Insurance Accounting Newsletter

IASB redeliberations start apace: decisions on CSM unlocking, OCI solution and revenue presentation achieved in two months

Main developments

The International Accounting Standards Board ("the Board") has continued its redeliberation to produce the first comprehensive International Financial Reporting Standard ("IFRS") on Insurance Contracts based on the comments received on its 2013 Exposure Draft on Insurance Contracts ("2013 ED") which, by November last year, had attracted nearly 200 comment letters.

The redeliberation process seems to have started apace in the Board meetings held in March and April, with the IASB having made tentative decisions in three of the five areas for which comments were sought in the 2013 ED. Coincidentally, in February the Financial Accounting Standards Board ("FASB") decided to narrow the scope of its insurance contracts project; therefore, the IASB's recent redeliberations have been conducted alone in contrast to the joint meetings it held with the FASB before January of this year.

The Board considered three of the five targeted proposals in the 2013 ED:

- Unlocking of the contractual service margin ("CSM");
- Presenting the effect of changes in discount rates in other comprehensive income ("OCI solution"); and
- Presentation of insurance revenue and expenses other than when the Premium Allocation Approach (PAA) is permitted and adopted by an insurer.

The Board considered these themes only in relation to insurance contracts that have no participating features. The reason for this is that one of the two remaining topics for redeliberation is the complex issue of accounting for participating features embedded in insurance contracts and financial instruments (the other topic is transition which received nearly universal support as drafted in the 2013 ED). The Board will tackle this topic starting from its June meeting and when complete it will reconsider prior decisions on the other topics to ensure internal consistency of the new accounting model.

In addition to making progress on these three areas the Board also confirmed during its April meeting that it will consider a set of items outside those exposed for comments in the 2013 ED which have been identified as being capable of enhancement ahead of the finalisation of the new IFRS.

Unlocking the CSM

The discussion on unlocking the CSM at the March meeting focused on the treatment of previously recognised losses and whether to unlock the CSM for changes in the risk adjustment. The Board confirmed the proposals in the 2013 ED by tentatively deciding that the CSM should be unlocked for changes in cash flows related to future coverage and services and that it must be fully released to earnings when the coverage of an insurance contract is expired.

Against this confirmation though the Board decided to change the CSM accounting by requiring the recognition of income when favourable changes arise after a portfolio has turned onerous (i.e. no CSM would be left). This income can only be recognised to the extent that they reverse prior losses from onerous portfolios.

The Board also decided on another change to the 2013 ED such that the CSM would be unlocked for changes in the risk adjustment that related to future coverage and/or other services. The Board reiterated that it believed that a risk adjustment in addition to a CSM would provide useful information to users of the financial statements.

The OCI solution

At its March meeting, the Board decided to change its position on recognising the effect of changes in discount rates in OCI. The 2013 ED had mandated this treatment, but the Board tentatively decided to allow an accounting policy choice at the portfolio level as to whether the effect of changes in discount rates should be presented in profit or loss or in OCI. The Board decided to develop guidance such that entities will apply the same accounting policy to groups of similar portfolios.

The Board also tentatively decided that new disclosures would be required in order to enable users to compare the recognition of interest expense and the effect of changes in discount rates among insurers that have made different accounting policy elections.

Presentation of insurance revenue and expenses

At its April meeting, the Board substantially confirmed all of the requirements proposed in the 2013 ED for the introduction of a new set of requirements applicable to all insurance contracts except those where the new IFRS permits, and the insurer elects to adopt, the PAA. The Board decided to confirm these requirements because of the comparability with revenue presentation from other contracts and in spite of a number of commentators recommending them to be removed in favour of a summarised margin presentation approach.

The tentative decisions reached during the March and April meetings apply only to non-participating contracts. Once issues relating to participating contracts have been addressed, the Staff will consider whether the tentative decisions reached for non-participating contracts will need to be revisited.

Unlocking the CSM

The Board tentatively confirmed its proposal in the 2013 ED to adjust the CSM for the differences between the current and the previous estimates of the present value of cash flows related to future coverage and other services, subject to the condition that the CSM should not turn negative.

One member commented that there is a need for the Board to consider the unit of account for the purpose of unlocking the CSM and the discount rate to use for the accretion of interest on the unearned CSM balance.

The 2013 ED and the current set of decisions require that an insurer always accretes interest on the CSM using the discount rate identified for the initial recognition of the CSM (locked-in discount rate). The unlocking of the CSM using the locked-in discount rate will add complexity to an insurer who decides not to use the OCI solution but instead decides to account for the time value of money on the estimated cash flow using a current discount rate for both balance sheet and profit or loss purposes. The Staff indicated their intention to address these topics at a future IASB meeting.

Treatment of previously recognised losses

As the Staff presented its proposals on the accounting treatment of previously recognised losses when subsequent favourable changes are expected in the fulfilment cash flows, the following two options were considered:

1. Re-establish the CSM equal to the entire amount relating to the favourable changes; or

2. Recognise in profit or loss the impact of these favourable changes to the extent that they reverse the losses relating to the future coverage and other services that were previously recognised in profit or loss. Any excess of favourable changes in cash flow estimates over losses previously recognised in profit or loss would rebuild the CSM component of the insurance portfolio liability.

Option 1 was part of the 2013 ED and it was seen as a simpler approach because there is no need to track the losses to be reversed in profit or loss in the subsequent periods when favourable changes arise in the estimates of the present value of future cash flows.

However, the Board accepted unanimously the Staff recommendation to adopt Option 2 as they believe that this accounting treatment is consistent with other IFRSs.

The Staff pointed out that many respondents believe that the benefit of doing so will outweigh the cost and that there was wide support for this proposal from various respondents. Fieldwork participants commented that the proposal is operational. Feedback from respondents had identified benefits of unlocking the CSM with a provision to reverse prior losses from onerous portfolios. These included:

- Better representation of the CSM as the unearned profit of the contract;

- Consistency of CSM measurement at initial recognition with the subsequent measurement; and

- Consistency of CSM measurement between the building block approach and the premium allocation approach.

At its March meeting the Board decided to change its position on recognising the effect of changes in discount rates in OCI.

Unlocking the CSM for changes in risk adjustments

The Board unanimously supported the Staff recommendation that the CSM should be unlocked for changes in risk adjustments. Consistent with the accounting proposals on the treatment of changes in the present value of cash flows, the CSM will be unlocked for changes in risk adjustments relating to future coverage and future services, subject to the CSM not turning negative. Changes in risk adjustments relating to current and past periods of coverage will be recognised immediately through profit or loss.

The rationale behind the proposal in the 2013 ED to recognise changes in risk adjustments immediately through profit or loss was to achieve transparency and avoid the operational complexity of separating changes in risk adjustments relating to future service and future coverage from those associated with post-coverage cash flows (e.g. claims settlement cash flows).

The Board debate highlighted the concern that this decision may hinder the benefit of having two margins given that the CSM will be unlocked for both changes in the present value of cash flows and changes in the risk adjustments relating to future services and future coverage.

However the Board eventually concluded that having an explicit risk adjustment figure will provide better information, particularly for long term contracts. This will include:

- Information on whether the insurance contract remains profitable or not after allowing in all cases for the cost the insurer would expect to pay given the uncertainty of the underlying cash flows. This is a critical element of the new IFRS where the expected estimates are calibrated at the statistical mean of the probability attributable to each scenario and the risk adjustment is determined in order to achieve an amount of the combined expected cash flows and risk adjustment that leaves the insurer indifferent between the uncertainty of cash flow outcomes and the scenario where that combined amount is due without uncertainty;

- The risk adjustment recognised in the balance sheet reflects the amount of risk still outstanding both for the future coverage and services as well as the risk of cash flows being settled at different amounts after the expiration of the coverage period (e.g. uncertainty of claims settlement cash flows); and

- The adjustment to the CSM represents only the change in the risk adjustment from one period to the next that is associated with the same set of cash flows that the 2013 ED had already required to be included in the unlocking mechanism.

The Board also observed that moving to an approach where changes in risk adjustments result in unlocking the CSM brings the two-margin approach closer to a single margin approach.

The Board considered in particular whether there are circumstances where a practical expedient could be provided to the insurer to apply a single margin approach, subject to the onerous contract test, including an allowance for risk. Eventually the Board decided to abandon this avenue on the grounds that this could add complexity because it would require the insurer to specify which contracts would qualify for such a practical expedient.

The risk adjustment has been an element of the new IFRS that captures the effects of risk pooling. The 2013 ED evolved the concept to an entity specific determination of the extent of such pooling by developing the concept of a risk adjustment as the element that, when added to the probability weighted estimate of cash flows, makes the insurer indifferent/neutral between holding the uncertain obligation represented by the aggregate of the insurance contracts and another obligation for the same amount where there is no uncertainty of cash outflows (e.g. a fixed amount payable). This approach introduces an aggregation of insurance contracts that is no longer dependent on the definition of a portfolio which the 2013 ED stipulated as "a group of insurance contracts that (a) provide coverage for similar risks and that are priced similarly relative to the risk taken on; and (b) are managed together as a single pool" and, in fact, could comprise several different portfolios. The decision to account for unlocking the CSM based on certain elements of the risk adjustment movements could require application guidance to reconcile the fact that these movements may be calculated at the entity level whereas the CSM is determined at the portfolio level.

Changes in risk adjustments relating to current and past periods of coverage will be recognised immediately through profit or loss. Those relating to future coverage will go against the CSM.

Use of OCI to present the changes in discount rates

Background

The 2013 ED proposed that the effect of changes in discount rates relating to the discounting of expected cash flows should always be recognised in OCI, and that the accretion of interest on the insurance contract liability should be recognised in profit or loss, using the discount rate determined on initial recognition.

A majority of the respondents were concerned about the accounting mismatches that could arise from the mandatory requirement to reflect the effect of changes in the discount rate in OCI given the different accounting treatment that might be applied to the underlying assets. These respondents requested the Board to make the use of the OCI solution optional. In the light of this request, the Staff have given further consideration to this issue, and proposed that the Board should make a change to the treatment proposed in the 2013 ED and require an insurer to make an accounting policy choice at the portfolio level as to whether to present the effect of changes in discount rates either in profit or loss or in OCI.

Exploring an option

Several Board members recognised that insurance contracts would be backed by assets accounted for under a mix of fair value though profit or loss, fair value through OCI, and amortised cost thus causing the accounting mismatch noted in the comment letters.

Some Board members expressed reservations about presenting the effect of changes in discount rate in OCI as they felt that presenting an amortised cost view in profit or loss would not provide useful information and it would add complexity, due to the need to apply locked-in rates in profit or loss and current rates in OCI to calculate interest expense. During the discussion it was considered whether a book yield approach as suggested by some in the insurance industry for participating contracts could provide an appropriate solution for non-participating contracts.

Other Board members considered that the use of OCI was appropriate for long-term contracts, as it removed the "noise" arising from changes in interest rates from profit or loss.

The Board tentatively decided by 13 votes for and 3 against that if the insurer chooses to present the effect of changes in discount rates in OCI, it should recognise:

- In profit or loss, the interest expense determined using the discount rates applied at the initial recognition of the contract; and
- In OCI, the difference between the carrying amount of the insurance contract measured using the discount rates applied at the reporting date and the carrying amount of the insurance contract measured using the locked-in discount rates.

These Board members also supported exploring an option to report the effect of changes in discount rates in profit or loss.

How the option should be achieved

The Board then discussed how best to achieve such an option, with particular reference to the Staff proposal that this should be an accounting policy choice.

Accounting policies are subject to the requirements of IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The Staff proposal would provide an insurer with the ability to change its accounting policy for particular portfolios of insurance contracts at a date after the initial choice of presentation of the effect of discounting in OCI or not. An insurer might consider this change when, for example, the composition of the backing assets changed, resulting in the creation of accounting mismatches. The Staff noted that the Board's stated objective for this project is to eliminate as many accounting mismatches as possible. This objective aligns with the primary reason why respondents had requested an option.

The Deloitte position[1] on the contractual service margin

The text below from the DTTL comment letter on the 2013 ED shows that Deloitte supported the unlocking of the CSM. However, we believe that the restriction that this should only be in respect of changes that relate to future coverage and other future services should be removed. We also consider that the release of the CSM to profit or loss should be over the duration of the insurance contract, such that it includes both the coverage and the claims handling period. We supported the proposal that the CSM should be unlocked for prospective changes in risk adjustments.

"We agree with adjusting the CSM for differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services (otherwise referred to as 'unlocking'). Overall we welcome the change in the recognition and measurement of the CSM from the 2010 ED because it now recognises the role of the CSM as unearned profit. Also, it will better reflect the economic substance of insurance contracts which we view as a payment received in advance for an obligation to stand ready to accept and handle a claim and to provide benefits to the policyholder or other parties associated with uncertain events adversely impacting the policyholder.

The unlocking of the CSM makes the accounting model in the 2013 ED more internally consistent because the CSM will now be recalculated at each reporting date in line with the revised estimates of the fulfilment cash flows.

Finally, we welcome the Board's agreement with the view expressed in our previous comment letter that on recalibration the CSM should not be negative. Accordingly, an entity must release to profit or loss any aggregate CSM in full for that onerous portfolio. Any subsequent favourable differences as a result of changes in assumptions would be recognised in CSM.

However, we believe that the unlocking of the CSM requires substantial improvements to allow for the faithful representation of the impact that insurance and participating contracts will have on insurers' performance. The key improvements are the removal of what we believe are inappropriate restrictions on the period over which the CSM is released to profit or loss and on the types of assumptions insurer should consider for unlocking."

The unlocking of the CSM makes the accounting model in the 2013 ED more internally consistent because the CSM will now be recalculated at each reporting date in line with the revised estimates of the fulfilment cash flows.

1 The Deloitte position expressed here and throughout this summary represents views set forth within the Deloitte Touche Tohmatsu Limited (DTTL) comment letter in response to the IASB 2013 ED

The Staff argued that if a requirement for an irrevocable designation had been established (as had been requested by many respondents) this outcome would not be achieved as effectively as with an accounting policy option albeit this approach would be more complex than one based on irrevocable designation.

Some Board members expressed concern that the ability to change accounting policies could be used for earnings management purposes; others did not view this as a significant risk, and considered that there needed to be a revocable option as the intention behind the OCI solution was to reduce accounting mismatches, but the composition of backing assets is dynamic, and could change significantly over time. It was noted that IAS 8 sets out the criteria that must be applied before it would be appropriate to change accounting policies. This included a requirement that the entity should demonstrate that a change in accounting policy would result in the financial statements providing more reliable and more relevant information about the effects of transactions. It was suggested that the Staff should consider whether a condition should be included in the final standard that there should be evidence demonstrating that fewer accounting mismatches would exist following a change in accounting policy.

Some Board members suggested that guidance should be included in the final standard on the way in which the requirements of IAS 8 in respect of the selection and changes of the accounting policy for the use of OCI for insurance contracts should be applied. One Board member noted that if a change of accounting policy occurred, IAS 8 requires retrospective application and restatement of comparatives, which would not fairly reflect the economic position if this was as a result of a change in asset liability management in the current year. Several Board members were concerned with the IAS 8 requirement to retrospectively restate comparative periods. The Board agreed that guidance should be developed to provide rigour about when it would be appropriate for entities to change accounting policies.

Unit of account

A majority of the Board members agreed that the application of an option at an entity level will not result in the elimination of many of the accounting mismatches, and that it would be impractical to apply the option at the contract level. However, differing views were expressed as to what would be the most appropriate unit of account. Some Board members felt that the portfolio may be too low a level, and others suggested that the Staff should investigate whether the option could be applied to products or portfolios with similar characteristics if the asset liability management strategy was applied to such groupings.

Some Board members expressed the view that the definition of a portfolio could be improved. The Staff agreed that they needed to reconsider the definition, in order to bring greater clarity and to ensure that there was an appropriate balance between ensuring that the definition was neither at too high nor too low a level.

The Chairman suggested that the Staff should investigate whether the unit of account should be at a higher level than the portfolio, and to explore whether any further restrictions on the option should be included in the final standard.

13 out of 13 members agreed with the Chairman's suggestion, and tentatively agreed that there should be an option to recognise the effect of changes in the discount rate either in OCI or in profit or loss.

Disclosures

The Staff proposed that additional disclosures about interest expense presented in total comprehensive income and the effect of changes in discount rates on the measurement of insurance contract liabilities would be required in order to enable users to understand these amounts.

The Staff had proposed that, irrespective of the accounting policy choice made, insurers prepare in their disclosures an analysis of total interest expenses included in total comprehensive income which should be disaggregated into:

- The amount of interest accretion determined with current discount rates;
- The effect on insurance liabilities of discount rate changes in the period; and
- The difference between the present value of changes in expected cash flows that adjust the CSM, measured using locked-in discount rates and current discount rates.

It is important to note that the Board approved the retention of the accretion of time value of money on the CSM balance using a locked-in discount rate. This requirement is the reason for the third compulsory disclosure above. We observe that any insurer would still be required to determine and keep a record of the locked-in discount rate for the CSM accounting requirements. This applies even if the option to account for time value of money on the expected cash flows is entirely recognised through profit or loss.

We observe that any insurer would still be required to determine and keep a record of the locked-in discount rate for the CSM accounting requirements.

The Staff had also proposed that for portfolios of insurance contracts where the effect of changes in discount rates are presented in OCI the analysis of the total interest expenses included in total comprehensive income should be disaggregated at a minimum into:

- Interest accretion at the locked-in discount rate reported in profit or loss for the period; and
- The movement in OCI for the period.

The Board tentatively decided by 15 votes against 1 that these additional disclosures provided useful information for users.

Comparison with the Deloitte position

The Deloitte position (as discussed in our response to the 2013 ED) is set out in the adjacent blue box. We believe that the final IFRS should allow insurers to designate which insurance contracts will be accounted for using the OCI solution, and which will be accounted by reflecting all changes in discount rate entirely through profit or loss, and that an irrevocable, unconstrained designation should be made available at initial recognition of an insurance contract for the accounting treatment of the associated interest expense.

We consider that the tentative decision to allow this by way of an accounting policy choice will result in unnecessary complexity for both accounting and disclosure requirements with marginal advantages in terms of the elimination of accounting mismatches.

As recommended in our comment letters to both the 2010 ED and the 2013 ED, we believe that the development of a hedge accounting solution for interest rate risk that takes into account the asset liability management practices of insurers should be considered as this has the potential to lead to a more representative position of the dynamic way in which insurers hedge their open interest rate exposure.

The Deloitte position on the OCI solution

We support the exploration of a methodology whereby all or portions of changes between the current discount rate and the discount rate determined at initial recognition of an insurance contract would be presented in other comprehensive income. We are of the view that considering the final IFRS on insurance contracts in conjunction with IFRS 9 (as amended) is the only pathway to achieve a faithful presentation of the insurance business model. However, we do not believe the proposal to require the presentation of part of the interest expense from insurance contracts through other comprehensive income ("the OCI solution") as set out in the 2013 ED fully captures the nuances of asset-liability management for many insurers. The results that would be presented in conjunction with IFRS 9 (as amended) will leave a substantial number of accounting mismatches not dealt with which would hinder the relevance of financial information prepared by insurers.

We support the "OCI solution" for all insurance contracts but believe an entity should be able to make an irrevocable election at initial recognition of insurance contracts to recognise the change in carrying value associated with changes in discount rates to profit or loss. This is consistent with our preferred approach for the fair value option of financial instruments under IFRS 9.

Insurance contract revenue

The Staff presented the proposal for the presentation of insurance contract revenue included in the 2013 ED. This proposal had received mixed views from respondents which were mainly driven by the types of products sold, i.e. life or non-life, and by the types of respondents. Those who support the proposal, being mainly the standard-setters, the regulators and the accounting bodies, believe that this will increase comparability with other industries. Insurers who mainly issue short-duration contracts also support the proposal due to the fact that it is broadly consistent with how they currently present their revenue.

Those who disagree with the proposal are mainly insurers who issue long-duration contracts and the users of financial statements who are currently using different revenue information from that proposed in the 2013 ED. As explained below, Deloitte recommended to the Board to remove this proposal from the final IFRS in favour of the summarised margin proposed in the 2010 ED.

The Staff informed the Board that there are alternative proposals for insurance contract revenue, e.g. the summarised margin approach as proposed in the 2010 ED, but these would not be discussed during the meeting if the Board agreed with the Staff recommendations.

The 2013 ED proposal on insurance contract revenue requires insurers to recognise insurance contract revenue as an amount that reflects the insurer's progress in satisfying its obligation to provide insurance coverage and other services over the coverage period.

This recognition principle is broadly in line with the principles set out in the Exposure Draft, R*evenue from Contracts with Customers* (expected to be published as IFRS 15 in the second half of May 2014).

The insurance contract revenue figure would have three components, which are:

- claims and benefits expected to be paid during the coverage period that falls within the reported period;
- change in the risk adjustment for the portion of the coverage that is expired by the end of the reported period, representing the compensation the insurer charges the policyholder for bearing risk in the reported period; and
- release of the CSM, representing the profit margin earned during the period as the insurer fulfils its obligations.

Some insurance contracts require the insurer to pay policyholders a specified amount even if an insured event did not occur. This is considered to be an investment or deposit component of the insurance contract.

Those who disagree with the proposal are mainly insurers who issue long-duration contracts and the users of financial statements who are currently using different revenue information from that proposed in the 2013 ED.

This obligation does not constitute a performance obligation associated with the acceptance of significant insurance risk (which is the bearing of the risk and the provision of coverage and other services) but is considered to be a performance obligation that does not generate revenue when fulfilled under any other IFRS. As such, the Board proposed in the 2013 ED to exclude the investment component from insurance contract revenue.

An education session was held prior to the meeting to discuss a Staff paper which describes the mechanics for determining insurance contract revenue using three example scenarios.

During the subsequent decision-making meeting, the Board deliberated three Staff recommendations relating to insurance contract revenue, which were:

- to prohibit insurers from presenting premium information in the statement of comprehensive income (SOCI) if that information is not consistent with the commonly understood notions of revenue;
- the cost of providing insurance contract revenue is justified for all contracts; and
- to retain the disclosures relating to volume information as proposed in the 2013 ED.

Prohibiting the presentation of premium information in the SOCI if not consistent with the definition of revenue

The Staff noted that for short-duration contracts for which the insurer has elected the PAA, the insurance contract revenue that is produced from this approach is already consistent with the new IFRS revenue recognition principles. In addition, the amount is similar to what insurers recognise as revenue under existing accounting practices. However, the insurance contract revenue proposals would represent a significant change in the way revenue is presented for long-duration contracts which cannot be accounted for using the simplifications of the PAA. This is due to the variety in current practices, which are largely dependent on the jurisdiction within which the insurer operates and the types of contracts that are issued. Several differences were noted, but the Staff highlighted two major features of the proposal that are different from current practices:

(a) the recognition pattern – under current practices revenue is recognised, for example, when it is due or when policies are written, which does not reflect the service that is provided under the insurance contract; and

(b) the total amount of insurance contract revenue – under current practices premiums recognised in the SOCI include some, but not all, of the investment components.

The Staff noted that they had considered other volume information for presentation in the SOCI but had decided to reject them. The Staff reminded the Board that the volume information currently presented as revenue under extant IFRS 4, *Insurance Contracts* was previously considered and was rejected in both the 2010 ED and the 2013 ED on the basis that such volume information decreases transparency of the financial statements.

Concerns were raised over presenting premium information, such as written premiums or premiums due, in the SOCI because there is a high likelihood that users of financial statements, especially those who are considered to be non-specialists, would be misled into treating such measures as revenue. The Staff commented that it has been observed in practice that data aggregators will usually take the top line item in the SOCI and treat this as revenue, and some users of financial statements also treat this figure as revenue.

Concerns were raised over presenting premium information, such as written premiums or premiums due, in the SOCI because there is a high likelihood that users of financial statements, especially those who are considered to be non-specialists, would be misled into treating such measures as revenue.

One Board member provided an argument that the income statement should present income and expense items, whereas the balance sheet should present asset and liability items. Similarly, the cash flows statement should present cash flows information only. As such, permitting insurers to present premiums due (which is a cash flow item) in the SOCI would be misleading.

Some alternatives discussed by Board members during the meeting were as follows:

a) presenting separately in the SOCI information on gross premiums less the investment component to arrive at a net premium revenue attributable to insurance coverage; and

b) no explicit prohibitions, but providing a clear definition of insurance revenue and what is to be excluded from that revenue, i.e. the investment component. An explanation would also be provided within either the application guidance or the basis of conclusion on the concerns over presenting gross premium including the investment component.

Fifteen Board members voted in favour of the Staff's recommendation with one Board member opposing it.

Cost of providing the insurance contract revenue

The Staff noted that respondents had raised concerns over the additional costs that would be incurred in excluding the investment component from insurance contract revenue. The Staff believed that some respondents may have misunderstood the accounting proposal and assessed it as more operationally complex than the Staff had intended it to be. The Staff acknowledged that additional costs would need to be incurred by insurers, but believe that the benefits resulting from such information are greater than the costs.

There was discussion about the value of the revenue information resulting from excluding the investment component from insurance contract revenue. These benefits include:

- increased comparability of the revenue information of insurers with those of other industries and across all insurance contracts; and

- information on what portion of the premium income relates to the investment component and to the non-investment component.

When asked to vote, thirteen Board members voted in favour of the Staff's recommendation to consistently apply the insurance contract revenue proposals to all insurance contracts, as the benefits of doing so are considered to exceed the additional costs that will be incurred. Three Board members voted against it.

Disclosure requirements relating to volume information

Disclosure requirements for insurance contract revenue mainly relate to revenue for long-term insurance contracts and to underwriting activity. The 2013 ED requires an insurer to disclose the following:

- information relating to movements in each of the components of the insurance contract asset or liability;

- a reconciliation of premium received to the insurance contract revenue for the period;

- inputs used in determining the insurance contract revenue, such as expected cash outflows excluding investment components, acquisition costs, changes in risk adjustments and CSMs that are attributable to the period; and information on new business and the impact on each of the components of the insurance contract asset or liability.

When asked to vote, a majority of fifteen Board members voted in favour of the Staff's recommendation with only one Board member voting against it.

Non-targeted areas

The Staff presented to the Board the common themes emerging from the comment letters relating to non-targeted areas in the 2013 ED. The Staff recommended seven non-targeted issues for redeliberation by the Board during future IASB meetings and nine non-targeted issues that should not be redeliberated.

After discussing the merits of each of the topics, a majority of fourteen Board members voted in favour of the Staff's recommendation with two Board members voting against. The non-targeted areas which the Board has tentatively decided to consider in future meetings are set out below.

The Deloitte position on insurance revenue presentation

We continue to support the measurement of an insurance contract using the fulfilment cash flows. We also continue to welcome and support the link to the measurement model and the identification of the sources of profit under the summarised margin as amended for those contracts where the simplified approach for measuring the liability for the remaining coverage is available.

However, we believe that the new revenue metric proposed by 2013 ED would not be the most faithful representation of the contribution that insurance contracts with long duration coverage provide to an insurer's financial performance in the period. The IASB desire to develop a common presentation requirement for all types of insurance contracts should be measured against the different characteristics of the various insurance contracts. We believe that the IASB should accept the co-existence of two different presentation requirements when these offer the most decision useful presentation of the contribution of short and long duration coverage insurance contracts to an insurer's performance in a given period.

Coupled with this fundamental concern we are also of the view that the new insurance revenue is not the volume information requested by investors.

The non-targeted areas which the Board has tentatively decided to consider in future meetings are set out below.

- *Fixed-fee service contracts*
  Fixed-fee service contracts with a primary purpose of providing services and that meet all the conditions set out in paragraph 7 (e) of the 2013 ED are scoped out from the requirements of the proposed insurance standard. These conditions are the pricing of risk on a portfolio rather than customer basis, compensation with services rather than cash in the event that an incident occurs and that the insurance risk arises primarily from the customer using a service or a piece of equipment. Cost-benefit concerns were raised over this straight scope exclusion by some respondents who currently account for such contracts as insurance contracts. The Staff recommended that the Board should consider whether to provide an option to account for fixed-fee service contracts as insurance contracts if they meet the definition of an insurance contract.

The Staff recommended seven non-targeted issues for redeliberation by the Board during future IASB meetings and nine non-targeted issues that should not be redeliberated

- ***Significant insurance risk guidance***
  Concerns were raised over the guidance provided in paragraph B19 of the 2013 ED relating to the assessment of whether the insurance risk being transferred is significant. This additional test on the definition is the only change from what is currently included in IFRS 4, which will require insurers to identify a scenario where the present value of outflows exceeds the inflows. At times this has been referred to as a "potential loss test". This scenario must have commercial substance and it cannot be a mere hypothetical one. Comments received from some respondents revealed that such guidance may lead to a change in the current accounting treatment for some specific types of contracts, particularly within the reinsurance sector and in those contracts designed for funding retirement needs of individuals. This resulting change was not the intention of the Board when this was first proposed in the 2010 ED and carried forward to the 2013 ED on the basis that this proposed guidance would not change existing practices. The Staff recommended that the Board should consider whether guidance on significant insurance risk should be provided.

- ***Portfolio definition and unit of account***
  Concerns were raised over the definition of a portfolio as provided in Appendix A of the 2013 ED. Some of these concerns relate to the use of a lower level of aggregation than that applied under existing measurement practices, and the difficulty in applying this definition to property and casualty policies which cover multiple risks. Some respondents also pointed out that there is conflicting guidance with regards to the unit of account for the CSM after initial recognition (e.g. at what level the portfolio is deemed onerous throughout its life and how this principle applies to open portfolios). The Staff recommended that the Board should consider whether the IASB's intention over the 'unit of account' and 'portfolio' should be clarified in order to achieve greater consistency.

- ***Discount rate for long-term contracts and unobservable market data***
  Paragraphs B70(a) and B71 of the Application Guidance of the 2013 ED provide guidance for the determination of discount rates for long-term contracts where there very limited observable market data. Some respondents have proposed alternative approaches for determining discount rates. However, the Staff highlighted in their paper that such alternative approaches had been rejected by the Board in its earlier meetings, and therefore did not propose to consider the proposed alternatives further. However, the Staff believes that further guidance is needed as the proposal may have been interpreted in different ways by respondents. The Staff therefore recommended that the Board should consider whether to include further guidance on the determination of discount rates where there is little or no observable market data.

- ***Asymmetrical treatment of reinsurance contracts***
  Concerns were raised by some respondents over the asymmetrical treatment between a reinsurance contract and the underlying insurance contract as proposed in the 2013 ED. This is because the proposals will result in the immediate recognition of a loss on the underlying insurance contract whereas the corresponding gain in the reinsurance contract will be spread over future periods. The Staff recommended that the Board considers whether in some circumstances there is an accounting, rather than an economic, mismatch between insurance contracts and reinsurance contracts because of the asymmetrical treatment of their CSMs, and if so, whether such a mismatch could be mitigated.

- ***Recognition of contracts acquired through a portfolio transfer or a business combination***
  Clarification was sought by respondents over the recognition principles of contracts acquired through a portfolio transfer or a business combination. The Staff recommended that the Board considers whether the requirements for portfolio transfers and business combinations could be simplified and clarified. In particular the acquisition of a portfolio of insurance contracts where coverage is expired (e.g. a porfolio of claims liabilities) would trigger the recognition of a CSM if the expected present value of cash flows is lower than the transaction price. Given the rule that CSM must be earned over coverage it is unclear whether this transaction generates a gain on recognition of the acquired insurance liabilities or not.

- ***Allocation pattern for the contractual service margin***
  Some respondents raised concerns over the subjective nature of determining the allocation pattern of the CSM. The Staff recommended that the Board considers providing more guidance on an appropriate allocation pattern for the CSM.

The Staff recommended that the Board should consider whether to include further guidance on the determination of discount rates where there is little or no observable market data.

Next steps

The Board will begin its discussion on the accounting for participating contracts during its meeting on 20 May 2014. This will be an education session and no decisions will be taken. Deloitte understands that the meetings in June and July are allocated for this topic to be discussed and decided upon.

In addition, on 21 May 2014 there will be a set of "non-targeted" items being brought to the table for discussion. These will include:

- The requirements on how to determine the pattern for releasing CSM to profit or loss;

- The amendments to the guidance on the assessment of significant insurance risk;

- The amendment of the scope for fixed-fee contracts; and

- The accounting for business combinations and portfolio transfers involving insurance contracts.

Contacts

Global insurance network

Neal Baumann
Global Insurance Leader
U.S.
+1 212 618 4105
nealbaumann@deloitte.com

Francesco Nagari
Global IFRS Insurance Leader
U.K.
+44 20 7303 8375
fnagari@deloitte.co.uk

Asia Pacific

Stuart Alexander
Australia
+61 2 9322 7155
stalexander@deloitte.com.au

Eric Lu
China
+86 10 8512 5809
erilu@deloitte.com.cn

Simon Walpole
Hong Kong
+852 2238 7229
siwalpole@deloitte.com.hk

Kumiko Aso
Japan
+81 90 3910 2898
kumiko.aso@tohmatsu.co.jp

Arata Otake
Japan
+81 90 6035 8857
arata.otake@tohmatsu.co.jp

EMEA

Thomas Ringsted
Denmark
+45 27 14 20 44
tringsted@deloitte.dk

Jerome Lemierre
France
+33 1 55 61 40 78
jlemierre@deloitte.fr

Colin Schenke
Germany
+49 2118 7722404
cschenke@deloitte.de

Peter Tripe
South Africa
+27 21 427 5364
ptripe@deloitte.co.za

Jordi Montalbo
Spain
+34 93 280 40 40
jmontalbo@deloitte.es

Sabine Betz
Switzerland
+41 58 279 68 81
sbetz@deloitte.ch

Latin America

Lionel Moure
Argentina
+54 11 4320 2700
lmoure@deloitte.com

Javier Vazquez
Mexico
+52 555 080 6091
javazquez@deloittemx.com

North America

John Johnston
Bermuda
+441 292 1301
john.johnston@deloitte.bm

Neil Harrison
Canada
+1 416 601 6307
nharrison@deloitte.ca

Derek Wright
Canada
+1 416 874 3753
dewright@deloitte.ca

Rajiv Basu
U.S.
+1 212 436 4808
rbasu@deloitte.com

Robert Miccolis
U.S.
+1 215 246 2566
rmiccolis@deloitte.com

Gary Shaw
U.S.
+1 973 602 6659
gashaw@deloitte.com

Rick Sojkowski
U.S.
+1 860 725 3094
rsojkowski@deloitte.com

Designed and produced by The Creative Studio at Deloitte, London. 35007A