International Accounting Standards Board®

Press Release

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IASB PUBLISHES PROPOSALS ON ACCOUNTING FOR INSURANCE CONTRACTS

The International Accounting Standards Board (IASB) today took the first step towards improving insurance accounting practices by publishing proposals for greater transparency. The proposals are set out in Exposure Draft ED 5 *Insurance Contracts*. The Exposure Draft proposes guidance for insurance companies that will be expected to comply with International Financial Reporting Standards (IFRSs) in 2005. At present there is no IFRS that addresses insurance contracts, and insurance contracts are excluded from some existing standards that would otherwise be relevant. Furthermore, accounting for insurance contracts varies widely throughout the world and is often inconsistent with accounting practices for other industries.

In developing ED 5, the IASB has tried to balance the need to introduce guidance into international standards with the recognition that developing a global consensus on a rigorous and comprehensive approach would require extensive consultation. That consultation could not be completed in time to meet the starting date of 2005 set by the European Union and other jurisdictions. In that light, ED 5 marks only the first phase of the IASB's insurance project. It is aimed at introducing improved disclosures for insurance contracts. In addition, the proposals are intended to introduce modest improvements to recognition and measurement practices, without requiring extensive changes that might need to be reversed when the IASB completes the second phase of this project.

In the second phase, the IASB will address broader conceptual and practical issues related to insurance accounting. These will be the subject of IASB deliberations and consultations with interested parties that will resume in the last quarter of 2003.

Introducing the Exposure Draft, Sir David Tweedie, IASB Chairman, said:

> "Developing a widely respected accounting standard that addresses the many complex practical and conceptual problems in insurance accounting remains a priority for the

> IASB. Reaching a conclusion on these issues, however, will require careful consideration of all issues and viewpoints that will occupy the Board for some time and could not possibly be completed by the 2005 deadline set in many jurisdictions. At the urging of regulators and industry, the IASB has published the proposals in ED 5 to show how light may be shed on existing insurance accounting practices without imposing significant costs on the insurance industry in advance of completing the more comprehensive project."

The IASB invites comments on the Exposure Draft by 31 October 2003.

Copies of ED 5 *Insurance Contracts* (ISBN 1-904230-27-X) (three-part set) are available, at £15 each (€24/US$23) including postage, from: IASCF Publications Department, 1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom. Tel: +44 (0)20 7332 2730, Fax: +44 (0)20 7332 2749. Email: publications@iasb.org.uk. Web: www.iasb.org.uk

Subscribers to the IASB's *Comprehensive Subscription Service* can view the Exposure Draft from the secure online services area of the IASB's Website. From 11 August the complete text of the Exposure Draft will be freely available from the Website.

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NOTES TO EDITORS

The proposals

1. The objective of the proposals in ED 5 is:

   (a) to make limited improvements to accounting practices for insurance contracts, without requiring major changes that may need to be reversed when the IASB completes the second phase of the project.

   (b) to require an entity issuing insurance contracts (an insurer) to disclose information about those contracts.

2. The proposals in ED 5 would apply to all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. They would not apply to other assets and liabilities of an insurer, such as financial assets and financial liabilities within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*. Furthermore, the proposals do not address accounting by policyholders.

3. The proposals would exempt an insurer temporarily (ie for accounting periods beginning before 1 January 2007) from some precedents set by other IFRSs and the IASB's *Framework*. However, the proposals would:

   (a) eliminate catastrophe and equalisation provisions.

   (b) require a loss recognition test if no such test exists under an insurer's existing accounting policies.

   (c) require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and to present insurance liabilities without offsetting them against related reinsurance assets.

4. The proposals would permit an insurer to change its accounting policies for insurance contracts only if that would mean that its financial statements present information that is more relevant and reliable. In particular, an insurer could not adopt a new accounting policy that involves any of the following, although it may continue using existing accounting policies that involve them:

   (a) measuring insurance liabilities on an undiscounted basis.

   (b) measuring insurance liabilities with excessive prudence.

   (c) reflecting future investment margins in the measurement of insurance liabilities.

   (d) using measurements that implicitly measure contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services.

   (e) using non-uniform accounting policies for the insurance liabilities (and related deferred acquisition costs, if any) of subsidiaries.

5. When an insurer changes its accounting policies for insurance liabilities, ED 5 would permit it to reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss.

6. The proposals would also:

   (a) exempt an insurer from accounting for an embedded derivative separately at fair value if the embedded derivative meets the definition of an insurance contract.

   (b) require an insurer to unbundle (ie account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet.

   (c) limit reporting anomalies when an insurer buys reinsurance.

   (d) permit an expanded presentation for insurance contracts acquired in a business combination or portfolio transfer.

   (e) address limited aspects of discretionary participation features contained in insurance contracts or financial instruments.

7. The proposals would require disclosure about:

   (a) the amounts in the insurer's financial statements that arise from insurance contracts.

   (b) the estimated amount, timing and uncertainty of future cash flows from insurance contracts. The proposals in this area address disclosures about the risks to which an insurer is exposed and they highlight material exposures to interest risk or market risk under embedded derivatives such as guaranteed annuity options.

   (c) the fair value of the insurer's insurance liabilities and insurance assets.

8. The proposals would come into effect for periods beginning on or after 1 January 2005 but earlier application would be encouraged. The requirement to disclose the fair value of insurance liabilities and insurance assets would apply from 31 December 2006.

9. The draft IFRS published in ED 5 is accompanied by two separate booklets. The first contains the Basis for Conclusions, which sets out the IASB's reasoning behind its proposals; and the second consists of draft implementation guidance.

Phase II of the project

10. The IASB has requested its staff to research an approach that would require an entity to measure at fair value its contractual rights and obligations arising from insurance contracts. The IASB intends to resume its research and consultation on phase II later in 2003. It will consider whether the approach being explored can be developed into a standard that is consistent with the IASB *Framework* and is workable in practice.

About the IASB

11. The IASB, based in London, began operations in 2001. It is funded by contributions collected by its Trustees, the IASC Foundation, from the major accounting firms, private financial institutions and industrial companies throughout the world, central and development banks, and other international and professional organisations. The 14 IASB members (12 of whom are full-time) reside in nine countries and have a variety of professional backgrounds. The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements.

In pursuit of this objective, the IASB cooperates with national accounting standard-setters to achieve convergence in accounting standards around the world.

12. At present, some 35 countries require the use of international standards for all domestic listed companies, six other countries require the use of international standards for some companies, and many countries base their national practices on international standards. In 2002, several jurisdictions, including Australia, the European Union, and Russia, announced that they would require international standards on or before 1 January 2005.