Insurance Contracts
Current status of the IASB project

Gerdus Dixon

KPMG
Background

- Project commenced in 1997
- IASB Discussion Paper (May 2007)
- FASB joins the project (October 2008)
- IASB Exposure Draft (July 2010)
  - 248 Comment letters received
- IASB is planning to re-expose or issue staff draft 2012
IASB/FASB Discussions

• The Boards discussions of the proposals in the IASB’s Exposure Draft and the FASB’s Discussion Paper have had the following outcomes:

  - Change to proposal

  - No decisions to date

  - Proposals tentatively confirmed
Recognition

- **Under the Exposure Draft**
  - RECOGNISE
  - BOUND BY TERMS
  - COVERAGE BEGINS
  - 1 NOVEMBER
  - 1 JANUARY

- **Current Tentative Status**
  - BOUND BY TERMS
  - ONEROUS CONTRACT CONSIDERATION
  - RECOGNISE
  - COVERAGE BEGINS
  - 1 NOVEMBER
  - 1 JANUARY
### Measurement Model – Three or Four Building Blocks?

<table>
<thead>
<tr>
<th>Four Building Blocks</th>
<th>Three Building Blocks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IASB Preference</strong></td>
<td><strong>FASB Preference</strong></td>
</tr>
<tr>
<td>(modified to exclude day one gains)</td>
<td>(modified to exclude day one gains)</td>
</tr>
<tr>
<td><strong>Expected future cash flows</strong> – explicit, unbiased and probability-weighted estimates of future cash outflows less future cash inflows*</td>
<td><strong>Expected future cash flows</strong> – explicit, unbiased and probability-weighted estimates of future cash outflows less future cash inflows*</td>
</tr>
<tr>
<td><strong>Time value of money</strong> – discounted using current rates to reflect the time value of money*</td>
<td><strong>Time value of money</strong> – discounted using current rates to reflect the time value of money*</td>
</tr>
<tr>
<td><strong>Risk adjustment</strong> – to adjust for the effects of uncertainty about the amount and timing of future cash flows*</td>
<td><strong>Composite margin</strong> – to remove any profit at inception and released over time</td>
</tr>
<tr>
<td><strong>Residual margin</strong> – to remove any profit at inception and released over time¹ **</td>
<td></td>
</tr>
</tbody>
</table>

* **Re-measured subsequent to inception through profit or loss**

** **The residual margin will be adjusted for changes in future cash flows. Changes are recognised prospectively.**

---

2011 CONVENTION 8 – 9 NOVEMBER
Measurement

An insurer would measure the present value of the fulfilment cash flows (includes risk adjustment) at a portfolio level of aggregation for insurance contracts.

(The definition of a portfolio will be discussed in a future meeting)

The residual margin should be determined by grouping insurance contracts by portfolio and, within the same portfolio, by date of inception of the contract and by coverage period of the contract.
Contract Boundaries

Contract renewals should be treated as a new contract:

- when the insurer is no longer required to provide coverage; or
- when the existing contract does not confer any substantive rights on the policyholder.

A contract does not confer any substantive rights on the policyholder:

- when the insurer has the right or the practical ability to reassess the risk of the particular policyholder and,
- as a result, can set a price that fully reflects the risk.

For a contract where the pricing of the premiums does not include risks relating to future periods, the contract would not confer any substantive rights on the policyholder

- when the insurer has the right or the practical ability to reassess the risk of the portfolio that the contract belongs to and,
- as a result, can set a price that fully reflects the risk of that portfolio.

All renewal rights should be considered in determining the contract boundary whether arising from a contract, from law or from regulation.
Acquisition Costs

Acquisition costs to be included in the initial measurement of a portfolio of insurance contracts should be all the direct costs that the insurer will incur in acquiring the contracts in the portfolio.

Measurement would exclude indirect costs including:

- rent and occupancy
- software dedicated to contract acquisition
- equipment maintenance and depreciation
- agent and sales staff recruiting and training
- administration
- advertising
- utilities
- other general overhead

FASB ONLY - LIMITED TO THOSE COSTS RELATED TO SUCCESSFUL ACQUISITION EFFORTS

IASB ONLY - NO DISTINCTION BETWEEN SUCCESSFUL AND UNSUCCESSFUL EFFORTS (ALL DIRECT COSTS INCLUDED)
Modified Measurement Approach

The modified measurement approach is required for pre-claims liabilities of short duration contracts.

• Short duration contracts are insurance contracts:
  • with a coverage period of approximately 12 months or less, and
  • do not contain any embedded options or derivatives that significantly affect the variability of cash flows.

No decisions to date

Also known as the “Premium Allocation Model”
Objective for this approach

- **One model view**
  - Simplification of the building block approach

- **Two model view**
  - A different model for measuring fundamentally different contracts

- Permit
- Require

No decisions to date
Reinsurance

- If the present value of the fulfilment cash flows (for this purpose the expected present value of the cedant’s future cash inflows plus the risk adjustment, if applicable, less the expected present value of the cedant’s future cash outflows) for the reinsurance contract is:
  - less than zero and the coverage provided by the reinsurance contract is for future events, the cedant should establish that amount as part of the reinsurance recoverable, representing a prepaid reinsurance premium and should recognise the cost over the coverage period of the underlying insurance contracts.
  - less than zero and the coverage provided by the reinsurance contract is for past events, the cedant should recognise the loss immediately.
  - greater than zero, the cedant should recognise a reinsurance residual or composite margin to remove the day-one gain.
Presentation and Disclosure

**Statement of financial position**
- Assets or liabilities presented for each portfolio of insurance contracts
- Unit-linked contracts presented as a separate asset and liability
- Reinsurance assets are not offset against insurance contract liabilities

**Income Statement**
- Summarised Margin Approach (exception for short-duration contracts)
- More Familiar Premiums and Claims Approach removed
- Unit-linked contracts presented as a separate line item

**General Disclosures**
- Incremental to IFRS 4
- Mixture of Quantitative and Narrative Disclosures
- Extensive Insurance Risk and Risk Management Disclosures

No decisions to date
Effective date

• How long of a transition period would you require?

Key
- 0 – 24 months: 9%
- 24 – 36 months: 34%
- 36+ months: 35%
- No comment: 22%

Key messages / observations
• There was a clear message from many of the respondents, that addressed this issue, a minimum of three years was needed.
• A number of respondents suggested a transition period of up to six years.
• Some first-time adopters of IFRS recommended transition periods exceeding five years.