



Project	Insurance Contracts
Topic	Policyholder accounting

Purpose of this paper

1. At the October joint meeting, the boards asked the staff to prepare an analysis of policyholder accounting with the goals of identifying:
 - (a) possible issues arising from lack of symmetry between policyholder accounting and the accounting by the issuer of the insurance contract and
 - (b) any similarities with accounting for reinsurance contracts from the perspective of the policyholder (the cedant).
2. This paper discusses (a). Agenda Paper 1A/38A discusses the treatment of reinsurance contracts by the cedant.
3. In February 2002, the IASB decided tentatively to pursue a simplified measurement model for policyholders. Since that discussion, work on policyholder accounting has been suspended because of other priorities. Appendix A sets out the model discussed in 2002 but this paper does not consider that model further. Instead it analyses how the model developed so far for insurers would apply to policyholders, whether any lack of symmetry might arise and if so, whether that is something that needs to be addressed at this stage of the project.

This paper has been prepared by the technical staff of the FASB and the IASCF for discussion at a public meeting of the FASB or the IASB.

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Summary of staff recommendations

Accounting by insurers

4. The staff has identified two types of potential difference between the model for insurers and a symmetrical model for policyholders. The first are differences that would arise because it seems unlikely that the boards would wish to apply the insurer model in a symmetrical manner to policyholders. The second are differences that might arise if the model were applied symmetrically, but different answers arose in practice, eg because of different assessments of future cash flows and risk adjustments by the insurer and policyholder.
5. On the first type of difference, the staff concludes that there are three differences that could arise because the boards may not wish to apply the proposal for insurers in a symmetrical manner to policyholders:
 - (a) the proposal not to update the measurement for changes in an insurer's non-performance risk. However, the staff does not think that is a reason for the boards to reconsider that proposal for insurers;
 - (b) the proposal not to capitalise acquisition costs and to prohibit the recognition of any revenue (or income) to offset those costs. The staff thinks this is something the boards may wish to consider in deciding on the insurer's approach to acquisition costs¹; and
 - (c) the FASB's preferred approach to participating features. A symmetrical application of this approach would probably give rise to day one losses for policyholders even though the policyholders presumably regard the transaction as an exchange of equal value. The staff thinks this is something the boards may wish to consider in deciding on the insurer's approach to participating features².

¹ The staff plans to bring a paper on acquisition costs to the boards in March.

² The staff plans to bring a paper on participating features to the Board in a later meeting.

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6. The second type of differences are those that might arise if the model were applied symmetrically, but the insurer and policyholder made different assessments of future cash flows and risk adjustments. In relation to these, the staff concludes that there are various situations in which the insurer and policyholder would measure the insurance contract at different amounts. However, the staff also concludes that these different measurements arise because of different assessments of future cash flows and risk-adjustments. Such differences are inevitable, and not something that the boards need to address further at this stage.

Accounting by policyholders

7. The staff thinks that the analysis in the paper demonstrates that the proposed model for insurers could, in principle, be applied to policyholders. However, there are a number of issues that would need to be discussed and resolved for policyholders, for example the issue of day one gains for policyholders. Based on the discussions in this paper and given the project timetable, the staff does not think the boards should consider policyholder accounting in more detail (other than reinsurance) before issuing the ED on accounting by insurers.

Staff analysis

8. The staff identified three main groups of insurance policyholders:
 - (a) holders of insurance contracts that provide employee benefits
 - (b) holders of short-duration insurance contracts
 - (c) holders of other insurance contracts.

Insurance contracts that provide employee benefits

9. Insurance contracts that provide employee benefits fall within the scope of IAS 19 *Employee Benefits* and ASC 715-30-35.

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- (a) Under IAS 19, if insurance contracts exactly match the amount and timing of some or all of the benefits payable under a defined benefit plan, they are measured at the present value of the related benefit obligations (with a reduction if the amounts receivable under the insurance contract are not recoverable in full).
 - (b) Under ASC 715-30-35-53, to the extent that benefits currently earned are covered by annuity contracts, the cost of those benefits shall be the cost of purchasing the contracts.
 - (c) Under both IAS 19 and US GAAP, other plan assets that take the form of contracts with insurance entities are measured at fair value.
10. The staff acknowledges that these measurement requirements are different to that being developed for insurers and hence will give rise to measurement asymmetry. However, the intent of the requirements described in 8(a) and (b) (which give the same result as each other in practice) is to eliminate accounting mismatches between the measurement of the plan assets and the measurement of the benefit obligation. It is beyond the scope of this project to consider changes to those requirements. In respect of the requirement in 8(c), the boards have already decided not to propose that insurers use a fair value measurement for insurance contracts.

Holders of short-duration insurance contracts

11. Most policyholders of contracts not providing employee benefits are individuals (households) and entities (businesses). Most households do not need accounting guidance and, for most entities, the purchase of an insurance contract is not a significant expense. Further, the IASB decided tentatively that:
- (a) an unearned premium approach would provide decision-useful information about pre-claims liabilities of short-duration insurance contracts and
 - (b) to require rather than permit the use of an unearned premium approach for those liabilities.

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12. The staff thinks that a holder of a short-duration insurance contract would recognise an asset for a prepayment of the premium and would amortise that asset over the coverage period. The staff thinks that such an approach would be symmetrical with an unearned premium approach for the insurer, except:
- (a) the insurer would apply a liability adequacy test to its liability which would not apply to the policyholder
 - (b) the policyholder would apply an impairment test to its asset which would not apply to the insurer (because the boards have tentatively decided to exclude from the measurement by the insurer the effect of changes in the insurer's non-performance risk).
13. Applying a liability adequacy test to liabilities and an impairment test to assets is a common feature of cost models for liabilities and assets. The staff sees no need for the boards to consider these differences further at this stage.

Holders of other insurance contracts

14. This leaves holders of insurance contracts of long duration for purposes other than providing employee benefits. Although this might not be a large group, the staff thinks that a comparison with the accounting that this group might apply is most likely to highlight issues that may concern the boards.
15. Appendix B sets out a full comparison. The staff has identified 8 issues to discuss in more detail. If a board member wishes to discuss any other aspect of the comparison at the meeting, please could they inform the staff in advance. The issues for discussion are:
- (a) inputs
 - (b) acquisition costs
 - (c) the effect of the risk adjustment
 - (d) the insurer's non-performance risk

- (e) day one gains and losses
- (f) the effect of expected policyholder behaviour, including the deposit floor
- (g) participating features in insurance contracts
- (h) unbundling and embedded derivatives.

Issue (a) - inputs

16. The boards have tentatively decided that the measurement of an insurance contract should consider all available information. However, because an active transfer market does not exist for insurance contracts, the measurement is based principally on the insurer's inputs and does not require the search for market inputs, except for market variables such as interest rates.

Non-market variables

17. For non-market variables, a policyholder's assessment might be different from the insurer's because of differences in information available to the insurer and the policyholder (information asymmetry).
18. The insurer and policyholder may therefore in practice make different assessments of the expected future cash flows, for example by using different probabilities for the claim amounts arising in each scenario. Whether that difference would affect the measurement of the contract depends on:
- (a) the treatment of day one gains and losses for initial measurement (see paragraphs 34-45 below).
 - (b) treatment of subsequent changes in expected cash flows. The boards have tentatively decided that all subsequent changes in estimates are to be reported in profit or loss immediately, so different assessments of expected future cash flows would result in the insurer and the policyholder measuring the contract at different amounts for subsequent reporting periods.

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19. The insurer and policyholder may also make different assessments of the risk adjustment. This is because the policyholder will attach more value than the insurer would to the value of the cash flow that will occur if the insured event happens³.
20. The staff thinks that differences in assessment of cash flows and risk-adjustments are inevitable and any resulting differences in measurement do not imply that there is a problem with the proposed model.

Market variables

21. The insurer and policyholder may have access to different markets: the policyholder to the retail insurance market and the insurer to a wholesale market. The staff thinks that the inputs for most market variables will be the same, regardless of the different markets, for example current discount rates.
22. However, the staff thinks that the different markets could potentially give rise to differences in measurement. The retail market gives individual policyholders access to insurance, ie the ability to pool their risks with others. In order to gain that access, individual policyholders have to pay the price offered by the insurer. That price will include amounts to cover the insurer's costs and profit on those costs, including acquisition costs.

Issue (b) - acquisition costs

23. The boards have tentatively decided to expense acquisition costs rather than to capitalise them and to prohibit the recognition of any revenue (or income) to offset those costs. Consider an example of an insurance contract which the insurer has priced at a single premium of 100 to cover:

Acquisition costs	20
Expected cash outflows	65

³ The effect of the risk adjustment on the policyholder's asset is discussed in more detail below.

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Risk adjustment	15
Total	100

24. Under the boards' proposals, the insurer would recognise a liability of 100 being the expected cash outflows (65), risk adjustment (15), and residual margin to prevent a day one gain (20), and an expense for acquisition costs of 20. If the policyholder made the same assessment of cash flows and risk-adjustment as the insurer, it would recognise an asset of 80 (expected cash inflows and risk adjustment⁴) and a loss of 20. There would be asymmetry in the measurement of the contract.
25. However, the staff thinks in practice a policyholder would not enter into such a contract if its assessments of cash flows and risk-adjustment were the same as the insurer's. If a policyholder enters into such a contract, it must be because its assessment of the cash flows and risk-adjustment is at least 100. Assuming that it assesses the cash flows and risk-adjustment as being equal to 100⁵, it would recognise an asset of 100.
26. The insurer's liability of 100 and the policyholder's asset of 100 appear symmetrical. However, the staff thinks that the above analysis illustrates that there are two opposing differences:
- (a) a difference caused by the proposal that the insurer should not capitalise acquisition costs and should not recognise revenue at inception to cover those costs and
 - (b) a difference caused by the policyholder's different assessment of cash flows and risk adjustments.

⁴ The fact that the risk adjustment increases the measurement of the asset is discussed below.

⁵ Day one gains could arise if the policyholder assessed the cash flows and risk adjustment at greater than 100. Such possible gains are discussed below.

27. The staff thinks that the first difference is something that the boards might wish to consider in relation to its proposals on acquisition costs. As noted above, the staff thinks the second difference does not imply a problem with the model.

Issue (c) - the effect of the risk adjustment

28. A risk adjustment increases the liability reported by the insurer. Symmetry would imply that it would also increase the asset for the policyholder. But risk is usually thought to reduce the value of assets.

29. The staff thinks that the symmetrical answer is valid in the case of insurance contracts. Although risk usually reduces the value of an asset, in the case of insurance contracts it will increase the value. In entering into an insurance contract, the policyholder is seeking to reduce the losses that would arise if the insured event occurs. Because the policyholder is risk averse, it values the net expected cash inflows it will receive if the insured event occurs more than it values the net cash outflow (the premium) if the insured event does not occur. In fact, if policyholders are not risk-averse, they would have no reason to buy insurance, because the premium will generally be more than the expected present value of the claims.

30. Consider the following example.

	Insured event occurs (30% probability)	Insured event does not occur (70% probability)	Expected value
Premium	100	100	100
Benefit receivable	250	0	75
Utility value of benefit	333	0	100

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The utility value is the value that the policyholder places on the inflow in the situation of the insured event occurring. It is the cash flow plus the risk adjustment. The policyholder is willing to pay 100 for an expected benefit of 75 because it values the certainty of receiving 250 if the insured event occurs at more than it values the outflow of 100 if the insured event does not occur.

31. Another way of expressing this is that the policyholder is paying for the insurance cover and reduced risk, rather than just for the expected cash flows. The greater the risk inherent in the insured event, the greater the value of the reduction in that risk provided by the insurance cover.
32. The staff concludes there is no inherent lack of symmetry in concept between insurer and policyholder.

Issue (d) - the insurer's non-performance risk

33. 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. Symmetry would imply that changes in the risk of non-performance by the insurer should also be excluded from the policyholder's assessments of future cash flows and risk adjustments. The staff does not think that the boards would wish to make such a proposal for policyholder accounting. We do not usually exclude non-performance from a current measurement of an asset. However, the staff does not think this is a reason for the boards to reconsider their proposal for insurers.

Issue (e) - day one gains or losses

34. Day one gains or losses arise when the measurement of the contract does not equal the initial premium (or does not equal nil if there is no initial premium). The boards have decided that the measurement of the contract by an insurer should not result in day one gains; but could result in day one losses.
35. A day one gain or loss could arise in principle for a policyholder for the following reasons:

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- (a) the insurer and policyholder have symmetrical information and the contract would have given rise to a day one gain for the insurer were it not for the boards' decision to eliminate the gain using a residual margin
- (b) the insurer and policyholder have symmetrical information and the contract gives rise to a day one loss for the insurer
- (c) information asymmetry causes the policyholder to determine the expected cash flows and risk margin differently from the insurer (and hence differently from the basis on which the premiums are set).

Contracts that would give rise to a day one gain for the insurer were it not for the residual margin

36. The boards have decided that an insurer should include in the measurement of a contract a residual margin to prevent the recognition of any day one gains. For a policyholder, the recognition of a symmetrical residual margin would prevent any day one losses.
37. The staff does not think that it would be appropriate to automatically prevent a policyholder from recognising day one losses. However, the staff notes that a policyholder is unlikely to enter into a contract that it assesses as creating a day one loss. This is because the policyholder is unlikely to take out a policy that costs more than the policyholder thinks it is worth.
38. The staff therefore argues that contracts that are assessed by the insurer as giving rise to a day one gain (excluding the residual margin) must be contracts that the policyholder assesses using different inputs because of asymmetry or different markets. Such contracts are discussed in paragraph 43 below.

Contracts that result in day one losses for an insurer

39. The boards have decided that the measurement of a contract by an insurer could result in day one losses. Symmetrical application of these proposals would result in the policyholder recognising a day one gain.

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40. The most common example of contracts that could create a day one loss for insurers are annuity contracts that are priced using a discount rate based on the expected return on assets held (see Agenda Paper 17D of the September IASB meeting for discussion of this issue). Some take the view that in using such a discount rate the insurer is including expected future asset returns in the price. If this were the case, then in principle, the policyholder should recognise a day one gain because the insurer has passed on the benefit of those expected returns to the policyholder when the contract is agreed (ie on day one).
41. Others take the view that the lower price reflects the illiquidity of the policyholder's asset. To the extent that this is the case, both the insurer and policyholder should include that effect in the measurement of the liability/asset and no day one loss/gain should arise. The staff plans to investigate further the issue of a liquidity premium, specifically for contracts such as annuities that appear to be priced using a discount rate based on the expected return on assets held.
42. The staff thinks that in principle the policyholder could adopt a measurement that is symmetrical with the measurement used by the insurer. In other words, if a day one loss arises for the insurer, then a day one gain would arise for the policyholder. In practice, of course, a policyholder might not be able to identify that such a gain exists.

Information asymmetry

43. As noted in paragraphs 18 and 19, the policyholder may make a different assessment from the insurer of the expected cash flows and risk margin. That different assessment could lead to a day one gain or loss because the premiums will be set using the insurer's assessments.
44. As noted above, the staff thinks that, from the policyholder's perspective, a day one loss is unlikely to arise. This is because the policyholder is unlikely to take out a policy that costs more than the policyholder thinks it is worth. So for contracts that would give rise to a day one gain for the insurer were it not for the residual margin, both insurer and policyholder would measure the contract initially without a gain or

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loss. In other words the insurer's residual margin and the information asymmetry between the insurer and policyholder compensate for each other.

45. A day one gain is more likely to arise from the policyholder's perspective. A policyholder would be willing to take on a contract under which it values the benefits greater than the premiums. If the boards were considering proposals for policyholder accounting, they might wish to consider whether a residual margin should be recognised to prevent day one gains for policyholders, similar to that proposed for insurers. However the staff does not think this question casts doubt on the proposed accounting for the insurer, and hence the staff does not think it needs to be addressed now.

Issue (f) - the effect of expected policyholder behaviour

46. The boards have tentatively decided that the insurer should include in the measurement of the insurance contract 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.
47. If the exercise of the options gives a net expected cash inflow for the insurer, that would reduce the insurer's reported liability. A symmetrical application of the proposals to the policyholder would reduce the policyholder's asset.
48. Some view this as requiring the insurer to recognise an asset and the policyholder a liability for an option held by the policyholder. They argue that an option held by the policyholder cannot give rise to a liability for the policyholder, because the policyholder can choose not to exercise the option.
49. The issue can be regarded as a unit of account issue. Consider a portfolio of contracts that provide health insurance to a group of policyholders. The insurer knows that some of the policyholders are unhealthy and likely to claim and that some are healthy and unlikely to submit a claim. But the insurer does not know which policyholders are healthy or unhealthy or only becomes aware of this

information over time. The insurer assesses and prices the portfolio as a whole. The healthy policyholders subsidise the unhealthy. In aggregate, there is information symmetry across the whole portfolio, but there may not be on a contract by contract basis (assuming that the policyholders know whether they are healthy or unhealthy).

50. The staff thinks the issue can also be analysed at the individual contract level, as a question of different assessments of cash flows and risk adjustment. The staff agrees that the policyholder does not have a liability in respect of options held by the policyholder. The staff thinks if an insurer expects a policyholder to exercise options that result in net cash inflows for the insurer, that implies that the policyholder is making a different assessment of the future cash flows and risk adjustments: one that results in a net asset for the policyholder. Otherwise, the policyholder would not be expected to exercise the options.
51. This also works in the opposite direction. When previously discussing the portfolio of healthy and unhealthy policyholders, IASB members seemed to accept that the measurement would have to assume realistic estimates of lapses by unhealthy policyholders, even though the effect would be to decrease the insurer's net liability. In this case, the fact that the unhealthy policyholders are expected to surrender the policy indicates that the contract is no longer of value to them. That is, their assessment of the cash flows and, in particular, the risk adjustment, is such that they would measure the ongoing contract at a negative amount. This could happen if their circumstances change so that they no longer need the cash inflows if the insured event occurs. Hence, they surrender the contract, eliminating what from the perspective of the insurer would be an onerous contract.
52. In both cases, there would be asymmetry between the measurement of the contract by the policyholder and insurer. In the situation in paragraph 50, the insurer and policyholder both recognise an asset and in the situation in paragraph 51, the insurer and policyholder both recognise a reduced liability. However, the asymmetry arises because of different assessments of cash flows and risk adjustments. As noted above, the staff does not think this implies that there is a problem with the proposed model.

The deposit floor

53. Consistent with its decision on policyholder behaviour, the boards have tentatively decided that the measurement of the contract by the insurer should not include a deposit floor. This means that the insurer's liability is measured by reference to the expected cash flows, even if the insurer would have to pay more if the policyholder surrendered the contract at the reporting date. Symmetrical measurement would result in the policyholder recognising a smaller asset than it could recover by allowing the contract to lapse.
54. The staff again thinks that under an insurance contract this situation implies the existence of different assessments of cash flows and risk adjustments. If the policyholder is expected to continue paying premiums under the policy, that implies the policyholder assesses the net benefit of the insurance coverage less future premiums as worth more than the deposit floor. So, applying its assessment of cash flows and risk margin, the policyholder would recognise an asset greater or equal to the deposit floor. The contract would be measured at different amounts by the insurer and policyholder, but that would be because of the different assessments of cash flows and risk-adjustments.

Issue (g) - participating features in insurance contracts

55. Participating insurance contracts are contracts in which part of the benefits paid to policyholders depends on the performance of an underlying pool of insurance contracts (and sometimes related investments).
56. 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.
57. 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

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liability. Discretionary cash flows will be recognised when the entity has an obligation to make payments.

58. The staff thinks that symmetrical application of the IASB preferred approach would be straight-forward. The policyholder would recognise an asset that included all expected cash flows.
59. The staff thinks that symmetrical application of the FASB preferred approach would probably result in day one losses for the policyholder. A policyholder would generally expect premiums for participating insurance contracts to exceed significantly the premium for an otherwise identical non-participating contract. If the expected cash flows from the participating feature were not included in the measurement of the policyholder's asset, the asset would be less than the premium paid. It is difficult to see why policyholders would systematically enter into transactions that give rise to economic losses on day one.

Issue (h) - unbundling and embedded derivatives

60. The boards have discussed when an insurance contract should be unbundled into separate components and when an embedded derivative should be bifurcated from the insurance contract. Both boards will discuss these issues further. However, the staff thinks that, in principle, any decision for the insurer ought to be applied symmetrically by the policyholder. Once the boards have finalised their proposals on unbundling and on embedded derivatives, the staff will check that symmetrical application by the policyholder would not cause any problems that would cast doubt on the validity of the decision for insurers.

Staff conclusion on accounting for insurers

61. The staff plans to bring papers on two of the proposals discussed above to later meetings:
- (a) the proposal not to capitalise acquisition costs and to prohibit the recognition of any revenue (or income) to offset those cost; and

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(b) the FASB's preferred approach to participating features.

62. The staff does not think that the other differences in measurement that might arise between an insurer and policyholder need to be considered further at this stage.

Question 1 for the boards

Do the boards agree that they do not need to consider further at this stage the differences in measurement that might arise if the boards' proposals for insurers were applied to policyholders, other than in relation to acquisition costs and participating features?

Is there a need to address policyholder accounting (other than reinsurance) now?

63. The staff thinks that the above analysis demonstrates that the proposed model for insurers could, in principle, be applied to policyholders. A lack of symmetry arises only because of:

- (a) insurers' non-performance risk
- (b) the proposal not to capitalise acquisition costs and to prohibit the recognition of any revenue (or income) to offset those costs
- (c) the FASB's preferred approach to participating features and
- (d) different assessments by policyholders and insurers of cash flows and risk-adjustments.

64. The staff thinks that (a) and (d) do not cast doubt on the proposed model. (b) and (c) may be issues that the boards might like to consider in relation to the model for insurers, but are not major issues for policyholders.

65. However, there are other issues that would need to be discussed and resolved for policyholders, for example the issue of day one gains for policyholders. The staff thinks that the need for requirements for policyholders is much less pressing than the need for requirements for insurers. As noted earlier in the paper, for most policyholders, insurance contracts are not a significant expense. Also, although no

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specific standard addresses policyholder accounting comprehensively, some IFRSs address limited aspects of policyholder accounting. These include the paragraphs in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* that specify a hierarchy of criteria that an entity should use in developing an accounting policy if no IFRS applies specifically to an item. Under US GAAP, there are various EITF Abstracts (now part of the ASC) that cover aspects of policyholder accounting.

66. Based on the discussions in this paper and given the project timetable, the staff does not think the boards should consider policyholder accounting in more detail (other than reinsurance) before issuing the ED on accounting by insurers.

Question 2 for the boards

Do the boards agree that, subject to issues arising on reinsurance, the boards should not consider non-reinsurance policyholder accounting in more detail before issuing the ED on accounting by insurers

Appendix A: 2002 IASB policyholder model

In February 2002, the IASB decided tentatively to pursue the following simplified measurement model for policyholders:

- (a) prepaid insurance premiums at amortised cost.
- (b) any readily identifiable investment component at fair value.
- (c) virtually certain reimbursements of expenditure required to settle a recognised provision at the present value of the reimbursement, but not more than the amount of the recognised provision (consistently with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* paragraph 53).
- (d) valid claims for an insured event that has already occurred at the present value of the expected future receipts under the claim. If it is not virtually certain that the insurer will accept the claim, the claim is a contingent asset and would, under IAS 37, not be recognised.

Appendix B: Overview of application of proposals for insurers to policyholders

Topic	IASB	FASB	Symmetrical application to policyholder
Measurement approach	The boards decided tentatively that the measurement approach should portray a current assessment of the insurer's obligation, using the following building blocks.		<p>The staff considered whether a current measurement might cause an accounting mismatch if the policyholder does not measure the underlying risk event at a current value. For example, suppose an entity takes out hurricane insurance over some buildings at the beginning of the hurricane season some months before the year-end. At the year-end a large hurricane is approaching the buildings. A current measurement of the entity's insurance asset will reflect the increased probability of a payout under the policy. But the entity might not recognise any impairment of the buildings until the hurricane hits. Recognising a gain because of an approaching hurricane might be regarded as counter-intuitive.</p> <p>The staff thinks that if the boards were to address policyholder accounting, they would need to think about this issue. But the staff thinks it is an issue that arises because of non-current measurement of policyholders' other assets (or liabilities). It does not cast doubt on the desirability of a current measurement for insurance contracts by insurers.</p>

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Topic	IASB	FASB	Symmetrical application to policyholder
Building Blocks	<p>The boards tentatively decided that the measurement for insurance obligations should include four building blocks:</p> <ul style="list-style-type: none"> • 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. 		<p>The staff sees no reason why the first three building blocks would not be equally applicable to a policyholder. Consequences of how the building blocks are specified are discussed below.</p>
Risk adjustment	<p>The boards decided tentatively that:</p> <p style="padding-left: 40px;">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.</p> <p style="padding-left: 40px;">the risk adjustment should be updated (remeasured) each reporting period.</p>		<p>The risk margin increases the liability for the insurer. Symmetry would imply that it would also increase the asset for the policyholder (even though risk is usually thought to reduce assets). The main body of the paper discusses this issue.</p>
Non-performance risk	<p>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.</p>		<p>The main body of the paper discusses this issue.</p>

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Topic	IASB	FASB	Symmetrical application to policyholder
Use of inputs	<p>The boards decided tentatively that the measurement should:</p> <ul style="list-style-type: none"> 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. 		The main body of the paper discusses the implications of information asymmetry and different markets in relations to inputs.
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.	The staff identifies no problems in a symmetrical application of the proposals to include discounting and margins.
Measurement of residual margin at inception	<p>The margin at inception should be measured by reference to the premium. Therefore no day one gains should be recognised in profit or loss.</p> <p>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.</p>		The main body of the paper discusses day one gains and losses.

Staff paper

Topic	IASB	FASB	Symmetrical application to policyholder
Subsequent treatment of residual margin	<p>The boards tentatively decided :</p> <p style="padding-left: 40px;">to develop specific guidance on how the residual margin should be released to profit or loss over time.</p> <p style="padding-left: 40px;">that the insurer should not adjust the residual margin in subsequent reporting periods for changes in estimates.</p>		<p>If the boards decided that a residual margin should be recognised by policyholders to eliminate any day one gains (see main body of paper), then it would also need to decide on the subsequent treatment of that margin. However, the staff does not think the boards need to consider that issue further at this stage of the project.</p>
Discount rates	<p>The IASB decided tentatively that:</p> <p>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</p> <p>b) the standard should not give detailed guidance on how to determine the discount rate</p>	<p>The FASB will discuss this issue further at a future meeting.</p>	<p>No symmetry issues with IASB decisions.</p>
Acquisition costs	<p>The boards decided tentatively that an insurer:</p> <ul style="list-style-type: none"> • should expense all acquisition costs when incurred. • should not recognize any revenue (or income) to offset those costs incurred. 		<p>This issue is discussed in the main body of the paper..</p>

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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 main body of the paper discusses this issue.
Deposit floor	The boards decided that no deposit floor applies in measuring insurance contracts.		The main body of the paper discusses this issue.
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.	The main body of the paper discusses this issue.

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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.	The policyholder will recognise an asset on entering the contract. No symmetry problems.
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 <i>Financial Instruments: Recognition and Measurement</i> .	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.	The policyholder will derecognise an asset when it no longer has any rights under the contract. No symmetry problems arise.

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Unbundling	The IASB decided tentatively that, for recognition and measurement, an insurer should: <ul data-bbox="448 391 873 606" style="list-style-type: none">• 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 will discuss this issue at a future meeting.	This issue is discussed in the main body of the paper.