IASB/FASB Meeting 4 May 2011

IASB Agenda reference	**1B**
FASB Agenda reference	**66B**

Staff Paper

Project	**Insurance contracts**
Topic	**Measurement of Policyholder Participation**

What is this paper about?

1. This paper considers how to measure contractual participation features.
2. This paper does not discuss the following topics, which will be discussed in future meetings:
   (a) whether the fulfilment cash flows should include payments to not only current but **also future policyholders** as a result of a contractual participation feature.
   (b) The accounting for **investment** contracts with participation features rather than **insurance** contracts with participation features.
3. This paper also does not discuss the discount rate for participating contracts. In the March 2011 meeting the boards tentatively decided that the objective of the discount rate used to measure participating insurance contracts should be consistent with the discount rate used to measure non-participating contracts. To the extent that the amount, timing and 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.

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

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 FASB or the IASB.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

Staff recommendation

4. The staff recommends that:

   (a) the fulfilment cash flows should include the cash flows expected to result from the policyholder participation on the same basis as the measurement of the underlying items the policyholder participates in. This could be assets and liabilities, the performance of underlying pool of insurance contracts or the performance of the entity.

   (b) the measurement of the participating contract should reflect the asymmetric risk sharing between insurer and policyholder in the contractually linked items that exists because of the minimum guarantee.

   (c) the presentation of the changes in the insurance contract liability in the statement of comprehensive income should be consistent with the presentation of the changes in the linked items (ie profit or loss, or in other comprehensive income)

   (d) the same measurement approach should apply to unit-linked and participating contracts. Consequently the boards should not proceed with the proposals in the IASB's exposure draft (ED) for consequential amendments relating to the following items held in unit-linked funds: treasury shares and owner occupied property.

Background

5. The Background section of the paper discusses

   (a) Participation features

   (b) Accounting mismatch versus economic mismatch

Participation features and unit linked contracts

6. For the purpose of this paper, a participating insurance contract (an insurance contract with a participation feature) is any insurance contract for which some or all of the benefits paid to policyholder depend contractually on the (favourable or unfavourable) performance of assets held by the insurer, liabilities of the insurer, a pool of insurance contracts of the insurer or even the entire performance of the insurer.

7. One specific form of policyholder participation is a unit-linked contract (referred to as a variable contract in some jurisdictions). The ED defines a unit-linked contract as "a contract for which some or all of the benefits are determined by the price of units in an internal or external investment fund (ie a specified pool of assets held by the insurer or a third party and operated in a manner similar to a mutual fund)." As a result, the shareholders and other policyholders neither benefit nor suffer from the investment performance of the underlying assets (except if the insurer provides additional guarantees, for example if the contract specifies that on death the payment will be the higher of the unit value and a fixed amount). However, unlike usual participating contracts, unit-linked contracts in general do not provide a minimum guarantee and both favourable and unfavourable performance of the underlying assets is transferred in full to the policyholder without any asymmetry.

8. The ED proposes that payments arising from the participation feature should be included in the measurement of insurance contracts in the same way as any other contractual cash outflow (ie applying the three building blocks, specifically on an expected present value basis). The proposal in the ED has two implications:

   (a) In some cases, the underlying assets (or liabilities) are measured at fair value in the financial statements, but a different basis (in many jurisdictions, a cost basis) is used to determine the amount currently available for distribution to participating policyholder). Timing differences arise between changes in fair value and changes in that other

basis (eg cost). Those timing differences are analogous to the temporary differences used in accounting for deferred taxes. As explained further in paragraph 11, the proposal in the ED measures the insurance contract liability on a basis that reflects the fair value of the underlying assets (and liabilities), even if the amount currently available for distribution is determined on a cost basis.

(b) if the underlying asset/liabilities are not carried at fair value, there is a potential for an accounting mismatch. The rest of this paper deals mainly with the implications of this accounting mismatch.

Accounting and economic mismatches

9. The Basis for Conclusions on IFRS 4 distinguishes two types of mismatches:

   (a) An 'economic mismatch' arises if the values of, or cash flows from, assets and liabilities respond differently to changes in economic conditions. For example, an economic mismatch arises if the duration of insurance liabilities is longer than the duration of fixed interest assets backing those liabilities.

   (b) An 'accounting mismatch' arises if changes in economic conditions affect assets and liabilities to the same extent, but the carrying amounts of those assets and liabilities do not respond equally to those economic changes because different measurement attributes are applied.

10. Users and preparers of financial statements and other interested parties have consistently stated that it is important for insurers to account for insurance contracts and related assets in a manner that avoids creating accounting mismatches. They have noted that it is burdensome for insurers to explain the effects of accounting mismatches even to sophisticated users, and less sophisticated users may be less able to understand these effects. In the 2007 discussion paper, the IASB expressed the preliminary view that an ideal

measurement model would report all economic mismatches and would not create any accounting mismatches.

11. The ED/DP propose a current measurement based on the building blocks, discounting expected cash flows at a current discount rate. Fair value generally follows a similar principle (expected cash flows at a current discount rate). This means that there should not be a significantly different reaction to changes in economic conditions for assets (and liabilities) compared to the measurement of the insurance contract liability in the ED, if the underlying assets (and liabilities) are measured at fair value. This does not imply that all mismatches are eliminated in this case, but that a measurement using fair value reduces the accounting mismatches except for the differences between the insurance contracts measurement model in the ED and fair value:
    (a) Use of entity specific assumptions for some inputs
    (b) The insurer's own non-performance risk.

12. Based on this, many accounting mismatches can be reduced by using a current measurement for the underlying assets and liabilities, ie fair value.

ED proposals and feedback received

13. Based on the ED proposals and feedback received, we consider firstly issues relating to unit-linked contracts because they illustrate the points more clearly (without any asymmetry), and then consider how to extend the analysis to participating contracts.

Feedback received: Accounting mismatch – Unit linked

14. In developing the ED, the IASB discussed accounting mismatches that could arise from the measurement of unit-linked contracts, in particular from the following items held in the fund underlying such contracts:

(a) The insurer's own shares. An accounting mismatch arises for these items today because they are not recognised as assets under IAS 32.

(b) Property occupied by the insurer. An accounting mismatch arises today for such property because IAS 16 *Property, Plant and Equipment* would treat it as owner-occupied. As a result, although the insurer would be able to measure that property at fair value, it would recognise changes in the property's fair value in other comprehensive income, not in profit or loss.

15. The IASB intended to avoid any accounting mismatch between the measurement of the unit-linked contract and the linked assets. The approach was to modify the accounting of the linked assets to achieve consistency with the measurement of the unit-linked contract. The ED proposes that, for those two particular types of assets, an insurer should recognise the underlying assets and measure them at fair value through profit or loss. In doing so, the Board proposed consequential amendments to:

    a. IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*, to address shares issued by the insurer (in effect, treasury shares held in the unit-linked fund).

    b. IAS 16 *Property, Plant and Equipment*, to address property held in the unit-linked fund and occupied by the insurer.

16. Question 15 of the ED asked respondents the following:

> **Question 15 – Unit-linked contracts**
>
> Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

17. The responses to the proposed amendments to other standards (on treasury shares and owner occupied property) were generally supportive and the respondents welcomed the intention of the boards to allow assets of a unit-linked contract to be subject to a fair value option. However, some respondents indicated that there are other, equally problematic, items that the boards did not consider such as own-

debt, interests in consolidated subsidiaries and investments for which an entity uses the equity method.

18. Some respondents thought the general intention to avoid any accounting inconsistency should be expanded to other participating contracts. This is because there are many different forms of policyholder participation and the degree of participation varies. Consequently they think that all forms of policyholder participation should be treated consistently with the linked items. The staff agrees with this analysis. The main difference between unit-linked and policyholder participation is that a unit-linked contract provides a full pass through (while participation refers explicitly to the specific performance of the linked items or the entity).

19. Consequently the staff addresses in the following section how all forms of participation, including unit-linked contracts, should be measured. This should reduce the risk of rules-based guidance.

20. The accounting mismatches identified for unit-linked contracts under IFRS are not relevant under US GAAP. This is because under US GAAP, separate accounts, also known as variable accounts, are used to support variable annuity contracts and variable life insurance policies. Separate accounts are registered investment companies under the Investment Company Act of 1940. A variable contract is both a security registered under the Securities Act of 1933 and an insurance policy filed with and approved and regulated by state insurance departments. Assets and liabilities included in separate accounts are measured at fair value under ASC Topic 946 – Investment Companies. This specific guidance removes the mismatches mentioned in Appendix A. IFRSs do not currently contain similar industry specific guidance. The IASB will publish an exposure draft later in 2011 proposing to introduce guidance for investment companies that will require such entities to measure investments in other entities at fair value. However, based on the current differences between the IASB and FASB on the scope of the Investment Company guidance this might not remove the mismatches mentioned above for IFRSs (ie the IASB ED will propose that a parent of an Investment

Company that is not an Investment Company must consolidate any investments, rather than measure such investments at fair value). The IASB and FASB expect to issue their respective Exposure Drafts on Investment Companies in the second quarter of 2011.

Feedback received: Accounting mismatch – other participating contracts

Measurement on expected present value basis

21. Question 10a of the ED asked respondents the following:

> Question 10 – Participating features
>
> (a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?

22. Some respondents state that measuring participating insurance contracts on the basis of the expected present value of cash flows can lead to an accounting mismatch between the measurement of the insurance contract liabilities, and the underlying assets and liabilities that are used to determine the cash flows that will result from the policyholder participation. This issue was mainly raised in jurisdictions where the policyholder participation is based on the performance of assets and liabilities not measured at fair value or where it is based on the entity's general performance. The issue was less important in jurisdictions where the measurement of the policyholder participation depends solely on financial and non-financial assets or liabilities that are measured at fair value though profit or loss.

23. The following extracts from a comment letter highlight the issue:

> "The main issue in respect of paragraph B61 (j) concerns the expected amount of surplus under a participation feature (..). This amount is typically based on statutory accounting principles and is referred to as

> the participation measurement basis. The three building blocks for premiums and guaranteed benefits include assumptions about expected surplus. IFRS values may anticipate future surplus not yet considered in the participation measurement basis or may defer some of the surplus already considered in the participation measurement basis. For example, the participation measurement basis may anticipate (..) overheads excluded under IFRS." (Comment Letter 146 International Actuarial Association)

Staff analysis and recommendation

Potential accounting mismatches

24. Under the proposals in the ED, cash flows from participation features are treated in the same way as any other cash flow in the measurement model. Depending on the nature of the participation feature, the insurer needs to determine the expected present value of the cash flows that will flow through to participating policyholders as a result of current and future statutory results. Many standards do not provide fair value measurement for the underlying assets/liabilities and Appendix A provides examples of items that may be subject to a participation feature but are not measured at a current value. As noted in paragraph 11 the inclusion of those cash flows on the basis proposed in the ED/DP will not lead to an accounting mismatch if the linked asset/liability is measured at fair value.

25. However, there is a potential for accounting mismatches when the measurement of the participating insurance contract liability is not consistent with the measurement of assets and liabilities used as the basis for determining the participation, ie if any asset or liability that is contractually linked to the policyholder cash flows is not recorded at fair value. The following simplified example illustrates the issue:

> Assume there is an asset with a fair value of CU1,200. IFRS/US GAAP book value is CU1,000. The policyholder participates with 90% of the performance of this asset above CU1,000.
>
> The insurance contract liability would be CU1,185 for this with the following components:
>
> - 1,000 guaranteed amount
> - 90% of the 200 (Fair Value above book, ie 1,200 – 1,000)
> - 5 (in this example assumed to be the fair value of the asymmetric risk sharing between policyholder and shareholder)
>
> In this case, there is an accounting mismatch of 180 for the difference between the book value of the assets and the present value of the expected cash flows of the insurance contract liability. That accounting mismatch would not arise if the insurer measured the asset at fair value.

26. The mismatches can be more or less pronounced depending on the jurisdiction and depending on which assets/liabilities are subject to the contractual linkage.

27. One of the project axioms discussed in the February 2011 joint board meeting, is that:

> "an ideal measurement model would report all economic mismatches (including duration mismatches) that exist and would not cause any accounting mismatches."

28. The paragraphs below analyse whether the measurement model should eliminate an accounting mismatch by reflecting a contractual link between the insurance contract liability and the assets (or other items) held by the insurer, and so provide more useful financial information than the proposal in the ED/DP. To do this, we consider the following questions in the context of the axiom in paragraph 27 and the comment letters:

    (a) What is the economic phenomenon that the measurement of the policyholder participation tries to depict?

(b) What is the most useful financial information for users of the financial statements about this economic phenomenon?

The economic phenomenon is the risk sharing

29. The ED proposed that the measurement of the liability is based on an explicit, unbiased and probability-weighted estimate (ie expected value, mean) of the future cash flows. This measurement is independent of the actual measurement of the assets and liabilities that generate cash flows in which the policyholders participate.

30. However, in the staff's view, a direct and explicit contractual link between the insurance contract and the assets and liabilities held by the insurer subject to the participation feature is a very important economic phenomenon and decisive for the economics of such contracts. Accordingly, the staff thinks that this should be reflected in their measurement.

31. The contractual link through the participation feature leads to a risk sharing on the favourable and unfavourable development of the specified assets and liabilities between the policyholder and the insurer. There is an element of asymmetry to this risk sharing: because most contracts with participation features provide also a minimum guarantee, policyholders share in the upside potential, but bear less of the downside risk. In the staff's view, the accounting needs to reflect this asymmetry.

32. The next question arises: What is the most useful financial information for users of the financial statements about this economic phenomenon? To answer this question we consider the following:

    (a) What is a faithful representation of the contractual linkage?

    (b) Is this information relevant to users of financial statements?

33. Firstly, what is a faithful representation of the contractual linkage? In the staff's view, a faithful representation of the insurer's financial position would reflect the linkage that occurs when cash flows are required by the contract to be determined

by reference to the performance in the assets/liabilities. This would mean that the measurement of the cash flows included in the measurement of the participating feature of the insurance contract liability should be consistent with the measurement of the underlying cash flows included in the measurement of the linked item. Based on the March 2011 tentative decision on the discount rates for participating contracts, the discount rate used for these cash flows would be consistent with the discount rate used for the linked items. In this method, the insurer avoids an accounting mismatch and reports the linkage.

34. The next question is whether this information is relevant to users of financial information. Participation features do not result in additional risk for the insurer as long as the minimum guarantees are covered. Measuring the participation feature (ie the contractual link) in a way that delinks the insurance contract liability from the assets and liabilities does not depict appropriately the fact that participation features pass on risk to the policyholder. As the discussion in paragraphs 25 - 26 illustrates, an independent measurement model can fail to depict the contractual linkage that results in risk sharing between shareholder and policyholder if the measurement of the linked item is not fair value. It would be more useful to reflect the contractual linkage.

35. In the staff's view, it is important that the contractual feature refers explicitly to assets or liabilities actually held by the insurer, i.e. a participation feature as defined above, because the cash flows to the policyholder are determined by the actual performance (as defined in the contract with the policyholder) of those assets and liabilities. It should not be applied by analogy for so-called index-linked features of other insurance contracts, where there is no contractual linkage to the assets held by the insurer but to market values of items as observed in markets or other external indices. Although the insurer may choose to hold the assets underlying an index-linking feature, to reduce its own risk exposure, the payment to the policyholder does not depend on whether the insurer actually holds those assets.

36. Finally, we consider the implications for the measurement of the liability. Obviously, adjusting the measurement of the liability to reflect contractual linkages to assets not measured at fair value would not result in a true estimate of the ultimate probability-weighted expected cash flows nor a market consistent measurement of the insurance contract liability. However, the resulting measurement of the liability would depict the amounts to be distributed to the policyholders based on the performance also recorded in the financial statements up to the reporting date. This means it would also remain a faithful representation of the liability to the policyholders.

How IFRS 3/ ASC topic 805 treat similar economic phenomena

37. A similar approach to that proposed by the staff is in the accounting for an 'indemnification asset' in IFRS 3/ASC 805 *Business Combinations*. IFRS 3/ASC 805-20-25 require that, in a business combination, when an asset represents an indemnification related to a specific liability, the acquirer should recognise and measure that indemnification asset on the same basis as that specific liability. Paragraphs BC301-BC303 of the Basis for Conclusion of IFRS 3 discusses how the boards addressed this topic (reproduced in Appendix B).

38. The general issue of the indemnification asset and policyholder participation is very similar. It addresses the fact that another party participates in positive (and partially negative) risk development of an underlying asset or liability. In IFRS 3/ASC 805 the boards came to the conclusion that the measurement attribute in these cases should be consistent between the asset and the underlying liability. An example mentioned there was tax provisions. Policyholder participation in itself is a risk sharing between the insurer and the policyholder. Some would argue that there is no substantial difference between the two cases, other than the scale of application (broad for participating contracts, relatively specialised for indemnification assets).

Existing US GAAP guidance

39. The existing US GAAP guidance under ASC 944-50-25 uses a similar principle to address participation features:

> 'Limitations may exist on the amount of net income from participating insurance contracts of a life insurance entity that may be distributed to stockholders. In that circumstance, the policyholders' share of net income on those contracts that cannot be distributed to stockholders shall be recognized by both:
> a. Excluding that share from stockholders' equity by a charge to operations
> b. Recognizing that share as a credit to a liability relating to participating policyholders' funds.
> Dividends declared or paid to participating policyholders shall reduce the liability recognized in (b); dividends declared or paid in excess of the liability shall be charged to operations.'
>
> ASC 944-50-30-2 states: "Income-based dividend provisions for participating contracts ... shall be based on net income that includes adjustments between general purpose and statutory financial statements that will reverse and enter into future calculations of the dividend provision."
>
> EITF Topic D-41states that "By analogy to the requirements of Statement 109, the SEC staff believes that, in addition to adjusting deferred tax assets and liabilities, registrants should adjust other assets and liabilities that would have been adjusted if the unrealized holding gains and losses from securities classified as available-for-sale actually had been realized. That is, to the extent that unrealized holding gains or losses from securities classified as available-for-sale would result in adjustments of ... policyholder liabilities..., the SEC staff believes that those balance sheet amounts should be adjusted with corresponding credits or charges reported directly to shareholders' equity. ...For example... Certain policyholder liabilities also should be adjusted to the extent that liabilities exist for insurance policies that, by contract, credit or charge the policyholders for either a portion or all of the realized gains or losses of specific securities classified as available-for-sale."

40. For non-US business, the Societies of Actuaries interpreted this US guidance in a way that is very similar to the treatment of deferred taxes.[1] The proposed staff recommendation would be consistent with this US GAAP guidance.

[1] See Societies of Actuaries US GAAP for Life insurers Chapter 16

Summary and Staff recommendation

41. The staff recommends that the boards modify the measurement of the participation features within the insurance contract liability as proposed in the ED, for the following reasons:

    (a) The more relevant economic phenomenon is the contractual linkage between the assets/liabilities and the insurance contracts liability. The staff sees more benefit in trying to depict this phenomenon than to model the ultimate cash outflows and thereby create accounting mismatches.

    (b) The relationship between the performance of the assets/pool of contracts/entity and the insurance contracts liability can be more easily explained to users.

42. We discuss this in the following paragraphs.

Eliminating the mismatch by requiring insurers to apply the fair value option

43. Some would argue that an insurer could eliminate some of the accounting mismatches by choosing the fair value option where possible. However, the staff is not convinced that this would appropriately reflect the contractual linkage, because:

    (a) This would leave significant accounting mismatches for participation features for which there are no fair value options, for example for deferred tax assets, property, plant and equipment and other liabilities. As some participation features refer to the entire (statutory) surplus of the insurer in fulfilling the contract, this would in consequence leave any item on the balance sheet that is not fair valued exposed to an accounting mismatch.

    (b) In addition, there are items, where even a measurement at fair value does not prevent an accounting mismatch. For example, assume the policyholders participate in all costs of an entity. The entity purchases a new computer system where the costs are not included in the

measurement of the insurance contract liability (because they are not direct). Under the ED proposal for the accounting for participation features this would effectively result in an immediate recognition of a gain because the participation feature would be reflected directly in profit or loss as a reduction of future cash flows to the policyholders, whereas the asset is recognised with no income effect.

(c) Some would argue that the other accounting standards provide different measurement attributes for good reasons and the fair value option should only be seen as an exit for unavoidable mismatches.

(d) In many cases, the participation feature is based on a measurement that is closer to the IFRS/US GAAP book values (eg amortised cost for financial assets is closer than fair value to the participation system in many countries). In such cases, trying to measure the participation cash outflows on a current (ie fair value) basis and remedy the accounting mismatch with the fair value option appears counterintuitive in relation to the nature of the participation feature and to introduce artificial complexity.

44. Therefore, we propose this treatment even in situations where the fair value option is available to eliminate an accounting mismatch.

What would the liability represent under the staff recommendation?

45. The insurance contract liability under the staff recommendation would show the current liability to the policyholders under the participation feature based on the performance of the linked item as reported in the IFRS or US GAAP financial statements, reflecting the fact that the cash generated by the linked items determines the cash in which the policyholders will participate.

Asymmetric risk sharing

46. As described in the example in paragraph 25, the asymmetric risk sharing and the guarantees to policyholders are important phenomena that need to be reflected in

the measurement of the insurance contract liability. This also means that the current intrinsic value and time value of the options and the guarantees need to be reflected in the measurement of the insurance contract.

The use of other comprehensive income

47. Some of the performance of the contractually linked assets and liabilities may be reported in other comprehensive income (OCI). In the staff's view, an accounting mismatch would arise if the measurement of the participation feature in the liability did not follow that linkage. Consequently, the staff proposes that the measurement of the linked participation feature should also be reflected in OCI to the extent that it results from participation in items of OCI. If these other standards require recycling of some amounts, the participation feature measurement would follow this treatment.

Unit-linked contracts

48. In the staff's view, the approach proposed in this paper would apply equally to unit-linked contracts. Thus, there would be no need to treat unit-linked contracts as a separate case, as proposed in the ED. Furthermore, there would be no need to expand the proposed fair value options for treasury shares and owner-occupied property. This would be result in consistent treatment for all types of policyholder participation.

49.

Questions to the boards
The staff recommends that the boards decide that: 1) the fulfilment cash flows should include the cash flows expected to result from the policyholder participation on the same basis as the measurement of the underlying items the policyholder participates in. This could be assets and liabilities, the performance of underlying pool of insurance contracts or the performance of the entity. 2) the measurement of the participating contract should reflect the asymmetric risk sharing between insurer and policyholder in the contractually linked items that exists because of the minimum guarantee. 3) the presentation of the changes in the insurance contract liability in the statement of comprehensive income should be consistent with the presentation of the changes in the linked items (ie profit or loss, or in other comprehensive income) 4) the same measurement approach should apply to unit-linked and participating contracts. Consequently the boards should not proceed with the proposals in the IASB's exposure draft (ED) for consequential amendments relating to the following items held in unit-linked funds: treasury shares and owner occupied property.

Implications for other parts of the project

Unbundling of unit-linked contracts

49. For some unit-linked contracts the decision on unbundling could result that the unit-linking feature is unbundled and these contracts would be largely within the scope of the financial instruments standards. The staff will revisit the measurement decisions on unit-linked contracts after the boards' decision on unbundling.

Presentation of contracts with policyholder participation and unit linked contracts

50. The staff will consider the nature of both types of contracts in developing the presentation model.

Appendix A: Examples of accounting mismatches in the ED and the effect of the staff recommendation

A1. Some participation features are linked to the surplus of an entity. To the extent that the surplus reflects the measurement of items not at fair value, an accounting mismatch can occur. The following list indicates some assets and liabilities that may determine the measurement of participation features:

(a) Financial Instruments at **amortised cost** (IFRS 9 *Financial Instruments/* ASC 320-10). Tentative FASB decisions in the *Accounting for Financial Instruments* project also contain amortized cost provisions for some instruments.

(b) **Equity instruments at Fair Value with changes through OCI** (IFRS 9)

(c) **Debt instrument at Fair Value with changes through OCI (ASC 320-10).** Tentative FASB decisions in the *Accounting for Financial Instruments* project also contain FV-OCI provisions for some debt instruments.

(d) **Fair value option for a financial liability** (IFRS 9/ASC 825)

(e) **Taxes** (IAS 12 Income Taxes/ ASC topic 740 Income Taxes) are measured on an undiscounted basis.

(f) **Other liabilities** (for example an environmental contingency) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*/ASC topic 410-30 Environmental obligations. The measurement is based on an expected present value, but the recognition criteria can be different.

(g) **Investment property** (IAS 40 *Investment Property*/ there is no equivalent standard under US GAAP) uses alternative models: cost model and fair value model. The FASB is scheduled to deliberate the treatment of investment property held by qualifying entities in the near future.

(h) **Owner occupied property** (IAS 16 *Property, Plant and Equipment*/ ASC topic 970-360 Real Estate) uses alternative models: cost model and revaluation model.

(i) **Treasury shares** and **own debt instruments**. These are not considered as assets and consequently not recognised under IAS 32. (IAS 32/ASC 505 and ASC 470)

(j) **Investments in associates** (IAS 28 *Investments in Associates* / ASC topic 323 Investments-Equity Method and Joint Ventures). The measurement is based on the equity method, but for unit-linked contracts, the fair value option could be selected.

(k) Other activities accounted for in **standards that do not use a current** measurement (eg leases) and future standard developments (eg leases) that could create additional accounting mismatches

(l) **Expenses** that are included in the participation feature. For example, if the entity decides to purchase a new claims administration system (and the policyholders are participating in the expense), the expected present values includes the policyholder participation in all expenses until the system is amortised, while the cost are amortised over the time horizon.

A2. Under investment company guidance in ASC 946 the mismatches described above do not exist since an entity measures their assets and liabilities at fair value. Most separate accounts in the US are accounted for using the investment company guidance.

Appendix B: Excerpt from the Basis for Conclusion of IFRS 3 BC 301-303

Indemnification assets

BC301 A few constituents asked about the potential inconsistency if an asset for an indemnification is measured at fair value at the acquisition date and the related liability is measured using a different measurement attribute. Members of the FASB's resource group raised the issue primarily in the context of FASB Interpretation 48, which requires an entity to measure a tax position that meets the more-likely-than-not recognition threshold at the largest amount of tax benefit that is more than 50 per cent likely to be realised upon ultimate settlement with a taxing authority.

BC302 The boards understand that a business combination sometimes includes an indemnification agreement under which the former owners of the acquiree are required to reimburse the acquirer for any payments the acquirer eventually makes upon settlement of a particular liability. If the indemnification pertains to uncertainty about a position taken in the acquiree's tax returns for prior years or to another item for which the revised standards provide a recognition or measurement exception, not providing a related exception for the indemnification asset would result in recognition or measurement anomalies. For example, for an indemnification pertaining to a deferred tax liability, the acquirer would recognise at the acquisition date a liability to the taxing authority for the deferred taxes and an asset for the indemnification due from the former owners of the acquiree. In the absence of an exception, the asset would be measured at fair value, and the liability would be measured in accordance with the pertinent income tax accounting requirements, such as FASB Interpretation 48 for an entity that applies US GAAP, because income taxes are an exception to the fair value measurement principle. Those two amounts would differ. The boards agreed with constituents that an asset representing an indemnification related to a specific liability should be recognised and measured on the same basis as that liability.

BC303 The boards also provided an exception to the recognition principle for indemnification assets. The reasons for that exception are much the same as the reasons why the boards exempted deferred tax assets and liabilities and employee benefits from that principle. Providing an exception to the recognition principle for indemnification assets clarifies that the acquirer does not apply that principle in determining whether or when to recognise such an asset. Rather, the acquirer recognises the asset when it recognises the related liability. Therefore, the revised standards provide an exception to the recognition and measurement principles for indemnification assets.