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Project **Insurance contracts**

Topic **Cover Note**

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### Agenda papers for this meeting

1. We have prepared the following agenda papers for this meeting:

Agenda Paper No.	Title	Objective
5	Cover note	Outlines objectives for this meeting and next steps.
5A	Margins	Gives an overview of the types of margins that can occur for insurance contracts and discusses some issues on margins relating to initial and subsequent measurement.
5B	Residual and composite margins	Discusses in more detail how to treat residual and composite margins.
5C	Acquisition costs	Discusses the treatment of acquisition costs and the part of the premium that recovers those costs.
5D	Policyholder behaviour	Provides material for a preliminary discussion on future insurance contract premium payments.

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This paper has been prepared by the technical staff of the IASB for the purposes of discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper and do not purport to represent the views of any individual members of the Board or the IASB.

Decisions made by the Board are reported in IASB *Update*.

Official pronouncements of the IASB are published only after the Board has completed its full due process, including appropriate public consultation and formal voting procedures.

**Objective of this meeting**

2. In this meeting the boards will discuss some topics on candidate measurement approaches for insurance contracts.
3. Agenda paper 5A deals with the various types of margins included in the candidate measurement approaches we are discussing in this project. Decisions the boards make on those issues will provide direction for developing a measurement approach and also will narrow down possibilities.
4. Agenda paper 5B discusses in more detail how to treat the residual and composite margins described in agenda paper 5A. The paper focuses on subsequent treatment of residual and composite margins, particularly in cases where subsequent changes in estimates occur. We will not ask for a decision on how to treat the residual and composite margins in this meeting.
5. At the February 2009 Board meetings, the boards decided that the initial recognition of an insurance contract should not result in the recognition of a day one gain in earnings or profit and loss. The staff noted at those meetings that the boards' discussion in February was not intended to reach a conclusion on acquisition costs and the part of the premium that recovers those costs; agenda paper 5C deals with this topic.
6. The purpose of Agenda paper 5D is to provide material for a preliminary discussion on future insurance contract premium payments (and other cash flows resulting from those premiums, e.g. benefits and claims). This paper does not ask the boards to make a choice between the alternatives, nor does it seek any other Board decisions; this will be part of a future Board meeting.

**Tentative decisions to date**

7. In previous meetings, the boards discussed a list of candidate measurement approaches for insurance liabilities. The following topics were addressed:

<b>Topic</b>	<b>IASB</b>	<b>FASB</b>
Features of a measurement approach	The IASB tentatively decided that a measurement approach for insurance contracts conceptually should: a) use estimates of financial market variables that are as	The FASB agreed that a measurement of the fulfilment value of an insurance contract should use expected cash flows rather than a best estimate of cash flows. The FASB also agreed that

IASB Staff paper

Topic	IASB	FASB
	<p>consistent as possible with observable market prices</p> <p>b) use explicit current estimates of the expected cash flows</p> <p>c) reflect the time value of money</p> <p>d) include an explicit margin</p>	<p>those expected cash flows should be updated each period</p> <p>The FASB agreed that the measurement of cash flows should consider all available information that represents the fulfilment of the insurance contract. All available information includes, but is not limited to, industry data, historical data of an entity's costs, and market inputs when those inputs are relevant to the fulfilment of the contract.</p> <p>The FASB will discuss time value of money and margins at a future meeting.</p>
Measurement objective	<p>The IASB discussed whether a measurement approach for insurance contracts should be based on an exit notion or a fulfilment notion. Views diverged and no clear consensus emerged.</p>	<p>The FASB agreed to explore an approach where an insurance contract is measured at a current fulfilment value rather than fair value as defined in FASB Statement No. 157, <i>Fair Value Measurements</i> (an exit value). The fulfilment value is currently not a defined measurement approach but would be based on entity-specific inputs that generally would not require consideration of market participant views.</p>
Measurement of the margin at inception	<p>The IASB tentatively decided that the margin at inception should be measured by reference to the premium and that therefore no day one gains should be recognised in profit or loss. The IASB will discuss at a future meeting how to treat acquisition costs and the part of the premium that recovers those costs.</p>	<p>The FASB agreed that in principle the initial recognition of an insurance contract should not result in the recognition of an accounting profit. However, some FASB members acknowledged that future deliberations and decisions (such as the accounting for acquisition costs) may necessitate revisiting whether an accounting profit should be recognised at inception of an insurance contract.</p>

## IASB Staff paper

Topic	IASB	FASB
Candidate measurement approaches	<p>The IASB noted the arguments for and against an approach that uses an estimate of future cash flows with no margins and no discounting. The IASB considered whether to use such an approach for non-life claims liabilities and tentatively decided not to add it to the list of candidates. The candidates to be considered at a future meeting include an unearned premium approach for short-duration pre-claims liabilities.</p> <p>The IASB discussed whether to add to the list of measurement candidates presented by the staff and asked the staff to analyse further whether to apply measurement approaches used in other existing and future standards, notably those on revenue recognition, financial instruments and non-financial liabilities.</p>	<p>The FASB will consider at a future meeting whether an approach for measuring insurance contracts would include using future cash flows with no margins and no discounting in certain instances.</p>

### Next steps

8. In May 2009, we intend to continue the discussion on margins, including the issue of cost of bearing risk and more details on guidance on risk margins. We also intend to discuss other issues related to the measurement approach, e.g. the use of unearned premium, and the discount rate.
9. In May 2009, we also intend to ask the boards to discuss and reach a conclusion on policyholder behaviour.
10. An updated project timetable is attached to this paper. The next Working Group meeting is confirmed for June 2009.

## Appendix: Timetable for Board discussions and Working Group meetings

<p><b>Contract approach</b></p> <p>We will ask the boards to discuss and reach a conclusion on the contract approach (follow-up on April 2009 Educational Board Session)</p>	May 2009
<p><b>Other issues on the measurement approach</b></p> <ul style="list-style-type: none"> <li>• Use of the unearned premium (candidate 5) for short-duration contracts</li> <li>• Margins: cost of bearing risk and subsequent measurement</li> <li>• Should other comprehensive income be used for some changes in insurance liabilities?</li> <li>• Non-performance risk</li> </ul> <p>Other relevant projects: revenue recognition, fair value measurements, employee benefits</p>	May 2009
<p><b>Discount rates</b></p> <ul style="list-style-type: none"> <li>• guidance on discount rates</li> </ul> <p>Other relevant projects: revenue recognition, fair value measurements, non-financial liabilities (IAS 37)</p>	May 2009
<p><b>Policyholder participation - classification</b></p> <ul style="list-style-type: none"> <li>• When should participation features be classified as equity and when should they be classified as liabilities? How should participation features be reported in the statements of financial position, financial performance and cash flows?</li> <li>• Are there any specific issues for mutuals?</li> </ul> <p>Other relevant projects: concepts (elements, recognition), financial instruments with characteristics of equity</p>	June 2009
<p><b>Inconsistencies with IAS 39 and IAS 18</b></p> <ul style="list-style-type: none"> <li>• For some or all financial liabilities and investment management contracts, should the Board eliminate some or all inconsistencies between the insurance contracts model and the models in IAS 39</li> </ul>	June 2009

<p>and IAS 18?</p> <ul style="list-style-type: none"> <li>• Should an insurance contract be unbundled if the contract contains more than one component?</li> <li>• Should any changes be made to the measurement attribute of assets held to back insurance contracts? (see also separate discussion for participating, unit-linked and index-linked contracts).</li> </ul> <p>Other relevant projects: revenue recognition, financial instruments</p>	
<p><b>Policyholder accounting – initial review</b></p> <ul style="list-style-type: none"> <li>• Initial review of whether the same measurement attribute is appropriate for policyholders as insurers.</li> <li>• If the same measurement attribute is appropriate, consider whether practical shortcuts are needed.</li> </ul> <p>Other relevant projects: concepts (measurement, unit of account), fair value measurements, non-financial liabilities (IAS 37)</p>	<p>June 2009</p>
<p><b>Policyholder participation - measurement</b></p> <ul style="list-style-type: none"> <li>• Consider specific measurement issues for participation features.</li> <li>• Do we need to amend the IFRS 4 definition of a discretionary participation feature (DPF)?</li> <li>• Should investment contracts with a DPF be in the scope of the insurance standard or financial instruments standards?</li> <li>• Are there any specific issues for mutuals?</li> </ul> <p>Other relevant projects: concepts (measurement), fair value measurements, financial instruments, financial instruments with characteristics of equity</p>	<p>June 2009</p>
<p><b>Meeting of Insurance Working Group</b></p>	<p>June 2009</p>
<p><b>Measurement approach</b></p> <p>We will ask the boards to discuss and reach a conclusion on the measurement approach (follow-up on February 2009 on the measurement approach)</p>	<p>July 2009</p>

<p><b>Participating, unit-linked and index-linked insurance contracts and investment contracts and universal life contracts</b></p> <ul style="list-style-type: none"> <li>• Should accounting mismatches be eliminated? If so, how?</li> <li>• If assets are held in separate funds, are they part of the reporting entity?</li> <li>• If policyholders bear part or all of the investment risk, how should this affect presentation and disclosure?</li> </ul> <p>Other relevant projects: concepts (unit of account), financial instruments, consolidation, concepts (reporting entity)</p>	<p>July 2009</p>
<p><b>Recognition and derecognition</b></p> <ul style="list-style-type: none"> <li>• When should an insurer recognise an insurance liability?</li> <li>• When should a cedant recognise reinsurance assets, especially if the underlying direct contracts have a different coverage period?</li> <li>• When should an insurer derecognise insurance liabilities and reinsurance assets?</li> </ul> <p>Other relevant projects: concepts (recognition and derecognition), derecognition, revenue recognition</p>	<p>July 2009</p>
<p><b>Definition and scope</b></p> <ul style="list-style-type: none"> <li>• Should the IFRS 4 definition of an insurance contract change?</li> <li>• Financial guarantee contracts</li> <li>• Should existing scope exclusions continue? Should new scope exclusions be added?</li> <li>• Catastrophe bonds and alternative risk transfer</li> </ul> <p>Other relevant projects: financial instruments, revenue recognition, pensions</p>	<p>July 2009</p>
<p><b>Presentation</b></p> <ul style="list-style-type: none"> <li>• Presentation of the balance sheet and the performance statement (Staff intends to discuss some presentation issues when discussing particular topics. The purpose of session is to discuss topics not discussed in earlier meetings).</li> </ul> <p>Other relevant projects: presentation of financial statements</p>	<p>September 2009</p>

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<p><b>Disclosure</b></p> <ul style="list-style-type: none"> <li>• What disclosures should be required?</li> </ul> <p>Other relevant projects: presentation of financial statements</p>	<p>September 2009</p>
<p><b>Other issues on the building blocks</b></p> <ul style="list-style-type: none"> <li>• Guarantee fund assessments</li> <li>• Tax issues</li> <li>• Salvage and subrogation</li> </ul> <p>Other relevant projects: non-financial liabilities (IAS 37), income taxes, fair value measurements</p>	<p>September 2009</p>
<p><b>Minor issues</b></p> <ul style="list-style-type: none"> <li>• Insurance contracts acquired in business combinations and portfolio transfers</li> <li>• Should some income taxes be reported as taxes on policyholders, rather than as taxes on the insurer?</li> <li>• Interim reporting</li> <li>• Transition, including transition for assets backing insurance contracts.</li> <li>• Consequential amendments</li> </ul> <p>Other relevant projects: presentation of financial statements</p>	<p>September 2009</p>
<p><b>Policyholder accounting – follow up</b></p> <ul style="list-style-type: none"> <li>• Review initial conclusions on policyholder accounting</li> </ul> <p>Other relevant projects: non-financial liabilities (IAS 37)</p>	<p>September 2009</p>
<p><b>Pre balloting</b></p>	<p>September/ October 2009</p>
<p><b>Sweep issues</b></p>	<p>November 2009</p>
<p><b>Publication of Exposure Draft</b></p>	<p>December 2009</p>
<p><b>Comments due</b></p>	<p>April 2010</p>



IASB Staff paper

<b>Summary of comments</b>	May 2010
<b>Discussion of Issues from comment letters</b> <ul style="list-style-type: none"><li>• The issues, both the content and the total number, cannot be estimated at this stage</li><li>• But we probably need to bring something to the Board every 1-2 months</li></ul>	June 2010 – January 2011
<b>Pre balloting</b>	February/March 2011
<b>Sweep</b>	April 2011
<b>Publication of final standard</b>	May 2011

Timing to be determined: consider the extent (if any) of field testing, planning for any field testing, reporting back on any field testing.