AASB Simplified Exposure Draft

Tier 2 Supplement to ED 201
July 2011

Insurance Contracts

Adverse comments to AASB by 30 September 2011

Australian Government

Australian Accounting Standards Board

Background on Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards, including Interpretations, to be applied by:

(a) entities required by the *Corporations Act 2001* to prepare financial reports;

(b) governments in preparing financial statements for the whole of government and the General Government Sector (GGS); and

(c) entities in the private or public for-profit or not-for-profit sectors that are reporting entities or that prepare general purpose financial statements.

AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two Tiers of reporting requirements for preparing general purpose financial statements:

(a) Tier 1: Australian Accounting Standards; and

(b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Australian Accounting Standards incorporate International Financial Reporting Standards (IFRSs), including Interpretations, issued by the International Accounting Standards Board (IASB), with the addition of paragraphs on the applicability of each Standard in the Australian environment.

Private sector for-profit entities complying with Tier 1 requirements will simultaneously comply with IFRSs. Many other entities complying with Tier 1 will also simultaneously comply with IFRSs.

Australian Accounting Standards also include requirements that are specific to Australian entities. These requirements may be located in Australian Accounting Standards that incorporate IFRSs or in other Australian Accounting Standards. In most instances, these requirements are either restricted to the not-for-profit or public sectors or include additional disclosures that address domestic, regulatory or other issues. In developing requirements for public sector entities, the AASB considers the requirements of International Public Sector Accounting Standards (IPSASs), as issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants.

Earlier Consultation on Insurance Contracts

AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts* were excluded from the scope of ED 192 *Revised Differential Reporting Framework* (the Exposure Draft proposing the differential reporting framework in AASB 1053) on the grounds that an entity required to apply any or all of these Standards would generally be a publicly accountable entity and therefore required to prepare Tier 1 general purpose financial statements.

In its redeliberations on the proposals in ED 192, the AASB noted that some respondents questioned whether 'captive' insurers should be classified as publicly accountable since, in their view, there is unlikely to be a broad group of outsiders involved (noted in paragraphs BC27 and BC28 of AASB 1053). The AASB also noted that the nature of captive insurers varies. Some only provide insurance to subsidiaries within their group and prepare only special purpose financial statements for consolidation purposes. Captive insurers might provide insurance cover to joint venture partners of their controlling entity, which may lead to a need for them to present general purpose financial statements. Given the significance of the relationship between an insurer and an outside party that is insured, the AASB considers the general purpose financial statements should be Tier 1.

The AASB has undertaken targeted consultation with specific constituents in regard to identifying whether there is a need for Tier 2 reporting requirements on insurance contracts (consistent with paragraph BC86 of AASB 1053) and found no evidence of such a need.

The IASB's Insurance Contracts project is ongoing and there may be further consultation processes.

AASB View on Insurance Contracts

The AASB concluded that it expects entities with material insurance activities that prepare general purpose financial statements to be publicly accountable. Accordingly, the AASB considers there is no need to specify Tier 2 disclosures.

The AASB also considers that, in respect of general purpose financial reporting of insurance contracts:

(a) there are no regulatory issues or other issues arising in the Australian environment that would necessitate specifying Tier 2 disclosures, particularly any issues relating to:

   (i) not-for-profit entities; and

   (ii) public sector entities; and

(b) having only Tier 1 requirements is in the best interests of the Australian economy.

Proposed Disclosure Requirements

AASB Exposure Draft ED 201 *Insurance Contracts* includes the disclosures proposed by the IASB in its ED/2010/8 *Insurance Contracts* (re-presented in Appendix A of this Exposure Draft). If adopted these disclosures would replace those in the current version of AASB 4 and those in AASB 1023 and AASB 1038.

Based on the AASB's view, there is no shading of the proposed disclosures identified in Appendix A. If you disagree with the Board's view, please identify which of the disclosures you believe should be considered when the Board amends the existing Standards.

As indicated, it is the AASB's view that there would be no entities with material insurance activities that would apply Tier 2 Reduced Disclosure Requirements (in respect of the Insurance Contracts Standard or any other Australian Accounting Standards).

Invitation to Comment

The AASB invites comments from constituents who hold a different view to be sent to:

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West   Victoria   8007
AUSTRALIA
E-mail: standard@aasb.gov.au

Any comments should be submitted to the AASB by 30 September 2011.

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Appendix A

Disclosures Proposed in ED 201 *Insurance Contracts*

Disclosure

79 To help users of financial statements understand the amount, timing and uncertainty of future cash flows arising from insurance contracts, an insurer shall disclose qualitative and quantitative information about:

(a) the amounts recognised in its financial statements arising from insurance contracts (see paragraphs 85–90); and

(b) the nature and extent of risks arising from insurance contracts (see paragraphs 91–97).

80 If the disclosures required by this [draft] IFRS and other IFRSs do not meet that objective in a particular situation, an insurer shall disclose whatever additional information is necessary to meet that objective.

81 An insurer shall consider the level of detail necessary to satisfy the disclosure requirements and how much emphasis to place on each of the various requirements. An insurer shall aggregate or disaggregate information so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

82 An insurer shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

83 The disclosures required in this [draft] IFRS shall not aggregate information relating to different reportable segments, as defined in IFRS 8 *Operating Segments*.

84 Examples of aggregation levels that might be appropriate are:

(a) type of contract.

(b) geography (eg country or region).

Explanation of recognised amounts

85 An insurer shall disclose information about the amounts recognised in its financial statements in sufficient detail to help users of its financial statements evaluate the timing, amount and uncertainty of future cash flows arising from insurance contracts, including:

(a) reconciliation from the opening to the closing aggregate contract balances (see paragraphs 86–89).

(b) the methods and inputs used to develop the measurements (see paragraph 90).

Reconciliation of contract balances

86 To comply with paragraph 85(a), an insurer shall disclose a reconciliation from the opening to the closing balance of each of the following, if applicable:

(a) insurance contract liabilities and, separately, insurance contract assets.

(b) risk adjustments included in (a).

(c) residual margins included in (a).

(d) reinsurance assets arising from reinsurance contracts held by the insurer as cedant.

(e) risk adjustments included in (d).

(f) residual margins included in (d).

(g) impairment losses on reinsurance assets.

87 For each reconciliation required by paragraph 86, an insurer shall show, at a minimum, each of the following, if applicable:

(a) the carrying amounts at the beginning and end of the period.

(b) new contracts recognised during the period.

(c) premiums received.

(d) payments, with separate disclosure of:

(i) claims and benefits.

(ii) expenses.

(iii) incremental acquisition costs.

(e) other cash paid and, separately, other cash received.

(f) income and expense, reconciled to the amounts disclosed to comply with paragraphs 72 and 75.

(g) amounts relating to contracts acquired from, or transferred to, other insurers in portfolio transfers or business combinations.

(h) net exchange differences arising on the translation of foreign currency amounts into the presentation currency.

88 For short-duration contracts measured using the measurement described in paragraphs 54–60, an insurer shall disclose the reconciliation required by paragraph 86 separately for:

(a) pre-claims liabilities.

(b) additional liabilities for onerous insurance contracts.

(c) claims liabilities.

89 For those contracts for which uncertainty about the amount and timing of claims payments is not typically resolved fully within one year, an insurer shall disclose the claims and expenses incurred during the period.

Methods and inputs used to develop the measurements

90 To comply with paragraph 85(b), an insurer shall disclose:

(a) for the measurements that have the most material effect on the recognised amounts arising from insurance contracts, the methods used and the processes for estimating the inputs to those methods. When practicable, the insurer shall also provide quantitative information about those inputs.

(b) to the extent not covered in (a), the methods and inputs used to estimate:

(i) the risk adjustment, including information about the confidence level to which the risk adjustment corresponds. If the insurer uses a conditional tail expectation technique or a cost of capital technique, it shall disclose the confidence level to which the risk adjustment estimated under those methods corresponds (eg that the risk adjustment was estimated at conditional tail expectation (Y) and corresponds to a confidence level of Z per cent).

(ii) discount rates.

(iii) estimates of policyholder dividends.

(c) the effect of changes in the inputs used to measure insurance contracts, showing separately the effect of each change that has a material effect on the financial statements.

(d) a measurement uncertainty analysis of the inputs that have a material effect on the measurement. If changing one or more inputs used in the measurement to a different amount that could have reasonably been used in the circumstances would have resulted in a materially higher or lower measurement, the insurer shall disclose the effect of using those different amounts and how it calculated that effect. When preparing a measurement uncertainty analysis, an insurer shall not take into account inputs that are associated with remote scenarios. An insurer shall take into account the effect of correlation between inputs if such correlation is relevant when estimating the effect on the measurement of using those different amounts. For that purpose, materiality shall be judged with respect to profit or loss, and total assets or total liabilities.

Nature and extent of risks arising from insurance contracts

91 **An insurer shall disclose information about the nature and extent of risks arising from insurance contracts in sufficient detail to help users of financial statements evaluate the amount, timing and uncertainty of future cash flows arising from insurance contracts.**

92 To comply with paragraph 91, an insurer shall disclose:

(a) the exposures to risks and how they arise.

(b) its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks.

(c) any changes in (a) or (b) from the previous period.

(d) information about the effect of the regulatory frameworks in which the insurer operates, for example minimum capital requirements or required interest rate guarantees.

(e) information about insurance risk on a gross and net basis, before and after risk mitigation (eg by reinsurance) including information about:

(i) the sensitivity to insurance risk in relation to its effect on profit or loss and equity. This shall be disclosed by a sensitivity analysis that shows any material effect on profit or loss and equity that would have resulted from:

(A) changes in the relevant risk variable that were reasonably possible at the end of the reporting period;

(B) the methods and inputs used in preparing the sensitivity analysis; and

(C) any changes from the previous period in the methods and inputs used.

However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as embedded value or value at risk, it can meet this requirement by disclosing that alternative sensitivity analysis.

(ii) concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration (eg type of insured event, geographical area or currency). Concentrations of insurance risk can arise if an insurer has, for example:

(A) underwritten risks concentrated in one geographical area or one industry.

(B) underwritten risks that are also present in its investment portfolio, for example if an insurer provides product liability protection to pharmaceutical companies and also holds investments in those companies.

(iii) actual claims compared with previous estimates of the undiscounted amount of the claims (ie claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose information about the development of claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year. An insurer shall reconcile the disclosure about claims development with the carrying amount of the insurance contract liabilities recognised in the statement of financial position.

93 For each type of risk, other than insurance risk, arising from insurance contracts, an insurer shall disclose:

(a) summary quantitative information about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to the key management personnel of the insurer and shall provide information about the risk management techniques and methodologies applied by the insurer.

(b) concentrations of risk if not apparent from other disclosures. Such concentrations can arise from, for example, interest rate guarantees that come into effect at the same level for an entire book of business.

94 With regard to credit risk arising from reinsurance contracts and, if applicable, other insurance contracts, an insurer shall disclose:

(a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period.

(b) information about the credit quality of reinsurance assets.

95 With regard to liquidity risk, an insurer shall disclose:

(a) either a maturity analysis that shows the remaining contractual maturities or information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities. This may take the form of an analysis, by estimated timing, of the amounts recognised in the statement of financial position.

(b) a description of how it manages the liquidity risk resulting from its insurance liabilities.

96 With regard to market risk (as defined in IFRS 7) an insurer shall disclose:

(a) a sensitivity analysis for each type of market risk to which the insurer is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date; if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, or a sensitivity analysis, such as value at risk, that reflects interdependencies between risk variables and uses it to manage *financial risks,* it may use that sensitivity analysis to meet this requirement.

(b) an explanation of the methods and main inputs used in preparing the sensitivity analysis.

(c) an explanation of the objective of the methods used and of limitations that may result in the information not fully reflecting the carrying amount of the insurance contracts involved.

(d) changes from the previous period in the methods and inputs used and the reasons for such changes.

(e) information about exposures to market risk arising from embedded derivatives contained in a host insurance contract, including information about the levels at which these exposures begin to have a material effect on the insurer's cash flows.

97 If the quantitative information about the insurer's exposure to risk at the end of the reporting period is not representative of its exposure to risk during the period, it shall disclose that fact, the reasons for those conclusions and shall provide further information that is representative of the exposure during the period.