

Press release

IASB issues exposure draft for insurance contracts

Fundamental changes proposed

The IASB's exposure draft for insurance contracts proposes significant accounting changes. These changes need to be fully understood by issuers of insurance contracts who will need to proactively assess the implications of the proposed changes and the impact on their business now and in the future.

Zurich, 4 August 2010 – The IASB has issued an exposure draft of a comprehensive standard that will fundamentally change accounting by insurers and other entities that issue contracts with insurance risk. The impact will be felt across the sector and will require insurers to conduct a complete overhaul of their systems and performance reporting. “These changes come at a time when Swiss insurers are facing resource constraints as they implement either the Swiss Solvency Test or Solvency II”, explains Dawn Kink, Partner FS Assurance Insurance, PricewaterhouseCoopers Switzerland. Early action is required as there is only a small window during which the industry has an opportunity to influence the final outcome of these proposals.

The proposed standard would apply to all entities issuing contracts that contain insurance risk. This broad definition could result in contracts issued by non-insurers being subject to the standard, for example, banks issuing some financial guarantees.

The proposals require that all insurance contracts use a current measurement model of the present value of expected cash flows to fulfil the obligation, where estimates are re-measured at each reporting period. Except for certain short duration contracts, this measurement model is based on building blocks of discounted probability-weighted cash flows, a risk adjustment and a residual margin to eliminate any initial profit. The estimated cash flows are discounted at risk free interest rates adjusted for differences between the liquidity characteristic of the insurance contracts and the corresponding risk free instruments. The proposals will create additional demands on data modelling systems.

The proposals will significantly impact the income statement. Issuers will not recognise premiums as revenue but will separately show an underwriting margin (comprising changes in the risk

adjustment and residual margin) and changes in estimates and experience variances. “The presentation of the income statement will change significantly, resulting in increased volatility in the income statement”, states Enrico Strozzi, Partner FS Assurance Insurance, PricewaterhouseCoopers Switzerland. This volatility in itself will be of concern to the insurance industry but how IFRS 9 on the asset side of the balance sheet and the insurance liability changes in the current proposals will interact will be an added uncertainty.

Many users of financial statements describe insurance accounting today as a “black box” that does not provide them with relevant information about an insurer’s financial position and financial performance. The release of this exposure draft shows progression in achieving a global comprehensive and comparable accounting model for insurance contracts.

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