

Snapshot: Insurance Contracts

This Snapshot is a brief introduction to the Exposure Draft *Insurance Contracts*, published in June 2013. It provides an overview of the main proposals developed by the International Accounting Standards Board (IASB).

Project objectives: To improve financial reporting by providing a consistent basis for the accounting for insurance contracts and to make it easier for users of financial statements to understand how insurance contracts affect an entity's financial position, financial performance and cash flows.

The proposals would enhance comparability across entities, jurisdictions and capital markets. The proposals would apply to all insurance contracts whether issued by insurers or by other entities.

Project stage: In June 2013, the IASB published the Exposure Draft *Insurance Contracts* (the 2013 Exposure Draft), which built on the previous consultations undertaken by the IASB in 2007 and 2010.

The 2013 Exposure Draft targets the specific aspects of the IASB's proposals that it revised after the previous consultations.

Next steps: The IASB invites comments from all interested parties and will undertake further outreach activities, including a third round of fieldwork, to seek views on these proposals. The proposals are open for comment until **25 October 2013**.

Following the 2013 Exposure Draft the IASB expects to have all of the information necessary to publish a final Standard.

The IASB expects to allow a period of approximately three years after it publishes a final Standard on insurance contracts before the Standard will come into effect to allow companies to prepare for implementation.

Background

Why is the IASB addressing the accounting for insurance contracts?

When the IASB began its work in 2001, International Accounting Standards (IASs) had no Standard on insurance contracts. In anticipation of adoption of IFRS by a number of jurisdictions, including the European Union, the IASB published IFRS 4 *Insurance Contracts*. That Standard enabled existing practices to be maintained and was intended as a stopgap measure pending a more fundamental reassessment of the accounting for insurance contracts.

As a result, IFRS today has little guidance for entities that issue insurance contracts. This means that existing and potential investors, lenders and other creditors are not provided with all the information they need to understand the financial statements of entities that issue insurance contracts or to make meaningful comparisons between such entities.

Who is affected by these proposals?

The IASB's proposals affect any entity that issues insurance contracts, not only regulated insurance companies. In addition, the proposals affect entities that issue:

- some types of fixed-fee service contracts;
- third-party product warranties and residual value guarantees; and
- investment contracts that contain discretionary participation features.

The proposals will also affect any users of the financial statements of those entities.

How would these proposals improve financial reporting?

The IASB's proposals would improve financial reporting by providing more transparent, comparable information about:

- the effect of the insurance contracts an entity issues on the entity's financial performance;
 - the way entities make profits or losses through underwriting risks and investing premiums from customers; and
 - the nature and extent of risks that entities are exposed to as a result of issuing insurance contracts.
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Building on previous consultations

The 2013 Exposure Draft builds on the proposals contained in the IASB's 2007 Discussion Paper *Preliminary Views on Insurance Contracts* and the 2010 Exposure Draft *Insurance Contracts*.

Extensive due process

In developing the 2013 Exposure Draft, the IASB has followed a comprehensive due process and undertaken extensive consultation with interested parties, including input from:

- more than 160 comment letters in response to the Discussion Paper and more than 250 comment letters in response to the 2010 Exposure Draft;
- 14 meetings of the Insurance Working Group;
- two rounds of targeted fieldwork; and
- six round-table meetings.

Complete draft of proposed Standard

The IASB has provided a complete draft of the proposed Standard on insurance contracts so that interested parties can consider the new proposals in context. Furthermore, the IASB welcomes views on whether the proposals as a whole are drafted clearly, can be implemented consistently and will provide useful financial information.

Targeted feedback

As a result of the feedback on its 2007 Discussion Paper and 2010 Exposure Draft, the IASB is satisfied that its measurement model for insurance contracts is appropriate and would result in improvements to financial reporting. This model has been retained in the 2013 Exposure Draft. However, the IASB has made significant changes to the way that model is implemented in response to the issues identified during previous consultations.

Accordingly, while the 2013 Exposure Draft sets out the full model for accounting for insurance contracts, the IASB seeks input only on the changes it has made to the proposals set out in the 2010 Exposure Draft. In redeliberations the IASB does not intend either to revisit issues that it has previously rejected or to reconsider consequences it has previously considered.

Balancing benefits against complexity

The revised proposals would result in a more faithful representation and more relevant and timely information about insurance contracts compared to the proposals in the 2010 Exposure Draft. The IASB has sought to balance those benefits with the costs of greater operational complexity for preparers, and any increased costs for users of financial statements in understanding the information produced.

The IASB acknowledges that these proposals are more complex than the proposals in the 2010 Exposure Draft and seeks particular input on whether the costs of providing the revised information are justified by the benefits of the information provided.

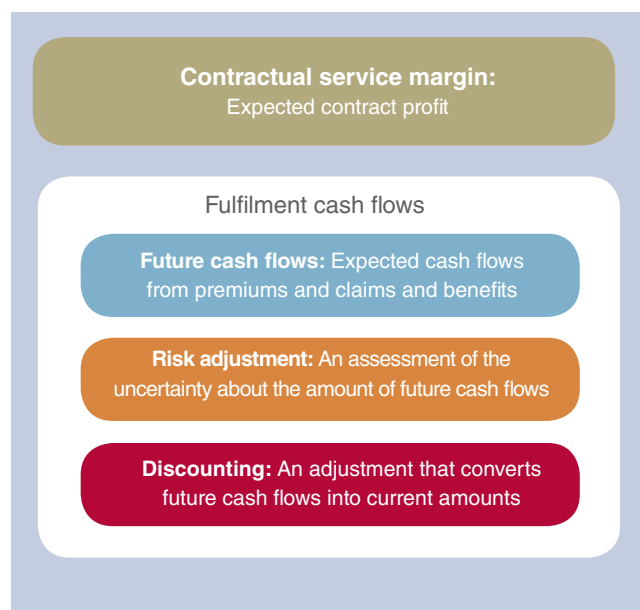


What is the IASB proposing?

In common with previous proposals, the 2013 Exposure Draft proposes a measurement model that provides information about how insurance contracts contribute to the entity's financial position and performance.

This page illustrates how insurance contracts will be shown on the balance sheet and statement of other comprehensive income.

Balance Sheet



The balance sheet amount reflects the **expected contract profit** from the insurance contract and a current estimate of the amount of **future cash flows** from the insurance contract, adjusted to reflect the **timing** and **uncertainty** relating to those cash flows.

Statement of Comprehensive Income

	20XX
Insurance contracts revenue	x
Incurred claims and expenses	(x)
Operating result	x
Investment income	x
Interest expense on insurance liability	(x)
Investment result	x
Profit or loss	x
Effect of discount rate changes	(x)
Total comprehensive income	xx

The statement of comprehensive income reports an operating result which reflects **underwriting experience**, the change in **uncertainty** and the **profit from services** in the period and, through the interest and discount rate changes, both a current and a cost-based view of the **cost of financing** the insurance contract.

Improving the 2010 proposals

Many respondents to the 2010 Exposure Draft agreed that using a current measurement of insurance contracts provided relevant and useful information to users of financial statements. However, some respondents also identified areas that would benefit from simplification, or greater clarity in the information provided. In response to that feedback, the IASB has revised its proposals to:

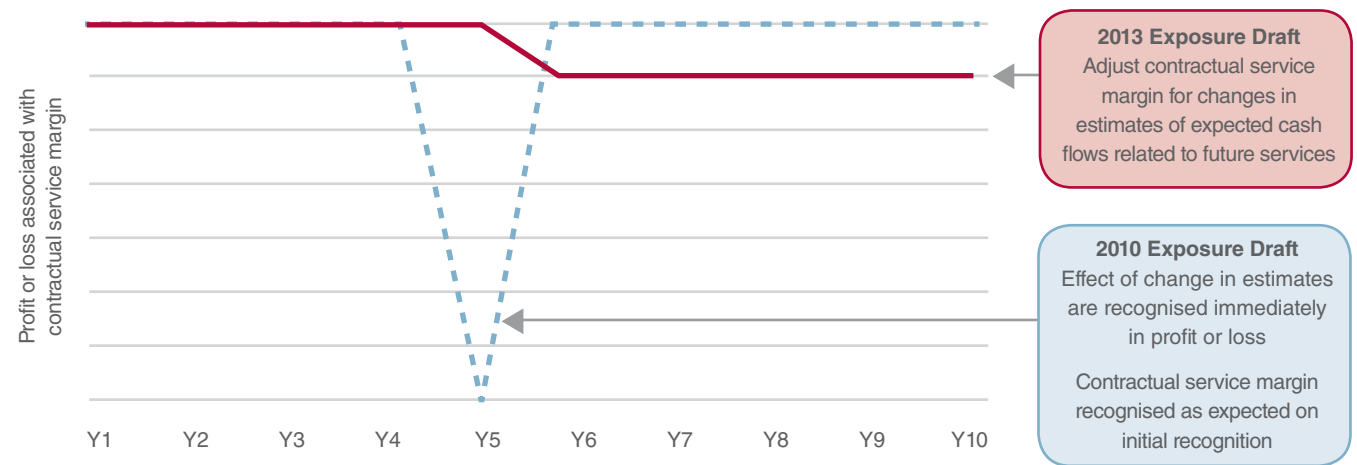
- refine the **measurement approach** to propose:
 - that an entity should recognise any change in estimates relating to future profits to be earned for insurance coverage under an insurance contract over the period in which that profit is earned (see page 7); and
 - a measurement and presentation exception to reflect situations in which there can be no economic mismatch between the insurance contract and assets backing that contract (see page 8).
 - develop the **presentation approach** to propose that an entity should:
 - align the presentation of revenue with that required for other contracts with customers by other IFRSs (see page 9); and
 - present interest expense from insurance contracts in a way that enables an amortised cost-based expense to be presented in profit or loss and a current-value-based balance sheet to be presented (see page 10).
 - amend the **transition approach** to propose simplifications that maximise the use of objective data and to improve comparability for contracts originated before and after application of the proposals (see page 11).
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Adjustments for changes in cash flows relating to future insurance coverage

The 2013 Exposure Draft proposes that any changes in estimates relating to the profits to be earned from an insurance contract are recognised over the remaining coverage period.

The 2010 Exposure Draft proposed that such changes in estimates should be recognised in full in the period in which the entity changes its estimate.

We were told that recognising an immediate effect in profit or loss for expected changes in future profits was not a faithful representation of the effect of those changes because it would mean that future periods would continue to reflect the original (unadjusted) estimates.

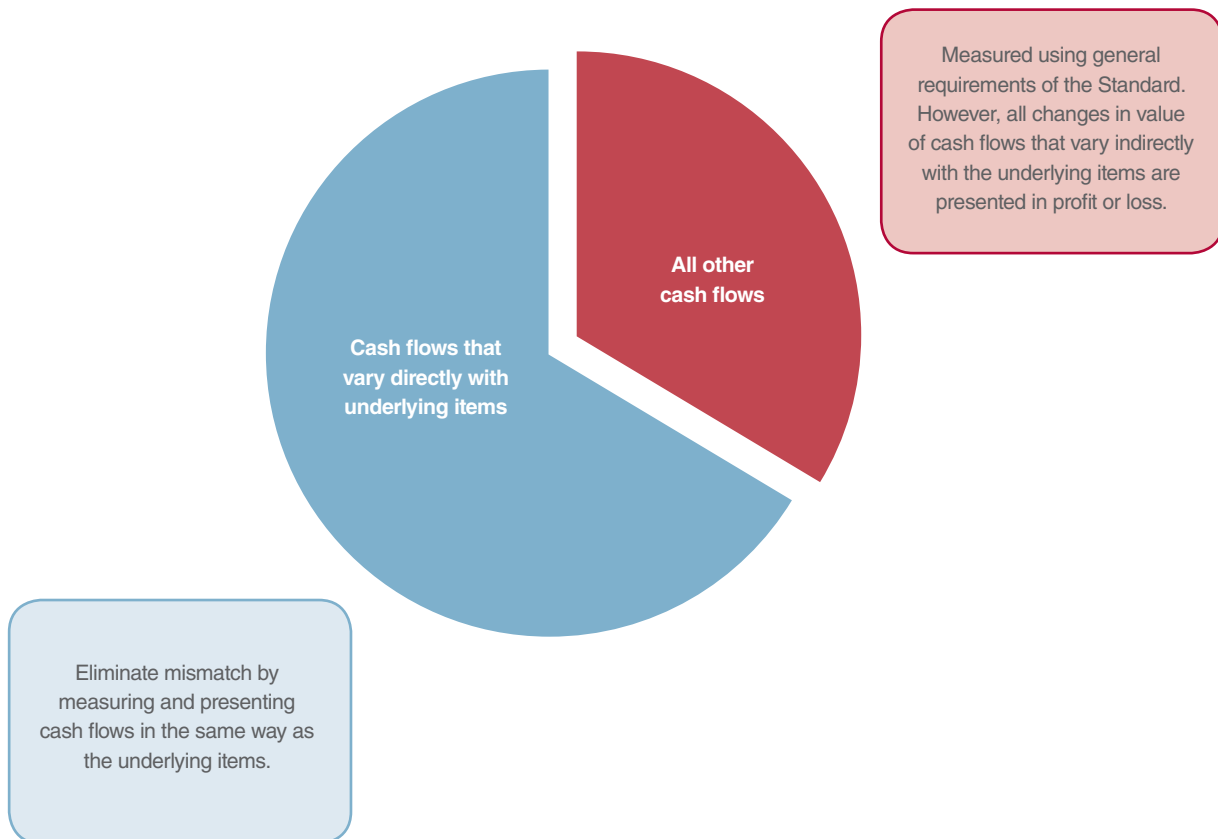


Contracts that have cash flows that are expected to vary directly with returns on underlying items

The 2013 Exposure Draft proposes an exception to how the insurance contract is measured and how changes in measurements are presented when there can be no economic mismatch between the insurance contract and assets backing that contract.

The exception applies when the contract requires that the entity holds underlying items and specifies a link to returns on those underlying items. It ensures that this linkage is reflected in the financial statements by making the measurement of the insurance contract consistent with that of the underlying item. The 2010 Exposure Draft did not specify different requirements for such contracts.

We were told in response to the 2010 proposals that it would be inconsistent with the economic situation to report accounting mismatches if the measurement of such an insurance contract was not aligned with the underlying items.



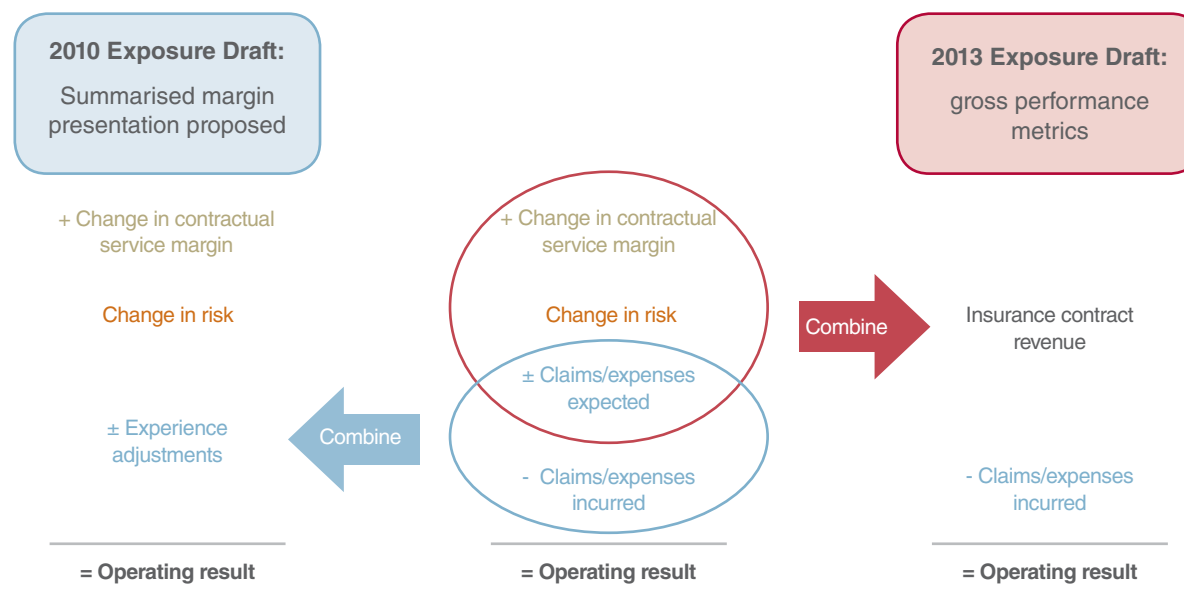
Presentation of insurance contract revenue and expense

The 2013 Exposure Draft proposes that entities present revenue from all insurance contracts consistently with the presentation of revenue in accordance with IFRS for other transactions.

The 2010 Exposure Draft proposed that an entity should present only net margin information in the statement of comprehensive income. The 2013 proposal responds to feedback that gross performance should be measured in a similar way to the revenue presented from non-insurance contracts with customers.

As a result, the IASB proposes that an entity should present as insurance contract revenue the consideration for insurance services provided under the insurance contract. As for other types of contract, an entity would not present as revenue amounts deposited by customers. The IASB also proposes that the expenses related to an insurance contract should be presented in the period incurred and exclude repayments of deposits.

The operating result is unchanged from that in the 2010 Exposure Draft. Only the presentation of revenue and expenses has been changed.



Insurance contract revenue represents consideration for:

- providing insurance coverage and other services
- paying expected claims, benefits and expenses
- bearing risk in the period

Determining interest expense

The 2013 Exposure Draft proposes that interest expense from insurance contracts is presented in profit or loss in a way that reflects a cost-based measurement and that the balance sheet carrying amount for insurance contracts reflects a current-value-based measurement.

Doing so highlights underwriting performance and aligns these proposals with the IASB's current proposals to modify the accounting requirements for financial assets. The IASB has proposed the introduction of a Fair Value Through OCI (FVOCI) category for some simple debt instruments. This proposal would mean that when an entity has assets measured at amortised cost or FVOCI, a cost-based profit or loss would result from the combination of the measurement of the insurance contract and those assets.

This proposal responds to the feedback received on the 2010 Exposure Draft that recognising all changes in the insurance contract in profit or loss would obscure the underwriting performance of the entity.

Statement of Comprehensive Income

	20XX
Underwriting result	x
Net interest and investment income	x
Interest expense on insurance contracts	x
Net interest and investment	(x)
Profit or loss	x
Fair value change of assets	x
Effect of discount rate changes on insurance liability	(x)
Total comprehensive income	xx

Profit or loss
Reflects amortised cost-based expense of providing insurance services

Other comprehensive income
Reports amounts that unwind over time

Total comprehensive income
Reflects a current view of income and expenses in the period

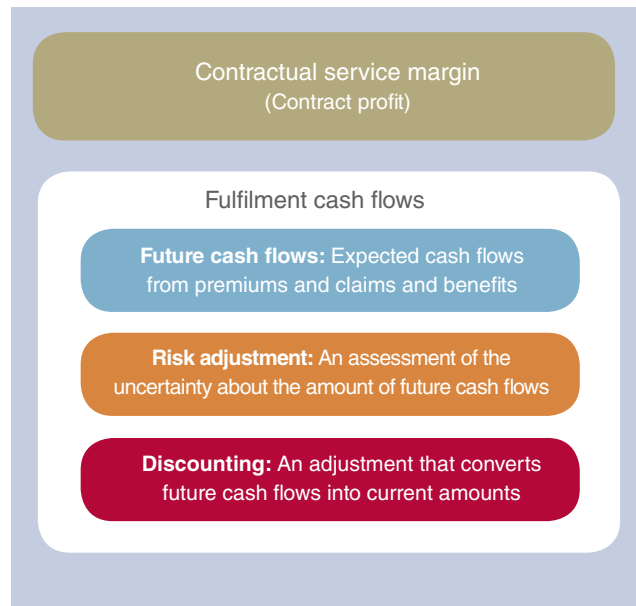
Applying the new accounting for the first time

The 2013 Exposure Draft proposes that entities applying the Standard for the first time should estimate the remaining unearned profit and insurance contract revenue on their existing insurance contracts. This allows comparison between contracts entered into before and after transition to the new accounting model.

This proposal modifies the previous proposal that an entity should assume that there would be no unearned future profit when the entity first applies the Standard. That approach was simple to apply. However, it would have reduced the amount recognised on the balance sheet for existing insurance contracts and no profits would have been recognised on those contracts over their remaining life after the date of transition to the new standard.

We were told that the lack of a contractual service margin (and thus future profit) would impair comparability between contracts written before and after the date of transition.

Information needed for transition



When proposed standard is first applied:



Estimate as if the Standard had always been applied, with simplifications that maximise the use of objective data if necessary

Measure on date of first time application

IFRS and US GAAP

The IASB and FASB are publishing separate Exposure Drafts on their proposals relating to insurance contracts. The two Exposure Drafts have overlapping comment periods, enabling interested parties to compare and comment on both proposals.

The IASB and the US Financial Accounting Standards Board (FASB), have worked jointly to develop proposals to improve and simplify financial reporting requirements and to provide investors with useful information about insurance contracts. As a result, most of the conclusions reached by the IASB and FASB are consistent, although important differences remain in how the IASB and FASB each propose to portray the pattern of profit recognition, and in how the entity reflects changes in the estimates of the profit that is earned from insurance contracts.

While the IASB and the FASB wish to achieve convergence in their proposals, each are subject to different time pressures and are at different stages in the progress of their projects. The IASB has no comprehensive Standard for the accounting for insurance contracts, and is seeking targeted input on the particular areas for which it proposes changes to its previous proposals in the 2010 Exposure Draft. In contrast, the FASB is seeking input on the entire package of its proposed improvements to long-standing US GAAP because the FASB has not previously published an Exposure Draft relating to proposals on this subject.

Interaction with the new proposals for financial instruments

The interaction between the proposals for the classification and measurement requirements for financial instruments and the proposals for insurance contracts are relevant, because entities hold financial assets to back their insurance contracts, either explicitly or implicitly.

Proposals for the classification and measurement of financial assets

In November 2012, the IASB issued an Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* that proposed the introduction of a fair value through other comprehensive income measurement category for sample debt instruments. The comment period ended on 28 March 2013. The IASB expects to finish its redeliberations on these amendments in the second half of 2013.

Effective dates

The IASB plans to consider the responses to the March 2013 Exposure Draft *Expected Credit Losses* when setting an appropriate effective date for IFRS 9. The IASB has noted that some believe the effective date of IFRS 9 should be aligned to that of the new insurance contracts Standard. However, the IASB also needs to consider the range of entities that apply IFRS 9 for which the accounting for insurance contracts is of little or no relevance.

Companies that have already applied IFRS 9

The IASB understands the importance of the interaction between the accounting for insurance contracts and financial assets. Consequently, the IASB has proposed that companies would be able to readdress accounting mismatches that would arise (or cease to arise) on first applying the insurance contract requirements by electing to measure (or cease measuring) relevant financial assets at fair value through profit or loss.

How can I comment on the ED?

The 2013 Exposure Draft includes questions on the proposals. Respondents are invited to comment on any or all of these questions. The IASB's consideration of the feedback received in response to these questions will take place in public meetings.

The deadline for comments on the 2013 Exposure Draft is **25 October 2013**. To view the 2013 Exposure Draft and to submit your comments, visit <http://go.ifrs.org/Exposure-Drafts>.

To stay up to date with the developments of the project and to sign up for email alerts about this project, please visit the project homepage on <http://go.ifrs.org/Insurance-Contracts>.

Previous documents and the comment letters on those documents, including the 2007 Discussion Paper and the 2010 Exposure Draft, are available on the project pages.

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Notes

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