Project **Insurance Contracts**

Topic **Cover note**

Agenda papers for this meeting

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

Agenda Paper No. / (FASB Memorandum)	Title
14 (39)	Cover note
14A (39A)	Universal life insurance and other account-driven contracts
14B (39B)	Variable and unit-linked contracts – Separate accounts
14C (39C)	Unbundling
14D (39D)	Unbundling- alternative view
14E (39E)	Presentation of the performance statement
14F (39F)	Field test results
14G (39G)	Timetable

Objective of the meeting

2. Agenda paper 14A (FASB Memorandum 39A) addresses the accounting for *account-driven* life insurance and annuity contracts. In agenda paper 14B

(FASB Memorandum 39B), we consider the accounting for the type of account-driven contracts generically referred to as *unit-linked* or *variable* insurance and annuity contracts. In particular, we address questions about whether the invested fund into which the premium is deposited represents an asset and corresponding liability of the insurance entity.

3. An insurance contract may contain insurance, deposit (or financial) and service components. Agenda papers 14C and 14D (FASB Memorandum 39C and 39D) discuss whether to account for those components of a contract as if they were separate contracts (unbundling). Agenda paper 14C (FASB Memorandum 39C) discusses one approach developed by some staff members. Agenda paper 14D (FASB Memorandum 39C) discusses an alternative approach developed by other staff members.

4. Agenda paper 14E (FASB Memorandum 39E) discusses the structure of the statement of comprehensive income (performance statement) and includes examples that illustrate the presentation models discussed in that paper.

5. Agenda paper 14F (FASB Memorandum 39F) summarises the results of the IASB field testing carried out between September and December 2009.

Tentative decisions to date

6. The appendix to this paper gives an overview of the boards' previous discussions.

7. The table in the appendix shows one single decision for those issues on which the boards reaches a similar tentative conclusion. If the boards reached different tentative conclusions or one of the boards has an outstanding discussion for a particular topic, a status is presented for each Board separately.

Appendix: Overview of topics discussed at previous meetings

<table>
<tr><th>Topic</th><th>IASB</th><th>FASB</th></tr>
<tr><td>Measurement approach</td><td colspan="2">The boards decided tentatively that the measurement approach should portray a current assessment of the contract, using the following building blocks:
the unbiased, probability-weighted average of future cash flows expected to arise as the insurer fulfils the obligation;
incorporation of time value of money;
a risk adjustment for the effects of uncertainty about the amount and timing of future cash flows; and
an amount that eliminates any gain at inception of the contract.
The boards also tentatively decided that:
these building blocks should be used to measure the combination of rights and obligations arising from an insurance contract rather than to measure the rights separately from the obligations. That combination of rights and obligations should be presented on a net basis.
the objective for measuring an insurance contract should refer to a value rather than cost. The staff will refine the description of that objective.</td></tr>
<tr><td>Risk adjustment</td><td colspan="2">The boards decided tentatively that the risk adjustment should measure the insurer's view of the uncertainty associated with the future cash flows and clarified that:
the risk adjustment should be the amount the insurer requires for bearing the uncertainty that arises from having to fulfil the net obligation arising from an insurance contract. The staff will develop guidance on how to determine the risk adjustment.
the risk adjustment should be updated (remeasured) each reporting period.</td></tr>
<tr><td>Non-performance risk</td><td colspan="2">The boards decided tentatively that the measurement of an insurance liability should not be updated for changes in the risk of non-performance by the insurer.</td></tr>
<tr><td>Use of inputs</td><td colspan="2">The boards decided tentatively that the measurement 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, and
should use current estimates of financial market variables that are as consistent as possible with observable market prices.</td></tr>
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<table>
<tr><th>Topic</th><th>IASB</th><th>FASB</th></tr>
<tr><td>Exclude discounting and margins in some instances?</td><td>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.</td><td>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.</td></tr>
<tr><td>Unearned Premium</td><td>The IASB decided tentatively that:
an unearned premium approach would provide decision-useful information about pre-claims liabilities of short-duration insurance contracts.
to require rather than permit the use of an unearned premium approach for those liabilities.</td><td>The FASB will discuss an unearned premium approach at a future meeting.</td></tr>
<tr><td>Measurement of margins at inception</td><td colspan="2">In principle the initial recognition of an insurance contract should not result in the recognition of an accounting profit.

In the proposed accounting approach, a loss arises at inception if, after applying a risk adjustment, the expected present value of cash outflows exceeds the expected present value of cash inflows. The boards tentatively decided that an entity should recognise that loss in profit or loss at inception.</td></tr>
<tr><td>Subsequent treatment of residual margins</td><td colspan="2">The proposed accounting approach eliminates any gain at inception by including a residual margin in the measurement of the combination of rights and obligations arising from the insurance contracts. The boards tentatively decided :
to develop specific guidance on how the residual margin should be released to profit or loss over time.
that the insurer should not adjust the residual margin in subsequent reporting periods for changes in estimates.</td></tr>
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<tr><th>Topic</th><th>IASB</th><th>FASB</th></tr>
<tr><td>Discount rates</td><td>The IASB decided tentatively that:
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
the standard should not give detailed guidance on how to determine the discount rate</td><td>The FASB will discuss this issue further at a future meeting.</td></tr>
<tr><td>Acquisition costs</td><td colspan="2">The boards decided tentatively that an insurer:
should expense all acquisition costs when incurred.
should not recognize any revenue (or income) to offset those costs incurred.</td></tr>
<tr><td>Policyholder behaviour and contract boundaries</td><td colspan="2">The decided tentatively that the policyholder options, as well as options, forwards, and guarantees related to existing coverage, should be included in the measurement of the insurance contract on a look through basis using the expected value of future cash flows (to the extent that those options are within the boundary of the existing contract). As a consequence, no deposit floor would apply. For a future discussion, the staff will develop material to identify the boundary of an existing contract.
The staff will do additional analysis as to whether an option pricing model can be used to measure the contract. The staff intends to provide that information at a future meeting as part of a discussion about risk margins.

The boards also discussed how to treat options, forwards, and guarantees that do not relate to the existing insurance contract coverage. The boards tentatively decided to exclude such features from the measurement of that contract. Instead, those features should be recognised and measured as new insurance contracts or other stand-alone instruments, according to their nature.</td></tr>
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Topic	**IASB**	**FASB**
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 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.
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.

Topic	**IASB**	**FASB**
Unbundling	The IASB decided tentatively that, for recognition and measurement, an insurer should: • unbundle a component of an insurance contract if it is not interdependent with other components of that contract, • not unbundle a component that is interdependent.	The FASB decided tentatively that if unbundling is not required for recognition and measurement, it should not be a permitted option. The FASB asked staff to clarify further how unbundling for recognition and measurement relates to (a) the definition of an insurance contract and the scope of the proposed standard, (b) the presentation models for the performance statement, and (c) bifurcation of embedded derivatives.
Presentation of the performance statement	The boards tentatively rejected a model that recognises revenue on the basis of written premiums (rather than recognising revenue as the insurer performs under the contract).	
Other comprehensive income (OCI)	The IASB decided tentatively: • not to change the accounting for an insurer's assets. • not to permit or require the use of OCI for insurance contracts.	The FASB will discuss OCI at a future meeting.