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INSURANCE

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KPMG
cutting through complexity

"With the Board's decision to use a variable fee approach for many participating contracts, the finalisation of the standard becomes attainable in the relatively near future."

Joachim Kölschbach, KPMG's global IFRS insurance leader

MOVING TOWARDS INTERNATIONAL INSURANCE ACCOUNTING

This edition of *IFRS Newsletter: Insurance* highlights the IASB's discussions in June 2015 on its insurance contracts project.

Highlights

Variable fee approach

- The IASB decided to unlock the contractual service margin (CSM) for changes in the estimate of the variable fee for service that the entity expects to earn from direct participating contracts. This fee would include the entity's expected share of returns on underlying items.
- The IASB agreed on the criteria for an insurance contract to qualify as a direct participating contract.
- The IASB discussed an unintended consequence of applying the variable fee approach if an entity uses derivatives to hedge financial market risks, but made no decision.

Release of the CSM for participating contracts

- For participating contracts, the IASB decided that an entity would recognise the CSM in profit or loss on the basis of the passage of time.

Applying IFRS 9 in conjunction with existing IFRS 4

Although decisions were not sought on this topic, the IASB was provided with information on the following matters at an education session focusing on implementing IFRS 9 *Financial Instruments* before the forthcoming insurance contracts standard:

- how to mitigate temporary accounting mismatches and other sources of volatility in profit or loss through amendments to existing IFRS 4 *Insurance Contracts*; and
- the costs and complexities associated with providing a deferral of IFRS 9 for insurance businesses.

PARTICIPATING CONTRACTS AND DIFFERENT EFFECTIVE DATES

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.

Since January 2014, the Board has been redeliberating issues raised through the ED. It initially focused on the model for non-participating contracts and has now turned its focus to modifications needed for participating contracts.

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.

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What happened in June 2015?

Alongside an education session about the interaction between the forthcoming insurance contracts standard and the changes to financial instruments accounting and the hedging of risks, the Board focused this month's decision-making session on adapting the general model for insurance contract accounting to accommodate participating features.

It decided to unlock the contractual service margin (CSM) for changes in the estimate of the variable fee for service that an entity expects to earn from direct participating contracts. This fee would be equal to the entity's expected share of returns on underlying items less any expected cash flows that do not vary directly with underlying items.

Direct participating contracts would be defined as contracts for which:

- the contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items;
- the entity expects to pay the policyholder an amount equal to a substantial share of the returns from the underlying items; and
- a substantial proportion of the cash flows that the entity expects to pay to the policyholder is expected to vary with the cash flows from the underlying items.

In addition, the IASB decided that an entity would recognise the CSM in profit or loss on the basis of the passage of time for participating contracts.

At its education session, the Board considered the unintended consequences of the variable fee approach for entities that hedge financial market risks using derivative contracts. It also discussed feedback on applying IFRS 9 before the new insurance contracts standard.

With respect to IFRS 9, the staff's papers provided observations about the issues raised thus far, considered how entities would apply IFRS 9 in conjunction with the existing IFRS 4 *Insurance Contracts* and discussed the complexities of deferring the effective date of IFRS 9 for the insurance industry until the effective date of the forthcoming insurance contracts standard.

The staff expect to ask the IASB for the technical decisions on outstanding issues 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 not 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).

The CSM would be unlocked for changes in the estimate of the variable fee for service that the entity expects to earn.

Unlocking the CSM

What's the issue?

The general model for insurance contract accounting depicts the gains and losses on an entity's investment portfolio in the same way as a stand-alone investment that the entity owns and controls.

For participating contracts, some view any benefit received by the entity as arising only as a consequence of holding those items on behalf of the policyholder. In these cases, the entity's financial statements would report a net investment return – i.e. the difference between returns from investments and payments promised to the policyholder – or a variable fee for service[3].

What did the staff recommend?

For direct participating contracts, the staff recommended that the IASB modify its general measurement model for insurance contract accounting so that changes in the estimate of the fee that the entity expects to earn from the contract are adjusted in the CSM. This fee is equal to the entity's expected share of returns on underlying items less any expected cash flows that do not vary directly with the underlying items.

What did the IASB discuss?

There was broad support for the staff recommendation and clarification that the modification to the general model would be *required*, and not optional.

Some Board members commented that they believed that this modification would be the best reflection of the economic substance of these contracts and that additional disclosures would be required. One member was concerned about the effect of guarantees in the contract. Another disagreed with the recommendation, because he believed that using the general model with bifurcation of cash flows would lead to the same outcome.

What did the IASB decide?

The IASB agreed with the staff's recommendation.

KPMG insight

Under the 'mirroring' exception proposed in the ED, changes in the value of embedded guarantees and options that are indirectly linked to underlying items would be recognised in profit or loss. Respondents to the ED were concerned about the potential increase in volatility in profit or loss. They also expressed concern about volatility caused by the shareholder's share in underlying items, particularly those that do not qualify for fair value through other comprehensive income (FVOCI) accounting, considering that the related profits are an element of the insurance contracts' overall profitability.

These concerns will have been alleviated by the Board's decision at this meeting. Under the variable fee approach, the CSM would be unlocked for changes in cash flows that include embedded options and guarantees in the contract.

3. For more detail, see IFRS Newsletter: Insurance – Issue 44.

The IASB agreed on the criteria for an insurance contract to qualify as a direct participating contract.

Direct participating contracts

What's the issue?

If the Board modifies the general model to permit the variable fee approach, then it will need to define the circumstances in which the modification would apply.

What did the staff recommend?

The staff recommended that direct participating contracts be defined as contracts for which:

- the contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items;
- the entity expects to pay to the policyholder an amount equal to a substantial share of returns from the underlying items; and
- a substantial portion of the cash flows that the entity expects to pay to the policyholder is expected to vary with the cash flows from the underlying items.

What did the IASB discuss?

Most Board members agreed with the staff proposal. However, they recommended that the scope be made clearer to avoid misleading outcomes.

What did the IASB decide?

The IASB agreed with the staff's recommendation.

KPMG insight

Qualifying for the variable fee approach would be based on expectations at inception of a contract. Consistent with the staff's proposal, the Board decision indicates that subsequent reassessment of eligibility would not be necessary; this means that in the absence of a change in contract terms entities would not have to continuously monitor the eligibility of existing contracts through their life.

The IASB discussed an unintended consequence for hedges using derivative instruments.

Hedging financial market risks

What's the issue?

As part of their risk management activities, some entities hedge financial market risks, especially interest rate risks, which arise from insurance contracts using derivative instruments.

Applying the variable fee approach in this situation could result in an accounting mismatch, because the effect of changes in financial market variables on the measurement of the:

- derivative instrument would be recognised immediately in profit or loss; and
- insurance contract liability would adjust the CSM and be released into profit or loss over the coverage period.

What did the staff recommend?

The following table outlines the approaches that the staff considered for addressing accounting mismatches caused by the application of the variable fee approach.

Principle	Effect
Limited application of variable fee approach	
An entity would have an option to apply the general model, rather than the variable fee approach.	This would allow an entity that hedges risks relating to insurance contracts to: • use the variable fee approach and accept the accounting mismatch that arises if the entity uses derivatives to hedge risks and cannot apply hedge accounting; or • recognise changes related to the guarantees and the entity's share in the underlying items according to the general measurement model.
Recognition of changes in value of guarantee and entity's share in underlying items in profit or loss instead of CSM	
An entity would be able to choose to recognise the effect of changes in financial market risks on the guarantee and/or on the entity's share in the underlying items in profit or loss.	This approach would: • enable an entity specifically to address the accounting mismatch created by unlocking the CSM for the value of the guarantee or entity's share in the underlying items without changing other proposals related to the variable fee approach; and • result in the recognition of the ineffectiveness of the hedging relationship in profit or loss.
Designation of derivative as underlying item	
Changes in the insurance contract liability equal to changes in the value of the underlying items would be recognised in the statement of profit or loss and other comprehensive income.	If the entity holds the underlying items (including derivative instruments), then changes in the value of the insurance obligation and changes in the value of the underlying items would offset each other in the statement of profit or loss and other comprehensive income.

The IASB could allow entities to:

- choose between these approaches, making this choice irrevocable at inception and/or requiring the option to be applied in the same way for groups or portfolios of similar contracts; or
- use any of the approaches on a conditional basis, using similar criteria to those in paragraph 6.4.1 of IFRS 9 – i.e. reflecting the entity's risk management activities – modified to reflect the difficulties in applying hedge accounting for insurance contracts. The staff noted that developing these criteria may be difficult.

The staff did not make a recommendation.

What did the IASB discuss?

All three of the options identified by the staff received support from one or more Board members, with no clear preference emerging.

One member questioned how the second and third options were different. The staff responded that there was a different measurement base, because the guarantee would be measured using current fulfilment value whereas the derivative would be measured at fair value.

Another questioned why the staff wasn't investigating a solution specifically for guarantees, which seemed to be the most significant source of the issue.

A couple of Board members suggested that the staff do nothing to resolve the issue. They noted that an insurer could apply general hedge accounting, if appropriate, and wondered whether the issue was even significant enough to warrant a response. These members expressed concern that each time the Board attempted to solve one problem, it seemed to create a new one. In this case, the members were referring to the introduction of the variable fee approach.

What did the IASB decide?

No decisions were made at this education session.

RELEASE OF THE CSM FOR PARTICIPATING CONTRACTS

For participating contracts, an entity would recognise the CSM in profit or loss on the basis of the passage of time.

What's the issue?

The distinguishing feature of a participating contract is that the contract provides policyholders with payments that vary with the returns on underlying items. In other words, participating contracts provide investment-related services in addition to insurance coverage.

The investment-related services transferred to policyholders could be considered to be governed by a combination of:

- the passage of time; and
- the amount of assets under management.

What did the staff recommend?

The staff believed that treating investment-related services as delivered on the basis of the passage of time for the release of the CSM would have the advantages of:

- reflecting the fact that the policyholder receives and consumes the benefits of the service continuously over time; and
- eliminating the issue of how to deal with contracts that provide more than one service.

Alternatively, investment-related services could be regarded as delivered on the basis of the assets under management. This would be more consistent with the stand-alone selling price for asset management services and the reporting of most non-insurance asset managers. To determine the release pattern of the CSM, this approach would require splitting the services into insurance coverage (provided on the basis of the passage of time) and investment-related services (provided on the basis of the assets under management).

The staff noted that an insurer would be required to unbundle distinct services under paragraph 10(c) of the ED, and those services that remain bundled would be highly inter-related and integrated with each other. Therefore, they believed that it would not be practicable to further separate services that are not unbundled. For this reason, the staff believed that an entity should select a single driver to allocate the CSM to profit or loss over the term of the contract, which would be consistent with the requirements of IFRS 15.

Requiring entities to reassess the predominant service used to allocate the CSM in each period could introduce considerable operational complexity and, potentially, a lack of comparability. Accordingly, although feedback indicated significant concerns from many sources, the staff thought that the least complex and subjective approach would be to require entities to recognise the CSM in profit or loss for all insurance contracts on the basis of the passage of time.

What did the IASB discuss?

Some Board members thought that the release of the CSM based simply on the passage of time would not be fully consistent with the IFRS 15 principle of recognising revenue according to the provision of services. However, they understood the complexity of applying this principle to insurance contracts and acknowledged the feedback on the ED suggesting that just stating this principle would not achieve consistent application. For these reasons, they believed that requiring the release of the CSM based on the passage of time would be the best solution.

Other Board members also agreed that the passage of time would be the most appropriate recognition basis. They believed that, in the case of insurance contracts, the service provided is standing ready to cover any claims that may arise.

One member also noted that the approach recommended by the staff would be consistent with the Board's decision on recognising the CSM in profit or loss for non-participating contracts.

What did the IASB decide?

The IASB agreed with the staff's recommendation.

KPMG insight

The IASB chose the least complex and subjective approach for the allocation of the CSM, which would improve comparability between insurers. However, this approach is not consistent with the reporting of most non-insurance asset managers.

Fees receivable under stand-alone asset management contracts are often based on the fair value or market value of assets under management, and asset managers therefore recognise revenue on this basis, even though there may not be a direct or linear relationship between the value of assets under management and the asset manager's expenses.

In contrast, if an entity receives regular premium payments from the policyholder and the invested amount accumulates, then an entity would release the CSM into profit or loss on the basis of the passage of time. This approach would therefore result in more profit being recognised in profit or loss, earlier in the life of the contract.

This would make it harder to compare insurers' financial statements with those of other entities, so would only partially meet users' demands for greater comparability.

APPLYING IFRS 9 IN CONJUNCTION WITH EXISTING IFRS 4

The staff examined several ways to mitigate temporary accounting mismatches, including changes to IFRS 4.

Reducing accounting mismatches under IFRS 4

What's the issue?

The IASB has received feedback from stakeholders concerned about temporary increases in accounting mismatches and other sources of volatility in profit or loss and equity created by the change in classification of financial assets if IFRS 9 is applied in advance of the forthcoming insurance contracts standard.

Many entities measure insurance contract liabilities on a cost basis – i.e. not discounting technical provisions at all or applying a locked-in discount rate. Under current accounting, these entities would have an accounting mismatch in profit or loss and in equity if they measured financial assets held to fund insurance contract liabilities as at fair value through profit or loss (FVTPL) under IAS 39 *Financial Instruments: Recognition and Measurement*. To avoid this, these entities measure as many financial assets as possible at amortised cost (in which case there may be little accounting mismatch) or available-for-sale (in which case the accounting mismatch may be largely presented in OCI) under IAS 39. However, these financial assets may not qualify for similar measurement approaches under IFRS 9.

These entities have expressed particular concern regarding:

- debt instruments currently classified as available-for-sale under IAS 39 that will not qualify for measurement at FVOCI under IFRS 9; and
- equity instruments currently classified as available-for-sale under IAS 39 that will be classified as at FVTPL under IFRS 9, because designating these instruments as at FVOCI under IFRS 9 would mean that the gains and losses on those instruments would never be reclassified into profit or loss.

Although initial feedback has focused on the possibility of deferring the effective date of IFRS 9 for entities that issue insurance contracts (see next article), the staff noted that these mismatches could be addressed by exploring accounting policy options available under current IFRS 4, or permitting additional options.

What did the staff recommend?

The staff noted that insurers have the ability to reduce accounting mismatches under IFRS 4 using the following methods.

Description of method	Limitation(s)
Shadow accounting	
This method enables an entity to adjust aggregate insurance liabilities to reduce accounting mismatches that can arise when unrealised gains and losses on assets held by the entity are recognised in the financial statements, but corresponding changes in the measurement of the insurance contract liability are not.	Applies only when there is a direct relationship between the realisation of gains and losses on an insurer's assets and the measurement of its insurance liabilities and related assets – i.e. would not apply for non-participating life contracts, non-life contracts or indirect participating contracts. In practice, regulatory restrictions and uncertainty about the extent to which insurers can recover unrealised losses from policyholders also limit application.
Use of a current market interest rate	
Insurers are permitted to introduce current market interest rates to measure insurance liabilities.	Would not fully eliminate accounting mismatches if an insurer measures financial assets using a mix of FVTPL, FVOCI and/or amortised cost.

Description of method	Limitation(s)
Voluntary change in accounting policy	
An entity can change its accounting policies to reduce accounting mismatches, including in ways that would be consistent with the application of the new insurance contracts standard.	May be impracticable for insurers to early adopt proposals from the forthcoming insurance contracts standard. There is also a concern that the cost of a significant change in accounting policy that is consistent with, but not the same as, the forthcoming insurance contracts standard would outweigh the benefits.

In addition, none of these methods would address the volatility that would arise from the recognition of an entity's share of underlying items in profit or loss before the application of the forthcoming insurance contracts standard.

In response to these concerns, the staff outlined the following ways that the IASB could reduce accounting mismatches and other sources of volatility.

- Allow an adjustment similar to shadow accounting when there is:
  - no direct relationship in the contract with the assets; or
  - a direct relationship, but gains and losses are attributable to the entity, not the policyholder.
- Permit entities to recognise a liability adjustment to reflect differences between the change in the value of the assets under IAS 39 and the change in their fair value under IFRS 9 to the extent that those changes are recognised in profit or loss (the 'liability adjustment solution').

The staff also noted that, similar to the current accounting, any temporary increase in accounting mismatches and other sources of volatility in profit or loss could also be explained using enhanced presentation and disclosure in the financial statements.

What did the IASB discuss?

A couple of members supported the expansion of shadow accounting, arguing that this would be a simple solution thanks to pre-existing guidance and the temporary nature of the problem. Another Board member questioned whether entities could currently interpret IFRS 4 to permit broader application of shadow accounting.

Other members expressed interest in the liability adjustment solution, but questioned whether it would, in effect, require entities to implement IFRS 9 and run it alongside IAS 39.

In general, Board members seemed to support exploring addressing temporary accounting mismatches through the liability side of the statement of financial position. They believed that such a course of action would have the benefits of:

- permitting users of the financial statements to digest one significant accounting change at a time – i.e. to first understand the impacts of IFRS 9 alongside limited amendments to IFRS 4, followed by the forthcoming insurance contracts standard;
- avoiding the costs and complexities associated with an IFRS 9 deferral, including some of the significant issues that arise with respect to scoping any deferral; and
- support from stakeholders, including regulators, who would like to see IFRS 9 implemented as soon as possible.

However, one Board member cautioned against postponing accounting mismatches that would continue to exist on implementation of the forthcoming insurance contracts standard.

What did the IASB decide?

No decisions were made at this education session.

KPMG insight

If the Board decides to mitigate temporary accounting mismatches through modifications to IFRS 4, then affected entities would need to consider:

- voluntary changes in accounting policies under IFRS 4 when they implement IFRS 9; and
- the limited redesignation options for financial assets on initial application of the forthcoming insurance contracts standard.

Any change in an entity's current accounting policies may require an entity to implement new, or modify existing, systems or processes. This includes modifying existing systems of internal control to maintain effective controls and governance over any stop-gap measures introduced.

Some Board members believed that deferring the effective date for the insurance industry would be complex and costly.

Possible deferral of IFRS 9

What's the issue?

Feedback received by the IASB argued that applying IFRS 9 before the forthcoming insurance contracts standard may disrupt the financial reporting of insurance activities – it would make financial reporting less understandable to users of the financial statements, while increasing the cost to preparers. This feedback has been largely driven by interested parties in Europe, but has been echoed in other jurisdictions, and those commenting have suggested that the IASB defer the effective date of IFRS 9 for insurers.

The staff acknowledged that two consecutive accounting changes in a short period would result in added costs and complexity for both preparers and users of the financial statements, as well as confusion for users. However, they stated that addressing those concerns by deferring the effective date of IFRS 9 could create costs and complexities for a variety of stakeholders, including standard setters and regulators.

What did the staff recommend?

If the IASB were to defer the effective date of IFRS 9 for the insurance industry, then it would need to:

- determine the scope of the deferral, including:
  - the level in a reporting entity to which a deferral would apply; and
  - the qualifying conditions for a deferral;
- assess whether there is a need for particular presentation and disclosure requirements; and
- identify whether there are any accounting consequences of the deferral that need to be addressed and develop the necessary guidance.

The staff have identified three broad approaches for deferring IFRS 9[4], including deferral at the reporting entity level, at the legal entity level and for insurance activities. Each approach would give rise to different accounting consequences and may require different qualifying conditions for a deferral. In particular, if some operations within a reporting entity were to apply IFRS 9 while other operations continued to apply IAS 39, then their accounting policies would be inconsistent. This would create complexity in disclosure and a need to develop guidance on transfers of financial assets between the different operations.

4. See Agenda Paper 2G The complexity of deferring the effective date of IFRS 9 *Financial Instruments* for the insurance industry (June 2015).

In general, the staff argued that there is an inverse relationship between:

- precision – e.g. the extent to which the deferral would be focused on insurance activities and minimise the scope of delayed application of IFRS 9; and
- simplicity – e.g. ease of development for the IASB and of implementation for entities.

What did the IASB discuss?

A few Board members were concerned about how to account for transfers of financial assets between entities or lines of business that had not been granted a deferral and those that had been granted a deferral. There was acknowledgement that additional information would be needed to determine how common transfers were between non-insurance and insurance operations within the same reporting entity.

One member believed that any costs would seem to outweigh the benefits the moment an entity or group was subject to both IAS 39 and IFRS 9 and that most of the solutions would require an entity to dual-run IAS 39 and IFRS 9.

Another noted that providing a deferral at the reporting entity level was the simplest solution, but asked whether banking regulators were concerned that banking operations would be scoped into a deferral. Another Board member responded that they understood that banking regulators would prefer all banks to use IFRS 9 and for any solution to be limited to the liability side of the financial statement of position.

What did the IASB decide?

No decisions were made at this education session.

KPMG insight

As part of the endorsement process, the European Commission requested that the European Financial Reporting Advisory Group (EFRAG) consider the inter-relationship between the forthcoming insurance contracts standard and IFRS 9.

In its draft endorsement advice, EFRAG observes many of the costs and complexities discussed above and recommends 'a global solution promulgated by the IASB'. As a result, it recommends that the European Commission ask the IASB to defer the effective date of IFRS 9 for insurance businesses.

Although discussion of this issue started in Europe, some stakeholders outside Europe – particularly large, multinational insurers – have expressed support for a deferral of IFRS 9 for insurers.

APPENDIX: SUMMARY OF IASB'S REDELIBERATIONS

<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 colspan="3">Targeted issues</td></tr>
<tr><td rowspan="3">Unlocking the contractual service margin (CSM)</td><td>• 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.</td><td>Yes</td></tr>
<tr><td>• 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.</td><td>Yes</td></tr>
<tr><td>• 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.</td><td>No</td></tr>
<tr><td rowspan="4">Presenting the effects of changes in the discount rate in OCI</td><td>• 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.</td><td>Yes</td></tr>
<tr><td>• 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.</td><td>Yes</td></tr>
<tr><td>• 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.</td><td>Yes</td></tr>
<tr><td>• 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.</td><td>Yes</td></tr>
</table>

What did the IASB discuss?	What did the IASB decide?	Is there an identified change to the ED?
Presenting the effects of changes in the discount rate in OCI (continued)	• 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.	Yes
	• 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.	Yes
Insurance contract revenue	• 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.	No
	• An entity would present insurance contract revenue in profit or loss, as proposed in paragraphs 56–59 and B88–B91 of the ED.	No
	• 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.	No
	• 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.	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 rowspan="4">Transition</td><td>• An entity would apply the forthcoming insurance contracts standard retrospectively in accordance with IAS 8, unless this is impracticable.</td><td>No</td></tr>
<tr><td>• 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.</td><td>Yes</td></tr>
<tr><td>• 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.</td><td>Yes</td></tr>
<tr><td>• 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.</td><td>Yes</td></tr>
<tr><td colspan="3">Participating contracts</td></tr>
<tr><td>The variable fee approach</td><td>• For direct participating contracts – i.e. those that meet the following criteria – the CSM would be unlocked for changes in the estimate of the variable fee for service that the entity expects to earn:
– the contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items;
– the entity expects to pay to the policyholder an amount equal to a substantial share of returns from the underlying items; and
– a substantial portion of the cash flows that the entity expects to pay to the policyholder is expected to vary with the cash flows from the underlying items.</td><td>Yes</td></tr>
<tr><td>Recognising the CSM in profit or loss</td><td>• An entity would recognise the CSM in profit or loss on the basis of the passage of time.</td><td>Yes</td></tr>
</table>

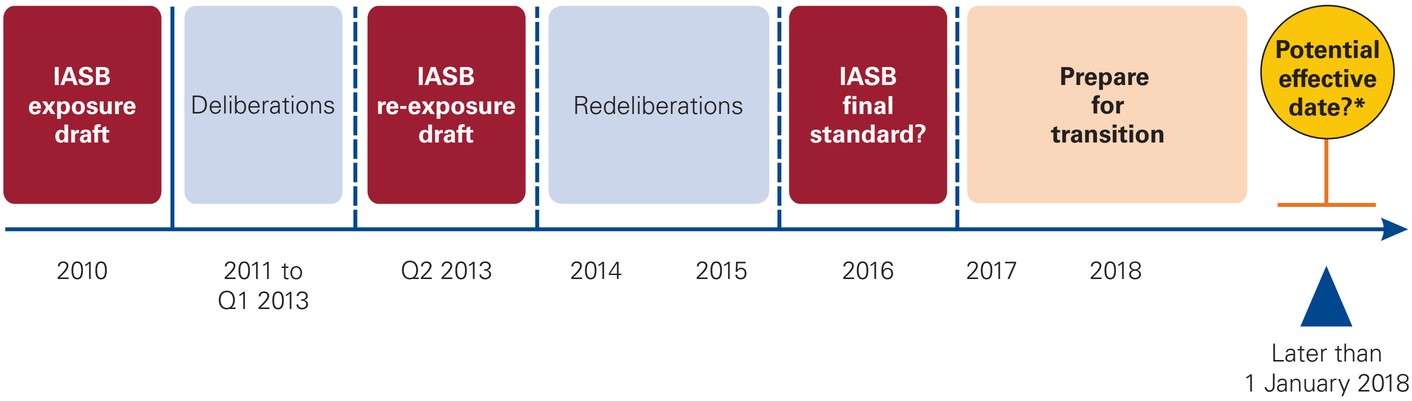
What did the IASB discuss?	What did the IASB decide?	Is there an identified change to the ED?
Non-targeted issues		
Recognising the CSM in profit or loss	• The remaining CSM would be recognised in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer 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
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

What did the IASB discuss?	What did the IASB decide?	Is there an identified change to the ED?
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[5]
	• 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

5. 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	Challenges posed to insurers by IFRS 9's classification and measurement requirements
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.

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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.

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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.