

Table 2.1 – Overview of Different Approaches

This table gives an overview of three approaches to accounting for insurance contracts.

- (a) Deferral and matching – Most approaches in use today contain many elements of a deferral and matching approach. There are a number of different ways of implementing such an approach. This DSOP does not permit deferral and matching approaches.
- (b) (i) Steering Committee proposals (entity-specific value) – This column shows the Steering Committee's proposals under an asset and liability measurement approach, if entity-specific value is adopted as the measurement objective.
- (b) (ii) Steering Committee proposals (fair value) – This column shows the Steering Committee's proposals under an asset and liability measurement approach, if fair value is adopted as the measurement objective.

The table does not consider specific issues relating to performance-linked contracts and reinsurance contracts.

Topic (Principle in parentheses)	(a) Deferral and matching	(b) Asset and liability – Steering Committee proposals	
		(i) (entity-specific value)	(ii) (fair value)
Objective (2.2)	Defer income and expense so that they can be matched with each other	Measure assets (contractual assets) and liabilities (contractual obligations) that arise from insurance contracts	Measure assets (contractual assets) and liabilities (contractual obligations) that arise from insurance contracts
Measurement of insurance liabilities (3.1)	Various – often based on an accumulation of past transactions	Entity-specific value	Fair value
Measurement of financial assets held by insurers	In practice, usually a mixture of cost basis and fair value In some cases, unrealised gains and losses are recognised on a smoothed basis over, for example, five years.	Under IAS 39: <ul style="list-style-type: none"> financial assets held for trading (including derivatives) and available-for-sale financial assets - at fair value held-to-maturity investments, originated loans and receivables and financial assets for which fair value is not reliably determinable – at amortised cost 	If required by a future standard on financial instruments): <ul style="list-style-type: none"> all financial assets – at fair value

Topic (Principle in parentheses)	(a) Deferral and matching	(b) Asset and liability – tentative Steering Committee proposals	
		(i) (entity-specific value)	(ii) (fair value)
Does measurement of assets affect measurement of insurance liabilities? (3.2)			
• General insurance	No	No	No
• Life – unit-linked and similar	Yes	Yes	Yes
• Life - other	In practice, often yes (see discussion of discount rate)	No	No
General insurance liability includes:			
• claims payable, including IBNR? (4.1)	Yes	Yes	Yes
• expected claim handling costs? (4.1)	Yes	Yes	Yes
• deferral of unearned premium for unexpired part of contract period? (4.1)	Yes (amount deferred may exceed present value of claims)	No (but see unexpired risk)	No (but see unexpired risk)
• provision for unexpired risk? (4.1)	Yes (if unearned premium is not enough to cover claims during unexpired part of contract period)	Yes (present value of expected claims for unexpired part of contract period)	Yes (present value of expected claims for unexpired part of contract period)
• catastrophe and equalisation provisions? (4.10)	Possibly	No	No
Basis for measuring liability for a traditional life insurance contract (4.1)	Liability is based on future cash flows, estimated at inception or currently	Liability is based on current estimates of future cash flows	Liability is based on current estimates of future cash flows

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Future investment margins affect measurement of insurance liabilities? (4.3)	General insurance – no (except where loss recognition is reduced by future investment returns) Life insurance - often yes (see discussion of discount rate).	No – except for (i) explicit investment charges levied on the policyholder and (ii) implicit charges arising where explicit interest paid to the policyholder is less than the interest on a comparable bank deposit.	No – except for (i) explicit investment charges levied on the policyholder and (ii) implicit charges arising where explicit interest paid to the policyholder is less than the interest on a comparable bank deposit.
Assumptions (4.4)	Various. May be: <ul style="list-style-type: none"> • locked-in at inception • locked-in at inception, but subject to loss recognition test • current best estimate • long-term trend • mandated by supervisor • some combination of the above 	Current estimate of all future events that will affect amount and timing of cash flows (including legislation and lapse)	Current estimate of all future events that will affect amount and timing of cash flows (including legislation and lapse)
Whose assumptions (4.4)?	In practice, usually insurer's own	Insurer's own, based on characteristics of the actual portfolio (for example, reflecting actual underwriting)	Market, based on characteristics of the actual portfolio (for example, reflecting actual underwriting). In practice, use insurer's own assumptions, unless evidence that market's assumptions would be different
Cash flows considered (4.4)	Cash flows that will arise as the insurer settles the liability in an orderly fashion over its life.	Cash flows that will arise as the insurer settles the liability in an orderly fashion over its life.	Reflects the price of a hypothetical transfer of the liability at the reporting date to another entity. Unless the market price is directly observable, this would normally be estimated on the basis of the cash flows that will arise as the insurer settles the liability in an orderly fashion over its life.

Topic (Principle in parentheses)	(a) Deferral and matching	(b) Asset and liability – tentative Steering Committee proposals	
		(i) (entity-specific value)	(ii) (fair value)
Measurement reflects entity-specific cash flows that are not available to other market participants? (4.4)	In practice, usually yes	Yes	No
Expense levels (4.4)	In practice, usually the insurer's own expense levels	Insurer's own expense levels, but do not allow unrealistic assumptions.	Reflect insurer's own cost strategy, consistent with lapse assumptions. Use the insurer's own expense levels, unless there is clear evidence that this is out of line with market expectations for the insurer's cost strategy.
Market assumptions (for example, assumptions about interest rates) (4.4)	Practice varies	Consistent with current market prices and other market-derived data	Consistent with current market prices and other market-derived data
Non-market assumptions (for example, mortality) (4.4)	Internal estimates	Internal estimates	Internal estimates, unless contrary data indicates that market participants would use different assumptions
Measurement of insurance liabilities reflects insurer's own credit standing: (4.8) • At inception of contract?	If implicit in premium rates	No	Conceptually yes, but practical implications need further investigation. May not be significant for most regulated insurers.

Topic (Principle in parentheses)	(a) Deferral and matching	(b) Asset and liability – tentative Steering Committee proposals	
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• Subsequent changes?	No	No	As above
Risk reflected in measurement of general and life insurance liabilities? (5.1)	Usually May differ from market value margin ¹	Yes – market value margin, reflecting insurer’s assessment of the risk profile of future cash flows, but priced using market’s risk preferences (5.3)	Yes - market value margin, reflecting market assessment of the risk profile of future cash flows, priced using market’s risk preferences (5.3)
Option-pricing methods used to price options and guarantees? (5.6)	In practice, usually no	Yes	Yes
Acquisition costs (4.11)	Generally deferred, subject to loss recognition test	Not deferred	Not deferred
Discounting used: (4.1)	General insurance – usually not in current practice Life insurance - yes	Yes	Yes
Discount rate (6.1)	Often based on expected long-term earnings on actual or notional investments backing the liability	Risk-free, adjusted for any risk not reflected in cash flows (asset based rate may be appropriate for asset-linked components of performance-linked contracts)	Same as entity-specific value
Premium revenue (13.4)	Recognised as earned – unearned premium is deferred.	Expected present value (probability-weighted) of all premiums, claims / benefits and expenses forms part of the initial measurement of the liability – and hence affects any net gain or loss on initial recognition. Subsequent changes in estimates are recognised immediately in the income statement.	Same as entity-specific value
Claims / benefit expense (13.4)	Estimate recognised as insured events occur. Additional amounts recognised when there is a premium deficiency.		
Ongoing contract maintenance expenses (13.4)	Recognised as incurred May also affect amounts recognised for premium deficiency		

¹ **Market value margin** = risk that would be reflected in the price of an arm’s length transaction between knowledgeable, willing parties.

Topic (Principle in parentheses)	(a) Deferral and matching	(b) Asset and liability – tentative Steering Committee proposals	
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Net income from long-term insurance contract (13.4)	Emerges based on predetermined attribution pattern Practice varies regarding adjustments for experience variations and changes in estimates and assumptions	Some gain or loss may emerge on initial recognition. Rest emerges as the insurer is released from risk and as actual experience differs from expected experience.	Some gain or loss may emerge on initial recognition. Rest emerges as the insurer is released from risk and as actual experience differs from expected experience.
Changes in carrying amount of an insurer's investments (13.4)	Generally recognised immediately in the income statement	Under IAS 39, changes in the: <ul style="list-style-type: none"> • fair value of financial assets held for trading (including derivatives) - recognised immediately in the income statement • changes in the fair value of available-for-sale financial assets – enterprise-wide choice to either recognise immediately in the income statement, or defer in equity until disposal • changes in the amortised cost of held-to-maturity investments, originated loans and receivables and financial assets for which fair value is not reliably determinable - recognised immediately in the income statement 	If required by a future standard on financial instruments - recognised immediately in the income statement

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Changes in carrying amount of an insurer's property (13.4)	Generally recognised immediately in the income statement	<ul style="list-style-type: none"> • under IAS 40, changes in the fair value of investment property – immediately in the income statement² • under IAS 16, changes in revalued amount of owner-occupied property – depreciation recognised in the income statement; revaluation gains recognised directly in revaluation surplus³ 	Same as for entity-specific value

² Principle 10.1 proposes to remove the cost option from IAS 40 for an entity whose primary business is issuing insurance contracts.

³ Principle 10.1 proposes to remove the benchmark treatment (depreciated historic cost) from IAS 16 for an entity whose primary business is issuing insurance contracts