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**Staff Paper**

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Topic

**Taking stock: Progress towards an IFRS for Insurance  
Contracts (for information)**

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1. This paper:
  - (a) summarises the progress the boards have made and the matters that they have yet to address (paragraph 2).
  - (b) describes next steps and provides a revised project timetable (paragraph 3 - 5).

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This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB Insurance Working Group.

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.

## Progress report

2. The following table summarises the progress the boards have made and the matters that they have yet to address.

Building block/Area	Topic	Tentative decisions	Open points
Building block 1 – Which cash flows?	Recognition point	<ul style="list-style-type: none"> <li>Recognise insurance contract assets and liabilities when the coverage period begins.</li> <li>Onerous contract liability to be recognised in the pre-coverage period if management becomes aware of onerous contracts in the pre-coverage period.</li> </ul>	<ul style="list-style-type: none"> <li>How to apply onerous contract test in pre-coverage period.</li> </ul>
	Contract boundary	<ul style="list-style-type: none"> <li>Contract renewals should be treated as a new contract:               <ol style="list-style-type: none"> <li>when the insurer is no longer required to provide coverage; or</li> <li>when the existing contract does not confer any substantive rights on the policyholder.</li> </ol> </li> <li>A contract does not confer on the policyholder any substantive rights when the insurer has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk.</li> <li>In addition, for contracts for which the pricing of the premiums does not include risks relating to future periods, a contract does not confer on the policyholder any substantive rights if the insurer has the right or the practical ability to reassess the risk of the portfolio the contract belongs to and, as a result, can set a price that fully reflects the risk of that portfolio.</li> <li>All renewal rights (whether arising from a contract, from law or from regulation) should be considered in determining the contract boundary.</li> </ul>	

Building block/Area	Topic	Tentative decisions	Open points
	Fulfilment cash flows – objective	Expected value, with guidance that: <ul style="list-style-type: none"> <li>• expected value refers to the mean that considers all relevant information; and</li> <li>• not all possible scenarios need to be identified and quantified, provided that the estimate is consistent with the measurement objective of determining the mean.</li> </ul>	
	Fulfilment cash flows – which cash flows	<ul style="list-style-type: none"> <li>• Include all costs that the insurer will incur directly in fulfilling the contracts in that portfolio, ie:                             <ul style="list-style-type: none"> <li>○ costs that relate directly to the fulfilment of the contracts in the portfolio;</li> <li>○ costs that are directly attributable to contract activity as part of fulfilling that portfolio of contracts and that can be allocated to those portfolios; and</li> <li>○ such other costs as are specifically chargeable to the policyholder under the terms of the contract.</li> </ul> </li> <li>• Exclude costs that do not relate directly to the insurance contracts or contract activities, which should be recognised as expenses in the period in which they are incurred.</li> </ul>	
	Acquisition costs	IASB: Include in fulfilment cash flows all the directly attributable costs that the insurer will incur in acquiring a portfolio of insurance contracts. FASB: Include in fulfilment cash flows: <ul style="list-style-type: none"> <li>• costs relating to successful acquisition efforts; and</li> <li>• direct costs relating to the acquisition of a portfolio of insurance contracts.</li> </ul>	

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Building block 2 – Time value of money	Discounting	<ul style="list-style-type: none"> <li>• Objective is to adjust the future cash flows for the time value of money and to reflect the characteristics of the insurance contract liability</li> <li>• Current rate that is updated each reporting period</li> <li>• Not required when the effect of discounting would be immaterial.</li> </ul>	
	Discount rate	<ul style="list-style-type: none"> <li>• No prescribed method to determining the discount rate, but rate should:                             <ul style="list-style-type: none"> <li>○ be consistent with observable current market prices for instruments with cash flows whose characteristics reflect those of the insurance contract liability, including timing, currency and liquidity, but excluding the effect of the insurer's non-performance risk;</li> <li>○ exclude any factors that influence the observed rates but that are not relevant to the insurance contract liability (eg risks not present in the liability but present in the instrument for which the market prices are observed, such as any investment risk taken by the insurer that cannot be passed to the policyholder); and</li> <li>○ reflect only the effect of risks and uncertainties that are not reflected elsewhere in the measurement of the insurance contract liability.</li> </ul> </li> <li>• To the extent that the amount, timing or uncertainty of the cash flows arising from an insurance contract depend wholly or partly on the performance of specific assets (ie for participating contracts), the insurer should adjust those cash flows using a discount rate that reflects that dependence.</li> </ul> <p>In some cases, the insurer determines the yield curve for the insurance contract liability based on a yield curve that reflects current market returns for either the actual portfolio of assets the insurer holds, or for a reference portfolio of assets with characteristics similar to those of the</p>	Disclosure

Building block/Area	Topic	Tentative decisions	Open points
		<p>insurance contract liability. In doing so, the insurer excludes from those rates factors that are not relevant to the insurance contract liability (a 'top-down' approach). In a 'top down' approach:</p> <ul style="list-style-type: none"> <li>• An insurer shall determine an appropriate yield curve based on current market information. The insurer may base its determination of the yield curve for the insurance contract liability on a yield curve that reflects current market returns for the actual portfolio of assets the insurer holds or for a reference portfolio of assets with characteristics similar to those of the insurance contract liability.</li> <li>• If there are no observable market prices for some points on that yield curve, the insurer shall use an estimate that is consistent with the boards' guidance on fair value measurement, in particular for Level 3 fair value measurement.</li> <li>• the cash flows of the instruments shall be adjusted so that they reflect the characteristics of the cash flows of the insurance contract liability. In adjusting the cash flows, the insurer shall make both of the following adjustments: <ul style="list-style-type: none"> <li>○ Type I, which adjust for differences between the timing of the cash flows to ensure that the assets in the portfolio (actual or reference) selected as a starting point are matched with the duration of the liability cash flows.</li> <li>○ Type II, which adjust for risks inherent in the assets that are not inherent in the liability. In the absence of an observable market risk premium for risks inherent in the asset but not inherent in the liability, the entity uses an appropriate technique to determine that market risk premium, consistent with (b).</li> </ul> </li> <li>• an insurer using a 'top-down' approach need not make adjustments for remaining differences between the liquidity inherent in the liability cash flows and the liquidity inherent in the asset cash flows.</li> </ul>	

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Building block 3 – Risk adjustment	Relevance of risk adjustment	If there are techniques that could faithfully represent the risk inherent in insurance liabilities, the inclusion of an explicit risk adjustment in the measurement of those liabilities would provide relevant information to users.	<ul style="list-style-type: none"> <li>Whether to require an explicit risk adjustment</li> </ul>
	Risk adjustment	Objective: The risk adjustment shall be the compensation the insurer requires to bear the risk that the ultimate cash flows could exceed those expected.	<ul style="list-style-type: none"> <li>Techniques</li> <li>Disclosures</li> <li>Level of aggregation (including diversification benefits)</li> </ul>
Building block 4 – Residual margin	Residual / composite margin	<ul style="list-style-type: none"> <li>No gain at inception of an insurance contract.</li> <li>Any loss on day one recognised immediately when it occurs, in profit or loss (net income).</li> </ul>	<ul style="list-style-type: none"> <li>Whether and how to unlock the residual or composite margin</li> <li>Level of aggregation</li> <li>Release of residual margin</li> </ul>
Special applications	Participating features	<ul style="list-style-type: none"> <li>Objective of the discount rate used to measure participating insurance contracts should be consistent with the discount rate used to measure non-participating insurance contracts.</li> <li>Provide guidance that to the extent that the amount, timing or uncertainty of the cash flows arising from an insurance contract depend wholly or partly on the performance of specific assets, the insurer should adjust those cash flows using a discount rate that reflects that dependence.</li> </ul>	<ul style="list-style-type: none"> <li>Measurement of policyholder participation at the May meeting</li> <li>Whether cash flows should include payments to current and future policyholders</li> </ul>
	Short duration contracts	<ul style="list-style-type: none"> <li>[IASB only]An insurer should deduct from the pre-claims obligation measurement the acquisition costs that the IASB would include in the measurement of the insurance contract liability using the building block approach.</li> <li>The insurer shall reduce the measurement of the pre-claims obligations over the coverage period as follows: <ul style="list-style-type: none"> <li>On the basis of time, but</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Objective of a modified approach</li> <li>Criteria for eligibility for a modified approach</li> <li>How to reflect the boards' tentative decision on reflecting the time value</li> </ul>

Building block/Area	Topic	Tentative decisions	Open points
		<ul style="list-style-type: none"> <li>○ On the basis of the expected timing of incurred claims and benefits if that pattern differs significantly from the passage of time.</li> <li>● An insurer should perform an onerous contract test if facts and circumstances indicate that the contract has become onerous in the pre-claims period.</li> </ul>	<p>of money in the revenue recognition project in determining whether the pre-claims obligation should reflect the time value of money.</p> <ul style="list-style-type: none"> <li>● Whether the modified approach should be permitted or required</li> <li>● [FASB only: acquisition costs]</li> <li>● Presentation</li> </ul>
	Reinsurance		<ul style="list-style-type: none"> <li>● Gains on inception</li> <li>● Contract boundary/short duration interaction</li> </ul>
Definitions, scope and unbundling	Definition of an insurance contract	<ul style="list-style-type: none"> <li>● Confirm proposed definition in the ED and DP, together with the guidance that:                             <ul style="list-style-type: none"> <li>(a) an insurer should consider the time value of money in assessing whether the additional benefits payable in any scenario are significant.</li> <li>(b) a contract does not transfer significant insurance risk if there is no scenario that has commercial substance in which the insurer can suffer a loss, with loss defined as an excess of the present value of net cash outflows over the present value of the premiums.</li> </ul> </li> </ul>	
	Scope	<ul style="list-style-type: none"> <li>● Exclude from the scope of the insurance contracts standard some fixed-fee service contracts which have as their primary purpose the provision of services.</li> <li>● Confirm all the other scope exceptions proposed in the ED</li> </ul>	<ul style="list-style-type: none"> <li>● How to identify fixed-fee service contracts which have as their primary purpose the provision of</li> </ul>

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		<ul style="list-style-type: none"> <li>• IASB: Financial guarantee contracts (as defined in IFRSs) would not be in the scope of the insurance contracts standard as proposed in the ED. Instead:               <ul style="list-style-type: none"> <li>(a) an issuer of a financial guarantee contract (as defined in IFRSs) is permitted to account for the contract as an insurance contract if the issuer had previously asserted that it regards such contracts as insurance contracts; and</li> <li>(b) an issuer of a financial guarantee contract (as defined in IFRSs) is required in accordance with the financial instruments standards in all other cases.</li> </ul> </li> </ul>	<p>services</p> <ul style="list-style-type: none"> <li>• Investment contracts with discretionary participation features</li> <li>• FASB: which financial guarantee arrangements, if any, should be within the scope of the insurance contracts standard.</li> </ul>
	Unbundling	<ul style="list-style-type: none"> <li>• An insurer should account separately for embedded derivatives that are contained in a host insurance contract that is not closely related to the embedded derivative.</li> <li>• Non-insurance goods and services and explicit account balances should be unbundled from an insurance contract using criteria based on those being developed in the revenue recognition project for identifying separate performance obligations. An insurer would not unbundle implicit account balances.</li> <li>• [IASB only] An insurer would account for an unbundled explicit account balance in accordance with the relevant requirements for financial instruments in IFRSs, subject to future decisions on allocation.</li> </ul>	<p>We will consider further unbundling issues at a future meeting, including contract riders, allocation of expenses to unbundled components and whether to permit unbundling where not required.</p>



Building block/Area	Topic	Tentative decisions	Open points
Presentation and disclosure	Presentation		<ul style="list-style-type: none"> <li>• Whether and how to expand the summarised margin approach</li> <li>• Whether some changes in the insurance contract liability should be presented in other comprehensive income</li> </ul>
	Disclosures		<ul style="list-style-type: none"> <li>• Address detailed issues raised</li> </ul>
	Transition and effective date		<ul style="list-style-type: none"> <li>• Consider how to approximate residual /composite margin on transition</li> <li>• Determine effective date</li> </ul>

## Next steps and proposed project timetable

3. On 21 April 2011, the IASB and FASB published a progress report on their joint work to improve International Financial Reporting Standards and US generally accepted accounting practices, and to bring about their convergence. This report stated that the boards are aiming to complete their deliberations on the major issues in the insurance contracts project by the end of June, but are unlikely to have completed all discussions until the second half of 2011. Once the boards have completed their deliberations, they will prepare their next due-process documents. For the FASB this will be an exposure draft and for the IASB this will be an IFRS. Before an insurance contracts standard is finalised the boards will follow the same procedures described in the progress report for the revenue recognition and leases projects, including assessing whether the proposals should be re-exposed and making a draft widely available as the basis for performing additional outreach.
4. The IASB aims to issue a new IFRS by the end of 2011. The FASB will consider the feedback received on its exposure draft with a view to finalising a standard in 2012. The boards will then consider any differences that may have arisen and how best to address them.
5. We set out a revised project plan on the following page.

