IFRS	**World Standard-Setters Meeting** Staff Paper	Agenda reference	**Agenda Paper 3**
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Project	**Insurance contracts**
Topic	**The Exposure Draft *Insurance Contracts***

Introduction

1. The IASB aims to improve the financial reporting for insurance contracts by issuing a high quality standard for all types of insurance contracts that provides a consistent basis for the accounting and analysis of financial statements that contain insurance contracts. The accounting following from the proposal is supposed to present clearly how insurance contracts affect the insurer's financial position, performance and its cash flows. The proposal also intends to enhance comparability across business sectors and entities.

2. The IASB published the Exposure Draft *Insurance Contracts* on 30 July 2010 (which can be downloaded from: http://www.ifrs.org/Current+Projects/IASB+Projects/Insurance+Contracts/Exposure+draft+2010/Exposure+draft+and+Comment+letters.htm) with a comment period until 30 November 2010. In addition to that, the IASB intends to undertake further outreach, including a second round of field tests.

3. The staff would like to use the WSS break-out session in two ways:

   (a) to present the main features of the exposure draft; and

   (b) to discuss the measurement model and some specific components of the measurement model.

Overview of the proposal

4. The exposure draft proposes a comprehensive measurement approach for all types of insurance contracts issued by entities (and reinsurance contracts held by entities), with a modified approach for some short-duration contracts. The measurement approach is based on the following building blocks:

   (a) a current estimate of the future cash flows

   (b) a discount rate that adjusts those cash flows for the time value of money

   (c) an explicit risk adjustment

   (d) a residual margin.

5. For most short-duration contracts, a modified model would apply. During the coverage period, the insurer would measure the contract using an allocation of the premium received. The insurer would use the building block approach to measure claims liabilities.

Issues to discuss

6. Some of the key issues of the measurement model are listed below to facilitate the discussion with the WSS.

Risk adjustment

7. The proposal introduces an explicit risk adjustment, which represents the maximum amount that an insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected. The risk adjustment has to be calculated with one of three permitted methods: confidence interval, conditional tail expectation or cost of capital.

Discount rate

8. Time value of money is one of the building blocks of the measurement. The discount rate shall reflect the characteristics of the insurance liability. For non-

participating insurance contracts, the proposal suggests a current, risk-free discount rate, which is adjusted for liquidity.

Residual margin

9. The residual margin eliminates any gain at inception of the contracts and shall subsequently be recognised in profit or loss over the coverage period in a systemic way. The residual margin does not act as a 'shock absorber', which means that the residual margin is not being updated, but 'locked-in' at inception.

Acquisition costs

10. Insurers often incur significant costs to sell, underwrite and initiate a new insurance contract. The proposal requires an insurer to include incremental acquisition costs as part of the contract cash flows, and therefore, in the measurement for the insurance contract. All other acquisition costs are recognised as expense when incurred.

Questions
Do you think the proposed measurement model will produce relevant information that will help users of an insurer's financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why? What are your views on the individual components of the measurement model?