p> <p>The Board considered that using value of expected claims would address all of the above flaws or weaknesses and this approach should be raised with the IASB.</p>
Fixed-fee service contracts, significant insurance risk, portfolio transfers and business combinations		
<p>(a) that entities should be permitted, but not required, to apply the revenue recognition Standard to the fixed-fee service contracts that meet the criteria in paragraph 7(e) of the 2013 ED.</p> <p>(b) to clarify the guidance in paragraph B19 of the 2013 ED that significant insurance risk only occurs when there is a possibility that an issuer will incur a loss on a present value basis.</p> <p>(c) to clarify the requirements for contracts acquired through a portfolio transfer or a business combination in paragraphs 43-45 of the 2013 ED, that such contracts should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or business combination.</p>	No specific comment in the AASB submission.	No issues noted with the tentative decisions on this topics.

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<i>June 2014</i>		
Discount rates for long-term contracts when there are few or no observable market data		
<p>(a) confirm the principle that the discount rates used to adjust the cash flows in an insurance contract for the time value of money should be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract; and</p> <p>(b) provide additional application guidance that, in determining those discount rates, an entity should use judgement to:</p> <p>(i) ensure that appropriate adjustments are made to observable inputs to accommodate any differences between observed transactions and the insurance contracts being measured.</p> <p>(ii) develop any unobservable inputs using the best information available in the circumstances, while remaining consistent with the objective of reflecting how market participants assess those inputs. Accordingly any unobservable inputs should not contradict any available and relevant market data.</p>	<p>1.3 The AASB supports the IASB’s proposals to discount estimates of fulfilment cash flows and also supports the IASB allowing a ‘bottom-up’ or ‘top-down’ approach to be used for determining the discount rates to use. Although this may lead to reduced comparability this would enable entities to select a method of determining discount rates which is most reliable and practical for them.</p> <p>1.4 On the face of it, the requirement to discount cash flows does not seem dissimilar to current Australian requirements. However, the discount rates proposed in the ED are likely to be somewhat different from those currently being employed by Australian insurers. Australian insurers would therefore be likely to require some changes to existing systems in order for them to adopt the proposals. The key difference between the proposals compared to current Australian GAAP on insurance contracts is the explicit consideration of liquidity risk (although the AASB notes that currently some life insurers already incorporate liquidity risk in their discount rate). The AASB supports the IASB’s proposal to require liquidity risk to be considered, to enhance comparability between entities.</p>	<p>Staff consider that the tentative decisions made are reasonable and would provide useful guidance on how to consider observable and unobservable inputs when determining the appropriate discount rate to use.</p>

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
Asymmetrical treatment of gains from reinsurance		
After inception, an entity should recognise in profit or loss any changes in estimates of fulfilment cash flows for a reinsurance contract that an entity holds when those changes arise as a result of changes in estimates of fulfilment cash flows for an underlying direct insurance contract that are recognised immediately in profit or loss.	No specific comment in the AASB submission.	Staff agree that the recognition of changes of fulfilment cash flows of reinsurance contracts should be recognised in profit or loss when the change in the underlying contracts are recognised in profit or loss to allow the amounts to be recognised in profit or loss at the same time.
Level of aggregation		
<p>(a) clarify that the objective of the proposed insurance contracts Standard is to provide principles for the measurement of an individual insurance contract, but that in applying the Standard an entity could aggregate insurance contracts provided that it meets that objective.</p> <p>(b) amend the definition of a portfolio of insurance contracts to be: "insurance contracts that provide coverage for similar risks and are managed together as a single pool"; and</p> <p>(c) add guidance to explain that in determining the CSM or loss at initial recognition, an entity should not aggregate onerous contracts with profit-making contracts. An entity should consider the facts and circumstances to determine whether a contract is onerous at initial recognition.</p> <p>To provide examples on how an entity could aggregate</p>	<p>No specific comment in the AASB submission on ED/2013/7, however the following comment was made in the AASB submission on ED/2010/8:</p> <p>31 The proposal to aggregate residual margins on the basis of portfolios of contracts that have similar dates of inception and similar coverage periods helps to enforce the notion that residual margins are locked in (potentially year-by-year), thereby facilitating application of proposal to systematically run residual margins off to profit or loss. However, we note that these proposals have a number of other consequences. In particular, restricting portfolios to groups of contracts that:</p> <p style="margin-left: 20px;">a) are subject to broadly similar risks and managed together by the insurer as a single pool; and</p> <p style="margin-left: 20px;">b) have similar dates of inception (short-duration insurance contracts); or</p> <p style="margin-left: 20px;">c) have similar dates of inception and similar coverage periods (all insurance contracts</p>	<p>Staff consider that the tentative decision to allow aggregation by portfolio, where the portfolio is based on similar risks and management as a single pool is reasonable, and is consistent with comments made by the AASB in its submission on ED/2010/8.</p>

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<p>contracts but nonetheless satisfy the objective in a. above when determining the CSM at a subsequent measurement.</p> <p>The IASB also tentatively decided to clarify that, in accordance with IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>, an entity should select and apply its accounting policies consistently for similar contracts, considering the portfolio in which the contract is included, the assets that the entity holds and how those assets are accounted for.</p> <p>(This is in light of the tentative decision made at its March 2014 meeting, that an entity should choose to present the effect of changes in discount rates in profit and loss or in other OCI as its accounting policy and should apply that accounting policy to all contracts within a portfolio.)</p>	<p>other than those measured using a premium allocation approach);</p> <p>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. Moreover, while 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. By restricting the size of portfolios of insurance contracts in practice, the proposals are also likely to require insurers to apply the remeasurement proposals for short-duration insurance contracts in paragraph 60 of ED/2010/8 more frequently than they might otherwise.</p>	

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<i>July 2014</i>		
Rate used to accrete interest and calculate the present value of cash flows that is offset against CSM		
<p>The IASB tentatively confirmed the proposal in the 2013 ED that, for contracts without participating features, an entity should use the locked-in rate at inception of the contract for accreting interest and for determining the change in the present value of expected cash flows that offsets the CSM.</p>	<p>No specific comment in the AASB submission – however the following comments were made in the AASB letter (dated 17 April 2014) to the IASB expressing concern about disclosures driven off locked-in rates:</p> <p style="padding-left: 40px;">...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 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 style="padding-left: 40px;">... 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</p>	<p>Staff continue to be concerned about the tentative decisions to require entities to track rates at inception of contracts.</p> <p>The concerns are consistent with those outlined in the 17 April 2014 letter to the IASB.</p> <p>In its September meeting the AASB decided to raise concerns with the IASB at the next ASAF meeting in relation to the tentative decisions made at the IASB's July 2014 meeting regarding use of locked in rates for disclosure and interest rate accretion.</p>

Appendix

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
	<p>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>	
Changes in accounting policy		
<p>The IASB tentatively decided that an entity should apply the requirements in IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> to changes in accounting policy relating to the presentation of the effect of changes in discount rates.</p>	<p>No specific comment in the AASB submission – the tentative decision relates to the tentative decision (in March 2014) to permit an accounting policy choice which was not contemplated in the IASB 2010 or 2013 EDs.</p>	<p>Staff consider that the tentative decision is reasonable and has the advantage of not creating new requirements specifically for insurance contract accounting.</p>

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<i>September 2014</i>		
Premium-allocation approach: revenue recognition pattern		
<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"> a) on the basis of the passage of time; but 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. 	<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 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 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>
Determination of interest expense in the premium-allocation approach		
<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"> a) discounts the liability for incurred claims; and b) chooses to present the effect of changes in discount rates in OCI; <p>the interest expense in profit or loss for the liability for 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>No specific comment in the AASB submission – however the following comments were made in the AASB letter (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 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</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 those outlined in the 17 April 2014 letter to the IASB.</p> <p>The concern was raised by AASB staff at the September 2014 ASAF meeting and with the IASB project staff.</p>

IASB Tentative Decisions	Comment from AASB Submission to IASB (emphasis added in bold)	AASB staff comment
<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>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>	