Project **Insurance contracts**

Topic **Candidate measurement approaches – tabular comparison**

Staff note

This table on measurement approaches for insurance contracts has the same content as agenda paper 10D for the June 2009 IASB and FASB meetings. The questions for participants on candidate measurement approaches are included in agenda paper 6 for the June 2009 Working Group meeting

Purpose of this paper

1. This paper provides a tabular overview of differences and similarities between the candidate measurement approaches for insurance contracts. The table includes all the approaches considered in this meeting, including those we recommend for removal (see agenda papers 10A and 10C).

2. The table reflects the candidates as currently defined by staff. The description of the candidates is tentative; as a result of discussions at future meetings the candidates may change.

3. The table tries to capture the main features of a measurement approach, but is not intended to show every detail.

CANDIDATE MEASUREMENT APPROACHES (TENTATIVE)

	Current exit value (previously candidate 1, modified) [**for consideration by IASB only**]	**Measurement approach based on updated IAS 37 model**	**Current fulfilment value (previously candidate 3)**	**Current fulfilment value (previously candidate 4)**	**Unearned premium (previously candidate 5)**
Definition	The amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. Plus a "residual margin", based on the day one difference.	The amount the entity would rationally pay at the end of the reporting period to be relieved of the present obligation. Plus a "residual margin, based on the day one difference.	The expected present value of the cost of fulfilling the obligation to the policy holder over time, **including** the cost of bearing risk. Plus a "residual margin", based on the day one difference.	The expected present value of the cost of fulfilling the obligation to the policy holder over time, **excluding** the cost of bearing risk. Plus a "composite margin", based on the day one difference.	The part of the premiums for the unexpired part of the insurer's contractual obligation, subject to a liability adequacy test.

	Current exit value (previously candidate 1, modified) [**for consideration by IASB only**]	**Measurement approach based on updated IAS 37 model**	**Current fulfilment value (previously candidate 3)**	**Current fulfilment value (previously candidate 4)**	**Unearned premium (previously candidate 5)**
Scope	All insurance liabilities.	All insurance liabilities.	All insurance liabilities	All insurance liabilities.	Only pre-claim short duration insurance liabilities.
Building blocks for the measurement approach*	- current estimate of the expected (ie probability weighted) present value of future cash flows - time value of money - an explicit margin	- current estimate of the expected (ie probability weighted) present value of future cash flows - time value of money - an explicit margin	- current estimate of the expected (ie probability weighted) present value of future cash flows - time value of money - an explicit margin	- current estimate of the expected (ie probability weighted) present value of future cash flows - time value of money - an explicit margin	An implicit building block approach that includes (1) expected cash flows (2) time value of money (3) a margin; all locked-in at inception.

* The IASB has decided tentatively that the measurement for an insurance liability will use all three building blocks. The FASB has decided tentatively to include a current estimate of the expected (ie probability weighted) present value of future cash flows, but has yet to discuss whether the measurement includes time value of money and an explicit margin.

	Current exit value (previously candidate 1, modified) [**for consideration by IASB only**]	**Measurement approach based on updated IAS 37 model**	**Current fulfilment value (previously candidate 3)**	**Current fulfilment value (previously candidate 4)**	**Unearned premium (previously candidate 5)**
Inputs for estimates of cash flows					
Inputs for which observable market information is available (financial market variables)	Consistent with observed market prices.	Consistent with observed market prices	Consistent with observed market prices.	Consistent with observed market prices.	Not applicable unless onerous.
Other inputs	The entity's estimate of the estimates that other market participants would make.	The entity's estimate of the cash flows it would incur in fulfilling the liability.	The entity's estimate of the cash flows it would incur in fulfilling the liability.	The entity's estimate of the cash flows it would incur in fulfilling the liability.	Not applicable unless onerous.
Characteristics of cash flows					
Cash flows that arise from the characteristics of the portfolio (portfolio-specific)	Included.	Included.	Included.	Included.	Not applicable unless onerous.

	Current exit value (previously candidate 1, modified) [**for consideration by IASB only**]	**Measurement approach based on updated IAS 37 model**	**Current fulfilment value (previously candidate 3)**	**Current fulfilment value (previously candidate 4)**	**Unearned premium (previously candidate 5)**
Cash flows that arise from the characteristics of the entity (entity-specific)	Excluded.	Included.	Included.	Included.	Not applicable unless onerous.
Subsequent measurement of cash flows	Current estimates for all variables.	Current estimates for all variables.	Current estimates for all variables.	Current estimates for all variables.	No remeasurement unless onerous.
Changes in estimates of cash flows*	Effect included in profit or loss.	Effect included in profit or loss.	Effect included in profit or loss.	Effect included in profit or loss.	Included in profit or loss if contract becomes onerous.

* The boards have not discussed yet a) whether to use other comprehensive income for some or all changes in estimates and b) whether all, some or no changes in estimates should result in adjustments to a residual or composite part of the margin.

	Current exit value (previously candidate 1, modified) [**for consideration by IASB only**]	**Measurement approach based on updated IAS 37 model**	**Current fulfilment value (previously candidate 3)**	**Current fulfilment value (previously candidate 4)**	**Unearned premium (previously candidate 5)**
Time value of money*	Consistent with observable current market prices, capturing the characteristics of the liability.	Consistent with observable current market prices, capturing the characteristics of the liability.	Consistent with observable current market prices, capturing the characteristics of the liability.	Consistent with observable current market prices, capturing the characteristics of the liability.	At inception, arguably implicit in the premium.
Components of the margin**	- risk margin - service margin - residual margin (calibrated to premium)	- risk margin - service margin - residual margin (calibrated to premium)	- risk margin - (no service margin) - residual margin (calibrated to premium)	- composite margin	No explicit margin. Implicit margin at inception, as implied by the premium
Risk margin	The compensation required by market participants for bearing risk.	The amount the entity would pay to be relieved of risk.	The cost of bearing risk, measured from an entity's perspective.	No explicit risk margin. Implicit in the "composite margin".	No explicit margin. Implicit margin at inception, as implied by the premium

* The IASB has decided tentatively that the measurement for an insurance liability will use time value of money. The FASB has yet to discuss time value of money.
** The IASB has decided tentatively that the measurement for an insurance liability will include an explicit margin. The FASB has yet to discuss margins.

	Current exit value (previously candidate 1, modified) [**for consideration by IASB only**]	**Measurement approach based on updated IAS 37 model**	**Current fulfilment value (previously candidate 3)**	**Current fulfilment value (previously candidate 4)**	**Unearned premium (previously candidate 5)**
Risk margin – initial measurement	May use premium for a ‘reasonableness’ check, but premium does not override an unbiased estimate of the margin required by market participants.	Estimates the amount the entity would pay to be relieved of risk.	Estimates risk margin based on the cost of bearing risk	Uses premium as basis for determining the initial composite margin.	Not applicable.
Risk margin – subsequent measurement	Remeasured at each reporting date.	Remeasured at each reporting date.	Remeasured at each reporting date.	Not applicable. (Implicit release as the composite margin runs off)	Not applicable. (Implicit release as the premium becomes earned)
Service margin	The compensation required by market participants for other services.	The amount required by the a contractor for other services. [Often to be estimated by the amount the entity requires for other services].	No explicit margin. Implicit in the “residual margin”.	No explicit service margin. Implicit in the “composite margin”.	No explicit margin. Implicit margin at inception, as implied by the premium
Service margin – subsequent measurement	Remeasured at each reporting date.	Remeasured at each reporting date.	Not applicable. (Implicit release as the residual margin runs off)	Not applicable. (Implicit release as the composite margin runs off)	Not applicable. (Implicit release as the premium becomes earned)

	Current exit value (previously candidate 1, modified) [**for consideration by IASB only**]	**Measurement approach based on updated IAS 37 model**	**Current fulfilment value (previously candidate 3)**	**Current fulfilment value (previously candidate 4)**	**Unearned premium (previously candidate 5)**
Day one difference (the difference between the actual margin and the required margin)	No profit at inception; "residual margin" recognised as a separate item (presumably within the insurance liabilities).	No profit at inception; "residual margin" recognised as a separate item (presumably within the insurance liabilities).	No profit at inception; "residual margin" recognised as a separate item (presumably within the insurance liabilities).	No profit at inception; "composite margin" recognised as a separate item (presumably within the insurance liabilities).	No profit at inception. Loss at inception if onerous.
Liability adequacy test	Not applicable.	Not applicable.	Not applicable.	Not applicable.	Required at inception and each subsequent reporting date.
Acquisition costs	Expensed when incurred.	Expensed when incurred.	Expensed when incurred.	Expensed when incurred.	Expensed when incurred.
Part of the premium expected to recover **incremental** acquisition costs	IASB: Recognised as revenue on day one. FASB: Included in the residual margin	IASB: Recognised as revenue on day one. FASB: Included in the residual margin	IASB: Recognised as revenue on day one. FASB: Included in the residual margin	IASB: Recognised as revenue on day one. FASB: Included in the composite margin	Recognised as revenue on day one.
Own credit risk	Included. (DP expressed view that this would not be significant at inception.)	To be discussed (arguably implicit in residual margin at inception).	To be discussed (arguably implicit in residual margin at inception).	To be discussed (arguably implicit in composite margin at inception).	Not applicable (arguably implicit at inception).