IASB/FASB Board meeting 15-16 November 2011
Insurance Accounting Alert

IASB decides to consider limited improvements to IFRS 9; Boards discuss unbundling

What you need to know

TThe IASB decided to open discussions on limited improvements to IFRS 9 *Financial Instruments* to consider the interaction with the insurance contracts project and seek further convergence with US GAAP. The IASB recently decided that the effective date of IFRS 9 would be changed from 2013 to 2015.

The IASB and the FASB discussed several aspects of separating insurance contracts into various elements and will coordinate further debate on this matter with their deliberations on the presentation of the statement of comprehensive income.

Overview

On 15 November, the International Accounting Standards Board (the IASB) continued its re-deliberations of the tentative decisions in the Exposure Draft *Insurance Contracts* (ED). This discussion focused on treatment of residual margins and was educational in nature. In a separate session, the IASB discussed whether to consider making limited improvements to IFRS 9.

On 16 November, the IASB met with the Financial Accounting Standards Board (the FASB) to discuss disaggregation/unbundling and the presentation of explicit account balances included within insurance contracts.

IFRS 9

The IASB decided that it will consider making limited improvements to IFRS 9. A key factor for this decision is the importance of considering the interaction between the accounting for financial assets under IFRS 9 and the proposed accounting model for insurance liabilities in the insurance contracts project. Limited improvements to IFRS 9 could also lead to opportunities for convergence with the FASB's proposals for financial instruments, although a limited revision of IFRS 9 would not come in lieu of the consultation request for the FASB proposals.

Since the release of the ED, discussions about increased earnings volatility caused by the proposed insurance model have been ongoing. Many respondents to the ED have suggested that the IASB should permit certain changes in both the measurement of insurance liabilities and assets backing those liabilities be reported directly via an OCI approach, as a way to reduce volatility caused by accounting mismatches. Prior to this meeting, the IASB concluded that it would not be viable to look at approaches that would fall outside the existing IFRS 9 classification and measurement requirements.

The decision to look at certain areas of IFRS 9 will allow the IASB to consider the accounting for financial instruments and the proposals for the future insurance model together - without being bound by the current requirements in IFRS 9. The FASB is expected to join this debate because it is expected to include an OCI approach in their proposal to revise the accounting for financial assets.

In a meeting on 7 November, the IASB agreed to change the mandatory effective date for application of IFRS 9 to 1 January 2015. However, the IASB also noted that it may revisit this date in the future, depending on the progress of the remaining phases of IFRS 9 and the insurance contracts project.

How we see it

The decision to look at IFRS 9 marks an important development for the insurance contracts project, and could ultimately lead to a fundamental change to key aspects of the insurance model as well as IFRS 9. This development, therefore, will be a top priority on the accounting change agenda of many insurers. We believe it is important that they get involved in the debate on OCI and consider providing further input on this topic to the Boards.

Residual Margins (Educational session)

For a contract that is based on the building block model, the residual margin at inception is the amount that must be recognised as a liability to prevent a gain at issue. The IASB's discussion on this topic focused on whether:

- The residual margin should be locked in at inception

Or

- It should be adjusted for changes in estimate of future cash flows, the effects of changes in discount rates or changes in the risk adjustment

And

- If adjusted for changes, which type of changes should be considered.

Some IASB members stated that a locked-in residual margin was more understandable and less complicated than one that was unlocked. However, most IASB members appear to be leaning towards unlocking the residual margin, as that would better reflect the margin an insurer expects to earn based on the most recent expectations.

IASB members had varying views about whether the changes in risk adjustment and in discount rates should also result in changes in the residual margin. They also noted that the treatment of residual margins needs to be synchronised with the possible use of OCI for changes in certain inputs such as discount rates.

The IASB asked the staff to prepare a comprehensive set of examples that illustrates the impact of changes in circumstances on key aspects of the model. Such examples would allow them to consider holistically the wider context of the overall model, including unlocking of residual margins, the use of OCI and the connection with changes in the measurement of assets backing insurance liabilities. These examples also would help the IASB to understand the practical issues of possible residual margin alternatives and to investigate other issues, such as the unit of aggregation for determining the residual margin and treatment for onerous contracts.

This session was purely educational and, as such, the IASB made no decisions.

How we see it

The challenge for the IASB will be to establish the right sequence of considerations and make certain that the decisions on various elements related to volatility fit together at the end. A request for examples may indicate that the IASB sees the potential complexity as an important factor to consider when determining the treatment of the residual margin.

Disaggregation of explicit account balances

In the last discussion, the Boards expressed a desire to approach the unbundling of financial and service features in the same fashion that is proposed in the revenue recognition project. Instead, the staffs proposed that insurers should use the building blocks for the measurement of all the cash flows, but with separate presentation of the explicit account value within an insurance contract from the remainder of the insurance liability. The staffs' proposal defined explicit account balances as those in which the balance is the accumulation of monetary transactions between the insurer and the policyholder and that balance is credited with an explicit return.

The Boards had a lengthy debate on various aspects of separating insurance contracts, and a range of views were expressed. They concluded there are two perspectives to this topic:

- The unbundling of components of insurance contracts that are to be measured under another standard, before the proposed building block model for insurance contracts is applied

And

- Disaggregating certain elements of the insurance liability and presenting them separately

The Boards were unable to decide between these two perspectives because they believe they need more information on the significance of the effect on the measurement. Because the second item addresses presentation, the Boards noted that this issue may be resolved when they conclude on the income statement volume disclosures.

How we see it

Life insurance contracts are often a combination of several interdependent elements, including a savings component. Developing an accounting model that presents that interdependence and also reflects the savings nature of the contracts will be a challenge and may introduce additional complexity to a model that already is complicated. Hence, the Boards will have to decide if they can be satisfied with what is essentially presentation or disclosure information about financial components of certain contracts, or whether they will insist that those components need to be treated like financial liabilities for measurement purposes.

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 exposure draft in the same period.

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

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