

Global Insurance GAAP

Update on the December 2009

IASB and FASB meetings

18 December 2009

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Agenda

- Outcomes of this month's decision making meetings:
 - 16 December : Joint IASB/FASB meeting
 - 15 December : IASB meeting
- Summary of Staff recommendations tabled but not discussed this month
- Timetable and next steps

Highlight of this week's meetings

IASB/FASB joint meeting 16 December 2009

Revenue Recognition accounting example

- The staff presented a simplified example to illustrate the application of revenue accounting principles to life insurance annuity contracts.

Measurement objective

- The Boards agreed with the staff recommendation that the measurement objective should be converged to include four components - cash flows, discounting, risk adjustment and residual margin.
- Consequently the measurement excludes own credit risk, service margin and the IAS37 consideration of transfer or commutation alternatives to fulfilment.

Agenda items not covered

- The Boards did not cover agenda items 7C to 7F Embedded derivatives, unbundling, presentation or timetable. In addition residual margin included in paper 7B was not considered.

Highlight of this week's meetings (cont.)

IASB/FASB joint meeting 16 December 2009 (cont.)

Risk adjustment

- The Boards agreed with the staff recommendation that this should be included as the third component of the measurement objective.
- The staff recommendation for the principle on the risk adjustment was amended to state that the risk adjustment should be defined in terms of its role to reflect the uncertainty in the distribution of insurance contract cash flows that is not captured in the value of discounted expected cash flows.
- The Boards agreed that the risk adjustment should be reported explicitly and its accounting value should be updated at each reporting date.

Highlight of this week's meetings (cont.)

IASB meeting 15 December 2009

Insurer's asset accounting

- The IASB agreed with the staff recommendation that assets held by insurers should not be treated differently from those held by other entities – unit and index linked assets will be considered at a later meeting.

Use of OCI for changes in insurance liabilities

- The IASB agreed with the staff recommendation that changes in insurance liabilities should never be recognised in OCI.

Details of IASB/FASB joint meeting – 16 December

Revenue recognition and insurance contracts – IASB/FASB example

- Annuity with 4 policyholders and single premiums of 250 on 1 Jan X1
 - Annuity benefit of 100 each 1 Jan, starting in X1
 - 1 expected death each year for 4 years
 - No lapses, no acquisition costs, no running costs, no margin
 - Discount rate of 0%, no investment income
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- The Staff objective was to prove that the revenue recognition approach is not suitable for insurance contracts
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- IASB and FASB agreed with the staff conclusion

Details of IASB/FASB joint meeting – 16 December

Revenue recognition and insurance contracts – IASB/FASB example (cont.)

Summary of performance obligations

Policyholder	X1	X2	X3	X4
A	50	50	50	100
B	50	50	150	
C	50	200		
D	250			
Total	400	300	200	100

Base case – Actual = Expected

	X1	X2	X3	X4
Revenue	400	300	200	100
Policyholder benefits	400	300	200	100
Profit	0	0	0	0

Details of IASB/FASB joint meeting – 16 December

Revenue recognition and insurance contracts – IASB/FASB example (cont.)

Summary of performance obligations

Policyholder	X1	X2	X3	X4
A	50	50	50	100
B	50	50	150	
C	50	50	150	
D	250			
Total	400	150	350	100

Case 2 – policyholders survive longer

	X1	X2	X3	X4
Revenue	400	150	350	100
Policyholder benefits	400	300	300	100
Profit	0	(150)	50	0

Details of IASB/FASB joint meeting – 16 December

Revenue recognition and insurance contracts – IASB/FASB example (cont.)

Case 3 – policyholders survive even longer

	X1	X2	X3	X4
Revenue	400	150	250	200
Policyholder benefits	400	300	300	200
Onerous test		50	(50)	
Profit	0	(200)	0	0

Case 4 – policyholders die earlier

	X1	X2	X3	X4
Revenue	400	450	150	0
Policyholder benefits	400	300	100	0
Profit	0	150	50	0

Details of IASB/FASB joint meeting – 16 December (cont.)

Measurement objective

- Staff proposed a building block approach as tentatively agreed at last joint meeting:
 - Unbiased probability-weighted cash flows
 - Time value of money
 - Explicit margin split into a risk adjustment for the effects of uncertainty about amount and timing of cash flows and a residual margin to eliminate any positive day one differences
 - Day one losses recognised immediately

Details of IASB/FASB joint meeting – 16 December (cont.)

Measurement objective (cont.)

- Staff proposed changes to the previous measurement model
 - no longer an explicit service margin. It is now included in the residual margin
 - IAS 37 transfer and commutation notions – no longer included in the model
- The Boards agreed with the proposed measurement objective
 - Nine members of IASB and three members of FASB voted in favour.

Details of IASB/FASB joint meeting – 16 December (cont.)

Risk adjustment

- IASB/FASB were asked to agree that the principle for the risk adjustment should be:
 - determined as the amount an insurer would rationally pay to be relieved of the risk, and
 - remeasured at each reporting date.
- The first staff recommendation was not agreed
- Instead the Boards agreed that the risk adjustment should be defined in terms of its role to reflect the uncertainty in the distribution of insurance contract cash flows that is not captured in the value of discounted expected cash flows.
 - Nine members of IASB and four members of FASB voted in favour.
- The Boards agreed that the risk adjustment should be remeasured at each reporting date.
 - Nine members of IASB and four members of FASB voted in favour.

Details of IASB/FASB joint meeting – 16 December (cont.)

Risk adjustment (cont.)

- No discussion has yet taken place on the unit of account for determining risk margin. Options are likely to include:
 - portfolio as previously defined,
 - some other measure of portfolio,
 - the reporting entity

Agenda issues not considered at IASB/FASB joint meeting – 16 December

Residual margins – not discussed at the meeting

- IASB/FASB were asked to decide whether the release of the residual margin should be based on
 - characteristics of that margin that best reflect performance under the contract, OR
 - release from risk.
- IASB/FASB staff considered whether the period for release of the residual margin should be
 - the coverage period
 - the coverage and claims handling period
 - some combination of the coverage and claims handling period.
- IASB/FASB were asked to decide whether the period for release of the residual margin should follow from the driver selected for release of the residual margin.

Agenda issues not considered at IASB/FASB joint meeting – 16 December (cont.)

Effect of changes in estimates on the residual margin – not discussed at the meeting

- IASB/FASB were asked to decide whether:
 - all changes in estimates should be reflected in P&L as they arise, OR
 - changes not arising from financial variables should be adjusted against remaining residual margins and only reflected in P&L to the extent that the residual margin is exhausted.
- IASB/FASB staff noted that:
 - Reflecting changes in estimates in P&L emphasises the principles of the measurement objective,
 - Adjusting changes against residual margin emphasises the revenue recognition principles,
 - Reflecting changes in estimates in P&L and leaving residual margin unchanged can have the effect of earning margins in subsequent periods that do not match the current contract estimates,
 - The result of adjusting changes against residual margin is to recognise such changes only when the contract becomes onerous.

Agenda issues not considered at IASB/FASB joint meeting – 16 December (cont.)

Embedded derivatives – not discussed at the meeting

- Staff recommended that derivatives embedded in an insurance contract be measured using the insurance contract measurement approach.
- IASB/FASB were asked to decide whether derivatives embedded in an insurance contract should be:
 - bifurcated from the insurance contract and measured at fair value, OR
 - measured using the insurance contract measurement approach.

Agenda issues not considered at IASB/FASB joint meeting – 16 December (cont.)

Unbundling – not discussed at the meeting

- Staff papers recommend that an insurer should unbundle a component of an insurance contract if that component is NOT interdependent with other components.
- If a component is interdependent insurers should not:
 - Unbundle deposit, insurance or service components for recognition and measurement, OR
 - Separate deposit, insurance or service components for presentation in the performance statement.
- Staff papers do not provide detailed guidance on interdependency noting only that the following might indicate or help to identify interdependency:
 - “for some or all elements that need to be considered when separating the components, the insurer cannot identify what to allocate to each of the components; thus the allocation would require an arbitrary split”
 - Presence of “significant embedded derivatives.”

Agenda issues not considered at IASB/FASB joint meeting – 16 December (cont.)

Unbundling – not discussed at the meeting (cont.)

- Staff papers recommended that where unbundling is not required for recognition and measurement it should be prohibited. Permitting unbundling would:
 - be inconsistent with reasoning that it is not useful to users for recognition and measurement, and
 - undermine comparability.
- Staff papers recommended that where unbundling is not required for recognition and measurement it should be prohibited for performance reporting:
 - If not useful to users for recognition and measurement then unbundling unlikely to be useful to users for performance reporting.

Agenda issues not considered at IASB/FASB joint meeting – 16 December (cont.)

Presentation – not discussed at the meeting

Staff papers recommended that an insurer should:

- Base revenue on an earned basis not written basis:
 - written basis is not consistent with revenue recognition principles, and
 - significant change for life insurance.
- Not report as revenue that part of the premium that is expected to be returned to the same policyholder:
 - payments for services under the contract are included as revenue
 - DEPOSIT components would not be included as revenue

Details of IASB meeting – 15 December

Asset accounting

- The staff excluded assets held to match unit-linked and index-linked liabilities from this analysis. They are expected to be considered in January.
- The staff recommended that the IASB should not, in the insurance project, change the accounting for assets held by an insurer to match its insurance liabilities for the following reasons:
 - the insurance contract IFRS should focus on contract assets and liabilities,
 - exemptions from other standards for insurer assets would reduce transparency for users of financial statements, and
 - it may not be possible to identify which of an insurer's assets are held to match insurance liabilities.
- The IASB unanimously agreed with this recommendation.

Details of IASB meeting – 15 December (cont.)

Use of OCI for changes in insurance liabilities

- Staff recommended that changes in insurance liabilities should not be recognised in OCI, noting that the use of OCI for changes in insurance liabilities would be likely to require complex and perhaps onerous procedures to:
 - identify those insurance liabilities backed by assets accounted for through OCI,
 - track detailed information for those assets to determine the split between P&L and OCI for the relevant changes in insurance liabilities,
 - determine whether and when to recycle amounts from OCI to P&L.
- It was also noted that under IFRS 9 insurers will have a fair value option for assets and therefore will not be required to value assets at either amortised cost or fair value through OCI.
- IASB approved the proposal almost unanimously – one member was undecided

Timetable

Commitment to an exposure draft in 2010

- Exposure draft issue date remains at April 2010
- Comment period closure moves from August to September 2010 – 5 Months
- Standard remains due in June 2011 – before substantial IASB membership changes

Timetable considerations

- Only January and February remains to cover issues not considered in December plus the following issues already scheduled for 2010 before a final sweep of issues in March in order to meet the April 2010 ED publication target:
 - follow up on policyholder participation, margins and presentation of premiums and benefits in the performance statement;
 - participating, unit linked and index linked insurance contracts, investment contracts and universal life contracts; and
 - disclosures, business combinations, reinsurance and transition.
- With the issues not considered in December the April timetable now looks optimistic unless extra meetings are scheduled as promised by the two Chairmen in November

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