



19 June 2009

Via e-mail

Ref: 9/106

Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sir David

The International Association of Insurance Supervisors (IAIS) welcomes the opportunity to comment on the IASB discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers*.

We intend only to answer two questions as we think that our answers to those questions, particularly question 2, should result in insurance specific issues being dealt with in the Insurance Contracts project. Our comments and key concerns focus on the effect of the proposals as they relate to the insurance industry.

**Question 2**

*Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?*

**The IAIS has concerns that some aspects of the proposals would not provide decision useful information if applied to insurance contracts. We are not proposing an alternative principle but note that, to the extent that the issues are specific to insurance, we believe that they would be better addressed in the Insurance Contracts project.**

We see both parallels between and potential difficulties with the approaches taken by the Board in the discussion paper and prudential supervisors' views of appropriate accounting for insurance contracts. While there are some similarities between the generic Revenue Recognition proposals and the apparent direction of the Insurance Contracts project, there are also some potential differences. It would be particularly helpful to understand whether the Board would accept a mixed measurement model in light of those differences.

The proposals may have different effects on insurers writing short duration contracts and insurers writing long duration contracts, and potentially also medical insurers. The discussion paper acknowledges that issues concerning revenue recognition on insurance contracts exist [5.89] and notes that the proposed model may be appropriate for some, while one of the alternative models (stated in Appendix B) may be appropriate for others [S11(b)].

Specific proposals for revenue recognition for insurers will effectively emerge from the developments in the Insurance Contracts Project.

#### **Question 4**

*Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.*

**For insurers, the performance obligation is the provision of risk bearing services. We recommend that there be clarification of this in the Insurance Contracts project.**

The performance obligations of insurers are satisfied during the contractual coverage period. This is not obvious from the generic nature of the discussion paper and we recommend that this be clarified in the Insurance Contracts project.

It is our view that the only relevant performance obligation for insurance is the obligation to provide risk coverage, and therefore that should determine the recognition of revenue. We argue below that this view is consistent with views of both the service provider (the insurer) and the customer (or policyholder).

#### ***Insurer's point of view:***

A basic insurance contract provides coverage for insured events, and the insurer stands ready to settle any claims that arise during the coverage period. The insurer will satisfy this obligation over the course of the policy whether underlying claims occur or not. For example, certain catastrophe coverages may not result in any claims in certain years. Nonetheless, the insurer will have stood ready to pay any claims arising over the coverage period, and at the end of the coverage period will have satisfied that performance obligation. The IAIS believes that this best describes the full performance obligation on a short-term contract.

An insurance contract provides coverage for a specified period of time although the actual settlement of the claims that arise during this coverage period may occur subsequently. The IAIS believes that the period of the contract is the correct timeframe in which revenue is to be recognised for insurers rather than the period over which claims may be settled. During the period of coverage, the insurer must make estimates of both known claims and as yet unknown claims – Incurred But Not Reported (IBNR) claims, both of which will be subject to a risk margin. These issues are being addressed in the Insurance Contracts project.

Some have suggested that there are separate performance obligations that arise subsequent to the stand ready period for settling claims that have occurred during the coverage period. However, we regard the settlement of claims as being related to the liability estimation as a result of events that took place while the insurer was providing risk coverage, not the provision of a good or service. That is, the performance obligation is effectively settled with the raising of the outstanding claims liability (including IBNR and inherent claim settlement and handling expenses) which represents the transfer of an asset to the policyholder or beneficiary. The claims handling process focuses on the transformation of the insured's asset from a receivable into cash or other assets – akin to the settlement of a debt or other financial instrument.

#### ***Policyholder's point of view:***

A policyholder transfers a risk of loss to an insurer in return for a premium payment (or set of payments). At the beginning of an insurance contract, the policyholder is relieved of the risk of adverse financial consequences as a result of loss for a specified period, and the insurer is

therefore providing the service to the policyholder throughout the specified period and the benefit the policyholder derives from the contract erodes – each day the amount of future coverage diminishes. One day after the end of the coverage period, the insurer is no longer providing coverage (or therefore performing the service), although admittedly it may or may not have a liability for a loss that arose during the coverage period. The policyholder will not expect the insurer to provide any additional good or service after the coverage period. The policyholder will expect the insurer to pay claims (i.e. transform receivables into cash) that have arisen as a result of the expired coverage period after the end of that period if they are still outstanding but will not be expecting the performance of any new services in the future.

### **Long term contracts:**

The proposed customer consideration model is broadly consistent with existing revenue recognition practice for many short-term contracts in the insurance industry. While the above comments regarding the performance obligation are valid for all forms of insurance, we see four additional issues resulting from the discussion paper for long-term insurance contracts:

1. The effect of acquisition costs is not entirely clear. Read literally [6.43-6.45 & Example 8, Appendix A], the discussion paper would require writing off acquisition costs without recognition of offsetting revenue which an insurer has a reasonable expectation of receiving. That is, it would likely lead to a loss on inception even for contracts that are fully expected to be profitable over their lives. This would not be a faithful representation of the economics of a long-term insurance contract (or other contracts, for that matter). The solution touched upon in paragraph 6.46 of the discussion paper is broadly consistent with prior IAIS positions.
2. The time value of money is not an explicit part of the proposed measurement of performance obligations. This would be problematical for long-term insurance contracts which are priced in such a way as to include consideration of the time value of money. We presume that the Board will address this issue in the insurance contracts project.
3. The lack of general remeasurement of performance obligations is possibly the most important issue for insurers in the discussion paper. The economics, in particular, of long-term contracts would not be faithfully represented by fixing the performance obligations of those products without remeasurement into the future. Such contracts may run for many years, and the likelihood is very remote that the exact assumptions made when the obligation is first measured will continue to be applicable throughout the obligation's existence. To recognise revenue in later years based on the profitability of the contract at inception is very unlikely to be indicative of the true profitability of the contract at that time.
4. Contract boundaries — we note that the board is discussing contract boundaries in relation to the revenue recognition project. This is a particularly important area for long term contracts, and we refer the board to our earlier letter dated 2 April 2009 on contract boundaries in relation to the Insurance Contracts project and to the Board's tentative decisions at its May 2009 meeting.

### **Financial Instruments**

This is a general point not related specifically to any of the questions. The lack of detail in relation to investment income does cause some concern and would be usefully handled by clarification of scope issues. Similarly, more clarity about revenues related to financial instruments would be useful. We acknowledge the interaction of this issue with the current joint Financial Instruments project. We also acknowledge that the Board has recognised this

in S11A. We would expect to provide further input to the Board on this issue as part of the Financial Instruments project.

As an international body representing prudential regulators, we would welcome the opportunity to discuss possible ways forward with the IASB and its staff. If there is any way in which the IAIS can assist the IASB further, please do not hesitate to contact Rob Esson, Chair of the IAIS Insurance Contracts Subcommittee (tel: + 1 816 783 8131; email: [resson@naic.org](mailto:resson@naic.org)) or Peter Windsor at the IAIS Secretariat (tel: +41 61 280 9196; email: [peter.windsor@bis.org](mailto:peter.windsor@bis.org)).

Yours faithfully



Peter Braumüller  
Chairman, Executive Committee



Alfred Gross  
Chairman, Technical Committee

*The IAIS is an international organisation composed of insurance supervisors from more than 190 jurisdictions. One of its main objectives is to promote the development of well-regulated insurance markets. This includes the development and implementation of high quality financial reporting standards, and as such the IAIS has a keen interest in the work of the IASB. We have also provided significant input to the IASB, in particular with respect to the projects that will most influence the overall accounting model for regulated insurance enterprises. We are an official observer of the IASB's Financial Instruments Working Group and Insurance Working Group, a member of the Standards Advisory Council and participates actively in the Financial Crisis Advisory Group.*