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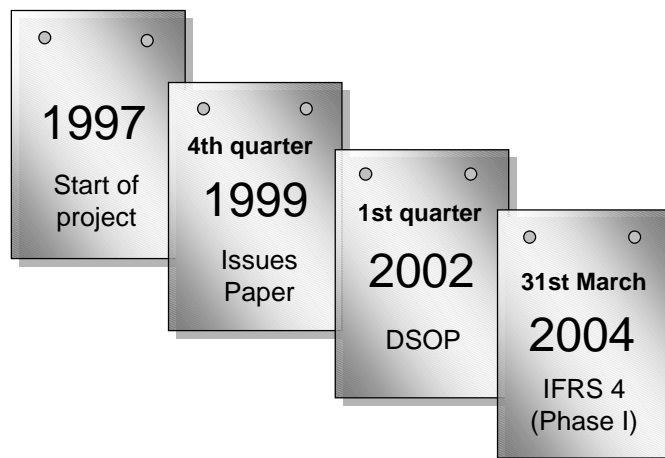
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IFRS for Insurance Contracts

Joachim Kölschbach, replaced by
Stefan Engelländer

The Insurance Contracts Project



Fair value accounting as a solution?

- **Financial Instruments**

- **IAS 39:** recognition and measurement
- **Scope:** all financial instruments in all industries
- **Exception:** rights and obligations arising under insurance contracts

- **Considerations:**

- If all insurer's financial instruments are measured at fair value, this should also apply for insurance contracts
- Changes in fair value should be represented in the same way



Fair value accounting limitations

- **Problems concerning insurance contracts**

- No active market, leads to difficulties with objective valuation
- Higher subjectivity in valuation enables opportunities for "earnings management"
- Volatility of results, possibly contradiction to the long term characteristics of insurance business

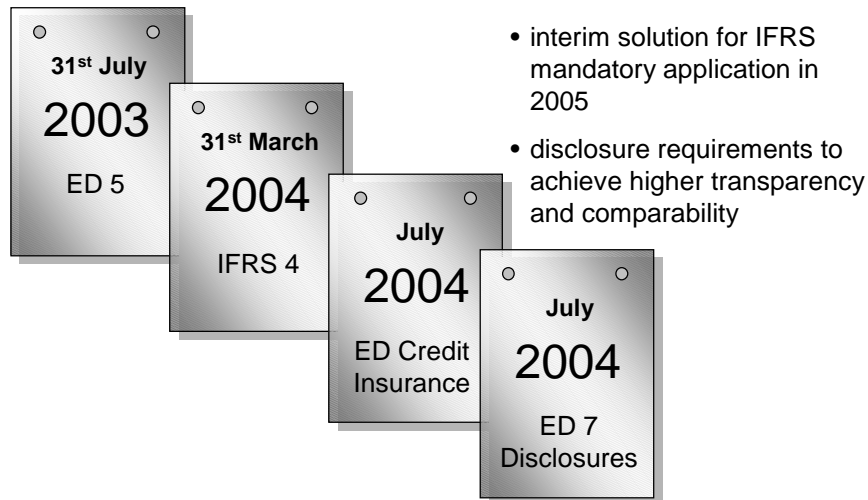
- **Questions**

- Valuation technique for future obligations
- Discount rate
- Risk adjustments

➔ **The IASB recognised these difficulties and divided the insurance project – with regard to 2005 – into two phases.**



Timetable Phase I



Overview of IFRS 4

- Defines an insurance contract and distinguishes from an investment contract
 - Allows 'business as usual' for qualifying insurance contracts, but any changes in policy must be 'improvements'
 - Elimination of catastrophe provisions or equalisation provisions
 - Requires IAS 39 to be applied to some pure investment contracts (but not to contracts with discretionary participation features)
 - Requires some embedded derivatives and some deposit components to be separated from insurance contracts
 - Requires a minimum liability adequacy test to be applied based on current estimates of future cash flows
 - IAS 39 applies to investments – no separate rules for insurers
- KPMG

Main issue of concern

- **Inconsistencies of assets and liabilities**
- **Possible mismatches in phase I if**
 - financial assets backing insurance contracts are measured inconsistently under IAS 39 and
 - insurance liabilities are measured on a different basis
- **Only limited compensation via shadow adjustments and discounting with current market interest rates**



Phase II on Insurance Contracts

IASB restarted its Insurance Project in 2004

Starting points:

- **“Fresh look” at financial reporting by insurers**
- **Restrictions: Framework and general principles established in existing Standards**
- **Past work is used as a resource but IASB does not feel bound by it**
- **Convergence with FASB**



Phase II on Insurance Contracts

- **Topic areas for the Insurance project**
 - Model
 - Measurement
 - Discounting
 - Asset/Liability interaction
 - Risk/Service adjustment
 - Gain or loss on initial measurement/liability recognition
 - Policyholder behaviour
 - Acquisition costs
 - Unbundling
 - Participating contracts
 - Credit Standing



Phase II on Insurance Contracts

- **Important interactions with other projects:**
 - Conceptual Framework
 - Revenue Recognition
 - Accounting Measurement
 - Performance Reporting
 - Financial Instruments
 - Revisions to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
 - Project on Liabilities and Equity



Phase II on Insurance Contracts

Phase II – final standard on insurance contracts (revised project plan)

- **Discussion paper**
not before end of **2005**
- **Exposure draft**
at the earliest mid of **2007**
- **Final standard**
at the earliest mid of **2008**

(IASB Update January 2005)



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