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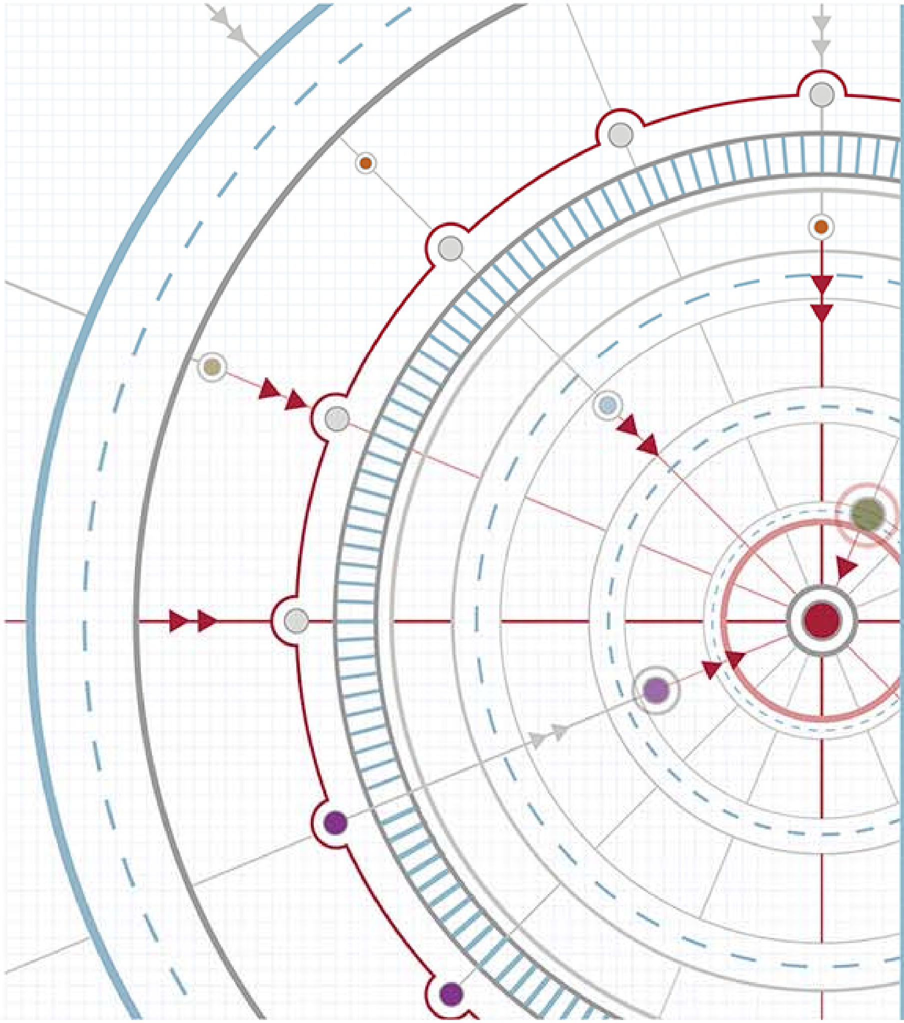

Beyond IFRS 4
Insurance Contracts *Project*

Darrel Scott, IASB Member

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The need for change and project history

Existing IFRS Accounting

- IFRS 4 Insurance Contracts is an interim Standard
  - Permits continuation of wide variety of practices
  - Includes a 'temporary exemption' from general requirement that accounting policies should be relevant and reliable
- IFRS 4 does not provide transparent information about the effect of insurance contracts on financial statements
- Existing accounting makes comparisons difficult between products, companies and across jurisdictions

Extensive consultation

- Three consultation documents issued
- Extensive outreach with investors, analysts, preparers, regulators, accounting firms and standard-setters, in all regions with significant insurance industry
- Benefitted from continuous feedback from industry
- Three rounds of fieldwork focused on assessing operationality of the proposals

Common concerns in feedback

- The IASB has received extensive and detailed feedback on its proposals. Underlying the feedback are three common concerns:
  - Concerns about the effect of changes in current value measurement on profit or loss
  - Concerns about the accounting for contracts with participating features
  - Concerns about complexity of the proposals as a whole
- A summary of how the IASB responded to specific feedback is available on the project website

Next Steps

- Drafting of the standard underway
- Consistent with recent projects, engagement will continue:
  - Targeted general updates of specific wording
  - Targeted testing of specific wording
  - Extensive fatal flaw review
  - Sweep Issues
- Detailed effects analysis will be included
- Still to consider:
  - Effective date

Scope

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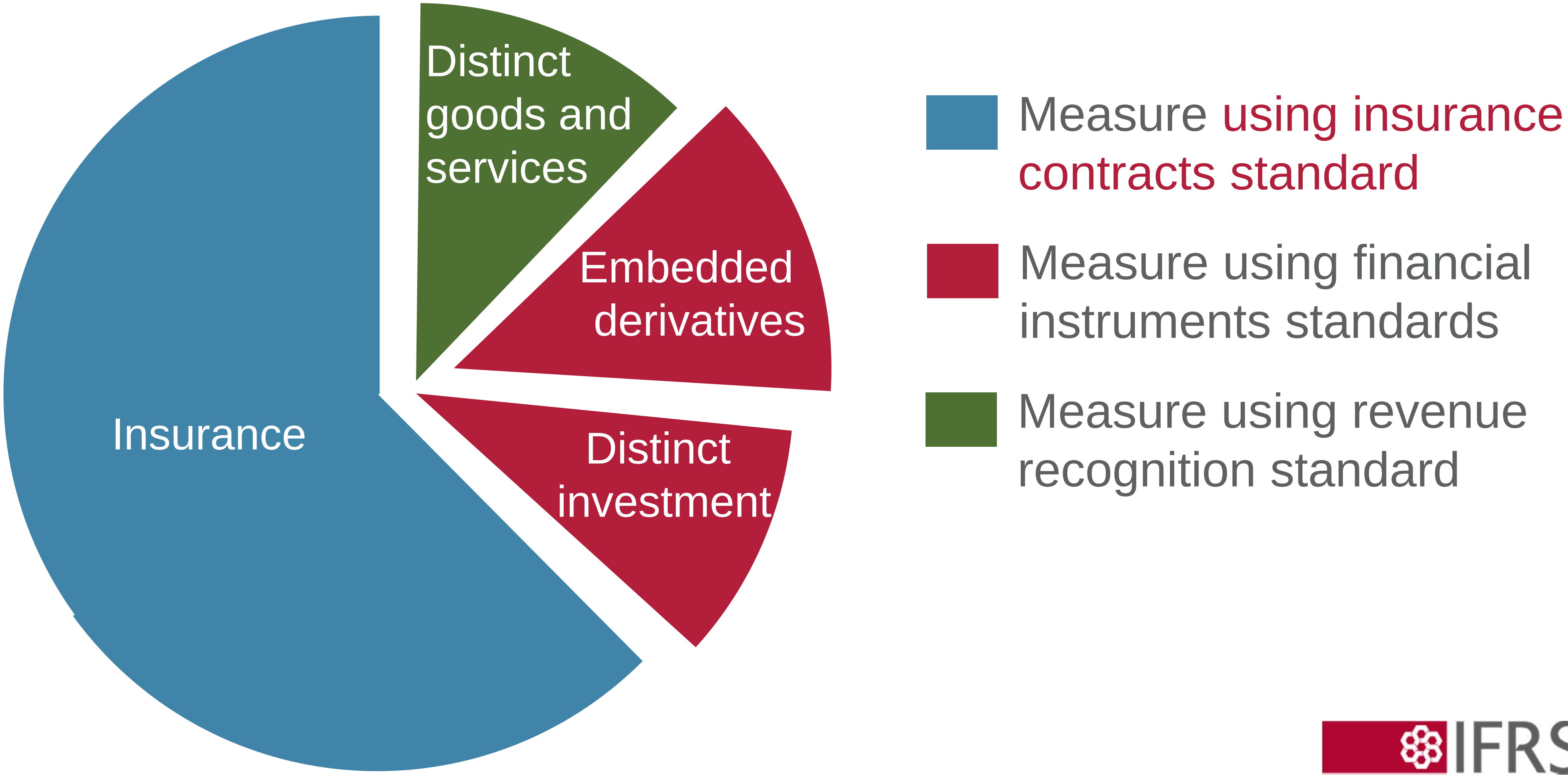
- Accounting for insurance contracts, **NOT** insurance entities
- Insurance contract: an insurer accepts significant insurance risk by agreeing to compensate policyholder if uncertain future event adversely affects policyholder
- Insurance risk is a risk, other than financial risk
- Similar to IFRS 4 definition

Scope

- Scoped in
  - Discretionary participating investment contracts
  - Option **to** apply insurance contracts Standard to financial guarantee contracts
- Scoped out
  - Option **not** to apply insurance contracts Standard to fixed fee service contracts which meet definition of insurance contract

Identify and recognise the contract

- Required to separate components of insurance contract



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Initial Measurement

Measure contract at initial recognition
Future cash flows

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

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

An explicit, unbiased and probability-weighted estimate of future cash flows that will arise as the insurer fulfils the insurance contract

Measure contract at initial recognition
Discounting

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

Future cash flows

Discounting
adjustment that converts future cash flows into current amounts

Should reflect characteristics of liability cash flows

Should be consistent with observable market

Can use either bottom up, or top down approach

Measure contract at initial recognition
Risk Adjustment

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

Future cash flows

Discounting

Risk adjustment
assessment of uncertainty about future cash flows and cost to entity

Compensation entity requires for bearing uncertainty

Entity specific measure:

level of risk aversion

degree of diversification

Measure contract at initial recognition

Fulfilment cash flows

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

‘Fulfilment cash flows’

- Future cash flows
- Discounting
- Risk adjustment

Fulfilment cash flows is a probability-weighted, risk adjusted, estimate of the present value of cash inflows and outflows that will arise as the entity fulfils the contract.

Measure contract at initial recognition
Fulfilment cash flows: Level of aggregation

Level of aggregation is **<u>not</u>** relevant for:

- Determination of fulfilment cash flows
  - Present value is consistently applied irrespective of level of application
- Determination and allocation of directly attributable expenses
  - Allocation based on nature and 'attribute-ability' of costs
- Determination and allocation of risk margin
  - Based on entity approach to determining compensation for risk

Measure contract at initial recognition
Contractual Service Margin (CSM)

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

Contractual service margin

'Fulfilment cash flows'

Future cash flows

Discounting

Risk adjustment

Contractual service margin is measured as the **positive** (net inflow) difference between the risk-adjusted present value of expected inflows and outflows at inception.

Fulfilment cash flows is a probability-weighted estimate of cash inflows and outflows that will arise as the entity fulfils the contract.

Measure contract at initial recognition
CSM

- CSM is determined as the risk adjusted present value of the cash inflows and outflows
- As such, at inception it captures the expected profitability of the contract over its entire expected life
  - If contract expected to be loss making, CSM is ‘negative’ and recognised in profit or loss (onerous contract)
  - If contract expected to be profit making, CSM is ‘positive’ and recognised as a liability (unearned profit)
- At inception, CSM is not a cash flow, instead it is the inverse of other cash flows

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CSM: Onerous contracts

- Loss for onerous contracts should be recognised only when the contractual service margin is negative for a group of contracts, and that group should comprise contracts that at inception have:
  - Cash flows entity expects will respond in similar ways to key drivers of risk in terms of amount and timing AND
  - Similar expected profitability (ie similar contractual service margin as a percentage of the premium)
- Within group, net off the negative and positive CSM
- Group not reassessed after inception

Measure contract at initial recognition

CSM: Effect of regulation

- No exception to the level of aggregation for determining onerous contracts or the allocation of the contractual service margin when regulation affects the pricing of contracts
  - Contracts that do not have similar profitability, even if as a consequence of regulation, may not be aggregated for determining onerous contracts

Subsequent Measurement

Remeasure in subsequent periods

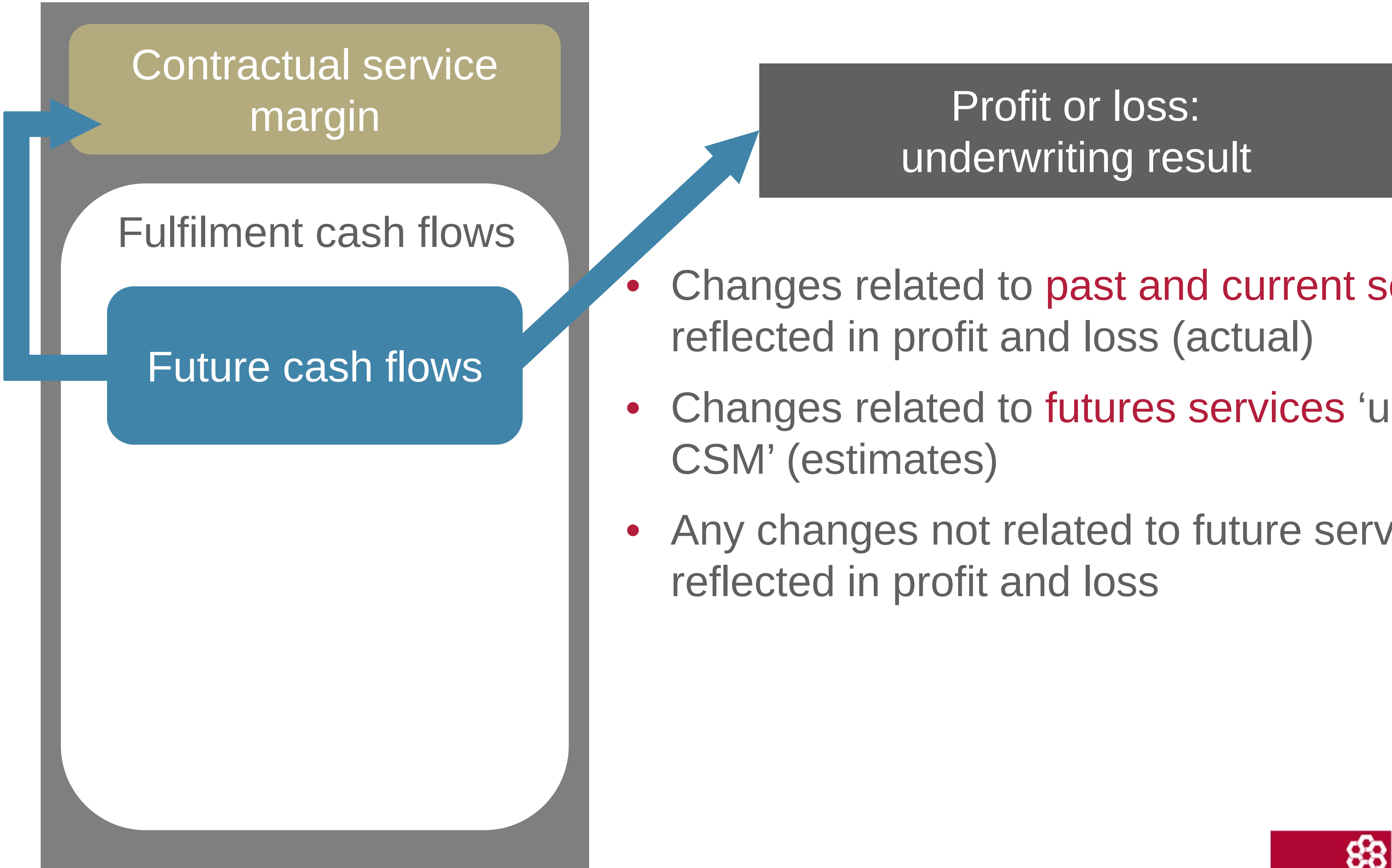
IASB believes a current value measure of an insurance contract provides the most useful information about insurance contracts in the statement of financial position.

Contractual service margin

'Fulfilment cash flows'

- Future cash flows
- Discounting
- Risk adjustment

Remeasure in subsequent periods
Recognition of changes in estimates



- Changes related to past and current services reflected in profit and loss (actual)
- Changes related to futures services 'unlock CSM' (estimates)
- Any changes not related to future services reflected in profit and loss

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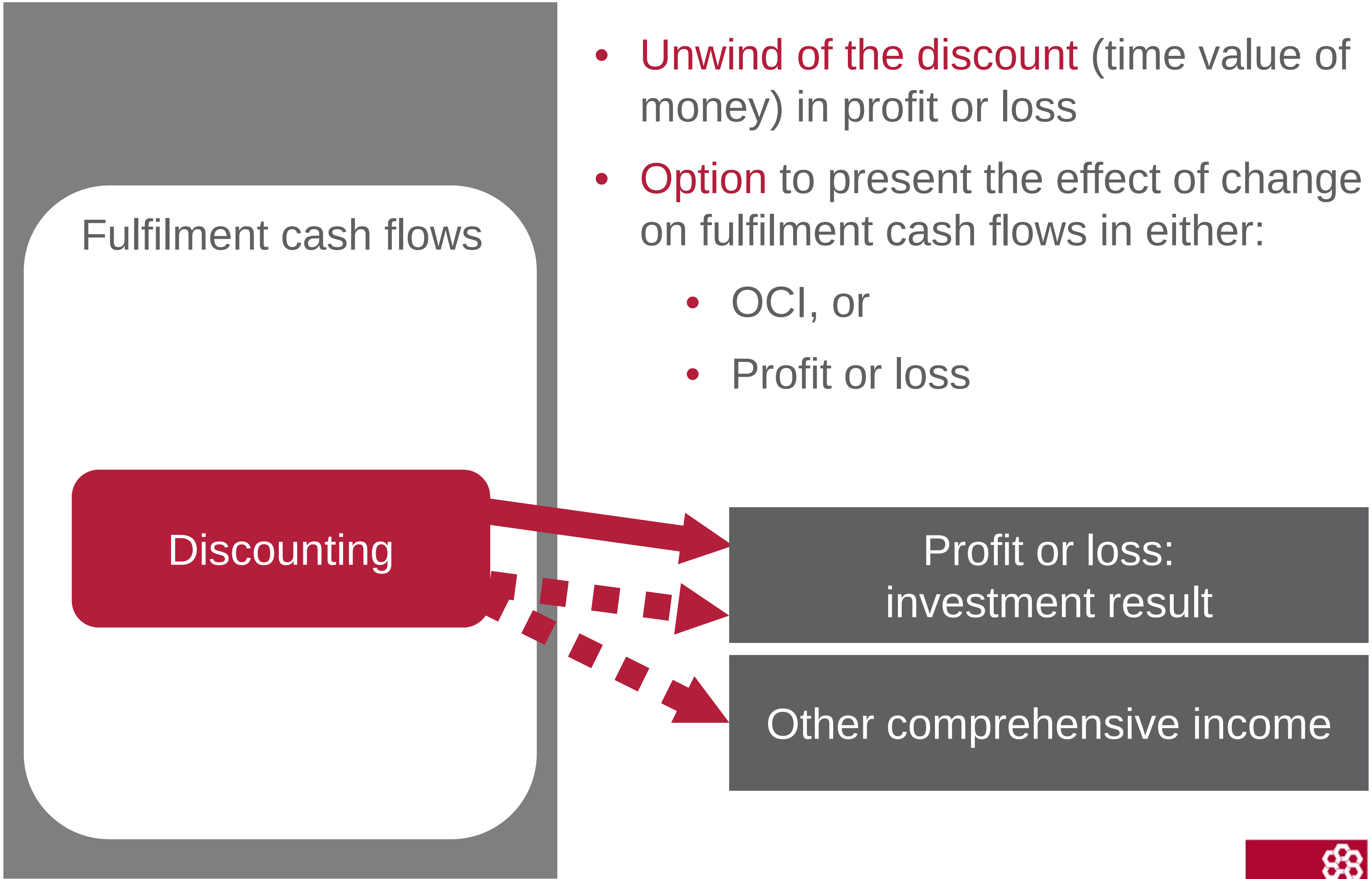

- Unwind of the discount (time value of money) in profit or loss
- Option to present the effect of change in rate on fulfilment cash flows in either:
  - OCI, or
  - Profit or loss

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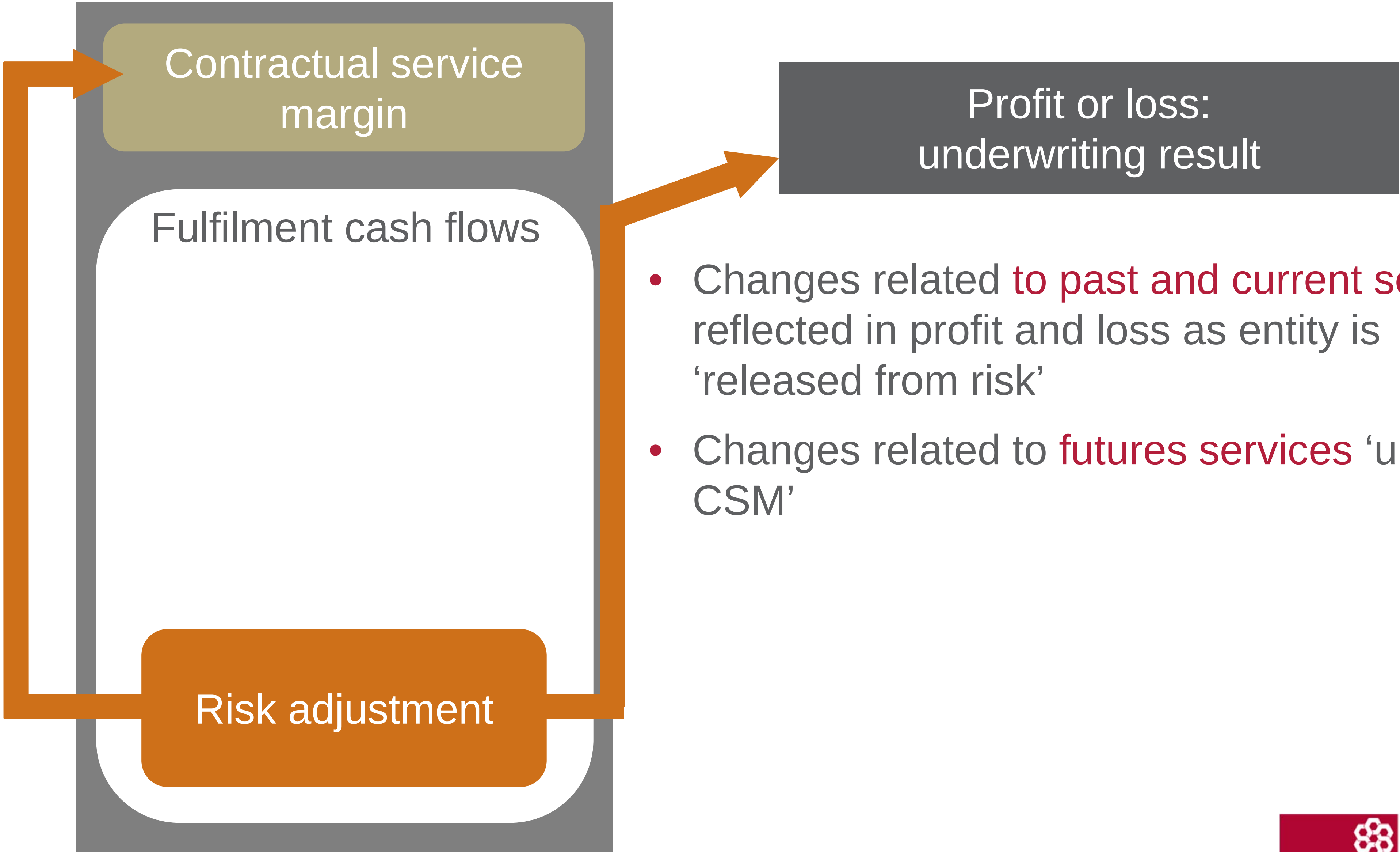


- Changes related to past and current services reflected in profit and loss as entity is 'released from risk'
- Changes related to futures services 'unlock CSM'

Remeasure in subsequent periods
Recognition of changes in estimates

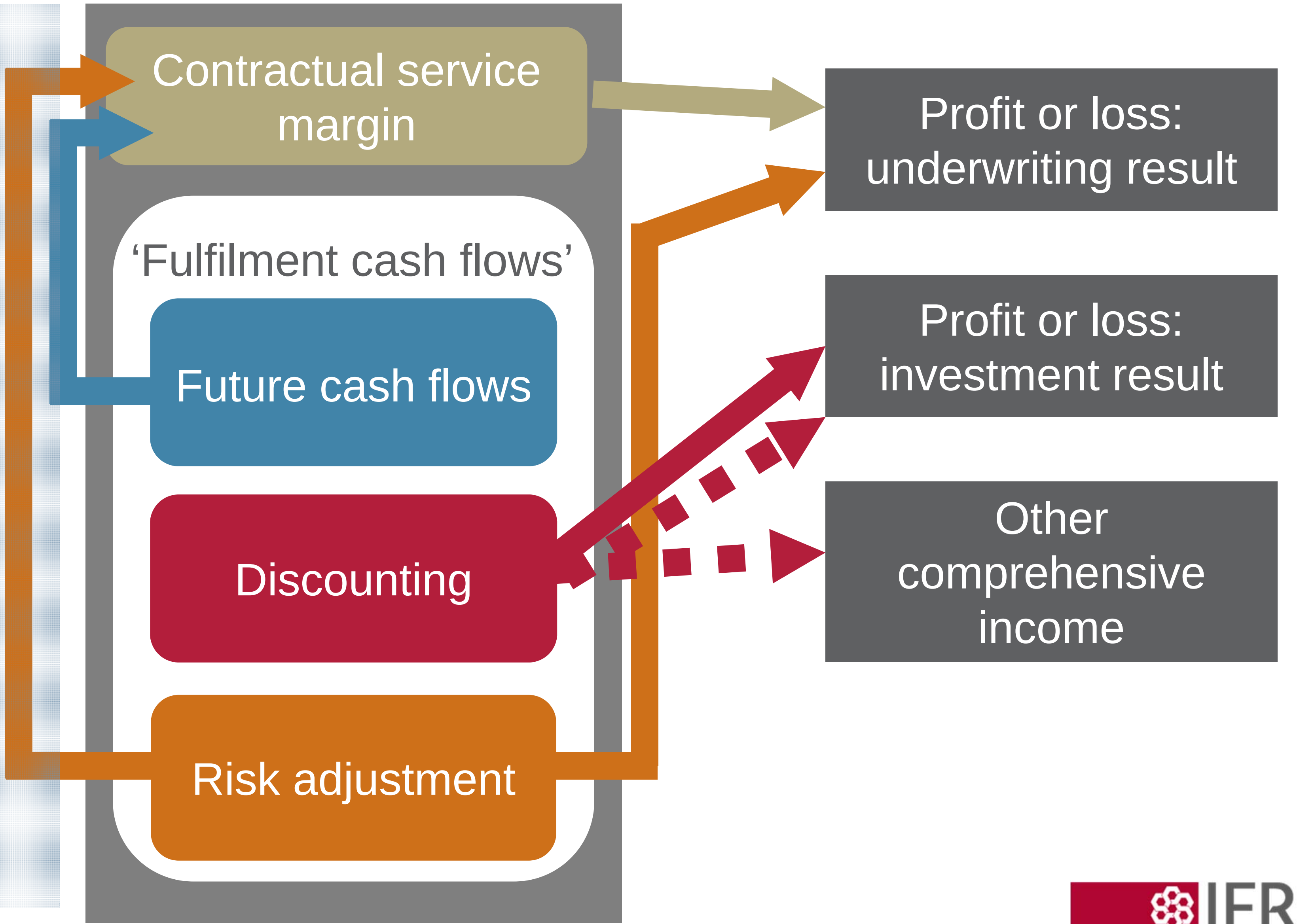
Contractual service margin

Profit or loss: underwriting result

- Recognise CSM in profit or loss as entity provides coverage:
  - Passage of time
  - Size and duration of contracts in force

The general model
Recognition of changes in estimates

The different types of changes in estimates are recognised in different parts of the financial statements.



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Modifications

Modifications to the general model

The new insurance contracts Standard modifies the accounting model to provide additional accounting models for different types of contract.

- A variable fee approach for contracts with participation features
- Accounting requirements for reinsurance contracts an entity holds, based on the general model
- Accounting requirements for investment contracts with discretionary participation features
- An optional simplified measurement approach for simpler insurance contracts, based on the unearned premium reserve approach used in many jurisdictions

Modifications to the general model
Variable fee approach: Scope

- Scope of the variable fee approach
  - Policyholder participates in share of clearly identified pool of underlying items;
  - Entity expects to pay policyholder a substantial share of the returns from those underlying items;
  - Cash flows expected to vary substantially with underlying items
- Variable contracts outside the variable fee approach apply the general model

Modifications to the general model
Variable fee approach: Sensitivity

- Includes any contract which creates an obligation linked to underlying items
  - Explicit contractual terms
  - Includes regulatory requirements
- However, measurement based on expected cash flows (not contractually-specified cash flows)
- Not dependent on holding of underlying assets
- Obligation need not be to current generation of policyholders

Modifications to the general model
Variable fee approach: Mechanics

- Measurement of obligation reflects change in fair value of all underlying items
- Fulfillment cash flow is calculated consistently with the general model
- Modify general model so that changes in the estimate of fee entity expects to earn are adjusted in CSM
  - Fee is equal to entity's expected share of returns on underlying items, less
  - any expected cash flows that do not vary with the underlying items.

Modifications to the general model
Reinsurance

- Apply general model approach to measure fulfilment cash flows
- If, at inception:
  - CSM is positive, record a liability consistent with general model
  - CSM is negative, record an asset (not consistent)
- After inception,
  - Recognise in CSM changes in estimates of FCF relating to future service (consistent), except
  - Recognise in profit or loss those changes which arise as a result of changes in estimates of FCF of underlying direct insurance contract, and which are recognised immediately in profit or loss.

Modifications to the general model
Investment contracts with DPF

- No insurance risk present in contract
- Apply general model approach to measurement of fulfilment cash flows with modifications to:
  - Recognition date: when entity becomes party to the contract
  - Contract boundary: ends when entity has the right or practical ability to deliver cash at a present or future date
  - Coverage period: period when entity required to provide asset management services under the contract
  - Allocation of CSM: systematic way that best reflects transfer of asset management services

Modifications to the general model
Premium allocation approach

- Optional practical expedient to general model – simplified approach (Premium Allocation Approach)
- Therefore:
  - Subject to entry criteria
  - Optional to use
- Key criteria: simplified approach should ‘mimic’ general model

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Presentation and Disclosure

Present result in financial statements

The presentation format of the statement of comprehen-sive income will be consistent between insurers and entities that do not issue insurance contracts.

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 (optional)	(X)
Total comprehensive income	XX

Revenue/expense recognised as earned (not received) or incurred (not paid)

Interest expense either current or 'cost', depending on accounting policy choice

If interest expense is 'cost', effect of difference between current and cost rates is presented in OCI

IFRS

Revenue

- Currently, insurance revenue determined as either premiums invoiced (premiums due), or present value of expected future premiums (premiums written)
  - Inconsistently applied
  - May include 'deposit-like' elements
  - May not reflect compensation for risk borne in each period
  - May give the same weight to single and recurring premiums
- Inconsistent with revenue principles in IFRS

Revenue

- Premiums allocated on an earned basis
- Premium that relates to investment components excluded from premium revenue
- Premium revenue in period represents the compensation insurer earned for coverage provided in that period

Present results in financial statements
Interest expense in profit or loss

Presenting interest expense in profit or loss on a cost basis can reduce accounting mismatches with income from related assets measured on a cost basis.

Approach for determining insurance finance expense in profit or loss

Cost measurement basis

- Apply effective yield approaches to determine insurance finance expense in profit or loss
- Different versions appropriate for different contracts

Current period book yield approach

- Insurance finance expense in profit or loss eliminates accounting mismatch with items held in profit or loss
- Only for specified contracts (ie with no economic mismatches)

OCI: difference between insurance finance expense in P&L and insurance finance expense determined on current basis

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Applying the Standard for the first time

Options permitted by the Standard

- Option to apply insurance contracts Standard to:
  - Fixed fee service contracts
  - Financial guarantee contracts
- Option to apply premium allocation approach (PAA), within PAA:
  - Option to expense acquisition costs if coverage period one year or less
  - Option not to accrete interest if coverage period one year or less
  - Option not to discount future cash flows expected to be paid in one year or less

Options permitted by the Standard

- Variable fee approach not optional (VFA), but within VFA:
  - Constrained option to recognise effect of changes in the value of guarantees in profit or loss if entity uses derivatives to mitigate financial market risk in those guarantees
  - Option to eliminate mismatch by measuring some assets at FVPL
- Presentation: option to present effect of changes in discount rate in profit or loss or OCI

Applying the Standard for the 1st time

The IASB has specified different approaches for estimating the contractual service margin in a way that balances comparability with the costs of obtaining historical information.

Retrospective application

When historical data exists and hindsight is not required

Prescribed simplified approach

When not all historical data is available but information about historical cash flows is available or can be constructed

Liability calibrated to fair value

When no historical information about cash flows is available

Transition reliefs

- Opportunity to fully evaluate accounting for insurance contracts by permitting reassessment of classifications for financial assets under IFRS 9 based on facts and circumstances that exist at the date of initial application
- Includes use of options available on first application of IFRS 9

Questions or comments?

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Appendix

The need for change

Existing IFRS Accounting

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Existing IFRS Accounting

Existing issues		New Accounting model
Variety of accounting treatments	→	Consistent accounting
Estimates not updated	→	Estimates reflect current information
Discount rate based on investment	→	Discount rate reflects cash flows of the contract
Lack of discounting	→	Measurement reflects discounting where significant
Little information about options and guarantees	→	Measurement reflects full range of possible outcomes

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Project History

Project History

1997	2004	2007	2010	2013	TBC
IASC starts project on insurance contracts	**IFRS 4 *Insurance contracts*** ‘Phase I’ Interim standard issued IASB takes up ‘Phase II’ Insurance Working Group formed	**Discussion paper** *Preliminary views on Insurance Contracts* 162 comment letters received	**Exposure Draft** *Insurance Contracts* 253 comment letters received	**Exposure Draft** *Insurance Contracts* 194 comment letters received	**Expected publication** **(**Approx end of 2016)

Extensive consultation

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- Extensive outreach with investors, analysts, preparers, regulators, accounting firms and standard-setters, in all regions with significant insurance industry
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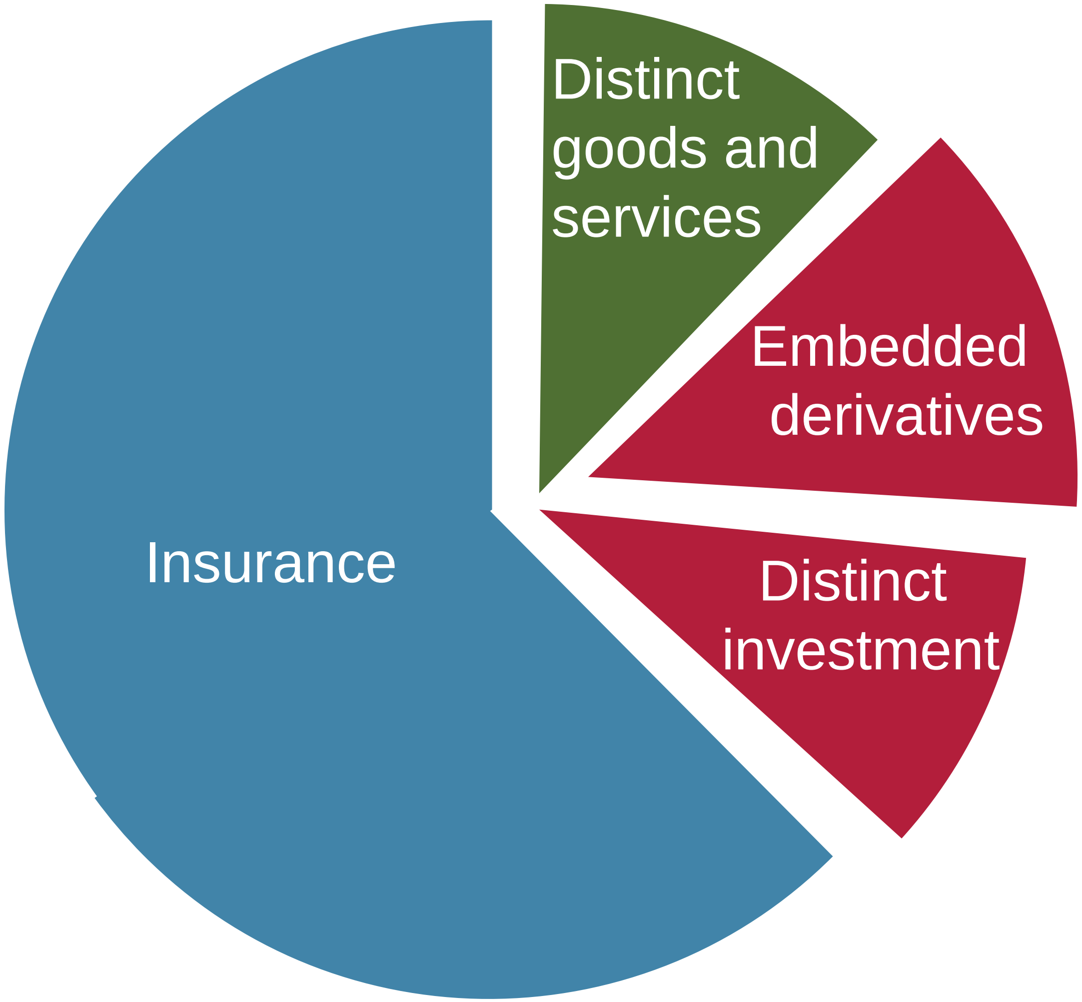

- Measure using insurance contracts standard
- Measure using financial instruments standards
- Measure using revenue recognition standard

Initial Measurement

Measure contract at initial recognition
Future cash flows

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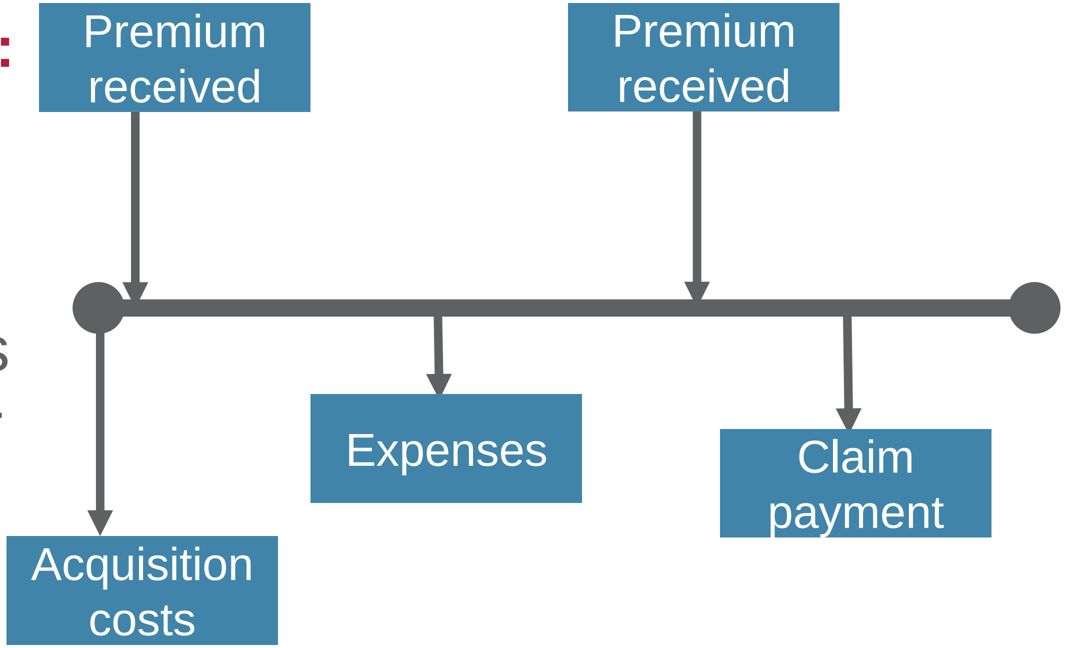
Future cash flows
expected cash flows from premiums, claims and benefits

An explicit, unbiased and probability-weighted estimate of future cash flows that will arise as the insurer fulfils the insurance contract

IFRS

Measure contract at initial recognition
Future cash flows

Recognition:
Contract starts when coverage period begins (may be after insurer is on risk) unless contract is onerous



Contract boundary:
Contract ends when:
- Not required to provide coverage
- Can reprice to reflect risks of policyholder
- Or, In some cases, to reflect risk of portfolio
- On substantial modification

Included in cash flows:
All direct costs of *originating* and all directly attributable costs incurred in *fulfilling* insurance contracts

IFRS

Measure contract at initial recognition
Future cash flows: mutualisation

In some contracts or contract types, other policyholders form first layer of risk absorption. In such cases:

- Expected cash flows from/to participating policyholders are part of the fulfilment cash flows of the primary policyholders: A group of policies is not considered to be onerous if another set of policyholders bears those losses
- Losses are only recognised in profit or loss from onerous contracts when the underlying items in the fund as a whole are insufficient to bear those losses, ie when no other policyholder has the capacity to absorb those losses

Example
Future cash flows: mutualisation

- Insurer issues 5 year motor insurance contracts, which compensate policyholders for theft and accidents
- Insurer also issues 5 year participating contracts, with a payout subject to profitability of the motor book – **if** motor book performs:
  - As expected, par contracts pay a market return;
  - Better then expected, extra return paid to par contracts
  - Worse then expected, shortfall deducted from par return
- In determining cash flows of the motor book, the insurer should consider the net cash flows (after participation)

Measure contract at initial recognition
Discounting

Measurement of an insurance contract incorporates all available information, in a way consistent with observable market information.

Future cash flows

Discounting
adjustment that converts future cash flows into current amounts

Measure contract at initial recognition
Discounting

- Discount rate should reflect the characteristics of the liability cash flows
- Discount rate should be consistent with observable market for instruments with cash flows with consistent characteristics
- Operationally, entity can use either:
  - A bottom up approach, or
  - A top down approach

Measure contract at initial recognition
Discounting: unobservable rates

- *Discount rate should be consistent with observable market for instruments with cash flows with consistent characteristics*
- Use judgement to:
  - Appropriately adjust observable inputs to accommodate differences between observable market and insurance contract cash flows
  - Develop unobservable inputs using best information available consistent with the objective (unobservable inputs should not contradict available and relevant market data).

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Future cash flows

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Risk adjustment
assessment of uncertainty about future cash flows and cost to entity

Measure contract at initial recognition
Risk Adjustment

- The compensation the entity requires for bearing the uncertainty
- Compensation that makes entity indifferent between:
  - fulfilling liability that has range of possible outcomes; and
  - fulfilling liability that will generate fixed cash flows with the same expected present value
- Entity specific measure:
  - The entity’s level of risk aversion
  - The degree of diversification benefit the entity considers in determining required compensation

Measure contract at initial recognition
Fulfilment cash flows

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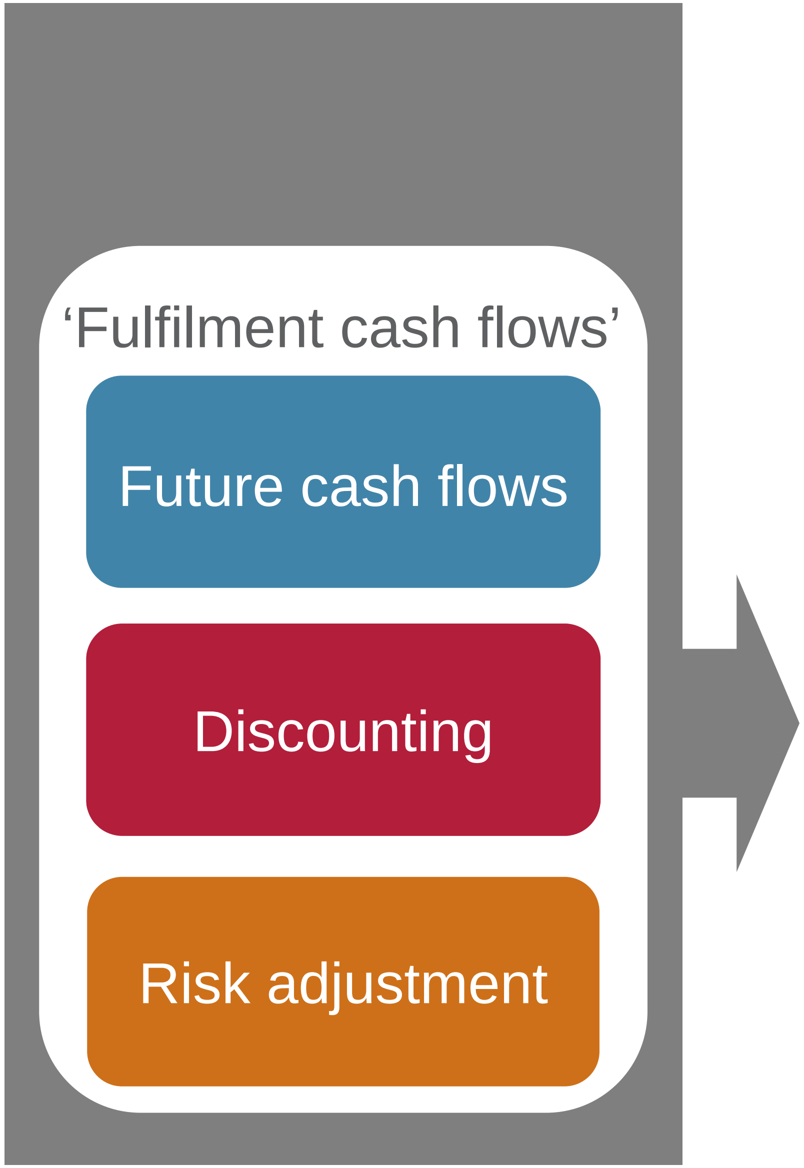

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- At inception, CSM is not a cash flow, instead it is the inverse of other cash flows

Measure contract at initial recognition
CSM: Level of aggregation?

- In some circumstances, CSM gains are treated differently from losses (onerous contracts)
- May create a different accounting outcome depending on level of aggregation
- Need to specify level of aggregation for determining onerous contracts
- Balance between loss of information about individual contracts and providing a faithful representation of the effect of grouping contracts

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CSM: Onerous contracts

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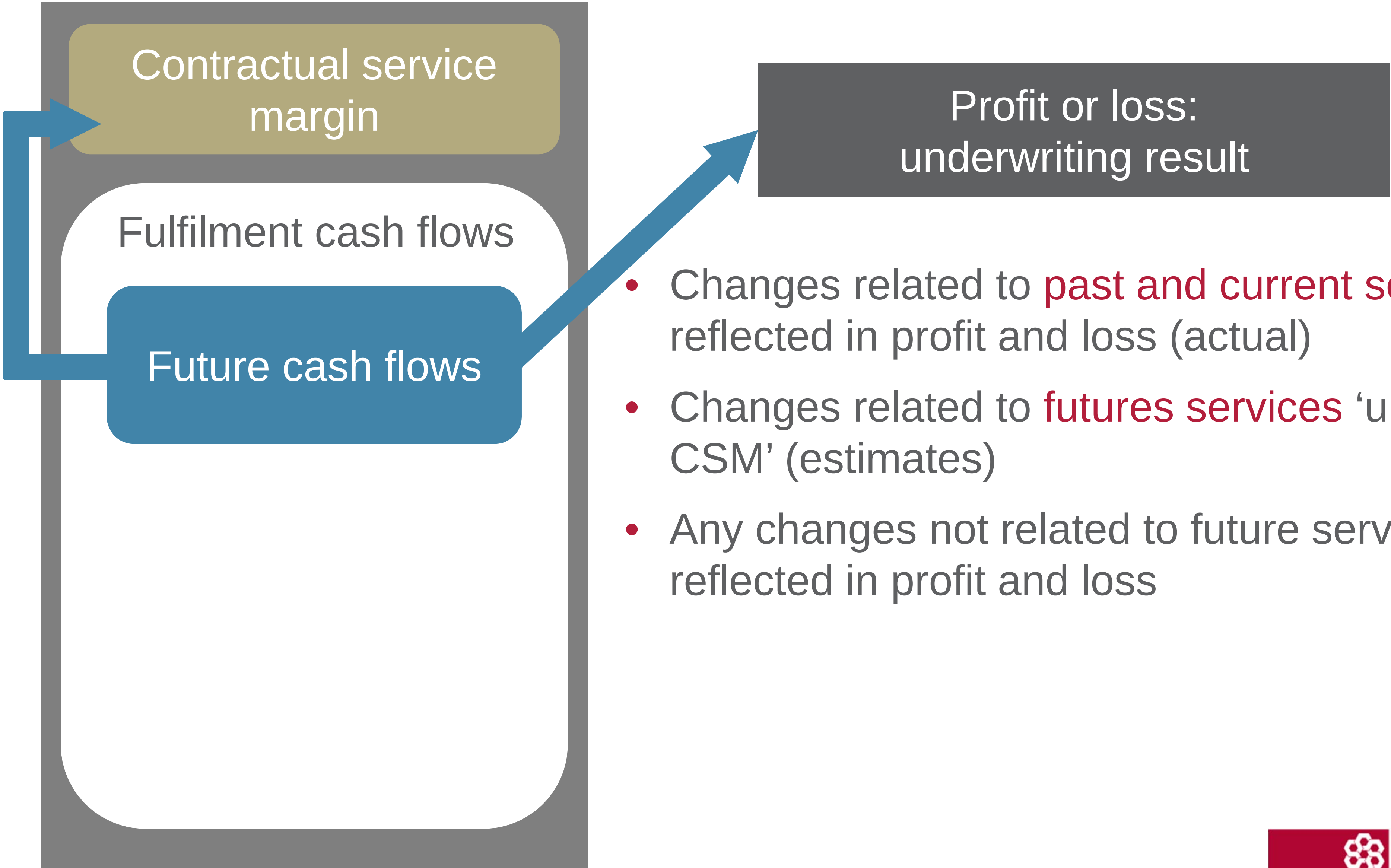

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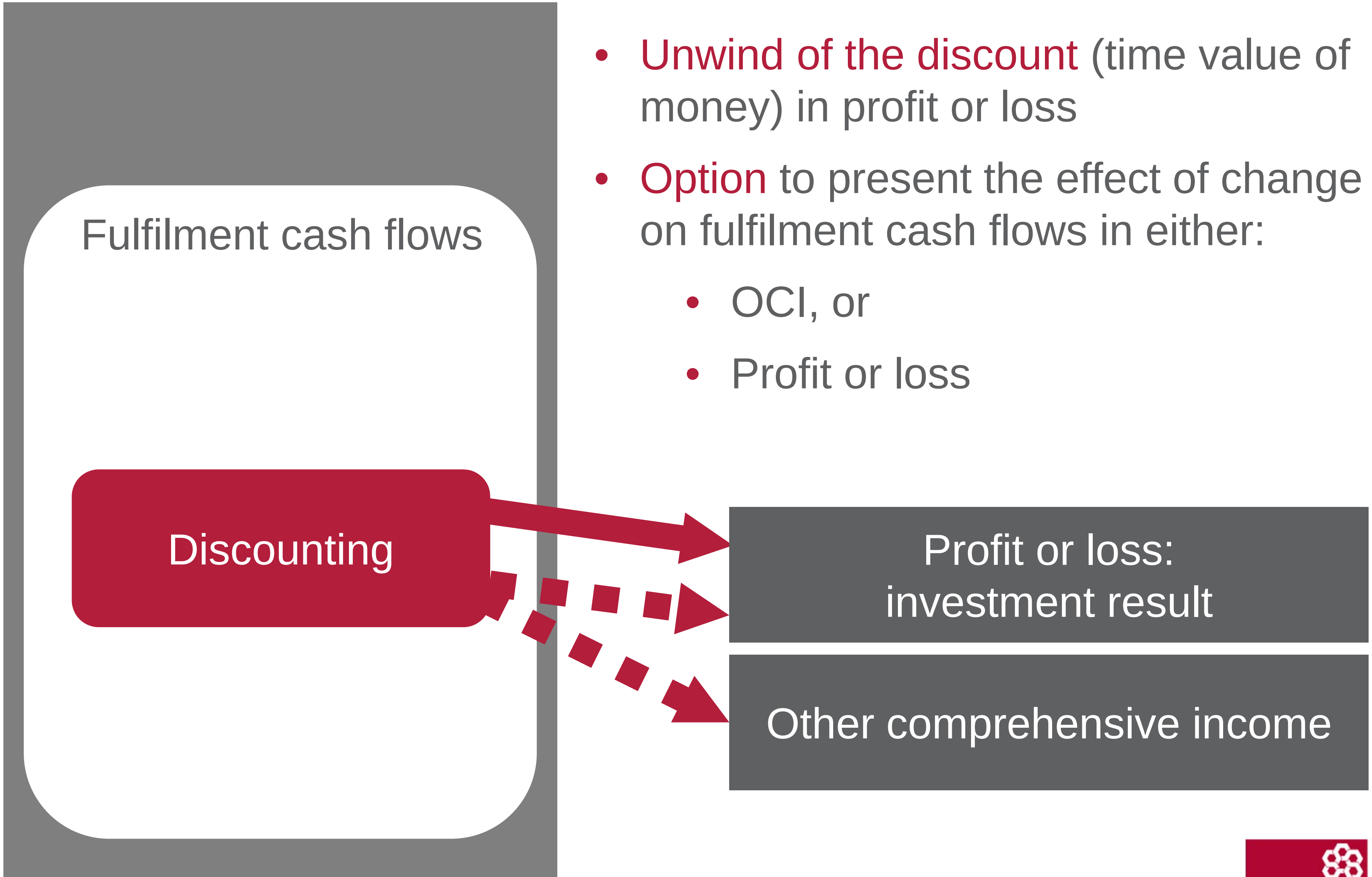
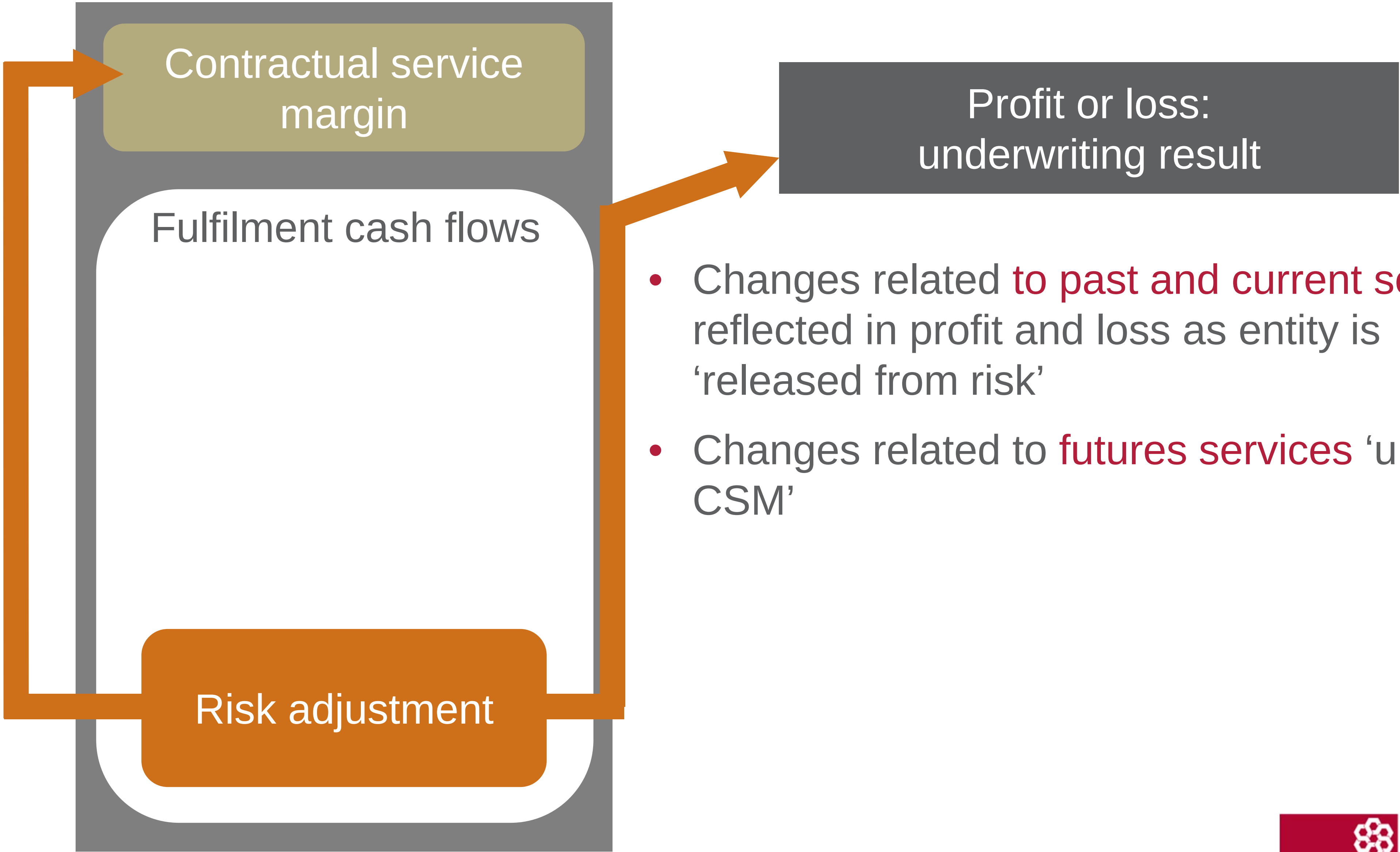


Remeasure in subsequent periods
Options and guarantees

- Updated value of the insurance contract, includes options and guarantees, consistent with market information
- Standard does not define ‘options and guarantees’, consequently changes in value of options and guarantees treated the same as other changes in cash flows and discount rates

Remeasure in subsequent periods
Recognition of changes in estimates



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Remeasure in subsequent periods
Recognition of changes in estimates

Contractual service margin

Profit or loss: underwriting result

- Recognise CSM in profit or loss as entity provides coverage:
  - Passage of time
  - Size and duration of contracts in force

Remeasure in subsequent periods
Accretion of CSM

- At inception, CSM is determined as a discounted amount
- Over time, the effect of that discounting should be reversed
- The unwinding of the discounting recognised at inception is referred to as accretion

BUT

- CSM is not a cash flow in itself
- Consequently, board has concluded that it
  - cannot be remeasured, and
  - discount rate should be the rate determined at inception

Remeasure in subsequent periods
Allocation of contractual service margin

- Objective: allocate remaining CSM in profit or loss over remaining coverage period in a systematic way that best reflects services to be provided
- Can be achieved by grouping contracts
- Is deemed to be achieved by grouping contracts that:
  - Have cash flows entity expects will respond in similar ways to key drivers of risk in terms of amount and timing
  - Had similar expected profitability
  - Entity adjusts the allocation to reflect expected duration and size of remaining contracts

Remeasure in subsequent periods
Need to identify effect of discretion

- Changes in fulfilment cash flows relating to future services adjust CSM*
- Changes in FCF arising from changes in market variables are recognised in SCI
- Discretionary changes by the entity relate to future service, so adjust the CSM (measured at the locked-in rate)
- Require entity to specify what it regards as non-discretionary (effectively the same as 2013 ED proposals which did not include requirements on how to make the distinction)

*Change measured at locked-in rate adjusts the CSM, difference between the amount measured at the locked-in rate and the amount measured at the current rate, recognise in SCI

Example
Need to identify effect of discretion

- Entity internally specifies return on an identified pool of assets as promised return on the project
- During most recent period, pool of assets returns 12%, ahead of expectation of 7%
- Entity decides to declare a return to policyholders of 8%
- Change in the return of assets (12%-7%) impacts the discount rate used to measure liability (effect to SCI)
- Exercise of discretion (decision to pay rate 4% less then specified) affects future service and is taken to CSM

The general model

IASB believes a current value measure of an insurance contract provides the most useful information about insurance contracts in the statement of financial position.

Contractual service margin

'Fulfilment cash flows'

Future cash flows

Discounting

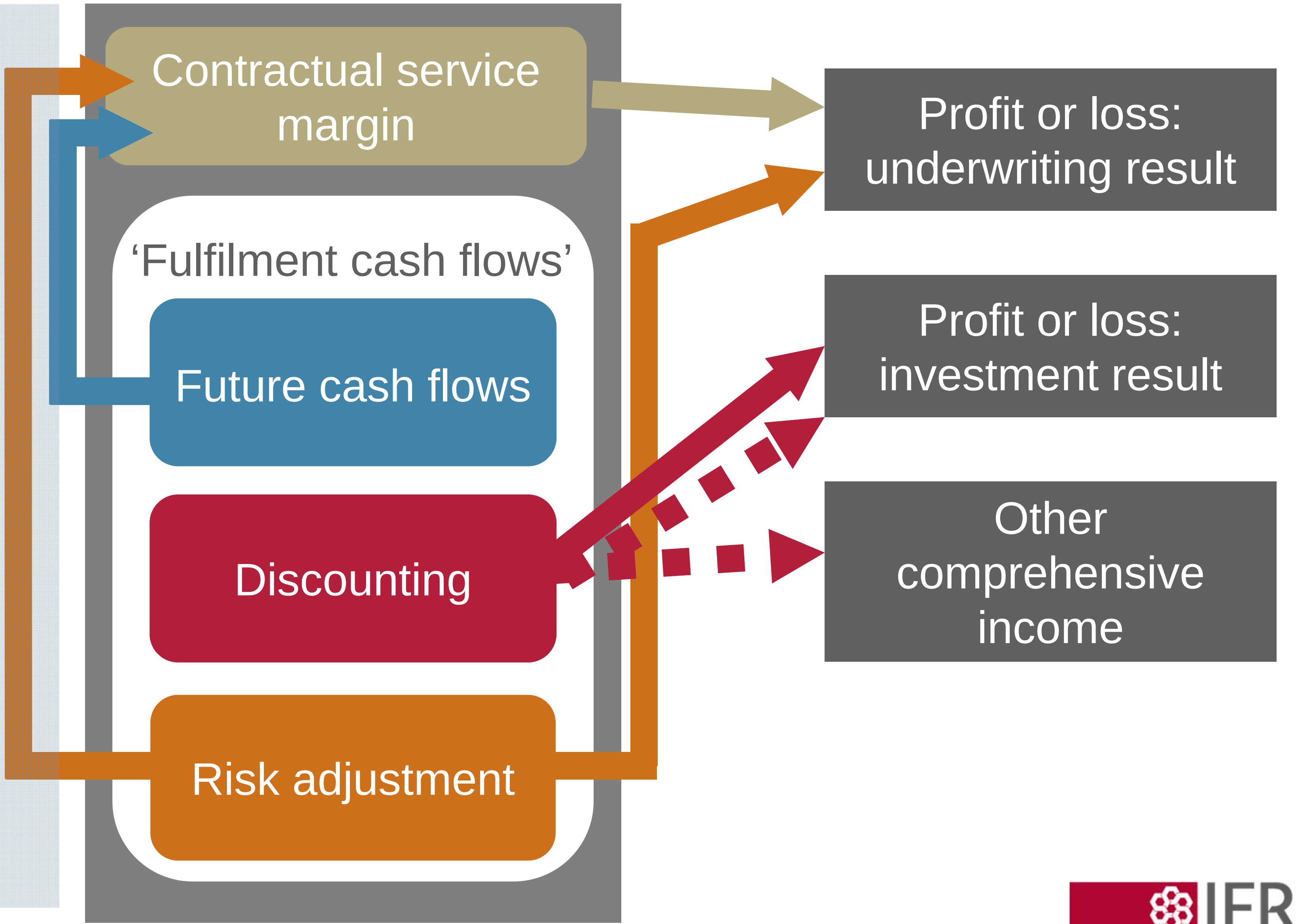
Risk adjustment

CSM is adjusted by changes in estimates and is allocated to profit or loss

In each reporting period, an entity remeasures the **fulfilment cash flows** using updated assumptions about cash flows, discount rate and risk.

The general model
Recognition of changes in estimates

The different types of changes in estimates are recognised in different parts of the financial statements.



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Modifications
Variable fee

Modifications to the general model

The new insurance contracts Standard modifies the accounting model to provide additional accounting models for different types of contract.

- A variable fee approach for contracts with participation features
- Accounting requirements for reinsurance contracts an entity holds, based on the general model
- Accounting requirements for investment contracts with discretionary participation features
- An optional simplified measurement approach for simpler insurance contracts, based on the unearned premium reserve approach used in many jurisdictions

Modifications to the general model
Variable fee approach: Scope

- Scope of the variable fee approach
  - Policyholder participates in share of clearly identified pool of underlying items;
  - Entity expects to pay policyholder a substantial share of the returns from those underlying items;
  - Cash flows expected to vary substantially with underlying items
- Variable contracts outside the variable fee approach apply the general model

Modifications to the general model
Variable fee approach: Sensitivity

- Includes any contract which creates an obligation linked to underlying items
  - Explicit contractual terms
  - Includes regulatory requirements
- However, measurement based on expected cash flows (not contractually-specified cash flows)
- Not dependent on holding of underlying assets
- Obligation need not be to current generation of policyholders

Modifications to the general model
Variable fee approach: Mechanics

- Measurement of obligation reflects change in fair value of all underlying items
- Fulfillment cash flow is calculated consistently with the general model
- Modify general model so that changes in the estimate of fee entity expects to earn are adjusted in CSM
  - Fee is equal to entity's expected share of returns on underlying items, less
  - any expected cash flows that do not vary with the underlying items.

Modifications to the general model

Variable fee approach: Risk mitigation

- Entity is permitted to recognise in profit or loss changes in value of guarantee (ie as in the general model) if:
  - Entity holds derivative instruments
  - consistent with entity's risk management strategy;
  - economic offset exists between guarantee and derivative, and
  - credit risk does not dominate the economic offset
- Entity is required to:
  - document its risk management objective and strategy
  - discontinue prospectively when economic offset ceases
  - disclose the effect of changes in the value of the guarantee in the profit or loss for the period

Modifications to the general model
Variable fee approach: Allocation of CSM

- Release pattern consistent with general model
  - Basis of passage of time
  - Number of contracts in force
- Alternatives rejected:
  - Based only on investment services
  - What is the pattern for those services?
  - How to reflect two services and changes in magnitude in those services over time?

Contrast with general model

General model versus variable fee

	General model	Variable fee model
Cash flows	No difference	
Discount rate	No difference	
Risk margin	No difference	
CSM at inception	No difference	
Allocation of CSM	No difference	
Discretion	No difference	

Contrast with general model
General model versus variable fee

	General model	Variable fee model
CSM		
Subsequent Measurement (financial)	Changes in all financial assumptions in SCI	Changes in guarantees and shareholders share in CSM
- Except risk mitigated	Changes in all financial assumptions in SCI	Changes in sh/share in CSM
Subsequent (non financial)	No difference	
Accretion	Accreted at locked in rate	'Effective' accretion at current rate

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Modifications

Other

Modifications to the general model

The new insurance contracts Standard modifies the accounting model to provide additional accounting models for different types of contract.

- A variable fee approach for contracts with participation features
- Accounting requirements for reinsurance contracts an entity holds, based on the general model
- Accounting requirements for investment contracts with discretionary participation features
- An optional simplified measurement approach for simpler insurance contracts, based on the unearned premium reserve approach used in many jurisdictions

Modifications to the general model
Reinsurance

- Apply general model approach to measure fulfilment cash flows
- If, at inception:
  - CSM is positive, record a liability consistent with general model
  - CSM is negative, record an asset (not consistent)
- After inception,
  - Recognise in CSM changes in estimates of FCF relating to future service (consistent), except
  - Recognise in profit or loss those changes which arise as a result of changes in estimates of FCF of underlying direct insurance contract, and which are recognised immediately in profit or loss.

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Modifications to the general model
investment contracts with DPF

- No insurance risk present in contract
- Apply general model approach to measurement of fulfilment cash flows with modifications to:
  - Recognition date: when entity becomes party to the contract
  - Contract boundary: ends when entity has the right or practical ability to deliver cash at a present or future date
  - Coverage period: period when entity required to provide asset management services under the contract
  - Allocation of CSM: systematic way that best reflects transfer of asset management services

Modifications to the general model
Premium allocation approach

- Optional practical expedient to general model – simplified approach (Premium Allocation Approach)
- Therefore:
  - Subject to entry criteria
  - Optional to use
- Key criteria: simplified approach should 'mimic' general model

Modifications to the general model
PAA: Eligibility

CSM

Time value of money

Risk adjustment

Cash flows

Permitted if reasonable approximation to the general model, ie if:

- coverage period is 12 months or less, or
- both following apply:
  - no significant changes in cash flow estimates are likely to occur before the claims incur
  - no significant judgement needed to allocate the premium over time

Modifications to the general model
PAA: Measurement

CSM

Time value of money

Risk adjustment

Cash flows

- On initial recognition
  - Record a liability at the PV of premiums received/receivable, less acquisition costs; or
  - Record an asset as the PV of premiums receivable
- Reduce the liability for passage of time
- Reduce asset for receipt of premiums
- Recognise a liability for incurred claims (using general model)

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Modifications to the general model

PAA: Measurement continued

CSM

Time value of money

Risk adjustment

Cash flows

Liability for incurred claims

- Measured consistently with the general model (with no contractual service margin)
- Discounted if material. Practical expedient 12 months
- Includes a risk adjustment

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Presentation and Disclosure

Present result in financial statements

The presentation format of the statement of comprehen-sive income will be consistent between insurers and entities that do not issue insurance contracts.

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 (optional)	(X)
Total comprehensive income	XX

Revenue/expense recognised as earned (not received) or incurred (not paid)

Interest expense either current or 'cost', depending on accounting policy choice

If interest expense is 'cost', effect of difference between current and cost rates is presented in OCI

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Revenue

- Currently, insurance revenue determined as either premiums invoiced (premiums due), or present value of expected future premiums (premiums written)
  - Inconsistently applied
  - May include ‘deposit-like’ elements
  - May not reflect compensation for risk borne in each period
  - May give the same weight to single and recurring premiums
- Inconsistent with revenue principles in IFRS

Revenue

- Premiums allocated on an earned basis
- Premium that relates to investment components excluded from premium revenue
- Premium revenue in period represents the compensation insurer earned for coverage provided in that period

Present results in financial statements
Interest expense in profit or loss

Presenting interest expense in profit or loss on a cost basis can reduce accounting mismatches with income from related assets measured on a cost basis.

Approach for determining insurance finance expense in profit or loss

Cost measurement basis

- Apply effective yield approaches to determine insurance finance expense in profit or loss
- Different versions appropriate for different contracts

Current period book yield approach

- Insurance finance expense in profit or loss eliminates accounting mismatch with items held in profit or loss
- Only for specified contracts (ie with no economic mismatches)

OCI: difference between insurance finance expense in P&L and insurance finance expense determined on current basis

Disclosures

The new standard provides insight into amounts recognised in financial statements and carries forward some existing disclosures in IFRS 4 relating to risk

Amounts

- Expected PV of future cash flows
- Risk and the contractual service margin
- Time value of money (interest expense)
- New contracts written in the period

Judgements

- Estimating inputs and methods
- Effects of changes in inputs and methods
- Reason for change, identifying the type of contracts affected

Risk

- Nature and extent of risks arising
- Extent of mitigation of risks by reinsurance and participation features
- Quantitative data about exposure to credit, market and liquidity risk

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Applying the Standard for the first time

Options permitted by the Standard

- Option to apply insurance contracts Standard to:
  - Fixed fee service contracts
  - Financial guarantee contracts
- Option to apply premium allocation approach (PAA), within PAA:
  - Option to expense acquisition costs if coverage period one year or less
  - Option not to accrete interest if coverage period one year or less
  - Option not to discount future cash flows expected to be paid in one year or less

Options permitted by the Standard

- Variable fee approach not optional (VFA), but within VFA:
  - Constrained option to recognise effect of changes in the value of guarantees in profit or loss if entity uses derivatives to mitigate financial market risk in those guarantees
  - Option to eliminate mismatch by measuring some assets at FVPL
- Presentation: option to present effect of changes in discount rate in profit or loss or OCI

Applying the Standard for the 1st time

When an entity applies Standard for the 1st time, it may have in-force contracts written many years ago. Historical data about those contracts:

- May require use of hindsight
- May not be available

✓

- The entity can measure the fulfilment cash flows directly

✗

- Historical data needed to:
  - Measure remaining balance of CSM
  - Measure liability for remaining coverage for revenue
  - For general model. determine discount rate at date of initial recognition for OCI, interest accretion and unlocking

Applying the Standard for the 1st time

The IASB has specified different approaches for estimating the contractual service margin in a way that balances comparability with the costs of obtaining historical information.

Retrospective application

When historical data exists and hindsight is not required

Prescribed simplified approach

When not all historical data is available but information about historical cash flows is available or can be constructed

Liability calibrated to fair value

When no historical information about cash flows is available

Estimating CSM
Prescribed simplified approach

General Model

- Estimate CSM at initial recognition using fulfilment cash flows at beginning of earliest period presented adjusted to reflect cash flows that already occurred
- Adjust CSM at initial recognition for allocation in proportion to contract duration
- Approximate discount rates at initial recognition

Variable fee approach

- Estimate CSM at initial recognition using the fair value of underlying items at date of initial application adjusted to reflect cash flows that already occurred
- Adjust CSM at initial recognition for allocation in proportion to contract duration

Estimating CSM
No information about cash flows available

- When it is impracticable to apply the prescribed simplified approach, the CSM is determined as the difference between the fair value of the insurance contracts at that date and the fulfilment cash flows measured at that date

Transition reliefs

- Opportunity to fully evaluate accounting for insurance contracts by permitting reassessment of classifications for financial assets under IFRS 9 based on facts and circumstances that exist at the date of initial application
- Includes use of options available on first application of IFRS 9

Disclosures

- Information about the earliest date of initial recognition of the portfolios that are measured retrospectively
- Amounts in the financial statements determined at transition using simplified approach or fair value approach, both on transition and in subsequent periods.
- If using the simplified approach that results in accumulated OCI for insurance contract being zero, disclose information of accumulated OCI for related financial assets measured at FVOCI in accordance with IFRS 9.

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