

## Insurance Accounting Alert

### What you need to know

- ▶ Although inclined to use a premium allocation approach for short duration contracts, the Boards were unable to reach agreement on the rationale.
- ▶ The Boards have instructed their staffs to further refine the criteria for application of the approach and to investigate which types of contracts would qualify for the treatment under these criteria.
- ▶ The IASB tentatively decided to move the mandatory effective date of IFRS 9 to 1 January 2015.

# Boards discuss premium allocation approach; tentatively revise effective date of IFRS 9

## Background

At a joint meeting on 21 July, the International Accounting Standards Board and the Financial Accounting Standards Board (the IASB and FASB, respectively, and collectively, the Boards) discussed the premium allocation approach (previously known as the modified approach) to measurement of liability for remaining coverage (previously known as pre-claims liabilities) of certain types of contracts. The Boards had also planned to discuss unbundling at this meeting, but instead postponed that discussion to a later date.

In its Exposure Draft (ED), the IASB proposed an approach for contracts with coverage periods that are less than one year in duration, referred to in the ED as short-duration contracts. The ED proposed recognising the premium as revenue on the basis of the passage of time or on the basis of the expected timing of incurred claims and benefits, if that pattern differs significantly from the passage of time. The measurement of the liability at any point in time would represent the unallocated part of the total premium for the contract period less any uncollected installments. The Discussion Paper (DP) of the FASB discussed the approach proposed in the ED, but stopped short of endorsing it.

Although the Boards received comments that widely supported the adoption of an premium allocation approach, these comments were critical of the specific proposal. For example, the respondents commented that the introduction of discounting was an unnecessary complication that would produce irrelevant information. Furthermore, the range of contracts to which the approach could be applied was viewed as too narrow. Respondents generally preferred a model that aligned closely to an existing unearned premium approach, such as the one found in US GAAP.

## What is the premium allocation approach?

The Boards are pursuing a premium allocation approach as an alternative to the building blocks approach for those contracts that would qualify. The discussion focused on whether the premium allocation approach should be seen as:

- ▶ An approximation or simplification of the building blocks and hence, a proxy
- Or
- ▶ A different model that reflects the perception that some (short) duration contracts are economically different from other (long) duration contracts

The Boards discussed these two possible rationales for an allocated premium approach. Both rationales lead to similar measurement. The Boards noted that the rationales might have different criteria for determining which contracts qualify for the premium allocation approach, potentially capturing different populations of contracts.

Therefore, much of the discussion related to which rationale would be superior and how it would align with the eligibility criteria. Most IASB members continue to view the premium allocation method as a liability measurement approach, while FASB members generally were sympathetic to using it as a separate model based on the concepts in the revenue recognition model. Regardless of their preferences, Board members generally identified the following contracts suitable for a premium allocation approach: property; casualty; non-life; and group contracts. However, some Board members expressed their concern about the application of the approach to all contracts within a type of contract. For example, should the approach be applied to a three-year surety, as well as to a one-year surety. As a result, they preferred the use of very specific eligibility criteria.

The Boards did not make any further decisions on the premium allocation method. However, they noted that, regardless of the rationale, the development of the right set of criteria for contracts that qualify for the premium allocation approach will be critical. Therefore, they asked the staffs to refine the eligibility criteria by investigating which types of products would be captured.

Although presentation was not on the agenda, many Board members noted that the premium allocation approach lends itself to a presentation model for the income statement that includes quantitative information such as premiums, claims and expenses. Furthermore, the Boards noted that the discussions on the premium allocation approach would not involve the development of specific proposals for the liability for incurred claims. Nevertheless, they are expected to assess how the premium allocation approach would connect with the accounting for the incurred claims liability.



### How we see it

The discussions clearly indicate that the Boards are predisposed to the adoption of a premium allocation approach for certain types of short-duration contracts. The Boards seem convinced that measurement by premium allocation would be appropriate for some contracts. Therefore, the discussion has shifted from how to rationalise the treatment to how to determine which contracts should qualify for the approach. Finding common ground on eligibility may ultimately help the Boards to reach consensus on what the premium allocation approach represents.

### Insurance project timetable

The Boards need to hold further discussions on the premium allocation approach before they can conclude that it is a suitable alternative to the building blocks approach. In addition they will continue to have delays to addressing other difficult topics such as unbundling. IASB activity will slow and only limited progress will be made over the next few months.

The IASB recently extended its timetable and now plans to make a decision on whether to expose or to issue a review draft of the standard by the end of 2011 or in the course of 2012. The Boards will set a publication date for the final standard in due course. The FASB currently aims to issue its exposure draft by the end of 2011.

### IFRS 9 effective date

During the course of the same meeting, the IASB tentatively decided to move the mandatory effective date of IFRS 9 to annual periods beginning on or after 1 January 2015. Previously, the effective date was 1 January 2013. The Boards now propose changing the IFRS 9 date in light of the overall progress of the financial instruments project. In addition, they also propose to potentially align the effective date with those of other projects that are to be completed in the foreseeable future, including insurance contracts. Read more on the proposed change to the IFRS 9 effective date in *IFRS Developments - Issue 12: IFRS 9 mandatory effective date to move to 2015*.



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