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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **15 November 2007, London**

Project: **Insurance Contracts**

Subject: **Policyholder accounting – process (Agenda Paper 6)**

Purpose of this paper

1. The May 2007 Discussion Paper *Preliminary Views on Insurance Contracts* states that the project on insurance contracts will address accounting by policyholders for their rights under insurance contracts ('policyholder accounting'). However, the Discussion Paper does not address it because the Board has not viewed policyholder accounting as a high priority. This paper discusses the process for dealing with this topic.

Summary of recommendations

2. This paper concludes that there is no need to develop a discussion paper on policyholder accounting before developing an exposure draft (either within an exposure draft on accounting by insurers for insurance contracts or separately).

Background

3. Rights and obligations under insurance contracts are scoped out of existing IFRSs on financial instruments (IAS 32, IAS 39 and IFRS 7), provisions (IAS 37), intangible assets (IAS 38) and impairment (IAS 36). Moreover, no specific standard addresses accounting

policyholder accounting comprehensively, although IFRSs address limited aspects of policyholder accounting:

(a) IAS 37 addresses accounting for reimbursements from insurers for expenditure required to settle a provision.

(b) IAS 16 addresses some aspects of compensation from third parties for property, plant and equipment that was impaired, lost or given up.

(c) IAS 19 addresses the measurement of insurance contracts held for a defined benefit employee benefit plan.

(d) The new version of IFRS 3 addresses contractual indemnification received from the seller in a business combination.

(e) Some insurance contracts contain embedded derivatives within the scope of the financial instruments standards (IAS 32, IAS 39 and IFRS 7).

(f) Paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify a hierarchy of criteria that an entity should use in developing an accounting policy if no IFRS applies specifically to an item. IFRS 4 *Insurance Contracts* exempts insurers from that hierarchy, but does not exempt policyholders. Therefore, that hierarchy applies to policyholder accounting.

4. In February 2002, the Board decided tentatively to pursue the following simplified measurement model for policyholders:

(a) prepaid insurance premiums at amortised cost.

(b) any readily identifiable investment component at fair value.

(c) virtually certain reimbursements of expenditure required to settle a recognised provision at the present value of the reimbursement, but not more than the amount of the recognised provision (consistently with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* paragraph 53).

(d) valid claims for an insured event that has already occurred at the present value of the expected future receipts under the claim. If it is not virtually certain that the insurer will accept the claim, the claim is a contingent asset and would, under IAS 37, not be recognised.

5. Since that discussion, work on policyholder accounting has been suspended because of other priorities. Given the time that has elapsed, the staff will probably restart the discussion of policyholder accounting with a clean sheet of paper. The staff expects that this will involve the following:

   (a) The staff will consider whether policyholders should measure insurance contracts at current exit value, for symmetry with the Board's preliminary view on the measurement attribute that insurers should use. The tentative conclusions in (a) and (b) above might often lead to a result close to current exit value.

   (b) The tentative conclusions in (c) and (d) above need to be revisited in the light of the project to amend IAS 37.

   (c) In some cases, an insurance contract may relate to a recognised or unrecognised asset or liability of the policyholder. The staff intends to investigate whether the measurement attribute of that asset or liability has any relevance for the selection of the measurement attribute for the policyholder's rights under the insurance contract.

6. In assessing alternatives, the staff will consider practicality and cost-benefit issues. In particular:

   (a) policyholders are likely to have less broadly-based information than insurers about loss probabilities, and less expertise to assess that information.

   (b) insurance contracts are often much less material for policyholders than for insurers.

Should the project deal with policyholder accounting?

7. Before considering the process, it is worth summarising why the scope of this project includes policyholder accounting:

   (a) There is a lack of relevant guidance in IFRSs at present. Although the staff is not aware of major practice issues within IFRSs, the FASB and EITF have felt it necessary to issue several documents dealing with various aspects of policyholder accounting in

US GAAP. Establishing clear principle-based guidance could prevent similar practice issues arising under IFRSs.

(b) The project deals with the accounting for a particular type of transaction, rather than by particular types of entity. It would be logical and efficient to consider the accounting by both parties in the same project.

(c) The project clearly needs to deal with policyholder accounting for one specific type of contract: accounting by an insurer for reinsurance that it holds. There is no obvious reason not to deal with all aspects of policyholder accounting.

(d) If the FASB adds this project to this agenda, there will be an opportunity for convergence.

(e) As outlined above, feasible accounting solutions are likely to be available.

(f) The staff does not expect work on policyholder accounting to add significantly to the staff resources required for the project.

Location of accounting requirements

8. The staff will consider where to place accounting requirements for policyholder accounting. Possible locations are one or more of the following:

(a) A standard on insurance contracts that covers accounting by both insurers and policyholders (a successor to IFRS 4). This would be logical, but because the standard will deal mainly with accounting by insurers, entities may overlook the material on policyholder accounting.

(b) Standards on financial instruments (IAS 39 and IFRS 7) or intangible assets (IAS 38). This would make the material more visible to policyholders, but may result in some duplication of material in the standard on insurance contracts.

(c) A separate standard on accounting by policyholders. This would make the material more visible to policyholders, but may give too much prominence to an issue that will be minor for many entities.

(d) For insurance contracts held for an employee benefit plan, in a standard on employee benefits (IAS 19).

Separate DP or straight to ED?

9. Paragraph 30 of the Due Process Handbook states:

> Although a discussion paper is not a mandatory step in its due process, the IASB normally publishes a discussion paper as its first publication on any major new topic as a vehicle to explain the issue and solicit early comment from constituents. If the IASB decides to omit this step, it will state its reasons.

10. In the staff's view, policyholder accounting is not a major new topic. Therefore, the staff does not consider a discussion paper necessary: an Exposure Draft would provide sufficient opportunity for public comment.

11. Entities that are policyholders may not read an exposure draft that deals mainly with accounting by insurers. Therefore, some may feel that the Board should publish a discussion paper to highlight the impact on policyholder accounting. However, in the staff's view, an exposure draft can, if structured properly with adequate signposting, give sufficient prominence to the need for policyholders to read the document.

FASB

12. In August, the FASB issued an Invitation to Comment *An FASB Agenda Proposal: Accounting for Insurance Contracts by Insurers and Policyholders, Including the IASB* Discussion Paper, Preliminary Views on Insurance Contracts. This asks respondents to comment on whether the FASB should add to its agenda a joint project on insurance contracts, to be conducted with the IASB. Among other things, the Invitation to Comment asks whether the FASB should address policyholder accounting. The appendix to this paper contains the relevant extracts.

Timetable

13. The staff suggests the following timetable for the initial work on policyholder accounting. Beyond that, the timetable will depend significantly on responses to our Discussion Paper and the FASB's Invitation to Comment, and on the FASB's agenda decision.

Deadline for comments on the IASB Discussion Paper and the FASB’s Invitation to Comment	16 November 2007
Initial review of whether current exit value might be an appropriate measurement attribute	First quarter 2008
Consider interaction with the work on reimbursements in the project to revise IAS 37	First quarter 2008
Identify other topics that the project may need to consider, including those arising in responses to the FASB’s Invitation to Comment.	First quarter 2008
FASB agenda decision expected (per FASB web site)	Third quarter of 2008

Appendix Extract from FASB Invitation to Comment

ACCOUNTING BY POLICYHOLDERS FOR INSURANCE CONTRACTS

33. The preceding discussion in this Invitation to Comment focuses principally on accounting by insurers. Existing U.S. guidance on accounting by policyholders for insurance contracts is limited. From a policyholder's viewpoint, the primary purpose of an insurance contract is to provide economic protection against an identifiable risk occurring or being discovered over a specified period of time. For a contract to be accounted for as insurance by both the policyholder and the insurer it must transfer significant insurance risk. Insurance accounting treats the payment of premiums by the policyholder as an expense and the receipt of any claims payments as income (an offset against the insured loss). If significant risk is not transferred, the contract is accounted for as a deposit, that is, the premium paid by the policyholder is accounted for like a loan to the insurer, and any claims payments made to the policyholder are accounted for like repayments of the loan.

34. The accounting framework for insurance contracts is based on paragraph 44 of FASB Statement No. 5, *Accounting for Contingencies:* "To the extent that an insurance contract…does not, despite its form, provide for indemnification of the insured…by the insurer…against loss or liability, the premium paid less the amount of the premium to be retained by the insurer…shall be accounted for as a deposit by the insured." As noted in paragraph 9 of this Invitation to Comment, the FASB has a risk transfer project on its agenda. That project could include a proposal that the risk transfer conditions for reinsurance contracts in Statement 113 should also apply to insurance contracts. If that guidance were to become a standard (note that it has not yet been exposed for public comment), it could apply to both policyholders and insurers.

35. U.S. GAAP also includes some limited guidance on accounting for investments in life insurance contracts—that is, generally at cash surrender value. However, more recently, guidance was issued to allow third-party investors more flexibility in accounting for their investment in life insurance contracts.

36. Other specialized guidance has been issued for certain types of insurance contracts, such as accounting for claims-made and retroactive insurance contracts by the policyholder. The list in Appendix A includes some of the insurance accounting guidance that has been issued. [not included here]

37. Although the IASB's Discussion Paper notes that its insurance contracts project ultimately will address accounting by policyholders, the paper also states that the IASB does not view work on policyholder accounting as a high priority and the preliminary views do not address policyholder accounting.

38. One of the issues on which the FASB seeks input in this Invitation to Comment is whether additional guidance on accounting by policyholders should be addressed in a joint insurance contracts project or undertaken once that project has been completed.

Question 3: Is there a need to address accounting by policyholders in an insurance contracts project? Why? If yes, should accounting by policyholders be addressed at the same time as the accounting by insurers? Can or should that wait until after the accounting by insurers is completed?