

IFRS Developments for Insurers

Boards debate premium allocation approach

Education Sessions continue discussion on eligibility criteria

What you should know

- ▶ The Boards held educational discussions on the eligibility criteria for the premium allocation approach (PAA) and asked the staff to further develop those criteria based on the direction provided during the meetings.
- ▶ The IASB and the FASB agreed to work together to seek to reduce differences in their classification and measurement models for financial instruments.
- ▶ The IASB will not delay the effective date for its new standards on consolidations, joint arrangements and related disclosures.

Overview

The International Accounting Standards Board (the IASB) and the Financial Accounting Standards Board (respectively the IASB and the FASB, or collectively the Boards) each held Education Sessions in January to re-deliberate the tentative decisions in the IASB's Exposure Draft *Insurance Contracts* (the ED) and in the FASB's Discussion Paper *Preliminary Views on Insurance Contracts* (the DP). The only topic discussed was the premium allocation method.

The IASB considered whether to delay the mandatory effective date for its new standards on consolidations, joint arrangements and related disclosures.

At a meeting on 27 January, the IASB and the FASB discussed whether to work jointly to improve the alignment between their classification and measurement models for financial instruments.

Premium allocation approach

In previous meetings, the Boards held extensive debates on various aspects of the premium allocation approach (PAA). In January, they each held Education Sessions to discuss a single proposal prepared by both staffs on eligibility for the PAA and certain aspects of the mechanics of that model. The staffs' intention in holding the meetings was to obtain the direction and clarification of both Boards on each of the topics.

Each of the Boards discussed the joint staff proposal that included the following criteria for contracts to be measured under the building blocks approach (BBA):

- (a) It is likely that, during the period before a claim is incurred, there will be a significant change in the expectations of net cash flows to fulfill the contract that would not be captured by the onerous contract test

Or

- (b) Significant judgement is required to determine the amount to be recognised in each reporting period

During the FASB session, Board members directed the staffs to modify these eligibility criteria to avoid unintended consequences caused by the reference to the onerous contract test. Several FASB members felt the reference would lead preparers to believe the first criterion applies only to unprofitable contracts.

At the IASB session, several members noted that instead of developing criteria for contracts that could not qualify for the PAA, the criteria should be structured to identify those contracts that could use the PAA. Therefore, the IASB Board asked the staff to further develop the eligibility proposal on the basis of:

- (a) Stating a principle that the PAA could be used when the results would be expected to be similar to those produced when using the BBA
- (b) Including a practical expedient that permits contracts with a coverage period of (approximately) 12 months or less to be eligible for the PAA, regardless of their other characteristics
- (c) Providing application guidance on when the PAA and the BBA would produce similar results based on the criteria proposed by the staff for this meeting

Both staffs were asked to prepare revised eligibility criteria based on the Boards' input from the educational sessions. They were asked to use a method that did not require the criteria to depend on the PAA being viewed as either an approximation for the BBA or, a separate model next to the BBA.

In terms of the structure of the PAA, considerable discussion took place as to what acquisition costs represent. The staff concluded that, before any of the details could be addressed, the Boards would have to deal with the conceptual nature of acquisition costs. In addition, the Boards queried whether those costs should be capitalised as a separate asset or reported as an element of the liability.

How we see it

The Boards are looking to achieve the same objective in determining the eligibility criteria for the PAA. However, past discussions, as well as this round of educational sessions, suggest that the IASB and the FASB have different viewpoints on some aspects of the PAA; for example, whether the PAA is an approximation of the BBA (IASB) versus a separate model (FASB). As such, much will depend on how the staff can accommodate those different viewpoints within their revised wording for the eligibility criteria.

The IASB's proposal to explicitly include a practical expedient based on the duration of the coverage period should help to alleviate concerns that insurers would be spending excessive time estimating and documenting measurement under both methods at the same time. This could indicate that the Boards want to avoid placing undue pressure and costs on insurers to demonstrate their ability to qualify for the PAA.

Financial instruments

The Boards agreed to work together to seek to reduce differences in their respective classification and measurement models for financial instruments. These discussions will be

part of the FASB's re-deliberation of the May 2010 Accounting Standards Update on financial instruments and the IASB's project to make limited scope changes to IFRS 9 associated with the development of the insurance contracts standard. The Boards will also work together with the objective to more closely align key aspects of their classification and measurement models. They will explore these key aspects jointly, and then decide whether to issue proposed amendments to IFRS 9 and US Generally Accepted Accounting Principles (US GAAP), respectively.

How we see it

The Boards' decision to work on certain classification and measurement aspects of financial instruments together could be an important step in their efforts to achieve convergence. This is not only true for financial instruments accounting, but also for the proposed insurance model because of the level of interaction between the two models. For insurance contracts, the task of reaching a converged solution would seem more challenging if significant differences were to remain between the Boards' respective classification and measurement models for financial instruments.

IFRS 10

In May 2011, the IASB issued its new standards on Consolidations (IFRS 10 *Consolidated Financial Statements*), *Joint Arrangements* (IFRS 11 *Joint Arrangements*) and disclosures related to those standards (IFRS 12 *Disclosure of Interests in other Entities*). In the same month, these standards were issued with a mandatory effective date of 2013. Some European constituents, including insurers,

have expressed concerns around that effective date and asked for a delay to 2014. One concern raised by insurers is how the interaction between IFRS 10 and the IASB's proposals in the exposure draft on investment entities will be addressed. They fear that the proposals in the investment entities project may introduce certain requirements that would conflict with or change the interpretation of the recently-issued IFRS 10 requirements.

While acknowledging these concerns, the Board decided not to defer the effective date. The IASB argued that a number of countries have already endorsed the new standards, and some companies are currently going through the process of implementing them.

The IASB also believes that it is extremely unlikely that any changes to the proposals on the consolidation exemption in the exposure draft on investment entities will lead to significant cost and effort for insurers and other companies, which would have been an important consideration for possible deferral. The IASB noted that it intends to provide clearer direction by June on the breadth of the consolidation exemption.

How we see it

Some insurers may have considered the possibility that the IASB would defer the mandatory effective date of the new consolidation standards, for example, as a result of the status of the investment entities project. With the IASB's decision not to defer the effective date, it now seems unavoidable that at least those insurers that apply full IFRS will have to adopt those standards for their 2013 financial statements.

In a number of jurisdictions (e.g., Europe), new standards only become applicable after local endorsement. Some of those jurisdictions may set a mandatory effective date later than 2013, perhaps with earlier adoption permitted. This would allow insurers to benefit from a later effective date in their jurisdiction by applying the standards only from the later effective date onwards. However, those companies would not be able to claim compliance with full IFRS in 2013, which raises the issue of how to apply the transitional provisions in the standards if they wish to be compliant with full IFRS in the future.

Next steps

The IASB plans to issue a revised exposure draft or a review draft of the final standard in the first half of 2012. It will establish a publication date for the final standard in due course. The FASB currently aims to issue its own exposure draft in the same period.

The Boards will have their next discussion on insurance during the February Board meetings; the topics have not been announced.



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