Project **Insurance contracts**

Topic **Margins**

Purpose of this paper

1. This paper deals with the various types of margins included in the candidate measurement approaches we are discussing in this project [a table attached to this paper gives an overview of those margins].

2. In agenda paper 10B (February 2009)/ FASB memorandum No. 8, staff presented five candidate measurement approaches for insurance liabilities. These approaches are:

   (a) 1- Current exit value as proposed by the discussion paper *Preliminary Views on Insurance Contracts* (DP).

   (b) 2- Current fulfilment value including a risk margin reflecting the cost of bearing risk.

   (c) 3- Current fulfilment value as in candidate 2 plus an additional separate margin, calibrated at inception to the premium.

   (d) 4- Current fulfilment value including a single margin calibrated at inception to the premium (ie similar to candidate 3, but with one overall margin, not two separate margins).

   (e) 5- Unearned premium (only for the pre-claims liability of short-duration contracts).

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.

3. This paper looks at the margins for candidates 1, 3 and 4. We will not look at candidate 2 because it is inconsistent with the boards' decision on day one differences (see paragraph 10). We will discuss candidate 5 at a future meeting.

4. This paper argues that:

   (a) If negative day one differences[1] (ie day one losses) arise, they should be recognised in profit or loss

   (b) The measurement approach for insurance contracts should include a separate risk margin that is remeasured at each reporting date.

   (c) A fulfilment notion should not include a separate service margin.

   (d) All of the margins identified in this paper for each of the candidates are part of the insurance liability.

5. The rest of this paper deals with the following subjects:

   (a) Features of margins discussed in previous meetings (paragraphs 7-17)

   (b) How to treat negative day one differences? (paragraphs 18-19)

   (c) Should the measurement approach include specified margins? (paragraphs 20-35)

   (d) Are all margins part of the insurance liability? (paragraphs 36-40)

   (e) Characteristics of risk margins (paragraphs 41-49)

[1] We defined day one differences as the difference between (1) the premium [possibly less relevant acquisition costs] and (2) the expected present value of the cash flows plus specified margins. We use the term 'day one difference' in order not to prejudge a discussion on this issue in one direction or the other.

6. This paper does not deal with:

   (a) Cost of bearing risk. Some are particularly concerned about including a cost notion for the risk margin in a fulfilment value. We will discuss cost of bearing risk at future meeting.

   (b) Acquisition costs – agenda paper 5C deals with the treatment of acquisition costs. For this paper, we assume that acquisition costs are nil.

   (c) Structure of the performance statement

   (d) Disclosure of margins

   (e) Level of aggregation of margins

   (f) Detailed guidance on margins

Features of margins discussed in previous meetings

7. In the February 2009 board meetings and previous educational sessions on a measurement approach for insurance contracts, staff identified a number of margins for each of the candidate measurement approaches and discussed some basic features of those margins. This section captures those features. Furthermore, this section analyses the impact of the boards' decision on initial measurement of the overall margin.

Basis for initial measurement

8. In February 2009, the boards discussed how to measure the margin at inception. The boards tentatively decided that the overall margin at inception should be measured by reference to the premium. Therefore, no day one gains would arise. 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 acquisition costs.

9. The decision not to recognise day one gains in profit or loss applies to both an exit notion and a fulfilment notion. As a result staff modified current exit price

(candidate 1) to include an explicit adjustment to the insurance liability after current exit value is determined that defers a positive day one difference[2]. Previously, the list of candidates included a current exit price that would recognise day one differences in profit or loss.

10. Furthermore, staff have tentatively excluded a fulfilment notion with only a margin for the cost of bearing risk (candidate 2) from the list of viable candidates. This candidate could result in the recognition of a day one gain in profit or loss and is therefore inconsistent with the boards' decision on day one gains. We therefore do not discuss candidate 2 further in this paper.

Decomposition of the overall margin at inception

11. Agenda paper 10B (February 2009)/ FASB memorandum No. 8 discussed an outline for initial measurement of the overall margin. That paper distinguished:

    (a) margins that arise from the definition of the measurement approach in question. This relates to risk margins (used in candidates 1 and 3) and service margin (used in candidate 1).

    (b) residual and composite margins[3]. A residual margin is a separate explicit adjustment to the insurance liability after current exit price or current fulfilment value is determined. A composite margin is a margin that is result from calibrating to the premium directly. Both residual margins and composite margins are, in effect, capturing any positive day one difference and result in no day one differences being recognised in profit or loss.

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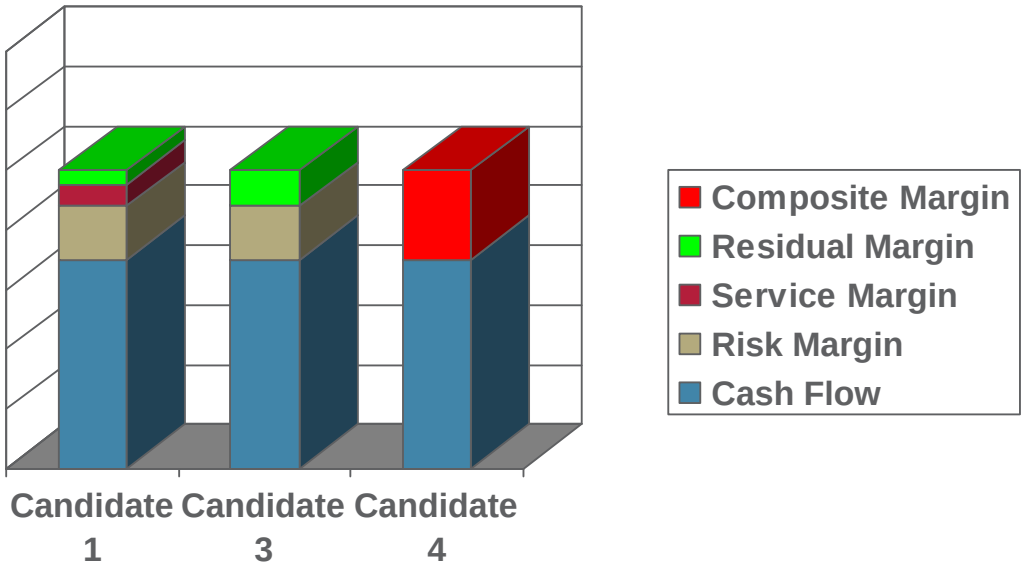
[2] In its Fair Value Measurement project, the IASB decided that any differences between transaction price and fair value (current exit price) at initial recognition are not part of fair value. Individual standards will specify whether that difference is recognised in profit or loss or deferred. For example, IAS 39 *Financial Instruments: Recognition and Measurement* would continue to specify that the difference is recognised in profit or loss only if it is evidenced by comparison with other observable current market transactions or based on a valuation technique whose variables include only data from observable markets.

[3] To add discussion, this paper uses a different term to identify the margins in each candidate. We would not necessarily recommend the same terms once the boards select an approach.

12. In addition to the table attached to this paper, the following illustration visualises the various margins for each of the candidates:



13. Candidate 1 (current exit price):

    (a) includes an estimate of the margin that market participants would require. This includes a risk margin, and also includes a margin for other services if market participants require such a margin.

    (b) may use the premium for a reasonableness check, but the premium does not override an unbiased estimate of the margin required by market participants.

    (c) may result in a day one difference. However, in line with the boards' decisions to prohibit a positive day one gain, the day one difference will not be recognised at inception in profit or loss but is treated as an explicit adjustment (residual margin) within the insurance liability.

14. The starting point for candidate 3 is the expected cost of fulfilling the obligation to the policyholder. Candidate 3 defines the cost of fulfilling the obligations as including the cost of bearing risk; because it captures the variability, we typically refer to it in this paper as a risk margin [which also facilitates the comparison with other candidates]. This measure can result in a day one difference. Candidate 3 recognises this day one difference as a part of the insurance liability, separate from

the risk margin. In previous meetings we tentatively referred to this margin as the 'additional margin'; from now on we will describe it as a residual margin. This residual margin could arise from various items, such as service margins (of the kind included in current exit value), selling margins, recovery of past investment, and measurement errors. Often, perhaps all of these factors are present and proponents of candidate 3 might argue that it is impracticable to quantify their separate effects. The residual margin cannot be negative; the insurance liability comprises at least the cost of fulfilling the obligations, including the cost of bearing risk.

15. Candidate 4 uses the premium to determine the initial overall margin, so no 'positive' day one difference can occur. Therefore, this margin would arguably include not only a margin for risk, but also other margin components. We therefore tentatively refer to this margin as a 'composite margin'. Proponents of candidate 4 do not regard a split (as included in candidate 3) between a risk margin and other components of the margin as reliable or useful. As a consequence of calibrating to the premium directly, a liability adequacy test is required at inception because the premium may not be sufficient to cover the obligations; if a 'negative' day one difference (day one loss) arises, it will be recognised in profit or loss immediately.

Basis for subsequent measurement

16. As already noted, some margins arise from the definition of a particular measurement approach. The boards already tentatively decided that the cash flows should be remeasured[4]. It seems natural that margins that are part of the definition of the approach in question are remeasured each reporting period:

    (a) Candidate 1 remeasures both the risk margin and service margin at each reporting date, based on what a market participant would require for the remaining risk and services. The margins are reported in income as the insurer is released from risk and performs services respectively.

[4] In February 2009, the IASB tentatively decided that a measurement approach for insurance contracts conceptually should use explicit current estimates of cash flows. On April 2, 2009, the FASB tentatively decided that the cash flows should be remeasured each reporting period.

(b) For candidate 3, the cost of bearing risk is considered to be one of the costs of fulfilling the obligation with the policy holder. It is remeasured at the end of each reporting period, based on the updated cost of bearing risk.

17. It is less straight forward to decide how to deal with residual and composite margins. Generally, it does not seem useful to explicitly remeasure components of the liability that are a mixture of things. Agenda paper 5B deals with the treatment of these margins for subsequent reporting.

How to treat negative day one differences?

18. Paragraphs 8-10 deal with day one gains, ie positive day one differences. However, if a premium may not be sufficient to cover the obligations; in that case day one differences will be negative. Recognising a 'negative' day one difference (ie day one loss) in profit or loss seems to be uncontroversial[5]. All of the proposed models currently included in the list of candidates recognise therefore a negative day one difference in profit or loss by either:

(a) including the requirement that a residual margin cannot be negative (candidates 1 and 3)

(b) requiring a liability adequacy test at inception (candidate 4).

19. This approach is consistent with the onerous contract test in the discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers* (DP on revenue). The DP on revenue explains that an entity should remeasure a performance obligation upwards if significant adverse changes in circumstances suggest that the measurement of the performance obligation is inadequate (ie does not depict faithfully the entity's obligation to provide goods and services to the customer).

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[5] Some are concerned with potential day one losses for contracts that are priced using an expected return on assets that exceeds the rate on government securities; this is related to choosing the right discount rate. We will come back to this issue at a later meeting.

Question for the boards
Do you agree that negative day one differences (ie day one losses) should be recognised in profit or loss?

Should the measurement approach include specified margins?

20. The previous sections imply that an overall margin of insurance contracts cannot be negative, both at inception of the contract and subsequent. We therefore know that the overall margin must be at least nil.

21. Some measurement models require that a margin is at least nil, but do not require the margin to be more than nil. Take for example the allocated transaction price model proposed in the DP on revenue. The transaction price includes an implicit margin. Adverse changes are absorbed by that margin up to a point where the contract becomes onerous. The onerous contract test proposed in the DP on revenue is a cost test and therefore requires an entity to remeasure the performance obligation to expected costs; the margin over the remainder of the contract would then be nil. Therefore, the contract can have a margin of nil at inception if the contract is sold with no margin or at a loss. A margin may also become nil over time if significant adverse changes occur during the life of the contract that would absorb the entire margin.

22. In its February 2009 meeting, the IASB decided that an insurance measurement should include an explicit margin (ie identified separately from the cash flows and time value of money)[6]. However, this decision does not yet answer the question whether one or more components of the margin must have a specified objective; those components of the margin need to be assessed at each reporting date and are typically required to be more than nil. We identified two types of margin to consider: risk margins and service margins.

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[6] In February 2009, the FASB discussed the potential components of a fulfilment value, including a margin, but did not come to any conclusions. The FASB will discuss margins at a future meeting.

Risk margins

23. The objective of including a risk margin is to convey decision-useful information to users about the uncertainty associated with future cash flows. A risk margin ensures that financial reporting does not represent two liabilities as the same if one liability is more risky than the other.

24. Insurance liabilities are characterised by an inherent variability of cash flows.

    (a) Not including a specified minimum margin could result in financial reporting representing two liabilities as the same if one liability is more risky than the other. As long as there is risk included in a liability, and presumably there is throughout the life of an insurance contract, the risk margin will be greater than nil.

    (b) Some preferred a cost test for revenue recognition (see paragraph 21) because including a margin in the onerous contract test could significantly increase the frequency of remeasurements in practice. Some might say that this, in effect, would undo the simplicity of an allocation of the original transaction price. However, this argument is arguably less appropriate when uncertainty is a significant inherent characteristic of the contract; in that case the aim of the measurement would be to report changes in circumstances promptly and transparently.

    (c) IAS 37 *Contingent Liabilities and Contingent Assets*, paragraph 42, says that risk and uncertainties shall be taken into account in the measurement of a liability. The current project to amend IAS 37 is not amending the measurement requirements for risk adjustments. It seems likely that IAS 37 would require a risk adjustment for an obligation with inherent variability of cash flows similar to an insurance contract. It arguably would be odd, some would probably even say inconsistent, that an insurance measurement would not capture variability in cash flows when IAS 37 standard does.

25. Based on the arguments in the previous paragraph, we conclude that a measurement approach for insurance liabilities should at least include a margin that conveys decision-useful information to users about the uncertainty associated with future

cash flows (a risk margin). This would apply to both initial and subsequent measurement to make sure that inherent variability of cash flows is reported throughout the life of the contract (ie the risk margin would be remeasured).

26. Two of the three candidates we discuss in this paper, by definition, require reporting on inherent variability of cash flows throughout the life of the contract (ie the risk margin is updated at each reporting period):

    (a) Candidate 1 includes a margin that market participants require for bearing risk.

    (b) Candidate 3 includes a margin for the cost of bearing risk. [As discussed earlier, candidate 3 does not actually define this as a margin, but it is convenient to analyse it as a margin for comparison with the other candidates.]

27. The other candidate, candidate 4, calibrates to the premium directly. This has the following implications:

    (a) at inception. The approach requires an onerous contract test because the premium may not be sufficient to cover the obligations. If the contract is (deemed to be) onerous, the insurance liability will include a risk margin if the liability adequacy test includes a risk margin. Candidate 4 is a fulfilment value. If the liability adequacy test includes a margin, an obvious candidate would be a margin for the cost of bearing risk like the one in candidate 3.

    (b) subsequent reporting. Candidate 4 builds on the rationale that no subsequent information will provide better evidence of the margin. As a result, the composite margin, including an implicit risk component, will not be remeasured for subsequent changes; no subsequent liability adequacy test is needed because all other building block elements are remeasured.

28. We identified the following issues with applying a risk margin to candidate 4:

    (a) in paragraph 25 staff concluded that an insurance measurement should include a risk margin. Consequently, the liability adequacy test at inception should include a risk margin. However, the rationale behind candidate 4 does not regard a split between a risk margin and other components of the margin as reliable or useful,

for both initial and subsequent measurement. It therefore seems odd to require an exercise (ie a liability adequacy test including a risk margin) that is not considered reliable or useful. Some might argue that this, in effect, results in applying candidate 3 and that, therefore, one might as well apply candidate 3 in the first place.

(b) the presumption that no subsequent information will provide better evidence of the margin means that the measurement will not pick up changes in risk. The total amount of risk can be split into the quantity of risk and the price (or cost) of risk. One could argue that a decrease in the quantity of risk is picked up by release from risk (which is one possible drive for releasing the composite margin to profit or loss). However, measuring changes in price of risk or increases in quantity of risk are arguably difficult to fit into an approach that does not measure a risk component separately. The presumption that no subsequent information will provide better evidence of the margin seems over-simplistic for insurance contracts. Variability of cash flows is a significant inherent characteristic of insurance contract, not only at inception but also throughout the life of the contract. That variability may increase or decrease during the life of the contract. If one does not measure variability explicitly, one arguably cannot be certain whether a composite margin is still an appropriate depiction of at least that inherent variability. This impact could be amplified if the measurement approach absorbs some or all changes in estimates in the composite margin [agenda paper 5B discusses this in detail].

29. As a result of the arguments in the previous paragraph, staff concludes that candidate 4 would not meet a requirement to include a risk margin throughout the life of the contract.

Question for the boards
Do you agree with staff's recommendation in paragraph 25 that a measurement approach should at least include a separate risk margin that is remeasured each reporting date? [This conclusion would in staff's view exclude candidate 4 from the list of candidates for future discussions].

Service margins

30. In its fair value measurement project, the IASB concluded that an exit price will include the margin that market participants would require for providing services other than bearing risk (although that margin may not be material in all cases)[7]. It is therefore self-evident that candidate 1, a current exit price, includes a service margin. [We note that many respondents to the DP found this point difficult to understand, even after the staff posted some questions and answers on this topic on the IASB website in October 2007.]

31. During the February 2009 meetings, some Board members suggested that a separate service margin might also be relevant to a fulfilment candidate. This was particularly noted for candidate 2; if an insurer typically requires a service margin, gains are likely to arise at initial recognition if the service margin is omitted from the initial fair value of a contract to provide services. [In paragraph 10 we explained why we did not include candidate 2 in this paper.]

32. The two fulfilment candidates we discuss in this paper, candidates 3 and 4, do not allow a positive day one difference to be recognised in profit or loss. Therefore, not including a service margin will in most cases not have an impact on profit or loss at inception [although a service margin could result in a higher day one loss if a contract is onerous or on the edge of being onerous].

33. Nevertheless, some may take the position that, similar to an exit notion, a fulfilment notion should include a separate service margin rather than include it implicitly in a residual or composite margin. A separate service margin ensures that the insurer includes and updates a margin it requires for services (if any) other than bearing risk each reporting period and reports the release of that margin in income in way that reflects that pattern of providing those services.

34. However, we identified the following issues for applying service margins to a fulfilment notion:

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[7] January 2009, Agenda paper 3E.

(a) we tentatively described current fulfilment value as 'the expected present value of the cost of fulfilling the obligation to the policyholder over time'. This definition arguably provides a basis for a risk margin (and is the basis for candidate 3). However, in our view this definition does not provide a rationale for a service margin.

(b) for a fulfilment value, the objective is to estimate the margin that the insurer would require for providing those services itself. In some cases the insurer could use margins required for activities that it also provides on a stand-alone basis, eg. some insurance groups provide fund management services or car repairs. Estimating a required separate service margin for other activities that might be seen as ancillary services is arguably less straight-forward, for example policy issue, policy administration, claims investigation, claims administration and claims payment. Under candidates 3 and 4, a service margin would be included implicitly in the residual and composite margins that follow from the actual transaction price. Proponents of candidates 3 and 4 might argue that it is impracticable and not useful to separate the service margin from any other implicit components in the margin.

35. Based on the arguments in paragraph 34, staff concludes that it is difficult to find a clear rationale for including a separate service margin in a fulfilment value. Staff therefore recommends not to require a separate service margin for candidates 3 and 4.

Question for the boards
Do you confirm candidates 3 and 4 should not include a separate service margin?

Are all margins part of the insurance liability?

36. Throughout this paper we discussed various types of margins. It seems uncontroversial that margins that flow from the definition of a particular measurement approach are part of the insurance liability. This would apply to both risk margins (used in candidates 1 and 3) and service margins (used in candidate 1).

37. As mentioned earlier, the residual and composite margins do not arise from the definition of either current exit price or current fulfilment value. So one has to decide whether these margins are either part of the total insurance liability or a separate liability outside the insurance liabilities. Staff developed the candidates on the rationale that these margins conceptually would be part of the overall insurance liability, but would be measured separately within the insurance liability. We have not found a rationale for recognising those margins outside the insurance liabilities.

38. Some refer to the residual margin of candidate 3 as an 'initial profit margin', akin to deferred income, and would recognise the day one difference as a liability, separate from the insurance liability. However, we believe that this residual margin should be regarded part of insurance liability for the following reasons:

    (a) it may be difficult, if not impossible, to describe this deferred item outside the insurance liability in such a way that it separately meets the definition of a liability.

    (b) we considered the option of treating the separated liability as a service component in line with IAS 18 *Revenue*. However, paragraph 7 of IAS 18 defines revenue as the gross inflow of economic benefits. The initial profit margin is a blend that can include service margins, margins for past origination activities and measurement errors. We find it difficult to reconcile such a blend to an approach that deals with **gross** inflows associated with servicing activities. Furthermore, applying the onerous contract test required by IAS 18 to the separated liability may be problematic.

    (c) the boards' preliminary views on revenue recognition do not seem to provide a basis to present two performance obligations from the same contract as separate items.

39. The staff view measurement candidates 1, 3 and 4 all as hybrids.

    (a) Candidate 1 is a hybrid of a current attribute (the exit price) and the remaining portion of a deferred difference (between the transaction price and the insurance liability's current exit price), determined at inception.

(b) Candidates 3 and 4 are hybrids of a current attribute (fulfilment value) and an allocated transaction price model for residual and composite margins.

40. In recommending that the margins are all conceptually part of the insurance liability, we do not intend to prejudge whether the boards should require separate disclosure of particular components of the liability. We will discuss disclosure at a future meeting.

Question for the boards
Do you agree that all margins identified for each of the candidates are part of the insurance liability rather than a separate liability outside the insurance liabilities?

Characteristics of risk margins

41. This section asks the boards for high-level direction on the characteristics of risk margins that would be included in a measurement of insurance liabilities using either an exit notion or a fulfilment notion. It is beyond the scope of this paper to discuss the guidance on risk margins in detail and to determine whether to prescribe or exclude any specific approaches for estimating risk margins. This will be part of a future meeting.

42. The DP states that the objective of a risk margin is to convey useful information to users about the uncertainty associated with the liability. As a result of including a risk margin, financial reporting does not represent two liabilities as the same if one liability is more risky than the other. The risk margin should be an explicit and unbiased estimate of the margin for bearing risk.

(a) For an exit notion, it would be the margin for bearing risk that market participants require.

(b) For a fulfilment notion, it would be the expected cost to the entity for bearing risk.

43. In principle, an adjustment for risk could be made by adjusting estimates of cash flows, adjusting the probabilities or adjusting the rate used to discount the expected

cash flows to their present values. We do not intend in this paper to prejudge whether all of these approaches are appropriate in some or all cases.

44. In the DP, the IASB expressed the view that it does not intend to prescribe specific techniques for developing risk margins. Instead, the Board intends to explain the attributes of techniques that will enable risk margins to convey useful information to users about the uncertainty associated with risk margins.

45. Respondents generally agreed that the carrying amount of insurance liabilities should include a risk margin, but most respondents wanted more information on how to estimate risk margins. Some advocated narrowing the range of acceptable methods for estimating risk margins, though many also agreed that it would be essential for the guidance to remain based on principles. Several suggested that bodies such as the International Actuarial Association (IAA) should provide more detailed guidance to support high level principles in the IFRS. The IAA is about to issue a paper on measurement of insurance liabilities, including risk margins, following exposure drafts published in February 2007 and March 2008.

46. Appendix F of the DP includes a draft discussion of those attributes. It proposes the following:

    (a) Risk margins should be explicit, not implicit. That is an important change from many existing practices that rely on estimates incorporating an implicit (and often unstated) degree of conservatism or prudence. Separating explicit estimates of future cash flows from explicit risk margins should improve the quality of estimates and enhance transparency.

    (b) The risk margin for an insurance liability should reflect all risks associated with the liability

    (c) The risk margin for an insurance liability should not reflect risks that do not arise from the liability, such as investment risk (except when investment risk affects the amount of payouts to policyholders), asset-liability mismatch risk or general operational risk relating to future transactions.

(d) The approach should be implementable at a reasonable cost and in a reasonable time, and be auditable.

(e) The approach should not ignore the tail risk in contracts with very skewed pay-offs, such as contracts that contain embedded options (eg the interest guarantees and other financial guarantees embedded in many life insurance products) or that cover low-frequency high-severity risks (such as earthquake), or portfolios that contain significant concentrations of risk.

(f) The approach should make it easy to provide concise and informative disclosure, and for users to benchmark the insurer's performance against the performance of other insurers.

(g) The approach should not overlook model risk (the risk that a model is not a good description of the underlying process) or parameter risk (the risk that a model uses estimates of parameters that differ from the true parameters, or that the parameters may change over time). However, because it may be difficult to quantify these risks and price them, care should be taken in building them into a model.

(h) For an exit notion, the margin should be as consistent as possible with observable market prices.

47. The characteristics of the risk margin are likely to include the following:

(a) The less that is known about the current estimate and its trend, the higher the risk margin should be.

(b) Risks with low frequency and high severity will have higher risk margins than risks with high frequency and low severity.

(c) For similar risks, long duration contracts will have higher risk margins than those of shorter duration.

(d) Risks with a wide probability distribution will have higher risk margins than those risks with a narrower distribution

(e) To the extent that emerging experience reduces uncertainty, risk margins will decrease, and vice versa.

48. The DP explained that, if more than one approach is compatible with the criteria described in paragraph 46 and 47, it is preferable to select an approach that builds on models that insurers use (or are developing) to run their business. For example, an insurer may be able to build on an economic capital model, an embedded value model or a model developed for solvency, if the resulting approach is compatible with the above criteria.

49. Although the DP described the risk margin as conceptually separate from the other building blocks (expected cash flows, discount rate), the staff believes that the IASB did not intend to preclude 'replicating portfolio' approaches. If a replicating asset exists for all (or, more likely, some) of the cash flows, the insurer can estimate the relevant contractual cash flows from an insurance contract without estimating their expected present value and without determining an explicit risk margin for some or all of the contractual cash flows arising. A replicating asset is one whose cash flows exactly match those contractual cash flows in amount, timing and uncertainty. If the fair value of the replicating asset is observable or determinable, the insurer can measure those contractual cash flows without estimating their expected present value and without determining an explicit risk margin.

Question for the boards
Do you have any high-level comments on the characteristics of risk margins?

Appendix: Overview of Margins Included in Candidate Measurement Approaches for Insurance Contracts

Candidate		**Margin components**	**Objective of the margin**	**Classification**	**Subsequent measurement**
1	Current exit price	Risk margin	Compensation for bearing risk required by a market participant	Part of current exit price	Update at each subsequent reporting date.
		Service margin	Margin required by market participant for services other than the service of bearing risk	Part of current exit price	Update at each subsequent reporting date.
		Deferred day one difference	Avoid any positive day one difference from being recognised in profit or loss	Part of the overall measurement of the liability, but not part of the liability's current exit price	Released to profit or loss over time based on an appropriate driver.

Candidate		Margin components	Objective of the margin	Classification	Subsequent measurement
3	Current fulfilment value – margin for cost of bearing risk plus an additional margin	Risk margin	The cost of bearing risk, measured from the particular insurer's perspective	Part of the liability's fulfilment value	Update at each subsequent reporting date.
		Additional margin	Avoid any positive day one difference from being recognised in profit or loss (consistency with revenue recognition)	Part of the overall measurement of the liability, but not part of the liability's fulfilment value	Released to profit or loss over time based on an appropriate driver. Possibly adjusted for subsequent changes in estimates other than (financial) market variables.
4	Current fulfilment value – composite margin	Composite margin	Capture the margin as implied by the actual transaction with the policyholder (premium) (consistency with revenue recognition)	Part of the overall measurement of the liability, but not part of the liability's fulfilment value	Released to profit or loss over time based on an appropriate driver. Possibly adjusted for subsequent changes in estimates other than (financial) market variables.
5	Unearned premium	Implicit margin	N/A	Margin as implied by the premium, part of the unearned premium (performance obligation)	Implicitly released in recognising revenue from the release of the unearned premium.