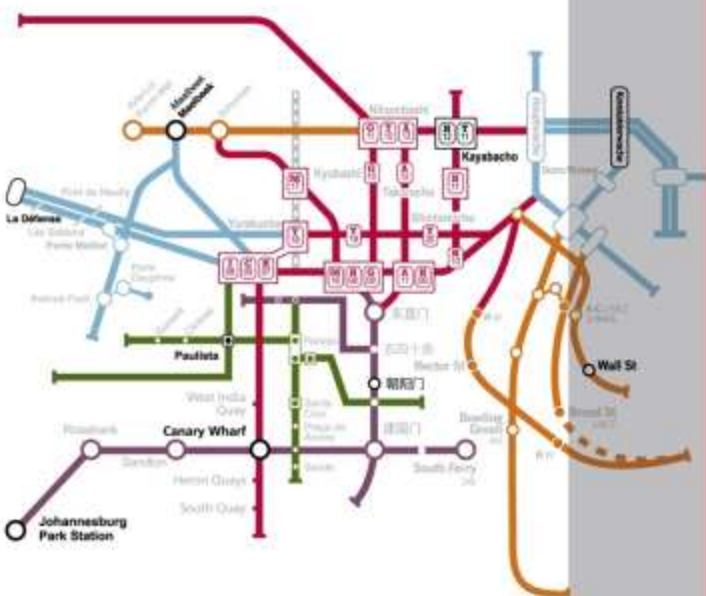
International Financial Reporting Standards



Insurance Contracts Project Update

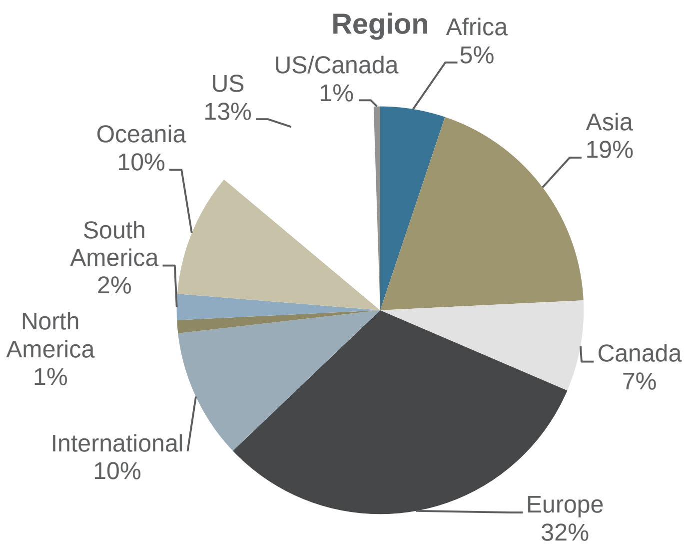
October 2014

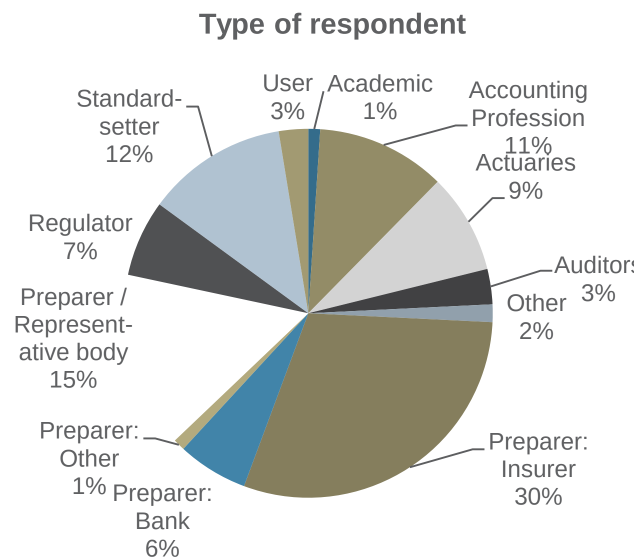
The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB or IFRS Foundation.

Contents

2013 ED *Insurance Contracts*

- Published 25 June, comment letter deadline 25 October 2013
- Received 194 comment letters and held 187 outreach meetings





- Comment letter summaries discussed in January 2014 and redeliberations began in March 2014

IFRS

A reminder
Current, market-consistent measurement

Contractual service margin
(Expected contract profit)

'Fulfilment cash flows'

Future cash flows: expected cash flows from premiums and claims and benefits

Risk adjustment: an assessment of the uncertainty about the amount of future cash flows

Discounting: an adjustment that converts future cash flows into current amounts

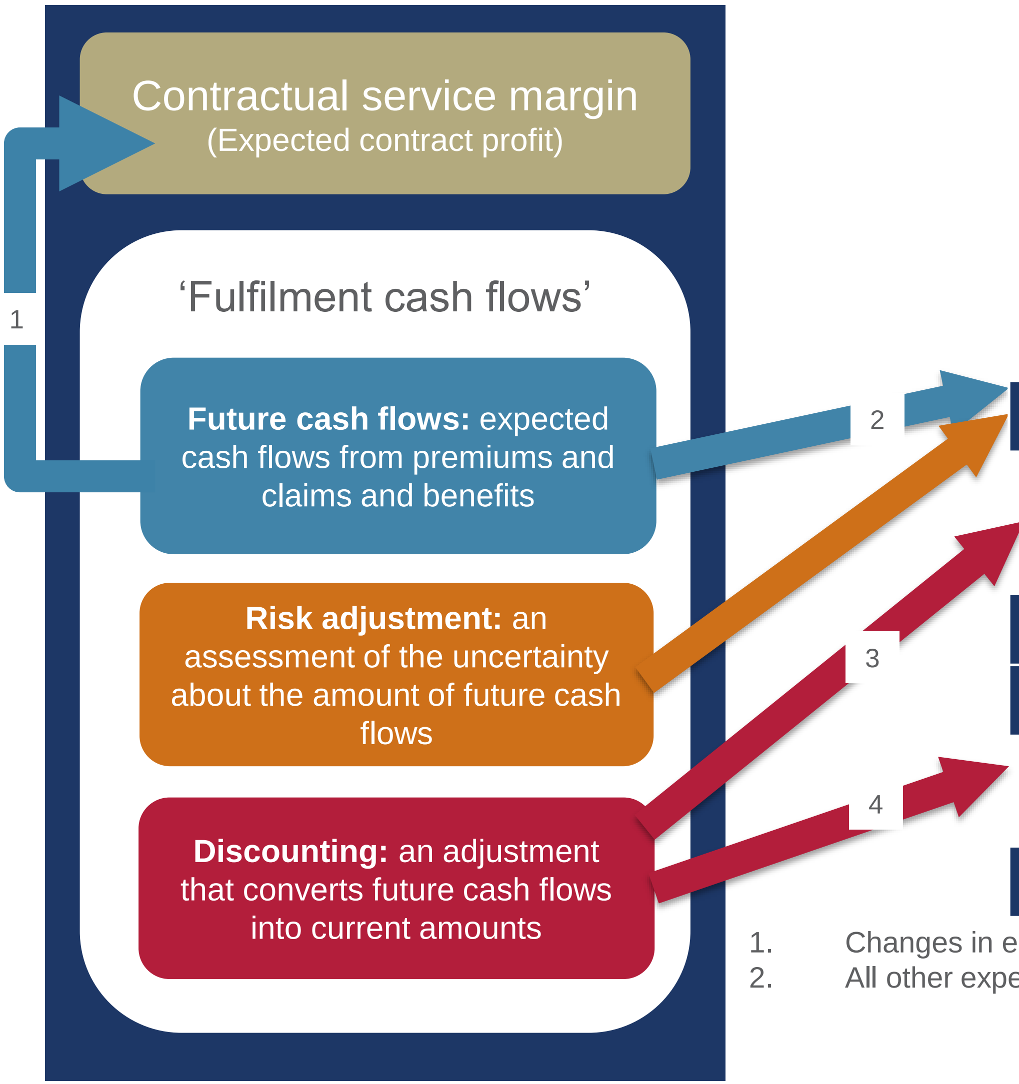
Contractual service margin

A component of the measurement of the insurance contract representing the risk-adjusted expected profit from the contract.

Fulfilment cash flows

A current, updated estimate of the amounts the entity expects to collect from premiums and pay out for claims, benefits and expenses, adjusted for risk and the time value of money.

A reminder
Up-to-date information about performance



Statement of Comprehensive Income

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

1. Changes in estimates relating to future services
2. All other expected cash flow changes
3. Based on a cost view
4. Based on a current view

A reminder
Disclosures

Amounts	Judgements	Risks
Expected present value of future payments & receipts	Processes for estimating inputs and methods used	Nature and extent of risks arising from insurance contracts
Changes in risk during the period	Effect of changes on methods and inputs used	Extent of mitigation of risks arising from reinsurance and participation features
Changes in unearned profit during the period	Explanation of reason for change, identifying type of contracts affected	Quantitative information about exposure to credit, market and liquidity risk
Effects of new contracts written in the period		

A reminder
Feedback on five targeted areas

Measurement proposals

1. Unlocking
Changes in estimates relating to expected contract profit for providing coverage recognised over remaining period

2. Mirroring
Measurement and presentation exception when no economic mismatch is possible

Presentation proposals

3. Revenue
Align to presentation of revenue required for other types of contracts with customers

4. OCI proposals
Interest expense is amortised cost-based in profit or loss, current value-on the balance sheet

Approach to transition

5. Transition
Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

Summary of feedback

+

- Welcome progress made since 2010 Exposure Draft
- Acknowledgement that IASB has responded to concerns raised on the 2010 Exposure Draft
- Widespread agreement with direction of proposals relating to:
  - unlocking of contractual service margin
  - transition
- Support at a conceptual level for insurance contract revenue

-

- Overarching concern about extent of accounting mismatches. As a result:
  - concern about scope of mirroring
  - concern about mandatory OCI
- Significant concerns that mirroring:
  - cannot be made operational
  - does not sufficiently address accounting mismatches overall to justify the complexity
  - would require options and guarantees to be reported in P&L

Reporting changes in estimates

Measurement proposals

1. Unlocking

Changes in estimates relating to expected contract profit for providing coverage recognised over remaining period

2. Mirroring

Measurement and presentation exception when no economic mismatch is possible

Presentation proposals

3. Revenue

Align to presentation of revenue required for other types of contracts with customers

4. OCI proposals

Interest expense is amortised cost-based in profit or loss, current value-on the balance sheet

Approach to transition

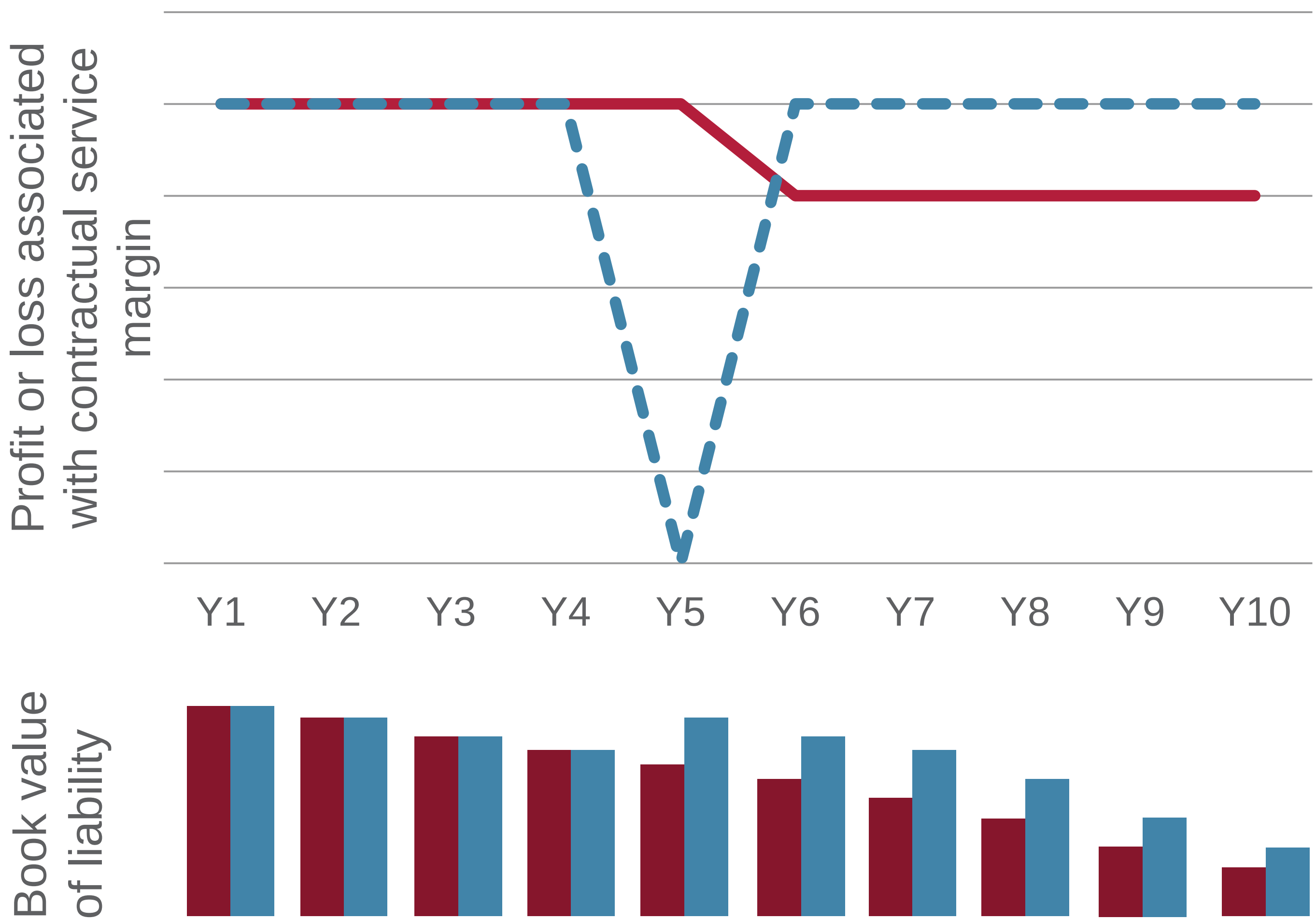
5. Transition

Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

Reporting changes in estimates
Issue

Changes in estimates affect the amount of profit the company expects to earn for providing future services. Should the effect of changes in estimates be reported in the period of change or as future services are provided?

Reporting changes in estimates
2013 ED proposals



Our proposal
Adjust contractual service margin for changes in estimates of expected cash flows related to future services

Alternative
Effects of change in estimates are recognised immediately in profit or loss

1 Reporting changes in estimates
What we heard

- General agreement with proposals, though some think proposals inappropriately smooth underwriting results and decrease transparency
- Some suggest minor modifications to proposals:
  - changes in risk adjustment relating to future coverage should also adjust the margin
  - losses recognised in P&L after the margin is eliminated should be reversed before rebuilding the margin
- Questions about mechanics
- Some preparers are concerned about the need to track information and unit of account
- Industry proposes an alternative model that would adjust the margin for other changes in value (see ‘mirroring’)

1 Reporting changes in estimates
Progress to date

Tentative decisions:

- Confirm the ED proposal that changes in estimates of cash flows should be recognised when the service is provided (ie adjust the contractual service margin)
- Modify the ED proposal so that:
  - changes in estimates of risk adjustment relating to future service are also recognised in the period when service is provided
  - losses previously recognised because of changes in estimates are reversed before margin is rebuilt
- Confirm that the discount rate to be used to determine the present value of cash flows that unlock the CSM should be the locked in rate

Next steps:

- Application to contracts with participating features

Contracts with participating features

Measurement proposals

1. Unlocking

Changes in estimates relating to expected contract profit for providing coverage recognised over remaining period

2. Mirroring

Measurement and presentation exception when no economic mismatch is possible

Presentation proposals

3. Revenue

Align to presentation of revenue required for other types of contracts with customers

4. OCI proposals

Interest expense is amortised cost-based in profit or loss, current value-on the balance sheet

Approach to transition

5. Transition

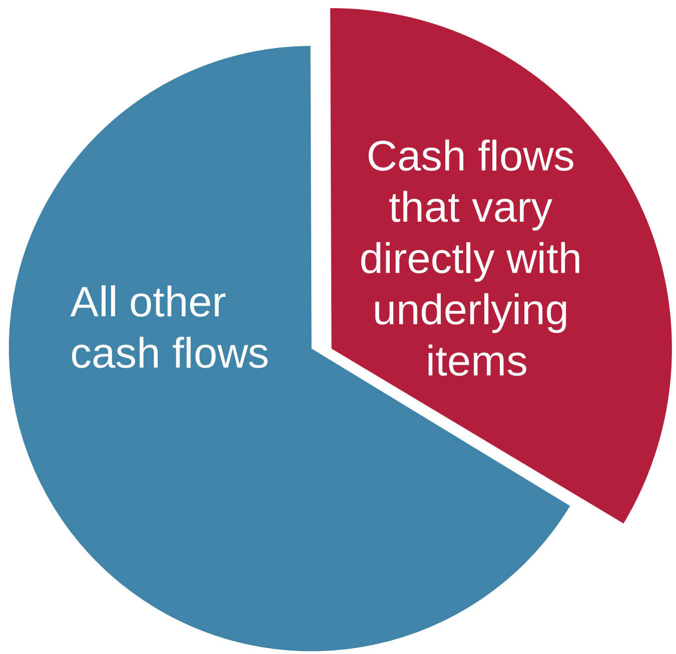
Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

Contracts with participating features
Background for the IASB's discussions

- Participating features result in payments to policyholders that vary with the returns on underlying items
  - The entity shares with policyholder some of the investment risks and benefits resulting from assets purchased with the premiums
- Common features of considered contracts
  - Embedded options and guarantees
  - Variety of types of payments to policyholders (including discretion over timing and amount of payment)
  - Variety of sources of profit to the entity

Contracts with participating features
2013 ED proposals

- 2013 ED proposed a limited scope exception for contracts where there is no possibility of economic mismatch.
- This occurs if the contract specifies that the company is required to hold underlying items and payments to the policyholder must vary directly with returns on underlying items.



Eliminate mismatch by measuring and presenting cash flows in the same way as underlying items.

Measured using general requirements of the Standard. However, all changes in the value of cash flows that vary indirectly with underlying items are presented in profit or loss.

Contracts with participating features
What we heard

- "Mirroring, on the face of it, looks like a really good idea." But:
  - concern that part of the liability would not be at current market-consistent value
  - disagreement that options and guarantees should be reported in P&L
  - concern about complexity of splitting different types of cash flows
  - concern about interaction between unlocking and mirroring
    - e.g. does mirroring apply to cash flows related to asset management fees? Or do changes in estimates of asset management fees unlock the margin?
  - questions about how widely or narrowly the proposals apply.
- Industry (mainly Europe) proposes an alternative proposal for contracts with participating features with wider scope and a different objective.

Contracts with participating features
Applying general proposals

IASB approach is to consider what adaptations are needed to general proposals

Fulfilment cash flows

- Measure on basis of all cash flows arising from contract
- Include all cash flows that arise from rights to share in return on underlying items
- Discount using rates that reflect the characteristics of the cash flows
- No special adaptations for risk adjustment

Contractual service margin (CSM)

- No special adaptations
- Determined to eliminate any Day 1 gain at initial recognition
- Subsequent to initial recognition, adjust the CSM to reflect changes in estimates of future services
- Payment of investment returns is not a service

Interest expense in profit and loss

- Determined at the date when the contract was initially recognised, updated to reflect changes in returns on underlying items to affect the amount of cash flows.

IASB will then consider whether mirroring exception is needed.

Contracts with participating features Overview of key issues 1/2

Issue	Direction
1. Whether there is a need for bifurcation of cash flows	The IASB concluded that the measurement model does not result in the requirement to bifurcate cash flows. It expects to consider how to avoid the bifurcation of cash flows for presentation purposes.
2. Whether there is a need for adaptations to account for the entity's share of underlying items	The IASB expects to consider the reporting the gains and losses for the insurer's share of the underlying items. If those gains and losses were adjusted against the contractual service margin, this would only be contemplated for a narrow set of participating contracts.
3. The appropriate recognition pattern for the contractual service margin for contracts with participating features	The IASB tentatively decided to confirm the principle in the 2013 ED that an entity should recognise the remaining contractual service margin in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of the services that are provided under an insurance contract. The IASB noted it would consider the application of that principle to contracts with participating features at a future meeting.

Contracts with participating features Overview of key issues 2/2

Issue	Direction
4. The treatment of changes in estimates of investment returns that affect the amount paid to the policyholder	The IASB has yet to consider this issue.
5. How an entity should account for changes in the value of options and guarantees	The IASB has yet to consider this issue.
6. Are there any contracts with participating features for which OCI approach provides useful information? If so, how should interest expense in P&L be determined?	The IASB plans to explore both a book yield and an effective yield approach. In both approaches, the discount rate for the presentation of interest expense in profit or loss would be reset for all the cash flows in the contract when the cash flows that vary with underlying items are a substantial proportion of the total benefits to the policyholder over the life of the contract.
7. Would any form of mirroring exception be necessary?	The IASB has yet to consider this issue.

Contract revenue and expense

Measurement proposals

1. Unlocking

Changes in estimates relating to expected contract profit for providing coverage recognised over remaining period

2. Mirroring

Measurement and presentation exception when no economic mismatch is possible

Presentation proposals

3. Revenue

Align to presentation of revenue required for other types of contracts with customers

4. OCI proposals

Interest expense is amortised cost-based in profit or loss, current value-on the balance sheet

Approach to transition

5. Transition

Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

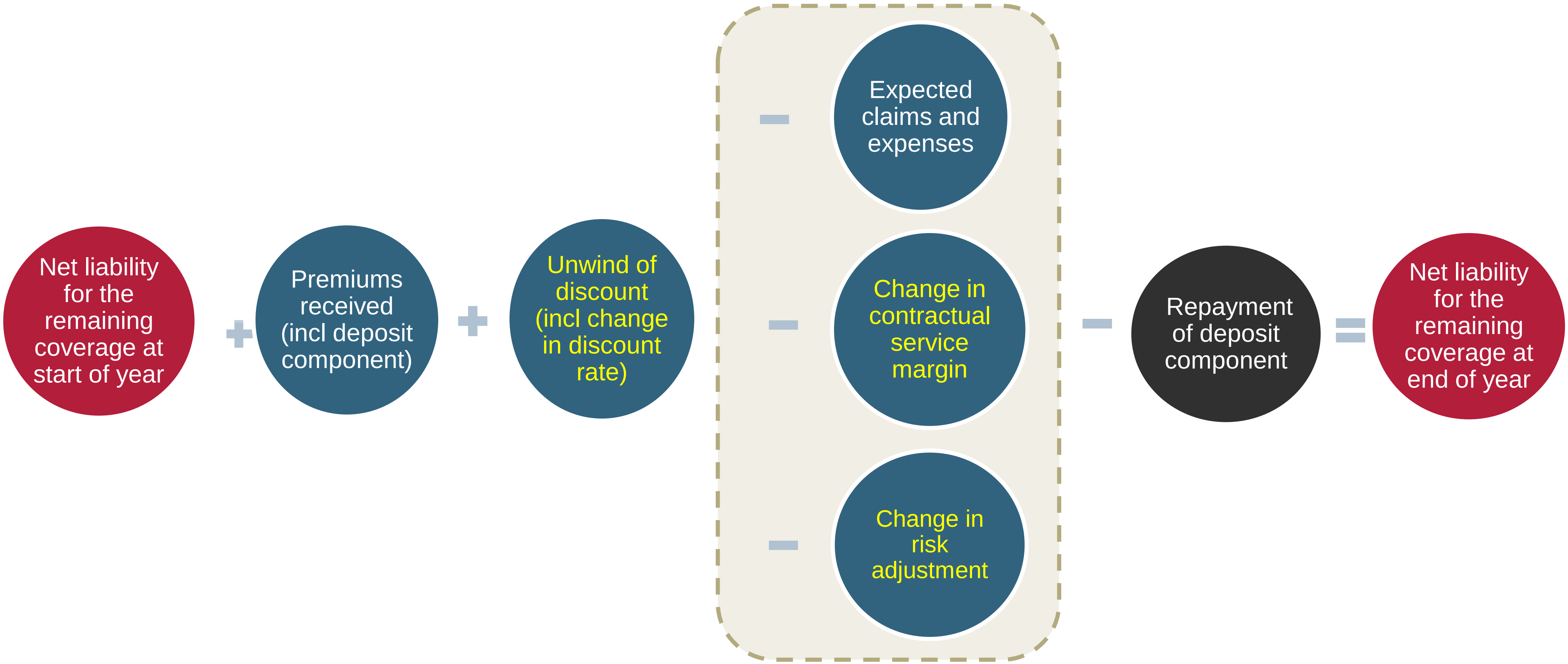
Contract revenue and expense
Issue

Should a company show information about gross performance rather than net margin?

If gross performance is more useful, should information be consistent with revenue and expense for other transactions?

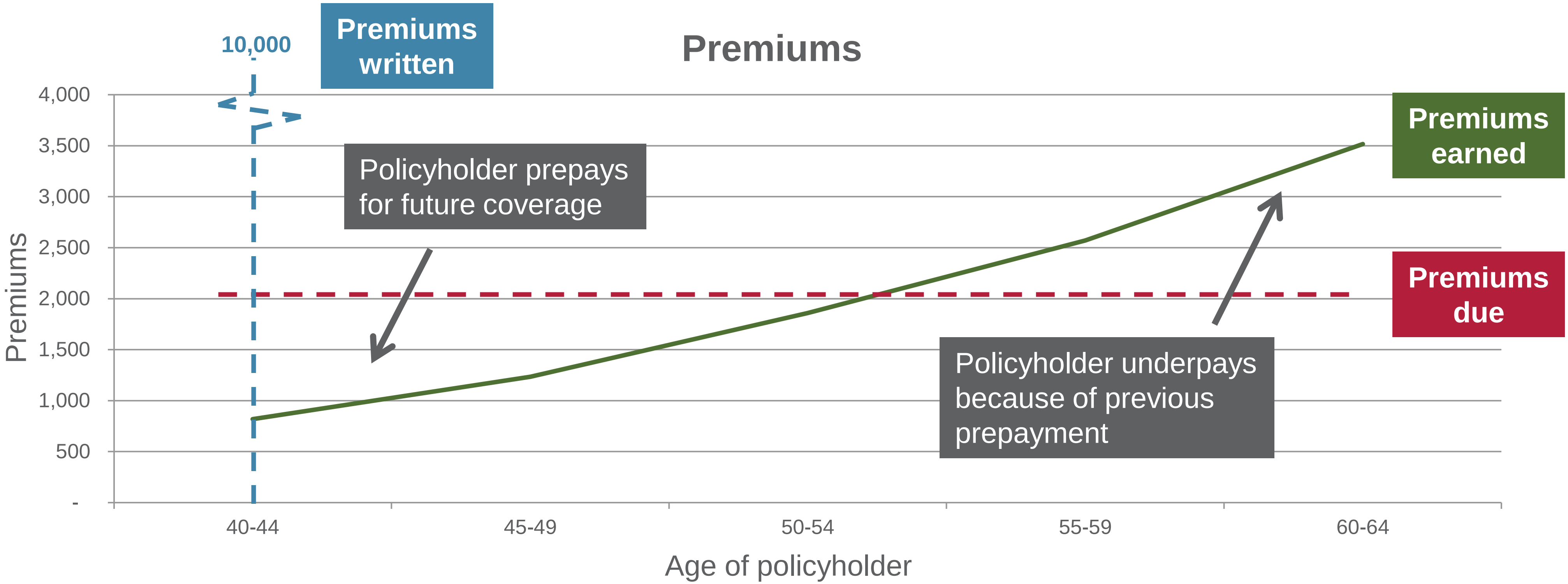
Contract revenue and expense
ED proposals

Insurance contract revenue



3 Contract revenue and expense

ED proposals level premium life contract



- Assumptions:
  - portfolio of term life contracts issued to 40-year-olds
  - expected claims/benefits are 10,000; premiums due are 2,000 each 5 year period
  - ignores premiums 'allocated' to the margins, payment of acquisition costs and payment of maintenance and benefits expense
  - assumes no lapses, no discounting and no investment component

Contract revenue and expense
What we heard

- Increasing acceptance of conceptual merits and some support for same presentation approach for all insurance contracts
- Agree that proposals increase comparability with other transactions, but:
  - some believe that unique nature of insurance justifies a different presentation
  - some users note that both revenue and summarised margin information is useful
  - specialist users think summarised margin information more relevant
- Vehement disagreement with proposals from some preparers, including disagreement about disaggregating deposits
- Doubt about whether insurance contract revenue would provide useful information
- All users agree that revenue should exclude investment components

Contract revenue and expense
Progress to date

Tentative decisions

- Insurance contract revenue and expense required in the statement of comprehensive income:
  - excludes investment components
  - recognised as earned
- Required disclosure:
  - reconciliations that explain how insurance contract revenue relates to premiums received, and the inputs used to determine insurance contracts revenue
  - 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
- Prohibit premium information in the statement of comprehensive income that is not consistent with commonly understood notions of revenue

Interest expense in profit or loss

Measurement proposals

1. Unlocking

Changes in estimates relating to expected contract profit for providing coverage recognised over remaining period

2. Mirroring

Measurement and presentation exception when no economic mismatch is possible

Presentation proposals

3. Revenue

Align to presentation of revenue required for other types of contracts with customers

4. OCI proposals

Interest expense is amortised cost-based in profit or loss, current value-on the balance sheet

Approach to transition

5. Transition

Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

Interest expense in profit or loss
Issue

Should companies be required to separate the results from underwriting and investment activities from the effects of changes in discount rates?

Interest expense in profit or loss
2013 ED proposals

Statement of Comprehensive Income

	20XX
Operating (underwriting) result	X
Investment income*	X
Interest expense (on insurance liability)	(X)
Investment result	X
Profit or loss	X
Effect of discount rate changes on insurance liability***	(X)
Total comprehensive income	XX

Profit or loss
Reflects the profit or loss from services using a cost view of the time value of money**

Total comprehensive income
Reflects the profit or loss of providing services using a current view of the time value of money**

*Includes interest revenue and gains and losses on financial assets measured at fair value through other comprehensive income
**Cost view uses the discount rate determined at contract inception, and current view uses the current discount rate at reporting date
*** The 'effect of discount rate changes' reconciles the current view and the amortised cost view of performance, assuming financial assets are measured at fair value through other comprehensive income

4

Interest expense in profit or loss
What we heard

- Acceptance that both amortised cost and current value view provide useful information but there is concerns about complexity
- Concern about accounting mismatches, strongly expressed in some jurisdictions, leading to:
  - call for an option to present all changes in profit and loss
  - some suggest a requirement to present all changes in profit or loss
  - suggestion that mismatches should be eliminated by adjusting accounting for all assets backing insurance contracts
- Some suggest changes in value of options and guarantees should be presented in OCI
- Users emphasised that information on effects of changes of discount rates should be clear
  (eg sensitivities, changes in the period)

IFRS®

Interest expense in profit or loss
Progress to date

Tentative decisions

- Accounting policy choice to present the effect of changes in discount rates in profit and loss or in OCI.
- An entity should apply the accounting policy to similar insurance contracts, taking into consideration the portfolio in which the contract is included and the related assets that the entity holds.
- Any changes in the accounting policy should be made in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- Require disclosures that would disaggregate the change in interest expense into its component parts, which would allow them to be compared.
- For the premium-allocation approach, an entity that chooses to present the effect of changes in discount rate in OCI, should determine the interest expense using the rate locked-in at the date the liability for incurred claims is recognised.

Next steps

- Application to contracts with participating features

Applying for the first time

Measurement proposals

1. Unlocking

Changes in estimates relating to expected contract profit for providing coverage recognised over remaining period

2. Mirroring

Measurement and presentation exception when no economic mismatch is possible

Presentation proposals

3. Revenue

Align to presentation of revenue required for other types of contracts with customers

4. OCI proposals

Interest expense is amortised cost-based in profit or loss, current value-on the balance sheet

Approach to transition

5. Transition

Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

IFRS®

Applying for the first time
Issue

The challenge for first-time application is measuring the contractual service margin at the date of transition.

How do we balance the verifiability of the amount recognised at transition date with comparability between contracts issued prior to and after transition date?

Applying for the first time
2013 ED proposals

Contractual service margin
(Expected contract profit)

Needs to be estimated → Estimate as if the Standard had always been applied, with simplifications that maximise the use of objective data if necessary

Fulfilment cash flows

- Expected cash flows from premiums and claims and benefits
- An assessment of the uncertainty about the amount of future cash flows
- An adjustment that converts future cash flows into current amounts

Can be directly measured → Measure on date of first-time application

5 Applying for the first time
What we heard

- Widespread agreement that proposals are an improvement from 2010 proposals
- Need for information about the assumptions used and the remaining margin that was determined in this way
- Some concerns raised about operational implications in emerging and newly-emergent economies
- Concerns about implications on transition of locked-in discount rate:
  - usefulness/practicality of determining accumulated OCI for liability for incurred claims for non-life contracts
  - application to portfolios acquired under previous business combinations

Applying for the first time *Progress to date*

Tentative decisions

- Confirm proposals for retrospective approach in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* unless impracticable; and
- When retrospective approach is impracticable, apply the simplified approach proposed in the 2013 ED with a modification for the risk adjustment:
  - to determine risk adjustment at initial recognition, adjust the RA at transition date for the assumed risk release until transition date.
- When the simplified approach is impracticable, apply fair value approach, where
  - the CSM is the difference between fair value of the contract and fulfilment cash flows at that date
  - the OCI in equity is estimated by using the method specified in the simplified approach (paragraphs C5-C6)
- When the simplified approach or fair value approach are used, disclose the information proposed in paragraph C8 of the 2013 ED separately for contracts measured using each approach.

Next steps

- Application to contracts with participating features

IFRS®

Other issues

Measurement proposals

1. Unlocking
Changes in estimates relating to expected contract profit for providing coverage recognised over remaining period

2. Mirroring
Measurement and presentation exception when no economic mismatch is possible

Presentation proposals

3. Revenue
Align to presentation of revenue required for other types of contracts with customers

4. OCI proposals
Interest expense is amortised cost-based in profit or loss, current value-on the balance sheet

Approach to transition

5. Transition
Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

Other issues

Other issues 1/3

Topic	Tentative decisions to date
1. Allocation of the contractual service margin	Clarify that, for contracts with no participating features, the service represented by the contractual service margin is insurance coverage that: - is provided on the basis of the passage of time; and - reflects the expected number of contracts in force
2. Premium-allocation approach	Clarify that an entity should recognise revenue in profit or loss: - on the basis of the passage of time; but - if the expected pattern of release of risks differs significantly from the passage of time, then on the basis of expected timing of incurred claims and benefits.
3. Definition of the significant insurance risk definition	Clarify the guidance in paragraph B19 of the 2013 ED that significant insurance risk only occurs when there is a possibility that an issuer will incur a loss on a present value basis

Other issues 2/3

Topic	Tentative decisions to date
4. Portfolio transfers and business combinations	Clarify that contracts acquired through portfolio transfers and business combinations should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or business combination
5. Fixed-fee service contracts	Permit, but not require, entities to apply IFRS 15 to some fixed-fee service contracts (those that meet the criteria in paragraph 7e) of the 2013 ED)
6. Level of aggregation and definition of 'portfolio'	Amend the definition of a portfolio of insurance contracts, add guidance about determining the CSM or loss, and provide examples on contracts aggregation.
7. Discount rates for long-term contracts when there is lack of or no observable market data	Provide more guidance about the need for judgement in assessing relevant inputs for determining the discount rate when markets are not active.

Other issues 3/3

Topic	Tentative decisions to date
8. Reinsurance contracts	Entity should recognise consistently any changes in estimates for reinsurance contracts that arises as a result of changes in estimates from an underlying direct insurance contract.
9. Time value of money effect on the CSM	An entity should use the locked-in rate at inception of the contract for accreting interest and for determining the change in the present value of expected cash flows that offsets the margin.

IFRS®

Timetable

20 June 2013
Revised Exposure Draft

25 Oct 2013
Comment letter deadline

2014
Board debates issues

2015
Issue IFRS

Effective date
Approx. 3 years after Standard finalised

For more information…

Stay up to date

- Visit our website:
  - www.ifrs.org
  - go.ifrs.org/insurance_contracts
- Sign up for our email alert

Ask questions or share your views

- Email us: insurancecontracts@ifrs.org
- Comment on our proposals: go.ifrs.org/Exposure-Drafts

Resources on IASB website

- IASB Update
- Project podcasts and webcasts
- Effect of redeliberations on the ED
- Investor resources
- High level summary of project

IFRS®

Thank you

IFRS®