**How we responded to feedback on the 2010 Exposure Draft**

In developing the proposals in the 2013 Exposure Draft *Insurance Contracts*, the IASB has responded to the feedback on the proposals in the 2010 Exposure Draft as summarised in the table below.

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<tr>
<th>Proposal in 2010 Exposure Draft</th>
<th>Feedback received</th>
<th>How we responded</th>
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<td><strong>Scope</strong>&lt;br&gt;• Apply Standard to most contracts that meet the definition of an insurance contract and some non-insurance contracts that have features similar to insurance contracts.</td>
<td>• Mixed views on whether financial guarantee contracts, which meet the definition of an insurance contract, should be within the scope of the Standard.&lt;br&gt;• Some raised concerns related to which fixed-fee contracts should be excluded.</td>
<td>The 2013 Exposure Draft:&lt;br&gt;• carries forward the scope of the proposed standard but excludes financial guarantee contracts unless previously regarded as an insurance contract.&lt;br&gt;• revises scope to include investment contracts with a discretionary participation feature but only if they are issued by an entity that also issues insurance contracts.&lt;br&gt;• confirms most scope exclusions.&lt;br&gt;• clarifies the criteria for fixed-fee contracts that are excluded from the scope of the proposals.</td>
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<th>Separating non-insurance components (unbundling)</th>
<th>Feedback received</th>
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<td>• An entity should account for any investment component or goods and</td>
<td>• Views on whether non-insurance components should be separated from insurance contracts and accounted for</td>
<td>The 2013 Exposure Draft:&lt;br&gt;• provides additional guidance on separating embedded derivatives, goods</td>
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## Proposal in 2010 Exposure Draft

- services component separately from the insurance contract in specified circumstances.

## Feedback received

- using other applicable Standards were mixed.
  - Many respondents said it was unclear when non-insurance components should be separated from an insurance contract.

## How we responded

- and services and investment components from insurance contracts, based on equivalent criteria in IFRS 9 Financial Instruments and the proposals for separating goods and services in Exposure Draft Revenue from Contracts with Customers.
  - proposes to prohibit separating components from insurance contracts if they do not meet specified criteria.
  - addresses concerns about the effect of non-distinct investment components on revenue and expenses by excluding such amounts from insurance contract revenue and expenses.

### Recognition and contract boundary

- An entity should recognise an insurance contract from the date it is party to the contract.
- An entity should recognise, as part of the contract, all premiums and related cash flows within the boundary of the contract, ie for which the entity does not have the right or practical ability to reprice to fully reflect the risks of the contract.

- Respondents were concerned about the practical implications:
  - some believed it would be onerous to track expected cash flows before the coverage period begins, and that there would be little benefit in doing so if the contract is not onerous.
  - some believed it would be onerous to

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### Proposal in 2010 Exposure Draft

- An insurance contract should be measured based on the assumption that the entity will fulfil its obligation. That measurement is based on expected value, rather than single outcomes, and uses current, market-consistent estimates.

### Feedback received

- Generally supported by respondents. Some expressed concerns about practical implications.

### How we responded

- The 2013 Exposure Draft confirms the core measurement approach proposed in the 2010 Exposure Draft.

### Core measurement approach

- The cash flows included in the measurement of an insurance contract should include all those that relate directly to fulfilling the insurance contract and acquisition costs that are incremental at the contract level.

### Cash flows

- Many respondents agreed with the proposal in the 2010 Exposure Draft that the measurement of the insurance contract should include all cash flows that are related to originating and fulfilling the insurance contract.

- The 2013 Exposure Draft proposes that an entity should include acquisition costs that can be directly attributed to the portfolio containing the contract in the cash flows that are used to measure an insurance contract.

- The 2013 Exposure Draft clarifies that overhead costs and taxes that can relate directly to the fulfilment of the insurance contract should be included in the cash flows.
### Proposal in 2010 Exposure Draft

- **Time value of money**
  - An entity should discount the cash flows in an insurance contract using a current rate that reflects only the characteristics of those cash flows. Those characteristics reflect the inherent illiquidity of insurance contracts.
  - Own credit risk should not be considered in determining the discount rate used to measure the insurance liability.

### Feedback received

- Respondents were concerned that it would be difficult to determine the illiquidity premium.
- Respondents also cited a lack of clarity on what happens if cash flows depend on asset returns.
- Some respondents did not support discounting all insurance contracts, or a rate that reflects only the characteristics of the insurance contract.
- Most respondents agreed with the approach to the own credit risk.

### How we responded

- The 2013 Exposure Draft confirms the IASB’s view that the cash flows from an insurance contract should be discounted using a current rate that reflects the characteristics of the cash flows that are being discounted.
- The IASB acknowledged the subjectivity inherent in determining the illiquidity premium. The 2013 Exposure Draft does not prescribe a method for determining the discount rate, but permits both:
  - A top-down approach, which eliminates from the discount rate of a reference portfolio those factors not relevant to the insurance contract; and
  - A bottom-up approach, which adds to the risk-free rate factors that are relevant to the insurance contract.
- The 2013 Exposure Draft clarifies that when the cash flows of the insurance contract vary with returns on underlying flows used to measure an insurance contract.

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- An entity should measure an insurance contract by incorporating a risk adjustment that is determined using one of three prescribed techniques. When determining the risk adjustment, the entity would consider diversification benefits at the portfolio level.

- Respondents stated that the objective of the risk adjustment lacked clarity.
- Respondents noted that many entities view risk on a more diversified level of aggregation than the portfolio.
- Respondents believed that restricting the techniques to be used would not reduce the subjectivity inherent in the measurement of the risk adjustment, but would impede the ability to provide faithful representation.

- The 2013 Exposure Draft proposes that the objective of the risk adjustment should be “the compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfils the insurance contract”.
- Consistent with this objective, the 2013 Exposure Draft proposes that an entity include the effect of diversification in the measurement of the risk adjustment to the extent that those benefits affect the compensation that the entity requires in order to bear risk.
- The 2013 Exposure Draft removes the limitation of techniques that may be used.

- The characteristics of the insurance contract are dependent on the characteristics of the underlying items and the discount rate should also reflect those characteristics.
- The 2013 Exposure Draft confirms that own credit risk should not be considered in determining the discount rate used to measure the insurance liability.

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<td>to measure the risk adjustment. To address concerns about comparability and subjectivity, the 2013 Exposure Draft confirms the proposal in the 2010 Exposure Draft that an entity should disclose the confidence level to which the risk adjustment corresponds.</td>
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<td><strong>Contractual service margin</strong></td>
<td>Respondents stated that unless the contractual service margin is adjusted to reflect changes in estimates of cash flows, there would not be a faithful representation of the remaining profitability of the contract, and counterintuitive effects would result in periods after the change in estimate.</td>
<td>The 2013 Exposure Draft proposes that contractual service margin should reflect the expected profitability of the contract and therefore an entity should adjust the contractual service margin for changes in future cash flows relating to future services.</td>
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<tr>
<td>An entity should recognise a contractual service margin on initial recognition, which eliminates any gain at inception.</td>
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<td>The contractual service margin is not subsequently adjusted for any changes in estimates.</td>
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<tr>
<td><strong>Insurance contract revenue and expenses</strong></td>
<td>Respondents stated that there is a need for a measure of gross performance for insurance contracts, similar to the revenue provided for short duration contracts and for other transactions.</td>
<td>The 2013 Exposure Draft proposes that entities should present insurance contract revenue and expenses on a basis consistent with generally accepted notions of revenue and expenses. As a consequence, insurance contract revenue:</td>
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<td>An entity should present:</td>
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<td>• excludes investment components</td>
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<td>• net margin information in the statement of comprehensive income for most life insurance contracts.</td>
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<td>• revenue and expenses for short-duration contracts.</td>
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1 The contractual service margin was referred to in the 2010 Exposure Draft as the ‘residual margin’.

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<td><strong>Other comprehensive income</strong>&lt;br&gt; An entity should recognise all changes in estimates in profit or loss.</td>
<td>Many respondents stated that recognising changes in the insurance contract obligation related to market fluctuations in profit or loss would obscure the underwriting performance of the entity.</td>
<td>The 2013 Exposure Draft proposes that the effect of changes in the discount rate on the insurance contract obligation is recognised in other comprehensive income.</td>
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<tr>
<td><strong>Contracts with cash flows that are expected to vary directly with returns on underlying items</strong>&lt;br&gt; No specific requirements</td>
<td>For some contracts, the contractual terms eliminate the possibility of economic mismatches between some cash flows and underlying items because they pass returns on underlying items on to the policyholder. Respondents were concerned about the accounting mismatches that would be reported if the entity reports changes in the contract on a current value basis while the assets are not measured at fair value through profit or loss.</td>
<td>The 2013 Exposure Draft proposes a measurement and presentation exception for cash flows that vary directly with underlying items in contracts for which the contractual terms eliminate the possibility of economic mismatches between such cash flows and underlying items.</td>
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<tr>
<td><strong>Premium-allocation approach for short-duration contracts</strong>&lt;br&gt; • The 2010 Exposure Draft proposed a premium-allocation approach that would</td>
<td>• Respondents generally supported the IASB’s approach of regarding the premium-allocation approach as a</td>
<td>The 2013 Exposure Draft proposes: • to permit, rather than require, the application of the premium-allocation approach</td>
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Proposal in 2010 Exposure Draft | Feedback received | How we responded
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be required for contracts with a coverage period of approximately 12 months. | simplification of general requirements. Thus, respondents believed:
• the premium-allocation should be permitted, rather than required.
• the eligibility criteria for the premium-allocation approach were too prescriptive.
• the premium-allocation approach described was too complex. | approach for eligible contracts.
• to specify that entities may apply the premium-allocation approach when it produces a measurement that is a reasonable approximation to the general requirements.
• to simplify the premium-allocation approach compared to the 2010 ED.

Reinsurance contracts
• The 2010 Exposure Draft proposed that reinsurance contracts held by an entity would be measured using a similar approach and consistent assumptions to that used to measure insurance contracts that the entity issues.
• On purchasing reinsurance coverage, the entity would recognise in profit or loss:
  o net gains at contract inception; and
  o net cost over the coverage period of the reinsurance contract.
• Some respondents were concerned that the requirement to recognise gains at contract inception might result in entities entering transactions to achieve an accounting result.
• Some respondents suggested that the net gain or cost of reinsurance should be determined by reference to the amount charged for the underlying contract, rather than by reference to the expected cash flows arising from the reinsurance contract.
• The 2013 Exposure Draft proposes that an entity would recognise both net gains and net costs of purchasing reinsurance coverage over the coverage period, except the net cost that arises from reinsurance coverage that relates to events that occurred in previous periods.
• The 2013 Exposure Draft confirmed the approach that the net gain or cost of purchasing a reinsurance contract should be determined only by reference to the cash flows that arise in the reinsurance contract, and not by reference to the profit of the underlying items.
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<td><strong>Transition</strong>&lt;br&gt;When entities apply the Standard for the first time, the contractual service margin on in-force contracts should be set to zero (thus, recognised immediately in retained earnings).</td>
<td>The lack of a contractual service margin on transition would impair comparability between contracts written before and after the date of transition.</td>
<td>The 2013 Exposure Draft proposes a modified retrospective approach for determining the contractual service margin:&lt;li&gt;retrospective application, if possible.&lt;/li&gt;&lt;li&gt;if retrospective application is not possible, the simplifications are provided with required disclosures.</td>
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