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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **February 2009, London**

Project: **Insurance Contracts**

Subject: **Measurement (Addendum to Agenda paper 10)**

PURPOSE OF THIS MEMORANDUM

1. At the February 11, 2009 FASB Education session on the measurement approach for insurance contracts, the FASB members noted that they would benefit from a high-level overview that would distinguish the decisions the staff are seeking at this Board meeting from other (more detailed) aspects of a measurement approach that will be discussed at future meetings; particularly with respect to the questions on the measurement objective and the margin at inception.

2. The purpose of this memorandum is to assist the Boards in analyzing the decisions the staff are seeking at this Board meeting by summarizing:

   a. what decisions are the staff seeking from the Boards on the measurement of insurance contracts for this meeting and

   b. what aspects of the measurement attribute will be addressed at future Board meetings (considering the direction the Boards provide during this meeting).

3. Staff attached to this paper a list of the candidates and a tabular overview of the margins for candidates 1-4 for reference purposes.

DECISIONS THE STAFF ARE SEEKING AT THE BOARD MEETING

4. The first question (paragraph 8 in Agenda Paper 10A / Board Memorandum No. 7) asks the Boards to confirm that the measurement approach for insurance contracts conceptually should (1) use estimates that are as consistent as possible with observable market prices, (2) use explicit current estimates of the expected cash flows, (3) reflect the time value of money, and (4) include an explicit margin. This would not preclude the use of practical expedients in some cases; for example as a result of cost-benefit considerations.

5. The views for the questions on the measurement objective (paragraph 27 in Agenda Paper 10A / Board Memorandum No. 7) and the margin at inception (paragraph 35 in Agenda Paper 10A / Board Memorandum No. 7) are as follows:

Questions	Potential Views / Decisions				
What should the measurement objective for insurance liabilities be?	**View A** Exit notion		**Views B or C** Fulfillment notion[1]		
	Candidate 1 – Current exit value		**Candidate 2 –** Current fulfillment value, including a risk margin reflecting what the insurer requires for bearing risk	**Candidate 3 -** Current fulfillment value, including a risk margin reflecting what the insurer requires for bearing risk plus an additional separate margin, calibrated at inception to the premium	**Candidate 4 –** Current fulfillment value, including a single margin calibrated at inception to the premium
How is the margin of the <u>insurance liability</u> measured at inception: should 'positive' day one differences be recognized in earnings at inception?	**Yes**, recognize difference in earnings	**No**, recognize as a separate explicit adjustment[2]	**Yes**, recognize difference in earnings	**No,** calibrate the overall margin to the premium at inception	

[1] Views B and C differ in the basis for arriving at a fulfillment notion.
[2] This view represents a variation of Candidate 1 as presented in the list of candidates. This variation has not been included in the list of candidates yet, but will, if necessary, be included in the list for future meetings.

DECISIONS TO BE MADE AT A FUTURE BOARD MEETING

6. The following is a list of aspects that will need to be addressed at future Board meetings related (either directly or indirectly) to a measurement approach of insurance contracts (however, this list is not intended to be exhaustive):

a. Should the unearned premium (Candidate 5 in Agenda Paper 10A / Board Memorandum No. 7) be used in the case of short-duration contracts, either as a reasonable approximation for one of the other candidates or the designated measurement approach in the case of short-duration contracts?

b. What guidance should be given on estimating the cash flows (for example, sources of estimates, using current estimates, which cash flows, etc.)?

c. Acquisition costs: If expensed at inception, is revenue accelerated? If not expensed at inception, how should acquisition costs be amortized?

d. Margins:

   i. What level of guidance should be given on estimating margins?

   ii. For a fulfillment notion with no 'positive' day one differences recognized in earnings: should the overall margin be split into a risk margin and other components?

   iii. How are the margins measured in subsequent periods (that is, are they amortized in a rational manner, remeasured, etc.)?

e. What structure should the performance statement have?

f. Should non-performance risk be included in the measurement of the liability, particularly for subsequent measurement?

g. What are the attributes of the discount rate?

h. Could other comprehensive income be used for recognizing some changes in insurance liabilities?

i. What is the minimum unit of recognition for an insurance contract? (policyholder behavior and policyholder participation)

j. Should an insurance contract be unbundled if the contract contains more than one component?

Candidates (tentatively):

- (1) Current exit value (as in DP)
- Current fulfilment value (3 versions)
  - (2) risk margin reflecting cost of bearing risk
  - (3) risk margin reflecting cost of bearing risk plus an additional margin
  - (4) margin calibrated at inception to the premium
- (5) Unearned premium – pre-claims short-duration

Margins for candidates 1-4