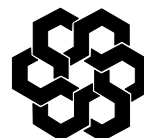




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*This document is provided as a convenience to observers at the joint IASB-FASB meeting, to assist them in following the Boards' discussion. It does not represent an official position of the IASB or the FASB. Board positions are set out in Standards (IASB) or Statements or other pronouncements (FASB).*

*These notes are based on the staff papers prepared for the IASB and FASB. Paragraph numbers correspond to paragraph numbers used in the joint IASB-FASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

#### INFORMATION FOR OBSERVERS

**IASB/FASB Meeting:** 23 October 2006, Norwalk

**Project:** Insurance Contracts Phase II

**Subject:** Insurance Contracts (Agenda Paper 3)

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#### Purpose of this paper

1. This paper provides a summary of phase II of the IASB's project on insurance contracts.
2. The Boards have stated that they intend to conduct this as a 'modified joint' project. In other words the IASB will develop a discussion paper containing the IASB's preliminary views. The FASB would issue an Invitation to Comment containing the IASB discussion paper.
3. The IASB expects the discussion paper to be ready in the first quarter of 2007.

## **Scope**

4. The objective of this project is to develop an IFRS on accounting for insurance contracts.
5. The Board does not expect this project to change existing IFRSs (eg IAS 39) for assets held by insurers (except possibly in some cases where the liability cash flows are contractually determined by the assets).
6. Many insurers issue some contracts that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* because they do not transfer significant insurance risk. The discussion paper will document the differences between the Board's tentative conclusions for insurance contracts and existing requirements in IAS 39 and IAS 18 *Revenue*. The discussion paper will present the Board's preliminary view that it would be preferable to eliminate those differences, but will not propose specific methods for doing so.
7. The project will address accounting by both insurers and policyholders. However, the Board does not view work on policyholder accounting as a high priority and the discussion paper will not address it. The staff will ask the Board in the first quarter of 2007 whether a separate discussion paper is needed on policyholder accounting, or whether it would be sufficient to go straight to an exposure draft. The Board has not yet discussed whether a single standard should cover both insurer accounting and policyholder accounting, or whether two standards will be needed.

## **Background**

### *Introduction*

8. The IASB's predecessor organisation, the IASC, started this project in 1997 because:
  - (a) there was then no international standard on insurance contracts, and insurance contracts were excluded from the scope of existing standards that would otherwise be relevant (on provisions, financial instruments, intangible assets).
  - (b) accounting practices for insurance contracts are very diverse, and also often differ from practices in other sectors.
  - (c) users complain that it is hard to understand insurers' financial statements.

9. The IASC set up a Steering Committee to carry out the initial work on this project. The Steering Committee published an Issues Paper in 1999. The first volume of the Issues Paper analysed the characteristics of different forms of insurance contract and considered the significant accounting issues. The second volume contained 82 illustrative examples, summarised relevant national standards and requirements in 17 countries and summarised the main features of the principal contracts found in eight countries.
10. The Issues Paper attracted 138 responses. The Steering Committee held two meetings of three days each to discuss the comment letters and two further meetings, totalling seven days, to develop a *Draft Statement of Principles* (DSOP). The Steering Committee used the DSOP as an internal report to the newly constituted IASB. The IASB posted the DSOP on its Website, but did not invite formal comments on it. The role of the Steering Committee finished at that point.
11. The IASB began discussing the project in November 2001, using the DSOP as the initial basis for the discussions. At point, the Board established an Insurance Advisory Committee to respond to requests from the IASB staff for advice. The Advisory Committee also had three face-to-face meetings in April 2002 and 2003. Its role finished at the end of phase I
12. Between October 2001 and June 2002, IASB staff and Board members conducted field visits to nineteen insurance companies from nine countries. The purpose was to assess the practical implications of implementing the model proposed in the DSOP.
13. By May 2002 it had become clear that the project could not be completed in time for insurers switching to IFRSs in 2005, so the Board split this project into two phases. The Board completed phase I in March 2004 by issuing IFRS 4 *Insurance Contracts*. The Board's objectives for phase I were:
  - (a) to make limited improvements to accounting practices for insurance contracts
  - (b) to avoid requiring major changes that may need to be reversed in phase II. To achieve this, IFRS 4 permits most existing accounting practices for insurance contracts to continue. IFRS 4 also exempts insurers from a hierarchy of criteria, specified in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, that an entity

must use in developing an accounting policy when no IFRS applies specifically. The criteria include compliance with the *Framework*.

(c) to require an insurer to disclose information about insurance contracts.

14. Because of competing priorities, the Board suspended work on phase II in early 2003, and restarted phase II in mid 2004. On restarting phase II, the Board decided to take a fresh look at financial reporting by insurers. To advise it on the project, the Board formed an Insurance Working Group (IWG), made up of senior financial executives, analysts, actuaries, auditors and regulators. The IWG has held eight two-day meetings, starting in September 2004. The most recent meeting was in June 2006. Generally, around five to seven IASB members have attended IWG meetings.

15. Since restarting the project in mid 2004, the Board has held 11 public educational sessions on insurance contracts (8 by outside presenters, 1 by the FASB staff and 2 by the IASB staff) and 10 decision-making sessions.

16. There are important interactions with other projects, particularly those on the conceptual framework, revenue recognition, accounting measurement, performance reporting, financial instruments and revisions to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and liabilities and equity. The Board expects that the work on insurance contracts will proceed in parallel with these other projects and will not wait for their outcome. This work may generate useful inputs for those other projects.

#### *Input from insurers and supervisors*

17. In September 2006, various insurance trade associations presented to the Board a summary of their recommendations in the following recent publications:

(a) *Elaborated Principles for an IFRS Phase II Insurance Accounting Model*, by the CFO Forum (of about 20 major European insurers)<sup>1</sup>

(b) *An International Accounting Standard for Life Insurance*, by the Group of North American Insurance Enterprises (GNAIE) and four major Japanese life insurers<sup>2</sup>

(c) *GNAIE Extended Principles for Non-life Insurance*, by GNAIE.

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<sup>1</sup> [http://www.cfoforum.nl/elaborated\\_principles.pdf](http://www.cfoforum.nl/elaborated_principles.pdf)

<sup>2</sup> <http://gnaie.net>

18. At the October IASB meeting, the Board will discuss the main differences between the trade associations' recommendations and the Board's tentative conclusions.
19. In May 2006, the International Association of Insurance Supervisors (IAIS) issued *Issues arising as a result of the IASB's Insurance Contracts Project – Phase II Second Set of IAIS Observations*,<sup>3</sup> following an earlier set of observations issued in 2005.

### **Tentative Conclusions to Date**

20. The following paragraphs summarise the tentative conclusions that the Board expects to include in the Discussion Paper:
- (a) Measurement (paragraphs 22-42)
  - (b) Future premiums and policyholder behaviour (paragraphs 43-48)
  - (c) Acquisition costs (paragraphs 49-51)
  - (d) Policyholder participation rights (paragraphs 52-58)
  - (e) Unbundling (bifurcation) (paragraphs 59-60)
  - (f) Other issues (paragraph 61)
21. The Board's tentative conclusions apply to all types of insurance contract: life and non-life, direct insurance and reinsurance. They also apply throughout the life cycle of a contract, through both the pre-claims period (ie the coverage period when the insurer is standing ready to meet valid claims) and the claims period (when the insured events have occurred but the ultimate payment is still uncertain).<sup>4</sup>

### **Measurement**

22. The Board has concluded tentatively that an insurer should use the following inputs (building blocks) to measure its insurance liabilities:
- (a) current unbiased probability-weighted estimates of future cash flows. (discussed further in paragraphs 24-28)

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<sup>3</sup> [http://www.iaisweb.org/060601\\_\\_Second\\_Liabilities\\_Paper\\_final.pdf](http://www.iaisweb.org/060601__Second_Liabilities_Paper_final.pdf)

<sup>4</sup> For life insurance, the claims period is generally very short because there is little or no uncertainty about the payment once the insured event has occurred, and payment occurs quickly.

- (b) current market discount rates that adjust the estimated future cash flows for the time value of money. (discussed further in paragraphs 29-33)
- (c) an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin). (discussed further in paragraphs 34-37)

23. After discussing these building blocks, this section considers how to define a measurement attribute that includes those building blocks (paragraphs 38-41) and summarises the advantages of using that measurement attribute (paragraph 42).

*Current estimates of future cash flows*

24. The need to estimate future cash flows would not be completely new. Insurers already use estimates of future cash flows for some aspects of many existing accounting approaches and many insurers already use cash flow estimates as one factor in pricing decisions. Nevertheless, a current value approach places more demands on estimates of cash flows than most existing approaches, particularly in longer duration contracts. This is because changes in estimated cash flows affect profit or loss immediately in a current value approach, but may do so only over time in some existing approaches.

25. Commentators sometimes object to proposals for current estimates on the grounds that it is not useful to require immediate adjustment of all estimates to be identical to the most recent actual experience. However, these objections are based on a misunderstanding. For example, suppose that mortality experience last year was 20 per cent worse than previous experience and previous expectations. Several factors could have caused the sudden change in experience, including:

- (a) lasting changes in mortality
- (b) changes in the characteristics of the insured population (eg changes in underwriting or distribution, or selective lapses by policyholders in unusually good or bad health)
- (c) random fluctuations
- (d) identifiable non-recurring causes.

26. An insurer would typically investigate the reasons for the change in experience and develop new probability estimates for each possible outcome, in the light of the most

recent experience, earlier experience and other information. Typically, the result would be that the expected present value of the cash flows increases, but not by as much as 20%. Actuaries have developed various 'credibility' techniques that an insurer could use in assessing the impact of new evidence on the probability of different outcomes. In this example, if mortality continues to run significantly above previous estimates, the insurer would increase over time the estimated probability assigned to high-mortality scenarios.

27. Estimates of the probabilities for each scenario should faithfully represent conditions at the reporting date. However, it is also important to consider whether changes in estimates faithfully represent changes in conditions during the period. For example, if estimates were at one end of a reasonable range at the beginning of the period and conditions have not changed, moving to the other end of the range would not faithfully represent what has happened during the period.
28. To the extent possible, estimates should be consistent with observed market prices:
  - (a) Some estimates relate to observable market variables, such as interest rates. An entity should use these variables as direct inputs without adjustment.
  - (b) Other estimates relate to variables (such as mortality) that cannot, in general, be observed directly from market prices and transactions. These estimates:
    - (i) should be reviewed every year and should be updated if they are no longer consistent with all available current information about conditions at the reporting date.
    - (ii) should not contradict observable market variables. For example, an assumption about future inflation rates should be within a range that is consistent with expectations implied by market interest rates.
    - (iii) should not incorporate the effect of synergies with other assets and liabilities. For example, if an insurer is significantly more or less efficient than other market participants, its estimates of cash flows should not reflect its own efficiencies or inefficiencies.

*Discount rates*

29. The discount rates should be consistent with observable market prices for cash flows whose characteristics match those of the insurance liability in terms of timing, currency and liquidity. They should exclude any factors that influence the observed rate but are not relevant to the liability (for example, risks present in the instrument used as a benchmark but not present in the liability).

*Discounting: non-life claims liabilities*

30. Some insurers, particularly in the US, have proposed that non-life claims liabilities should be measured on an undiscounted basis, with no margin. Their concerns have focused on:

- (a) estimating the timing of the cash flows.
- (b) estimating margins
- (c) users' reactions if discounting leads to lower measurements of claims liabilities.

31. The Board will discuss these concerns again at its October meeting.

*Discounting: unearned premium as an approximation*

32. When an insurer enters into an insurance contract, it takes on an obligation to stand ready to pay valid claims for future insured events arising under the existing contract. Many existing models for non-life insurance measure that obligation by reference to the unearned portion of the premium received. That approach may sometimes provide a reasonable approximation to the result of the Board's tentative conclusions if the pattern of risk is linear, the contract is short-term and not likely to be highly profitable or highly unprofitable, and circumstances have not changed significantly since inception.

33. The trade associations have suggested that the Board should, in specified circumstances, explicitly permit an unearned premium approach (combined with a liability adequacy test) as a proxy for carrying out the measurement required by the Board's proposals. However, the Board believes that would be out of place in a principles-based standard.

*Estimating the margin*

34. As explained above, one input to be used in measuring an insurance liability is a margin. Several Board members believe the margin should be calibrated to the observed price for the transaction with the policyholder and, in consequence, that an insurer should not recognise a net gain at inception. The trade associations have also taken this position.



35. However, a majority of Board members believe the observed price for the transaction with the policyholder, although useful as a reasonableness check on the initial measurement of the insurance liability, should not override an unbiased estimate of the margin another party would require if it took over the insurer's contractual rights and obligations. The IAIS has also taken this position (with the caveat that the margins must be determined reliably).
36. The Board does not intend to prescribe specific methods for determining margins, but does intend to give some guidance on characteristics that a margin would need to have.
37. Some other initiatives may lead to useful inputs for guidance on risk margins, although it is probably best to think of most of these other projects as work in progress. The International Actuarial Association (IAA) has set up a Risk Margin Working Group. Several supervisors (for example, as part of the European Solvency 2 project) have been developing ideas on risk margins for solvency purposes. Also, several insurers have been developing thoughts on risk margins for solvency purposes, as well as for internal economical capital projects.

*Defining the measurement attribute*

38. A concise name for a measurement attribute that uses the three building blocks described above is 'current exit value'. Current exit value is the amount the insurer would expect to have to pay today if it transferred all its remaining contractual rights and obligations immediately to another entity.
39. Typically, the current exit value of an insurance liability is not observable, so it must be estimated using the three inputs described above.
40. It is too early for the Board to conclude whether current exit value is synonymous with fair value. The Board will review that question as work proceeds on the Board's fair value measurement project. For that project, the Board intends to issue a discussion paper containing FASB Statement 157 *Fair Value Measurements*. A fair value measurement of an insurance liability would generally (probably always) be on level 3 of the hierarchy in Statement 157.
41. A measurement of insurance liabilities at current exit value is not intended to imply that an insurer can, will or should actually transfer the liability to a third party. Indeed, in

most cases, insurers cannot transfer the liabilities to a third party and would not wish to do so. Rather, the purpose of specifying this measurement is to provide useful information that will help users make economic decisions.

*Why does the IASB prefer a measurement at current exit value?*

42. In the Board's view, a measurement of insurance liabilities at current exit value will provide several benefits to users of an insurer's financial statements:

- (a) More relevant information about the amount, timing and uncertainty of future cash flows arising from existing insurance contracts. Given the uncertainty associated with insurance liabilities and the long duration of many insurance contracts, such information is particularly important.
- (b) A more consistent approach to favourable changes in estimates. In most existing approaches, some favourable changes are recognised implicitly by offset against other changes that are adverse. Thus, these existing approaches recognise favourable changes arbitrarily, depending on whether other adverse changes occur at the same time and on the size of implicit margins that existed at inception.
- (c) A more coherent framework to resolve emerging issues without resorting to unprincipled distinctions and arbitrary new rules.
- (d) Consistency with other IFRSs that already require current estimates of future cash flows in measuring non-financial liabilities (see IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) and financial liabilities (see IAS 39 *Financial Instruments: Recognition and Measurement*).
- (e) Less (and perhaps no) need to separate embedded derivatives.
- (f) Less (and perhaps no) need for anti-abuse rules to prevent selective recognition of previously unrecognised economic gains through reinsurance.
- (g) Less (and perhaps no) need for arbitrary criteria to distinguish amendments to an existing contract (with unchanged estimates and an unchanged discount rate, in a cost-based approach) from new contracts (with new estimates and a new discount rate).
- (h) Margins that are explicit rather than implicit.

- (i) Clearer reporting of economic mismatches between insurance liabilities and related assets, and elimination of accounting mismatches that often arise in phase I.

Accounting mismatches are a major concern of many constituents in phase I.

### **Future premiums and policyholder behaviour**

- 43. For many regular premium contracts, the policyholder can cancel the contract before paying all premiums. We could analyse these contracts as short-term contracts containing a stand-ready obligation for the insurer to accept the remaining premiums. Alternatively, we could view them as long-term contracts containing a stand-ready obligation to pay extra amounts (if any) if the policyholder cancels. Logically, the two views ought to be equivalent, though one view may accord better with the perceptions of the insurer and policyholder in particular cases.
- 44. Suppose we view these contracts as a short-term contract with a stand-ready obligation to accept further premiums. For some groups of policyholders, the payment of extra premiums will result in extra net cash flows from the insurer (for example, for groups of life policyholders with severely impaired health). There is no doubt that the measurement of the insurance liability needs to include the extra net cash outflows that will result.
- 45. However, in other cases, the insurer wants policyholders to continue paying premiums because, in aggregate, the result is beneficial to the insurer. This is typically the case in the early years of many life insurance contracts. These cases are more problematic. The insurer expects most policyholders to continue paying. Policyholders also expect to continue paying, unless their circumstances change. Otherwise, the policyholder probably bought the wrong product. Nevertheless, the insurer cannot compel the policyholder to continue paying premiums.
- 46. The Board has reached the following conclusions in this area:
  - (a) The insurer has an asset relating to the future premiums that the policyholder must make to retain a right to guaranteed insurability (less additional benefits that result from those premiums). Guaranteed insurability refers to a right that permits continued coverage without reconfirmation of the policyholder's risk profile, at a price that is contractually constrained.

- (b) Conceptually, that asset is best viewed as a portion of a customer relationship, not as a contractual right.
- (c) When the insurer becomes a party to the contract, the insurer should recognise that portion of the customer relationship (but not the rest of the customer relationship relating to future contracts).
- (d) The insurer should measure that portion of the customer relationship and the related liability in the same way, and should present them together. Although the customer relationship is conceptually separate from the contractual rights and contractual obligations, separate recognition and measurement would be impracticable and, arguably, not useful.

47. Most constituents do not understand why we have struggled so much with this issue. In their view, the solution is simply to include all the cash flows that result from the contract, taking into account estimates of policyholder behaviour. However, in the staff's view, that 'solution' would be incomplete. We would need to specify that the cash flows are ones that result from substantive rights and obligations in the contract. The only plausible test is one that relies on the fact that the insurer has a pricing commitment – and that would lead us straight back to the apparent paradox that an insurer recognises a larger asset as a result of taking on an extra obligation.

48. We plan to discuss in November how the Board's tentative conclusions work for universal life contracts. The likely implication is that some future premiums would be included and others would not.

### **Acquisition costs**

49. Insurers incur costs to sell, underwrite, and initiate a new insurance contract (acquisition costs). Many existing accounting models defer the acquisition costs as an asset. The trade associations have argued that acquisition costs should be viewed as the cost of an investment in the customer relationship.

50. Suppose an insurer charges the policyholder CU<sup>5</sup> 90 for the insurance coverage and CU 10 for the insurer's acquisition costs. From the policyholder's perspective, it paid CU 100 for the insurance cover and has an asset of CU 100. However, should the insurer

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<sup>5</sup> CU = currency unit

recognise initially a liability of CU 100 and intangible asset of CU 10? In the Board's view, the insurer should recognise a liability of CU 90. The insurer would also recognise the acquisition costs of CU 10 as an expense when it incurs them, and would recognise income of CU 10. The perceived 'need' to defer the acquisition costs arises from an overstatement of the insurer's obligation.

51. Moreover, if acquisition costs are deferred, some mechanism is needed to determine which part of each premium relates to recovery of the acquisition costs and which part is paying for the insurance coverage. Any such mechanism will be arbitrary.

### **Policyholder participation rights**

#### *Participating contracts*

52. Participating (with profits) contracts entitle the policyholder to benefit from favourable performance of a group of contracts and/or related assets. The insurer has some discretion over whether, how and when the benefits are allocated to policyholders collectively and as individuals, but there are often constraints over that discretion. There is a huge variety of types of participation, and in many cases the constraints on the insurer's discretion may not have been tested.
53. The key accounting issue is whether the insurer has an obligation to pay those benefits, or whether the policyholders' interest is an unusual form of equity interest. The Board's tentative conclusion is that the policyholders' participation right is not a liability unless it is enforceable (including by a supervisor), and mere economic compulsion (must pay bonuses to stay competitive in the market) does not make a liability. Moreover, the fact that policyholders may have a collective prior claim on the surplus does not, in itself, make an obligation.
54. The Board's tentative conclusion is unpopular with constituents. Many prefer a model in which the liability measurement includes all cash flows that are generated by existing assets and liabilities and are expected to go to policyholders. (It is not clear to the staff that this model could be applied identically to mutuals and to stockholder insurers.)
55. Some insurers issue participating contracts that do not transfer significant insurance risk. IFRS 4 scoped these out of IAS 39. The Board expects to apply the same principles to the participation features in these contracts as to similar features in insurance contracts.

*Universal life contracts*

56. Universal life insurance contracts allow the policyholder to vary premiums, subject to specified minimums and maximums and allow the insurer to vary charges to policyholders within specified limits. The Board has discussed these contracts, focusing on the proposed test for including future premiums (ie guaranteed insurability), the classification (as a liability or as equity) of crediting rates that exceed the minimum that can be contractually required and the interaction of crediting rates with estimates of lapses. The staff will investigate these issues further.

57. In some respects, universal life contracts could be viewed as a form of participating contract because the insurer's approach to crediting rights etc is likely to depend on the performance of the contracts, as well as on competitive factors for new business.

*Unit-linked (variable) contracts*

58. Unit-linked (variable) contracts pass on investment performance to policyholders in much the same way as a mutual fund. Typically, the underlying assets are measured at fair value and the same measurement is used for the related part of the liability. Problems may arise in three main areas:

- (a) Should the insurer consolidate the pool of assets? This is a matter for the Board's work on consolidations generally.
- (b) What happens if the assets cannot be carried under IFRSs at fair value through profit or loss? This occurs if the pool of assets includes treasury shares (the insurer's own shares, not assets from the insurer's perspective), owner-occupied property (eg an office building held in the pool of assets as an investment but rented to the insurer for its own operations) or goodwill in a subsidiary. The discussion paper will examine possible approaches, but not express a preliminary view.
- (c) Some unit-linked contracts do not transfer significant insurance risk. At present, IFRSs defer the portion of the incremental acquisition costs relating to the provision of future investment management services. Should this approach be changed to conform to the Board's approach to acquisition costs for insurance contracts? The discussion paper will review this issue, but not express a preliminary view.

### **Unbundling (bifurcation)**

59. Many, perhaps most, insurance contracts can be viewed as containing a deposit component, and some may also contain a separate service component (eg investment management). The Board's tentative conclusions are as follows:

- (a) For the purpose of recognition and measurement, an insurer should not unbundle (bifurcate) insurance, deposit and service components of insurance contracts if the components are so interdependent that the components can be measured only on an arbitrary basis, but should unbundle them if such interdependencies are not present.
- (b) In relation to presentation, the discussion paper will discuss, without expressing a preliminary view at this stage, whether an insurer should:
  - (i) present all premiums as revenue, all premiums as deposit receipts, or some premiums as revenue and some premiums as deposit receipts.
  - (ii) split premiums for some or all insurance contracts into a revenue component and a deposit component.

60. In its project on risk transfer in insurance and reinsurance contracts, the FASB is developing a definition of insurance contracts and exploring simplified approaches to bifurcating insurance contracts. In May 2006, the FASB published an *Invitation to Comment on Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting*. The IASB staff currently expects that the IASB's Discussion Paper:

- (a) will consider whether some or all insurance contracts should be unbundled. IFRS 4 requires unbundling in some cases and permits, but does not require, it in others.
- (b) will not review the IASB's existing definition of an insurance contract in IFRS 4 and related guidance. The IASB staff does not view work on this definition as a high priority. Nevertheless, the staff will monitor the FASB's work in this area and assess the implications for phase II.

### **Other issues**

61. We note below, without discussion, some of the Board's other tentative conclusions:

- (a) An insurer should recognise rights and obligations created by an insurance contract when it becomes a party to the contract.

- (b) An insurer should derecognise an insurance liability (or a part of an insurance liability) when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.
- (c) In principle, the expected (probability-weighted) cash flows from a portfolio equal the sum of the expected cash flows of the individual contracts. Therefore, the unit of measurement does not affect the expected present value of future cash flows. Moreover, unbiased estimates of cash flows reflect all relevant inputs, regardless of whether those inputs are derived contract by contract or in aggregate.
- (d) Risk margins should be determined for a portfolio of insurance contracts that are subject to broadly similar risks and managed together as a single portfolio. Risk margins should not reflect benefits, if any, of diversification between portfolios and of negative correlation between portfolios.
- (e) The current exit value of a liability reflects its credit characteristics. An insurer should disclose any material effect of such credit characteristics at inception and subsequent changes, if any, in their effect.
- (f) Reinsurance assets should be measured at current exit value. Among other things, that measurement incorporates a reduction for the expected (probability-weighted) present value of losses from default or disputes, with a further reduction for the margin that market participants would require to compensate them for bearing the risk that defaults or disputes exceed expected value (an expected loss model).
- (g) The discussion paper will discuss the components of changes in insurance liabilities and discuss in general terms approaches to presenting and disclosing them, but will not propose specific requirements for presenting and disclosing those changes. The project on presentation of financial statements will be relevant.
- (h) The FASB is reviewing the measurement of financial guarantee insurance contracts and expects to issue an exposure draft of an FASB Staff Position in the fourth quarter of 2006. The IASB staff will monitor the FASB's work in this area, and assess the implications for phase II.