Project **Insurance contracts**

Topic **Cover Note**

Agenda papers for this meeting

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

Agenda Paper No.	Title	Objective
10	Cover note	Outlines objectives for this meeting and next steps.
10A	Measurement approach for Insurance contracts	Analyses the list of candidate measurement approaches.
10B	The updated IAS 37 model as a candidate for insurance contracts	Analyses how the measurement approach being developed in the project to amend IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (the updated IAS 37 model) could be applied to insurance contracts.
10C	Current exit price	Considers whether the IASB should retain current exit price as one of the candidate measurement approaches for insurance contracts.

10D	Candidate measurement approaches – tabular comparison	Provides a tabular overview of differences and similarities between the candidate measurement approaches
10E	Field Testing	Includes the staff's recommendations for field testing.
10F	Timetable	Gives the time table for Board discussions and Working Group meetings.

Objective of this meeting

2. In this meeting the boards will continue their debate on candidate measurement approaches for insurance contracts.
3. Agenda paper 10A analyses the list of candidate measurement approaches and proposes some changes to the list of candidate measurement approaches for insurance contracts. We will ask the boards to confirm those changes. We will not ask the boards to select one of the candidates at this meeting.
4. In support of agenda paper 10A, Agenda paper 10B analyses how the updated IAS 37 model could be applied to insurance contracts.
5. Agenda paper 10C considers for the IASB Board whether current exit price (modified to exclude day one gains) should be retained as one of the candidate measurement approaches for insurance contracts.
6. The purpose of Agenda paper 10E is to give the staff's recommendations for field testing the proposals in the Insurance Contracts Project and ask the boards for high level comments on the approach and timing.
7. Agenda paper 10F includes the time table for Board discussions and Insurance Working Group meetings.

Tentative decisions to date

8. 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

9. In July 2009, we intend to ask the boards to conclude on the measurement approach for insurance contracts. We do not expect to get a conclusive answer on all the features of the measurement approach in that meeting, but we are aiming for a decision on key areas like the measurement objective.

10. In June we also intend to discuss whether to use the unearned premium approach for the pre-claims period of short duration contracts.

11. In previous meetings, the boards reached different tentative decisions on acquisition costs. Staff also intends to bring back this issue at a future meeting in order to reach a consistent answer.

Appendix: Overview of topics discussed at previous meetings

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 objective	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.	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.
Measurement of the margin at inception	The 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 (except for the part of the premium that covers acquisition costs, as discussed	In principle the initial recognition of an insurance contract should not result in the recognition of an accounting profit.

Topic	IASB	FASB
	in more detail below). The Board decided tentatively that 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.	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
Candidate measurement approaches	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 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.
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	An entity: • should expense all acquisition costs when incurred. • should not recognize any revenue (or income) to offset those costs incurred.

Topic	IASB	FASB
	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.	
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 at a future meeting.