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## **CUSTOMER CONSIDERATION APPROACH FOR REVENUE RECOGNITION CALLED GOOD STARTING POINT FOR INSURANCE CONTRACTS**

**BASEL, Feb. 4** – Customer consideration, as proposed in the joint IASB/FASB revenue recognition project discussion paper, is an appropriate starting point for setting a revenue recognition standard for insurance contracts, global insurance regulators were told here today by the Group of North American Insurance Enterprises (GNAIE), an organization of major life and property/casualty insurers and reinsurers.

In a presentation to a meeting of the International Association of Insurance Supervisors insurance contracts subcommittee, Jerry de St. Paer, Executive Chairman of GNAIE, said that the boards of the IASB and FASB have come down clearly on the side of the customer consideration approach and evolved away from the “exit” value approach to revenue measurement.

De St. Paer called the December 18 preliminary views discussion paper on Revenue Recognition in Contracts with Customers “a promising (?) starting basis”, in part, because it recognizes that a contract can provide services as well as goods. “Insurance contracts, especially non-life contracts, primarily provide a service – insurance coverage,” he said.

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To influence the development of international accounting and solvency standards to ensure that they result in robust, high quality standards for insurance enterprises.

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In addition, the discussion paper's use of revenue recognition has three other benefits: it properly recognizes revenue as the insurer is released from risk; it recognizes that the transaction price is the one and only market transaction and therefore calibrates obligations to the consideration at the time of issue; and, it is less hypothetical and subjective than exit value, according to de St. Paer.

He added that while GNAIE has not worked out in detail all the implications of the discussion paper and its effect on insurance contracts accounting, it tentatively observed that the discussion paper properly treats the contract as a whole and indicates that it is the *contract* that is the asset or liability rather than individual cash flows. "GNAIE believes this is the best overall approach to measurement of insurance contracts as well," said de St. Paer.

Because GNAIE views the insurance contract as providing the service of insurance protection, it would not consider the actual payment pattern of claims in recognizing revenue. "This is fully consistent with the intent of the IASB/FASB joint boards' discussion paper," said de St. Paer, who also pointed out that the basis "for measurement and re-measurement of reported claim liabilities would need to be in the insurance contracts standard."

The joint boards' objective is to improve the existing accounting guidance worldwide by developing a single revenue model that can be applied consistently regardless of industry.

He noted that GNAIE is comfortable with the three building blocks in the revenue recognition discussion paper, but may want some additional guidance when it discusses insurance obligations in more detail. "Although the three building blocks in the revenue

recognition paper are the same as those in the insurance contracts discussion paper, they are in far less objectionable detail, “de St. Paer said.

De St. Paer said GNAIE had several issues with the discussion paper, however. For life insurance contracts, GNAIE is concerned with how the discussion paper would be extended to recurring contracts since it specifically does not address the measurement of rights under contracts.

“It would seem logical to us to treat future rights in the same manner by including the best estimate of expected future incomes and discounting for the time value of money,” he said.

Consequently, GNAIE believes it would make sense” to calibrate the present value of all considerations to the present value of all obligations under the contract and allow a single margin to achieve no gain or loss at issue”, said de St. Paer. Although this treatment could result in significant up-front losses for most life insurance contracts and some non-life contracts, he said there are several possible ways to address this potential problem. GNAIE hopes to endorse a position later this year.

De St. Paer also expressed concern with the discussion paper’s lack of re-measurement for performance obligations (and presumably for rights) under a contract. In particular, this would not work well for an embedded option in an insurance contract or a standalone option of any type, he said.

“We strongly recommend that an insurance revenue recognition standard require re-measurement of the expected costs and rights on a regular basis whether the general revenue recognition standard requires it or not,” de St. Paer said.

He further cautioned that “there are nuances specific to insurance contracts that will need to be clarified in the IASB/FASB’s joint insurance contracts project/guidance.” These

include the unlocking of assumptions, treatment of rights under the contracts and dealing with heaped first year expenses.

The goals of GNAIE are to influence international accounting and solvency standards to ensure that they result in robust high quality accounting and solvency standards for insurance companies and, to that end, to increase communications between insurers doing business in North America and international regulators and standard setters. GNAIE works to meet its goals through modeling of proposed accounting standards, analysis, comment and coordination with various end users of financial reports.

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