

Straight away

Financial reporting bulletin from PwC

20 March 2014

New UK GAAP insurance contracts standard is here

What's the issue?

The Financial Reporting Council (FRC) issued [FRS 103, 'Insurance contracts'](#), and accompanying implementation guidance (IG) on 20 March 2014. FRS 103 provides, for entities reporting under new UK GAAP, a single source of financial reporting requirements for insurance contracts.

FRS 103 applies to all entities adopting FRS 102, 'The financial reporting standard applicable in the UK and Republic of Ireland', that issue insurance contracts.

What are the main changes?

Scope

FRS 103 applies to insurance contracts (including reinsurance contracts) issued and reinsurance contracts held. The definition of an insurance contract is the same as that contained in IFRS 4, which was previously used in 'old' UK GAAP where FRS 26 was applied. Contracts falling within this definition are within the scope of FRS 103, regardless of whether they are regarded as insurance contracts for legal or regulatory purposes.

However, some specific types of contract falling within the definition of an insurance contract (such as product warranties issued directly by a manufacturer, dealer or retailer) are excluded from the scope of FRS 103 and are accounted for under the relevant sections of FRS 102.

FRS 103 also applies to issued financial instruments with discretionary participation features (DPF). In the UK, this includes with-profits contracts that do not transfer significant insurance risk.

Sources of the standard

FRS 103's requirements are primarily based on IFRS 4. The main body of the standard also includes FRS 27's recognition and measurement requirements in respect of with-profits funds measured on a 'realistic' basis for regulatory purposes.

Also, elements of the ABI SORP and some of FRS 27's disclosure requirements are included as guidance in the IG.

Existing practice continues, with scope for changes in accounting policy

FRS 103 generally allows management to continue with current accounting practices for insurance contracts. This is subject to meeting some minimum requirements (for example, in respect of a liability adequacy test). In general, it is expected that 'old' UK GAAP for regulated insurance contracts will meet these minimum requirements.

FRS 103 provides the ability, as under IFRS 4, to make improvements (subject to legal and regulatory requirements) to existing accounting policies. That is, an accounting policy can be changed if the new policy makes the financial statements either more reliable and no less relevant, or more relevant and no less reliable.

Disclosures

FRS 103's disclosure requirements are largely based on those in IFRS 4.

More disclosures are likely to be required, compared to previous practice under 'old' UK GAAP, including IFRS 4 disclosure requirements such as claims development tables and risk disclosures.

The IG provides guidance for life insurers, based on FRS 27, on capital disclosures. These disclosures go beyond FRS 102's minimum requirements. However, the guidance is consistent with current practice for life insurers, so following the guidance is unlikely to be unduly burdensome.

Main change made since FRED 49

The FRC decided, following deliberations, that FRS 103 should address an accounting mismatch issue faced by UK general insurers which write foreign currency-denominated business. Under FRS 23, some balances arising from foreign currency-denominated insurance contracts (such as unearned premiums) were treated as non-monetary items, and so they were not retranslated. This gave rise to accounting mismatches where these contracts were backed with foreign currency-denominated financial assets that were retranslated at each reporting date.

To resolve this issue, for the purposes of applying FRS 102's requirements in respect of foreign currency translation, FRS 103 requires an entity to treat all assets and liabilities arising from an insurance contract as monetary items. We specifically highlighted this issue in our [comment letter on FRED 49](#), and so we welcome this change.

Am I affected?

All entities that apply FRS 102 and issue insurance contracts or financial instruments with DPF are affected.

Entities that have not previously adopted FRS 26 will be applying the definition of an insurance contract for the first time. Management will therefore need to perform a 'contract classification' exercise to determine which of their contracts fall within FRS 103's scope and which contracts need to be accounted for as financial instruments under section 11 or 12 of FRS 102. This is likely to affect life insurers who might issue contracts without significant insurance risk.

For most regulated insurance entities currently reporting under UK GAAP, FRS 103 will generally permit existing practice to continue for those contracts falling within its scope, but additional disclosures are likely to be required.

Entities that are not regulated insurers are required to apply FRS 103 to contracts issued by them that meet the definition of insurance contracts. While the ability to continue existing practices means that the recognition and measurement of contracts such as product warranties (issued by third parties) might not change, such contracts are subject to FRS 103's disclosure requirements.

Effective date

FRS 103 applies to accounting periods beginning on or after 1 January 2015. Early adoption is permitted.

FRS 27 and the ABI SORP will be withdrawn once FRS 103 becomes effective. The FRC anticipates that FRS 103 will have a limited life, and expects to review it when the IASB has issued its updated standard on insurance contracts. In addition, the FRC might make interim amendments to FRS 103 once changes in the regulatory regime for insurers (Solvency II) come into force.

What do I need to do?

As noted above, we generally do not expect FRS 103 to require significant changes to the way in which entities measure insurance contracts. But, if you have not previously applied FRS 26, you will need to go through a 'contract classification' exercise to determine which contracts are within FRS 103's scope.

You should familiarise yourself with the incremental disclosure requirements for insurance contracts under FRS 103 and ensure that systems are in place to capture the information needed.

Following the withdrawal of the ABI SORP, you might need to reconsider the accounting for any items where guidance in the SORP has not been carried forward in FRS 103 (for example, levies based on premium income). These items will now be subject to the general requirements of FRS 102.