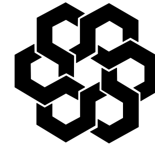

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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

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

INFORMATION FOR OBSERVERS

Board Meeting:	**19 April 2007, London**
Project:	**Business Combinations II**
Subject:	**Insurance Contracts – FASB Memorandum, Follow-up (Agenda Paper 2H)**

ACCOUNTING FOR INSURANCE CONTRACTS ACQUIRED IN A BUSINESS COMBINATION (FOLLOW-UP)

The business combinations Exposure Draft provides specific guidance about accounting for insurance contracts acquired in a business combination. At its February 13, 2007 meeting, the Board considered several issues raised by respondents to the Exposure Draft and requested that the staff perform additional research on some of those issues. At the Board meeting, the staff will seek the Board's tentative decisions on the issues that remained unresolved at the last Board meeting and on certain related issues addressed at that meeting.

As with substantially all assets and liabilities acquired in a business combination, acquired insurance contract assets and liabilities are initially recognized at fair value. This also includes any customer- or contract-related intangible assets. The issues in this handout concern subsequent accounting (called day 2 accounting in this handout) for the acquired

insurance contracts assets and liabilities as specified in paragraph 36(b)(2) of the contingencies guidance of the Exposure Draft:

> After initial recognition, contingencies shall be accounted for as follows:
>
> b. All other contingencies shall be accounted for in accordance with generally accepted accounting principles. For example:
>
> (2) A contingency that is an asset or liability arising from an insurance contract shall be accounted for in accordance with FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* as amended (including the intangible asset, if any, recognized for the difference between the amounts recognized on the acquisition date at fair value and the amounts that would be recognized in accordance with Statement 60).

As described in the Exposure Draft, Statement 60 should have included additional accounting guidance for reinsurance and nontraditional and participating insurance contracts. For purposes of this handout, Statement 60 should be read as incorporating that additional guidance.

Under the guidance in the Exposure Draft for insurance contracts acquired in a business combination, what interpretations should be applied to the following?

Issue 1: What amounts should be recognized in accordance with Statement 60?

The staff recommends that the contracts be accounted for as any other newly written or assumed business—meaning the inception date for the business would be the date of acquisition. The staff believes this reflects the "fresh-start" nature of purchase accounting. Therefore, preacquisition balances of the acquiree are not relevant in recording the new business. The staff also would limit the application of the special insurance accounting provided in the Exposure Draft to short-duration claim and claim expense liabilities and long-duration benefit liabilities. The staff believes other insurance contract assets and liabilities can be accounted for without the need for a fair value intangible asset.

Issue 2: What is the nature of the fair value intangible assets?

The short-duration and long-duration fair value intangible assets, if any, are the difference between the amounts recognized on the acquisition date at fair value and the amounts that would be recognized in accordance with Statement 60.

The staff believes the short-duration fair value intangible asset is essentially a “plug” number that is associated with acquired claims liabilities (future claims and claims expense payments). Although that intangible asset is composed of a risk margin and discount, its can readily be identified and characterized as a discount for accounting purposes. Accordingly, the staff recommends that it be accounted for as such using an effective yield method like that described in FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.*

Although the long-duration fair value intangible asset also is essentially a “plug” number, this asset—related to the long-duration benefit liability—is like a “cost” of the business acquired. That is, the debit amount that would be included in the fair value measurement of the liability and become a standalone asset when compared to the Statement 60 measurement of that liability. The staff recommends that this balance be accounted for using the long-duration deferred acquisition cost (DAC) guidance included in Statement 60 (including accretion and amortization). The guidance that EITF Issue No. 92-9, “Accounting for the Present Value of Future Profits Resulting from the Acquisition of a Life Insurance Company,” provides for the present value of future premiums (PVFP), a similar intangible asset that currently is accounted for like long-duration DAC, should be nullified.

Issue 3: What impairment tests should be used?

The staff’s original objective was to develop a single approach to testing for impairment of the short-duration and long-duration fair value intangible assets. The staff recommended use of the short- and long duration premium deficiency tests. Given the different character of those intangible assets, the different accounting models used today, and the mechanics of the impairment tests, the single approach for all seems not to work well.

Adapting the short-duration premium deficiency test to the short-duration fair value intangible asset involves both (a) potentially providing a “free pass” accounting policy change to include investment income in that test and (b) including in that test investment income related to the short-duration claim and claim expense liabilities (which normally would not be included in a premium deficiency test). In addition to this complexity, the staff believes it is preferable to adapt the approach to the underlying character of the

intangible asset—in this case a discount. Significant changes in the amount or timing of estimated cash flows (claim and claim expense payments) related to the short-duration fair value intangible asset or "discount" could be reflected through effective yield adjustments similar to the accounting approach in Statement 91. This is not an impairment test, but it does address and adjust for changes in the underlying cash flows.

The fair value intangible asset related to the long-duration benefit liabilities, accounted for as a DAC-like intangible asset, would be tested for impairment as originally proposed using the long-duration premium deficiency tests in Statement 60.

Issue 4: For retrospective measurements that include a look-back period for amortization and accruals, should that period be to contract inception or the date of contract acquisition? Should insurance contracts acquired in a business combination be reassessed for risk transfer?

Consistent with the staff's recommendation that insurance contracts acquired in a business combination be considered new business, the staff recommends that the look-back period for retrospective adjustments only return to the date of acquisition. This would be a change from the Board's earlier preference based on a different view of the acquired contract.

The initial classification of contracts as insurance or deposits is based on the significance of the insurance risk transferred as assessed at the inception of the contract. The IASB staff has prepared a paper that considers on a broad basis whether certain contract classifications should be reassessed at the date of acquisition. The staff recommends that the FASB consider that discussion for guidance on the insurance contract issue.

Issue 5: How should the acquirer account for a seller's guarantee of the adequacy of the acquiree's short-duration claims liability?

EITF Topic D-54, "Accounting by the Purchaser for a Seller's Guarantee of the Adequacy of Liabilities for Losses and Loss Adjustment Expenses of an Insurance Enterprise Acquired in a Purchase Business Combination," provides guidance that these guarantees of claims liability adequacy are no different from other guarantees and should be accounted for like those other guarantees. The intent of the Exposure Draft was to incorporate that guidance from Topic D-54 and then nullify that Topic. Accordingly, the staff believes these guarantees should be accounted for like other guarantees (as

contingencies) and measured at fair value from the date of acquisition forward. Topic D-54 would be nullified.