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Project **Insurance Contracts**

Topic **Derecognition of insurance liabilities**

Purpose

1. This paper discusses derecognition of insurance liabilities.

2. This paper does not discuss derecognition of insurance assets. We will deal with derecognition of insurance assets (direct and reinsurance) when we discuss reinsurance.

Summary of Staff recommendations

3. This paper argues that that an insurer should derecognise an insurance liability when it no longer qualifies as a liability of the insurer, applying the derecognition principle in IAS 39 *Financial Instruments: Recognition and Measurement*.

4. The staff prepared this paper in the context of IFRSs. The staff expects that a similar analysis in the context of US GAAP would lead to the same recommendation.

Derecognition

5. The exposure draft (ED) *Derecognition, Proposed amendments to IAS 39 and IFRS 7* proposes to amend paragraph 14(c) of IFRS 4 *Insurance Contracts*, as follows (with proposed additions underlined and proposed deletions struck through):

> [an insurer] shall ~~remove~~ derecognise an insurance liability (or a part of ~~an insurance liability~~it) ~~from its statement of financial position~~ when~~, and only when,~~ it ~~is extinguished – ie when the obligation specified in the contract is discharged or cancelled or expires~~ (or the part) no longer qualifies as a liability of the insurer. An insurance liability ceases to qualify as a liability of the insurer if the present obligation is eliminated and the insurer is no longer required to transfer economic resources in respect of that obligation.

6. These requirements are based on the derecognition requirements included in paragraph 39A of IAS 39 *Financial Instruments: Recognition and Measurement* (as proposed to be amended by the Derecognition ED).

7. Paragraph 105 of the Basis for Conclusions on IFRS 4 gives the following explanation:

> The Board identified no reasons why derecognition requirements for insurance liabilities and insurance assets should differ from those for financial liabilities and financial assets. Therefore, the derecognition requirements for insurance liabilities are the same as for financial liabilities (see paragraph 14(c) of the IFRS). However, because derecognition of financial assets is a controversial topic, the IFRS does not address derecognition of insurance assets.

8. The staff regards those conclusions as still valid; we have not identified any reason to treat derecognition of liabilities from insurance contracts differently from the derecognition requirements in IAS 39.

Respondents views

9. Respondents suggested that the derecognition principle proposed in the discussion paper (DP) *Preliminary Views on Insurance Contracts* would result in application issues. For example, claims are sometimes reported significantly after than the end of the coverage period and an insurer may not know precisely whether a liability is extinguished. Respondents argued that some types of

insurance contracts can generate claims many years after the end of the coverage period. Thus, they argued the insurer might never be able to derecognise these contracts. In their view, this would be unreasonable and unduly burdensome.

10. However, staff notes that:

    (a) if an insurer has no information that a possible claim still exists, the insurer will not measure the liability at a significant amount. Thus, there is little practical difference between (i) saying that an insurance liability exists but is measured at an immaterial amount and (ii) derecognising the liability.

    (b) while the insurer's contractual obligations still remain in existence and can still generate valid claims, ignoring those obligations would not result in a faithful representation of the insurer's financial position.

    (c) the DP proposes to retain the derecognition principle included in the existing IFRS 4; we have not received any input that significant derecognition issues exist in (current) practice for determining when an insurance liability is extinguished.

Question for the boards
Staff recommends in paragraph 8 that an insurer should derecognise insurance contracts when it no longer qualifies as a liability of the insurer, applying the derecognition principle in IAS 39. Do you agree with staff recommendation?