Project **Insurance Contracts**

Topic **Cover note**

Agenda papers for this meeting

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

Agenda Paper No. / (FASB Memorandum)	Title	Objective
7 (32)	Cover note	Outlines objectives for this meeting and next steps.
7A (32A)	Measurement objective	Discusses the objective for the measurement model.
7B (32B)	Margins	Discusses the issue of margin, for both initial and subsequent measurement.
7C (32C)	Embedded derivatives	Discusses the treatment of embedded derivatives within insurance contracts.
7D (32D)	Unbundling	Discusses unbundling of an insurance contract.
7E (32E)	Presentation	Discusses the presentation of the performance statement for insurance contracts
7F (32F)	Timetable	Gives the time table for Board discussions.

16	Other comprehensive income	Addresses the use of other comprehensive income for insurance contracts.

Objective of the meeting

2. Agenda papers 7A-7F will be discussed at the December joint meeting.

3. At their October joint meeting, the boards discussed the similarities and differences between their preliminary decisions on a measurement approach. The boards asked the staff to draft a measurement objective that included both boards' views and tentative decisions made to date on measurement. Agenda paper 7A (FASB Memorandum 32A) provides a draft of a measurement objective for insurance contracts with an analysis of the language (and intent of the language) used in that objective.

4. Agenda paper 7B (FASB Memorandum 32B) discusses the accounting treatment for margins in an insurance contract, both at inception of the contract and for subsequent reporting periods, including the issue of a risk margin.

5. Agenda paper 7C (FASB Memorandum 32C) discusses the accounting treatment for derivatives embedded within the context of a building block model for insurance contracts.

6. An insurance contract may contain insurance, deposit (or financial) and service components. Agenda paper 7D (FASB Memorandum 32D) discusses whether to account for those components of a contract as if they were separate contracts (unbundling).

7. Agenda paper 7E (FASB Memorandum 32E) discusses the structure of the statement of comprehensive income (performance statement) and includes examples that illustrates the presentation models discussed in that paper.

8. Agenda paper 16 will be discussed at meetings of the individual boards: This paper discusses whether the boards should permit or require insurers to use other comprehensive income (OCI) for remeasurements of insurance liabilities if

financial assets held to back those liabilities are not carried at fair value through profit or loss.

Tentative decisions to date

9. In previous meetings, the boards discussed a list of candidate measurement approaches for insurance liabilities. The appendix to this paper gives an overview of the topics that were addressed.

10. After the December joint meeting, considering input from that meeting, the staff will seek to develop a common wording for decisions that are similar.

Appendix: Overview of topics discussed at previous meetings

Topic	IASB	FASB
Building Blocks	The IASB tentatively decided that the measurement for insurance contracts should include three building blocks: • current estimates of expected (that is, probability-weighted) future cash flows, • incorporation of time value of money, and • an explicit margin.	The FASB agreed that at a high-level the measurement for insurance contracts should include three building blocks: • current estimates of expected (that is, probability-weighted) future cash flows, • incorporation of time value of money, and • a margin.
Candidate measurement approaches	The IASB tentatively selected the approach being developed in the project to amend IAS 37, modified to exclude day one gains. Nevertheless, a significant minority of Board members supported the approach based on current fulfilment value. Therefore, the exposure draft will explain both approaches.	The FASB tentatively selected a current fulfilment approach with a composite margin.
Exclude discounting and margins in some instances?	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 FASB will consider at a future meeting whether, in certain instances, a measurement of insurance contracts would use future cash flows with no margins and no discounting.

Topic	IASB	FASB
Use of inputs	A measurement approach for insurance contracts conceptually should use current estimates of financial market variables that are as consistent as possible with observable market prices The measurement of cash flows should be discounted and the discount rate should be updated each reporting period.	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. The measurement of cash flows should be discounted and the discount rate should be updated each reporting period.
Unearned Premium	The IASB decided tentatively that: (a) an unearned premium approach would provide decision-useful information about pre-claims liabilities of short-duration insurance contracts. (b) to require rather than permit the use of an unearned premium approach for those liabilities.	The FASB will discuss an unearned premium approach at a future meeting.
Measurement of margins at inception	The margin at inception should be measured by reference to the premium. Therefore no day one gains should be recognised in profit or loss. If the initial measurement of an insurance contract results in a day-one loss, the insurer should recognise that day-one loss in profit or loss.	In principle the initial recognition of an insurance contract should not result in the recognition of an accounting profit. The FASB will discuss this issue (day-one loss) at the December meeting.

Topic	**IASB**	**FASB**
Subsequent treatment of margins	On the residual margin, the IASB decided tentatively that: a) the driver selected for releasing the residual margins should result in recognising those margins in income in a systematic way that best depicts the insurer's performance under the contract. b) the residual margin should be released over the period during which the insurer is standing ready to accept valid claims (the coverage period). c) the insurer should not adjust the residual margin in subsequent reporting periods for changes in estimates.	The FASB will discuss the subsequent treatment of margins at the December meeting.
Discount rates	The IASB decided tentatively that: a) the discount rate for insurance liabilities should conceptually adjust estimated future cash flows for the time value of money in a way that captures the characteristics of that liability rather than using a discount rate based on expected returns on actual assets backing those liabilities b) the standard should not give detailed guidance on how to determine the discount rate	The FASB will discuss this issue further at a future meeting.
Acquisition costs	An insurer: • should expense all acquisition costs when incurred. • should not recognize any revenue (or income) to offset those costs incurred.	An insurer: • should expense all acquisition costs when incurred. • should not recognize any revenue (or income) to offset those costs incurred.

Topic	**IASB**	**FASB**
Policyholder behaviour and contract boundaries	The measurement should include the expected (ie probability-weighted) cash flows (future premiums and other cash flows resulting from those premiums, eg benefits and claims) resulting from those contracts, including those cash flows whose amount or timing depends on whether policyholders exercise options in the contracts. To identify the boundary between existing contracts and new contracts, the starting point would be to consider whether the insurer can cancel the contract or change the pricing or other terms. The staff will develop more specific proposals for identifying the boundary.	The FASB will discuss this issue further at a future meeting.
Deposit floor	The IASB confirmed that, applying tentative decisions it has already made on policyholder behaviour, no deposit floor applies in measuring insurance contracts.	The FASB will discuss this issue at a future meeting.
Participating features in insurance contracts	The IASB expressed an initial preference for an approach that includes all cash flows that arise from a participating feature in the measurement of the insurance liability on an expected present value basis. The participating feature is not considered separately for recognition, classification and measurement, but rather as part of the whole contract.	The FASB expressed an initial preference for an approach that analyses cash flows expected to arise from a participating feature to determine whether those flows are required (eg by the contract or by a statute) or are discretionary. Required cash flows (if there are any) will be included in the measurement of the insurance liability. Discretionary cash flows will be recognised when the entity has an obligation to make payments.

Topic	**IASB**	**FASB**
Recognition	The IASB discussed the recognition of rights and obligations arising under insurance contracts, including the treatment of the contract in the period (if any) between entering into the contract and the start of the coverage period. No clear consensus emerged. The Boards will return to the topic of recognition at a future meeting.	The FASB tentatively decided that an entity should recognize an insurance obligation at the earlier of (1) the entity being on risk to provide coverage to the policyholder for insured events and (2) the signing of the insurance contract.
Derecognition	The IASB discussed derecognition of insurance liabilities and decided tentatively that that an insurer should derecognise an insurance liability when it no longer qualifies as a liability of the insurer, applying the derecognition principle in IAS 39 *Financial Instruments: Recognition and Measurement*.	The FASB tentatively decided on a principle that an insurance liability should be derecognized by an entity when that obligation no longer qualifies as a liability. The liability is eliminated when the entity is no longer on risk and no longer required to transfer any economic resources for that obligation.
Policyholder accounting	The IASB asked the staff to prepare an analysis of policyholder accounting with the goals of • Identifying possible issues arising from lack of symmetry between policyholder accounting and the accounting by the issuer of the insurance contract and • Any similarities with accounting for reinsurance contracts from the perspective of the policyholder.	The FASB asked the staff to prepare an analysis of policyholder accounting with the goals of • Identifying possible issues arising from lack of symmetry between policyholder accounting and the accounting by the issuer of the insurance contract and • Any similarities with accounting for reinsurance contracts from the perspective of the policyholder.