

Appendix E

Summary of Tentative Steering Committee Views

This appendix lists all the tentative Steering Committee views set out in this Issues Paper, referenced by paragraph number.

Scope

Basic issue 1 Should the Project Cover all Aspects of Accounting by Insurers (Insurance Enterprises) or should it Focus Mainly on Insurance Contracts of All Enterprises?

Sub-issue 1A Should the Project Cover all Aspects of Accounting by Insurers or should it Focus Mainly on Insurance Contracts of all Enterprises?

11. *The Steering Committee recommends that the main focus of the project should be on insurance contracts of all enterprises. However, the project will also need to deal with some enterprise-wide issues, such as the following:*
- (a) *identifying the reporting entity; and*
 - (b) *presentation requirements, including format of the financial statements.*
12. *Sub-issue 1A addresses a scope issue – should the project focus on particular types of enterprise (insurers) or on particular types of transaction (insurance contracts)? Sub-issue 6A addresses a separate recognition and measurement issue: should an enterprise account for groups (or “books”) of insurance contracts on a portfolio basis or should it account for individual insurance contracts? The Steering Committee’s scope decision to focus on insurance contracts is not intended to prejudge that recognition and measurement issue.*

Sub-issue 1B How should Insurance Contracts be Defined?

16. *The Steering Committee believes that the definition used in IAS 32 needs to be refined so that it focuses more specifically on the features of insurance contracts that cause accounting problems unique to insurance contracts.*
17. *The Steering Committee believes that the feature that distinguishes insurance contracts from other financial instruments is the risk that the insurer will need to make payment (in cash or in kind) to another party if a specified uncertain future event occurs.*
18. *The Steering Committee believes that a contract that transfers only **price risk** (i.e. a derivative) should not be included in the definition of an insurance contract and should fall within the scope of the financial instruments project. Therefore, the Steering Committee proposes that the definition of insurance contract should exclude contracts where the only uncertain future event that triggers payment is a change in a specified interest rate, security price, commodity price, foreign exchange rate, index*

of prices or rates, a credit rating or credit index or similar variable. This is consistent with IAS 39, Financial Instruments: Recognition and Measurement, which defines a derivative as “a financial instrument:

- (a) whose value changes in response to the change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or similar variable (sometimes called the ‘underlying’);*
 - (b) that requires no initial net investment or little initial net investment relative to other types of contracts that have a similar response to changes in market conditions; and*
 - (c) that is settled at a future date.”*
19. *Under some insurance contracts, the insurer is required to make payments in kind rather than by transferring cash or other financial assets to the policyholder (or other beneficiary named in the contract). An example is where the insurer replaces a stolen article directly, instead of reimbursing the policyholder. Such contracts may not meet the definition of financial instruments in International Accounting Standards. The Steering Committee acknowledges that payments in kind may make it more difficult to measure an insurer’s obligations under such contracts. However, the Steering Committee believes that there is no conceptual reason to treat such contracts differently from other insurance contracts that are financial instruments.*
20. *An important economic feature of insurance is that a population of policyholders are pooling their risks when they take out insurance. Some believe that the pooling of risks – either between different policyholders or over time - is a factor that may need to be considered in measuring insurance liabilities. However, the Steering Committee believes that this feature is not relevant in defining insurance contracts for financial reporting purposes.*
21. *In some countries, the legal definition of insurance requires that the policyholder (or the beneficiary under the contract) should have an insurable interest in the insured event. Such requirements are often created on public policy grounds to discourage behaviour such as insuring other people's lives and then causing their death or to discourage gambling. Insurable interest is defined in different ways in different countries. Also, it is difficult to find a simple definition of insurable interest that is adequate for such different types of insurance as insurance against fire, term life insurance and annuities.*
22. *Contracts that require payment if a specified uncertain future event occurs cause similar types of economic exposure, whether or not the other party has an insurable interest. Accordingly, the Steering Committee believes that there is no need to refer to insurable interest in defining an insurance contract for financial reporting purposes.*
23. *Because it does not contain a notion of an insurable interest, the proposed definition of an insurance contract captures not only transactions that are traditionally viewed as insurance but also other transactions that are sometimes regarded as gambling.*

There are important social, moral, legal and regulatory differences between insurance and gambling. Nevertheless, issuers of insurance contracts and issuers of gambling contracts both accept an obligation to make payments of unknown timing or amount related to uncertain future events. Accordingly, the Steering Committee has so far identified no economic reason to exclude gambling transactions from the definition of insurance contract used for financial reporting purposes and from the scope of the project.

24. *An insurer generally receives a payment (often known as a **premium**) as consideration for undertaking the obligations set out in the insurance contract. However, the receipt of a premium is not a feature that distinguishes an insurance contract from other types of contract. Accordingly, the Steering Committee believes that there is no need to refer to the premium in defining an insurance contract for financial reporting purposes.*
25. *The Steering Committee proposes the following definition of an insurance contract, for use in all International Accounting Standards, and related guidance. The Steering Committee recognises that other definitions may sometimes be appropriate for other purposes.*

Definition

- 25.1 An insurance contract is a contract under which one party (the insurer) accepts an insurance risk by agreeing with another party (the policyholder) to make payment if a specified uncertain future event occurs (other than an event that is only a change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or similar variable).

Suggested Guidance to Support the Definition

- 25.2 Uncertainty (or risk) is the essence of an insurance contract. Accordingly, it is uncertain at the inception of a contract:
 - (a) whether a future event specified in the contract will occur;
 - (b) when the specified future event will occur; or
 - (c) how much the insurer will need to pay if the specified future event occurs.
- 25.3 Some insurance contracts cover events that are discovered during the term of the contract, even if they occurred before the inception of the contract; these contracts do not cover events that are discovered after the end of the contract term, even if the events occurred during the contract term. Other insurance contracts cover events that occur during the term of the contract, even if those losses are discovered after the end of the contract term.
- 25.4 Insurance contracts may require payments to be made directly to the policyholder, to their dependants or to third parties. Insurance contracts may

require payments to be made in cash or in kind.

25.5 It is convenient to describe the risk that is present in an insurance contract as **insurance risk** and the risk that is present in a derivative financial instrument as **price risk**. Insurance risk may be analysed into a number of different types of risk, including:

- (a) **occurrence risk** (the possibility that the number of insured events will differ from those expected);
- (b) **severity risk** (the possibility that the cost of events will differ from expected cost); and
- (c) **development risk** (a residual category. It refers generally to changes in the amount of an insurer's obligation after the end of a contract period. Such changes may result from the late identification of insured events that occurred during the contract period, the possibility that claims will settle more quickly or in amounts greater than expected, that courts may interpret the insurer's liability differently than expected, and other factors that may change the insurer's initial estimate of costs to settle incurred claims).

25.6 Insurance contracts often expose an insurer to further risks, in addition to insurance risk. For example, an insurer is often exposed to **financial risk** (the possible variation in amounts earned from investing premiums during the period from receipt to payment of claims. It includes the possibility of duration mismatch and liquidity risk). Similarly, many life insurance contracts guarantee a minimum rate of return to policyholders and such guarantees expose the insurer to financial risk. However, a contract that exposes the issuer to financial risk without insurance risk is not an insurance contract.

25.7 The amount to be paid under an insurance contract may be affected by changes in a price or a similar variable, such as an index. However, a contract does not meet the definition of an insurance contract if the only event that triggers payment is a change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or similar variable. Such a contract is a derivative financial instrument and falls within the scope of IAS 39, Financial Instruments: Recognition and Measurement.

25.8 Some insurance contracts include an **embedded derivative** with economic characteristics and risks that are not closely related to the characteristics and risks of the insurance contract. An example is a guarantee of the returns on an investment (either an absolute return or by reference to an index or interest rates). IAS 39 requires that an enterprise should separate the embedded derivative from the "host" insurance contract and account for it at fair value as if it were a separate derivative, unless the enterprise measures the combined

instrument at fair value and includes the changes in fair value in net profit or loss.¹

25.9 The following are examples of contracts that meet the definition of an insurance contract:

- (a) insurance against damage to property;
- (b) insurance against product liability, professional liability, civil liability or legal expenses;
- (c) life insurance (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur at all within the period covered by the insurance);
- (d) **annuities** and pensions (for annuities, the uncertain future event is the survival of the annuitant);
- (e) disability and medical cover;
- (f) **performance bonds** and **bid bonds** (under which an enterprise undertakes to make a payment if another party fails to perform a contractual obligation, for example an obligation to construct a building);
- (g) product warranties issued either directly by a manufacturer or dealer or indirectly by an insurer;
- (h) **financial guarantees**, for example of a loan;
- (i) **title insurance** (insurance against the discovery of defects in title to land that were not apparent when the insurance contract was written. In this case, the uncertain future event is the discovery of a defect in the title, not the defect itself);
- (j) **travel assistance** (compensation in cash or in kind to policyholders for losses suffered while they are travelling);
- (k) **catastrophe bonds** (bonds that provide for reduced payments of principal and/or interest if a specified event occurs);
- (l) contracts that require a payment based on climatic, geological or other physical variables (commonly referred to as **weather derivatives**); and
- (m) **reinsurance** (insurance contracts between a **direct insurer** and a **reinsurer**, or between two reinsurers, in order to limit the risk

¹ Sub-issue 1E addresses the question of separate accounting for embedded derivatives or other components of an insurance contract.

exposure of the first insurer).

25.10 The following are examples of items that do not meet the definition of an insurance contract:

- (a) investment products that have the legal form of an insurance contract but do not expose the insurer to insurance risk (such contracts are non-insurance financial instruments);²
- (b) **derivatives**, in other words contracts (financial instruments) that require one party to make payment based solely on changes in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or similar variable; and
- (c) “**self-insurance**”, in other words an enterprise’s decision to retain a risk that could have been covered by insurance. There is no insurance contract because there is no agreement with another party (unless the risk retained itself arises from an agreement with another party, for example, under a product warranty).

25.11 Under some contracts, the amount payable is linked to a price index, but the uncertain event that triggers payment is not a change in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or similar variable. Such contracts are insurance contracts. For example, an annuity linked to a cost-of-living index is an insurance contract. That is because payment is based not solely on changes in the index but is triggered by an uncertain event – the survival of the annuitant.

Sub-issue 1C How much Uncertainty is Required for a Contract to Qualify as an Insurance Contract?

38. *Contracts that do not create insurance risk are financial instruments, but not insurance contracts for financial reporting purposes. The Steering Committee intends to develop guidance to clarify that these products fall within the scope of the Financial Instruments project. This sub-issue will not be particularly significant if the recognition, measurement and disclosure requirements for insurance contracts are consistent with those for other financial instruments.*
39. *The Steering Committee has not yet developed guidance on the amount of insurance risk that should be present for a contract to qualify as an insurance contract for financial reporting purposes. The Steering Committee welcomes comments on:*
- (a) *whether detailed guidance is needed on the amount of insurance risk that should be present for a contract to qualify as an insurance contract;*

² Paragraph 27 describes an example of a contract that might have the legal form of an insurance contract in some countries but does not expose the insurer to insurance risk.

- (b) *the amount of insurance risk that should be present for a contract to qualify as an insurance contract; and*
 - (c) *whether any contracts that do transfer insurance risk should be excluded from the definition of insurance contracts.*
40. *The Steering Committee believes that insurance risk is present if either the amount or timing (or both) of the insurer's payments vary directly with the amount or timing (or both) of losses incurred by the policyholder.*
41. *The Steering Committee proposes that reinsurance contracts should be defined simply as insurance contracts between two insurers. To determine whether a contract transfers insurance risk, the same principles should be used for both a reinsurance contract and a (direct) insurance contract.*
42. *Some argue that the definition of a reinsurance contract should exclude contracts where the timing of payments by the reinsurer does not vary directly with the timing of losses incurred by the direct insurer. They believe that this restriction is necessary to avoid the abuse of reinsurance accounting where the direct insurance liability is measured on an undiscounted basis. However, as explained in sub-issue 7I, the Steering Committee proposes that all insurance liabilities should be discounted. Accordingly, there is no need to consider such a restriction.*

Sub-issue 1D Should an Enterprise Assess whether a Contract Creates Insurance Risk Only at Inception of the Contract or Throughout the Life of the Contract?

46. *For the reasons described in the previous paragraph, the Steering Committee believes that:*
- (a) *a contract that qualifies as an insurance contract at inception remains an insurance contract until all rights and obligations are extinguished or expire; and*
 - (b) *if a contract does not qualify as an insurance contract at inception, it should be subsequently reclassified as an insurance contract if an uncertainty that was previously considered insignificant becomes significant.*
47. *Paragraph 27 describes an investment contract that does not create insurance risk at inception, but includes an option for the policyholder to buy an annuity at market rates that are current when the investor buys the annuity. Until the policyholder exercises the option, the contract is not an insurance contract for financial reporting purposes. If the policyholder decides to buy the annuity, the insurer will account for the annuity as an insurance contract from that date.*

Sub-issue 1E **Should an Enterprise Account Separately for the Components of Insurance Contracts that Bundle Together an Insurance Element and Other Elements, such as an Investment Element or an Embedded Derivative?**

57. *The Steering Committee believes that unbundling as described in paragraph 48(a) is conceptually preferable but that it relies on distinctions that may be difficult to make in practice. The Steering Committee proposes that contracts should be unbundled when the separate components are either:*
- (a) disclosed explicitly to the policyholder; or*
 - (b) clearly identifiable from the terms of the contract.*
58. *The Steering Committee believes that a derivative embedded in a host insurance contract is clearly identifiable from the terms of the policy, and should be separated from the host insurance contract, where all of the following conditions are met:*
- (a) the embedded derivative does not create insurance risk;*
 - (b) the embedded derivative has characteristics and risks that are not closely related to the characteristics and risks of the host insurance contract; and*
 - (c) a stand-alone instrument with similar terms would meet the definition of a derivative.*
59. *The Steering Committee would welcome comments on whether unbundling should be used for other contracts.*
60. *If all financial instruments, including insurance contracts, are measured at fair value, it may be less important to account separately for the components of insurance contracts that bundle together an insurance element and other elements. This is because there would be no scope for accounting arbitrage between contracts treated as insurance and contracts treated as other financial instruments. On the other hand, there may still be a need for some unbundling to the extent that there are differences in presentation or disclosure requirements – for example, if all cash inflows for insurance contracts are treated as premium revenue and cash inflows for some other financial instruments are treated as deposits.*

Sub-issue 1F **Should Catastrophe Bonds be Treated as Insurance Contracts?**

62. *In substance, the holder of a catastrophe bond has issued an insurance contract that is embedded in a conventional bond. The premium for that contract is the additional interest that the bondholder will receive if the specified event does not occur. Consistent with the Steering Committee's view on sub-issue 1E, both an issuer and a bondholder should account separately for (unbundle) the host bond and the embedded insurance contract:*
- (a) the host bond should be treated as an asset of the bondholder and a liability of the issuer; and*

- (b) *the embedded insurance contract should be treated as an insurance contract issued by the bondholder (in substance, an insurer) to the issuer of the bond (in substance, a policyholder).*
63. *Separate accounting will be particularly important if there are any differences between the measurement bases for insurance contracts and financial instruments. However, where a catastrophe bond is quoted in a deep and liquid market, the fair value of the bond will be readily obtainable and this may reduce the need for separate accounting for the components.*

Sub-issue 1G Should Financial Guarantees be Treated as Insurance Contracts or as (Other) Financial Instruments?

65. *The Steering Committee has identified three types of financial guarantee:*
- (a) *financial guarantees that require payments in response to changes in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or similar variable. Such financial guarantees meet the definition of derivatives in IAS 39 and IAS 39 establishes accounting requirements for them. In the Steering Committee's view, these financial guarantees should remain within the scope of the financial instruments project;*
 - (b) *financial guarantees that require payments to be made if the debtor fails to make payment when due. In the Steering Committee's view, the credit risk resulting from these contracts is a form of insurance risk. Therefore, the Steering Committee believes that they should be covered by a standard on insurance rather than by IAS 37 (as at present) or a standard on financial instruments; and*
 - (c) *financial guarantees that require payments to be made (either to the debtor or to the creditor) if the debtor's income is reduced by specified adverse events such as unemployment or illness, even if the debtor continues to pay off the loan when due. The Steering Committee believes that the insurance project should cover these contracts.*

Sub-issue 1H Should Product Warranties be Included in the Scope of the Project?

68. *The Steering Committee believes that the insurance standard should address product warranties issued by insurers on behalf of other parties (such as a retailer or manufacturer) because such product warranties are excluded from the scope of IAS 37 and IAS 39. However, the Steering Committee believes that the insurance standard should not address product warranties issued directly by a retailer or manufacturer, as these are already covered by IAS 37.*

Sub-issue 1I Should the Project Deal with Accounting by Insured Enterprises?

72. *The Steering Committee's view is that accounting by insured enterprises for insurance contracts should not be excluded from the project at this stage. The Steering Committee will consider such an exclusion later in the project. The Steering*

Committee has not considered whether recognition and measurement requirements for insured enterprises should be the same as the recognition and measurement requirements for insurers.

Sub-issue 1J Should the Project Deal with Employee Benefit Plans?

75. *The Steering Committee proposes to exclude employee benefits from the scope of the project, as IAS 19 and IAS 26 already deal with this issue.*

Sub-issue 1K Is the Distinction between General Insurance and Life Insurance Important? If So, How should the Distinction be made?

82. *The Steering Committee intends to develop accounting models for general insurance and life insurance that are separate, but based on the same underlying principles.*
83. *The Steering Committee believes that the main economic feature that distinguishes most general insurance contracts from most life insurance contracts is the length of the contract. For most general insurance contracts, the contract is for a short term and the insurer is free to change premiums after the end of the period covered by the current premium, or even to decline to renew the contract. For many life insurance contracts, the contract is for a long term and the insurer has limited or no ability to reset premiums and is required to continue to provide cover if the policyholder continues to pay premiums. This requirement to continue providing cover is a source of additional liabilities (and, perhaps, assets) that do not arise in contracts that do not have this feature.*
84. *Accordingly, the Steering Committee proposes to make the distinction for financial reporting purposes as follows:*
- (a) insurance should be treated as general insurance for financial reporting purposes if the insurer is committed to a pricing structure for not more than twelve months; and*
 - (b) insurance should be treated as life insurance for financial reporting purposes if the insurer is committed to a pricing structure for more than twelve months.*

Sub-issue 1L Are there any Specific Issues that are Unique to Health and Medical Insurance?

86. *The Steering Committee has not identified any characteristics of health and medical insurance that are not already addressed elsewhere in this Issues Paper. The Steering Committee welcomes comments on any aspects of health and medical insurance that need to be considered separately.*
87. *The Steering Committee believes that health and medical insurance will sometimes be best classified for accounting purposes as general insurance and sometimes as life insurance, depending on the specific characteristic of each contract.*

Sub-issue 1M Should Different Accounting Requirements be Set for Different Types of Insurer or for Insurers with Different Legal Forms?

92. *The Steering Committee sees no reason to set different accounting requirements for different types of insurer. As the project progresses, the Steering Committee will consider whether there is a need for additional requirements for certain types of insurer to supplement the requirements that it will develop for all enterprises that are parties to insurance contracts.*

Sub-issue 1N Should Specific Guidance be Given on Self-insurance?

94. *The Steering Committee believes that the example that was contained in E59 is consistent with the principles set out in IAS 37: where there is no obligation at the reporting date to another party, no liability should be recognised. The Steering Committee does not intend to develop guidance on self-insurance, other than perhaps a brief reference to explain how self-insurance differs from insurance.*

Basic issue 2 Should the Project Deal with Financial Instruments (Other than Insurance Contracts) held by Insurers?

108. *The Steering Committee believes that the project should deal with financial instruments that are insurance contracts, but not with other financial instruments. The Steering Committee will monitor progress by the Joint Working Group on financial instruments.*
109. *In developing proposals for the treatment of insurance contracts, the Steering Committee will work for consistency with the treatment of assets held by insurers. For this purpose, the Steering Committee has assumed that IAS 39 will be replaced, before the end of the Insurance project, by a new International Accounting Standard that will require full fair value accounting for the substantial majority of financial assets and liabilities, including all non-insurance financial assets and non-insurance financial liabilities held by insurers.*

Project Timetable

Basic issue 3 Should IASC Issue Provisional Guidance on Certain Aspects of Insurance Accounting or Disclosure?

115. *For the reasons discussed in paragraph 113, the Steering Committee considers that it is not worthwhile trying to develop an interim standard on recognition and measurement of insurance contracts. When it reviews the comment letters on this Issues Paper, the Steering Committee will consider whether there is case for trying to develop a separate Standard on disclosure issues at an earlier date.*

Recognition and Measurement – Overall Objectives

Basic Issue 4 What should be the Overall Objectives of a Recognition and Measurement System for Insurance Contracts?

Sub-issue 4A Should the Project Focus on General Purpose Financial Statements?

144. *In the Steering Committee's view, the interests of different user groups overlap. All share an interest in relevant and reliable information about the insurance enterprise, its assets and liabilities, its financial performance, and its ability to meet obligations. The IASC project on insurance accounting necessarily emphasises general purpose financial statements and the IASC's Framework of financial reporting concepts.*
145. *Although the project will focus on general purpose financial statements, the outcome of the project may have implications for insurance supervisors. In some countries, national requirements for general purpose financial reporting may change in response to an International Accounting Standard on Insurance. Such changes could have a direct effect on those insurance supervisors who rely mainly on general purpose financial statements to assess capital adequacy and solvency. In other countries, insurance supervisors receive separate special purpose reports prepared on a different basis and may be affected less directly. Nevertheless, insurance supervisors are increasingly looking to develop a common international approach to issues such as solvency and capital adequacy - and may wish to look to an International Accounting Standard to define the data used in such requirements - although supervisors will, of course, still have responsibility for setting the requirements.*
146. *The Steering Committee hopes that insurance supervisors will find that they can build on general-purpose financial statements in performing their statutory function. Insurance supervisors have several tools that they can use to monitor solvency, including capital adequacy testing, risk-based capital requirements and restrictions on investment policies. In the Steering Committee's view, those devices allow insurance supervisors to maintain appropriate control within their jurisdictions, while allowing the development of general purpose financial reporting that is useful to a broad range of financial statement users.*
147. *In the Steering Committee's view, overstatement of insurance liabilities in general purpose financial statements should not be used to impose implicit solvency or capital adequacy requirements.*

Sub-issue 4B Should IASC use the IASC Framework as a Basis for Developing an International Accounting Standard on Insurance?

151. *The Steering Committee intends to use the IASC Framework as the basis for developing an International Accounting Standard on Insurance, for the reasons set out in paragraph 150.*

Sub-issue 4C**What should be the Overall Objectives of Recognition and Measurement in Accounting for Insurance Contracts?**

162. *The Steering Committee believes that the deferral and matching view is not consistent with IASC's Framework, as the Framework does not permit the recognition of items in the balance sheet that do not meet the Framework's definition of assets and liabilities. The Steering Committee acknowledges that insurance has special features, but does not believe that these special features are sufficient to justify a departure from the Framework. Accordingly, the Steering Committee favours the asset-and-liability measurement view. By restricting the recognition of assets and liabilities to items that meet the definitions in the Framework, the Steering Committee considers that insurers will report financial information that better meets the needs of users. Also, the asset-and-liability view enhances the ability of users to make comparisons, as the asset and liability view forms the basis for other standards issued by IASC.*
163. *Although the Steering Committee does not favour the deferral and matching view, this view has formed the basis of accounting for insurance in many countries. Therefore, the Steering Committee has also examined certain accounting issues from a deferral and matching perspective, as a useful analytical double-check on the solutions that the asset-and-liability view offers.*
164. *Although the Steering Committee favours the asset-and-liability measurement view, this does not lead automatically to a preference for fair value as the measurement attribute for the assets and liabilities that arise under insurance contracts. The Steering Committee is working on the assumption that IAS 39 will be replaced, before the end of the Insurance project, by a new International Accounting Standard that will require full fair value accounting for the substantial majority of financial assets and liabilities (see discussion in Basic Issue 2). The Steering Committee believes that, if such a standard exists, assets and liabilities arising under insurance contracts should also be measured at fair value. However, if such a standard is not in place, it may be appropriate to select a different measurement attribute.*
165. *For this reason, Basic Issues 4 to 10 examine issues in the context of largely traditional approaches to measuring assets and liabilities. Basic Issue 11 extends that analysis to consider the further issues that arise when assets and liabilities connected with insurance activities are measured at fair value or at embedded value.*

Basic Issue 5**To what extent should the Measurement of an Insurer's Assets Affect the Measurement of its Liabilities?**

180. *In the Steering Committee's view:*
- (a) *the measurement basis adopted for an insurer's liabilities should be consistent with the measurement basis adopted for its assets; and*
 - (b) *in general, the actual measurement of liabilities should not be affected by the type of assets or by the return on those assets (except where the amount of benefits paid to policyholders is directly influenced by the return on specified assets, as with certain participating contracts and unit-linked contracts). However, the Steering Committee is evenly divided on the effect of future*

investment margins in a fair value model (see Sub-issue 11G). Some members believe that the future investment margins should be considered in determining the fair value of insurance liabilities. Other members believe that they should not.

Basic Issue 6 What Assumptions and Conventions should be used in Measuring Insurance Liabilities?

Sub-issue 6A Should the Unit of Account be Individual Contracts or Groups of Similar Contracts?

190. *In the Steering Committee's view, the established practice of accounting for groups of similar contracts is consistent with the diversification of risk inherent in an insurance activity. However, the Steering Committee observes that contracts that are not similar (for example, property damage and professional liability contracts) should not be combined into a single accounting unit. The Steering Committee believes that the unit of account should be a group of contracts that have substantially the same contractual terms and were priced on the basis of substantially the same assumptions.*
191. *The Steering Committee favours a closed book approach, as an open book approach would be inconsistent with the Framework. The closed book comprises existing contracts, including only those renewals where existing contracts commit the insurer to a specified pricing structure for the renewals. The closed book excludes both new contracts and other renewals of existing contracts.*
192. *The Steering Committee believes that future cash flows that may arise from possible renewals of an insurance contract do not arise directly from the contract. Under IAS 38, Intangible Assets, it is highly unlikely that they would be considered to give rise to a recognisable asset for the insurer that issues the contracts.*
193. *If insurance contracts are acquired in a business combination, one question that arises is whether the future cash flows should be represented as a separate asset or included in goodwill. The Steering Committee has not discussed this question. A similar issue arises when an insurer acquires a block of insurance contracts in a separate acquisition (not a business combination). Basic Issue 15 deals with such acquisitions.*

Sub-issue 6B Should there be an Implicit or an Explicit Approach to Assumptions?

199. *The Steering Committee considers an explicit approach to be superior to an implicit approach. An explicit approach is consistent with recently-issued IASC standards on provisions (IAS 37) and pensions (IAS 19), provides greater transparency, and produces estimates that are more understandable. An explicit approach does not preclude, and in fact requires, consideration of interactions between different assumptions. An explicit approach does not preclude the use of stochastic modelling and similar techniques.*

Sub-issue 6C Should Assumptions Reflect Current Information at the Date of the Financial Statements or Long-term Expectations?

205. *The Steering Committee favours an approach to measurement that focuses on current information and assumptions. If deferral mechanisms like the corridor approach in IAS 19, Employee Benefits, are considered appropriate, financial statements will be more understandable and transparent if any deferrals are computed and presented separately from underlying measurements.*

Sub-issue 6D Should Measurement Reflect the Market's Expectations or the Insurer's Expectations?

210. *In the Steering Committee's view, a measurement based on market expectations is appropriate under the asset-and-liability measurement view.*
211. *The Steering Committee recognises that market expectations may not always be observable directly. In such cases, an insurer would need to make its own estimates – but the important point is that the estimates should be an attempt to consider the factors that are considered by the market, not factors that are specific to the insurer itself and that would not be considered by the market.*

Sub-issue 6E Should Assumptions Reflect All Future Events that will affect the Amount and Timing of Cash Flows?

222. *The Steering Committee favours an all-future-events approach to measurement assumptions, to the extent practicable, consistent with the requirements of IAS 37. While estimates are often difficult and subjective, financial statement users are best served by liability measurements that reflect the entire estimated cost of claims rather than measurements that exclude some costs.*
223. *The Steering Committee emphasises that the all-future-events approach does not justify premature accounting for events that, at the measurement date, are not reasonably foreseeable consequences of exposures under existing insurance contracts. For example, there may be a 20% probability at the balance sheet date that a major storm will strike during the remaining six months of an insurance contract. After the balance sheet date and before the financial statements are authorised for issue, a storm may actually strike. The measurement of the liability under that contract should not reflect the storm that, with hindsight, is known to have occurred. Instead, the measurement will reflect the 20% probability that was apparent at the balance sheet date (with an appropriate adjustment for risk and uncertainty, as discussed below).*
224. *The treatment described in the preceding paragraph is consistent with IAS 10, Events After the Balance Sheet Date, which would treat the storm as a non-adjusting event after the balance sheet date. If a non-adjusting event after the balance sheet date is of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions, IAS 10 requires an enterprise to disclose the nature of the event and an estimate of its financial effect (or a statement that such an estimate cannot be made).*

Sub-Issue 6F Should the Measurement of Assets and Liabilities arising from Insurance Contracts Reflect Risk and Uncertainty?

243. *In the Steering Committee's view, the measurement of insurance liabilities should reflect the risk that would be reflected in the price of an arm's length transaction between knowledgeable, willing parties.*
244. *The Steering Committee notes that determining the necessary adjustment for risk will inevitably be subjective. To improve comparability, the Steering Committee intends to develop guidance on this topic.*
245. *In the Steering Committee's view, there will be a need for some disclosure about the extent of risk adjustments. One possibility might be to require disclosure (either in the notes or on the face of the balance sheet and income statement) of the difference between the actual (risk-adjusted) amounts recognised and the expected values of the related cash flows.*
246. *In addressing risk adjustments for small portfolios, it is worth considering the needs of both investors and policyholders. In the Steering Committee's view, the additional diversifiable risk inherent in a small portfolio is irrelevant for investors who are able to diversify their investments. Although many policyholders may be unable to diversify risks of this kind, the most transparent way to protect their interests is through appropriate solvency or risk-based capital requirements, rather than through adjustments to reported liabilities. Therefore, the risk adjustment for a small portfolio should be the same as for a large portfolio (except for any indirect effect arising where the small size of a portfolio makes statistical evidence less credible).*

Sub-issue 6G When and How Should an Insurer Account for Changes in Assumptions about Future Cash Flows and Actual Experience that Differs from Assumptions

272. *The Steering Committee favours a fresh-start approach to changes in accounting estimates and current recognition of the effect of differences between actual experience and earlier assumptions. In the Steering Committee's view, a consistent approach to changes in estimates is preferable to a collection of rules that use different approaches for different types of changes. Sub-issue 19D discusses how an enterprise should present and disclose the effects of changes in estimates and differences between actual experience and earlier assumptions. The Steering Committee does not favour a corridor approach to recognising changes in estimate.*

General Insurance

Basic Issue 7 What Assumptions and Conventions should be used in Accounting for General Insurance Contracts?

Sub-issue 7A Should Alternatives to the Annual Basis of Accounting be Prohibited, Permitted or Required?

288. *The Steering Committee does not consider either the open-year model or zero-balance model to be appropriate for most insurance activities. Financial statement users are better served by periodic reporting of revenue and expenses when the events occur that give rise to those items. However, occasions may arise in which estimates cannot be made with sufficient reliability and periodic reporting is not possible. In those situations, the Steering Committee favours the zero-balance model, which it considers consistent with IAS 18.*

Sub-issue 7B Should an Insurer Recognise a Liability for Claims Payable?

296. *In the Steering Committee's view, an insurer should recognise claims payable as a liability. An insurer's liability for claims payable includes claims that have been reported, claims incurred but not reported, and claim handling expenses. Those amounts meet the definition of a liability as outlined in IAS 37. The Steering Committee believes that the insurer has a present obligation to incur claim handling expenses relating to existing contracts because the insurer will be compelled to pay these expenses if the policyholder presents a valid claim. (And, if the insurer settles the liability by a transferring the liability to another party, the insurer will pay claim handling costs implicitly through the pricing of the transfer.) Claim handling expenses should be recognised based on the manner in which the insurer expects to settle the related claim liabilities.*

Sub-issue 7C Should an Insurer Recognise a Liability for Unexpired Risk?

316. *The Steering Committee considers an asset-and-liability-measurement approach more consistent than a deferral-and-matching approach with the IASC Framework and with recent International Accounting Standards, including the recently-issued IAS 37, Provisions, Contingent Liabilities and Contingent Assets. Therefore, an insurer should recognise a provision for unexpired risk, rather than provisions for unearned premium and premium deficiency. The provision for unexpired risk reflects the amount of estimated future claim payments arising from future insured events that are covered by existing insurance contracts. The provision for unexpired risk will also include an estimate of refunds that the insurer will need to pay to policyholders who cancel existing contracts during the term of the contracts. Sub-issue 7I discusses whether that provision should be determined on a present value basis.*
317. *In the Steering Committee's view, there is no logical reason to prohibit the recognition of a gain when an insurance contract is sold. However, the Steering Committee recognises that some commentators may have reservations about this change from existing practice. The Steering Committee concluded tentatively in Sub-issue 6F that the measurement of insurance liabilities should reflect the risk that*

would be reflected in the price of an arm's length transaction between knowledgeable, willing parties. The implications of this decision are that:

- (a) *the initial measurement of the liability at inception may be less than the premium charged to the policyholder; and*
- (b) *the required margin to reflect risk will be recognised as income as the insurer is released from risks assumed at inception.*

Sub-issue 7D Should Acquisition Costs be Deferred and Recognised as an Asset?

328. *The Steering Committee concludes that acquisition costs should be recognised as an expense, on the basis that they do not meet the Framework's definition of an asset. Also, the measurement of insurance liabilities already reflects the future cash flows to be generated by the insurance contract, so the recognition of an asset would lead to double counting.*

Sub-issue 7E If Acquisition Costs are Deferred and Recognised as an Asset, How Should they be Measured?

334. *Given the Steering Committee's view that acquisition costs should be recognised as an expense, there is no need to specify how deferred acquisition costs should be measured.*

Sub-issue 7F How Should an Insurer Account for Recoveries Related to Claims?

337. *The receipt of salvage property from the policyholder and the subrogation of a policyholder's rights to the insurer occur at the same time as the settlement of the claim with the policyholder. Accordingly, the Steering Committee believes that an insurer should recognise its potential recoveries as a reduction in its net liability to the policyholder.*
338. *In the Steering Committee's view this is not inconsistent with IAS 37 because IAS 37 contemplates cases where an enterprise pays the creditor and then obtains a recovery by selling an asset or by claiming reimbursement from another party. However, salvage and subrogation differ because the insurer pays the claim and, at the same time, receives salvage or subrogation rights from the policyholder (rather than from another party). In other words, the insurer's obligation is to make a net settlement, comprising a cash payment less the fair value of the simultaneous receipt of salvage or subrogation rights. Market participants would take both the cash payment and the salvage or subrogation rights into account when they price the insurer's (net) obligation.*
339. *In the Steering Committee's view, an insurer should measure estimated recoveries in a manner consistent with underlying claim liabilities.*
340. *Once an insurer acquires salvage property or subrogation rights, the insurer has an asset to which the normal asset recognition and measurement criteria should be applied.*

Sub-issue 7G How Should an Insurer Account for Retrospectively-Rated Contracts?

347. *The Steering Committee favours an asset-liability approach to accounting for retrospectively-rated contracts. The Steering Committee considers this view to be consistent with the terms of these contracts.*
348. *In some cases, such retrospective rating may eliminate insurance risk for the reinsurer or may create a non-insurance element that may need to be accounted for separately. Sub-issues IC and IE deal with such questions.*
349. *The Steering Committee notes that retrospectively-rated contracts present certain similarities to participating contracts, which are discussed in Basic Issue 9.*

Sub-issue 7H Should Provisions for Catastrophes or Equalisation be Required, Permitted or Prohibited?

357. *In the view of a majority of the Steering Committee, catastrophe and equalisation provisions do not meet the definition of a liability articulated in IAS 37 and the Framework. However, a minority concludes that they do meet the definition. The Steering Committee would welcome comments on these issues, including whether catastrophe and/or equalisation provisions should be recognised as a liability and how best to convey information about low-frequency, high-severity risks and about random fluctuations of claims.*

Sub-issue 7I Should General Insurance Liabilities be Measured using Present Value (Discounting) Techniques?

368. *The Steering Committee concludes that the use of present value in measuring general insurance claim liabilities is consistent with the Framework's emphasis on information that is relevant and decision-useful. A claim payable within one month imposes a higher economic burden than a claim of similar amount that will be paid two years in the future. The use of present value allows financial statements to provide information that distinguishes those two claims from one another. The Steering Committee also observes that IAS 37 mandates the use of present value in measurement of similar liabilities (provisions). The Steering Committee finds no basis for exempting general insurance claim liabilities from similar measurement.*

Sub-issue 7J If Present Value Techniques are Used, What Discount Rate is Appropriate

370. *The Steering Committee concluded in sub-issue 6F that the measurement of insurance liabilities should reflect the risk that would be reflected in the price of an arm's length transaction between knowledgeable, willing parties. To the extent that estimated cash flows reflect this risk, the discount rate should be a risk-free rate. To the extent that estimated cash flows do not reflect this risk, the discount rate should be a risk-adjusted rate. In developing further guidance on this topic, the Steering Committee will monitor the present value projects of IASC and national standard setters.*

Life Insurance

Basic Issue 8 What Assumptions and Conventions Should be Used in Accounting for Life Insurance Contracts

379. *In the Steering Committee's view, the conclusions presented in Table 7 should also apply to life insurance contracts.*

Sub-issue 8B What Assets and Liabilities are Created by Life Insurance Contracts?

387. *In the Steering Committee's view, payments that an insurer is required to make on termination of the contract by the policyholder meet the definition of a liability.*
389. *In the Steering Committee's view, payments (including related claim handling costs) that the insurer is required to make as a consequence of insured events that have occurred (policyholder deaths) clearly meet the definition of a liability, even though the claims may not have been reported to the insurer.*
393. *In the Steering Committee's view, an insurer's obligation for claims (including related claim handling costs) arising from insured events that may occur during the period covered by the current premium meets the definition of a liability and should be recognised as such.*
398. *In the Steering Committee's view, the combination of future premiums, expenses, and claims beyond the current premium period from contracts like the term-life contract described in this section create assets or liabilities. Those assets or liabilities exist as a consequence of a past transaction (signing the contract) that imposes benefits or sacrifices on the insurer.*
399. *In the Steering Committee's view, contracts that guarantee the policyholder's right to renew the contract and that restrict the insurer's ability to change the amount of renewal premiums create an asset or liability that would not exist in the absence of such guarantees or restrictions.*
400. *The Steering Committee observes that the contract provisions described in these paragraphs are more common in life insurance than general insurance contracts. As a result, the Steering Committee observes that most general insurance contracts do not give rise to assets and liabilities related to premiums and claims after the end of the current premium period. However, general insurance contracts in some jurisdictions include the features described in this Steering Committee view. The Steering Committee's views are based on the nature of the contractual relationships, not the nature of the insured events. Accordingly, the Steering Committee would extend its conclusions to general insurance contracts with similar features. Indeed, under the definition proposed in Sub-issue 1K, such contracts would be classified as life insurance contracts for financial reporting purposes.*
402. *Consistent with its tentative view in Sub-issue 7D for general insurance, the Steering Committee concludes that acquisition costs for life insurance contracts should be*

recognised as an expense, on the basis that they do not meet the Framework's definition of an asset. Also, the measurement of insurance liabilities already reflects the future cash flows to be generated by the insurance contract, so the recognition of an asset would lead to double counting.

403. *In summary, the Steering Committee concludes that the following assets and liabilities are created by a non-participating life insurance contract:*

- (a) a liability for payments that an insurer is required to make on termination of the contract by the policyholder;*
- (b) a liability for payments that the insurer is required to make as a consequence of insured events that have occurred;*
- (c) a liability for payments of claims that may occur during the period covered by the current premium; and*
- (d) a net contractual right or obligation to receive or pay cash as a result of existing insurance contracts.*

404. *The terms of some life insurance contracts allow for a different decomposition of the life insurance contract. For example, some contracts such as **universal life**, **variable**, and **indexed** contracts allow separate identification of future charges against the contract for administration and mortality coverage, future interest credits, and future charges for early termination. The ability to separately identify contract components is a prerequisite for the policyholder-deposit accounting model discussed later in this section. However, many contracts (including the term-life contract described earlier) do not allow for this level of analysis. In addition, the individual elements listed above are included in the cash flows associated with the several assets and liabilities described in the preceding paragraph.*

Sub-issue 8C Should the Various Assets and Liabilities Created by a Life Insurance Contract be Combined into a Single Recognition and Measurement Scheme?

411. *In the Steering Committee's view, the insurer's rights and obligations under the contract create a single net liability or asset. Therefore, the Steering Committee favours an approach to accounting for life insurance that combines the various assets and liabilities created by a book of contracts in a single recognition and measurement scheme. Similarly, the Steering Committee considers that the offsetting requirements in IAS 32 are not relevant.*

412. *The conclusion in the previous paragraph does not apply to those components of insurance contracts that are unbundled under the tentative Steering Committee view in Sub-issue 1E.*

Sub-issue 8D Should IASC Prescribe a Single Accounting Model for Life Insurance Activities?

425. *In the Steering Committee's view, a prospective (policyholder-benefit) approach is consistent with its view of a life insurance contract as a single set of interrelated*

assets and liabilities. However, the amount recorded as a liability should not be less than the amount that would result from applying a retrospective (policyholder-deposit) approach. The Steering Committee expects that a prospective approach, applied without restriction based on the retrospective approach, would be more consistent with an estimate of fair value.

426. *In reaching the view outlined above, Steering Committee members noted the following points that influenced their deliberations:*

- (a) *when considered in a traditional (rather than fair-value) context, accounting for life insurance has typically focused on the service provided by the insurer. Traditional policyholder-benefit approaches attempt to report earnings from the contract as the service is provided. In this regard, they are similar to accounting for other long-term contracts, as described in IAS 18, Revenue; and*
- (b) *the liability recognised in a policyholder-deposit model - the policyholder's account balance - is a financial liability that is typically payable to policyholders on demand (although it may be subject to surrender charges or penalties). When considered in a traditional context, the balance of this financial liability represents a minimum measurement of the liability.*

Sub-issue 8E Should IASC Specify a Single Attribution Approach for Life Insurance Contracts?

430. *In the Steering Committee's view, the income attribution approach should be the result of the liability measurement. Accounting conventions that produce liability measurements as a by-product of a predetermined pattern of reported income are inconsistent with an asset-and-liability-measurement approach.*

431. *The Steering Committee observes that if its view is applied, income emerges as a function of contract margins for those periods in which the liability to policyholders is computed using the policyholder-deposit measurement. Income emerges as a function of release from risk for those periods in which the liability to policyholders is computed using the policyholder-benefit measurement.³*

432. *The Steering Committee observes that other approaches to measuring the insurer's assets and liabilities give rise to other patterns of income attribution. Some of those patterns are illustrated in Appendix A. The Steering Committee invites comments from readers who consider one or more alternative approaches superior to the approach that flows from the Steering Committee's tentative views.*

³ If insurance liabilities are measured at fair value, income will emerge as a function of release from risk.

Participating (With-Profits) Contracts

Basic Issue 9 Are there any Specific Accounting Issues for Participating (With-Profits) Contracts?

Sub-issue 9A Should Unallocated Divisible Surplus be Recognised as a Liability or as Equity?

461. *In the Steering Committee's view:*

- (a) *unallocated surplus should be classified as a liability, except to the extent that the insurer:*
 - (i) *has no legal or constructive obligation at the balance sheet date to allocate part of the surplus to current or future policyholders; or*
 - (ii) *has such a legal or constructive obligation, but cannot measure that obligation reliably; and*
- (b) *the rest of the unallocated surplus should be classified as equity. Where there is any doubt as to whether, or what amount of, that equity will flow to the insurer's owners, the insurer should disclose the fact that the owners have restricted access to that equity.*

462. *Allocations made after the balance sheet date should influence the classification of unallocated divisible surplus only to the extent that they give evidence of whether a legal or constructive obligation existed at the balance sheet date. This is consistent with the Framework's definition of a liability and with IAS 10, Events After the Balance Sheet Date.*

463. *For the purpose of determining whether an insurer can measure an obligation reliably, the Steering Committee refers to the following guidance in paragraphs 25 and 26 of IAS 37, Provisions, Contingent Liabilities and Contingent Assets.*

25. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other balance sheet items. Except in extremely rare cases, an enterprise will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision.

26. In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph 86).

464. *Under some participating contracts, policyholder benefits are linked to the historical cost of designated assets. To the extent that the designated assets are measured at fair value in the financial statements, the measurement of the related liabilities should reflect the fair value of the assets.*

Sub-issue 9B Does a Mutual Insurer have Equity?

467. *The Steering Committee notes that the question of whether a mutual has equity is not unique to the insurance industry. In the Steering Committee's view:*

- (a) a mutual insurer should classify unallocated surplus as a liability, except to the extent that the mutual insurer;*
 - (i) has no legal or constructive obligation at the balance sheet date to allocate part of the surplus to current or future policyholders; or*
 - (ii) has such a legal or constructive obligation, but cannot measure that obligation reliably; and*
- (b) a mutual insurer should classify the rest of the unallocated surplus as equity.*

Sub-issue 9C Should Insurers Recognise Allocations to Participating Policyholders as an Expense or as an Appropriation of Equity?

472. *The Steering Committee supports the view that allocations to participating policyholders are expenses, regardless of whether the allocations have been made to individual policyholders or to a class of policyholders and regardless of whether the insurer is mutual or stockholder-owned. This is on the basis that the allocations give rise to increases in liabilities and are therefore expenses. Similarly, increases (decreases) in the liability portion of unallocated divisible surplus are an expense (income).*

Sub-issue 9D Are any Specific Disclosures needed about Participating (With-Profits) Contracts?

473. *The Steering Committee believes that there may be a need for disclosures about an insurer's policy in making allocations for participating (with-profits) contracts and about the related assumptions that are reflected in the financial statements. The Steering Committee invites commentators to indicate any specific disclosures that may be needed for such contracts.*

Sub-issue 9E Are there any other Specific Issues for Mutual Insurers?

474. *The Steering Committee invites commentators to indicate whether there are any specific issues for mutual insurers that this Issues Paper does not address. The Steering Committee is not aware of any such issues.*

Reinsurance

Basic Issue 10 Are there any Specific Accounting Issues for Reinsurance Contracts?

Sub-issue 10A Is the Distinction between Direct Insurance and Reinsurance Important Enough to Warrant Different Accounting Treatments?

483. *The Steering Committee has not identified any reason to set different accounting requirements for reinsurers. Among other things, the Steering Committee believes that improvements in communications mean that the deferred annual method is no longer needed. The Steering Committee would welcome comments on any aspects of reinsurance that warrant separate consideration.*
484. *The principles discussed in the Steering Committee's view on Sub-issue 6A may sometimes lead to a unit of account in reinsurance that differs from the unit of account in direct insurance.*

Sub-issue 10B Should a Ceding Insurer Recognise Gains or Losses when it Enters into a Reinsurance Transaction?

498. *The Steering Committee prefers an asset and liability approach to this Sub-issue. Deferred gains of the kind discussed above do not meet the Framework's definition of a liability. Therefore, such gains should be recognised immediately.*

Sub-issue 10C Should a Ceding Insurer Recognise Separate Assets and Liabilities arising from Reinsurance Arrangements, or should Amounts be Offset against Related Ceded Liabilities?

503. *In view of the requirements in IAS 32 and IAS 37, the Steering Committee knows of no basis for offsetting amounts due from reinsurers against related insurance liabilities.*

Sub-issue 10D How Should a Ceding Insurer Report Revenue and Expenses from Reinsurance Arrangements?

508. *To enhance the comparability of insurance financial statements, the Steering Committee recommends that activity with reinsurers be reported gross in the income statement, rather than offset against related accounts. However, the Steering Committee does not find a strong conceptual basis for favouring either a net presentation or a gross presentation on the face of the income statement. If a net presentation is permitted, the Steering Committee believes that the gross amounts should be disclosed in the notes to the financial statements.*

Sub-issue 10E When, if Ever, should a Reinsurance Arrangement be Treated as an Extinguishment of Liabilities?

512. *The Steering Committee observes that this issue is under consideration by the Joint Working Group on financial instruments. The conclusion reached in that context will be very important in determining conditions (if any) under which reinsurance contracts can serve as a basis for derecognition either of an entire liability or of*

certain components of a liability. At this stage, the Steering Committee believes that derecognition is appropriate only when the obligation specified in the contract is discharged or cancelled, or expires. In other words, derecognition is appropriate only for a novation or for assumption reinsurance, but not for indemnity reinsurance.

Sub-issue 10F Are there any Special Considerations in Measuring Assets and Liabilities under Reinsurance Contracts?

516. *At this stage, the Steering Committee does not intend to give additional guidance on measurement of reinsurance assets and liabilities. In the Steering Committee's view, all important aspects of the measurement of reinsurance assets and liabilities are covered by the discussion in other parts of this Issues Paper.*

Fair Value Issues

Basic Issue 11 What Issues are Raised by the Use of Fair Value in the Measurement of Insurance Obligations?

Sub-issue 11A Are Insurance Contracts Financial Instruments?

537. *In the Steering Committee's view, insurance contracts should be considered financial instruments. Insurance contracts may have non-financial attributes. However, any attempt to exclude them from consideration as financial instruments will lead to accounting differences between insurance contracts and other economically similar instruments. The Steering Committee acknowledges that viewing insurance contracts as financial instruments may lead to conclusions that differ from those that follow from a view of insurance contracts as service contracts.*

Sub-issue 11B Should Insurance Contracts be Included in a Fair Value Standard?

556. *The Steering Committee holds the following views, all in the assumed context of a future International Accounting Standard that requires all financial instruments to be measured at fair value:*

- (a) if the other enterprises use fair value for financial instruments, insurers should not be excluded;*
- (b) if all other financial assets and financial liabilities of an insurer are at fair value, insurance contracts should be at fair value;*
- (c) movements in the fair values of an insurer's financial assets and liabilities should be reported in a consistent manner. For example, if some movements in the fair value of assets are excluded from net profit or loss for the period and reported as a component of equity, accompanying movements in liabilities should be reported in the same fashion; and*
- (d) accounting for insurance contracts at fair value should be covered in the insurance standard, not in the financial instruments standard.*

557. *The Steering Committee assumes that, on the completion of this project, IASC will have adopted a comprehensive approach to reporting all financial instruments at fair value, with all movements in fair value reported in the income statement. The Steering Committee considers consistency between the treatment of assets and liabilities of an insurance enterprise a precondition for proper reporting. Therefore, the assets and liabilities arising out of insurance contracts should be measured at fair value, with all movements in fair value reported in the income statement.*
558. *The Steering Committee acknowledges that, at this time, it is often difficult to estimate the fair value of assets and liabilities created by insurance contracts on a reliable, objective, and verifiable basis. Therefore, the Steering Committee intends to develop further guidelines to address estimation. In the meantime, the Steering Committee would welcome any suggestions for those guidelines.*

Sub-issue 11C What should be the General Approach in Applying Fair Value to Insurance Contracts?

566. *In the Steering Committee's view, the measurement approach described in IAS 37 provides a general model for estimating the fair value of most insurance obligations. The approach employs elements similar to those found in established techniques already used by insurers and actuaries. While there may be inconsistencies between the guidance found in IAS 37 and IAS 39, the Steering Committee observes that IAS 37 was designed to deal with liabilities that have uncertain cash flows - a common characteristic of most insurance liabilities.*
567. *The Steering Committee also notes the similarity between this approach and the present value techniques described in the recent FASB proposed Statement of Financial Concepts, Using Cash Flow Information and Present Value in Accounting Measurements. The Steering Committee observes that an insurer's internal estimates may sometimes provide the only available information about its liabilities, and notes the observation in paragraph 26 of the FASB's proposed Concepts Statement:*

Adopting fair value as the objective of present value measurements does not preclude the use of information and assumptions based on an entity's expectations. An entity that uses cash flows in accounting measurements often has little or no information about the assumptions that marketplace participants would use in assessing the fair value of an asset or liability. In those situations, the entity must necessarily use the information that is available without undue cost and effort in developing cash flow estimates. The use of an entity's own assumptions about future cash flows is compatible with an estimate of fair value, as long as there are no contrary data indicating that marketplace participants would use different assumptions. If such data exist, the entity must adjust its assumptions to incorporate that market information.

Sub-issue 11D Should the Fair Value of an Insurance Contract Include the Fair Value of Intangibles and Other Items Related to the Insurance Contract?

576. *In the Steering Committee's view, the fair value of insurance assets and liabilities should represent the value of the financial assets or liabilities embodied in the insurance contract and should not include the value of intangible assets, renewal*

premiums, and related claims that would not otherwise meet the criteria for recognition in financial statements.

Sub-issue 11E Should the Fair Value of Insurance Contracts be based on Individual Contracts or Books of Similar Contracts?

580. *In the Steering Committee's view, any application of fair value to insurance contracts should continue the existing focus on groups of insurance contracts that have substantially the same contractual terms and were priced on the basis of substantially the same assumptions, rather than on individual insurance contracts (see Sub-issue 6A). Consistent with that view, insurance exposures that are not similar (for example, residential and marine exposures or professional liability and auto exposures) should not be combined.*

Sub-issue 11F Should the Fair Value of Insurance Contracts be Estimated using Entry or Exit Values and should the application of Fair Value Measurements result in a Gain or Loss on the Sale of Insurance Contracts?

596. *The Steering Committee considers exit value to be consistent with the definition of fair value, with the provisions of IAS 37, and with previous conclusions in this paper. The Steering Committee acknowledges that exit values may give rise to gains and losses upon the sale of insurance contracts, and that some may be concerned with that result. However, the Steering Committee does not consider it appropriate to use artificial, or overly conservative, assumptions intended to produce no gain on the sale of insurance contracts.*
597. *The Steering Committee observes that, as a practical matter, a significant gain on the sale of insurance contracts may be indicative of flawed assumptions used in the estimation of fair value. In particular, a significant gain may suggest that the insurer has failed to properly consider the amount of risk premium that another insurer might demand in determining the price of settling the liabilities in question. However, there may be situations in which an insurer operating in a niche market or with special distribution channels may be able to realise significant gains on sale.*

Sub-issue 11G Should Fair Value of Insurance Contracts be Estimated using Rates of Return on the Insurer's Assets or using some other Discount Rate?

610. *Pending further discussion, the Steering Committee is evenly divided on whether the fair value of an insurer's liabilities incorporates the expected return on the insurer's assets. In the view of some members of the Steering Committee, such a measurement is consistent with the manner in which an insurance enterprise is managed. They also consider such a measurement consistent with the observed price of settlement transactions, to the extent they exist, and reinsurance transactions.*
611. *In the view of other members of the Steering Committee, the fair value of liabilities should not be affected by the type of assets held by the insurer or the return on those assets. In their view, the Steering Committee reached the appropriate conclusion in*

Basic Issue 5, and they see no justification for not extending that view to estimates of fair value.

Sub-issue 11H Should the Estimated Fair Value of Insurance Contracts include a Provision for the Risk Inherent in those Contracts ?

619. *Consistent with its view in Sub-issue 6F, the Steering Committee observes that the estimated fair value of an insurer's liability should include the premium that marketplace participants demand for bearing the uncertainty inherent in estimated future cash flows. The Steering Committee observes that this premium may be difficult to estimate, however, excluding the adjustment for risk may lead to measurements that make different liabilities, with different risk profiles, appear the same.*

Sub-issue 11I Should the Estimated Fair Value of Insurance Contracts reflect the Insurer's Credit Standing?

626. *Questions about the role of an enterprise's credit standing (and changes in credit standing) in measuring liabilities extend beyond the measurement of insurance liabilities. The Joint Working Group on financial instruments is also considering these issues. The Insurance Steering Committee expects to monitor that activity and to co-ordinate its deliberations with those of the Joint Working Group.*

Sub-issue 11J Does a Fair Value Accounting System for Insurance Contracts include Deferred Acquisition Costs?

631. *In the Steering Committee's view, the practice of reporting deferred acquisition costs as an asset, while consistent with some traditional accounting models, is not consistent with determining the fair value of the insurer's financial assets and liabilities. That determination is fundamentally a prospective computation unrelated to costs that the insurer may have incurred in selling insurance contracts. However, the Steering Committee observes that cash flow assumptions used in estimating fair value should reflect the fact that other marketplace participants may accept less to assume an insurer's obligations, because they would likely avoid the acquisition costs incurred by the insurer.*

Sub-issue 11K Is the Embedded-Value Method an Appropriate Approach to use in Estimating and Reporting the Fair Value of Insurance Assets and Liabilities?

643. *The Steering Committee considers that:*
- (a) *embedded values should not be recognised as assets in financial statements as a means of correcting for inappropriate measurement of insurance liabilities;*
 - (b) *an insurer's rights under an insurance contract should be factored into the measurement of the insurer's net liability under the contract; and*
 - (c) *depending on the measurement basis adopted for insurance liabilities, there may be a need for disclosure of additional information about embedded values.*

Sub-issue 11L Should Decisions about the Fair Value of an Insurer's Financial Assets and Liabilities be extended to other Assets and Liabilities of an Insurer?

652. *Although it is not part of the Steering Committee's mandate to review accounting for property, plant and equipment generally, the Steering Committee believes that IASC should review accounting by insurers for these assets.*

Deferred Tax

Basic issue 12 Should an Insurer Discount Deferred Tax Liabilities and Deferred Tax Assets Relating to Insurance Contracts?

661. *The Steering Committee recommends that IASC should consider in the project on discounting whether to require or permit discounting of all deferred tax assets and liabilities.*

Reporting Enterprise and Consolidation

Basic issue 13 What is the Reporting Enterprise for an Insurer?

Sub-issue 13A Does the Reporting Enterprise for an Insurer Include any Separate Statutory Funds?

672. *The Steering Committee considers that the insurer, comprising both policyholder and stockholder interests, is a single reporting enterprise which should prepare a single set of financial statements. Restrictions imposed by insurance regulators on the use of policyholder assets are not sufficient to justify excluding the assets and liabilities of different classes of policyholders and any stockholders.*
673. *Although policyholder interests and stockholder interests comprise a single reporting enterprise, there may be a need for separate disclosures about policyholder interests. Sub-issue 18D addresses that question.*

Sub-issue 13B Should the Reporting Enterprise include Investments and Liabilities Relating to Investment-linked Contracts?

686. *The Steering Committee considers that liabilities under investment-linked insurance contracts, and the related investments, should be recognised in the balance sheet as two single line items (asset and liability). The Steering Committee notes that there is a strong argument for treating investment-linked contracts sold by insurers (life insurers in particular) in the same way that managers treat the funds they manage on behalf of investors, namely by not recognising assets and liabilities in relation to investment-linked contracts. However, the Steering Committee considers that the single line items treatment for investment-linked insurance contracts best reflects the terms of the contracts between insurers and policyholders. Sub-issue 18D addresses the question of separate disclosures about these items.*

687. *Where an insurance contract includes an investment-linked component, the contract may need to be unbundled so that the investment-linked component is treated in the same way as an investment-linked contract (see Sub-issue 1E).*

Basic issue 13C How should a Parent Treat its Interest in an Insurer Subsidiary?

696. *The Steering Committee considers that a parent of an insurer subsidiary should consolidate the whole insurer subsidiary comprising the stockholder and policyholder interests that it controls.*

Sub-issue 13D Should Horizontal Groups be Required to Present Consolidated Financial Statements Covering all Enterprises under Unified Management?

701. *In the Steering Committee's view, horizontal groups should prepare combined financial statements covering all the enterprises under unified management.*
702. *The Steering Committee would welcome comments on any specific disclosures that may be needed to reflect the fact that the enterprises in a horizontal group may have different stakeholders.*

Basic Issue 14 How Should an Insurer Account for Subsidiaries, Associates and Interests in Joint Ventures?

Sub-issue 14A Should an Insurer Account for the Excess of Fair Value over the Net Assets and Liabilities of its Subsidiaries?

716. *The Steering Committee favours the following approach:*
- (a) *to the extent that policyholder benefits are linked directly to the fair value of a subsidiary, the consolidated balance sheet should include the goodwill of that subsidiary at its fair value (in other words the fair value of the investment in the subsidiary less its net assets). This goodwill should be disclosed separately because other goodwill is not measured at fair value – other acquired goodwill is measured at amortised cost and other internally generated goodwill is not recognised at all; and*
 - (b) *in all other cases, the consolidated balance sheet should exclude the excess of fair value over the net assets (including unamortised purchased goodwill) less liabilities of subsidiaries, as this exclusion is consistent with accounting by other types of enterprises.*
717. *Based on the Steering Committee's tentative view on issue 13A, that the insurer reporting enterprise comprises both policyholder and stockholder interests, no distinction should be made based on whether the subsidiary is held via policyholder funds or via a stockholder fund.*

Sub-issue 14B How should an Insurer Account for Associates and Interests in Joint Ventures?

722. *As for investments in subsidiaries, the Steering Committee favours the following approach for investments in associates:*

- (a) *to the extent that policyholder benefits are linked directly to the fair value of an associate, the consolidated balance sheet should include that associate at its fair value; and*
- (b) *in all other cases, the consolidated balance sheet should exclude the excess of fair value over the net assets (including unamortised purchased goodwill) less liabilities of associates, as this exclusion is consistent with accounting by other types of enterprises.*

Basic Issue 15 How should the Transferee Account for the Transfer of a Block of Insurance Contracts?

736. *The Steering Committee considers that the acquisition of a block of insurance contracts should be treated in the same manner as the acquisition of an insurance enterprise to avoid having similar transactions being treated differently.*

Basic Issue 16 Should the Effects of Internal Transactions be Eliminated from Financial Statements

750. *The Steering Committee considers that transactions between separate policyholder funds of an insurer should not be recognised in the financial statements as assets, liabilities, income or expenses. Income and expense from transactions between policyholder funds and stockholder funds should be eliminated. However, where such transactions affect the relative interests of policyholders and stockholders in the assets held in the respective funds, the effect of such transactions should not be eliminated in determining the balance sheet effect.*

751. *The Steering Committee notes, however, that the effects of transactions between separately reported segments need to be preserved in segment disclosures. Appendix 2 to IAS 14, Segment Reporting, contains a specimen disclosure that illustrates the presentation of segment disclosures before eliminations, with a final column to show the effect of eliminations.*

Interim Financial Reporting

Basic Issue 17 Is More Guidance Needed to Supplement IAS 34 on the Treatment of Insurance Contracts in Interim Financial Reports?

757. *The Steering Committee does not intend to develop guidance on the application of IAS 34 to insurance contracts. If commentators believe that such guidance would be helpful, the Steering Committee would appreciate comments on the form that such guidance should take.*

Presentation and Disclosure

Basic Issue 18 How Should Information about Insurance Contracts be Presented in the Financial Statements?

Sub-Issue 18A Should IASC Specify Reporting Formats for the Balance Sheet, Income Statement and Cash Flow Statement of an Insurer?

762. *The Steering Committee believes that an International Accounting Standard on insurance may need to require the presentation of certain insurance specific items on the face of the balance sheet, income statement and cash flow statement, in addition to those required by IAS 1 and IAS 7. The Steering Committee also recommends that illustrative formats for the balance sheet, income statement, cash flow statement and note disclosures should be provided as an appendix to the Standard. Illustrations A77-A82 in the accompanying booklet are illustrative balance sheet, income statement and cash flow statement formats for insurers.*

Sub-issue 18B Should an Insurer Make the Current/Non-current Distinction in its Balance Sheet?

767. *In the Steering Committee's view, it is not useful for an insurer's balance sheet to present current assets and liabilities separately from non-current assets and liabilities.*

Sub-issue 18C Should IAS 7, Cash Flow Statements, be Amended for Insurers?

774. *The Steering Committee recommends that all insurers should present a cash flow statement under IAS 7. An illustrative cash flow statement could be provided in the Standard in order to promote consistency. The Steering Committee has not yet discussed whether investment income and cash flows from purchase and sale of investments should be included in operating cash flows.*
775. *The Steering Committee will consider whether there is a need for specific cash flow disclosures about insurance contracts. The Steering Committee notes that traditional income statement formats for insurers often include information about cash flows. If this information is no longer presented separately in the income statement, there may be a need for specific disclosures.*
776. *The Steering Committee invites respondents to indicate whether the presentation and disclosure requirements in IAS 7 need any amendment in order to provide informative information to users of financial statements.*

Sub-issue 18D Should Policyholder Interests be shown Separately from Stockholder Interests on the Face of the Balance Sheet, Income Statement and Cash Flow Statement?

783. *The Steering Committee believes that policyholder assets and liabilities and related income, expense and cash flows should be disclosed separately in the notes to the financial statements where practicable (practicability may vary by jurisdiction);*

separate presentation on the face of the balance sheet, income statement and cash flow statement should be permitted but not required. Separate disclosure in the notes may be needed where there is uncertainty about how assets of specific funds will be allocated between policyholders and stockholders, as is the case with some assets of some UK insurers. Separate disclosure may also be needed of cash flows between policyholders' funds and stockholders' funds.

784. *Where insurance enterprises hold assets on behalf of policyholders and the benefits payable to the policyholders are directly linked to those assets, the Steering Committee recommends that these assets and liabilities and related income, expense and cash flows should be presented separately on the face of the balance sheet, income statement and cash flow statement.*

Basic Issue 19 How Should Income and Expense from Insurance Contracts be Presented?

Sub-issue 19A How should an Enterprise Present Income and Expense arising from Insurance Contracts?

803. *The Steering Committee plans to review the progress made by the Joint Working Group on Financial Instruments and by the G4+1 before developing specific proposals for presenting income and expense arising from insurance contracts.*

Sub-issue 19B Should an Insurer Present Premium Revenue and Claims Expense on the Face of the Income Statement?

810. *The Steering Committee believes that premiums and claims should be presented as a single item for premium revenue and a single item for claims expense, not as cash receipts and payments alongside movements on related asset and liabilities.*

Sub-issue 19C Should an Insurer Present Unwinding of the Discount as Operating Expense or as Finance Expense?

814. *In the Steering Committee's view, the "unwinding" of the discount should be classified in the same way as interest income and interest expense.*

Sub-issue 19D How Should an Insurer Present the Effect of Experience Adjustments and Changes in Assumptions?

818. *At this stage, the Steering Committee has not formed a view on this issue. The Steering Committee will monitor progress by the Joint Working Group on Financial Instruments and in IASC's projects on Agriculture and Investment Property.*

Sub-issue 19E Should an Insurer Include All, Part or None of its Investment Return in Operating Activities?

826. *The Steering Committee believes that the results of operating activities should include the total investment return (dividend and interest income, as well as gains and losses both realised and - to the extent recognised - unrealised) as it reflects the total performance of the management in managing the underwriting and investment*

activities of the enterprise.

827. *The Joint Working Group on Financial Instruments will be considering various issues about the reporting of changes in the carrying amount of financial instruments. The Steering Committee will monitor the progress of that work.*

Sub-issue 19F Should Income and Expense be Presented in the Income Statement Separately for Life Insurance Contracts and for General Insurance Contracts?

831. *The Steering Committee believes that the most appropriate presentation format for the income statement is a single statement combining general and life insurance with further analysis provided as segmental information in the notes to the financial statements. The Steering Committee recognises that this approach may require amendment to legislation in certain jurisdictions.*

Sub-Issue 19G Should Taxes and Levies be Included in Premium Income?^{835.} *The Steering Committee recommends that insurers follow IAS 18, Revenue, in determining which amounts are included in premium income. The Steering Committee further recommends that insurers disclose which taxes and levies have been included or excluded from the amount presented as premium income.*

Basic Issue 20 What Disclosures Should be Required about Insurance Contracts?

Sub-issue 20A Should the Disclosures about Financial Instruments in IAS 32 and IAS 39 be Extended to Cover Insurance Contracts?

847. *The Steering Committee believes that most of the disclosures required by IAS 32 are also likely to be relevant for insurance contracts. The Steering Committee intends to give some additional guidance to clarify how these requirements should be applied to insurance contracts in an informative and concise way. The Steering Committee notes that the Canadian Institute of Chartered Accountants (CICA) has issued guidance (Accounting Guideline AcG-4, Actuarial Liabilities of Life Insurance Enterprises) on how life insurers should make disclosures required by section 3860 of the CICA Handbook. Section 3860 and IAS 32 were developed together as part of a joint project and are virtually identical. Unlike IAS 32, section 3860 does not have a scope exclusion for insurance contracts.*
848. *Most of the disclosures required by IAS 39 arise from specific details of the recognition and measurement requirements of IAS 39. Similar requirements may or may not be needed for insurance contracts; this will depend on the recognition and measurement requirements adopted for insurance contracts.*

Sub-Issue 20B Should IASC extend IAS 37's Disclosure Requirements about Provisions to Cover Insurance Contracts?

854. *The Steering Committee believes that the disclosures in IAS 37 should be extended to cover insurance contracts. The Steering Committee intends to give further guidance*

on the application of these disclosures to insurance contracts, including illustrative examples.

855. *The Steering Committee believes that disclosures about the extent of risk adjustments may be useful. One possibility might be to require disclosure of the difference between the actual (risk-adjusted) amounts recognised and the expected values of the related cash flows, and of the movements in that difference during the period. The Steering Committee plans to develop further thoughts in this area. Illustrations A77-A81 show ways of presenting disclosures about the effect of risk adjustments.*

Sub-Issue 20C Should an Insurer Disclose Details of Claims Development?

861. *The Steering Committee believes that claims development disclosures would be useful for general insurance activities. The Steering Committee has not yet developed detailed proposals, as these are likely to depend on recognition and measurement requirements.*

Sub-issue 20D Should Disclosures of Solvency be Made in the Financial Statements?

865. *The Steering Committee recognises that, for a large group, disclosure of regulatory solvency margins may turn out to be either very voluminous, or aggregated at such a high level that it is not meaningful. In the Steering Committee's view, an insurer should disclose how much of its equity is not available for distribution to stockholders, distinguishing amounts that are not distributable because of legal or other regulatory requirements from amounts that the insurer's management considers are not distributable for commercial reasons. The Steering Committee believes that an insurer should also disclose information about restrictions on its assets. The Steering Committee would welcome views on the best way to provide solvency information for a group in a concise and meaningful way.*

Sub-Issue 20E Does IAS 14 give Sufficient Guidance on Segment Reporting by Insurers?

875. *The Steering Committee recommends that segmental analysis following IAS 14 should be provided by all insurance enterprises, and not merely by those that have issued publicly traded equity or debt securities.*
876. *The Steering Committee intends to develop guidance on the identification of reportable segments by class of business. The Steering Committee believes that, the organisational and management structure and internal financial reporting system of some insurers may not indicate the insurers' predominant source of risks and returns for the purpose of their segment reporting.*
877. *The Steering Committee will consider whether there is a need for insurers to provide any additional segment disclosures beyond those required by IAS 14.*

Sub-issue 20F Should Disclosures be Required About Key Performance Indicators?

881. *The Steering Committee believes that insurers should disclose key performance indicators, including the level of new business and the sum assured in life business. The Steering Committee welcomes comments on the sort of key performance indicators that would give users relevant and reliable information at a reasonable cost.*
882. *The Steering Committee will investigate whether there is a need for specific disclosures about low-frequency, high-severity risks - perhaps by segregating a separate component of equity.*

Sub-issue 20G Should Disclosures be Required About Sensitivity?

887. *The Steering Committee believes that sensitivity disclosures, possibly including value at risk measures, would be useful to users of financial statements. The Steering Committee plans to develop further thoughts in these areas.*

Sub-issue 20H Should Other Disclosures be Required about Insurance Contracts?

888. *The Steering Committee invites commentators to indicate whether any other disclosures should be required about insurance contracts.*