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IFRS 9 will be amended to address insurers' concerns
IFRS 4 Phase II Update

IASB and FASB joint meetings – November 2011

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Agenda

- Highlights of decisions from latest joint meetings
- Detailed analysis of Staff recommendations and Boards decisions for the IASB only meeting on 15 November and the joint meeting held on 16 November 2011
- Update on the timetable and next steps

Highlights – 15th and 16th November 2011

Revisions to IFRS 9 – 15th November

– The IASB decided to consider making limited improvements to IFRS 9 and, in particular, to consider the interaction with the insurance contracts project.

Residual margin - 15th November

– Education session for the IASB only
– The Board indicated a leaning towards only unlocking non-financial estimates.

Disaggregation of account balances – 16th November Joint Meeting

– Staff introduced the concept of disaggregation differentiating it from unbundling
– Strong support for disaggregation/separate presentation of “explicit account balances”.
– Boards clashed on the merit of a full unbundling approach or a simpler disaggregation
– No tentative decisions were reached and topic will have to be brought back

Details of IASB meeting – 15 November

Paper 11 (IASB) – Targeted improvements to IFRS 9

Staff recommendation

The staff recommends that the Board consider making improvements to IFRS 9, in particular, to consider the interaction with the insurance contracts project. This will also enable the IASB to consider the FASB's classification and measurement model.

Discussion

- The primary reason for the reconsideration of IFRS 9 as presented by the staff was the interaction with the insurance contracts project and classification and measurement of financial assets under IFRS 9
- Specifically, the decisions to date in the insurance project would recognise the re-measurement of insurance liabilities with components through profit or loss and other components through other comprehensive income.
- Meanwhile the financial assets backing those insurance liabilities would be recognised at either amortised cost or fair value through profit or loss resulting in an accounting mismatch with the associated liabilities.
- IASB voted unanimously in favour of the Staff recommendation

Details of IASB education session – 15 November

Paper 6A (IASB) – which changes in estimate adjust the residual margin?

Main discussion point raised by staff:

Based on the tentative decision to unlock the residual margin reached in June, which changes in estimate would adjust the residual margin?

Discussion

- The IASB staff presented the papers and asked Board members to indicate whether they were leaning towards a particular approach and whether further analysis is required.
- Formal decisions were not requested at this session although the Staff sought IASB members' "leanings"
- FASB joined by teleconference to listen in the discussion although it did not participate as it has chosen to use a single composite margin.
- Discussion on whether elements such as change in discount rate should be unlocked indicated that there is an emerging preference for unlocking only for changes in cash flows that are caused by non-financial estimates.
- Staff pointed out that financial and non-financial estimates can be intertwined, for example a change in longevity could cause an asset mismatch for an insurer who has issued a portfolio of annuity contracts

Details of IASB education session – 15 November

Paper 6B (IASB): Residual margin – two approaches

Main discussion points raised by staff:

– Should the margin be locked in at inception as proposed in the ED?
– Should the margin be adjusted for some or all changes in estimates?

Residual margin two approaches – discussions

- Given the unlocking decision in June was a 8 vs. 7 majority and two IASB members have rotated in the meantime the IASB members continue to be fairly split on unlocking
- IASB members remain concerned that an unlocked approach would have complex practical implications
- Staff pointed out that locking the margin for a long term contract could be equally complex.
- Discussion on whether adjustments should include changes in future estimates or be limited to changes in experience over the period suggested that the majority was “leaning” towards the former
- We noted significant concern raised over the extent to which changes in estimate should be reflected in the profit or loss and contribute to volatility of results which could be read in favour of retaining the unlocking decision
- The interaction with a potential “OCI solution” given the decision to reopen IFRS 9 was requested for a future session
- Papers on allocation and interest accretion were not discussed due to time constraints

Details of joint meeting – 16 November

Paper 9A (IASB) / 75A (FASB) – disaggregation of explicit account balances

Staff recommendations include:

1. All explicit account balances should be separated from the insurance contract liability.
2. A contract has an explicit account balance if:
   a) it is an accumulation of the monetary amount of transactions between the policyholder and the insurer; and
   b) it is credited with an explicit return (as detailed in the paper).

- Previous tentative decisions that an insurer should unbundle embedded derivatives and obligations to deliver goods and services under certain criteria were not revisited.
- The paper did not consider the presentation in the statement of financial position of assets that are legally segregated from the assets of an insurer.

Details of joint meeting – 16 November

Paper 9A (IASB) / 75A (FASB) – disaggregation of explicit account balances

Staff recommendations include:

3. Explicit account balances and the related assets should not be offset against each other in the financial statements.
4. Explicit account balances and associated services should be measured together with the other components of insurance contracts.
5. Explicit account balances should be presented separately from the insurance liability on the face of the financial statements (not in the notes) as

   i) the explicit account balance; and

   ii) an accrual for all fees and returns through the reporting date.
6. In respect of explicit account balances, the statement of comprehensive income should recognise fees, interest return and interest credited to the balances, but not premiums paid to or claims made from the explicit account balance.

- The concept of “disaggregation” is introduced to achieve a display result that would not alter the underlying profit based on the building-blocks valuations but would facilitate the separation of “non revenue” components from the premium receivable

Details of joint meeting – 16 November

Paper 9A (IASB) / 75A (FASB) – disaggregation of explicit account balances

Discussions

- Concerns were raised over a number of items:
  - The definition of the explicit return on the account balance which was proposed as either a contractual formula in which the insurer may have the ability to reset the return rate during the life of the contract, or an allocation determined directly by the performance of specified assets
  - Unbundling versus disaggregation and the potential for inconsistencies, for example:
    - Whole insurance liability measured using the building blocks, from which account balance is taken out for presentation;
    - Undiscounted account balance versus discounted insurance cash flows.
  - The need for separate calculations and potential for arbitrary allocations between the account balance and the rest of the contract
  - The level of disaggregation to be sufficient to produce relevant financial information in particular with similar contracts being accounted for in a similar way
  - The impact of the disaggregation decision on the income statement presentation

Details of joint meeting – 16 November

Paper 9A (IASB) / 75A (FASB) – disaggregation of explicit account balances

Discussions

- Following these discussions it emerged a strong support for the separation of explicit account balances with FASB unanimously voting for the separation of explicit account balances as defined in the Staff paper.
- IASB members were also supportive of the separation but they did not reach a final vote.
- The IASB staff attempted to survey the IASB with certain basic questions:
  - Who believes the whole contract should be measured using the building blocks (excluding embedded derivatives, etc. and other items already unbundled)?

    YES = 9, No = 6
  - Who would like to explore a disaggregation of some kind?

    YES = 15.
  - Who would like to restrict this to only explicit as defined in the paper?

    YES = 9, No = 6
- No joint decision could be reached and the fundamental issues of disaggregation vs. unbundling together with the definition of explicit account balance remain open at the end of this long session
- The IASB chairman closed the joint meeting acknowledging the lack of decisions from the IASB side asked the staff to explore other approaches and for more concise papers

Next steps and timetable

- FASB still holding educational sessions where the full set of joint papers are debated prior to the joint meetings. The explicit account papers were discussed on 9th November
- Next joint meeting expected in week commencing 12 December
- FASB only educational session on participating contracts is scheduled today with a FASB only decision-making meeting on 30th November on the same topic
- Likely topics for discussion in December:
  - Short duration contracts – eligibility criteria
  - Participating contracts
- Next IWG meeting – Likely date late March 2012
- No updates on the technical plans which remain with the following milestones:
  - Release of a review draft or re-exposure (IASB) and publication of an exposure draft (FASB) during the first half of 2012
  - Finalisation of the accounting standard in 2013

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Insurance Accounting Newsletter

Insurance Working Group meeting

Link to **Deloitte IFRS Insurance materials:**

http://www.iasplus.com/agenda/insure2.htm

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