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At the Singapore meeting of the International Actuarial Association (IAA) in October 2013, the Insurance Accounting Committee (IAC) spent most of its energy on the task of finalizing its comment letter to the International Accounting Standards Board (IASB) on its exposure draft Insurance Contracts (ED). The IAC also announced the publication of *Discount Rates in Financial Reporting: A Practical Guide*.

THE COMMENT LETTER

The IAA represents 95 percent of actuaries practicing around the world. The comment letter is a collaborative work of actuaries involved in insurance accounting from many countries, and hence provides a unique perspective of practitioners who will be heavily involved in the implementation of that new standard. They bring insights from a global range of products, operating environments and regulatory regimes. The IASB appreciates the benefits of receiving input from the IAA, as is evident from the long history of interaction with the board and staff during the project and the memorandum of understanding that formalized the relationship of the IAA with the IASB.

Endorsement of the Model, but …

The letter begins by stating that the IAA supports the model proposed in the ED. It characterizes the model as a current value approach and states the objective that the measurement principles should reflect the business model of the reporting entity. The need to correspond to the insurer's business model underlies many of the specific comments. As is typical of comment letters, the largest part of the letter expresses ways that the proposed standard could be improved. The IAA letter runs to 30 pages, so it is apparent that actuaries see a lot of need for improvement. The letter emphasizes needs for improvement in the proposals for the updating of the contractual service margin (CSM), for measurement of contracts with participation features, for the use of other comprehensive income (OCI) in presentation, and in the guidance for the transition to the new standard.

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Updating the CSM

The CSM is the amount determined at the inception of a contract that defers profit. It is amortized in relation to the services provided with discounting. The CSM is updated for changes in estimates of future cash flows (for example, due to assumption changes), so that these changes do not affect profit or loss (P&L) in the current period. The IAA expresses support for the general approach to updating CSM but also identifies several problems with the specific guidance.

- The first is that the discounting is locked in at inception. The IAA believes that discounting should be on the same basis as the future cash flows (i.e., dual rates with a fixed rate for the expense and a current rate for measurement).
- The second problem is that the amortization is not adjusted for changes in the expected pattern of service to be provided. The IAA recommends that amortization in the current period should be adjusted to reflect that services have been deferred to future periods or accelerated from future periods, as compared to previous estimates.
- The IAA also notes general lack of clarity in how the effects of changes in various items affect the updating of CSM. The effects referred to are the effects on the projection of services provided, which form the basis for the amortization of the CSM. Items specifically referred to are:
    - o Effects of changes in the carrying amount of liabilities that use the mirroring approach, which may be reported in P&L or in OCI,
    - o Effects of changes in cash flows that are not measured under the mirroring approach but vary with returns on the underlying item, which are reported in P&L, and

- o Effects from changes in cash flows or discount rates determined entirely using market variables, which are reported in P&L.

Contracts with Participation Features
The IAA supports the concept of considering underlying items (i.e., those that provide the basis for participation) in the measurement of dependent cash flows, but it does not agree with the conclusion of the IASB that this requires separating cash flows into those that are dependent on the underlying and those that are not for differentiated discounting. The IAA finds the decomposition of cash flows overly complex and impractical to implement, while not providing any useful additional information.

The IAA finds the criteria to determine whether to apply the approach of mirroring too strict and does not encompass the range of products and business models that can be found around the world. In fact the IAA suggests that all participating contracts should be treated consistently, which would mean that it would be permissible for all types of participating contracts to reflect the measurement of the underlying item in the measurement of the liability. One main implication of the consistent treatment would be that the interest expense presented in P&L would be consistent with the investment income. Not explicitly stated in the letter, the implication of this point is that because the investment income in the P&L is based on an effective yield rate, the corresponding interest expense should be based on a similar levelized rate rather than on the unwind of the discounting along a yield curve.

Presentation
The ED proposes that the effects of changes in discount rates be shown in OCI for both insurance liabilities and for the backing fixed-income assets. The IAA letter notes that this treatment does not meet the objective of avoiding accounting mismatches for many business models and recommends that insurers be able to choose to recognize the effects of changes in discount rates in P&L.

The members of the IAC were narrowly in favor of the earned premium approach for the presentation of revenue, with a sizable minority in favor of the summarized margin approach. Of particular concern with the earned premium approach was the separation of the investment component from revenue and expense. The IAA letter notes that a few actuaries continue to ask for premiums as revenue in the presentation.

Transition
The IAA welcomes the requirement that contracts that are in force at the time of an insurer's transition to the new standard have a CSM. This requirement is one of the more significant changes to the ED as compared to

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the first exposure draft (from 2010). The letter notes that there are practical implementation issues with the guidance in the ED, particularly with comparability among companies of the OCI at transition. The letter suggests changes to make the implementation more practical and more comparable.

Other Topics

The IAA letter addresses at length all the questions for which the IASB requested comments. Actuaries wishing to read the complete letter can access it at the IAA website at: *http://www.actuaries.org/LIBRARY/Submissions/FTP4_2013_CommentsonIASBED.pdf*.

Other Comment Letters and the IASB's Likely Response

The IASB received nearly 200 comment letters. The letters had many themes in common with the letter from the IAA. The IASB has shown in the past that it carefully considers contracts comment letters and has often modified its proposals in response to the comments. How far it will go to meet the concerns of the IAA and others is of course uncertain. Re-deliberations are set to start in the first quarter of 2014, and there is no indication in the IASB's current work plan of when it expects to issue an International Financial Reporting Standard (IFRS).

IAA MONOGRAPH ON DISCOUNTING

The IAC announced the publication of *Discount Rates in Financial Reporting: A Practical Guide*. The book is the product of a team of actuaries from Milliman, under the direction of the IAC. The Financial Reporting Section and other sponsors financed the book.

The book on discounting is the second of three monographs intended to assist actuaries with the new challenges of reporting under the proposed revised IFRS for insurance. The first is *Stochastic Modeling* (released in May 2010), and the third is a monograph on risk margins, which is underway but waiting now for the accounting standard to be finalized so that the monograph can specifically address the requirements of the emergent IFRS. The Financial Reporting Section is a sponsor of these publications as well.

NEXT MEETING AND IAC ACTIVITIES

The IAA meets again in April 2014. The IAC plans to start drafting International Actuarial Notes (IANs) on the new IFRS for insurance. With luck, by the time of the meeting the IAC can at least organize its efforts and then begin drafting IANs as soon as the IASB's decisions become final. ■