Project **Insurance Contracts**

Topic **Cover note**

Agenda papers for this meeting

1. We have prepared the following agenda papers for the July meetings:

Agenda Paper No.	Title	Objective
11	Cover note	Outlines objectives for the July meetings and next steps.
11A	Measurement approach for Insurance contracts	Discusses the measurement approaches that are applicable to all insurance contracts.
11B	Unearned premium model	Discusses whether an unearned premium approach should (or could) be applied to some insurance liabilities (pre-claims liabilities arising under short duration contracts).
11C	Candidate measurement approaches – tabular comparison	Provides a tabular overview of differences and similarities between the candidate measurement approaches.
11D	Acquisition costs	Deals with the accounting for acquisition costs arising from insurance contracts.

11E	Timetable	Gives the time table for Board discussions.

Objective of the July meetings

2. At the July Joint Board meeting, staff will ask the boards to conclude on the measurement approach for insurance contracts. In preparation for that meeting, staff will ask each Board to take an indicative vote on the candidate measurement approaches in the July 21 FASB meeting and the July 22 IASB meeting.

3. We aim at publishing an exposure draft in December 2009. In order to achieve this, it is critical that the boards conclude on the measurement approach during their July meetings.

4. Agenda paper 11A discusses the measurement approaches that are applicable to all insurance contracts. When discussing these measurement approaches with the boards, staff will focus on the main features of models. This paper will be a basis for both the indicative vote at the July 21 FASB meeting and the July 22 IASB meeting and the discussion on measurement at the July joint meeting.

5. Agenda paper 11B discusses whether an unearned premium approach should (or could) be used for pre-claims liabilities of short-duration contracts. We intend to discuss this paper at separate Board meetings and do not expect it to be addressed at the July joint meeting.

6. The table in agenda paper 11C compares the measurement candidates we consider for selection in the July meetings; this table will be used as reference material during both the preparatory meetings and the July joint meeting.

7. In previous meetings, the boards reached different tentative decisions on acquisition costs. Agenda paper 11D seeks to develop a common view between the boards about the accounting for acquisition costs. Because both boards already reached tentative decisions, this paper is prepared for a discussion at the July joint meeting.

8. Agenda paper 11E includes the updated time table for Board discussions.

Tentative decisions to date

9. In previous meetings, the boards discussed a list of candidate measurement approaches for insurance liabilities. An overview of the topics that were addressed is included in the appendix to this paper.

Next steps

10. In September, staff will bring back guidance on measurement in more detail. One way to do this would be to structure the Board discussions around draft measurement guidance developed for the exposure draft.

11. Other issues that the staff is likely to bring to the boards early on are discount rates, changes in insurance liabilities (including the use of other comprehensive income) and participating contracts.

12. Staff also intends to start up the field testing activities, provided that the boards make some progress on measurement during the July meetings.

Appendix: Overview of topics discussed at previous meetings

Topic	IASB	FASB
Candidate measurement approaches	The IASB decided tentatively to include in the list of candidates a measurement approach based on the updated model being developed in the project to amend IAS 37 (modified to exclude day one gains). The Board also tentatively removed the following candidates from that list: (a) a fulfilment value that includes a margin for the cost of bearing risk and a residual margin (former candidate 3) (b) a current exit price (modified to exclude day one gains, former candidate 1) 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. 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.	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, *Fair Value Measurements* (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. The FASB will further discuss the candidate measurement approaches at its July 21 meeting. 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.

Topic	**IASB**	**FASB**
Features of a measurement approach	A measurement approach for insurance contracts conceptually should: (a) use estimates of financial market variables that are as consistent as possible with observable market prices (b) use explicit current estimates of the expected cash flows (c) reflect the time value of money (d) include an explicit margin.	A measurement of the fulfilment value of an insurance contract should use expected cash flows rather than a best estimate of cash flows. Those expected cash flows should be updated each 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 FASB will discuss time value of money and margins at a future meeting.
Measurement of the margin at inception	The margin at inception should be measured by reference to the premium and therefore no day one gains should be recognised in profit or loss (except for the part of the premium that covers acquisition costs, as discussed in more detail below). 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 a future meeting.
Margins	The IASB discussed some topics on margins. Views diverged and no clear consensus emerged. The Board will return to the topic of margins at a future meeting.	The FASB discussed several aspects of the accounting for risk margins. The FASB did not reach any decisions on these issues and will continue the discussion at a future meeting.

Topic	IASB	FASB
Acquisition costs	The Board discussed an example in which two insurers issue identical insurance contracts but incurred different acquisition costs and, as a result, charged premiums that differ by the same amount. The Board decided tentatively that those contracts should have the same initial measurement. As a follow up, the Board decided tentatively that at inception an insurer should recognise as revenue the part of the premium that covers acquisition costs. For this purpose, acquisition costs should be limited to the incremental costs of issuing (ie selling, underwriting and initiating) an insurance contract and should not include other direct costs. Incremental costs are those costs that the insurer would not have incurred if it had not issued those contracts.	An entity: • 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.