Agenda paper 5.1

asian-oceanian standard-setters group

THE SIXTH ANNUAL AOSSG MEETING

Continuing to build and strengthen regional capacity in IFRS

26-27 November 2014 Hong Kong

Insurance Contracts

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Korea Accounting Standards Board (KASB)

WG members: Korea (Lead), China (Co-lead), Australia, Hong Kong, Japan, Macau, Malaysia, Nepal, New Zealand, Pakistan, Sri Lanka, Thailand

The views expressed in this presentation are those of the presenter, not necessarily those of the KASB.

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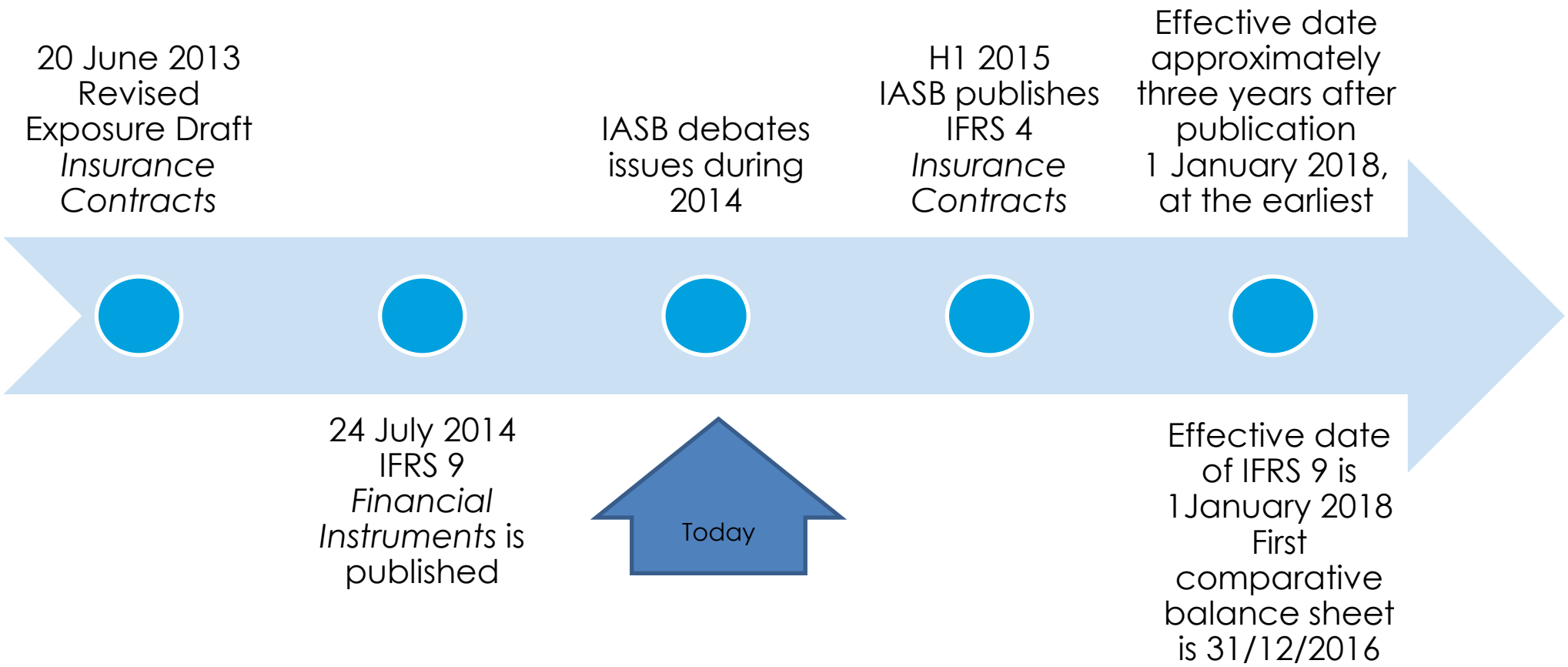
Latest update

- Since January 2014, the IASB has been deliberating issues raised in the third consultation round.
- So far, the IASB has completed its discussions on the model for non-participating contracts.
- In recent IASB meetings, the IASB has explored aspects of the model for insurance contracts with participating features.
- In November, the IASB will hold an education session for an alternative model for par products suggested by European CFO forum.
- The IASB expects to publish the final standard in 2015.

Expected timeline



Requirements that are now complete

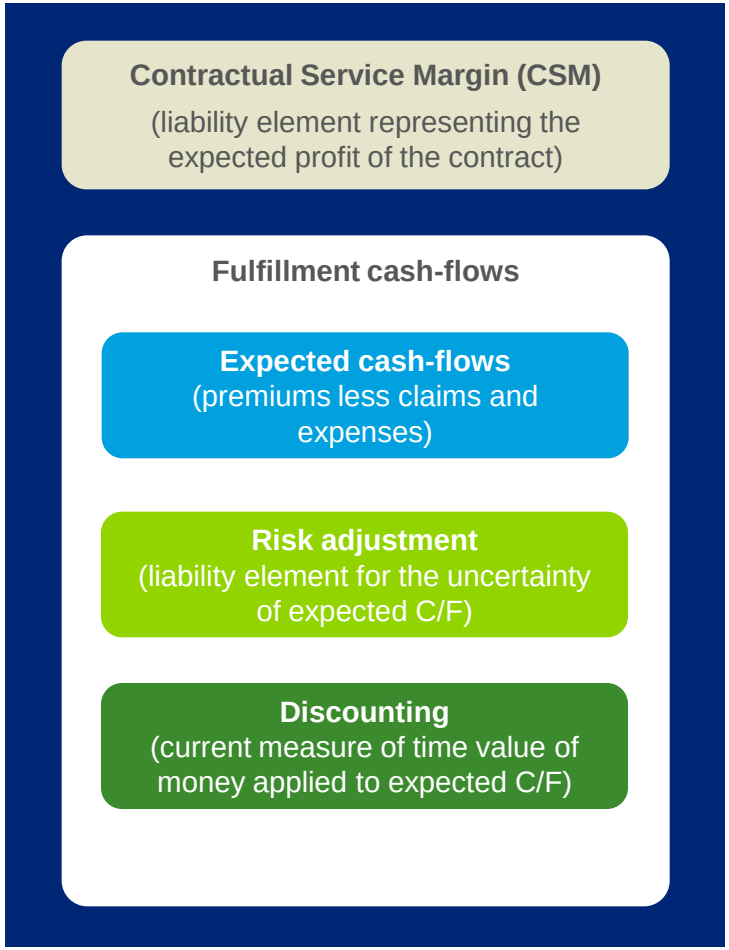
- Non-participating contracts

Single figure in the balance sheet to represent the portfolios of insurance contracts

The value of the contracts is the **present value of the cash-flows** and a **contractual service margin** liability element **that represent the expected profit for the contract**.

The present value of the fulfilment cash-flows includes a **risk adjustment liability** element, which reflects the uncertainty in the future cash-flows.

Balance sheet amounts must use current market consistent inputs (e.g. discount rates and value of options and guarantees)



Requirements that are now complete

- An "imperfect" solution for interest rate volatility

- Insurers can opt to keep interest rate volatility from a market consistent discount rate out of reported earnings. **This is an accounting policy choice at portfolio level**
- Volatility is recognised **directly against shareholders' equity** using "Other Comprehensive Income" (OCI)
- Interest expense is based on **historical market interest rates** when contracts were sold. This approach is still open for participating contracts.
- IFRS 9 offers a parallel solution for interest rate volatility on the assets: **fair value through OCI**
- This "OCI" solution has limitations.

Requirements that are now complete

-How CSM drives profit recognition

There are two key drivers for profit recognition under the new IFRS

1. Profit recognised in the year for **the expected fulfilment of contractual obligations towards the policyholders** over the coverage expired during the year; and
2. CSM/expected profit adjustments from **changes in assumptions for future obligations/cash flows**. This called the "**unlocking of the CSM**"

The CSM is earned over the remaining coverage period in a "systematic way that best reflects the remaining transfer of services that are provided under the contract."

For **non-participating contracts** the best reflection of profit recognition is the **passage of time**

Requirements that are now complete

Transition requirements are very demanding despite special rules

- The new standard is applied retrospectively to all contracts in force at "the beginning of the earliest period presented"
- The in-force at that date is divided in three parts where the restatement on a contract by contract basis under the new IFRS is done using:
  - **Full restatement**
  - **Simplified approach with some modifications to RA**
  - **Fair Value approach**

Requirements under discussion

Status quo of IASB debate regarding participating contracts

- IASB acknowledged that the 2013 ED proposal to introduce a "mirroring approach" has been widely rejected by constituents
- Several commentators directed the IASB towards using the BBA with adaptations to reflect the nature of the participation feature included in these contracts
- The IASB accepts that this feature may be present in insurance contracts and financial instruments
- The current scope will include some financial instruments with participation features and all insurance contracts

Requirements under discussion

Status quo of IASB debate(contd.)

- The adaptations being considered are primarily around two areas
  - The "unlocking" of the CSM could **take into account the changes in the insurer's future share of return generated by the underlying items**. The profit recognition basis for this adapted CSM should be defined
  - The accounting policy option to present the time value of money separately between profit or loss and OCI would use an **asset dependent yield based on the projected crediting rates** rather than the market consistent discount rate curve set at initial recognition
- In the event that the IASB accepts these adaptations it would become critical for them to consider **the scope of application** for these adaptations

Requirements under discussion

Status quo of IASB debate(Alternative model)

- European CFO Forum has proposed a model for participating contracts that has been welcomed by the European Financial Reporting Advisory Group (EFRAG)
- This is a conceptual model that is **applicable to all participating contracts**. These are defined as those contracts that offer a **variable return linked to a specified pool of assets irrespective of whether or not the actual assets are held by the insurer**
- The scope is broad and would include European-style, Asian-style and American-style insurance contracts
- The scope will also capture a portion of contracts where there is **no insurance risk transfer** if the variable return includes a discretionary element derived from underlying items held by the insurer (**investment contracts with discretionary participation**)

Requirements under discussion

Status quo of IASB debate(Alternative model : contd)

- The key features are:
- **No bifurcation of cash flows** with a **single discount rate curve** for all cash flows (asset-dependent or not) for balance sheet measurement
- **Book yield rate** for the "presentation" of the time value of money in P&L with the difference to OCI
- Definition of the CSM of the **insurer's share of future profits** from the underlying items with full unlocking of all variables (including options and guarantees)
- **Profit recognition** based on the **delivery of the service to the policyholder**

Discussion topics

- Transition requirements for contracts with no participating features (October-2014)
- Alternative model for accounting for contracts with participating features (November-2014)

Q & A session

- Future time plan for IFRS 4 Phase2
- Effective date for IFRS 4
- Any additional comment