Staff Paper

Topic **Discount rate for insurance contracts**

1. We provide three papers on the discount rate for insurance contracts:

   (a) **Agenda paper 4A:** A feedback statement on the board's tentative decisions on the discount rate to date, including an outline of significant matters raised with us and how we responded.

   (b) **Agenda paper 4B:** A description of how we propose to implement the boards' conclusions that:

      (i) the objective of the discount rate is to adjust the future cash flows of the insurance contract for the time value of money and

      (ii) It would not specify a method for determining the discount rate. Accordingly the objective can be met using either a top-down or a bottom-up approach.

   (c) **Agenda paper 4C:** An overview of the staff's proposals for the March Board meeting.

2. On the following pages, we provide a pictorial representation of the boards' discount rate decisions.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB working group identified in the header of this paper.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

The meeting at which this paper is discussed is a public meeting but it is not a decision-making meeting of the Board.

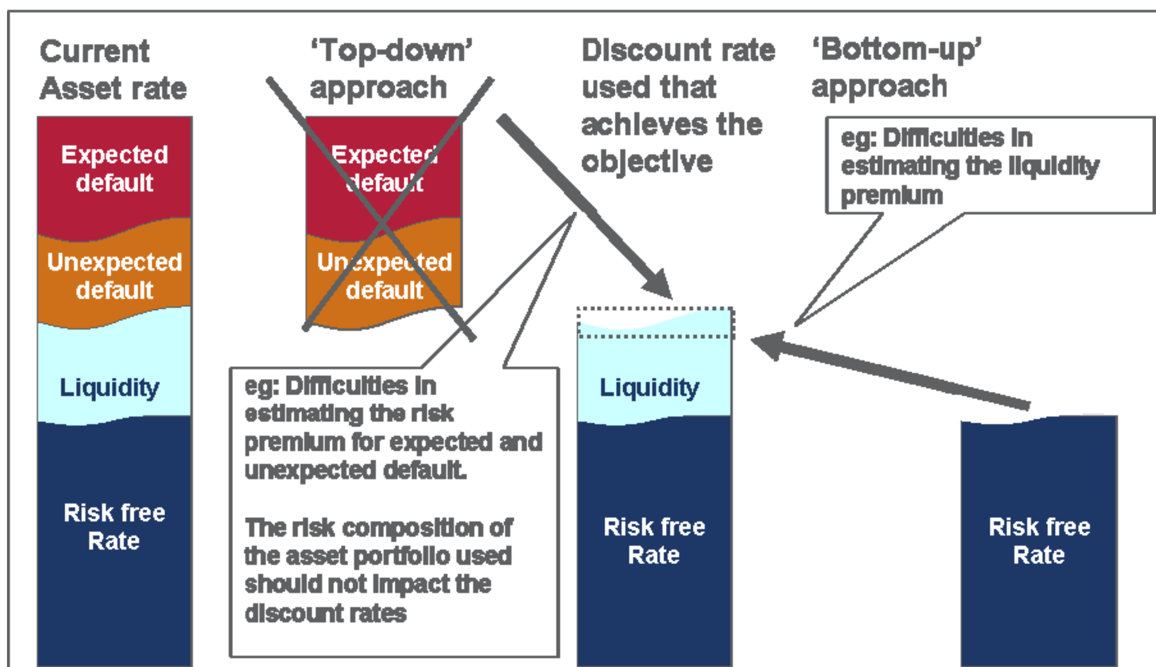
Official pronouncements of the IASB are published only after the Board has completed its full due process, including appropriate public consultation and formal voting procedures.

'Top-down' versus 'Bottom-up' for one spot rate

3. The following diagram illustrates the interactions between:

   (a) 'Top-down' approaches based on market-consistent expected asset returns, such on the assets held by the insurer, a reference portfolio, or those contemplated in pricing the contract, adjusted to remove items that relate only to the assets. Any remaining difference between the adjusted rate and the risk-free rate would be regarded as the liquidity premium.

   (b) 'Bottom-up' approaches based on risk-free rates, adjusted to add an illiquidity premium. We acknowledge that many had interpreted the ED as permitting only the bottom-up approach, but that was not our intention.:



How the boards' tentative decision would work in practice

4. The following diagram illustrates how an insurer might analyse the current asset yield of a reference instrument to derive a discount rate that reflects the characteristics of the liability.