STAFF PAPER

IASB | FASB Meeting

27 February – 3 March 2012

Project	Insurance contracts		
Paper topic	Cover note: Background information and progress report		
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1. This paper:

   a. Provides background information about the insurance contracts project (paragraphs 3-15)

   b. Summarises the boards' progress in the insurance contracts project (paragraphs 16-19).

   c. Provides an overview of the papers for the February meeting, together with a summary of the staff recommendations (paragraphs 20-35).

   d. Describes next steps towards issuing a new IFRS (paragraph 36).

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

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 have decided:

a. That it should develop a coherent framework for all types of insurance contracts. This is intended to eliminate much of the complexity that is present in insurance contracts accounting in many jurisdictions.

b. The accounting for insurance contracts should be based on 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 and risk adjustment would be less significant, and may be immaterial.

      (ii) For long-tail contracts, discounting and risk-adjustment would 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 some type 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.

Current measurement of the insurance contracts liability

8. 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.

9. 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.**

10. 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.

11. 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 assumptions than on short term fluctuations, this may mean that less volatility arises than some respondents had assumed.

12. 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, or in the premium that investors charge for bearing liquidity risk that is present in the assets but not in the liabilities.

   c. Duration mismatches between assets and liabilities

   d. 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.

13. In spite of this, we recognise that giving excessive prominence to those effects may not provide particularly relevant information to users of an insurer's

financial statements if we do 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.

What would change for current practice

14. 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 audited financial statements about claims liabilities, changes in risk and effects of discounting.
15. 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

Tentative decisions so far

16. 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.

17. The IASB and FASB have to come to different conclusions in some areas, notably on whether the measurement of an insurance contract liability should:

    a. include an explicit, updated risk adjustment (IASB), or reflect risk implicitly through a single margin (FASB).

b. 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).

c. 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).

18. 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 jointly redeliberate selected aspects of their classification and measurement models to seek to reduce key differences. The boards tentatively 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. 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 March 2012.

19. 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	How the standard measures the contract	Special applications	Presentation and disclosure
	•Definition of insurance contract •Scope exemptions •Unbundling •Recognition and contract boundary	•Cash flows •Discounting •Risk adjustment (IASB only) •Residual/single margin	•Short duration contracts (not addressed in FASB DP) •Participating contracts •Reinsurance assets	•Statement of comprehensive income •Statement of financial position •Note disclosures (not addressed in FASB DP)
Main changes from ED	•Financial guarantee contracts •More unbundling •Recognition when coverage period begins •Contract boundary determined at portfolio level for some contracts	•Application guidance for discount rate •Risk adjustment reflects compensation insurer requires for bearing uncertainty in expected fulfilment cash flows. •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 reinsurance recognised over contract term	• Presentation of premiums, claims and expenses on statement of comprehensive income
Still to conclude	•Investment contracts with discretionary participation features •Unbundling deposit components	•Unlocking residual margin details	•Eligibility criteria for short duration contracts •Mechanics of premium allocation approach	•How to define premiums in statement of comprehensive income •Use of other comprehensive income

Overview of papers on for this meeting

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

    a. Onerous contracts (agenda papers 3A/79A and 3B/79B)

    b. Measurement of liabilities for infrequent, high-severity events (agenda paper 3C/79C)

    c. Unbundling goods and services components (agenda paper 3D/79D)

    d. Eligibility and mechanics of the premium allocation approach (agenda papers 3E/79E – 3I/79I)

21. In addition, the boards will consider at separate meetings the applicable standards for investment contracts with discretionary participation features. As discussed in paragraph 31, the staff are asking each of the two boards (the IASB and the FASB) to reach its own decisions on these questions because the two boards have different factors to consider (IASB agenda papers 14-14C, FASB memo 80).

Onerous contracts

22. Agenda papers 3A/79A and 3B/79B conclude the discussions that boards started in December 2011.

    a. AP3A/79A *Onerous contracts* recommends that:

        (i) the measurement of an identified onerous contract liability should be updated at the end of each reporting period.

        (ii) [IASB only] the risk adjustment should be considered when identifying onerous contracts and the measurement of an onerous contract liability should include a risk adjustment.

    b. AP3B/79B *Onerous contracts – implications of tentative decisions* recommends that if an insurer elects not to discount the liability for incurred claims which are expected to be paid within 12 months of the date of the incurred loss the insurer should identify whether a contract is onerous on a discounted basis; and

(i) measure the liability for onerous contracts on an undiscounted basis (consistent with the current tentative decisions) according to some staff recommendation,

(ii) measure the liability for onerous contracts on a discounted basis according to other staff recommendation.

Measurement of liabilities for infrequent, high-severity events

23. AP 3C/79C *Measurement of liabilities for infrequent high-severity events* recommends the Boards to confirm the proposal in the exposure draft *Insurance contracts* and discussion paper *Preliminary views on Insurance contracts*, that insurers should measure insurance contract liabilities taking into account estimates of expected cash flows at the balance sheet date. However:

a. some staff recommend that, for all insurance contract liabilities, if the effects on the financial statements are material, insurers should update cash flow estimates made at the balance sheet date for events that occur after the balance sheet date but before the financial statements are issued when all of the following conditions are met:

   (i) An infrequent, high-severity event, such as a catastrophe is impending as of the balance sheet date, but has not yet occurred;

   (ii) Where the expected losses related to the event in (a) are based on information that is subject to substantial deviation prior to the event occurring; and

   (iii) The time period between when the insurer first projects loss estimates related to the event to the occurrence of the event is relatively short.

b. other staff recommend that insurers should not recognise an onerous contract liability at the balance sheet date if the onerous contract liability is already known to have reversed in the post balance sheet period as a result of subsequent events.

Unbundling goods and services components

24. AP 3D/79D *Unbundling- Goods and Services* recommends the criteria for unbundling goods and services should read as follows:

    (a) 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 U.S. GAAP in accounting for that performance obligation.

    (b) 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 as the services are performed. Hence, those promised setup activities are not a performance obligation.

    (c) Except as specified in the following paragraph, a good or service is distinct if either of the following criteria is met:

        (i) The insurer regularly sells the good or service separately.

        (ii) 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).

(d) 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:

(i) The good or service is highly interrelated with the insurance component and transferring them 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.

(ii) The good or service is significantly modified or customized in order to fulfil the contract.

Eligibility and mechanics of the premium allocation approach

25. The boards discussed the premium allocation approach on three previous occasions, 27 April 2011; 21 July 2011; and 20 October 2011. The boards have also held education session on this topic, most recently in January 2012.

26. This papers for this meeting build on the papers originally prepared for the January meeting as follows:

a. Agenda paper 3E/79E *Premium allocation approach: Amendments to the January staff recommendations on eligibility and mechanics,* which modifies the recommendations in the January papers.

b. Agenda paper 3F/79F *Premium allocation approach: Eligibility criteria*, previously AP2A/78A for the January meeting discusses eligibility criteria,

c. Agenda paper 3G/79G *Premium allocation approach: Mechanics*, previously AP2B/78B for the January meeting, discusses some mechanics of applying premium allocation approach.

Eligibility criteria

27. Agenda paper 3H/79H *Premium allocation approach: IASB staff recommendation* recommends:

a. 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.

b. A contract should be deemed to meet the condition in (a) without further work if the coverage period is one year or less.

c. The boards should provide application guidance that contracts would not produce measurements that are a reasonable approximation to those that would be produced by the building block approach if, at the contract inception date, either of the following conditions are 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 performance obligations in each reporting period. This may be the case if, for example, significant uncertainty exists about:

1. The premium that would reflect the exposure and risk the insurer has for each reporting period; or

2. the length of the coverage period.

d. An insurer should be permitted but not required to apply the premium allocation approach to contracts that are eligible for that approach.

28. Agenda paper 3I/79I *Premium allocation approach: FASB staff recommendation* recommends:

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:

1. the premium that would reflect the exposure and risk the insurer has for each reporting period; or

2. the length of the coverage period.

b. A contract should fall within the scope of the premium allocation approach without further evaluation if the coverage period is one year or less.

c. The premium allocation approach should be required for contracts that qualify for premium allocation approach.

Mechanics

29. The IASB staff recommend:

    a. Discounting and interest accretion should be required in measuring the liability for remaining coverage for contracts that have a significant financing component.[1]

    b. The board should provide a practical expedient that permits insurers not to adjust the measurement of the liability for remaining coverage to reflect the time value of money, aligned with the proposals in the exposure draft *Revenue from Contracts with Customers*.

       This would state that insurers need not adjust the measurement of the liability for remaining coverage to reflect the time value of money if the insurer expects at contract inception that the period of time between payment by the policyholder of all or substantially all of the premium and the satisfaction of the insurer's obligation to provide insurance coverage will be one year or less.

30. The FASB staff recommend the liability for remaining coverage should not be discounted and interest should not be accreted on the liability. However, if the boards decide to require discounting and accretion of interest, the wording of the practical expedient should instead be as follows:

> As a practical expedient, insurers need not apply discounting or interest accretion to reflect the time value of money in measuring the liability for remaining coverage if the insurer expects at contract inception that the period of time between payment by the policyholder of all or substantially all of the premium and the satisfaction of the insurer's ***corresponding*** obligation to provide insurance coverage will be one year or less.

[1] In assessing whether a financing component is significant to a contract, an entity shall consider various factors, including any of the following:
(a) The expected length of time between the receipt of initial premium and the coverage period
(b) Whether the amount of consideration would differ substantially if the customer paid in cash upfront or over the coverage period
(c) The interest rate in the contract and prevailing interest rates in the relevant market.

Financial instruments with discretionary participation features (agenda paper 14 series)

31. The staff are asking each of the two boards (the IASB and the FASB) to reach its own decisions on these questions because the two boards have different factors to consider:

    a. the instruments are widespread in some countries but uncommon in the US.

    b. all financial instruments with discretionary participation features are within the scope of IFRS 4 *Insurance Contracts* at present. Consequently, the IASB needs to specify requirements for these instruments when it withdraws IFRS 4. In contrast, there are no specific requirements in US GAAP at present. The FASB would not necessarily have to specify requirements within the timetable of the insurance contracts project.

    c. if excluded from the insurance contracts standard, financial instruments with discretionary participation features would be within the scope of the general financial instruments standards. The IFRS financial instruments standards are not the same as the US GAAP financial instruments standards. Thus, the consequences of excluding financial instruments with discretionary participation features from the insurance contracts standard are different for the two boards.

32. The IASB have prepared the following papers on the topic of financial instruments with discretionary participation features for the IASB meeting:

    a. Agenda paper 14: *Overview of papers*

    b. Agenda paper 14A: *Background information*

    c. Agenda paper 14B: *Applicable standard*

    d. Agenda paper 14C: *Definition of discretionary participation feature*

33. Paper 14B recommends that financial instruments with discretionary participation features should be within the scope of the insurance contracts

standard. Paper 14C recommends that the definition should be the same as that in IFRS 4 at present.

34. The FASB intend to discuss the applicable standard for financial instruments with discretionary participation features at its meeting on 7 March. FASB memo 80 for that meeting recommends:

    a. Investment contracts with discretionary participation features should not be explicitly scoped into the insurance contracts standard (as proposed in the FASB discussion paper)

    b. Should the FASB decide to include investment contracts with discretionary participation features within the scope of the insurance contracts standard, the definition should be narrowed to apply to a unique set of contracts.

35. Because IFRS financial instruments standards are not the same as the US GAAP financial instruments standards, the IASB and FASB will achieve convergence on this matter only if:

    a. they both choose to apply the insurance contracts model to all financial instruments with discretionary participation features; or

    b. they take on a project jointly to develop requirements specifically for financial instruments (other than insurance contracts) with discretionary participation features.

Next steps

36. 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 AP2/78 for the January meeting are marked (new text underlined, deleted text struck-through).

Topic	Tentative decisions	Open points
	Building block 1 – Which cash flows?	
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
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	• 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
	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. • All renewal rights should be considered in determining the contract boundary whether arising from a contract, from law or from regulation.	
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.	~~• Whether to adjust the expected value in some circumstances.~~ • Whether for some contracts (eg catastrophe insurance) cash flows estimates should be updated for some post balance sheet events (to be discussed in agenda paper **3C/79C** ***Measurement of liabilities for infrequent and high-severity events***)
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;	• Treatment of taxes paid on behalf of policyholders

Topic	Tentative decisions	Open points
	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.	
Acquisition costs	Include in fulfillment cash flows all the direct costs that the insurer will incur in 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 limit the costs to those related to successful acquisition efforts.	

Topic	Tentative decisions	Open points
	Building block 2 – Time value of money	
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. • 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.	• Interaction between decisions on onerous contracts and the practical expedient that permits insurers not to discount incurred claims expected to be settled within 12 months. (to be discussed in **agenda paper 3B/79B Onerous contracts –implications of tentative decisions**)
Discount rate	• No prescribed method to determining the discount rate, but rate should: o be consistent with observable current market prices for instruments with cash flows whose characteristics reflect those of the insurance contract liability, including timing, currency and liquidity, but excluding the effect of the insurer's non-performance risk; o 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 o reflect only the effect of risks and uncertainties	

Topic	Tentative decisions	Open points
	that are not reflected elsewhere in the measurement of the insurance contract liability. • To the extent that the amount, timing or uncertainty of the cash flows arising from an insurance contract depend wholly or partly on the performance of specific assets (ie for participating contracts), the insurer should adjust those cash flows using a discount rate that reflects that dependence. In some cases, the insurer determines the yield curve for the insurance contract liability based on a yield curve that reflects current market returns for either the actual portfolio of assets the insurer holds, or for a reference portfolio of assets with characteristics similar to those of the insurance contract liability. In doing so, the insurer excludes from those rates factors that are not relevant to the insurance contract liability (a 'top-down' approach). In a 'top down' approach: • An insurer shall determine an appropriate yield curve based on current market information. • 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. • 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	

Topic	Tentative decisions	Open points
	contract liability. In adjusting the cash flows, the insurer shall make both of the following adjustments: o Type I, which adjust for differences between the timing of the cash flows to 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. o 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. • 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.	

Topic	Tentative decisions	Open points
	Building block 3 – Risk adjustment	
Risk adjustment	**IASB:** • 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. • 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. • No limit on the range of available techniques to determine the risk adjustment. • Application guidance: o 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 50%	

Topic	Tentative decisions	Open points
	probability of being 90 and a 50% probability of being 110 or (2) fulfilling a liability of 100. o 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. o 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 o 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 • Confirmed the confidence level equivalent disclosure that had been proposed in paragraph 90(b)(i) of the ED. **FASB** • 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.	

Topic	Tentative decisions	Open points
	Building block 4 – residual margin	
Residual / single margin	• No gain at inception of an insurance contract. • Any loss on day one 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 • 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. • 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	*(IASB only)* • Whether to unlock the residual margin for changes in discount rate • Level of aggregation for measuring and allocating residual margin.

Topic	Tentative decisions	Open points
	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.	
	Application guidance for building blocks	
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 reflects 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
	o 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 o 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.	

Topic	Tentative decisions	Open points
Short duration contracts	• In the premium allocation approach, the insurer measures the liability for remaining coverage using the premium receivable at inception ~~less acquisition costs~~. • The insurer shall reduce the measurement of the pre-claims obligations over the coverage period as follows: o On the basis of time, but o On the basis of the expected timing of incurred claims and benefits if that pattern differs significantly from the passage of time. • For the IASB the liability for incurred claims is measured using the risk-adjusted expected present value of fulfilment cash flows. For the FASB, an insurer that applies the premium allocation approach to measure the liability for remaining coverage shall measure the liability for incurred claims using the expected present value of cash flows, without adding a margin. • If an insurer that applies the premium allocation approach to measure the liability for remaining coverage. The insurer need not discount liabilities for incurred claims which are expected to be paid within 12 months. • When applying the premium allocation approach, an insurer shall test whether a contract is onerous if facts and circumstances indicate that the contract	• Criteria for eligibility (to be discussed in **agenda papers 3E/78E *Premium allocation approach: Amendments to the January staff recommendations on eligibility and mechanics*, 3F~~2A~~/79~~8~~F~~A~~ *Premium allocation approach: eligibility criteria*, 3H/79H *IASB staff recommendation on eligibility criteria* and 3I/79I *FASB staff recommendation on eligibility criteria***) • Mechanics for the premium allocation approach (to be discussed in **agenda papers 3E/78E *Premium allocation approach: Amendments to the January staff recommendations on eligibility and mechanics* and 3G~~2B~~/79G~~8B~~ *Premium allocation approach: mechanics)*** • Whether the premium allocation approach should be permitted or required (also discussed in **papers 3H/79H and 3I/79I)** • Presentation of acquisition costs

Topic	Tentative decisions	Open points
	might be onerous.	
Reinsurance	• [IASB only] The ceded portion of the risk adjustment should represent the risk being removed through the use of reinsurance. • If the expected present value of the fulfillment cash flows (including the risk adjustment for the IASB) for the reinsurance contract is: o 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. o Less than zero and the coverage provided by the reinsurance contract is for past events, the cedant should recognise the loss immediately. o Greater than zero, the cedant should recognise a reinsurance residual margin [IASB] / single margin [FASB]. • 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	• Presentation • When and whether a reinsurance contract modifies the underlying contract • Interaction with requirements for short-duration contracts • Interaction with other requirements in standard

Topic	Tentative decisions	Open points
	insurance contract or contracts, after remeasuring the underlying insurance contracts on initial recognition of the reinsurance contract. • When considering non-performance by the reinsurer: o The cedant shall apply the impairment model for financial instruments when determining the recoverability of the reinsurance asset. o The assessment of risk of non-performance by the reinsurer should consider all facts and circumstances, including collateral. o 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.	
Onerous contracts	• An insurance contract is onerous if the expected present value of the future cash outflows from that contract [plus, for the IASB, the risk adjustment] exceeds: o the expected present value of the future cash inflows from that contract (for the pre-coverage period). o the carrying amount of the liability for the remaining coverage (for the premium allocation approach).	• Unit of account for the onerous contracts • [IASB only] Whether risk adjustment should be included for identification and measurement of onerous contracts (to be discussed in **agenda paper 3C/79A *Onerous contracts***) • When insurer should remeasure an onerous contract liability (to be discussed in **agenda paper 3C/79A *Onerous contracts***) • Interaction between decisions on onerous contracts and the practical expedient that permits insurers not to discount incurred claims expected to be settled within 12 months (to

Topic	Tentative decisions	Open points
	• 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..	be discussed in **agenda paper 3B/79B *Onerous contracts –implications of tentative decisions***)
	Definitions, scope and unbundling	
Definition	• 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 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	• Definition of portfolio

Topic	Tentative decisions	Open points
	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.	

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 the insurance contracts standard as proposed in the ED. Instead an issuer of a financial guarantee contract (as defined in IFRSs):
		• Investment contracts with discretionary participation features (to be discussed in agenda paper 14-14C for the IASB and FASB memo 80)
		• FASB: which financial guarantee arrangements, if any, should be within the scope of the insurance contracts standard.

Topic	Tentative decisions	Open points
	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 shall/should apply the financial instruments standards to these contracts in all other cases. • Confirmed all the other scope exceptions proposed in the ED	
Unbundling	• An insurer should separate **embedded derivatives** that are not closely related to the insurance contract and account for them using IFRS 9 *Financial Instruments*. • An insurer should account for a good or service and insurance coverage bundled in an insurance contract as a single performance obligation if the insurer integrates that good or service with the insurance coverage into a single item that the insurer provides to the policyholder. (If this criterion is satisfied, the insurer need not consider the further criteria set out below). • When a good or service is bundled with insurance coverage in an insurance contract and the insurer does not integrate that good or service with the insurance coverage into a single item the insurer provides to the customer, the entity should account for the promised good or service as a separate performance obligation if:	• Whether there are account balances in addition to explicit account balances that should be separated from the insurance contract liability • How income and expense items related to the explicit account balance should be recognised in the statement of comprehensive income • Whether to measure separated account balances: o Using requirements other than those being developed in the insurance contract project o As part of the insurance contract liability but disaggregated for presentation or disclosure • Issues related to contract riders • Allocation of expenses to unbundled components • Whether to permit unbundling where not required • Whether to combine separate contracts in some circumstances • <u>How to unbundle goods and services component using the criteria for identifying separate performance obligation</u>

Topic	Tentative decisions	Open points
	o the pattern of transfer of the good or service is different from the pattern of transfer of other promised goods or services in the contract, and o the good or service has a distinct function. • A good or service has a distinct function if either: o the insurer regularly sells the good or service separately, or o the policyholder can use the good or service either on its own or together with resources that are readily available to the policyholder. [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. • (IASB members indicated their preference: o to measure explicit account balances as part	from revenue project (to be discussed in **agenda paper 3D/79D *Unbundling – goods and services***)

Topic	Tentative decisions	Open points
	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.)	
	Presentation and disclosures	
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. • The presentation of the cash flows relating to acquisition costs should be separately disaggregated. • 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 • Presentation of reinsurance assets, policyholder participation and short duration contracts
Other comprehensive income	• 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).	• 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.

Topic	Tentative decisions	Open points
Statement of financial position	a. 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. b. For those contracts measured using the premium allocation approach, the liability for remaining coverage should be presented separately from the liability for incurred claims in the statement of financial position. c. For those contracts measured using the building block approach, any unconditional right to any premiums or other consideration should be presented in the statement of financial position as a receivable separately from the insurance contract asset or liability and accounted for in accordance with existing guidance for receivables. The	• 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

Topic	Tentative decisions	Open points
	remaining insurance contracts rights and obligations should be presented on a net basis in the statement of financial position. d. For those contracts measured using the premium allocation approach, all insurance contract rights and obligations should be presented on a gross basis in the statement of financial position. e. 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. f. Portfolios that are in an asset position should not be aggregated with portfolios that are in a liability position in the statement of financial position.	
Disclosures	Confirm the disclosures proposed in paragraphs 90-97 of the IASB's exposure draft *Insurance contracts* (ED), with changes as follows: • 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	• Level of disaggregation and reconciliation of contract balances • Whether to add any additional disclosures

Topic	Tentative decisions	Open points
	would add to the examples listed in paragraph 84 of the ED by stating that one appropriate aggregation level might be reportable segments. • 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. • 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. • *[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.]	

Topic	Tentative decisions	Open points
	• [*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	
Business combination issues		• To scope and consider issues to be discussed.
Transition and effective date		• Consider how to approximate residual /composite margin on transition • Consider redesignation of financial assets • Determine effective date