STAFF PAPER

IASB | FASB Meeting

16 – 19 April 2012

Project	**Insurance contracts**		
Paper topic	Cover note: Background information and progress report		
CONTACT(S)	Andrea Pryde	apryde@ifrs.org	+44 (0)20 7246 6491
	Jennifer Weiner	jmweiner@fasb.org	+ 1 203-956-5305

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1. This paper:

   a. Provides background information about the insurance contracts project (paragraphs 3-18)

   b. Summarises the boards' progress in the insurance contracts project (paragraphs 21-25).

   c. Provides an overview of the papers for the April meeting, together with a summary of the staff recommendations (paragraphs 29-35).

   d. Describes next steps towards issuing a new IFRS (paragraph 38).

2. The Appendix provides a summary of previous decisions taken by the boards and describes what is still to come.

A reminder: why develop a building block approach?

3. At the most basic level, insurers receive cash in the form of premiums, invest that cash into assets (generally financial assets) and promise to pay cash to the policyholder, sometimes many years in the future. In addition, many insurance contracts create complex interdependencies between rights and obligations that

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make them difficult to account for using existing standards. The difficulties of applying generally applicable standards include:

a. Interdependencies between rights and obligations can make it difficult to identify the various performance obligations provided by the contract or to allocate the consideration paid by policyholders to those performance obligations.

b. Uncertainty of outcomes can make it difficult to make estimates reliably and options and guarantees can exacerbate the uncertainty of outcomes. There can be significant changes in the cash flows that would be needed to fulfill the contracts.

c. Long durations can mean that estimates made at the inception of a contract may not provide useful information throughout the life of the contract.

4. The boards' standard on insurance contracts is intended to address some of these difficulties. In undertaking this project, the boards intended to base their respective standards for insurance contracts on:

a. a coherent framework for all types of insurance contracts. This would eliminate much of the complexity that is present in insurance contracts accounting in many jurisdictions.

b. the current measurement of the insurance contracts liability, incorporating a current, unbiased estimate of the cash flows expected to fulfill the liability, an adjustment to reflect the time value of money (and, for the IASB, to reflect the effect of risk and uncertainty). The insurance contract liability should be calibrated at inception to the premium.

Coherent framework for all insurance contracts

5. The building block approach is useful to reflect the many different ways in which insurers make money, ie from asset management services, spread business or protection business. Some insurance contracts are predominantly

focused on one type of activity, for example, many non-life contracts are focused on providing risk protection. However, most insurance contracts blend different activities in different proportions and sometimes the importance of those activities varies over the life of a contract. For example, consider an account-driven contract with a guaranteed minimum death benefit. In the early stages of the contract, the risk undertaken in providing the death benefit is most significant. However, as the account balance builds up, the death benefit becomes less significant and the investment return and asset spreads become more relevant.

6. An advantage of a comprehensive, coherent framework for all insurance contracts is that, depending on what features are significant to any given contract at any given time, the measurement of the liability reflects those features as appropriate, without creating the cliff effects that would occur if different models were used to reflect the different features. Thus:

    a. For short duration contracts, the main driver of the insurance contract liability is the cash flows (and risk associated with those cash flows). If the building block approach is applied to short duration contracts, the residual margin would exist only during the coverage period, and it is unlikely that the initial estimate of the liability will change significantly during that period.

        (i) For short-tail contracts, discounting would be less significant, and may be immaterial. Similarly, the risk adjustment is likely to run-off in a fairly predictable manner over the coverage period and there is little potential for changes in the risk adjustment in the liability for incurred claims.

        (ii) For long-tail contracts, discounting would be more significant. The amount of risk and potential for changes in the risk adjustment in the liability for incurred claims would also be more significant.

b. Longer duration contracts generally mix investment and risk to a greater extent.

(i) For annuity contracts and term life contracts, initial expectations of the risk in a portfolio of contracts may not vary significantly over the life of the contract. Thus, changes in the risk adjustment would be less significant (although it may be a significant component at inception) and discounting and estimates of cash flows would be significant.

(ii) For participating contracts, the risks in the investment components and perhaps also the insurance components are passed to the policyholder to some extent. However, the estimates of cash flows arising from guarantees and the discounting of those cash flows remain significant.

7. In the past, accounting models have evolved to address the specific needs of the contract being considered. However, this creates problems when insurance contracts combine elements typically found in different types of contracts. For example, some property-casualty contracts may specify the payment of annuity payments, rather than a single lump sum. Such contracts combine underwriting risk (ie whether the insured event will occur) and investment risk (after the insured event occurs). If different accounting models are applied to underwriting risk and investment risk, it would not be clear which model to apply to such a contract. A comprehensive framework for insurance contracts avoids that problem.

8. At their February 2012 joint meeting:

a. the IASB tentatively decided that contracts should be eligible for the premium allocation approach if that approach would produce measurements that are a reasonable approximation to those that would be produced by the building block approach. Thus, the IASB confirmed its view that there should be a single accounting model for all types of insurance contracts.

b. the FASB tentatively decided that insurers would be required to apply the premium allocation approach for contracts that meet specified criteria. Thus, the FASB confirmed its view that there should be two accounting models for two different types of insurance contracts.

Current measurement of the insurance contracts liability

9. The use of a current measurement model for the insurance contracts liability is necessary for two important reasons:

   a. It provides transparent reporting of changes in the insurance contract liability and provides complete information about changes in estimates.

   b. It results in transparent reporting of the economic value of options and guarantees embedded in insurance contracts.

10. However, volatility is an inevitable consequence of a current measurement model. Volatility arises:

   (a) if the values of, or cash flows from, assets and liabilities respond differently to changes in economic conditions. Such **economic** mismatches may result in reported volatility which we believe faithfully represents the underlying economics.

   (b) 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 they are measured on different bases. We seek to eliminate such **accounting mismatches.**

11. We believe that volatility in itself is not undesirable as long as the source of volatility can be understood and clearly related to economic phenomena. Throughout their discussions, the boards have considered whether any reported volatility is a faithful representation of the underlying economic phenomena and sought to identify and eliminate any sources of accounting mismatch. Accordingly the boards:

a. introduced a ‘mirroring approach’ for participating contracts, which eliminates any mismatch between assets and liabilities that are contractually linked. This approach also means that, when permitted by existing accounting treatments, insurers could use cost-based measurements for the items underlying the policyholder participation, without creating an accounting mismatch.

b. permitted a top-down approach to determining the discount rate, which significantly reduces accounting mismatch arising from the effect of credit spread changes. The top-down approach does this by reflecting the effect of credit spread changes in both the assets and liability measurement. Thus, to the extent that an insurer is duration matched, and changes in spreads are driven by liquidity or sentiment, then this eliminates the effect of credit spread changes in profit and loss. This removes a portion of the volatility from the changes in bond yields, compared to the ‘bottom-up’ approach that most respondents interpreted the ED/DP to require. However, it does not eliminate the effect of estimated credit defaults.

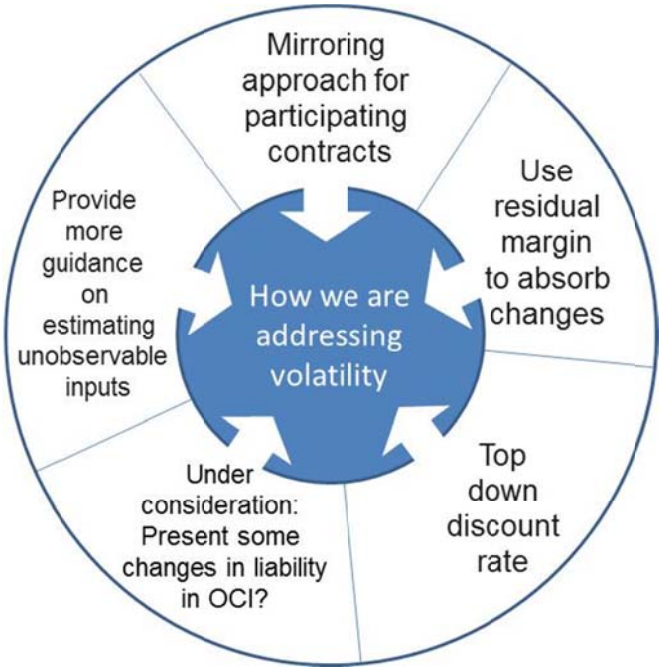
c. (for the IASB) unlocked the residual margin for changes in cash flow estimates. This updates the measure of the expected profit to be earned in a long-term contract and recognises the effect of some changes in the expected profit over the whole of the coverage period.

12. Furthermore, in response to concerns that current period fluctuations in discount rates exaggerate the volatility of very long-dated liabilities, we provided clarification that if there are no observable inputs (eg market data) for determining the discount rate, the insurer shall use an estimate that is consistent with the boards’ guidance on fair value measurement, in particular fair value measurements categorised within Level 3 of the fair value hierarchy. Thus an insurer is not required to use an observable input without adjustment if that input relates to a liability whose characteristics differ from the characteristics of the liability being measured. Because forecasts of unobservable inputs tend to

put more weight on longer term estimates than on short term fluctuations, this may mean that less volatility arises than some respondents had assumed.

13. We will explore at this meeting whether some changes in the insurance contract liability should be presented in other comprehensive income.

14. The changes we have made since the ED that would reduce volatility are summarized in the following diagram.



15. Nonetheless, we believe that when an insurer has an economic mismatch, market fluctuations give rise to real economic effects, and a current measurement of the liability portray those effects. Such economic mismatches include:

    a. Changes in expected credit losses on assets if those credit losses do not affect the amounts payable to policyholders.

    b. Changes in the risk premium that investors charge for bearing the risk that credit losses might exceed expectations if those credit losses do not affect the amounts payable to policyholders

    c. Changes in the premium that investors pay (as a reduced return) to invest in assets that provide liquidity, if the amounts paid to

policyholders do not include a similar reduction because the liabilities do not provide similar liquidity for policyholders.

d. Duration mismatches between assets and liabilities.

e. Any guarantees written by the insurer, eg a requirement that the insurer will pay policyholders the higher of a return based on actual asset returns and a specified minimum return.

16. In spite of this, we recognise that giving excessive prominence to those effects may not provide information in the clearest way to users of an insurer's financial statements if that information does not help users to understand the source of volatility and to relate it to economic phenomena. Accordingly, we are continuing to explore ways to present the effects of economic mismatches in a way that distinguishes market movements from longer term performance. At this meeting, the IASB will hold an education session to explore approaches that would present some changes in the insurance contract liability in other comprehensive income.

What would change for current practice

17. Because different accounting models have evolved in different jurisdictions and at different times to address the products most prevalent in their jurisdictions, the proposed model would affect different jurisdictions in different ways. However, in the main, there will be relatively little change for many non-life contracts. The main changes for non-life are:

a. The introduction of discounting (and risk adjustment for IASB) in measuring the liability for incurred claims.

b. More information in the financial statements about claims liabilities, changes in risk and effects of discounting.

18. For life contracts, there is more significant divergence today and more significant changes would result from the standard. The main changes are:

a. Updated assumptions rather than locked-in assumptions

b. Recognition of guarantees and options previously not recognised (or recognised using a smoothing model) using expected present value of cash flows, discounted using current, market-consistent discount rates.

c. More information about assumptions and effects of assumptions including risk and effects of discounting.

d. A discount rate that reflects the features of the insurance liability, rather than one that reflects the features of the assets backing that liability. The resulting measurement of the liability will not be reduced by hoped-for investment spreads.

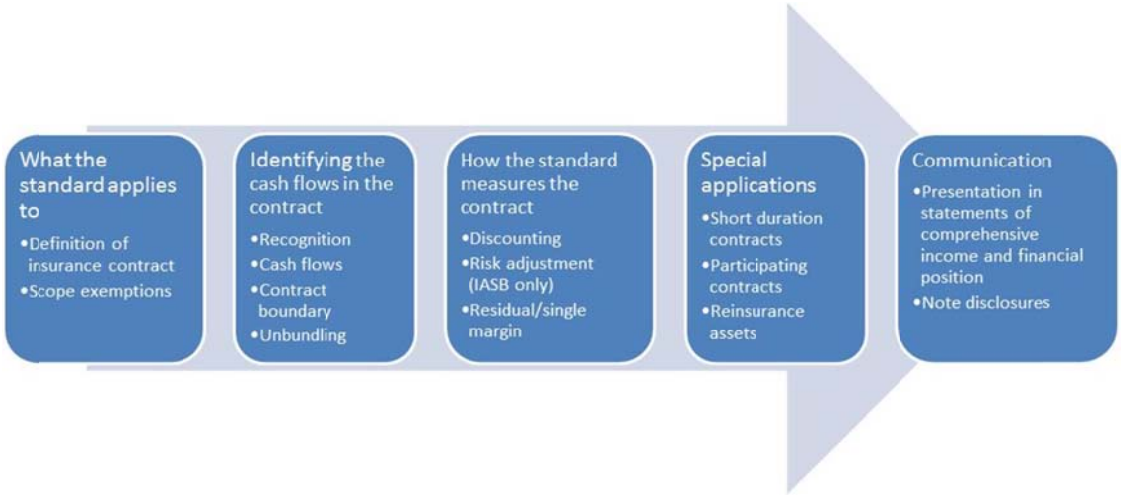
e. More transparent information about changes in estimates.

f. Cash flows used to measure insurance contracts would include acquisition costs. As a result, there would be no need to defer acquisition costs, and no need for complex and hard-to-understand mechanisms for dealing with that deferral.

g. One accounting model for all life insurance contracts, rather than different accounting models based on product type.

Where we are in the project

19. The ED/DP contained proposals for a standard on insurance contracts as follows:



20. This section summarises our progress in redebating those proposals. Further details are in the appendix.

Tentative decisions so far

21. We have substantially completed the tentative decisions relating to the measurement of the insurance contract liability. In reaching these decisions, the boards have reached converged decisions in many key areas, notably that:

    a. an insurer should measure insurance contracts on the basis of all the cash flows expected to arise as the insurer fulfils the contract, adjusted to reflect any contractual linkage between the contract and any underlying assets.

    b. an insurer should discount those cash flows using a rate that reflects only the characteristics of the liability.

    c. the measurement of insurance contracts should use updated estimates and assumptions and, where available, estimates consistent with prices in financial markets.

    d. there should be no gain at inception.

    e. the presentation of financial statements should show information about key drivers of profitability, including volume information.

    f. The mechanics of the premium allocation approach. The premium allocation approach would, in general, be applied to the measurement of the liability for remaining coverage of contracts with a coverage period of one year or less or contracts that meet specified criteria.

22. The IASB and FASB have to come to different conclusions in some areas, notably on:

    a. Whether the measurement of an insurance contract liability applying the building block approach should:

(i) include an explicit, updated risk adjustment (IASB), or reflect risk implicitly through a single margin (FASB) when contracts are not eligible for the premium allocation approach.

(ii) offset changes in some estimates of cash flows in the measurement of the residual margin ('unlocking', IASB), or recognise all changes in estimates in the statement of comprehensive income (FASB).

(iii) in estimating the cash flows used to measure the contract, include acquisition costs for both successful and unsuccessful efforts (IASB) or for successful efforts only (FASB).

b. Whether the measurement of the liability for incurred claims for contracts applying the premium allocation approach should include an explicit, updated risk adjustment (IASB), or include no margin to reflect risk, but be measured using only the present value of expected cash flows. (FASB).

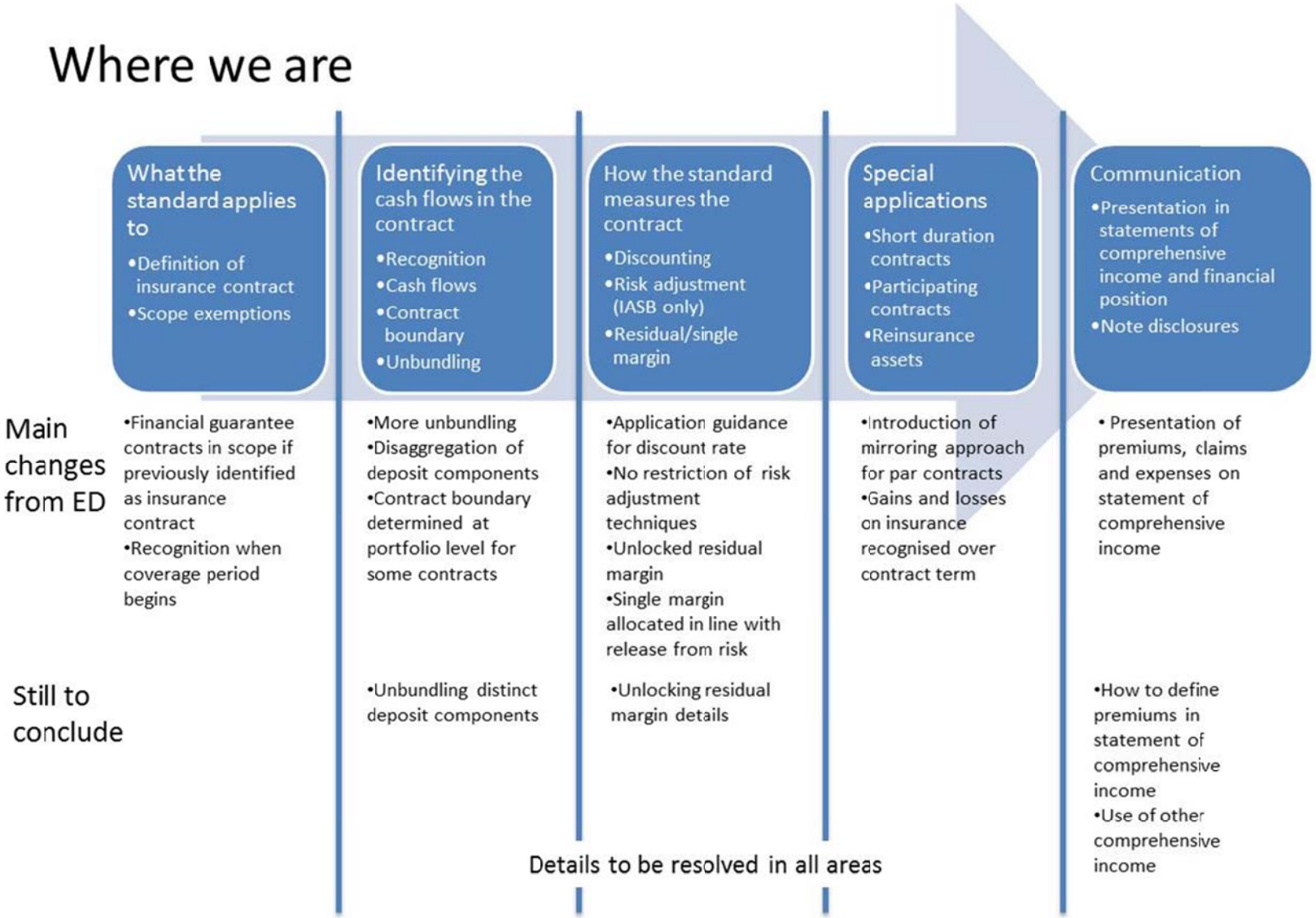
23. As noted in paragraph 8, the IASB and FASB also differ in the eligibility criteria for the premium allocation approach for measuring insurance contracts.

24. In addition, insurers hold assets, in particular financial assets, to back insurance contract liabilities and the IASB and FASB have differing conclusions on how to account for those financial assets. In January 2012, the IASB and FASB decided to discuss selected aspects of their classification and measurement models jointly, to seek to reduce key differences. The boards plan to discuss each issue jointly and consider what changes, if any, they would propose to make to their separate models and incorporate in their respective exposure drafts. For the IASB, such an exposure draft would propose amendments to its recently issued standard, IFRS 9 *Financial Instruments*. As noted in November 2011, the IASB intends to make any changes as soon as possible and to limit the scope of the project to minimise potential disruption to those who have already applied, or who are close to applying IFRS 9, and to assist in timely

completion of the project. The boards are expected to begin discussions on this topic from April 2012.

25. The diagram on the following page summarises where the boards are, and the main changes from the ED. Further details of the boards' tentative decisions are given in the Appendix.

Where we are


What the standard applies to
•Definition of insurance contract
•Scope exemptions
Identifying the cash flows in the contract
•Recognition
•Cash flows
•Contract boundary
•Unbundling
How the standard measures the contract
•Discounting
•Risk adjustment (IASB only)
•Residual/single margin
Special applications
•Short duration contracts
•Participating contracts
•Reinsurance assets
Communication
•Presentation in statements of comprehensive income and financial position
•Note disclosures
Main changes from ED
•Financial guarantee contracts in scope if previously identified as insurance contract
•Recognition when coverage period begins
•More unbundling
•Disaggregation of deposit components
•Contract boundary determined at portfolio level for some contracts
•Application guidance for discount rate
•No restriction of risk adjustment techniques
•Unlocked residual margin
•Single margin allocated in line with release from risk
•Introduction of mirroring approach for par contracts
•Gains and losses on insurance recognised over contract term
• Presentation of premiums, claims and expenses on statement of comprehensive income
Still to conclude
•Unbundling distinct deposit components
•Unlocking residual margin details
•How to define premiums in statement of comprehensive income
•Use of other comprehensive income
Details to be resolved in all areas

Review of last meeting

26. At the last meeting, the boards:

    a. concluded discussions on the unit of account

    b. decided that, in general, the investment and insurance components of a contract should be measured together using the insurance contracts model. However, premiums for the investment component should be disaggregated from the total premiums and excluded from the statement of comprehensive income.

27. In addition, the boards asked the staff to consider whether some investment components that are not interrelated should be unbundled.

28. The IASB also discussed the possible use of OCI in an education session

Overview of papers for this meeting

29. At this meeting, the boards will consider papers on the following topics:

    a. The use of other comprehensive income for some changes in the insurance contracts liability (agenda papers 2A/82A-2E/82E)

    b. Issues relating to reinsurance (agenda paper 2F/82F)

    c. Issues relating contract modifications, policy loans and riders (agenda paper 2G/82G and 2H/82H)

    d. the FASB's single margin approach (education session, agenda paper 2I/82I).

The use of other comprehensive income for some changes in the insurance contracts liability

30. Agenda papers 2A/82A-2E/82E explore approaches that would present changes in the insurance contracts liability in other comprehensive income. These papers have been prepared on the working assumption that the fair value of at

least some debt instruments would be presented in other comprehensive income. No decisions will be made at this session.

Reinsurance

31. Agenda paper 2F/82F *Reinsurance* discusses:

    a. the period the FASB single margin and the IASB residual margin on profitable retroactive reinsurance contracts should be released over. The staff recommends that the residual or single margin included in the cedant's reinsurance recoverable and the reinsurer's insurance contract liability should be amortized over the remaining settlement period in the same manner as the release of the single/residual margin, ie in line with the pattern of services (for the IASB) or release from risk (for the FASB).

    b. the measurement and recognition of loss sensitive features and other contingent terms of reinsurance contracts. The staff recommends , essentially, that insurer should treat cash flows resulting from loss sensitive features that are not accounted for as investment components as part of the claims and benefits cash flows (rather than part of the premiums) and that any premium adjustments that are not loss-sensitive should be treated in the same way as other changes in estimates of premiums arising from the contract.

    c. the accounting model (building block approach or premium allocation approach) used by the cedant and reinsurer:

        (i) For the IASB the staff recommends that both the insurer and reinsurer should evaluate whether to account for the reinsurance contract using the building block approach or premium allocation approach in the same manner in which an insurer should evaluate a direct insurance contract approach. In other words, the PAA would be permitted if it would produce

measurements that are a reasonable proxy to those that are produced by the BBA.

(ii) For the FASB the staff recommends that:

1. The **reinsurer** should evaluate whether the reinsurance contract should be accounted for under the building block approach or premium allocation approach in the same manner in which an insurer should evaluate a direct insurance contract.

2. The **cedant** should account for a reinsurance contract using the same approach (building block approach or premium allocation approach) that the cedant uses to account for the underlying direct insurance contracts. Reinsurance contracts that reinsure both insurance contracts measured using the building block approach and insurance contracts measured using the premium allocation approach, should be separated based on the underlying contract measurement model and each component accounted for using the same approach used to account for the underlying direct insurance contracts.

Contract modifications, riders and policy loans

32. Agenda papers 2G/82G and 2H/82H consider features that modify contracts.

33. Agenda paper 2G/82G *Contract modifications* discusses how to account for modifications to contracts after inception. This paper recommends that:

a. Insurers shall consider whether a contract modification would have resulted in a different assessment of any of the following items if the amended terms had been in place at the inception of the contract:

(i) Whether the insurance contract is within the scope of the insurance contract standard;

(ii) Whether an insurance contract should be accounted for under the premium allocation approach or the building block approach; or

(iii) Which portfolio the insurance contract would be included in.

Any modification that would have changed one or more of these conclusions would be deemed a substantial modification for which insurers shall extinguish the old contract and recognize the new contract under the applicable guidance for the new contract.

b. When an insurer makes a substantial modification to an insurance contract, the gain or loss on extinguishment of the original contract should be determined by measuring the existing insurance contract using the current entity-specific price that the insurer would hypothetically charge the policyholder for a contract equivalent to the newly recognized insurance contract.

(a) Insurers should account for non-substantial modifications as follows:

(i) If the modification eliminates the insurer's obligation to provide some of the benefits that the contract would previously have required it to provide, the insurer shall derecognise that portion of its obligation (including any related portion of the residual/single margin).

(ii) If the modification entitles the policyholder to further benefits, the insurer shall treat the modification as if the amendment was a new standalone contract (i.e., the margin is determined in the same way as for a new standalone contract with no effect on the measurement of the original contract)

(b) Reinsurers and cedants shall present any gains or losses on commutations as an adjustment to claims or benefits but should not gross up the premiums, claims, or benefits in recognising the transaction on the statement of comprehensive income.

34. Agenda paper 2H/82H *Riders and policy loans* discusses how to account for some features that might modify an insurance contract that are present at the inception of the contract. In this paper, the staff recommends:

    a. in applying the general decisions on unbundling and disaggregation, policy loans should be considered in the determining the amount of the investment component which they relate to,

    b. insurers should account for riders that are part of the insurance contract at inception as part of the contractual terms of the contract. Thus the general decisions on unbundling and disaggregation should apply to riders.

Single margin approach

35. Agenda paper 2I/82I *Single margin approach* contains material for an education session for the IASB to consider the FASB's single margin approach.

36. No decisions will be made at this session.

37. Agenda paper 3A/73A *Report on FASB single margin approach* from the joint meeting in the week commencing 19 September summarized the FASB's decisions on the single margin. That paper and the FASB staff paper that was the basis for the FASB's discussions on the single margin is available to IASB members on request from the staff.

Next steps

38. The boards expect to work through the remaining topics, summarised in the diagram after paragraph 19, and plan to evaluate any differences between the boards in the context of a near-final model. The boards would then assess whether they can come together on some or all of those differences. After that point, the FASB would publish an exposure draft. However, the next steps after that point for the IASB are less clear because its due process is further forward and because of the urgent need for an IFRS on insurance contracts. Thus, the

IASB would need to consider whether to move straight to a staff review draft with the aim of finalising an IFRS, publish an exposure draft with questions focussed on a narrow set of issues, or publish a comprehensive joint exposure draft with the FASB. Both boards expect to complete technical discussions by mid-2012.

Appendix: Detailed progress report

The following table summarises the progress the boards have made and describes what is still to come. Main changes since AP2/81 for the March meeting are marked (new text underlined, deleted text struck-through).

	Topic	Tentative decisions	Open points
	Building block 1 – Which cash flows?		
1.	Recognition point	• Recognise insurance contract assets and liabilities when the coverage period begins, unless facts and circumstances indicate that contract might be onerous. • A cedant should recognize a reinsurance asset: o when the reinsurance contract coverage period begins, if the reinsurance coverage is based on aggregate losses of the portfolio of underlying contracts covered by the reinsurance contract. o when the underlying contract is recognized, in all other cases.	• Treatment of acquisition costs in the pre-coverage period
2.	Contract boundary	• Contract renewals should be treated as a new contract: o when the insurer is no longer required to provide coverage; or o when the existing contract does not confer any substantive rights on the policyholder. • 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. • 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 when 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.	• Consider whether there are unintended consequences of the decision to determine the contract boundary on the basis of the portfolio in some cases.

	Topic	Tentative decisions	Open points
		• All renewal rights should be considered in determining the contract boundary whether arising from a contract, from law or from regulation.	
3.	Fulfilment cash flows – objective	Expected value, with guidance that: • expected value refers to the mean that considers all relevant information; and • not all possible scenarios need to be identified and quantified, provided that the estimate is consistent with the measurement objective of determining the mean. • if an insured event (for example an infrequent, high-severity event such as a hurricane) was impending at the end of the reporting period and subsequently occurs (or does not occur), that subsequent occurrence (or non-occurrence) does not constitute evidence of a condition that existed at the end of the reporting period (non-adjusting event according to IAS 10)	
4.	Fulfilment cash flows – which cash flows	• Include all costs that the insurer will incur directly as it fulfils the contracts in that portfolio, ie: o costs that relate directly to the fulfilment of the contracts in the portfolio; o 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 o such other costs as are specifically chargeable to the policyholder under the terms of the contract. • 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.	• Treatment of taxes paid on behalf of policyholders • **Agenda paper 2G/82G *Amendments and Modifications and Commutations of insurance contracts* and 2H/82H *Policy loans and riders* discuss when modification to contracts would affect estimates of cash flows.**
5.	Acquisition	Include in fulfillment cash flows all the direct costs that the insurer necessarily incurs in	• Whether to net

	Topic	Tentative decisions	Open points
	costs	acquiring the contracts in the portfolio, and exclude indirect costs such as: • software dedicated to contract acquisition • equipment maintenance and depreciation • agent and sales staff recruiting and training • administration • rent and occupancy • utilities • other general overhead • advertising. FASB: additionally exclude the costs necessarily incurred in acquiring the contracts in the portfolio but deemed to relate to unsuccessful acquisition efforts.	acquisition costs against the single/residual margin in the building block approach or against the liability for remaining coverage in the premium allocation approach and present that amount separately from the present value of expected cash flows (plus a risk adjustment for the IASB).
	Building block 2 – Time value of money		
6.	Discounting	• Adjust the future cash flows for the time value of money using a current discount rate that reflects the characteristics of the insurance contract liability. That rate should be updated each reporting period • Discounting not required when the effect of discounting would be immaterial. • Practical expedient: An insurer that applies the premium allocation approach is permitted not to discount liabilities for incurred claims which are expected to be paid within 12 months. An insurer that elects to apply this practical expedient should use an undiscounted basis when identifying whether contracts are onerous and in measuring the liability for onerous contracts.	
7.	Discount rate	(a) No prescribed method to determining the discount rate, but rate should: (i) be consistent with observable current market prices for instruments with cash flows whose characteristics reflect those of the insurance contract liability,	

	Topic	Tentative decisions	Open points
		including timing, currency and liquidity, but excluding the effect of the insurer's non-performance risk; (ii) 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 (iii) reflect only the effect of risks and uncertainties that are not reflected elsewhere in the measurement of the insurance contract liability. (iv) Reflect any dependence between the amount, timing or uncertainty of the cash flows arising from an insurance contract and the performance of specific assets (ie for participating contracts). (b) Provide application guidance that when 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 insurance contract liability. In those cases, 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: (i) An insurer shall determine an appropriate yield curve based on current market information. (ii) 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. (iii) to determine the yield curve, 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: (1) Type I, which adjust for differences between the timing of the cash flows to	

	Topic	Tentative decisions	Open points
		ensure that the durations of the assets in the portfolio (actual or reference) selected as a starting point are matched with the duration of the liability cash flows. (2) 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 those risks, the entity uses an appropriate technique to determine that market risk premium, consistent with the objective for the discount rate, as stated above. (iv) 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.	
	Building block 3 – Risk adjustment		
8.	Risk adjustment	**IASB:** (a) Measurement of an insurance contract should include an explicit adjustment for risk. That adjustment should be determined independently from the premium and re-measured in each reporting period. (b) The objective of risk adjustment should be to reflect the 'compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfils the insurance contract', including the extent to which any diversification benefits affect the amount of compensation required. (c) No limit on the range of available techniques to determine the risk adjustment. (d) Application guidance: (i) the risk adjustment measures the compensation that the insurer would require to make it indifferent between (1) fulfilling an insurance contract liability which would have a range of possible outcomes or (2) fulfilling a fixed liability that has the same expected present value of cash flows as the insurance contract. For example, the risk adjustment would measure the compensation that the insurer would require to make it indifferent between (1) fulfilling a liability that has a	

	Topic	Tentative decisions	Open points
		50% probability of being 90 and a 50% probability of being 110 or (2) fulfilling a liability of 100. (ii) in estimating the risk adjustment, the insurer should consider both favourable and unfavourable outcomes in a way that reflects its degree of risk aversion. A risk averse insurer would place more weight on unfavourable outcomes than on favourable ones. (iii) Retain the list of characteristics, proposed in paragraph of B72 of the ED, that a risk adjustment technique should exhibit if that technique is to meet the objective of the risk adjustment (iv) Retain as examples the three techniques proposed in the ED (confidence levels, conditional tail expectation and cost of capital), together with the related application guidance (e) Confirmed the confidence level equivalent disclosure that had been proposed in paragraph 90(b)(i) of the ED. **FASB** (f) Measurement of an insurance contract should use a single margin approach that recognises profit as the insurer satisfies its performance obligation to stand ready to compensate the policyholder if a specified uncertain future event adversely affects that policyholder.	
		Building block 4 – residual margin	
9.	Residual / single margin	• No gain at inception of an insurance contract. • Any loss on day one <u>determined at portfolio level</u> recognised immediately in profit or loss (net income). *For residual margin (IASB only)* • Changes in estimates for some cash flows offset prospectively in the residual margin (unlocking). • Changes in risk adjustment recognised in profit or loss in the period of the change	• Whether to unlock the residual margin for changes in discount rate *(IASB only)* • ~~Level of aggregation for measuring and allocating residual /~~

	Topic	Tentative decisions	Open points
		• Residual margin allocated over the coverage period on a systematic basis that is consistent with the pattern of transfer of services provided under the contract *For single margin (FASB only):* • The single margin should be recognised as profit as the insurer satisfies its performance obligation to stand ready to compensate the policyholder if a specified uncertain future event adversely affects that policyholder, determined at portfolio level. • An insurer satisfies its performance obligation as it is released from exposure to risk as evidenced by a reduction in the variability of cash outflows. • An insurer is released from risk on the basis of reduced uncertainty in the timing of the insured event and/or as variability in the cash flows is reduced as information about expected cash flows becomes more known throughout the life cycle of the contract. • An insurer should not remeasure or recalibrate the single margin to recapture previously recognised margin.	~~single margin (to be discussed in **agenda paper 2A/81A *Unit of account: Portfolio***)~~ • Agenda paper 2I/82I describes the FASB's single margin approach.
	Application guidance for building blocks		
10.	Participating features	• When an insurance contract liability requires payment depending wholly or partly on the performance of specified assets and liabilities of the insurer, the measurement of that liability should include all such payments that result from that contract, whether paid to current or future policyholders. • 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 discount rate shall reflect that dependence. That discount rate shall reflect only the characteristics of the insurance contract liability (consistent with the objective for the discount rate used to measure non-participating insurance contracts). • Measure the performance-linked participation feature in a way that mirrors how the underlying items are measured in the US GAAP/IFRS financial statements. That could be achieved by two methods, which both lead to the same measurement:	• Clarify how previous decisions apply to contracts with non-guaranteed features that are not performance linked • Whether proposed measurement creates a need for any specific disclosures

	Topic	Tentative decisions	Open points
		○ eliminating from the expected present value of the fulfillment cash flows (including the risk adjustment for the IASB)] changes in value not reflected in the measurement of the underlying items; or ○ adjusting the insurer's current liability (that is, the contractual obligation incurred to date) to eliminate accounting mismatches that reflect timing differences (between the current liability and the measurement of the underlying items in the US GAAP/IFRS statement of financial position) that are expected to reverse within the boundary of the insurance contract. • An insurer should present changes in the insurance contract liability in the statement of comprehensive income consistently with the presentation of changes in the linked items (ie in profit or loss, or in other comprehensive income). • If options and guarantees embedded in insurance contracts are not separately accounted for as derivatives using the financial instrument requirements, they should be measured within the overall insurance contract obligation, using a current, market-consistent, expected value approach. • [IASB] The insurer may recognise and measure treasury shares and owner – occupied property at fair value through profit or loss.	
11.	Premium allocation approach	*For the FASB*: (a) Insurers should apply the building block approach rather than the premium allocation approach if, at the contract inception date, either of the following conditions is met: (i) it is likely that, during the period before a claim is incurred, there will be a significant change in the expectations of net cash flows required to fulfil the contract; or, (ii) significant judgement is required to allocate the premium to the insurer's obligation to each reporting period. This may be the case if, for example, significant uncertainty exists about: – the premium that would reflect the exposure and risk that the insurer has	• Whether to deduct acquisition costs in determining the single/residual margin in the building block approach or against the liability for remaining coverage in the premium allocation approach and present

	Topic	Tentative decisions	Open points
		for each reporting period; or – the length of the coverage period. (iii) The premium allocation approach should be required for contracts that qualify for that approach. *For the IASB* (a) Permit, rather than require, insurers to apply the premium allocation approach if that approach would produce measurements that are a reasonable approximation to those that would be produced by the building block approach. (b) State that the premium allocation approach is deemed to produce measurements that are a reasonable approximation to those that would be produced by the building block approach if the coverage period is one year or less. (c) Provide application guidance that this there would not be a reasonable approximation between the approaches if: (i) it is likely that, during the period before a claim is incurred, there will be a significant change in the expectations of net cash flows required to fulfil the contract; or, (ii) significant judgement is required to allocate the premium to the insurer's obligation to each reporting period. This may be the case if, for example, significant uncertainty exists about: – the premium that would reflect the exposure and risk that the insurer has for each reporting period; or – the length of the coverage period. *For both the IASB and the FASB:* (a) In the premium allocation approach, the insurer measures the liability for remaining coverage using the premium receivable at inception. (b) Acquisition costs should include directly attributable costs (for FASB limited to successful efforts only), consistently with the building block approach. The insurer is	that amount separately from the expected present value of cash flows (plus a risk adjustment for the IASB).

	Topic	Tentative decisions	Open points
		permitted to recognise all acquisition costs as an expense if the coverage period is one year or less. (c) The insurer shall reduce the measurement of the liability for remaining coverage over the coverage period as follows: ▪ On the basis of time, but ▪ On the basis of the expected timing of incurred claims and benefits if that pattern differs significantly from the passage of time. (d) For contracts that have a significant financing component (defined in the same way as in the revenue recognition proposals), the liability for remaining coverage should reflect time value of money (by discounting and interest accretion). However insurers need not discount or accrue interest on the liability for remaining coverage if the period between the premium payment and satisfaction of the obligation to provide insurance coverage is expected to be one year or less. (e) For the IASB the liability for incurred claims is measured using the risk-adjusted expected present value of fulfilment cash flows. For the FASB, if an insurer applies the premium allocation approach to measure the liability for remaining coverage, it shall measure the liability for incurred claims using the expected present value of cash flows, without adding a margin. (f) Practical expedient: if an insurer applies the premium allocation approach to measure the liability for remaining coverage, it need not discount liabilities for incurred claims which are expected to be paid within 12 months. An insurer that elects to apply this practical expedient should use an undiscounted basis when identifying and measuring onerous contracts. (g) When applying the premium allocation approach, an insurer shall test whether a contract is onerous if facts and circumstances indicate that the contract might be onerous.	
12.	Reinsurance	(a) [IASB only] The ceded portion of the risk adjustment should represent the risk being	• Presentation

	Topic	Tentative decisions	Open points
		removed through the use of reinsurance. (b) If the expected present value of the fulfillment cash flows (including the risk adjustment for the IASB) for the reinsurance contract is: (i) Less than zero and the coverage provided by the reinsurance contract is for future events, the cedant should include that amount in the measurement of the reinsurance recoverable, representing a prepaid reinsurance premium and should recognise the cost over the coverage period of the underlying insurance contracts. (ii) Less than zero and the coverage provided by the reinsurance contract is for past events, the cedant should recognise the loss immediately. (iii) Greater than zero, the cedant should recognise a reinsurance residual margin [IASB] / single margin [FASB]. (c) The cedant should estimate the expected present value of the fulfillment cash flow for the reinsurance contract, including the ceded premium and without reference to the residual/composite margin on the underlying contracts, in the same manner as the corresponding part of the expected present value of the fulfillment cash flows for the underlying insurance contract or contracts, after remeasuring the underlying insurance contracts on initial recognition of the reinsurance contract. (d) When considering non-performance by the reinsurer: (i) The cedant shall apply the impairment model for financial instruments when determining the recoverability of the reinsurance asset. (ii) The assessment of risk of non-performance by the reinsurer should consider all facts and circumstances, including collateral. (iii) Losses from disputes should be reflected in the measurement of the recoverable when there is an indication that current information and events suggest the cedant may be unable to collect amounts due according to the contractual terms of the reinsurance contract.	• When and whether a reinsurance contract modifies the underlying contract • Interaction with requirements for short-duration contracts • Interaction with other requirements in standard Some to be discussed in **agenda paper 2F/82F *Reinsurance*** for this meeting

	Topic	Tentative decisions	Open points
13.	Onerous contracts	• ~~An~~ A portfolio of insurance contracts is onerous if the expected present value of the future cash outflows from that ~~contract~~ portfolio [plus, for the IASB, the risk adjustment] exceeds: o the expected present value of the future cash inflows from that ~~contract~~ portfolio (for the pre-coverage period). o the carrying amount of the liability for the remaining coverage (for the premium allocation approach). • IASB: the risk adjustment should be considered when identifying and measuring onerous contracts. • Onerous contracts should be measured: o If identified in the pre-coverage period, on a basis that is consistent with the measurement of the liability recognised at the start of the coverage period. o If identified under the premium allocation approach, on a basis that is consistent with the measurement of the liability for claims incurred. o An insurer that elects not to discount the liability for incurred claims that are expected to be paid within 12 months should use an undiscounted basis when identifying and measuring onerous contracts. o The measurement of the liability for onerous contracts should be updated at the end of each reporting period.	• ~~Unit of account for onerous contracts (to be discussed in **agenda paper 2A/81A *Unit of account: Portfolio***)~~
		Definitions, scope and unbundling	
14.	Definitions	• Definition of an insurance contract - Confirm proposed definition in the ED and DP, together with the guidance that: o an insurer should consider the time value of money in assessing whether the additional benefits payable in any scenario are significant. o 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	• ~~Definition of portfolio (to be discussed in **agenda paper 2A/81A *Unit of account: Portfolio***)~~

	Topic	Tentative decisions	Open points
		premiums. • If a reinsurance contract does not transfer significant insurance risk because the assuming company is not exposed to a loss, the reinsurance contract is nevertheless deemed to transfer significant insurance risk if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts is assumed by the reinsurer. • An insurer should assess the significance of insurance risk at the individual contract level. Contracts entered into simultaneously with a single counterparty for the same risk, or contracts that are otherwise interdependent should be considered a single contract for the purpose of determining risk transfer. • *IASB*: A portfolio of insurance contracts should be defined as contracts that are: o subject to similar risks and priced similarly relative to the risk taken on; and o managed together as a single pool. • *FASB*: A portfolio of insurance contracts should be defined as contracts that are: o subject to similar risks and priced similarly relative to the risk taken on; and o have similar duration and similar expected patterns of release of the single margin.	
15.	Scope	• Exclude from the scope of the insurance contracts standard fixed–fee service contracts that provide service as their primary purpose and that meet all of the following criteria: o The contracts are not priced based on an assessment of the risk associated with an individual customer, o The contracts compensate customers by providing a service, rather than cash payment, and, o The type of risk transferred by the contracts are primarily related to the utilization (or frequency) of services relative to the overall risk transferred • *IASB*: Financial guarantee contracts (as defined in IFRSs) would not be in the scope of	• FASB: which financial guarantee arrangements, if any, should be within the scope of the insurance contracts standard.

	Topic	Tentative decisions	Open points
		the insurance contracts standard as proposed in the ED. Instead an issuer of a financial guarantee contract (as defined in IFRSs): o may account for the contract as an insurance contract if the issuer had previously asserted that it regards such contracts as insurance contracts; and o should apply the financial instruments standards to these contracts in all other cases. • Confirmed all the other scope exceptions proposed in the ED	
16.	Unbundling	(a) An insurer should separate **embedded derivatives** that are not closely related to the insurance contract and account for them using IFRS 9 *Financial Instruments*. (b) An insurer shall identify whether any promises to provide goods or services in an insurance contract would be performance obligations as defined in the Exposure Draft *Revenue from Contracts with Customers*. If a performance obligation to provide goods or services is distinct, an insurer shall apply the applicable IFRSs or US GAAP in accounting for that performance obligation. (i) A performance obligation is a promise in a contract with a policyholder to transfer a good or service to the policyholder. Performance obligations include promises that are implied by an insurer's customary business practices, published policies, or specific statements if those promises create a valid expectation of the policyholder that the insurer will transfer a good or service. Performance obligations do not include activities that an insurer must undertake to fulfil a contract unless the insurer transfers a good or service to a policyholder as those activities occur. For example, an insurer may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the policyholder. Hence, the promise to perform those setup activities is not a performance obligation. (ii) Except as specified in the following paragraph, a good or service is distinct if either of the following criteria is met:	• Issues related to contract riders (to be discussed in **agenda paper 2H/82H *Riders and policy loans***) • Allocation of expenses to unbundled components • Whether to permit unbundling where not required • Whether any investment components (as defined) are sufficiently distinct from the insurance component that they should be recognised separately and measured applying the financial instrument standard,

	Topic	Tentative decisions	Open points
		(1) The insurer regularly sells the good or service separately. (2) the policyholder can benefit from the good or service either on its own or together with other resources that are readily available to the policyholder. Readily available resources are goods or services that are sold separately (by the insurer or another entity), or resources that the policyholder already has obtained (from the insurer or from other transactions or events). (iii) Notwithstanding the requirements in previous paragraph, a good or service in an insurance contract is not distinct and, therefore, the insurer shall account for the good or service together with the insurance component under the insurance contracts standard if both of the following criteria are met: (1) The good or service is highly interrelated with the insurance component and transferring the good or service to the policyholder requires the insurer also to provide a significant service of integrating the good or service into the combined insurance contract the insurer has entered into with the policyholder. (2) The good or service is significantly modified or customized in order to fulfil the contract. ~~[FASB only:] An insurer should separate **explicit account balances** from the insurance contract liability. Explicit account balances are account balances within a contract that meet both the following criteria:~~ • ~~the balance is an accumulation of the monetary amount of transactions between the policyholder and an insurer.~~ • ~~The balance is credited with an explicit return. A return is explicit if it is determined by applying either of the following to the balance:~~ o ~~A contractual formula in which the insurer may have the ability to reset the return rate during the life of the contract~~ o ~~An allocation determined directly by the performance of the specified assets.~~	rather than the insurance contracts standard. • *FASB only*: what amount to exclude from the aggregate premium presented in the SCI.

	Topic	Tentative decisions	Open points
		• ~~(IASB members indicated their preference:~~ o ~~to measure explicit account balances as part of the insurance contract~~ o ~~to disaggregate such explicit account balances for presentation or disclosure.~~ o ~~to consider whether further deposit components could be disaggregated for presentation or disclosure.)~~ (c) An insurer should measure investment and insurance components together using the insurance contracts standard. (d) An investment component in an insurance contract is an amount that the insurer is obligated to pay the policyholder or a beneficiary regardless of whether an insured event occurs. (e) *IASB only*: Insurers should exclude from the aggregate premium presented in the statement of comprehensive income the present value of the amounts the insurer is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs, determined consistently with measurement of the overall insurance contract liability.	
	Presentation and disclosures		
17.	Premiums claims and expense in statement of comprehensive income	An insurer should present premiums, claims, benefits, and the gross underwriting margin in the statement of comprehensive income.	• How to define the premiums related to each accounting period • Whether to present separately as a single line item in the statement of comprehensive income the effects of amortising acquisition costs and the single/residual margin

	Topic	Tentative decisions	Open points
			(or liability for remaining coverage in the premium allocation approach). • Whether the face of the primary statements should present information about contracts accounted for using the premium allocation approach separately from those accounted for using the building block approach • Presentation of reinsurance assets, policyholder participation and short duration conracts **Agenda paper 2G/82G *Amendments and Modifications and Communtations of insurance contracts* discusses the presentation of gains and losses arising from the commutation of**

	Topic	Tentative decisions	Open points
			reinsurance contracts.
18.	Other comprehensive income	• When an insurance contract requires payment depending wholly or partly on the performance of specified assets and liabilities of the insurer it should present changes in the insurance contract liability in the statement of comprehensive income consistently with the presentation of changes in the linked items (ie in profit or loss, or in other comprehensive income).	• Whether some changes in the insurance liability should be presented in other comprehensive income and related issues including: o Identification of changes to be presented in OCI o whether recognition for those changes should be permitted or required o Whether and how to recycle o whether to specify a loss recognition test. **Agenda paper ~~2B~~2A/82A-2E/82E** explores approaches that would present changes in the insurance contract liability in other comprehensive

	Topic	Tentative decisions	Open points
			income, if the ~~IASB~~ boards decide~~s~~ that changes in the fair value of some financial assets could be presented in other comprehensive income.
19.	Statement of financial position	1. An insurer should disaggregate the following components, either in the statement of financial position or in the notes, in a way that reconciles to the amounts included in the statement of financial position: (a) Expected future cash flows (b) Risk adjustment (for the IASB), (c) Residual margin (for the IASB), (d) The single margin, where relevant (for the FASB), and (e) The effect of discounting. 2. For those contracts measured using the premium allocation approach, the statement of financial position should present the liability for remaining coverage separately from the liability for incurred claims. 3. For those contracts measured using the building block approach, the statement of financial position should present any unconditional right to any premiums or other consideration as a receivable separately from the insurance contract asset or liability. The insurer should account for that receivable in accordance with existing guidance for receivables. The remaining insurance contracts rights and obligations should be presented on a net basis in the statement of financial position. 4. For those contracts measured using the premium allocation approach, the statement	• ~~Whether an insurer should present separately on the face of the primary statements information about contracts accounted for using the premium allocation approach separately from those accounted for using the building block approach~~ • Whether to net acquisition costs against the single/residual margin in the building block approach or against the liability for remaining coverage in the premium allocation approach and present that amount separately

	Topic	Tentative decisions	Open points
		of financial position should present all insurance contract rights and obligations on a gross basis. 5. Liabilities (or assets) for insurance contracts should be presented separately for those measured using the building block approach and those measured using the premium allocation approach. 6. The statement of financial position should not aggregate portfolios that are in an asset position with portfolios that are in a liability position.	from the present value of expected cash flows (plus a risk adjustment for the IASB).
20.	Disclosures	Confirm the disclosures proposed in paragraphs 90-97 of the IASB's exposure draft *Insurance contracts* (ED), with changes as follows: (a) to delete the requirement that an insurer shall not aggregate information relating to different reportable segments (ie paragraph 83 of the ED) to avoid a conflict with the principle for the aggregation level of disclosures. Thus the level of aggregation could vary for different types of qualitative and quantitative disclosures. However, the standard would add to the examples listed in paragraph 84 of the ED by stating that one appropriate aggregation level might be reportable segments. (b) to require the insurer to disclose separately the effect of each change in inputs and methods, together with an explanation of the reason for the change, including the type of the contracts affected. (c) for contracts in which the cash flows do not depend on the performance of specified assets (ie non-participating contracts), to require disclosure of the yield curve (or range of yield curves) used. (d) To require disclosure of: (i) the portion of the insurance contract liability that represents the aggregated portions of premiums received (and claims / benefits paid) that were excluded from the statement of comprehensive income; and	• Level of disaggregation and reconciliation of contract balances • Whether to add any additional disclosures ~~(**Agenda paper 2H/81H** *Separation of investment components from insurance contracts – Statement of financial position presentation* proposes some additional disclosures related to investment components.)~~

	Topic	Tentative decisions	Open points
		(ii) the amounts payable on demand. (e) *[IASB only]* to require the maturity analysis of net cash outflows resulting from recognised insurance liabilities proposed in paragraph 95(a) of the ED to be based on expected maturities and remove the option to base maturity analysis on remaining contractual maturities. Furthermore, within the context of time bands, to require the insurer to disclose, at a minimum, the expected maturities on an annual basis for the first five years and in aggregate for maturities beyond five years. *[In place of this disclosure, the FASB would rely on its tentative decisions relating to risk disclosures for financial institutions reached in its project on financial instruments at the FASB board meeting held on 7 September 2011. Those disclosures would apply to insurance entities.]* (f) [*IASB only]* to delete the proposed requirement in paragraph 90(d) of the ED to disclose a measurement uncertainty analysis and to consider (in due course) whether to develop disclosure about measurement uncertainty part of a possible follow up to IFRS 13 *Fair Value Measurement*. (The FASB tentatively decided to retain this disclosure.)	
	Other		
21.	Business combination issues		• To scope and consider issues to be discussed.
22.	Transition and effective date		• Consider how to approximate residual /single margin on transition • Consider redesignation of financial assets

	Topic	Tentative decisions	Open points
			• Determine effective date