IFRS NEWSLETTER
INSURANCE

Issue 45, May 2015

cutting through complexity

“The IASB is making significant progress towards a final standard that responds to industry concerns while striving for consistency with the concepts underlying other IFRSs.”

Joachim Kölschbach, KPMG’s global IFRS insurance leader

MOVING TOWARDS INTERNATIONAL INSURANCE ACCOUNTING

This edition of *IFRS Newsletter: Insurance* focuses on this month’s education session on the insurance contracts project. No decisions were made because the Board is still discussing how the general model may need to be modified for participating contracts.

Highlights

Application of the variable fee approach

- The IASB discussed when and how to consider the effect of mutualisation in the measurement of insurance contracts.
- The IASB discussed modifications to the transition requirements for entities applying the simplified retrospective approach.

Subsequent measurement of the CSM

- The IASB discussed whether a current rate should be used to measure the contractual service margin subsequent to initial recognition for all insurance contracts.

Indirect participating contracts

- The staff recommended that interest expense in profit or loss be determined by applying the level yield method of the effective yield approach.

Presentation of interest expense for participating contracts

- The IASB discussed whether to provide issuers of participating contracts with an accounting policy choice.

THE VARIABLE FEE APPROACH AND OTHER PARTICIPATING CONTRACT MATTERS

The story so far …

The current phase of the insurance project was launched in May 2007, when the IASB published a discussion paper, *Preliminary Views on Insurance Contracts*. More recently, the IASB re-exposed its revised insurance contracts proposals for public comment by publishing the exposure draft ED/2013/7 *Insurance Contracts* (the ED) in June 2013.

Interaction with other standards

Throughout its redeliberations, the Board has considered whether the accounting for insurance contracts would be consistent with other existing or future standards, including the new revenue recognition standard – IFRS 15 *Revenue from Contracts with Customers*[1]. Much of the guidance contained in the ED was designed to align with the IASB's and the FASB's joint standard on revenue recognition.

The Board has also considered many of the decisions made in the new financial instruments standard, IFRS 9 *Financial Instruments*[2] – including the way in which IFRS 9 might interact with the final insurance contracts standard – because IFRS 9 will cover a large majority of an insurer's investments.

Contents

What happened in May 2015?

At this month's education session, the Board continued to consider in which circumstances adaptations may be needed to the general model for insurance contract accounting to accommodate participating contracts.

No decisions were made and the Board was reminded that the staff intend to consider all discussions held during education sessions when making recommendations on participating contracts, as a whole, at a later meeting.

The Board considered the possible application of the variable fee approach introduced in March 2015, including:

- introducing the concept of mutualisation, including its effect on the measurement of fulfilment cash flows and therefore the contractual service margin (CSM), and the criteria for considering any impact from mutualisation; and
- the practicability of applying the proposals for the presentation of insurance contract revenue and transition for non-participating contracts to participating contracts when an entity applies the variable fee approach.

As part of its discussion on indirect participating contracts, the Board considered whether to modify its previous decisions so that a current rate is used to measure the CSM subsequent to initial recognition for all insurance contracts. It also discussed how an entity's discretion would affect the measurement of the CSM and revisited its discussion from September 2014 on determining interest expense in profit or loss or in other comprehensive income (OCI) – i.e. the effective yield approach.

The staff presented the merits of providing issuers of participating contracts with an accounting policy choice over whether to present the effects of changes in interest rates in profit or loss or in OCI.

The IASB also received an update on the interaction between IFRS 9 and the insurance contacts project, for information purposes only, and there were no questions for the IASB on this topic.

The staff expects to ask the IASB for the technical decisions on outstanding issues, including on the accounting for direct and indirect participating contracts, during the remainder of 2015. The effective date of the final standard will be discussed after the IASB has concluded its redeliberations on other topics. A final standard is no longer expected in 2015.

1. See our Issues In-Depth: Revenue from Contracts with Customers (September 2014). In February 2015, the IASB started discussing targeted amendments to the new standard; for more detail, see our IFRS Newsletter: Revenue.
2. See our First Impressions: Financial instruments – The complete standard (September 2014).

APPLICATION OF THE VARIABLE FEE APPROACH

The IASB discussed when and how to consider the effect of mutualisation in the measurement of insurance contracts.

Mutualisation

What's the issue?

The variable fee approach was first introduced at the Board's March 2015 meeting (see Issue 44 of *IFRS Newsletter: Insurance*). At that time, the IASB noted that, for some participating contracts – i.e. direct participating contracts – the entity's interest in the underlying items might be viewed as a variable fee for a service, rather than as an entity's share of economic returns from the underlying items.

The IASB indicated that the variable fee approach would be appropriate only if the following conditions were met:

- the contract specifies that the policyholder participates in a clearly identified pool of underlying items;
- the entity expects a substantial proportion of cash flows from the contract to vary with changes in underlying items; and
- the entity expects the policyholder to receive an amount representing a substantial share of the returns from underlying items.

Policyholders have mutualised their risk when the terms of their contract with the insurer require that:

- they share with other policyholders in the returns of the same specified pool of underlying items; and
- they may have their share of the returns of the underlying items reduced as a consequence of any required payments, including under any guarantees made to other policyholders that share in that pool; or
- if their guarantees are in the money, their guarantees may reduce the share of underlying items returned to other policyholders.

The staff considered how to identify when there is mutualisation, and how the effect of mutualisation would be reflected in the measurement of cash flows.

What did the staff recommend?

According to the staff, mutualisation occurs when the contractual agreement specifies:

- the returns from the underlying items that the policyholder participates in; and
- that the returns that are finally passed to the policyholder may be reduced by any guarantees to other policyholders.

The staff explained why, in their view, mutualisation does not occur in the following circumstances.

- *There is diversification of risk:* because this is the insurer's action, which occurs without policyholders' awareness and has no effect on claims, whereas mutualisation terms are known to policyholders and the claims or benefits of one policyholder are directly impacted by those of other policyholders.
- *There is discretion in the amounts of the returns from the underlying items that are passed to policyholders:* because there could be many factors that determine the amounts that an entity decides to share with policyholders under discretion arrangements – i.e. the guarantees required to be paid to other policyholders under mutualisation may not be the only factor affecting the amounts passed to policyholders.

The staff also believed that if mutualisation is taken into account, then:

- there would be no losses recognised in profit or loss when a group of policies becomes onerous – e.g. if the guarantee on those contracts is in the money – if another set of policyholders bears those losses by reducing their otherwise applicable share in the underlying items; and
- losses would be recognised in profit or loss from onerous contracts only when the underlying items in the fund as a whole are insufficient to bear those losses – i.e. when no other policyholder has the capacity to absorb those losses.

Because it would increase complexity, the staff did not believe that an exception to the above approach should apply to contracts that are onerous at inception, which some parties had suggested should be recognised immediately as a loss.

The staff will consider whether further disclosures should be required on the nature of the guarantees issued to policyholders.

What did the IASB discuss?

One Board member opposed the stance that policyholder awareness of the arrangement is necessary for a contract to qualify for mutualisation, because many policyholders are not aware of the mechanics of participating features even though they may be written into the contracts.

Another questioned why mutualisation should be limited to contracts measured using the variable fee approach. In this member's view, neither of the following is required for mutualisation (*emphasis added*): the entity expecting *a substantial portion* of cash flows from the contract to vary with changes in underlying items; or policyholders expecting to receive an amount representing *a substantial share* of the returns from underlying items.

The staff agreed to consider both of these points when drafting future agenda papers.

Other Board members questioned how discretion would be defined and the impact of discretion on the definition of mutualisation. This question arose because an entity's exercise of discretion could result in a similar economic outcome to mutualisation. The staff clarified that although discretion may be present in contracts that qualify for mutualisation, discretion on its own does not constitute mutualisation.

In addition, although one Board member believed that the information necessary for additional disclosures would probably be readily available, other members questioned the usefulness of this information to investors.

What did the IASB decide?

No decisions were made at this education session.

The IASB discussed how revenue would be presented under the variable fee approach.

Revenue

What's the issue?

A possible approach to presenting revenue under the variable fee approach could include:

- separating the liability for the remaining coverage;
- excluding the investment component;
- reconciling acquisition costs; and
- determining revenue with reference to the fulfilment cash flows and the CSM.

The staff analysed the application of this approach for direct participating contracts.

What did the staff recommend?

The staff did not present a recommendation at this stage; only its analysis. It believed that separating the liability for the remaining coverage and reconciling acquisition costs for participating contracts should be similar to that for non-participating contracts.

The amount of the disaggregated investment component could be significant for direct participating contracts, but it might be less complex to exclude an investment component from such contracts, because an investment component is frequently an explicit amount that an entity clearly differentiates.

The staff also noted that revenue for contracts with direct participation features could be explained as the sum of:

- the latest estimates of the expected claims and expenses relating to coverage for the current period;
- the amount of the CSM recognised in profit or loss in the period; and
- the amount of the risk adjustment recognised in profit or loss in the period.

In some cases, when insurance risk is not as significant for direct participating contracts, revenue for the period would be mainly related to the release of the CSM and the risk adjustment, and the allocation of acquisition costs and other expenses included in the measurement of insurance contracts.

What did the IASB decide?

No decisions were made at this education session.

The IASB discussed modifications to determine the CSM when using the simplified retrospective approach.

Determining the CSM on transition

What's the issue?

In its October 2014 meeting, the Board agreed to modify its transition proposals for non-participating contacts. It confirmed:

- that the forthcoming insurance standard would be applied retrospectively, unless this is impracticable as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*;
- a simplified retrospective approach for cases in which full retrospective application is impracticable; and
- a fair value approach to retrospective application for cases in which both full retrospective application and the simplified retrospective approach are impracticable.

For non-participating contracts and those under the variable fee approach, the CSM would be adjusted for changes in estimates relating to future services and allocated to profit or loss in line with the delivery of service. However, under the variable fee approach the CSM would be adjusted after initial recognition by changes in estimates of the variable fee for service.

The staff noted that historical information would be required to determine the cumulative amounts of the CSM at the beginning of the earliest period presented. They believed that the use of the retrospective and the simplified retrospective approaches would be impracticable for entities that apply the variable fee approach and had not previously recorded the fair value of the underlying items at each reporting date because of the need to use hindsight in estimating the necessary information.

What did the staff recommend?

The staff proposed two approaches to address this issue.

Option 1: Do not provide additional simplification for the variable fee approach

Entities that apply the variable fee approach would generally apply the fair value transition approach to determining the CSM at the beginning of the earliest period presented. However, this would reduce comparability between contracts written before and after the beginning of the earliest period presented.

Option 2: Provide an additional simplification to the simplified retrospective approach for the variable fee approach

To calculate the CSM at initial recognition, an entity would add:

- the expected variable fee adjusted to reflect the time value of money between the date of initial recognition and the beginning of the earliest period presented. The expected variable fee would comprise the fair value of the entity's share of returns from the underlying items adjusted for the risk-adjusted expected present value of the net cost of providing the contract; and
- the payments of cash flows related to the variable fee that occurred before the beginning of the earliest period presented. These payments would include, for example, payments of any cash flow related to expenses included in the fulfilment cash flow and amounts distributed from the underlying items to the entity and the policyholder.

The staff believed that this method would provide a reasonable approximation of the retrospective approach in a similar way to other simplifications for non-participating contracts.

What did the IASB decide?

No decisions were made at this education session.

The IASB discussed modifications to determine the amount of accumulated OCI when using the simplified retrospective approach.

Determining the amount of accumulated OCI

What's the issue?

Historical information might be needed to estimate the accumulated balance of OCI recognised at the beginning of the earliest period presented when the current-period book yield approach is applied. The staff believed that this would often be impracticable, because entities would have to estimate the value of the interest expense that would have been recognised in profit or loss during such periods retrospectively, which would generally entail the use of hindsight.

What did the staff recommend?

The staff proposed a simplification to enable entities to approximate the cumulative OCI for insurance contracts at transition as follows.

- The entity would assume that there are no differences in the accumulated balance of OCI for insurance contracts and underlying assets.
- The entity would assume that the accumulated balance of OCI for the insurance contracts is determined as follows:
  - *if the underlying items are measured at fair value through profit or loss (FVTPL):* there would be no amounts accumulated in OCI for either underlying items or insurance contracts;
  - *if the underlying items are measured at fair value through other comprehensive income (FVOCI):* the accumulated balance of OCI for the insurance contract would be equal and opposite to the accumulated balance of OCI recognised for the underlying items; and

– *if the underlying items are measured at amortised cost:* the accumulated balance of OCI for the insurance contracts would be the difference between the amortised cost of the underlying items and their fair value.

What did the IASB decide?

No decisions were made at this education session.

KPMG insight

The current-period book yield approach would require an entity to calculate the cumulative amount of interest income or expense recognised in profit or loss between initial recognition of the insurance contract and the beginning of the earliest period presented. However, this amount would be difficult to estimate retrospectively – the IASB's proposed approach depends on the measurement of the underlying items. This reflects the IASB's desire to minimise any accounting mismatches between the underlying assets under IFRS 9 and the insurance liabilities under the forthcoming insurance standard.

SUBSEQUENT MEASUREMENT OF THE CSM

The IASB discussed whether a current rate should be used to measure the CSM subsequent to initial recognition for all insurance contracts.

Current rate vs locked-in rate

What's the issue?

Although this topic was introduced during the IASB's discussions on indirect participating contracts (see page 10), it was discussed more generally in the context of all insurance contracts, rather than being limited to indirect participating contracts.

At initial recognition, there would be no difference between the CSM determined under the general model for insurance contract accounting and that under the variable fee approach.

However, after initial recognition the CSM would differ as follows.

	General model	Variable fee approach
An adjustment to the CSM would be determined using ...	The rate at initial recognition	The rate at the date of the change in estimate
The rate used to accrete interest on the CSM would be ...	The rate at initial recognition	A current rate
Therefore, the balance of the CSM would reflect ...	The rate at initial recognition	Changes in rates

Some suggest that the IASB should modify its previous decisions so that a current rate is used for all insurance contracts to:

- determine adjustments to the CSM; and
- accrete interest on the CSM.

What did the staff recommend?

The staff noted the following advantages and disadvantages of using a current rate for all insurance contracts and asked the IASB for any questions or comments.

Advantages	Disadvantages
• Increased consistency in the model, because a current rate would be used for all components of an insurance contract and the same rate would be used for all insurance contracts. • No need for entities to track discount rates at initial recognition for each cohort of insurance contracts.	• Potential loss of disaggregated information about underwriting and investing results. • Increased complexity for entities that choose as an accounting policy to present some changes in the insurance contract liability in OCI. • Consistency only if entities remeasure the CSM to reflect changes in discount rates since the previous period; but remeasuring the CSM as if it were a cash flow would be economically meaningless.

What did the IASB discuss?

One Board member strongly supported the use of the current rate throughout the whole model for accounting for insurance contracts, including for non-participating contracts. This member disagreed with the staff's assertion that the use of a current rate for all contracts would result in a loss of disaggregated information about underwriting and investing results. The member argued instead that the current rate would provide more relevant information to users of the financial statements and may reduce or eliminate difficult-to-explain amounts that may arise as a result of using the current rate to remeasure fulfilment cash flows and a locked-in rate to adjust the CSM.

Other members acknowledged that there were conceptually valid arguments for and against the use of a current rate and the use of a locked-in rate.

What did the IASB decide?

No decisions were made at this education session.

KPMG insight

Any decision by the IASB to permit the use of current rates to measure the CSM subsequent to initial recognition would probably be well-received by preparers intending to choose as their accounting policy to present the effects of changes in discount rates in profit or loss, rather than in OCI.

This is because those preparers would no longer be required to make the systems changes necessary to track historical discount rates.

INDIRECT PARTICIPATING CONTRACTS

The IASB discussed how to account for changes in cash flows resulting from an entity's exercise of discretion.

Subsequent measurement of the CSM

What's the issue?

An indirect participating contract has cash flows that vary with the returns on assets, but does not create an obligation to pay the policyholder an amount equal to underlying items less a variable fee. As a result, an entity would apply the general model for measuring insurance contracts – i.e. the model for non-participating insurance contracts – to indirect participating contracts, rather than the variable fee approach developed for direct participating contracts.

Under the general model, when a contract includes asset-dependent cash flows the initial estimate of the fulfilment cash flows would be determined using the entity's estimate of the expected cash flows, discounted using a discount rate that reflects the extent of any dependence on asset returns.

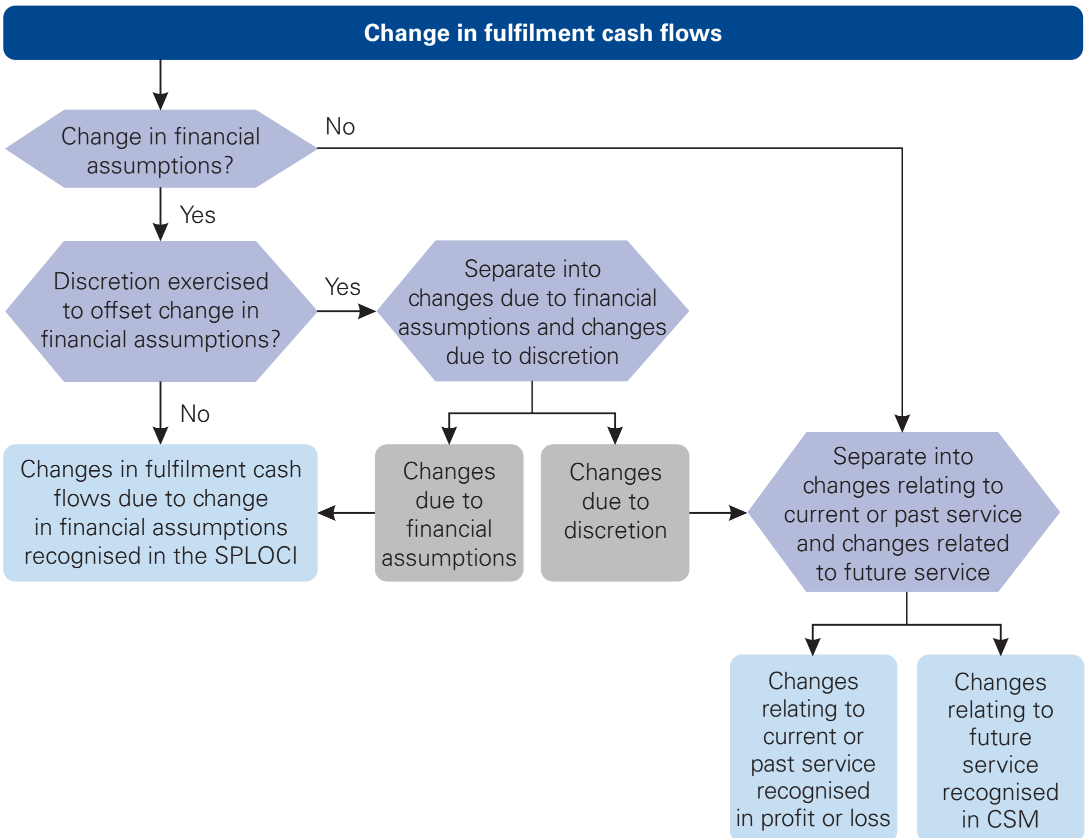
Subsequent changes in estimates of cash outflows that arise as a consequence of changes in asset gains or losses, and the corresponding change in discount rates – i.e. changes arising from financial assumptions – would be recognised in the statement of profit or loss and OCI (SPLOCI).

However, changes in the estimates of the participation percentages – i.e. changes that arise from the exercise of an entity's discretion – relate to estimated consideration for services provided by the entity, and consequently an entity would recognise changes in estimates of consideration for:

- future services as an adjustment to the CSM; and
- services in the current and past periods immediately in profit or loss.

What did the staff recommend?

The staff explained the mechanics of applying the general model for insurance contract accounting to indirect participating contracts as follows.



What did the IASB discuss?

A few Board members discussed the concept of an entity's discretion and suggested that the staff consider defining it more clearly. To illustrate the point, a scenario was described in which an entity retains 100 basis points of any return on underlying items. In this scenario, the returns on underlying items changed from 5 percent (in which case the entity would return 4 percent to policyholders) to 10 percent (in which case the entity would return 9 percent to policyholders). The IASB member asked the staff whether this would qualify as a change in cash flows arising from the entity's discretion.

What did the IASB decide?

No decisions were made at this education session.

The staff recommended that interest expense in profit or loss be determined by applying the level yield method of the effective yield approach.

Determining interest expense in comprehensive income

What's the issue?

The ED proposed that if some of the cash flows of an insurance contract vary with the changes in expected investment returns, then the interest expense recognised in profit or loss would be calculated as follows. The discount rates applied to cash flows that:

- do not vary with changes in expected investment returns would be locked in at initial recognition; and
- vary with changes in expected investment returns would be reset every time there are changes in the estimates of those investment returns that result in changes in the amounts paid to policyholders.

Many respondents to the ED disagreed with the proposal, noting that:

- it would be difficult to apply different discount rates to different sets of cash flows; and
- the costs of applying different discount rates updated at different times to different sets of cash flows would not be justified by the benefits of doing so.

The IASB has previously responded to this feedback as follows.

IASB meeting	Decisions and discussions
July 2014	Decided to avoid an OCI approach that would result in the need to split cash flows with different characteristics within a contract, because it would introduce complexity and arbitrariness. For more detail, see Issue 42 of *IFRS Newsletter: Insurance*.
September 2014	Considered the following variations of the effective yield approach: • level yield method; • projected crediting variation; and • modified effective yield approach. For more detail, see Issue 43 of *IFRS Newsletter: Insurance.*

IASB meeting	Decisions and discussions
March 2015	Explored a current-period book yield approach in which the interest expense in profit or loss on the insurance contract liability is equal and opposite in amount to the investment income on the underlying items that is reported in profit or loss. For more detail, see Issue 44 of *IFRS Newsletter: Insurance.*

At the March 2015 meeting, the staff proposed that the current-period book yield approach would apply only when there is no possibility of an economic mismatch – i.e. when the entity:

- has an obligation to pay to the policyholder an amount equal to the value of the underlying items less a variable fee for service; and
- holds the underlying items.

As a result, the question about how to determine interest expense when a contract does not qualify for the current-period book yield approach remains.

What did the staff recommend?

The staff recommended that the level yield method of the effective yield approach be used to determine interest expense in the statement of profit or loss and OCI for indirect participating contracts. This would determine the interest expense in profit or loss using a single discount rate that exactly reverses any amounts recognised in OCI over the life of the contract.

In the staff's view, the IASB should not modify the effective yield approach to reduce accounting mismatches caused by:

- different patterns of recognition for the investment income from assets (and therefore the amounts credited to the policyholder) and the investment expense from the insurance contract;
- a mixture of underlying items accounted for at FVTPL, FVOCI or amortised cost; or
- situations in which there is a realisation in profit or loss of gains and losses from assets measured at amortised cost or FVOCI, but no corresponding increase in the cash flows for the insurance contract liability in the period of realisation.

In the staff's view, amendments to the effective yield approach would increase the complexity of determining the effective yield and make it more difficult to understand its objective.

What did the IASB discuss?

One Board member said that he would prefer the projected crediting version of the effective yield method because he believed that it would produce a more understandable and more relevant result.

What did the IASB decide?

No decisions were made at this education session.

ACCOUNTING POLICY CHOICE FOR PRESENTATION OF INTEREST EXPENSE

The IASB discussed whether to provide issuers of participating contracts with an accounting policy choice.

Presenting the effects of changes in profit or loss or in OCI

What's the issue?

In March 2014, the IASB decided that an entity should choose as its accounting policy whether to present the effects of changes in discount rates on non-participating contracts in profit and loss or in OCI[3].

The IASB is considering two approaches to determining the amounts presented in profit or loss and OCI for participating contracts.

- *Current-period book yield approach,* which would apply to contracts that create an obligation for the entity to pay to the policyholder an amount equal to the value of the underlying items, which the entity holds, less a variable fee for service – i.e. direct participating contracts.
- *Effective yield approach,* which would apply to all other participating contracts.

The issue is whether the accounting policy choice should be extended to participating contracts.

What did the staff recommend?

The staff noted that contracts qualifying for the current-period book yield approach may in the future no longer qualify for this approach – e.g. if the insurer ceases to hold the underlying items. Therefore, they believed that for a contract that qualifies for the current-period book yield approach at initial recognition, an entity should have an accounting policy choice to determine the interest expense in profit or loss using:

- the current-period book yield approach;
- the effective yield approach; or
- current discount rates.

For the effective yield approach, the staff believed that an entity should choose as its accounting policy to present interest expense either:

- all in profit or loss; or
- in profit or loss and OCI.

What did the IASB discuss?

Some Board members cautioned against providing too many options; they suggested instead that entities should only be permitted to use the most relevant method to determine interest expense in profit or loss or in OCI.

What did the IASB decide?

No decisions were made at this education session.

3. For more detail, see Issue 38 of *IFRS Newsletter: Insurance.*

KPMG insight

The cost and complexity, and accounting mismatches, that would arise from the mandatory use of one approach could outweigh the cost of allowing entities an accounting policy choice. However, given the nature and the diversity of insurance portfolios, preparers of financial statements would need to be aware of:

- the financial impact of these options;
- the possible outcomes of using a mixture of options at an entity level; and
- consistency between the options at a group level.

For users, too many options would make the financial statements more difficult to understand.

INTERACTION BETWEEN IFRS 9 AND THE INSURANCE CONTRACTS PROJECT

Stakeholders have asked the IASB to defer the effective date of IFRS 9 for insurance companies so as to align it with that of the forthcoming insurance contracts standard.

What's the issue?

At its January 2015 meeting, the IASB noted that the effective date of the new insurance contracts standard could no longer be aligned with the effective date of IFRS 9 (1 January 2018). Accordingly, it decided to:

- confirm the transition reliefs proposed in the ED; and
- consider providing further transition relief to permit or require an entity to reassess the business model for managing financial assets when the new insurance contracts standard is initially applied.

The staff reminded the IASB that it has previously said that deferring the effective date of IFRS 9 would 'neither be appropriate nor feasible', and that deferring IFRS 9 for some, but not all, reporting entities would create confusion and reduce comparability and require arbitrary 'bright lines'.

At the March 2015 meeting of the Accounting Standards Advisory Forum, a representative of the European Financial Reporting Advisory Group (EFRAG) asked the IASB to reconsider its position of not deferring IFRS 9 for entities that issue insurance contracts. This was followed by draft endorsement advice issued by EFRAG in May 2015, including draft advice to the European Commission to ask the IASB to defer the effective date of IFRS 9 for insurance businesses and align it with the effective date of the new insurance contracts standard.

What is the staff's view?

The staff noted that in previous discussions those requesting a deferral of IFRS 9 had suggested an approach whereby IAS 39 *Financial Instruments: Recognition and Measurement* would continue to apply to the 'insurance business' within a reporting entity, whereas IFRS 9 would otherwise apply. However, this would give rise to questions about the accounting for transfers of financial assets within a reporting entity that might result in a change in how a financial asset is classified and measured and/or the impairment model that would apply.

The staff will continue to monitor developments and provide updates to the IASB as necessary, including updates on further insights into the potential effects of implementing IFRS 9 in advance of the new insurance contracts standard.

What did the IASB discuss?

Two Board members highlighted the need for additional detailed information because the following are unclear:

- the nature and size of the problem;
- which types of contracts the problem relates to; and
- whether the issue has been analysed taking into consideration options and elections currently available under IFRS 4 *Insurance Contracts* – e.g. shadow accounting.

What did the IASB decide?

No decisions were made at this education session.

APPENDIX: SUMMARY OF IASB'S REDELIBERATIONS

Decisions reached by the IASB during its redeliberations consider only non-participating contracts. Issues specific to participating contracts are now being considered. After this, the staff will consider whether the tentative decisions reached for non-participating contracts need to be revised.

What did the IASB discuss?	What did the IASB decide?	Is there an identified change to the ED?
Targeted issues		
Unlocking the contractual service margin (CSM)	• Favourable changes in estimates that arise after losses have previously been recognised in profit or loss would be recognised in profit or loss to the extent that they reverse losses that relate to coverage and other services in the future.	Yes
	• Differences between the current and previous estimates of the risk adjustment that relate to coverage and other services for future periods would be added to, or deducted from, the CSM, subject to the condition that the CSM would not be negative. Consequently, changes in the risk adjustment that relate to coverage and other services provided in the current and past periods would be recognised immediately in profit or loss.	Yes
	• For non-participating contracts, the locked-in rate at inception of the contract would be used for: – accreting interest on the CSM; and – calculating the change in the present value of expected cash flows that adjust the CSM.	No
Presenting the effects of changes in the discount rate in OCI	• An entity could choose as its accounting policy to present the effects of changes in discount rates in profit or loss or in OCI, and apply that accounting policy to all contracts within a portfolio.	Yes
	• Application guidance would be added to clarify that, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity would 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.	Yes
	• The requirements in IAS 8 would be applied without modification to changes in accounting policy relating to the presentation of the effects of changes in discount rates.	Yes
	• If an entity chooses to present the effects of changes in discount rates in OCI, then it would recognise: – *in profit or loss:* the interest expense determined using the discount rates that applied at the date on which the contract was initially recognised; and – *in OCI:* the difference between the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date and the amount of the insurance contract measured using the discount rates that applied at the date on which the contract was initially recognised.	Yes

<table>
<tr><th>What did the IASB discuss?</th><th>What did the IASB decide?</th><th>Is there an identified change to the ED?</th></tr>
<tr><td>Presenting the effects of changes in the discount rate in OCI (continued)</td><td>• An entity would disclose the following information.
– For all portfolios of insurance contracts: An analysis of total interest expense included in total comprehensive income disaggregated at a minimum into:
• the amount of interest accretion determined using current discount rates;
• the effects on the measurement of the insurance contract of changes in discount rates in the period; and
• the difference between the present value of changes in expected cash flows that adjust the CSM in a reporting period measured using the discount rates that applied on initial recognition of insurance contracts and current discount rates.
– In addition, for portfolios of insurance contracts for which the effects of changes in discount rates are presented in OCI: An analysis of total interest expense included in total comprehensive income disaggregated at a minimum into:
• interest accretion at the discount rate that applied at initial recognition of insurance contracts reported in profit or loss for the period; and
• the movement in OCI for the period.</td><td>Yes</td></tr>
<tr><td></td><td>• For non-participating contracts accounted for under the premium allocation approach (PAA), when an entity presents the effects of changes in discount rates in OCI, the discount rate that is used to determine the interest expense for the liability for incurred claims would be the rate locked in at the date the claim was incurred. This would also apply if a liability for onerous contracts is established under the PAA, in which case the locked-in discount rate would be the rate on the date the liability is recognised.</td><td>Yes</td></tr>
<tr><td>Insurance contract revenue</td><td>• An entity would be prohibited from presenting premium information in profit or loss if that information is not consistent with commonly understood notions of revenue.</td><td>No</td></tr>
<tr><td></td><td>• An entity would present insurance contract revenue in profit or loss, as proposed in paragraphs 56–59 and B88–B91 of the ED.</td><td>No</td></tr>
<tr><td></td><td>• An entity would disclose the following:
– a reconciliation that separately reconciles the opening and closing balances of the components of the insurance contract asset or liability;
– a reconciliation from the premiums received in the period to the insurance contract revenue in the period;
– the inputs used when determining the insurance contract revenue that is recognised in the period; and
– 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.</td><td>No</td></tr>
<tr><td></td><td>• For contracts accounted for under the PAA, insurance contract revenue would be recognised on the basis of the passage of time. However, if the expected pattern of release of risk differs significantly from the passage of time, then it would be recognised on the basis of the expected timing of incurred claims and benefits.</td><td>Yes</td></tr>
</table>

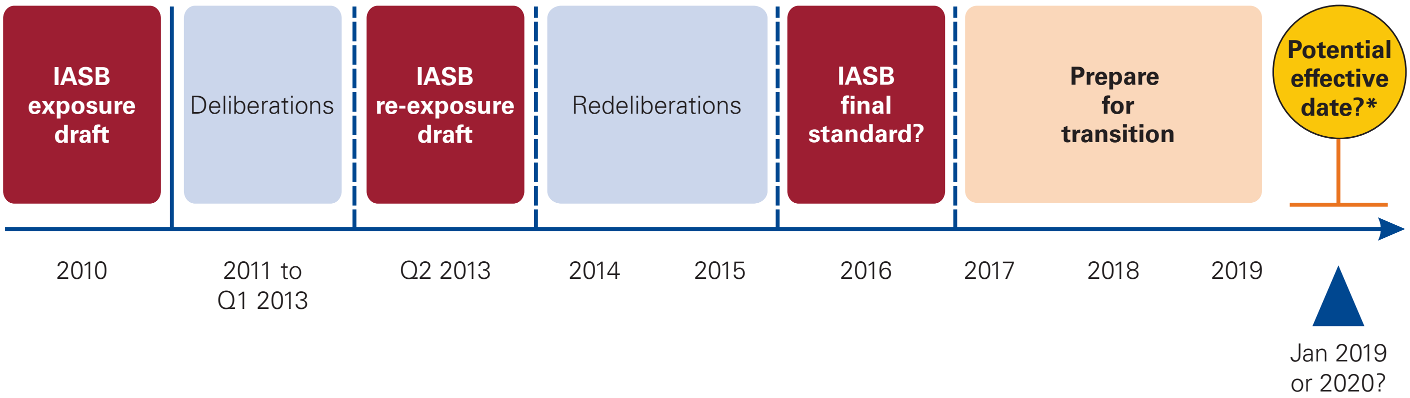
What did the IASB discuss?	What did the IASB decide?	Is there an identified change to the ED?
Transition	• An entity would apply the forthcoming insurance contracts standard retrospectively in accordance with IAS 8, unless this is impracticable.	No
	• For the simplified retrospective approach, instead of estimating the risk adjustment at the date of initial recognition as the risk adjustment at the beginning of the earliest period presented, an entity would estimate it by adjusting the risk adjustment at the beginning of the earliest period presented by the expected release of the risk before the beginning of the earliest period presented. The expected release of risk would be determined with reference to the release of risk for similar insurance contracts that the entity issued at the beginning of the earliest period presented.	Yes
	• If the simplified retrospective approach is impracticable, then an entity would apply a fair value approach. The entity would determine the: – CSM at the beginning of the earliest period presented as the difference between the fair value of the insurance contract and the fulfilment cash flows measured at that date; and – interest expense in profit or loss, and the related amount of OCI accumulated in equity, by estimating the discount rate at the date of initial recognition using the method in the simplified retrospective approach proposed in the ED.	Yes
	• For each period presented for which there are contracts measured in accordance with the simplified retrospective approach or the fair value approach, an entity would disclose the information proposed in paragraph C8 of the ED separately for contracts measured using the: – simplified retrospective approach; and – fair value approach.	Yes
Non-targeted issues		
Recognising the CSM in profit or loss	• The remaining CSM would be recognised in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of the services under the insurance contract.	No
	• For non-participating contracts, the service represented by the CSM would be insurance coverage that: – is provided on the basis of the passage of time; and – reflects the expected number of contracts in force.	Yes
Fixed-fee service contracts	• Entities would be permitted, but not required, to apply the revenue recognition standard to fixed-fee service contracts that meet the criteria stated in paragraph 7(e) of the ED.	Yes
Significant insurance risk	• The ED's guidance will be adjusted to clarify that significant insurance risk occurs only when there is a possibility that an issuer will incur a loss on a present-value basis.	Yes
Portfolio transfers and business combinations	• Paragraphs 43–45 of the ED will be amended to clarify that contracts acquired through a portfolio transfer or a business combination would be accounted for as if they had been issued by the entity at the date of the portfolio transfer or the business combination.	Yes

What did the IASB discuss?	What did the IASB decide?	Is there an identified change to the ED?
Determining discount rates when there is a lack of observable data	• The discount rates used to adjust the cash flows of an insurance contract for the time value of money would be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract.	No
	• In determining those discount rates, an entity would use judgement to: – ensure that appropriate adjustments are made to observable inputs, to accommodate any differences between observed transactions and the insurance contracts being measured; and – develop any unobservable inputs using the best information available in the circumstances, while remaining consistent with the objective of reflecting the way market participants assess those inputs – accordingly, any unobservable inputs should not contradict any available and relevant market data.	Yes
Asymmetrical treatment of gains from reinsurance contracts	• After inception, entities would recognise in profit or loss any changes in estimates of cash flows for a reinsurance contract that arise as a result of changes in estimates of cash flows that are recognised immediately in profit or loss for an underlying insurance contract.	Yes
Level of aggregation	• The objective of the proposed insurance standard is to provide principles for measuring an individual insurance contract; but in applying the standard, an entity could aggregate insurance contracts, provided that the aggregation would meet that objective.	No[4]
	• The definition of a portfolio of insurance contracts would be amended to "insurance contracts that provide coverage for similar risks and are managed together as a single pool".	Yes
	• Guidance would be added to explain that, in determining the CSM or loss at initial recognition, an entity would not aggregate onerous contracts with profit-making contracts. An entity would consider the facts and circumstances to determine whether a contract is onerous at initial recognition.	Yes
	• Examples would be provided of how an entity could aggregate contracts but nevertheless satisfy the objective of the proposed insurance standard when determining the CSM on subsequent measurement.	Yes

4. In the staff's view, this decision represents a clarification of the principle already included in the ED. However, many respondents to the ED noted that they were unsure how to apply the different levels of aggregation. Consequently, this clarification may result in a change in the application of the principle.

PROJECT MILESTONES AND TIMELINE FOR COMPLETION

The IASB re-exposed its insurance contracts proposals and issued ED/2013/7 *Insurance Contracts* in June 2013. A final standard is no longer expected during 2015.



* The effective date of the final standard is expected to be approximately three years after the standard is issued. The IASB staff do not expect the final standard to be published before the end of 2015. The mandatory effective date will be considered after the redeliberations on the model for participating contracts have been completed.

Our suite of publications considers the different aspects of the project.

	KPMG publications
1	IFRS Newsletter: Insurance (issued after IASB deliberations)
2	New on the Horizon: Insurance contracts (July 2013)
3	Towards the Final Frontier: Business perspectives on the insurance accounting proposals (January 2014)
4	Evolving Insurance Regulation: The journey begins (March 2015)

For more information on the project, including our publications on the IASB's insurance proposals, see our website. You can also find, in the same place, information about the FASB's insurance contracts project before February 2014, when this newsletter stopped following that project. For information on the FASB's project subsequent to February 2014, see KPMG's Issues & Trends in Insurance.

The IASB's website and the FASB's website contain summaries of the Boards' meetings, meeting materials, project summaries and status updates.

KPMG CONTACTS

Global Head of Insurance
Gary Reader
T: +44 20 7694 4040
E: gary.reader@kpmg.co.uk

Global Insurance Accounting Change Leader
Danny Clark
T: +44 20 7311 5684
E: danny.clark@kpmg.co.uk

Global IFRS Insurance Leader
Joachim Kölschbach
T: +49 221 2073 6326
E: jkoelschbach@kpmg.com

Global IFRS Insurance Deputy Leader
Darryl Briley
T: +1 212 909 5680
E: drbriley@kpmg.com

Australia
Scott A Guse
Partner
T: +61 7 3233 3127
E: sguse@kpmg.com.au

Bermuda
Richard Lightowler
Partner
T: +1 441 295 5063
E: richardlightowler@kpmg.bm

Brazil
Luciene T Magalhaes
Partner
T: +55 11218 33144
E: ltmagalhaes@kpmg.com.br

Canada
Neil Parkinson
Partner
T: +1 416 777 3906
E: nparkinson@kpmg.ca

China
Walkman Lee
Partner
T: +86 10850 87043
E: walkman.lee@kpmg.com

Czech Republic
Roger Gascoigne
Partner
T: +420 2221 23481
E: rogergascoigne@kpmg.cz

France
Vivian Leflaive
Partner
T: +33 1556 86227
E: vleflaive@kpmg.fr

Germany
Martin Hoser
Senior Manager
T: +49 89 9282 4684
E: mhoser@kpmg.com

India
Akeel Master
Partner
T: +91 22 3090 2486
E: amaster@kpmg.com

Ireland
Hubert Crehan
Partner
T: +35 3141 02629
E: hubert.crehan@kpmg.ie

Italy
Giuseppe Rossano Latorre
Partner
T: +39 0267 6431
E: glatorre@kpmg.it

Japan
Ikuo Hirakuri
Partner
T: +813 3548 5107
E: ikuo.hirakuri@jp.kpmg.com

Korea
Won Duk Cho
Partner
T: +82 2 2112 0215
E: wcho@kr.kpmg.com

Kuwait
Bhavesh Gandhi
Director
T: +965 2228 7000
E: bgandhi@kpmg.com

Luxemburg
Geoffroy Gailly
Director
T: +35 222 5151 7250
E: geoffroy.gailly@kpmg.lu

Netherlands
Frank van den Wildenberg
Partner
T: +31 0 20 656 4039
E: vandenwildenberg.frank@kpmg.nl

South Africa
Gerdus Dixon
Partner
T: +27 21408 7000
E: gerdus.dixon@kpmg.co.za

Spain
Antonio Lechuga Campillo
Partner
T: +34 9325 32947
E: alechuga@kpmg.es

Switzerland
Marc Gössi
Partner
T: +41 44 249 31 42
E: mgoessi@kpmg.com

UK
Danny Clark
Partner
T: +44 20 7311 5684
E: danny.clark@kpmg.co.uk

US
Mark S McMorrow
Partner
T: + 1 818 227 6908
E: msmcmorrow@kpmg.com

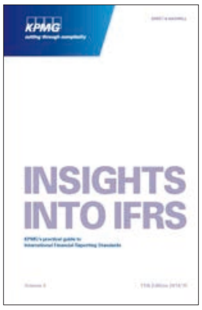
FIND OUT MORE

For more information on the insurance project, please speak to your usual KPMG contact or visit the IFRS – insurance hot topics page.

You can also go to the insurance pages on the IASB website.

Visit our Global IFRS Institute to access KPMG's most recent publications on the IASB's major projects and other activities.

Insights into IFRS: Volume 3 – IFRS 9 (2014)



Builds on previous publications to bring you our first complete work of interpretative guidance based on IFRS 9 (2014).

April 2015

First Impressions: IFRS 9 *Financial Instruments*

Provides our detailed analysis on the complete version of IFRS 9 *Financial Instruments*.

September 2014

IFRS Newsletter: IFRS 9 Impairment – Issue 1

Highlights the discussions of the IFRS Transition Group for Impairment of Financial Instruments on the impairment requirements of IFRS 9.

April 2015

IFRS Newsletter: Revenue – Issue 13

Examines the latest developments on the new revenue standard.

March 2015

IFRS Newsletter: Leases – Issue 17

Highlights the recent discussions of the IASB and the FASB on their lease accounting proposals published in 2013.

March 2015

Breaking News

Brings you the latest need-to-know information on international standards in the accounting, audit and regulatory space.

Acknowledgements

We would like to acknowledge the effort of the principal authors of this publication: Dana Chaput, Barbara Jaworek and Eduardo Lopez.

We would also like to thank the following reviewers for their input: Darryl Briley, Joachim Kölschbach and Chris Spall.

KPMG International Standards Group is part of KPMG IFRG Limited.

Publication name: *IFRS Newsletter: Insurance*

Publication number: Issue 45

Publication date: May 2015

kpmg.com/ifrs

***IFRS Newsletter: Insurance* is KPMG's update on accounting and reporting developments in the insurance sector.**

If you would like further information on any of the matters discussed in this Newsletter, please talk to your usual local KPMG contact or call any of KPMG firms' offices.