Insurance Accounting Alert

February 2016

IASB decides not to re-expose draft insurance contracts standard

What you need to know

- The IASB is satisfied that the required due process steps have been taken in developing its proposed insurance contracts model.
- The Board does not intend to re-expose the current proposals, and unanimously instructed staff to work on preparing the draft of the new accounting standard.
- None of the board members intend to dissent from the new standard.
- The drafting process is likely to take the remainder of 2016 and, during this time, there will be ongoing consultation and communication with participants and focused testing of specific elements of the model with a small group of constituents.

Overview

During its February meeting, the International Accounting Standards Board (IASB or the Board) reviewed the due process steps taken in developing the proposed insurance contracts model. It also discussed whether to re-expose its insurance contracts proposals, and, if not, whether to permit staff to begin the drafting process for the new standard.

- All the Board members agreed that the mandatory due process in the insurance contracts project has been met.
- The Board unanimously granted the staff permission to begin the drafting process for the new insurance contracts standard, without the need for re-exposure.
- None of the Board members expressed an intention, at this time, to dissent from the new standard.

The story so far

The IASB's website provides information about tentative decisions made on the insurance contracts accounting model prior to this meeting, including:

- The cover note and papers on insurance for the February meeting. These contain an overall summary to date of the progress on the insurance contracts project and an overview of the tentative decisions made and the proposed model for insurance contracts: www.ifrs.org/Meetings/MeetingDocs/IASB/2016/February/AP02B-Insurance-contracts.pdf
- Further information on the project and the proposed model: www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Pages/Insurance-Contracts.aspx

Due process

Having outlined the due process steps it has undertaken throughout the insurance contracts project, the staff asked the Board to confirm that it was satisfied that all mandatory requirements have been met. All of the board members confirmed that they were satisfied in this regard.

The mandatory steps that have been taken include: debating the proposals in public meetings; exposing the draft of the new standard for public comment; consideration of comment letters received; considering whether proposals should be exposed again; and reporting to the Advisory Council.

Non-mandatory due process steps taken include activities, such as: preliminary discussion papers; roundtable meetings; outreach events; discussion forums and fieldwork to understand some aspects of practical application of the standard.

Re-exposure

The Board agreed not to re-expose the proposals for the insurance contracts standard again, although it noted there would be a need for targeted consultation and testing of the final wording on areas such as the variable fee approach.

The staff recognised that some interested parties conveyed a view that there should be re-exposure in light of the significant changes the standard will introduce, the complexity of the model, and the degree of change to the proposals in the 2013 Exposure Draft (the 2013 ED).

The staff acknowledged that there have been two significant areas of change for contracts with participating features. One such change is the introduction of the variable fee approach for certain participating contracts (in which changes in the variable fee for service are recognised as an adjustment to the contractual service margin (CSM), except where an entity uses derivatives to mitigate financial market risk in such contracts). The other change is the new requirement for the disaggregation of the effect of financial market variables between profit or loss and other comprehensive income, including the use of a current period book yield approach in specific circumstances.

Staff argued that the tentative decisions taken subsequent to the 2013 ED have been in response to feedback received, and do not include any fundamental changes that constituents did not have the opportunity to comment on. It was also noted that extensive consultations have taken place throughout the project.

The Board considered the costs of re-exposure against the benefits. Given the complexity of the model, further re-exposure would cause significant delays to this high priority project and thereby impact users of financial statements. Additional changes would only further increase the complexity of the model. Reference was made to the Board's *Due Process Handbook*, which states that it is inevitable that final proposals will include changes from those originally proposed, and these changes do not necessarily compel the Board to re-expose the proposals.

Permission to begin the balloting process

Having concluded that due process has been completed, the Board unanimously granted the staff permission to begin the balloting process for the new standard. This will commence with work to produce a draft standard for Board members to vote upon.

The Board noted that ongoing communication during the balloting process is important. It advised the staff to follow the approach taken with other standards to provide project updates during the process. This would also help avoid the appearance of working in a vacuum or behind closed doors.

The staff also noted that they would likely bring back to the Board, for resolution, any issues that emerge during the drafting process that require decisions to be taken in the public domain.

The Board recognises that it has built a complex model, which is a fundamental change for the insurance industry. It discussed the need for focused testing during the drafting process, but emphasised this should not be viewed as general "road testing" of the entire model by a wide range of participants, the results of which would be difficult to interpret. Rather, there will be testing of specific targeted areas by a small group of participants, with the intention to test the quality, understanding and application of the draft wording.

Several Board members requested that more examples be provided in the new standard or its application guidance than in the 2013 ED. In areas where they have made high-level decisions and there is not enough detail to apply the standard in an unambiguous way, appropriate examples would help explain the IASB's intention. Areas where this may apply include amortisation of the CSM, the level of aggregation, and discretion.

Other Board members flagged the danger of providing too many examples that could be interpreted in an overly prescriptive way or provide unintended bright lines. Staff indicated they may provide broad worked examples in their update papers, but would limit the use of examples in the standard itself to focused examples to help with the application of specific points.

One Board member urged the staff to ensure that, during the drafting process, the disclosure requirements deal with the nuanced and complex decisions reached in recent months on areas such as: scoping of the variable fee approach; use of judgement to determine the level of aggregation; and determination of discretion. In this Board member's view, the importance of such disclosure cannot be underestimated in ensuring the proposed model is intelligible and allowing users to understand how judgements and assumptions have been applied by different entities.

A few Board members used the meeting to state for the record those elements of the model that they strongly disagree with, but would not dissent against, in order to get the standard through.

These include the use of OCI for changes in discount rates, which the Board chair and another Board member strongly oppose. They view the change in discount rates as an essential part of an insurance company that can make or break a company and should, as such, go to profit or loss rather than OCI. As a result, they asked the staff not to develop wording that puts the option to use OCI in the light of being a better approach. The Board chair also expressed his conceptual doubts over the variable fee approach, but recognised that it was necessary to accept it in order to conclude on the standard.

Despite these reservations, the Board chair shared his view that the proposal is a huge improvement over current practice and that he has no doubt about supporting it. He congratulated the staff on the work done to reach to this point, and recognised the challenges of balancing the large volume of feedback from the industry against the needs of users. The Board members offered their full support and help to the staff for the balloting process.

With decisions reached, the IASB concluded its redeliberations on the insurance contracts project.

How we see it

The decisions not to re-expose and to start drafting the new standard mark a crucial step in finalising the project. Considering the changes made by the Board during the redeliberations, the drafting process is likely to be extensive and to require a balanced process of developing wording of the new standard, based on the Board's decisions, and ensuring that the words reflect the Board's intention. The Board also made reference to continued consultation with participants, the focused testing of specific elements of the model with a small group of constituents and the production of an effects analysis. It is likely that the Board will be asked to reconsider some aspects of the model as the drafting process is finalised.

With this significant decision from the IASB, we expect insurance groups and companies to start their own implementation activities. These would typically include operational impact analyses to inform budgeting and project planning, and financial impact analyses to better understand the impacts of the model on future reported performance metrics, profit volatility and the IFRS capital position.

What's next?

Now that the Board has given permission, the staff will begin the balloting process in order to reach the point of having a draft insurance contracts standard for a Board ballot. The process is expected to take up the remainder of 2016, and, as referred to above, there will be ongoing communication and targeted consultation during this period. The Board will decide on the effective date of the new standard in due course.

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